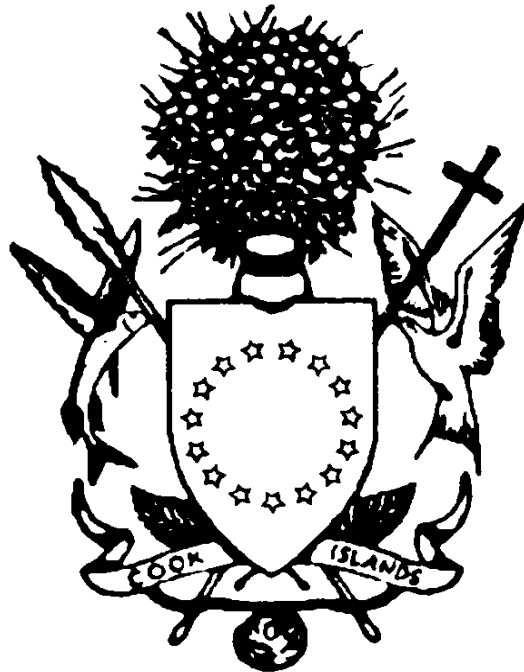

COOK ISLANDS GOVERNMENT

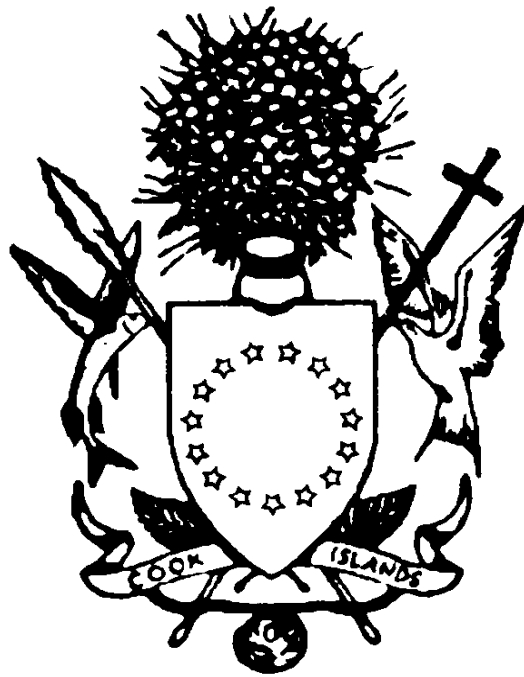
**2017/18 Half-year Economic and
Fiscal Update**



Hon. Mark Brown
Minister of Finance

COOK ISLANDS GOVERNMENT

2017/18 Half-year Economic and Fiscal Update



Disclaimer

The 2016/17 actuals will differ from the June Quarterly due to the accrual accounting system used by the Cook Islands Government. The figures included in the 2017/18 HYEPU are a more accurate reflection of actuals expenditure and revenues in 2016/17.

December 2017

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MINISTER OF FINANCE
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05 December 2017

STATEMENT OF RESPONSIBILITY

I have read the Financial Secretary's Statement of Responsibility and concur with him regarding the preparation of the 2017/18 Half Year Economic and Fiscal Update.

To enable the Ministry of Finance and Economic Management to prepare this Half Year Economic and Fiscal Update, I have ensured that the Financial Secretary has been advised of all Government decisions and other circumstances as at December 2017 of which I was aware and had material economic and fiscal implications.

The 2017/18 Half Year Economic and Fiscal Update have been produced in accordance with the Ministry of Finance and Economic Management Act 1995/96.

I accept the overall responsibility for the integrity of the disclosures contained in this document, and the consistency and completeness of the information in compliance with the requirements of the Ministry of Finance and Economic Management Act 1995/96.

Kia Manuia,

A handwritten signature in black ink, appearing to read 'Mark Brown', with a long horizontal flourish extending to the right.

Honourable Mark Brown

Minister of Finance



MINISTRY OF FINANCE AND ECONOMIC MANAGEMENT GOVERNMENT OF THE COOK ISLANDS

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05 December 2017

STATEMENT OF RESPONSIBILITY

This Half Year Economic and Fiscal Update (HYEFU) 2017/18 is prepared in accordance with Section 11 and 16 of the *Ministry of Finance and Economic Management Act 1995-96*. Section 16 further states that the Minister shall no earlier than the 1st day of December, nor later than the 31st day of December in each financial year, cause to be published a report containing an economic and fiscal update prepared by the Ministry.

Therefore in accordance with Section 30(2) of the *Ministry of Finance and Economic Management Act 1995/96*, the Minister of Finance and the Financial Secretary shall prepare and sign a Statement of Responsibility for the financial statements.

The integrity of the disclosures and consistency with the requirements of the *Ministry of Finance and Economic Management Act 1995/96* are warranted in relation to the financial statements included within this 2017/18 HYEFU.

The update incorporates the fiscal and economic implications both of Government decisions and circumstances as at December 2017 that were communicated to me, and of other economic and fiscal information available to the Ministry in accordance with the provisions of the *Ministry of Finance and Economic Management Act 1995/96*.

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

Kia Manuia,

Garth Henderson

A handwritten signature in black ink, appearing to read 'G Henderson'.

Financial Secretary

2 PREFACE

The Ministry of Finance and Economic Management has published through this document both the 2018/19 Budget Policy Statement (BPS) with the 2017/18 Half Year Economic and Fiscal Update (HYEFU).

Budget Policy Statement

Section 11 of the *Ministry of Finance and Economic Management Act 1995/96* requires the Minister of Finance to publish a Budget Policy Statement (BPS) no later than 31 March in each year to come into action on 1 July of that same year. Cabinet has directed that the 2018/19 BPS will be published on the 6 December 2017 to enable better aligned planning by government departments and development partners in the 2018/19 Budget going forward.

The BPS states Government's policy intent for the 2018/19 fiscal year going forward including the Government's fiscal policy, its broad strategic priorities for the 2018/19 fiscal year, and any specific outputs and other expenditure that the Government anticipates to be included in the 2018/19 Budget.

Half Year Economic and Fiscal Update

Section 16 of the *Ministry of Finance and Economic Management Act 1995/96* also requires the Minister of Finance to publish a Half Year Economic and Fiscal Update (HYEFU) no earlier than 1 December and no later than 31 December in each year.

The 2017/18 HYEFU provides an update of the economic and fiscal forecasts made at the time of the 2017/18 Budget and provides analysis of the changes in key economic variables and their impact on the fiscal status of Government.

Given the publishing of the BPS on 6 December 2017, the HYEFU will also be published on 6 December 2017 as one document so that the reader is provided with both the Government's priorities and the context with which these priorities and policy intentions are set.

3 ECONOMIC AND FISCAL STRATEGY

The Cook Islands has experienced strong economic growth in recent years which provides a sound economic and fiscal context. The Government is committed to continuing to support economic growth and ensuring long-term, sustainable economic and social development for the people of the Cook Islands. This was recently pursued through the 2017/18 budget by improving real wages in the Cook Islands, and undertaking capital works that support both local development and the tourism industry.

Strong economic growth in recent years has largely been driven by increases in tourism arrivals. While the growth has resulted in an increase in the standard of living for Cook Islanders, and increases in Government revenue, the Government is committed to increasing the diversification of the economy, such as through the Manatua Submarine Cable, to ensure the sustainability of growth over the long-term.

Recent economic growth has provided the Government with a fiscal environment of strong revenues, which has provided capacity to take on capital and operating expenses that had previously been left wanting. Despite this, the Government acknowledges the need to find a balance between these spending priorities and strong fiscal management.

The Government is committed to responsible fiscal management, and is anticipating a smooth pathway back to budget balance with the aim of achieving fiscal balances by 2020/21, while recognizing the need for economic development. To ensure that this goal is achieved, the Government will focus on maximizing outcomes within current expenditure baselines in the 2018/19 Budget prior to considering the appropriation of additional funds. The fiscal balance is subsequently expected to improve from a deficit of \$40.4 million (-9.3 per cent of GDP) in 2017/18 to positive fiscal balances by 2020/21.

The path outlined for achieving budget balance will also assist the Government in meeting its fiscal responsibility ratios for cash reserves over the medium-term, while ensuring that net debt ratios continue to be adhered to.

The Government is committed to fair, reasonable and efficient spending targeted at key priority areas as outlined in the Budget Policy Statement. The Government will enforce strong program planning procedures and build upon recent progress in the area of budget prioritization over the medium-term, with the intention of improving budget planning and implementation to ensure that all spending undertaken is for the ultimate improvement of the livelihood of the people of the Cook Islands.

The Government aims to release a medium-term fiscal strategy and medium-term expenditure framework within the next year. These documents will outline key Government expenditure priorities and their funding sources, and provide a clear path for the economic and fiscal management of the Cook Islands. This analysis will also consider the financial implications of the Cook Islands' possible graduation from Overseas Development Assistance (ODA).


































4 2018/19 BUDGET POLICY STATEMENT

The 2018-19 Budget Policy Statement confirms the Government’s medium term strategy and identifies the key fiscal priorities for the 2018-19 Budget.

4.1 Medium Term Priorities

The Government’s medium term priorities identify the annual focus for budget priority setting for each year within the 2016-2020 period drawing upon the National Sustainable Development Plan 2016-2020 (NSDP).

Figure 4.1 Medium-Term Budget Priorities

| | | | | | | | | |
|---------|---|---|---|---|--|---|---|---|
| 2016/17 |  |  |  |  |  |  |  |  |
| 2017/18 |  |  |  |  |  |  |  | |
| 2018/19 |  |  |  |  |  |  |  | |
| 2019/20 |  |  |  |  |  |  |  |  |
| 2020/21 |  |  |  |  | | | | |

The 2018-19 Budget is the third year of implementation of the medium-term priorities set in the NSDP 2016-2020 and is expected to continue to progress the identified Government’s programmes and priorities. The medium term priorities were reviewed and confirmed at the Public Sector Leaders Conference held in October 2017. The key priorities for the 2018-19 Budget will be guided by these NSDP Goals:



- NSDP Goal 4 Sustainable management of water and sanitation

- NSDP Goal 5 Build resilient infrastructure and information communication technologies to improve our standard of living
- NSDP Goal 8 Ensure inclusive and equitable quality education and promote life-long learning opportunities
- NSDP Goal 10 Achieve food security and improved nutrition, and increase sustainable agriculture
- NSDP Goal 11 Promote sustainable land use, management of terrestrial ecosystems, and protect biodiversity
- NSDP Goal 15 Ensure a sustainable population engaged in development by Cook Islanders for Cook Islanders
- NSDP Goal 16 Promote a peaceful and just society and practice good governance with transparency and accountability

The realisation of these goals will also have positive impacts on all other NSDP goals.

The total Government expenditure in recent years confirms that baseline expenditure has largely targeted economic affairs, driven by tourism, energy and infrastructure expenditure, representing more than a third of total government expenditure. Recent investment in education towards the construction of Apii Nikao and Tereora College, in addition to general education expenditure, temporarily lifted education expenditure to 11 per cent of Government expenditure in 2017-18. Other major areas of baseline government spending have been in general public services at 26 per cent, housing and community amenities (which includes housing development, water supply and street lighting) at 10 per cent, social protection (social welfare) at 8 per cent and health at 6 per cent.

A number of significant national events are expected to take place over the 2018-19 financial year, including the 2018 General Election and the 53rd Te Maeva Nui celebrations, envisaged to encompass all Pa Enea.

Recent developments regarding the Cook Islands development status will require careful planning and transition should developed country status be achieved in the medium-term. Government agencies will be expected to consider developing medium term strategies for potential changes in funding sources and our relationship with external development partners.

In this context, with expected constraints on new revenue streams and commitments to existing programmes and activities, the Government will need to focus on achieving its key priorities within current operating baselines to the best extent possible.

The public sector, including the island governments, will be expected to engage in collaborative discussions, within and between sectors, to identify and balance key multi-sectoral priorities. A collaborative approach can deliver improved agency planning for better performance, efficient service delivery and public accountability.

4.2 2018/19 Priorities

Investing in our People

In recent years, Government has continued to invest significant resources in people through targeting improvements in labour protection, social benefits and public service salary adjustments. In 2017-18, the Government provided \$2.3 million to increase the minimum wage and provide salary adjustments for government employees within the government pay banding structure. \$400,000 was also provided to allow Agencies to make performance-based pay increases to top performing staff. The Government provided \$1.4 million to increase the Child Benefit payment from \$66 to \$100 per month and extended the Child Benefit to the age of 15 for children with disabilities. An additional \$130,000 was provided to remunerate teacher aides who provide inclusive education for special needs children. The Family Support and Protection Act was passed improving protection against child abuse and domestic violence. The Government introduced the Tax Amnesty program and agreed to provide \$500,000 to refund taxpayers for any tax penalties paid from 1 January to 31 July 2017 as part of the Tax Amnesty. An additional \$600,000 was provided to the Social Impact Fund which assists NGOs in delivering services for women, youth, children and people with disabilities. Funding of \$85,000 was also provided for the development of a Dental Health Therapy Certification to train dental personnel to provide quality oral health care for our people in Rarotonga and the Pa Enuā.

The 2018-19 priorities that will support *Investing in Our People* should be guided by the following NSDP Goals:

- NSDP Goal 8 - Ensure inclusive and equitable quality education and promote life-long learning opportunities
- NSDP Goal 10 - Achieve food security and improved nutrition, and increase sustainable agriculture

Continued investment in education should support implementation of the Education Master Plan and target lifelong learning through teacher development, improving the effectiveness of Maori language teaching and learning techniques, and ensuring relevant support across all schools throughout the Cook Islands. Government will look at support for families with secondary school age children through options to extend the Child Benefit age beyond the current eligibility age of 12 years.

Building resilience for our people through Food Security will require strengthening our systems to support effective and appropriate agricultural activities across the Cook Islands. New approaches to enhance import substitution, support biosecurity and build resilience to climate change and economic hardship should be guided by innovation and collaboration to address challenges facing agricultural food security including water, land use, workforce, inter island and external transport/shipping.

Consolidating our Infrastructure

The Government has committed to a significant infrastructure programme in recent years, both on Rarotonga and the Pa Enua including investment into water, waste, renewable energy, roads, harbour development, telecommunications. Many of these projects are multi-year projects and at various stages of completion. It will be necessary for agencies to continue to consolidate and complete existing work plans. In the most recent Budget, \$13 million was provided for Stage 2 of the Te Mato Vai project (from an estimated \$53.2 million investment over 4 years) and \$10.9 million has been allocated for the Manatua Sub-Marine Cable to improve the speed and quality of internet services. Road projects on Rarotonga and the Outer Islands were supported with \$3.4 million and \$2.8 million was provided to commence the Aitutaki Renewable Energy Project. This was in addition to \$27.7 million approved in the 2016-17 Budget for Renewable Energy Projects in the remaining Southern Group islands. \$2 million was provided for Mei Te Vai Ki Te Vai (Muri Sanitation) and \$2.4 million has been provided for the establishment of cyclone shelters in the Northern Group in 2017/18 and 2018/19. An additional \$1.5 million was invested in water projects on Rarotonga and in the Outer Islands. There is an expectation that agencies will focus on consolidating and completing the current infrastructure plans.

The 2018-19 priorities that will support *Consolidating Our Infrastructure* should be guided by the following NSDP Goals:

- NSDP Goal 4 - Sustainable management of water and sanitation
- NSDP Goal 5 - Build resilient infrastructure and information communication technologies to improve our standard of living

The Government will support consolidation of the ambitious infrastructure plans through review of the National Infrastructure Investment Plan. The Government will continue to ensure plans to improve water security, both quality and quantity, are delivered through the existing approved infrastructure plans and additional support is provided where necessary to ensure the completion of projects. The Government will explore and determine an appropriate and

cost-effective solution to address solid waste management issues on Rarotonga and the Pa Enua. The Government will continue to support improvements in ICT infrastructure to ensure effective connectivity and ensure an enabling environment for telecommunications.

Improving Government Capabilities and Systems

The Government has supported the Public Service Strategy to improve better public services through targeting investment in our people, systems and strategies. In 2017-18, the Government supported investment in the public service workforce through the increase the minimum wage and consequential salary adjustments for government employees within the revised government pay banding structure. Funding was also provided to allow Agencies to make performance-based pay increases to top performing staff. The Cook Islands also began to roll out the revised Tertiary Scholarship scheme that allows greater scope to support more Cook Islands students and greater in-country study support.

Investment in systems has included the development and implementation of the new centralised Human Resources Management Information System delivering efficiencies in managing the public service, and more recently an investment of \$1 million for the implementation of the centralised Financial Management Information System over 3 years. The centralised ICT system has also delivered efficiencies across the public service.

There has been an increase in agency focus on developing medium-term strategies to support delivery of the NSDP 2016-20 and some agencies have been supported through Public Service Commissioner led capacity assessments.

The 2018-19 priorities that will support *Improving Government Capabilities and Systems* should be guided by the following NSDP Goals:

- NSDP Goal 5 - Build resilient infrastructure and information communication technologies to improve our standard of living
- NSDP Goal 15 - Ensure a sustainable population engaged in development by Cook Islanders for Cook Islanders
- NSDP Goal 16 - Promote a peaceful and just society and practice good governance with transparency and accountability

There will be a continued approach to consolidate and advance shared services to improve efficiencies in the public service. Agencies will be expected to focus on improving data collection and analysis for evidence-based decision making. Some agencies will require support in technical, policy and research capabilities to improve performance effectiveness in meeting government objectives.

Protecting our Environment and Building Resilience

In recent years, the Cook Islands has demonstrated innovation in protecting and managing our environment, and in particular the large ocean resource, with the passage of the Marae Moana Act. The legislation is a world-first that provides a framework for coordination and management of all proposed activities that will occur in the entire 1.9 million square kilometre Exclusive Economic Zone.

The Cook Islands has also focused on improving climate change resilience through the first and second iteration of the Joint National Action Plan on Climate Change and Disaster Risk Reduction with assistance through the Adaptation Fund and is set to achieve its mitigation related Nationally Determined Contributions of reducing its emissions from electricity generation by 2020. The Cook Islands has faced some challenges in its ability to effectively control activities that pose environmental risks in relation to private land use.

The 2018-19 priorities that will support *Protecting our Environment and Building Resilience* should be guided by the following NSDP Goal:

- NSDP Goal 11 - Promote sustainable land use, management of terrestrial ecosystems, and protect biodiversity

The Government will support the current legislative review of the Environment Act to ensure that the legislation is effective in achieving its conservation objectives. This will need to be done in a collaborative manner taking into account all stakeholder views and in particular to achieve sustainable land use. The Government will also support the implementation of the Marae Moana Act. Government will continue to review options for an effective systematic collection and disposal of hard waste. Consideration will be given to transitioning ground transportation towards electrification, both nationally and within Government's fleet over the medium term.

4.3 Conclusion

The 2018-19 Budget will continue our momentum towards the achievement of our national goals. The Government will continue to implement the medium term priorities set out in the NSDP 2016-2020 with a key focus on the identified 2018-19 priorities. Given the fiscal context, the 2018-19 Budget will require Government agencies to deliver core priorities, to the extent possible, within existing resources. This may require agencies to review current programmes and focus on productivity and efficiencies. The NSDP Goals for 2018-19 supports *Investing in Our People, Consolidating our Infrastructure, Improving Government Capabilities and Systems*

and *Protecting our Environment and Building Resilience*. New proposals for 2018-19 must be clearly aligned to the NSDP Goals for 2018-19 and demonstrate clear benefits for our people based on good evidence and research. The 2018-19 Budget will be a budget of reflection and action through consolidating our efforts and ensuring that our finances will provide the future we want.

Figure 4.2 National Sustainable Development Plan

| | | |
|---|----|--|
|  | 1 | Improve welfare, reduce inequity and economic hardship |
|  | 2 | Expand economic opportunities, improve economic resilience and productive employment to ensure decent work for all |
|  | 3 | Promote sustainable practices and effectively manage solid and hazardous waste |
|  | 4 | Sustainable management of water and sanitation |
|  | 5 | Build resilient infrastructure and Information Communication Technologies to improve our standard of living |
|  | 6 | Improve access to affordable, reliable, sustainable, modern energy and transport |
|  | 7 | Improve health and promote healthy lifestyles |
|  | 8 | Ensure inclusive and equitable quality education and promote life-long learning opportunities |
|  | 9 | Accelerate gender equality, empower all women and girls, and advance the rights of youth, the elderly and disabled |
|  | 10 | Achieve food security and improved nutrition, and increase sustainable agriculture |
|  | 11 | Promote sustainable land use, management of terrestrial ecosystems, and protect biodiversity |
|  | 12 | Sustainable management of oceans, lagoons and marine resources |
|  | 13 | Strengthen resilience to combat the impacts of climate change and natural disasters |
|  | 14 | Preserve our heritage and history, protect our traditional knowledge, and develop our language, creative and cultural endeavours |
|  | 15 | Ensure a sustainable population engaged in development by Cook Islanders for Cook Islanders |
|  | 16 | Promote a peaceful and just society and practice good governance with transparency and accountability |

5 GOVERNMENT FINANCIAL STATISTICS OPERATING STATEMENT

The Government Financial Statistics (GFS) 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. The GFS operating statement encompasses all funds managed at the general government level including the Loan Repayment Fund.

Table 5.1 GFS Operating Statement

| Statement of Government Operations | 2016/17 Actual | 2017/18 HYEFU Estimate | 2018/19 Projection | 2019/20 Projection | 2020/21 Projection |
|--|-------------------|------------------------------|-----------------------|-----------------------|-----------------------|
| REVENUE | 192,408 | 232,751 | 181,984 | 166,891 | 154,609 |
| Taxes | 124,898 | 123,633 | 125,417 | 128,953 | 131,549 |
| Social contributions | - | 75 | 75 | 75 | 75 |
| Grants | 33,775 | 81,161 | 31,996 | 15,263 | 422 |
| <i>Current</i> | 16,704 | 36,424 | 15,149 | 14,872 | 122 |
| <i>Capital</i> | 17,071 | 44,737 | 16,847 | 391 | 300 |
| Other revenue | 33,735 | 27,881 | 24,496 | 22,601 | 22,562 |
| EXPENSE | 140,346 | 180,458 | 155,572 | 154,460 | 137,270 |
| Compensation of employees | 51,958 | 56,747 | 54,889 | 55,089 | 55,089 |
| Use of goods and services | 37,299 | 61,289 | 41,963 | 41,551 | 25,300 |
| Depreciation | 9,644 | 12,423 | 12,529 | 12,529 | 12,529 |
| Interest | 1,710 | 2,063 | 2,060 | 2,032 | 2,032 |
| Subsidies | 14,928 | 17,068 | 15,718 | 15,718 | 15,718 |
| Grants | - | - | - | - | - |
| Social benefits | 17,903 | 19,674 | 19,206 | 19,370 | 19,370 |
| Other expense | 6,905 | 11,193 | 9,207 | 8,170 | 7,230 |
| NET OPERATING BALANCE | 52,061 | 52,292 | 26,412 | 12,432 | 17,339 |
| <i>Plus</i> NON CASH APPROPRIATIONS | | | | | |
| Depreciation | 9,644 | 12,423 | 12,529 | 12,529 | 12,529 |
| CASH SURPLUS/(DEFICIT) FROM OPERATING TRANSACTIONS | 61,705 | 64,716 | 38,941 | 24,960 | 29,868 |
| CASH TRANSACTIONS IN NONFINANCIAL ASSETS | | | | | |
| Net Cash Applied to the Acquisition of Fixed Assets | 30,512 | 105,111 | 57,593 | 24,978 | 16,365 |
| Gross transactions in Non-Financial Assets | 40,155 | 117,534 | 70,122 | 37,507 | 28,894 |
| <i>Less</i> Non Cash Transactions in Non-Financial Assets (Depreciation) | (9,644) | (12,423) | (12,529) | (12,529) | (12,529) |
| NET (BORROWING)/LENDING | 31,193 | (40,395) | (18,653) | (18) | 13,503 |
| CASH APPLIED TO THE NET ACQUISITION OF FINANCIAL ASSETS | 27,778 | (26,328) | (18,246) | (9,894) | 1,828 |
| Domestic Transactions | 27,778 | (26,328) | (18,246) | (9,894) | 1,828 |
| Foreign Transactions | - | - | - | - | - |
| CASH APPLIED TO THE NET INCURRENCE OF LIABILITIES | 4,363 | (16,486) | (2,337) | 8,035 | 9,807 |
| Domestic Transactions | - | - | - | - | - |
| Foreign Transactions | 4,363 | (16,486) | (2,337) | 8,035 | 9,807 |
| NET CASH FINANCING TRANSACTIONS | 32,141 | (42,814) | (20,583) | (1,859) | 11,635 |
| <i>Statistical discrepancy with financial statements</i> | 948 | (2,419) | (1,930) | (1,841) | (1,868) |

5.1 GFS Net Operating Balance

The GFS net operating balance is the balance of operating revenues less operating expenditure by the Government and its development partners. The GFS net operating balance in 2017/18 is estimated to be a \$52.2 million.

Going forward, changes in expenditure and revenue estimates are predicted to result in a \$26.4 million operating balance in 2018/19, \$12.4 million in 2019/20, and \$17.3 million in 2020/21.

5.1.1 GFS Operating Revenue

Operating revenues are made up of taxation receipts (64 per cent in 2016/17), grants from other governments (18 per cent) and other revenues, which include agency trading revenues, interest and dividend receipts (18 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 apparent).

At the time of the 2017/18 Budget published in June 2017, GFS Operating revenues in 2017/18 were estimated to tally to \$223.9 million, of which \$118.4 million was expected to be collected in taxes.

Since June 2017, total movements in operating revenue have resulted in an upward revision of operating revenues by \$5.4 million to \$159.3 million, predominately due to increased tax revenue forecasts.

For the 2017/18 year, tax revenue is anticipated to be \$5.2 million higher than previously forecast, due to increased economic activity, and stronger collections than anticipated at Budget. The actual for 2016/17 reflects actual monies received that were not reported at the previous update.

5.1.2 GFS Operating Expenditure

Operating expenditure is made up of compensation of employees (31 per cent in 2017/18), use of goods and services (34 per cent), social benefits (11 per cent), subsidies (10 per cent), depreciation (7 per cent), and other expenses including interest expenses (7 per cent).

Since the time of the Budget published in June 2017, total movements in operating expenditure have resulted in an upward revision of operating expenditure by \$2.6 million to \$152.3 million in 2017/18, due to policy decisions. This increase is, predominantly in goods and services.

5.2 GFS Non-Operating Items

Cash Transactions in Non-Financial Assets outlines the transactions relating to capital, the details of which are outlined in further depth at each Budget in Budget Book 1 (Capital Chapter). This spending includes public works, purchase of plant and equipment and investments in ICT. Large purchases of non-financial assets, mainly in infrastructure (renewable energy, Te Mato Vai, and others) continue in 2017/18 and 2018/19. Total purchases of non-financial assets (excluding depreciation) is budgeted to be \$117.5 million in 2017/18. This reflects both Cook Island Government funded capital spending and ODA capital spending.

The Net Borrowing/Lending Requirement outlines whether there is sufficient cash from current revenue to cover the costs of the ongoing operations of government and capital. The net borrowing requirement is the addition of the cash operating transactions and the cash transactions in non-financial assets – a positive number indicates a surplus which can be accumulated to reserves, a deficit requires borrowings or depletion of reserves. Consistent with the large capital works currently underway, the net borrowing requirement is \$40.3 million in 2017/18. This requirement is serviced by a combination of cash and debt financing, with net cash transactions contributing \$26.3 million and net debt finance (new loans minus repayments) contributing \$16.4 million. There is also a small statistical discrepancy which arises out of timing differences between assets and liabilities.

There are some smaller movements not captured in the GFS schedules, with most of these relating to the classification of reserves in the financial schedules.

Most of the statistical discrepancy shown in the GFS Operating Statement relates to timing issues between when projects are executed and when their funding is received into the Crown account. The sum of the statistical discrepancy across the years shown is not considered to be significant.

5.3 Classification of Functions of Government (COFOG)

The Classification of the Functions of Government (COFOG) classifies government expenditure data by the purpose for which the funds are used. This standard classification allows for comparisons on functional expenditure across different jurisdictions

The COFOG has 10 main functions at the highest level and 69 functions at the second (sub-functional) level. Table 5.2 classifies the Budget to the sub-functional level for both Cook Islands Government spending and ODA.

Table 5.2 Classification of Functions of Cook Island Government 2017/18 HYEFU¹

| Function of Government | 2016/17 Actual | 2017/18 HYEFU Estimate | 2018/19 Projection | 2019/20 Projection | 2020/21 Projection |
|--|--------------------|------------------------------|-----------------------|-----------------------|-----------------------|
| Cook Islands Government (CIG) Expenditure | | | | | |
| General public services | 33,637,334 | 41,436,667 | 37,344,808 | 42,317,651 | 39,958,408 |
| Executive and legislative organs, financial and fiscal affairs, external affairs | 29,387,539 | 36,298,287 | 32,209,388 | 37,210,344 | 34,851,101 |
| General services | - | - | - | - | - |
| General public services | 1,433,168 | 2,733,360 | 2,733,360 | 2,733,360 | 2,733,360 |
| Public debt transactions | - | - | - | - | - |
| Defense | - | - | - | - | - |
| Public order and safety | 1,106,577 | 342,067 | 341,650 | 341,650 | 341,650 |
| Police services | 1,710,050 | 2,062,953 | 2,060,410 | 2,032,297 | 2,032,297 |
| Fire protection services | - | - | - | - | - |
| Law courts | 5,949,509 | 5,927,101 | 5,970,246 | 5,836,519 | 5,836,519 |
| Prisons | 4,075,775 | 4,043,829 | 4,210,640 | 4,076,913 | 4,076,913 |
| Economic affairs | - | - | - | - | - |
| General economic, commercial, and labor affairs | 1,151,216 | 1,155,955 | 1,034,123 | 1,034,123 | 1,034,123 |
| Agriculture, forestry, fishing, and hunting | 722,518 | 727,317 | 725,483 | 725,483 | 725,483 |
| Fuel and energy | - | - | - | - | - |
| Mining, manufacturing, and construction | - | - | - | - | - |
| Transport | 40,906,128 | 72,628,290 | 53,016,131 | 39,836,756 | 39,586,975 |
| Communication | 8,995,178 | 22,644,275 | 22,713,323 | 11,685,167 | 11,685,167 |
| Tourism | 3,810,219 | 4,087,052 | 3,894,031 | 3,900,319 | 3,900,319 |
| Economic affairs n.e.c. | 3,221,996 | 15,755,044 | 1,340,427 | 1,336,350 | 1,086,569 |
| Environmental protection | 508,310 | 1,408,410 | 2,299,105 | 300,049 | 300,049 |
| Waste management | 4,659,986 | 6,486,131 | 2,847,964 | 2,834,464 | 2,834,464 |
| Waster water management | - | 35,000 | - | - | - |
| Protection of biodiversity and landscape | - | - | - | - | - |
| Environmental protection n.e.c. | - | - | - | - | - |
| Housing and community amenities | 19,480,339 | 21,982,280 | 19,691,182 | 19,550,308 | 19,550,308 |
| Community development | - | - | - | - | - |
| Water supply | - | - | - | - | - |
| Housing and community amenities n.e.c. | 230,099 | 230,099 | 230,099 | 230,099 | 230,099 |
| Health | 3,623,414 | 4,616,194 | 12,729,589 | 9,440,955 | 9,440,955 |
| Medical products, appliances, and equipment | 176,554 | 226,554 | 126,554 | 123,168 | 123,168 |
| Hospital services | 2,382,831 | 3,278,604 | 11,487,449 | 8,197,758 | 8,197,758 |
| Public health services | - | - | - | - | - |
| Health n.e.c. | 270,350 | 305,164 | 305,164 | 305,164 | 305,164 |
| Recreation, culture, and religion | - | - | - | - | - |
| Recreational and sporting services | 793,679 | 805,872 | 810,422 | 814,865 | 814,865 |
| Cultural services | 7,614,328 | 23,595,465 | 18,159,213 | 13,394,470 | 5,281,214 |
| Education | - | - | - | - | - |
| Pre-primary and primary education | 151,035 | 250,000 | 250,000 | 250,000 | - |
| Secondary education | 2,743,766 | 18,491,801 | 13,109,939 | 8,394,843 | 581,807 |
| Tertiary education | - | - | - | - | - |
| Education not definable by level | - | - | - | - | - |
| Education n.e.c. | 4,719,527 | 4,853,664 | 4,799,274 | 4,749,627 | 4,699,406 |
| Social protection | 14,227,932 | 15,765,698 | 13,599,500 | 13,645,813 | 13,645,813 |
| Sickness and disability | 2,350,437 | 2,252,198 | 1,492,800 | 1,492,800 | 1,492,800 |
| Old age | - | - | - | - | - |
| Family and children | 8,590,237 | 9,591,199 | 8,267,399 | 8,313,712 | 8,313,712 |
| Housing | 2,115,823 | 2,115,823 | 2,115,823 | 2,115,823 | 2,115,823 |
| Social exclusion n.e.c. | - | - | - | - | - |
| Social protection n.e.c. | 1,171,435 | 1,806,478 | 1,723,478 | 1,723,478 | 1,723,478 |
| Total CIG Expenditure | 145,932,181 | 209,178,723 | 178,736,520 | 162,367,933 | 151,405,653 |
| Official Development Assistance (ODA) Expenditure | | | | | |
| General public services | 10,760,937 | 17,239,075 | 1,790,066 | 2,856,474 | 111,074 |
| Executive and legislative organs, financial and fiscal affairs, external affairs | 9,577,757 | 15,675,871 | 1,472,035 | 2,538,444 | 111,074 |
| Foreign economic aid | 980,161 | 1,231,223 | 3,030 | 318,030 | - |
| General public services | 203,019 | 331,981 | - | - | - |

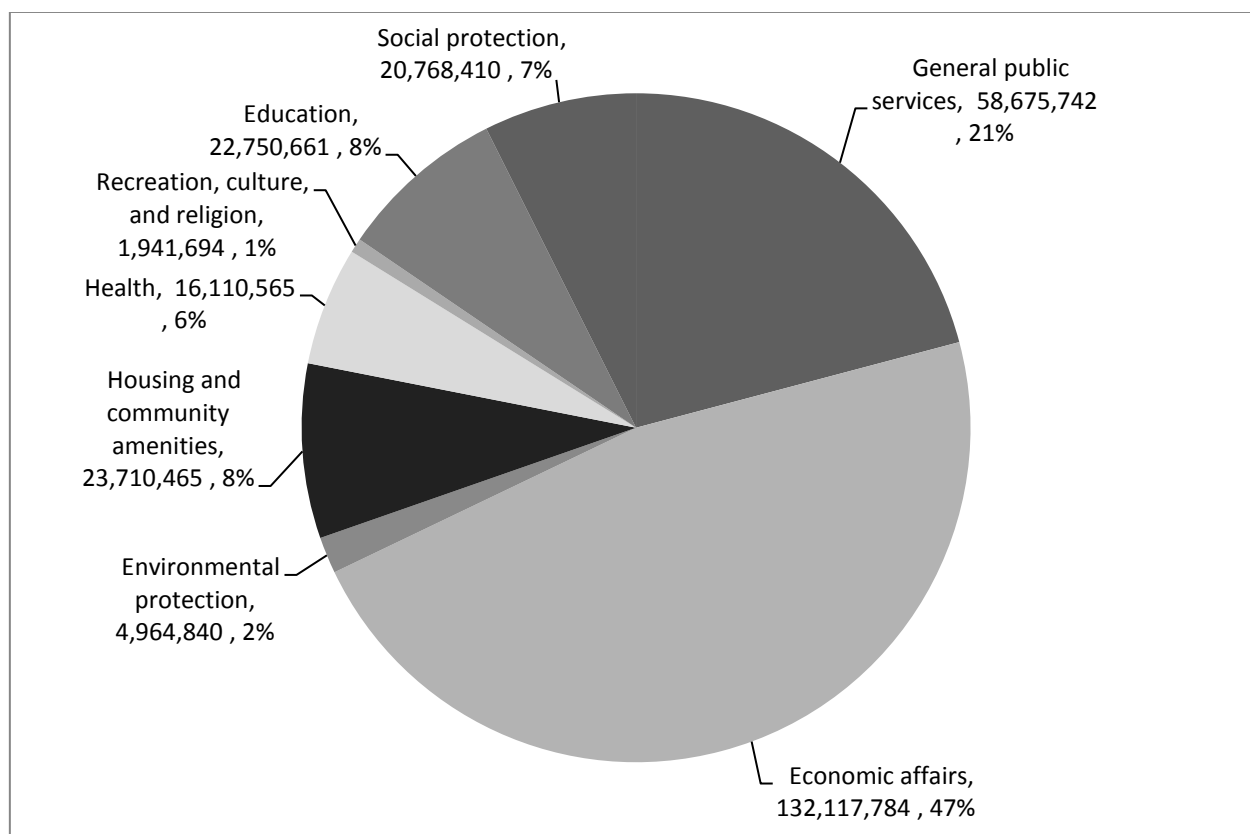
¹ Discrepancies from the 2017/18 Budget are due to the changes described in the Fiscal Update, and some technical adjustments to the classification

| | | | | | |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|
| Defense | - | - | - | - | - |
| Public order and safety | - | - | - | - | - |
| Economic affairs | 22,414,354 | 59,463,493 | 30,118,861 | 12,319,887 | 300,000 |
| General economic, commercial, and labor affairs | - | 300,000 | 300,000 | 300,000 | 300,000 |
| Agriculture, forestry, fishing, and hunting | 909,229 | 3,689,378 | 3,142,983 | 1,359,582 | - |
| Fuel and energy | 4,660,739 | 15,652,232 | 10,660,305 | 10,660,305 | - |
| Mining, manufacturing, and construction | 16,430,998 | 29,749,420 | 11,015,573 | - | - |
| Communication | 413,388 | 10,072,464 | 5,000,000 | - | - |
| Environmental protection | 326,958 | 348,646 | 75,758 | 75,758 | - |
| Waste management | 250,035 | 120,000 | - | - | - |
| Pollution abatement | - | 15,714 | - | - | - |
| Protection of biodiversity and landscape | 76,923 | 212,932 | 75,758 | 75,758 | - |
| Housing and community amenities | 45,000 | 115,000 | - | - | - |
| Housing development | - | 87,101 | - | - | - |
| Community development | 45,000 | - | - | - | - |
| Housing and community amenities n.e.c. | - | 27,899 | - | - | - |
| Health | 44,979 | 344,866 | 11,074 | 11,074 | 11,074 |
| Medical products, appliances, and equipment | - | 289,855 | - | - | - |
| Hospital services | 44,979 | 55,011 | 11,074 | 11,074 | 11,074 |
| Education | 109,510 | 20,000 | - | - | - |
| Education not definable by level | 109,510 | 20,000 | - | - | - |
| Social protection | 85,218 | 231,459 | - | - | - |
| Sickness and disability | 85,218 | - | - | - | - |
| Social protection n.e.c. | - | 231,459 | - | - | - |
| Total ODA Expenditure | 33,786,956 | 77,762,540 | 31,995,759 | 15,263,193 | 422,148 |
| | 179,719,138 | 286,941,263 | 210,732,279 | 177,631,126 | 151,827,801 |

Note: there is a small statistical discrepancy in the COFOG totals versus GFS, mainly stemming from the classifications of balance sheet transactions.

Figure 5.1 classifies the combined Cook Islands Government and ODA spending in the 2017/18 HYEFU at the 10 main functional levels.

Figure 5.1 Classification of Functions of Cook Island Government 2017/18 HYEFU



Economic affairs is by far the largest area of total public expenditure at 47 per cent of the total spending, driven by tourism spending through the Cook Islands Government appropriation, and energy infrastructure in the ODA spend.

General public services is next, at around 21 per cent of total public spending, with the Cook Islands Government administration costs being the main driver.

Education is the third largest area of spending at 8 per cent, driven mainly by the Cook Islands Government's own expenditures, but also the construction activity by the Chinese and New Zealand Governments at Apii Nikao and Tereora respectively.

Other major areas of spending are housing and community amenities (which includes general community infrastructure) at 8 per cent, social protection (social welfare) at 7 per cent, and Health 6 per cent.

6 FISCAL UPDATE

| Table 6.1 Fiscal Indicators Summary | 2016/17 Actual | 2017/18 Budget Estimate | 2017/18 HYEFU Estimate | 2018/19 Projection | 2019/20 Projection | 2020/21 Projection |
|---|-------------------|-------------------------------|------------------------------|-----------------------|-----------------------|-----------------------|
| Statement of Financial Performance | | | | | | |
| Taxation Revenue (\$m) | 124.9 | 118.4 | 123.6 | 125.4 | 129.0 | 131.5 |
| Social Contributions (\$m) | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Other Revenue (\$m) | 41.5 | 35.4 | 35.6 | 24.5 | 22.6 | 22.6 |
| Total Operating Revenue (\$m) | 166.4 | 153.9 | 159.4 | 150.0 | 151.6 | 154.2 |
| Total Operating Revenue Percentage of GDP | 39.4 | 34.4 | 36.8 | 34.0 | 33.7 | 33.4 |
| Tax Revenue Percentage of GDP | 29.6 | 26.5 | 28.5 | 28.4 | 28.7 | 28.5 |
| Total Cyclical Revenue (\$m) | 32.5 | 26.3 | 26.2 | 22.3 | 20.4 | 20.4 |
| Total Cyclical Revenue Percentage of GDP | 7.7 | 5.9 | 6.0 | 5.1 | 4.5 | 4.4 |
| Total Structural Revenue (\$m) | 133.9 | 127.7 | 133.1 | 127.7 | 131.3 | 133.8 |
| Total Structural Revenue Percentage of GDP | 31.7 | 28.5 | 30.7 | 28.9 | 29.2 | 29.0 |
| Personnel (\$m) | 51.9 | 58.9 | 59.4 | 57.0 | 57.2 | 56.6 |
| Percentage of Total Revenue | 31.2 | 38.3 | 37.3 | 38.0 | 37.7 | 36.7 |
| Percentage of Structural Revenue | 38.8 | 46.2 | 44.6 | 44.7 | 43.6 | 42.3 |
| Total Operating Expenditure (\$m) | 132.0 | 149.7 | 152.4 | 140.4 | 139.6 | 137.1 |
| Percentage of GDP | 31.3 | 33.5 | 35.2 | 31.8 | 31.0 | 29.7 |
| Percentage of Operating Revenue | 79.3 | 97.3 | 95.6 | 93.6 | 92.0 | 88.9 |
| Cash Operating Expenditure* | 120.9 | 136.3 | 139.4 | 127.2 | 126.5 | 124.0 |
| Operating Balance (\$m) | 34.4 | 4.2 | 7.0 | 9.6 | 12.1 | 17.1 |
| Percentage of GDP | 8.1 | 0.9 | 1.6 | 2.2 | 2.7 | 3.7 |
| Capital Expenditure | 13.6 | 44.9 | 60.3 | 40.7 | 24.6 | 16.1 |
| Depreciation | 10.5 | 12.8 | 12.8 | 13.0 | 13.0 | 13.0 |
| Non Operating Balance (\$m) | -23.0 | -45.4 | -49.4 | -41.6 | -35.7 | -27.2 |
| Fiscal Balance surplus/deficit (\$m) * | 31.2 | -27.9 | -40.4 | -18.2 | 0.4 | 14.0 |
| Percentage of GDP | 7.4 | -6.2 | -9.3 | -4.1 | 0.1 | 3.0 |
| Statement of Financial Position (\$m) | | | | | | |
| Assets (\$m) | 583.7 | 692.5 | 647.2 | 676.9 | 682.7 | 690.4 |
| Liabilities (\$m) | 134.4 | 166.1 | 159.4 | 147.8 | 140.6 | 131.4 |
| Crown Balance (\$m) | 449.3 | 526.4 | 487.7 | 529.2 | 542.2 | 559.7 |
| Percentage of GDP | 106.4 | 117.7 | 112.6 | 119.9 | 120.5 | 121.2 |
| Cash & Equivalents (\$m) | 60.1 | 23.8 | 33.9 | 15.6 | 5.7 | 7.6 |
| Cash & Equivalents (months coverage) | 6.0 | 2.1 | 2.9 | 1.5 | 0.5 | 0.7 |
| Statement of Borrowings (\$m) | | | | | | |
| Gross Debt end of FY (\$m) | 95.5 | 150.2 | 143.5 | 135.5 | 128.7 | 118.3 |
| (Excluding Contingency Loan) | 95.5 | 136.3 | 129.6 | 121.6 | 114.8 | 104.9 |
| Gross Debt as Percentage of GDP | 22.6 | 33.6 | 33.1 | 30.7 | 28.6 | 25.6 |
| Net Crown Debt, end of FY (\$m) | 76.6 | 130.3 | 122.3 | 114.6 | 108.2 | 99.7 |
| Percentage of GDP | 18.1 | 29.1 | 28.2 | 26.0 | 24.0 | 21.6 |
| Loan Repayment Reserves Held (\$m) | 18.9 | 19.9 | 21.2 | 20.9 | 20.5 | 18.6 |
| Net Debt Servicing (\$m) | 7.0 | 9.1 | 8.4 | 11.1 | 10.7 | 12.3 |
| Percentage of Total Revenue | 4.2 | 5.9 | 5.3 | 7.4 | 7.1 | 8.0 |
| Percentage of Structural Revenue | 5.2 | 7.1 | 6.3 | 8.7 | 8.2 | 9.2 |
| Development Partner Support (\$m) | | | | | | |
| Grants (\$m) | 25.4 | 69.4 | 69.4 | 32.0 | 15.3 | 0.4 |
| Percentage of GDP | 6.0 | 15.5 | 16.0 | 7.2 | 3.4 | 0.1 |
| Memo item: Nominal GDP (\$m) | 422.3 | 447.3 | 433.3 | 441.4 | 450.1 | 461.8 |

6.1 Overview

The purpose of the Fiscal Update is to provide information on revisions made to the fiscal forecasts as at the time of the 2017/18 Budget (June 2017). In updating the fiscal forecasts, the following factors have been considered:

- year-to-date assessment of revenues and expenditure patterns against original Budget estimates for the 2017/18 fiscal year;
- updated economic forecasts and their associated impact on forecasted government revenues; and
- re-evaluation of debt stock and debt servicing based on updated exchange rate movements and new loans.

6.1.1 Movements from 2017/18 Budget

Since the publication of the 2017/18 Budget in June, revisions have been made to the 2016/17 actual spend due to the availability of new data. Total Operating Revenue received for 2016/17 is \$7.8 million higher than estimated at the time of the 2017/18 Budget receiving \$166.4 million. After reviewing each government expenditure, the Total Operating Expenditure is \$132.0 million, a slight decrease of \$3 million compared to what was estimated at the 2017/18 Budget. Capital spending for 2016/17 have been revised downwards significantly to capture its actual spend of \$13.6 million. All these new data result in a fiscal surplus balance of \$31.2 million. Due to the major underspend in Capital Projects, cash reserves was \$60.1 million. The majority of these are committed to capital project in 2017/18 as reflected in the fiscal responsibility ratios.

The following table shows the movements from the 2017/18 Budget to the 2017/18 HYEPU.

Table 6.2 Reconciliation of Operating Statement between 2017/18 Budgets and 2017/18 HYEFU (\$'000)

| Statement of Government Operations | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|---|--------------------|--------------------|-------------------|-------------------|
| Operating balance as at 2017/18 Budget | 4,190 | 9,610 | 13,714 | 18,594 |
| Revenue | | | | |
| <i>Revenue Parameter Changes</i> | 5,225 | 3,570 | 3,824 | 3,862 |
| <i>Adjustments to:</i> | | | | |
| Value Added Tax (VAT) | 883 | 602 | 455 | 668 |
| Income tax | 1,668 | 1,662 | 1,598 | 1,776 |
| Import levies | (84) | (483) | (482) | (488) |
| Company tax | 1,729 | 1,195 | 1,655 | 1,283 |
| Departure tax | 544 | 593 | 598 | 622 |
| Withholding tax | 485 | 0 | 0 | 0 |
| <i>Other Revenue Changes</i> | 202 | -3,582 | -5,456 | -5,375 |
| Other revenue | 317 | (3,188) | (5,188) | (5,188) |
| Trading Revenue | 0 | 0 | 0 | 0 |
| Dividend | (115) | (394) | (268) | (187) |
| Core Sector support | 0 | 0 | 0 | 0 |
| Total Revenue Changes to 2017/18 HYEFU | 5,426 | -12 | -1,632 | -1,513 |
| Expenditure | | | | |
| <i>Expenditure Decisions by Government</i> | 2,634 | 0 | 0 | 0 |
| <i>Decisions by BPS Goal</i> | | | | |
| <i>Technical adjustments</i> | 0 | 0 | 0 | 0 |
| <i>Reclassifications of expenditure</i> | 0 | 0 | 0 | 0 |
| <i>Parameter changes</i> | 0 | 2 | 10 | 10 |
| Total Expenditure Changes to 2017/18 HYEFU | 2,634 | 2 | 10 | 10 |
| OPERATING BALANCE as at 2017/18 HYEFU | 6,983 | 9,596 | 12,072 | 17,070 |
| Capital Expenditure | 60,266 | 40,747 | 24,587 | 16,065 |
| Depreciation | 12,845 | 12,950 | 12,950 | 12,950 |
| FISCAL BALANCE – 2017/18 HYEFU | -40,438 | -18,200 | 435 | 13,956 |
| <i>plus New Zealand GFA Bonus Payment</i> | | | | |
| FISCAL BALANCE (incl. bonus payment) - 2017/18 HYEFU | -39,834 | -18,200 | 435 | 13,956 |

6.1.2 Year to Date Assessment of revenues and expenditure patterns

Since the publication of the 2017/18 Budget in June, revisions have been made to the revenue projections for 2017/18 and the forward estimates due to the availability of new data.

Upward revisions have been made to tax collections in 2017/18 and each year to 2020/21, driven by anticipated increases in the collections of Value Added Tax (VAT), Income tax, Company tax, and Departure Tax. These adjustments are offset by expected reductions in Other ROBOCs, largely driven by revisions to fisheries revenue from 2018/19 to 2020/21.

Since the 2017/18 Budget, some additional current expenditure has been committed towards a number of government priorities. At the same time, there have been a number of carry forwards of 2016/17 funds approved. This has resulted in a total increase of \$2.6 million in operating expenditure in 2017/18. Parameter changes, resulting from the impact of updated exchange rate projections on debt servicing, increases operating expenditure in each year from 2018/19 to 2020/21.

In the 2017/18 Budget, the net operating surplus was expected to be \$4.2 million. Upward revisions to revenue in the 2017/18 financial year are only slightly offset by changes to expenditures to date, resulting in an upward revision to the net operating surplus to \$7.0 million at the 2017/18 HYEPU. The operating balance expected in 2018/19 remains stable at \$9.6 million, while the balance is now estimated to be lower than expected at 2017/18 Budget in 2019/20 and 2020/21 at \$12.1 million and \$17.1 million respectively.

These revisions show that the Government is currently in a relatively strong position, however with the large capital investment programme and projects still in the design stage, Government will need to practice fiscal discipline moving forward.

6.1.3 Changes to Revenue

At the 2017/18 HYEPU total operating revenue is estimated to reach \$159.4 million in 2017/18; consisting of \$123.6 million in tax revenue and \$35.6 million in non-tax revenue. These estimates include the impact of the following policy changes and initiatives committed to by Government in previous updates:

- five per cent indexation of the levies on tobacco, alcohol, and sweetened drinks;
- decrease of the income tax rate for income between \$11,000 and \$30,000 from 17.5 per cent to 17.0 per cent and decrease the upper income bracket from 27.5 per cent to 27.0 per cent from 1 January 2018;
- The Revenue on Behalf of Crown (ROBOC) estimates, include anticipated revenue from a slight increase in Immigration Fees.

Table 6.3 Parameter Changes to Tax Revenue (\$000)

| | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|----------------------------------|--------------|--------------|--------------|--------------|
| VAT | 883 | 602 | 455 | 668 |
| Income tax | 1668 | 1662 | 1598 | 1776 |
| Company tax | 1,729 | 1,195 | 1,655 | 1,283 |
| Import levies | -84 | -483 | -482 | -488 |
| Withholding tax | 485 | 0 | 0 | 0 |
| Departure tax | 544 | 593 | 598 | 622 |
| Total Changes in Taxation | 5,225 | 3,570 | 3,824 | 3,862 |

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

Total taxation revenue parameter changes are reflected in the table above. Overall movements indicate that tax revenue will be increased substantially from the estimates in the 2017/18 Budget by total of \$5.2 million. This revision is based on total taxation revenue collected in the first four months of 2017/18 coming in higher than budgeted (particularly evident in the case of withholding tax which is budgeted at 0). It is expected that there will be a steady increase in tax revenue going forward.

Income tax was originally forecast at \$23.1 million for 2017/18. Due to higher than anticipated collections in the first quarter of the year, this forecast has been revised upwards by \$1.7 million to \$24.7 million for 2017/18. Slightly higher forecasts in the outer years reflect a change in forecast assumptions, in particular around the impact of the tax amnesty on collections.

Company tax has seen the largest upward revision, with the 2017/18 forecast being increased by \$1.73 million relative to budget, to reflect higher collections that are a result of the increased economic activity leading to greater profitability and a change in assumptions around the impact of the tax amnesty on collections. Smaller, but still substantial, upward revisions are also made to the forecasts in the forward years.

As withholding tax is not forecast due to its volatility, receipts from this tax are simply recognised when they are collected; the \$0.48 million collected so far in 2017/18 is recognised here.

VAT is estimated to reach \$59.6 million for 2017/18, a \$0.89 million increase on the \$58.7 million estimated at the time of the 2017/18 budget. This is expected due to the increase in economic activity with higher tourist arrivals. Upward revisions are also made to estimates in the forward years.

Estimates for import and excise-equivalent duties have been revised downwards for 2017/18 and 2018/19 by \$0.08 million and \$0.48 million respectively due to revisions in import estimates. It is anticipated that import levy estimates will improve in 2019/20 and 2020/21.

Movements in other revenues:

- Fisheries Revenue is expected to remain unchanged at \$12.7 million for the 2017/18 financial year. This is expected to decrease significantly in 2018/19 and the forward years due to an expected decrease in fishing licenses collected resulting from an anticipated

reduction in fishing areas over the coming years. For the 2017/18 financial year, actuals collected to date for fishing revenue totals \$2.8 million. This consists of unanticipated revenue collected for Fisheries Catch totalling up to \$0.3 million received in the first four months as well as higher than expected revenue collected for Fisheries US Treaties.

- Revenue from instant fines is expected to increase for 2017/18 and the forward years to \$40,000 due to procedural changes made to the collection of outstanding fines. Actuals received to date total \$35,020 representing a substantial increase in revenue collected in the first four months.
- Driver's licenses - \$100,000 in revenue is expected to be received in 2017/18 representing an increase of \$30,000 from the \$70,000 budget estimates for 2017/18 and the forward years. This is the result of an increase in tourist arrivals and an increase in fees. Actuals received to date are \$62,400.
- Total dividends to the crown are estimated to reach \$1.7 million in 2017/18. Going forward this is expected to reduce and fluctuate in the outer years due to adjustments to account for the income tax component on dividends payable to CIIC.
- Censorship fees are expected to decrease with total collection estimated to be \$4,000 for 2017/18 and the forward years. Trends over previous years have shown a steady decrease in fees collected, adjustments have been made to reflect this.
- Due to steady growth over the last three years in revenue received for immigration fees, this line item has been adjusted upwards to \$860,000 from the \$587,000 previously budgeted in 2017/18. This is also reflected in the forward years. For the 2017/18 financial year, actuals to date for immigration fees total \$296,000 representing a significant increase in fees collected when compared to budget.

6.1.4 Changes to Expenditures

Expenditure changes are a result of two broad types of changes, these are parameter changes and policy changes. Parameter changes are a result of factors outside of the immediate control of the Government, whereas policy changes reflect the impact of the Government's decisions, as well as technical and classification changes.

Changes to expenditure are caused by:

- Policy decisions leading to new initiatives, or the carry forward of previous initiatives, undertaken by Government;
- Technical changes such as reclassification of expenditure; or
- Movements that occur outside of a decision, referred to as parameter changes, through no short term action by the government. For example, these would include depreciation, changes to the level of the Air New Zealand underwrite due to a change in fuel costs, or movements in welfare beneficiary numbers.

There have been significant changes in expenditure since the 2017/18 budget. Changes were predominantly the result of expenditure decisions by the Government.

Additional expenditure for 2017/18 was approved for a number of government priorities. This totalled \$2.1 million, details are outlined below:

- \$530,000 was provided as Government's contribution to assist with the construction of new classrooms for Nukutere College.
- \$11,900 was provided to enable Government to meet rental arrears obligations for Member of Parliament and Government Whip, Toka Hagai. The current Government Whip requires housing to enable him to reside in Rarotonga and carry out the functions of Government Whip. This position is not recognized as eligible for housing allowance in the existing Remuneration Tribunal Order 2009. Government has provided the support to allow him to carry out his responsibilities here in Rarotonga. A review of the Remuneration Tribunal Order is currently in progress.
- \$374,322 for additional funding for the Aitutaki Road Sealing project to support ICI to complete the sealing of additional roads that were not planned in 2016/17. These costs also factored in associated costs of mechanical breakdowns and other unforeseen costs.
- \$424,741 for the Muri Road Widening Project to assist with clearing and sealing 840 meters of road surface including pavements and drainage work. The work is intended to cover the distance between Avana Bridge to the Nautilus Resort, an area popular to tourists and commercial businesses. The project is being undertaken to improve safety in the popular tourist area.
- \$20,000 to meet the proposed variation of the Rakahanga Island Government aluminum pontoon boat. Through observations at early stages of the boat fabrication and assembly at the Rarotonga Welding workshop, it was indicated that the boat was too large to be powered by the outboard motor proposed by the Rakahanga Island Government. Boat modifications and variations to contract were essential to ensure that the Island Government will be able to deliver ongoing and essential services that can be catered for by the new Aluminium Pontoon Boat (Barge) in a safe and efficient manner.
- \$180,850 in additional funding was provided to meet the Ministers' and Members' travel demands from September to December 2017. Invitations to attend or take part in these engagements have increased, funds are thus required for Government to continue meeting its regional and international obligations and engagements for 2017/18.
- \$62,465 was approved for the consultation of the Crimes Bill in the Northern Group and its Maori translation. Parliament established the Crimes Bill 2017 Special Select Committee to review the Crimes Bill through public consultations. UNDP confirmed funding availability for public consultations to the Southern Group, however, the same fund was insufficient to carry out consultations to the Northern Group. Furthermore, there was no provision of funding to assist with the Maori translation of the Bill as required and stipulated in the Constitution.

- \$28,300 for the Remuneration Tribunal Committee work plan and budget. The Remuneration Tribunal Committee's role is to review and identify legislative gaps in the existing Civil List Acts and Remuneration Tribunal Executive Orders relating to the Members of Parliament remuneration entitlements and allowances. The Remuneration Tribunal 2017/18 have finalized their workplan and are currently underway.
- \$100,000 to top up the Contingency Fund to cover unforeseen costs to government.
- \$263,700 to assist Nukutere College to cover the VAT component associated with the proposed taking of land by warrant for educational purposes. Possible court ordered compensation for taking by warrant was estimated at \$1.7 million. The VAT component of the \$1.7 million payment was not factored as the Nukutere College Incorporation was not VAT registered.
- \$15,868 for costs associated with sending an extra four members with the Cook Islands Delegation travel to Zhuhai, China from 8th – 15th December 2017. Zhuhai province invited officials from the Ministry of Culture, Tourism and Arts troupes from the Cook Islands to attend the Guangdong International Tourism and Cultural Festival in December 2017. Zhuhai province is covering all costs associated with this travel for twelve members of the Cook Islands Government delegation. An extra four members will now be part-funded by the Cook Islands Government.
- \$100,000 was allocated to Ministry of Health to top up the salary currently being paid to the Anesthetist and Pediatrician positions. These critical and specialized positions were recognized by the ministry as requiring market rate salaries. These positions will be vacant by December 2017, and the current salary package no longer provides the Ministry with a favorable position to attract, recruit and retain a replacement Anesthetist and Pediatrician due to the shortage of qualified personnel within the region.
- \$33,000 allocated to the Ministry of Health to top up the operating budget appropriation that was overspent during the 12th Pacific Health Minister's Meeting held on Rarotonga from 28 – 30th August 2017. A budget appropriation of \$50,000 was approved through the 2017/18 budget to accommodate associated costs with hosting this regional event, however due to the high level status of this ministerial meeting extra costs accumulated.

Additional Expenditures Carried Forward from 2016/17 into 2017/18:

- \$1,250,000 carried forward for Te Mato Vai Stage 1 backroad ringmain
- \$10,948,000 carried forward for the Southern Group Renewable Energy Project- loan component
- \$500,000 carried forward for Pukapuka Government House
- \$1,793,323 carried forward for various capital projects with ICI
- \$49,898.27 carried forward Medical Service Beds
- \$485,108.45 carried forward for SIF

- \$15,000 carried forward for OPSC Operating
- \$374,500 carried forward for Land Rent Reviews
- \$50,000 carried forward for House of Ariki
- \$275,214 carried forward for the Public Sector Strengthening – processes and systems
- \$107,600 carried forward to correct educations operating baselines
- -\$56,000 removed from Transport for Director of Aviation
- \$56,000 for Director of Aviation transferred to MFEM

6.1.5 Core Sector Support Funding

The goal of the Core Sector Support (CSS) arrangement with New Zealand is to enhance the Cook Islands self-sufficiency to enable effective delivery of priority development objectives.

Similar to recent processes of disbursing the CSS funding, it will continuously be injected into key sectors such as education and health services to ensure quality of core services are delivered, maintain economic growth through tourism development and to also strengthen public financial management and the overall public sector.

The CSS was budgeted for two financial years 2016/17 and 2017/18, therefore there is no agreement terms set as to whether this support funding will continue in 2018/19. This process is still in negotiation between the Development Coordination Division of MFEM and New Zealand Aid.

Reported actuals for 2016/17 and the 2017/18 HYEPU estimates are shown in the table below.

Table 6.4 Core Sector Support

| | 2016/17 Actual | 2017/18 HYEPU Estimate |
|---|-----------------------|-----------------------------------|
| Funding received under CSS | 7,730,400 | 7,730,400 |
| Public Sector Strengthening/Technical Assistance Fund | 1,876,720 | 2,745,100 |
| Total Expenditure from PBBS Funding | 9,607,120 | 10,475,500 |

6.2 Fiscal Responsibility Ratios

To limit the role of Government budgets on fiscal and macroeconomic stability, the Government of the day must operate within the fiscal responsibility principles outlined in the Ministry of Finance and Economic Management Act 1995/96 as follows:

- ensuring that unless Crown debt is at prudent levels, operating expenses will be less than operating revenues (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;
- prudently managing 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.

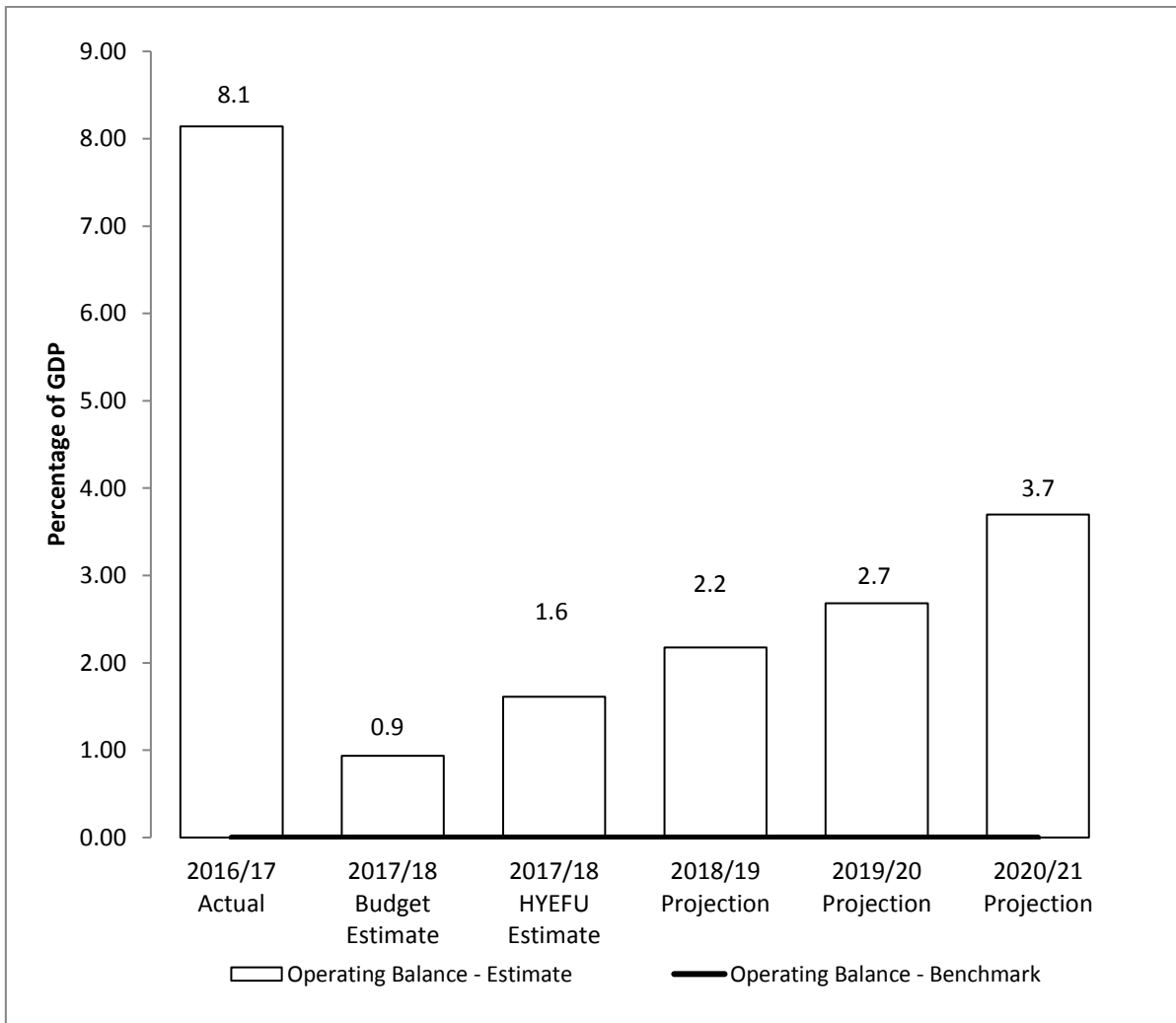
The Ministry of Finance and Economic Management (MFEM) quantifies these principles through the Fiscal Responsibility Ratios (FRR) as reported in the 2017/18 Budget. The current, and expected, performance of each of the FRRs are discussed below.

6.2.1 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. The Government has set a benchmark of running an operating surplus in each Budget. As illustrated below, it is anticipated that Government has an operating surplus of \$7.0 million for 2017/18 HYEPU, which is equivalent to 1.6 per cent of GDP.

Going forward, changes in expenditure and revenue estimates are predicted to result in an operating surplus of 1.6 per cent of GDP in 2017/18, followed by surpluses of 2.2 per cent in 2018/19, 2.7 per cent in 2019/20 and 3.7 per cent in 2020/21.

Figure 6.1 Operating Balance 2016/17 to 2020/21

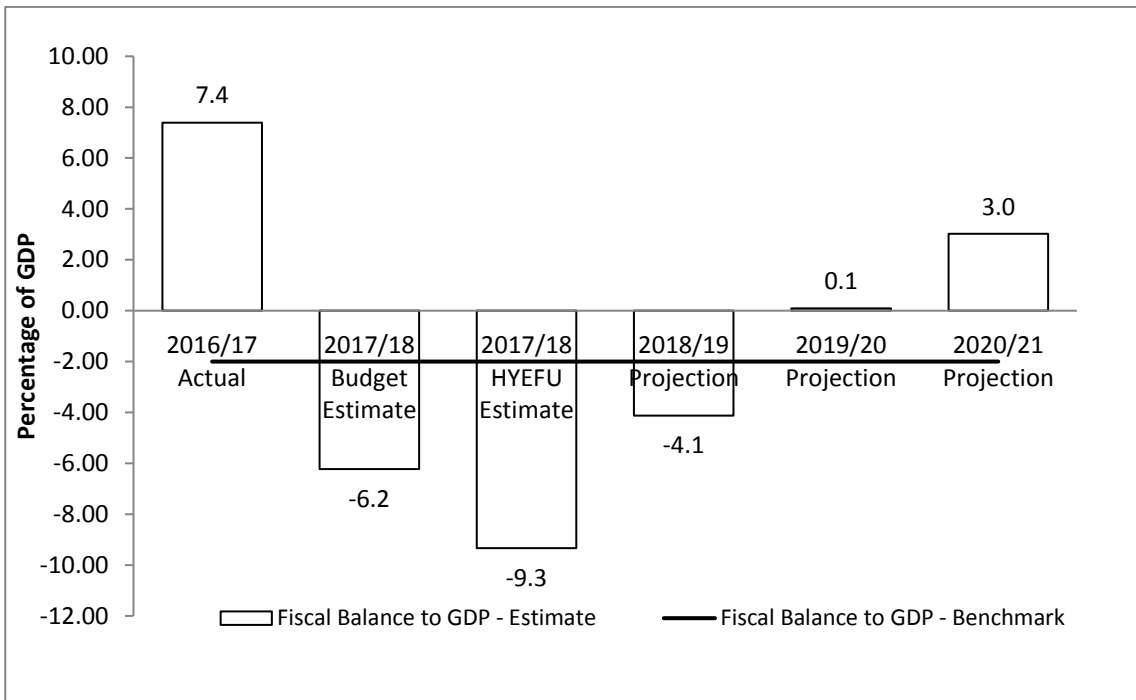


6.2.2 Fiscal Balance to GDP

The Fiscal Balance is the operating balance less net capital expenditure (total capital expenditure less depreciation). Where the fiscal 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.

As the figure below illustrates, the Government breaches the fiscal balance for 2 years from 2017/18 to 2018/19 due to large scale infrastructure projects which are financed by a combination of concessional lending and using cash reserves. The fiscal balance has increased in the 2017/18 HYEFU compared to 2017/18 Budget largely as a result of projects being carried forward from 2016/17. Large fiscal deficits are only expected over the short-term due to the nature of the projects in question. If projects are completed as scheduled, the fiscal position is expected to improve going forward.

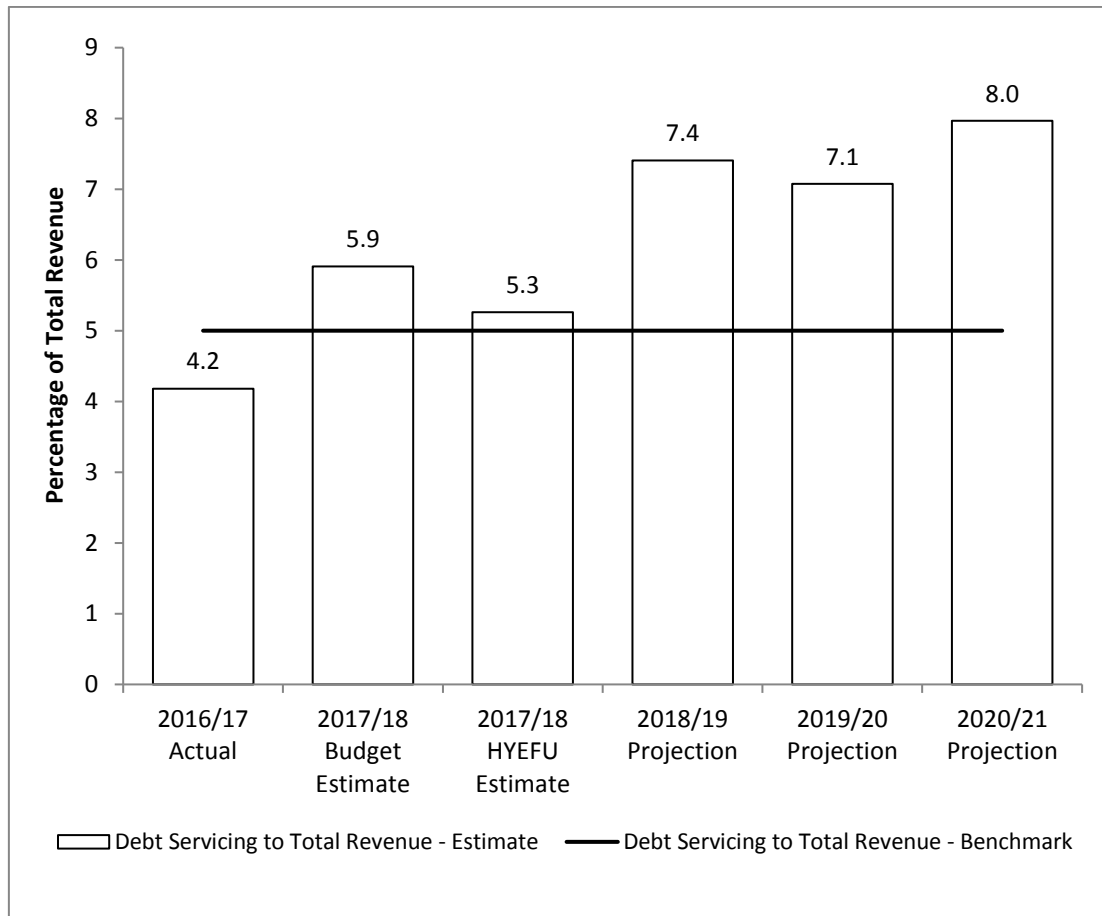
Figure 6.2 Fiscal Balance to GDP 2016/17 to 2020/21



6.2.3 Debt Servicing to Revenue

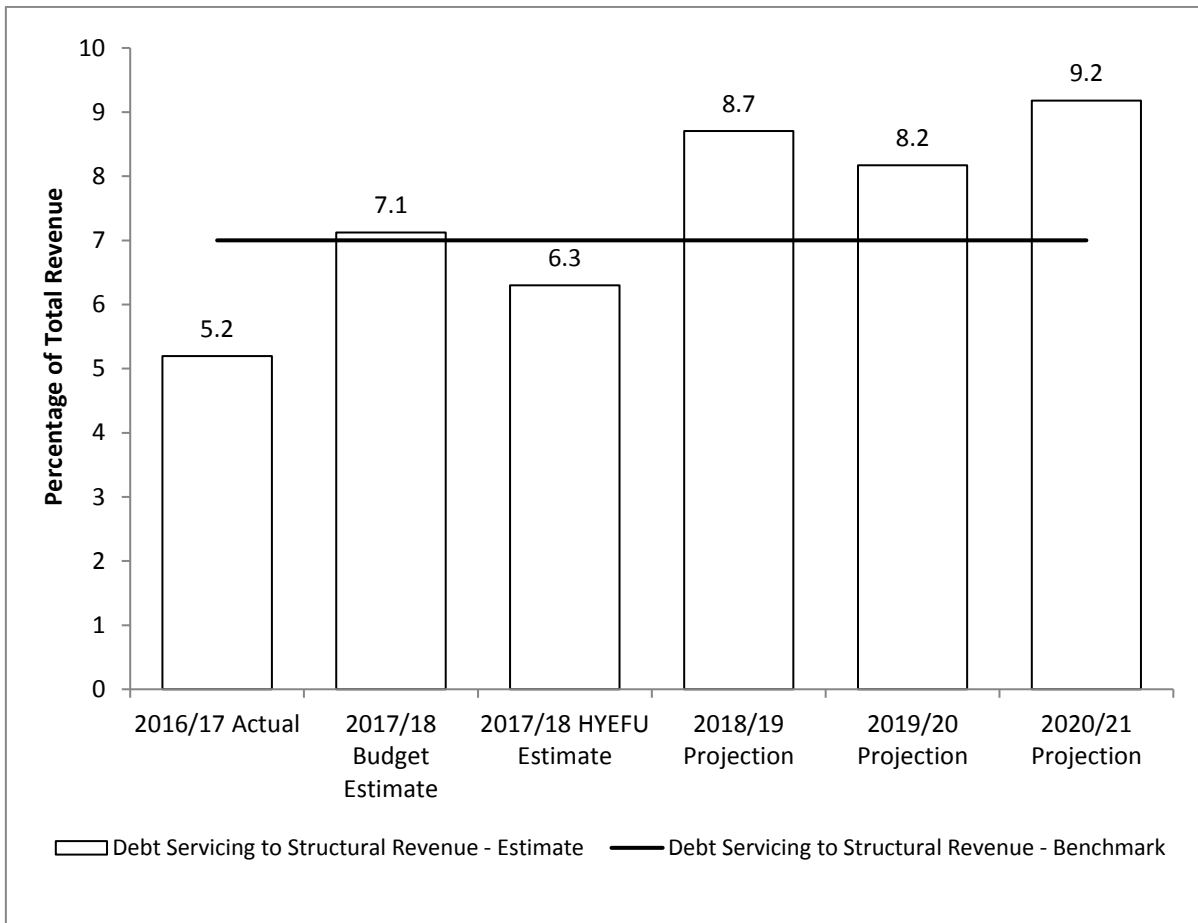
Debt servicing to total revenue measures the ability of Government to service its debt obligations from revenue collected. Debt servicing includes both interest and principle. The figure shown below represents the debt servicing payment going out of the Loan Repayment Fund (LRF), minus any interest earnings of the LRF (rather than the amount paid into the LRF in the specified year). The ratio of debt servicing to revenue is 5 per cent. As can be seen below, this is breached from 2017/18 onward. Debt servicing to revenue has decreased in the 2017/18 HYEFU compared to 2017/18 Budget as a result of favourable exchange rate movements in that year and an increase in revenues. However, the figures have worsened over the forward estimates due to downward revisions to revenues.

Figure 6.3 Debt Servicing to Revenue 2016/17 to 2020/21



It is useful to compare debt servicing with structural revenue to form an opinion of government’s ability to meet debt obligations in the longer term. Structural revenue is estimated to be locally sourced (non-grant) revenue, excluding withholding tax, revenues from seabed mining and fishing revenue. While fishing revenues are likely to be smoother over longer time horizons, due to large changes in recent times, it has been excluded here. When considering debt servicing to structural revenue we must adjust the benchmark level upwards to 7 per cent, as structural revenue is, by definition, smaller than total revenue. Revised figures in the 2017/18 HYEFU show that in that year, debt servicing will be below the benchmark amount as a result of increased structural revenues. However, debt servicing increases dramatically from 2018/19 due to the ending of grace periods on some large loans.

Figure 6.4 Debt Servicing to Structural Revenue

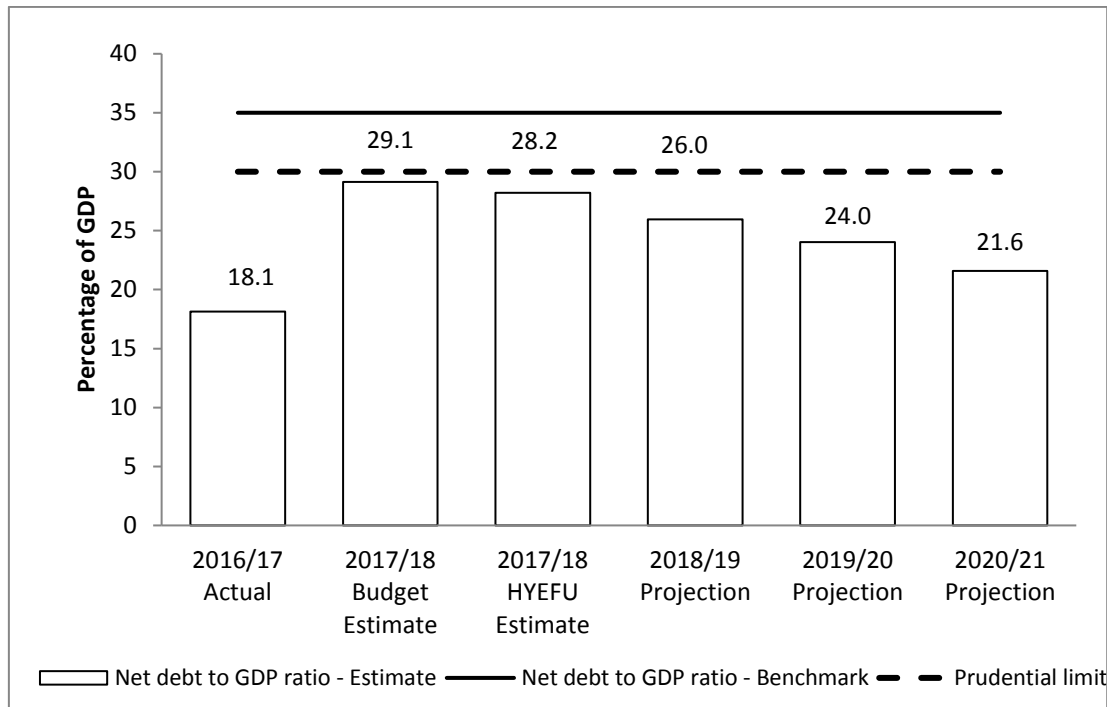


6.2.4 Net Debt to GDP

Net debt (taken here to be gross debt obligations, net of the funds in the LRF) 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 limit agreed to by Government is to maintain net debt within 35 per cent of GDP. This would represent net borrowings of approximately \$151.6 million based on the 2017/18 HYEUFU. The Government is well within the net debt benchmark over the short and medium term.

Shown in the graph below is also a 30 per cent debt target that the Government is committed to staying below (this would be equivalent to approximately \$130 million). This ensures that there is at least 5 per cent of GDP available in debt financing should there ever be a major economic or natural disaster before the Government breaches the voluntary debt limit.

Figure 6.5 Net Debt to GDP Ratio 2016/17 to 2020/21



As can be seen, net debt peaks in 2017/18 below both ratios, at 28.2 per cent of GDP. Changes since 2017/18 Budget are the result in a change in calculation methodology and changes in exchange rates.

These ratios should not be looked at in isolation. Any proposal to take on additional borrowing should be looked at in the context of the whole of the Government Budget, the Crown’s ability to pay annual debt servicing and international best practice. The latter aspect includes prudential requirements set by the Crown’s lenders.

There is a question of the appropriateness of the five per cent debt servicing to revenue level and whether it is in fact too low. The net debt servicing to total revenue ratio controls the servicing of debt, which includes interest and principal payments. 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.

An independent assessment undertaken by the ADB in 2013 concluded that the five per cent debt servicing to revenue ratio was likely too conservative and inconsistent with the debt to GDP ratio constraint. The review noted that a more reasonable and consistent ratio of debt servicing to revenue would be 10 per cent.

Proposals to take on new loans must be treated under transparent processes as required by the MFEM Act 1995/96 and the LRF Act 2014. The fiscal responsibility ratios will assist Government to prudently manage its future loan obligations and borrowing plan.

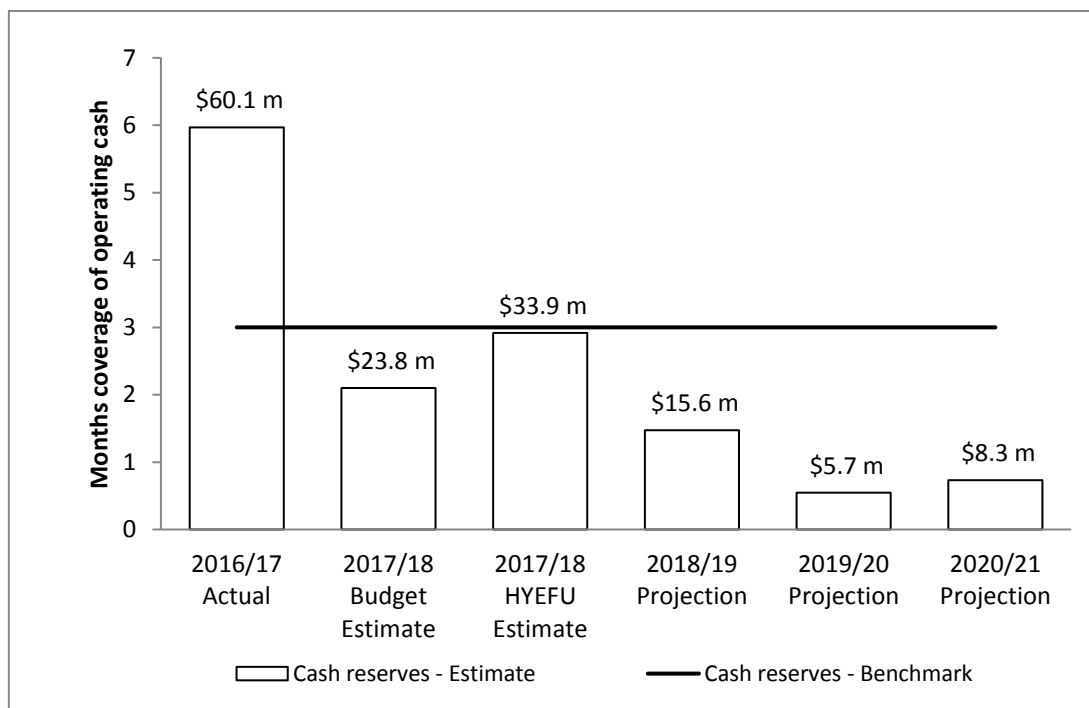
The LRF Act 2014 requires MFEM to analyse and report to the Parliament and the public on the impact of new borrowing in the context of Government lending policy, including the amortisation schedule, the impact on debt service burden of the government over the life of the loan, and an assessment of the sustainability of aggregate government debt. Reports should be made in advance of loan agreements being finalised.

6.2.5 Cash reserves

For prudential reasons, the government requires a level of cash reserves to be on hand at all times, to act as a buffer in case of a liquidity shortage. For example, if a large cyclone were to impact Rarotonga, and cause a halt to tax collections, the government would require a level of cash to be held in reserve to cover this scenario. A prudent level of cash reserves is considered to be three months of operating expenditure, which is shown in the chart below.

In the 2017/18 year, and each year going forward, this threshold is not satisfied, increasing the risk of cashflow difficulties if there was a major disaster.

Figure 6.6 Months of Operational Expenditure covered by Cash Reserves

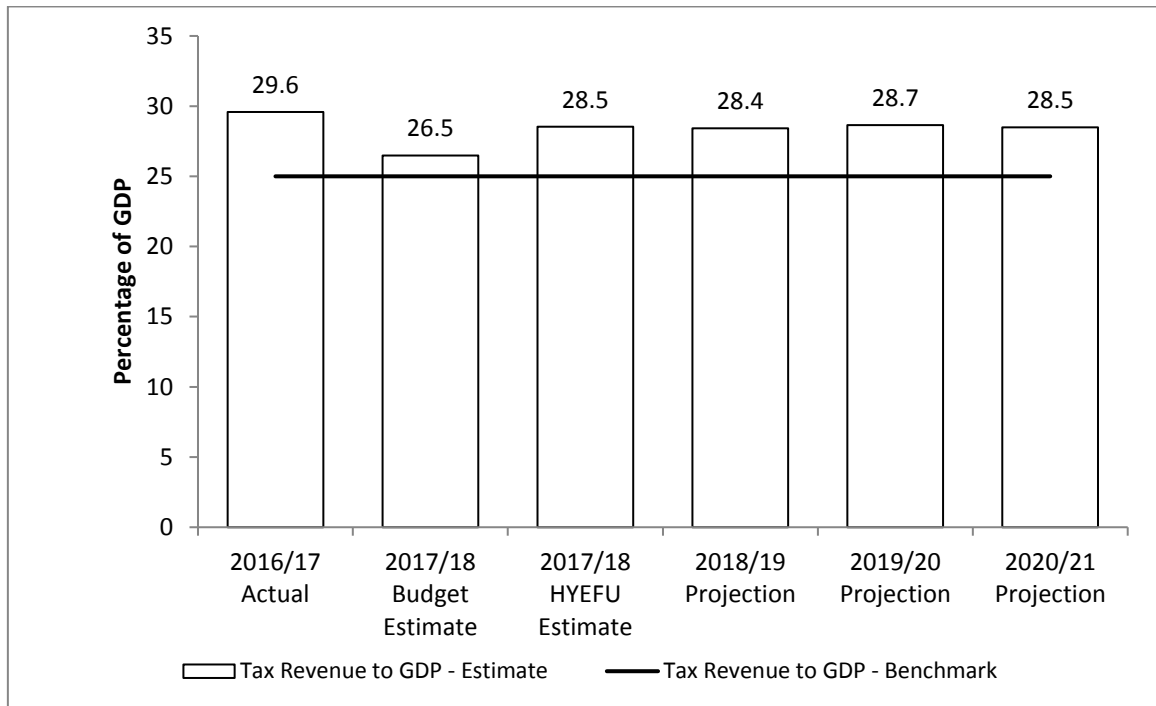


6.2.6 Tax Revenue to GDP

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 the chart below.

Current forecasts estimate that the Government is forecast to exceed the benchmark in 2017/18 (28.5 per cent) and will maintain this going forward.

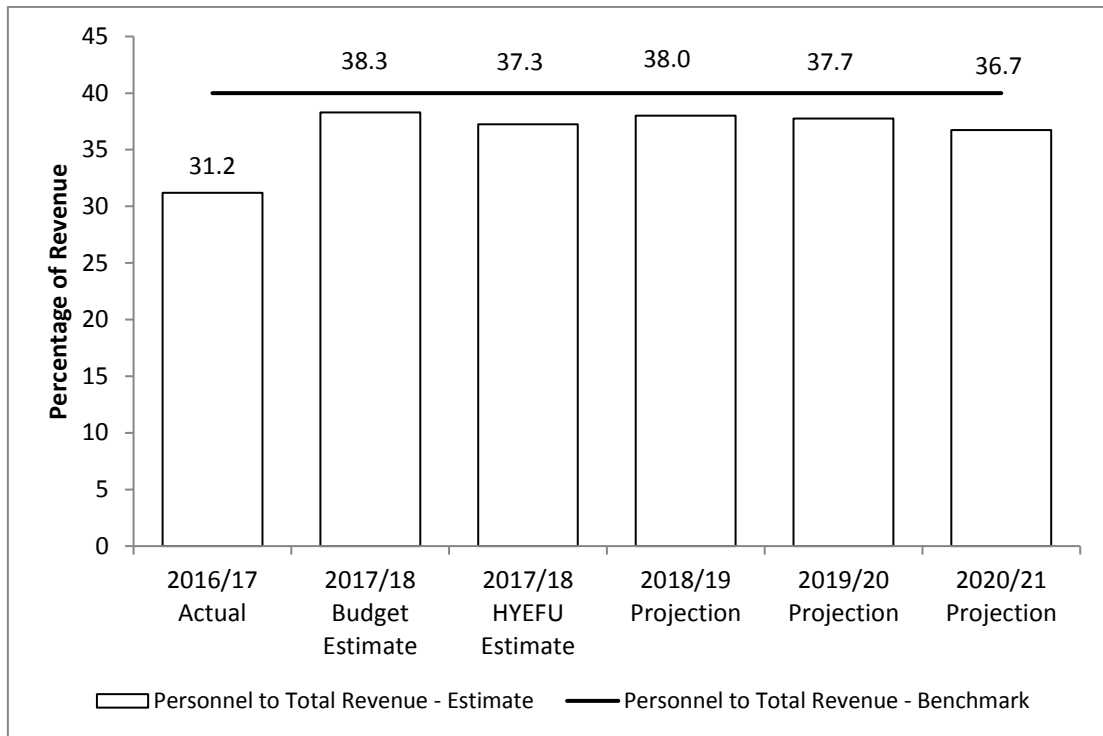
Figure 6.7 Tax Revenue to GDP 2016/17 to 2020/21



6.2.7 Personnel Expenditure to Revenue

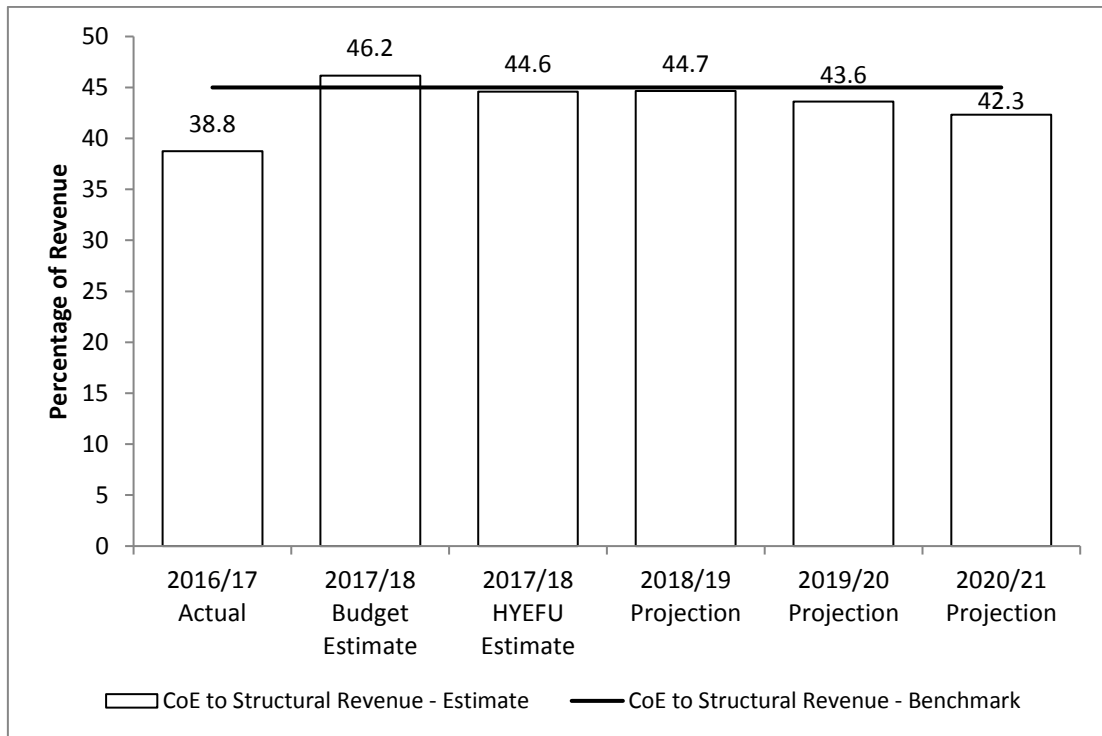
This ratio is aimed at controlling the expansion in the size of the public sector. The benchmark that current and previous governments agreed to work within is maintaining the expenditure on personnel within 40 per cent of total revenues. As is illustrated in Figure 6.8 below, currently this target is being achieved.

Figure 6.8 Personnel Expenditure to Total Revenue 2016/17 to 2020/21



However, as personnel spending is a structural spending component, and some of the revenue included in the ratio for Figure 6.8 is not structural in nature, it is useful to consider the ratio shown in Figure 6.9 as well. This ratio compares total ‘Compensation of Employees’ (a Government Financial Statistics measure of personnel expenditure, which includes personnel funded through Administered Payments and POBOCs) with structural revenue to indicate the level of personnel spending as a proportion of structural revenue.

Figure 6.9 Compensation of Employees to Structural Revenue - Estimate 2016/17 to 2020/21



Part of the ongoing public financial management improvements will be to identify a more suitable ratio than the current Personnel-to-Revenue measure, and Figure 6.9 offers a different perspective on the challenge of maintaining fiscal sustainability, with a benchmark ratio of 45 per cent used as an indicator. As shown above, due to the revised forecast in revenue this has resulted in this spending to fall within the 45 per cent benchmark in 2017/18. This will be maintained over the forward estimates.

6.3 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 forecast on the basis of recent trends in economic activity as well as one off considerations.

Both GDP and trade data are updated to the June quarter 2017. The data sets used were those available as at 30 November 2017.

Nominal GDP is expected to grow by:

- 1.7 per cent in 2016/17 (provisional actual)
- 2.6 per cent in 2017/18
- 1.9 per cent in 2018/19
- 2.0 per cent in 2019/20
- 2.6 per cent in 2020/21

The general model used to forecast nominal economic growth is based on the expenditure national accounting measure and uses estimates of public sector consumption and investment (including aid assistance), net merchandise trade, total tourism spending, domestic investment, and domestic consumption.

Tourism expenditure is the largest single component of the forecasts, and is based on average stays of 8.4 days for New Zealand arrivals, 8.9 for Australia, 8.2 for USA, 10.1 for Canada, 8.7 for Europe (including the UK), 6.6 for Asia, 7.9 for French Polynesia and 10.2 for other – an overall average of around 8.5 days depending on the composition of total arrivals in any given month. This data is based on 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 is assumed to be NZD 243.60 per day, which is estimated from quarterly visitor surveys and a CPI indexation of a basket of tourist services.

Public consumption is the second largest single item and is estimated based on the personnel and operating appropriation for both Government and aid spending. Public investment is also a significant component of the model, and is estimated based on capital plans (including ODA investment), for which a realisation (or completion) rate is applied to capital projects to allow for project slippage from one year to the next, and issues of capacity. This is based around the total capital projects over the period, smoothed to follow an estimated profile based on historical realization rates around 40%.

Government consumption expenditure is based on the Operating Actuals until 2016/17 and Operating Estimates for the forwards as outlined in the Appropriation for 2017/18, and is expected to grow as follows:

- -1.3 per cent in 2016/17 (provisional actual)
- 3.2 per cent in 2017/18
- 0.21 per cent in 2018/19
- 4.2 per cent in 2019/20
- -0.8 per cent in 2020/21

Domestic (private) consumption is the next largest single item and is estimated based on consumption patterns as observed through the VAT series, along with expected inflation and population changes. The methodology derives a “consumption per head per day” metric and scales back to the full population.

Growth in prices measured through movements in the Consumer Price Index are projected based on global commodity prices and exchange rate movements as forecast by the IMF and World Bank (used to construct a ‘Tradeables’ series), as well as historical trends for non-tradable components of the CPI basket. Growth in the CPI has been, and is expected to be:

- -0.13 per cent in 2016/17 (actual)
- 1.6 per cent in 2017/18
- 1.6 per cent in 2018/19
- 1.1 per cent in 2019/20
- 1.3 per cent in 2020/21

Operating Expenditure movements in the outer years are based on actual commitments and are modelled through the Medium Term Budgeting Framework.

The level of borrowings is based on exchange rates provided by Bancorp, derived using Consensus Economics forecasts.

7 ECONOMIC UPDATE

7.1 Introduction

The Cook Islands economy has experienced strong growth in recent years, largely based on unprecedented growth in tourism arrivals. The Cook Islands is scattered across 1.8 million square kilometres of the Pacific Ocean in the form of 15 islands, this creates both advantages and disadvantages for the economy. The unique geographic set up of the country has contributed to the natural beauty of the country's land and waters. The natural beauty along with the unique culture has allowed the economy to become the tourism based economy that it is today.

It is estimated that 161,000 tourists will travel to the Cook Islands in 2017/18, following a record of 155,800 in 2016/17. This growth has raised the standard of living and quality of life for Cook Islanders. It has also allowed the country to continue its progression towards higher levels of economic prosperity, which may result in the graduation of the Cook Islands from Official Development Assistance.

However, in this context, the heavy reliance that the economy has on the tourism sector makes the Cook Islands vulnerable to shocks in external markets and natural disasters. As noted in section 7.6.1 economic downturns in major tourism markets such as New Zealand, and natural disasters in Rarotonga pose a risk of the Cook Islands losing up to 67 per cent its current tourism base. If a major cyclone were to hit Rarotonga, it would take time before the tourism industry could rebuild to a standard acceptable to tourists, affecting both economic growth and government revenues.

The layout of the Cook Islands also has a significant impact on the economy. Rarotonga is the hub of commercial activities and tourism, and was also home to around 72 per cent of the population as at Census 2016. Only a small per cent of the population lives on the remaining islands, with around 20 per cent of the population living in the five southern group islands and 7 per cent living in the northern group islands. Due to the small populations on the outer islands, the economies are largely built on subsistence farming, with some islands working towards small tourism, agriculture and pearl industries. The Cook Islands Government thus provides high levels of support to the outer islands to ensure that a reasonable standard of living is achieved for all residents. Despite this, inequality between Rarotonga and the Pa Enua remains an issue.

Strong growth in tourism appears to slowly be seeping towards non-tourism sectors of the economy with growth in both residential and commercial construction. The government is also in the process of implementing an ambitious capital plan which is expected to have a positive impact on the economy through the employment of local staff and contractors over the medium term, with some projects such as water sanitation expected to continue into the long-term. Growth in tourism and construction whilst encouraging growth in the national accounts, both

increase imports which can detract from some of the positive growth estimated. This is expected to occur over the forwards, with increases in imports.

There was a minimum wage increase that was implemented in July 2017. This addressed high cost of living relative to wages issue that the government was concerned about. The minimum wage was increased from \$6.25 to \$7.00. At the same time, the government increased government salary bands in line with the minimum wage increase. The full impact of the increase in minimum wage is unknown at this point because there is no measure of marginal consumption in the Cook Islands.

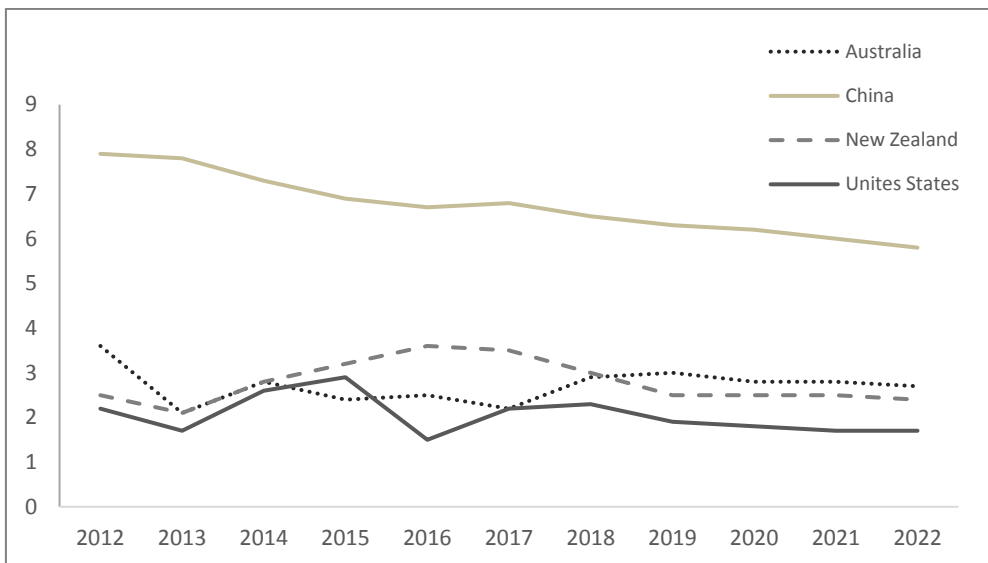
The Asian Development Bank Outlook 2017 provides a positive outlook on the Cook Islands, although noting that it must maintain prudent macroeconomic management against rising risks from economic and climatic shocks. The ADB estimated economic growth of 5 per cent in 2016/17, however provisional actuals suggest that there was only 1.7 per cent growth during this period. The ADB argues that higher growth is prevented by capacity constraints in the tourism industry which are difficult to resolve over the short term, predominantly issues with land-ownership and leasing arrangements. Furthermore, the ADB notes structural impediments to private sector growth, in particular rules around foreign direct investment. The Cook Islands Government is looking to review current FDI policy in the coming months to assess any changes required to encourage FDI, while ensuring that local businesses are also supported.

Work is also being undertaken to develop balance of payments data for the Cook Islands. In working on this new data, possible issues around other economic indicators have been raised. Uncovering these possible issues may initiate the revision of other economic indicators.

7.2 The global economy

The Cook Islands economy must be seen in the context of the global economy due to its open nature and heavy reliance on the export of goods and services. The IMF has increased its growth estimates for 2017 to 3.6 per cent in the October World Economic Outlook, up 0.1 per cent from the world economic outlook in April, 2017. Economic activity is expected to pick up in most countries across the globe. Despite this, the unsettled global political environment remains the biggest risk for the global economy.

Figure 7.1: IMF Growth Estimates for selected countries



In the case of emerging economies, China’s growth for the beginning half of the year has been stronger than expected as a result of government policy support, and supply side reforms. Going forward the expectation of government maintaining a sufficiently expansionary policy mix has influenced the upward revision of all growth rates going forward. Results have not been as positive for some other emerging economies with growth slowing in India. In April the growth rates were revised down to 7.2. The growth rates has been revised down further in October to 6.7 per cent, this is expected to improve going forward.

Growth in the global economy is expected to have a positive impact on the Cook Islands’ economy through increased tourism, although it does pose a risk of increased inflation. The IMF have downgraded their original forecasts for growth for two of the Cook Islands’ three key markets namely, Australia and the United States in 2017 and 2018. The forecast remain positive for the years to come, however at slightly lower levels.

New Zealand has experienced growth in recent years as a result of record high net migration. High profit capacity and low interest rates, have helped to boost business investment. This in turn has helped to decrease the unemployment rate to 4.9 per cent. These factors, together with recent expansionary policies influenced the IMF to revise their forecasts from 3.1 per cent to 3.5 per cent in 2017, and from 2.9 per cent to 3.0 per cent in 2018. The New Zealand market was the only one of the three key market that was not revised downwards in the October world economic update.

Australia’s expected growth was downgraded from 3.1 per cent to 2.2 per cent in 2017 and 3.0 to 2.9 in 2018 due to mining exports and housing investments were undermined by bad weather in the first half of the year. Coal prices in Australia decreased from March until June due damages that Cyclone Debbie had caused. Cyclone Debbie also caused housing investment to decrease in the first half of the year. After these events the IMF revised growth estimates down. Any negative

shocks to the New Zealand and Australian housing markets could have serious negative impacts on both economies, predominantly due to the high level of dependence between each nation's banks.

Originally it was estimated that the United States would see real growth of 2.3 per cent in 2017 and 2.5 per cent in 2018. This has now been downgraded to 2.2 per cent in 2017 and 2.3 per cent in 2018. The downgrade was due to major corrections in fiscal policy assumptions. It was originally assumed that fiscal policy would boost demand, at the time of the October world economic update an assumption of unchanged policies was made, this meant that the predicted growth rate was revised and downgraded. Since this publication there has been tax cuts which may stimulate more growth than expected in the remaining part of the year.

Oil prices have increased from the predicted price of US\$50 to \$US51 following a series of hurricanes and tropical storms hitting the US coastal areas. Several oil rigs were forced to stop production and evacuate workers because of the various storms. Despite the small increase in oil prices, the effect of this on petrol prices is quite large. While oil extraction was not halted for long, oil refineries had to remain closed for long periods of time due to flooding and damage. This caused petrol prices to increase globally, it is expected that the petrol prices will decrease towards the previous estimates by the end of the year.

7.3 Economic Indicators

Tourism has grown consistently since 2015, with 11 per cent growth in 2015/16 and 14.9 per cent growth in 2016/17, it is expected that tourism will continue to grow albeit at lower rates. Tourist arrivals in 2016/17 performed better than expected with growth expected to be 12.8 in the 2017/18 Budget, as opposed to the actual of 14.9 per cent.

Tourism arrival estimates for 2017/18 have been revised down since the 2017/18 Budget due to New Zealand arrivals being lower than expected for the year to date. 2017/18 budget estimates were 5.4 per cent growth however the growth rate is now estimated to come to 3.5 per cent. Increases in fuel prices may have a negative impact on the tourism industry going forward through higher airfares. Lower average airfares to ensure that the large 777-200 planes are reaching adequate capacity on the SYD-RAR and RAR-LAX routes have helped to increase tourist arrivals from Australia and North America.

Following these developments and global economic growth, nominal gross domestic product was expected to grow at 4.0 per cent in 2016/17, however provisional actuals show growth of 1.7 per cent. The growth rate is expected to stay relatively steady going forward, with growth expected to increase to 2.6 per cent in 2017/18 as opposed to the 3.6 percent that was expected in 2017/18. The budget growth estimates for 2018/19 have been revised down from 2.4 per cent to 1.9 per cent. For the year 2019/20 growth was estimated to be 2.3 at the time of the budget, it is now estimated to be 2.0 per cent.

The GDP deflator was estimated to equal -0.2 per cent in 2016/17 actuals showed that the GDP deflator was equal to -1.5 per cent showing falling prices across the economy. Real GDP grew at a slower rate than expected, 3.2 per cent as opposed to the 4.2 per cent expected at Budget, however it can be seen that it grew at a faster rate than nominal GDP.

Table 7.1 Summary of Economic Indicators

| | 2016/2017 Estimate | 2017/2018 Estimate | 2018/2019 Projection | 2019/2020 Projection | 2020/2021 Projection |
|--|-----------------------|-----------------------|-------------------------|-------------------------|-------------------------|
| Economic Activity | | | | | |
| Nominal GDP (\$'000) | 422,264 | 433,335 | 441,395 | 450,062 | 461,790 |
| Percentage change (YOY) | 1.7 | 2.6 | 1.9 | 2.0 | 2.6 |
| Real GDP (at Constant 2006 Prices, \$'000) | 339,261 | 344,731 | 346,485 | 352,877 | 357,690 |
| Percentage change (YOY) | 3.2 | 1.6 | 0.5 | 1.8 | 1.4 |
| Inflation | | | | | |
| Percentage change (YOY) | -0.1 | 1.6 | 1.6 | 1.1 | 1.3 |
| Construction/Capital Investment | | | | | |
| Commercial Building Approvals (\$'000) | 24,476 | 19,476 | 15,476 | 15,476 | 15,476 |
| Residential Building Approvals (\$'000) | 11,864 | 12,042 | 12,222 | 12,405 | 12,591 |
| Public Works (\$'000) | 16,001 | 37,102 | 29,180 | 22,336 | 1,571 |
| Productive Sector Indicators | | | | | |
| Visitor Arrivals | 155,230 | 160,686 | 165,130 | 168,188 | 169,874 |
| Percentage change (YOY) | 14.9 | 3.5 | 2.8 | 1.9 | 1.0 |
| Estimated Visitor Expenditures (\$'000) | 322,199 | 331,447 | 344,214 | 354,663 | 362,993 |
| Pearl Exports (\$'000) | 170 | 170 | 170 | 170 | 170 |
| Fish Exports (\$'000) | 16,718 | 16,718 | 16,718 | 16,718 | 16,718 |
| External Sector | | | | | |
| Merchandise Trade Balance (\$'000) | (147,457) | (154,483) | (155,165) | (154,698) | (148,701) |
| Services Trade Balance (\$'000) | 322,199 | 331,447 | 344,214 | 354,663 | 362,993 |
| Exchange Rate (USD/NZD Average) | 0.6959 | 0.7150 | 0.7100 | 0.7000 | 0.7000 |

7.4 Gross Domestic Product (GDP)

The Cook Islands is still experiencing a sustained period of economic growth with positive real growth every year since 2011/12. Over the past 10 years real growth has averaged 1.7 per cent per year, with growth reaching a high of 8.4 per cent in 2015/16. Moderate growth is expected to continue going forward.

Following downward revisions to real GDP actuals in 2015/16, provisional real GDP growth actuals in 2016/17 were 3.2 per cent rather than the 4.2 per cent that was previously estimated. Going forward, the predictions for real GDP growth in 2017/18 have also been revised down from the 2.6 per cent that was predicted in the budget to 1.6 per cent.

Nominal GDP grew at a slower rate than expected in 2016/17. It was estimated that nominal GDP would grow by 4.0 per cent in 2016/17 in the 2017/18 Budget. However actuals show that the nominal growth for 2016/17 was a lot slower than expected, at 1.7 per cent. Going forward it is

expected that the nominal growth rates will remain lower than the estimated figures as at the 2017/18 budget.

Table 7.2 GDP growth revisions

| | 2016/17 | | 2017/18 | | 2018/19 | |
|--|---------|-------|---------|-------|---------|-------|
| | Budget | HYEFU | Budget | HYEFU | Budget | HYEFU |
| Nominal GDP growth (per cent) | 4.0 | 1.7 | 3.6 | 2.6 | 2.4 | 1.9 |
| Real GDP growth (per cent) | 4.2 | 3.2 | 2.6 | 1.6 | 2.3 | 0.5 |
| Implicit GDP deflator (percentage change) | -0.2 | -1.5 | 1.0 | 1.0 | 0.1 | 1.3 |

The figures above compare the growth rates estimated in the 2017/18 Budget with the current HYEFU estimates for each respective year.

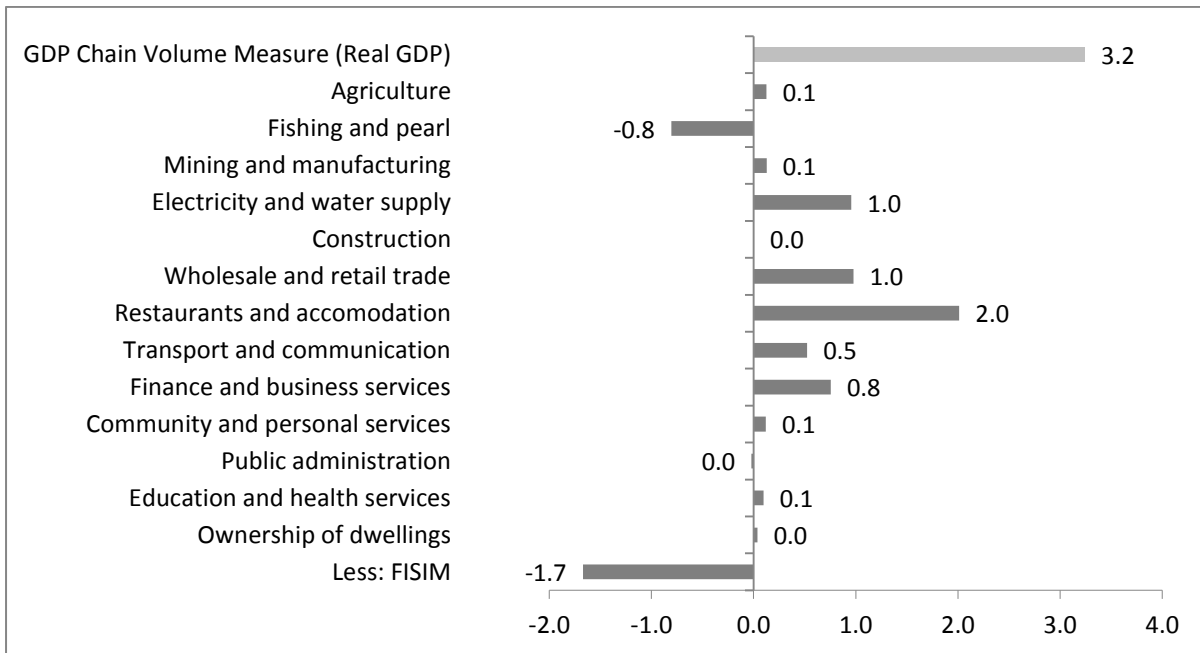
Higher than expected tourism arrivals helped to keep real growth buoyant, despite lower than expected investment. The tertiary (services) sector is by far the strongest sector in the Cook Islands growing by 5 per cent in real terms. Restaurants and accommodation grew by 8.8 per cent, transport and communication grew by 3.5 per cent and wholesale and retail trade grew by 5 per cent in 2016/17.

In terms of the overall contribution to economic growth in 2016/17, the tertiary sector contributed 4.5 percentage points, of which restaurants and accommodation contributed 2 percentage points to real economic growth, accompanied by transport and communication which contributed 0.5 percentage points. Wholesale and retail trade contributed 1 percentage point to growth in 2016/17. Without this sector, the real growth rate would have been -1.3 per cent.

A number of other industries in the tertiary sector made small but positive contributions to economic growth in 2016/17. Education and health services contributed 0.1 percentage points to growth, growing by 1.7 per cent in 2016/17 to just under \$19 million. While Finance and Business also contributed 0.8 percentage points to growth, growing by 5.9 per cent to \$44.3 million.

In the primary sector, Fishing and Pearl detracted 0.8 percentage points from real growth in 2016/17. While agriculture contributed 0.1 percentage points to growth.

Figure 7.2: Contribution to 2016/2017 real growth (percentage point)

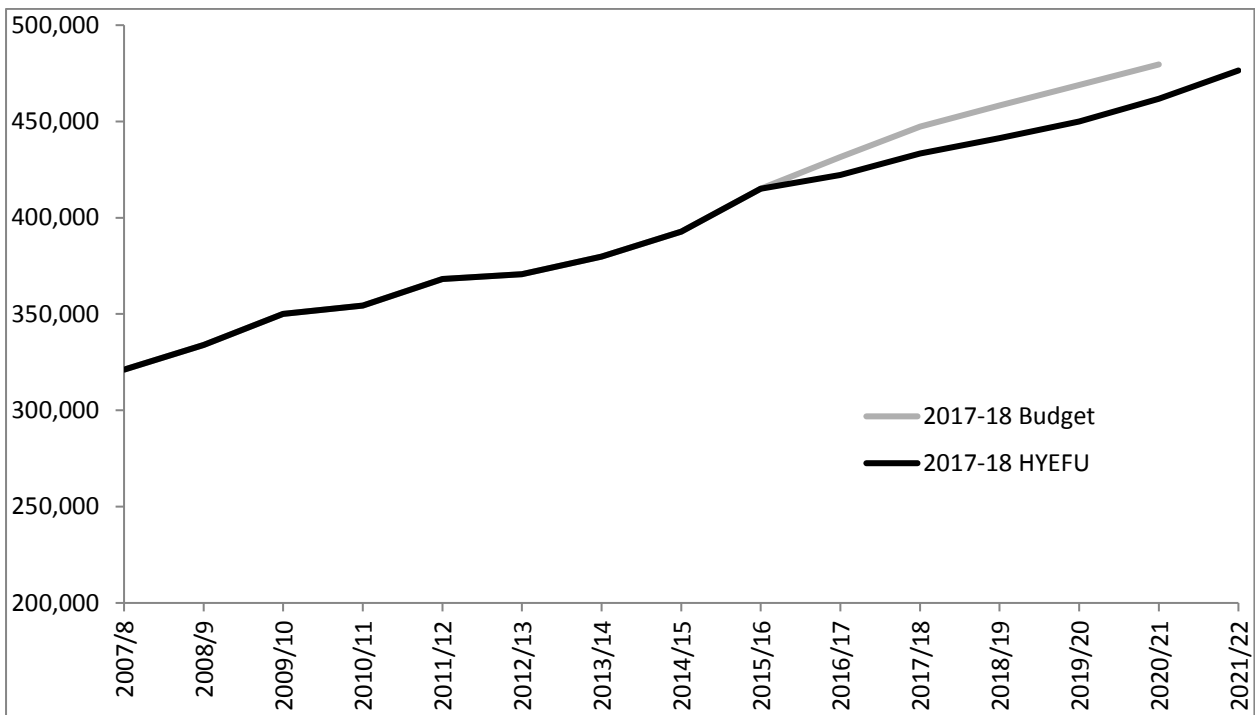


On the consumption side, government consumption contributed 0.5 percentage points to nominal growth in 2016/17 and is expected to contribute 0.7 percentage points in 2017/18. While private consumption contributed 0.3 percentage points 2016/17 and is expected to contribute 0.4 percentage points in 2017/18. Private consumption is expected to increase in the long run as a result of the minimum wage increase that the government has put in place.

Gross fixed investment (public and private) contributed 0.3 percentage points in 2016/17 and is expected to contribute 0.5 percentage points in 2017/18. This is largely due to investment in machines, transport and equipment. The recent increase in building approvals has increased the estimate of gross fixed investment through construction and machines, transport and equipment. Contribution to GDP will increase if building approvals continue to grow.

Increases in imports and imported components of capital expenditure were higher than historically seen and detracted 0.8 percentage points from nominal growth in 2016/17. In 2017/18 imported components of capital expenditure are expected to be even higher and it is expected that imports will detract 1.3 percentage points from growth in 2017/18. Tourism arrivals contributed 1.4 percentage points to growth in 2016/17. It is expected that tourism arrivals will contribute 2.1 percentage points in 2017/18 outweighing the negative impacts of increased imports.

Figure 7.3 Nominal GDP growth 2007/08 to 2021/22

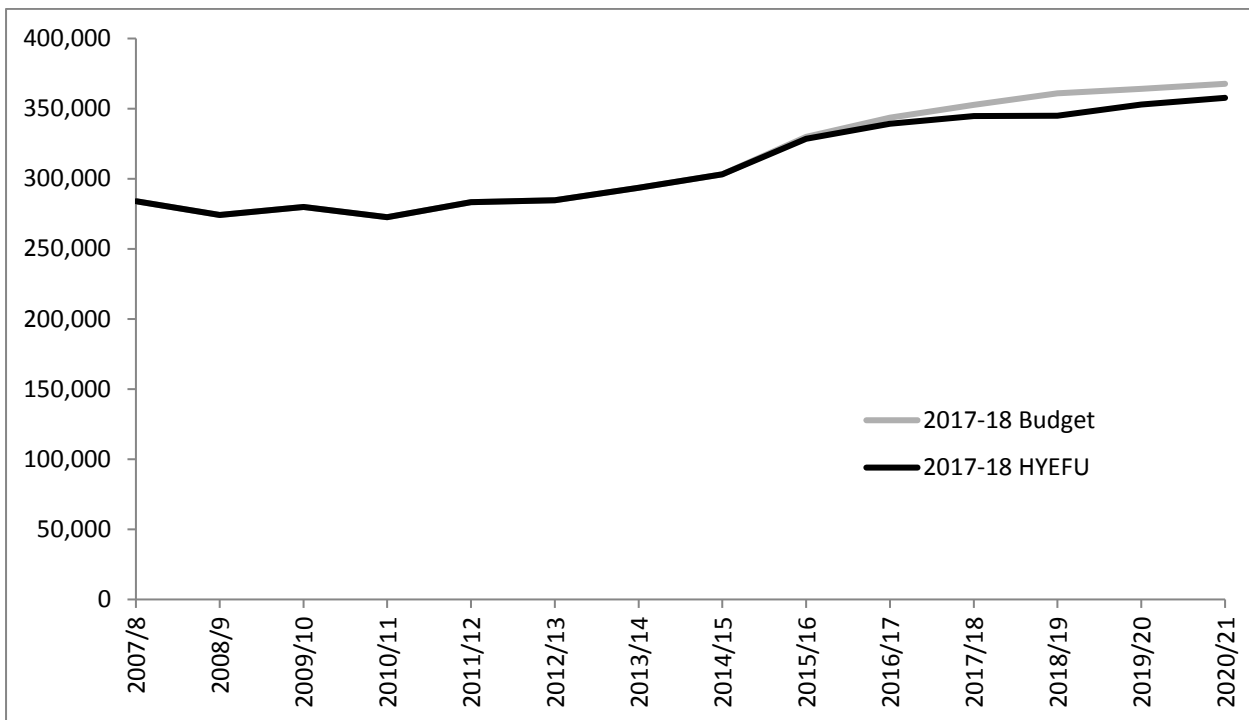


As can be seen in Figure 7.3, GDP has been revised down in 2016/17 and going forward. Nominal growth is still expected to follow a relatively steady upward trend. Growth is expected to be between 1.9 and 3.5 per cent over the forward estimates with minimal growth expected in 2018/19.

Real GDP has been revised down since the 2017/18 Budget. Going forward growth is expected to be slower than previously anticipated in medium term but is expected to pick up again in the long term.

Real growth of 1.6 percent is expected in 2017/18 due to continued growth in tourism and investment (public and private). In 2018/19 it is expected that real GDP will be relatively static with a growth rate of 0.5 per cent following lower growth in tourism and a slowdown in government expenditure.

Figure 7.4 Real GDP 2007/08 to 2021/22



There are a number positive and negative risks to the above predictions. The following are positive risks:

- Higher economic growth in key tourism markets than currently expected, increasing arrivals;
- Oil prices remain at their current level or decrease, allowing airlines to maintain current low ticket prices;
- Investment in private construction continues which decreases capacity constraints in the tourism industry;
- Growth in tourism could be sustained at higher levels than anticipated due to increases in accommodation capacity.

On the downside a number of risks are evident:

- Global growth could stall causing downturns in both Australia and New Zealand, which would impact upon tourism arrivals;
- Increased competition from competing tourism destinations such as Hawaii and Samoa could negatively impact tourism arrivals;
- Inflation and oil prices could increase at higher rates than expected, impacting upon tourism numbers (through high travel costs) and import values;
- Further delays could be seen in the capital plan, pushing back wage earnings and improvements to infrastructure;
- The CIG's ambitious capital plan could crowd out private investment in capital, pushing down construction and limiting capacity growth.

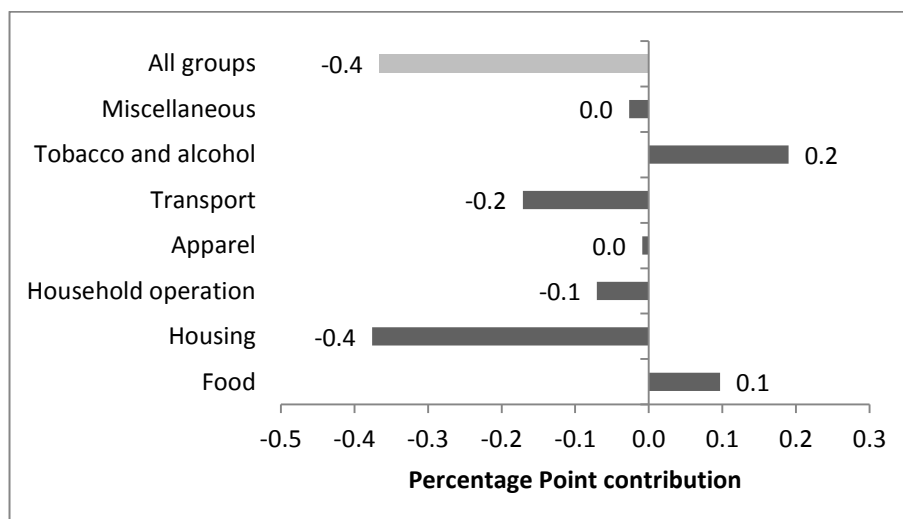
7.5 Consumer Price Index (CPI)

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, inflation has been fairly steady averaging 2.7 per cent annually (1.8 per cent if oil spikes in 2008-09 are removed). Recently, inflation has slowed right down and in some cases reversed. This reverse resulted in deflation through 2016/17. Actuals for 2016/17 showed that the inflation rate for the year was -0.13 per cent, following a large drop in prices during the December quarter. Prices improved throughout the remaining quarters, however not by enough to generate a positive inflation figure in 2016/17.

Deflation in 2016/17 can largely be attributed to decreases in the cost of transport, due to decreases in petrol prices and decreases in the cost of international airfares. Transport detracted 2 percentage points from September quarter 2017 year average inflation. A decrease in the value of home loans has caused deflation in the housing sector to be reported, detracting a further 0.4 percentage points from inflation. The other contributor to 'Housing', housing rents, did not follow the same downward trend due to limited housing supply and an increase in the use of private homes for tourist accommodation.

Deflation in transport and housing have partially been offset by inflation in the cost of food which had a positive contribution of 1 percentage point. Prices of tobacco and alcohol also rose over the period contributing 0.2 percentage points to September quarter 2017 year average inflation. The costs of tobacco and alcohol only increased by 1 per cent through the year to March.

**Figure 7.5 Contribution to September quarter 2017 year average inflation
(Percentage point contribution)**



Following low oil prices in 2016/17, there has been significant volatility in oil prices so far in 2017/18. Oil prices during the September quarter of 2017/18 were unstable following some major hurricanes affecting the Texas (United States), and Gulf of Mexico regions. Oil prices spiked

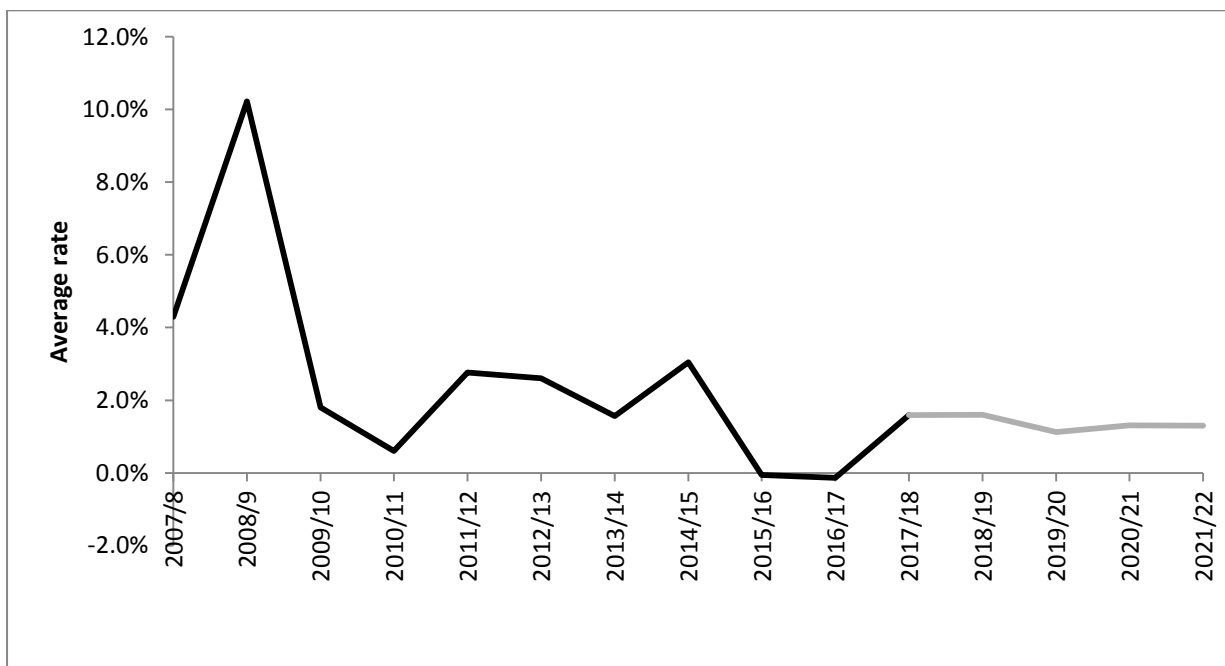
after major oil rigs were forced to shut down production. The oil rigs were able to resume production quickly due to limited damage to the oil rigs. Petrol prices on the other hand experienced a spike due to the oil refineries in the affected areas being damaged. Limited refineries resulted in a limited supply of petrol. This had a major impact on petrol prices during the September quarter of the 2017/18 financial year. Transport in effect had an inflation rate of 2.03 per cent during this quarter. Based on a recent price order increasing the maximum cost of petrol to \$2.15 per litre, it is expected that petrol prices will continue to drive inflation in the December quarter.

CPI has been relatively stable throughout the first quarter of 2017/18 – with an increase of 0.3 per cent in the September Quarter.

Use of the New Zealand dollar as the national currency has helped to ensure that inflation in the Cook Islands has been relatively stable over the past 10 years (with the exception of a peak in 2008/09). The IMF forecasts improvements in the US economy and a tightening of interest rates going forward both of which are expected to result in increased strength in the US dollar. Thus, it is expected that the value of the NZD will decrease somewhat over the forwards. However, as this is yet to occur, the value of the New Zealand dollar is still higher than expected which has maintained the downward pressure on inflation. Anticipated increases in the USD, together with the expectation that global inflation will improve to around 3.5 per cent in 2017, should help to push inflation up slightly going forward (through increased costs of imports).

As a result of these factors, CPI is expected to be 1.6 per cent over 2017/18. This is expected to continue in 2018/19 before decreasing slightly over the medium-term.

Figure 7.6 Consumer Price Index (CPI), year average, 2007/08 – 2021/22



7.6 Tourism

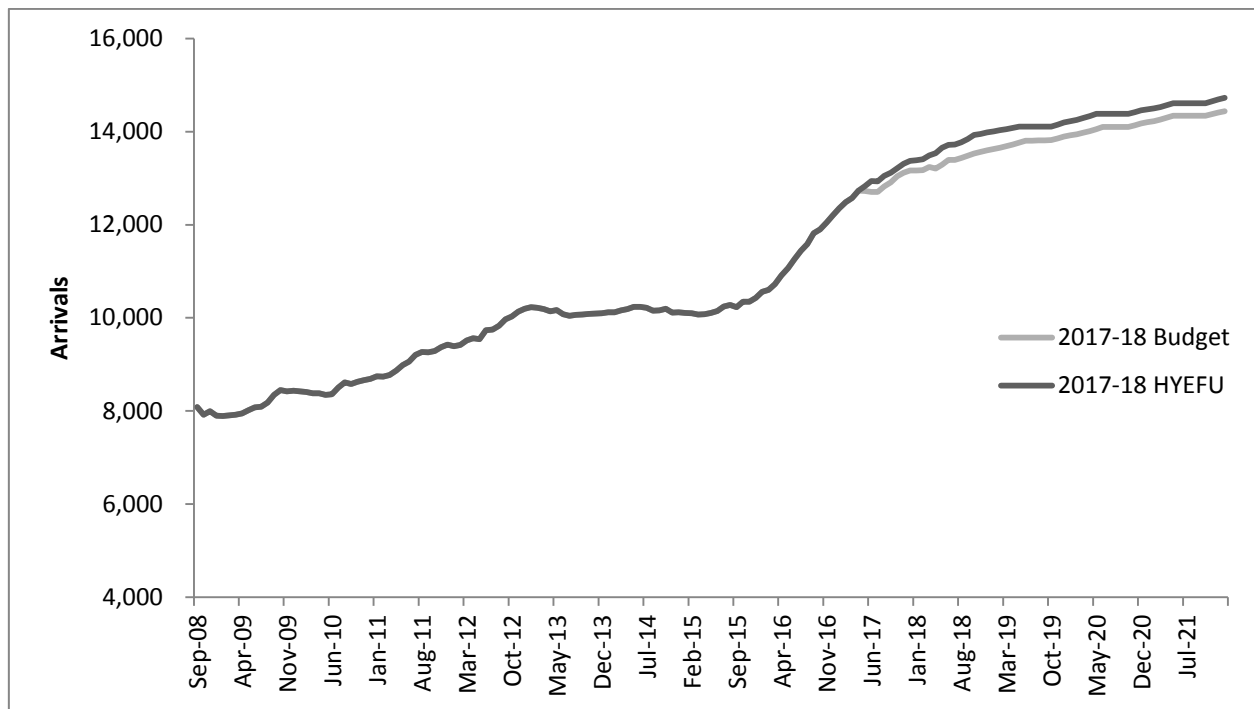
Strong growth in tourist arrivals in 2016/17 has ensured that tourism remains the focal point of economic activity in the Cook Islands. After contracting by 0.9 per cent in 2014/15, the tourism market saw growth of 11 per cent in 2015/16 and was expected to achieve further growth of 12.8 per cent in 2016/17. Year-end results for 2016/17 showed that growth tourist arrivals was above that forecast, at 14.9 per cent.

As expected growth has been strong across most markets. The largest growth seen over 2016/17 was in arrivals from the United States, Canada and Asia. Visitors from the US, Canada and Asia grew by 26.5 per cent, 29.2 per cent and 27.6 per cent respectively, albeit from lower bases than other key markets. Tourist arrivals from Europe and New Zealand have also grown strongly, at 11.8 and 16.9 per cent respectively.

Growth was expected across all markets in 2017/18, however actuals to October have come in slightly lower than expected for the New Zealand market, which has seen growth of just 1.7 per cent in this fiscal year to date compared to 2016/17. Despite this, growth in other markets has ensured that slow growth in the New Zealand market during this period has not had a significant impact, with total arrivals growing by 5.6 per cent this fiscal year to date (July to October) and 9.9 per cent in this calendar year to date (January to October). This suggests a slight increase in the diversification of tourist arrivals.

Actual arrivals in 2016/17 totalled 155,230 up from the 135,000 seen in 2015/16. As can be seen in Figure 7.7, the steep growth in arrivals throughout 2016 and early 2017 has continued for a longer period of time than previously anticipated. This growth is expected to level out during 2017-18 with more sustainable growth expected going forward.

Figure 7.7 Total monthly visitor arrivals (12 month moving average) 2008-2021



The limited number of accommodation providers in the Cook Islands places a limit on the sustainable number of tourists that can visit the country at any point in time. Further to this, the standard of infrastructure is inadequate to handle a significantly higher number of visitors.

Accurate data on tourism capacity in the Cook Islands is not currently available, particularly due to the recent growth in private holiday rentals. The economic forecasting in this chapter is based on an assumed tourist capacity of 16,469 per month, based on the highest number of tourists that the country has seen (July 2016). If tourist arrivals continued to grow at the rates recently seen without improvements to infrastructure and accommodation capacity, possible risks include increased costs to the tourism industry, decreased visitor satisfaction, and the dissatisfaction of local residents.

Due to a strong increase in building approvals for commercial developments, tourism capacity is expected to grow in the short term. These building approvals are for both new and existing businesses. There has also been a strong increase in holiday home rentals throughout the year of 2016/17.

Environmental issues regarding the lagoons within the Cook Islands are a cause for concern. Muri lagoon has been the main focus of the tourism industry, however an algae outbreak occurred in the later months of 2016. Work is currently being undertaken to determine the cause of the outbreak, however it is expected that high density tourism accommodation in the area may have been a contributing factor. To address this, Government is undertaking significant work within the project Mei Ti Vai Ki Te Vai to improve waste water sanitation.

Table 7.3 Estimated total tourism numbers by quarter 2015/16 to 2020/21

| | Qtr 1 | Qtr 2 | Qtr 3 | Qtr 4 | Total |
|---------|--------------|--------------|--------------|--------------|--------------|
| 2015/16 | 39,084 | 33,813 | 24,261 | 37,978 | 135,136 |
| 2016/17 | 45,770 | 38,464 | 28,661 | 42,335 | 155,230 |
| 2017/18 | 47,977 | 40,400 | 28,600 | 43,700 | 160,686 |
| 2018/19 | 49,400 | 42,000 | 29,400 | 44,300 | 165,100 |
| 2019/20 | 49,400 | 43,000 | 30,500 | 45,300 | 168,200 |
| 2020/21 | 49,400 | 43,600 | 31,000 | 45,900 | 169,900 |

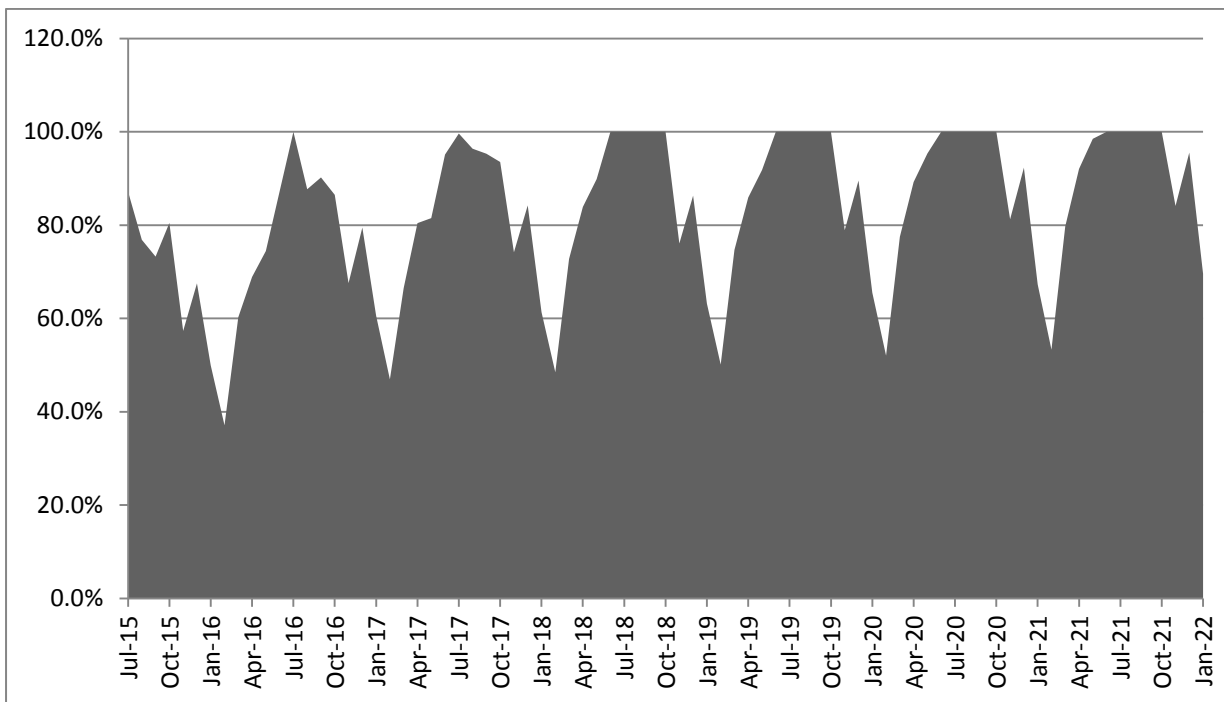
The September quarter (Qtr 1) is the busiest time of year for tourism as shown in Table 7.3. Every month of this quarter is expected to reach maximum capacity from 2018/19 going forward. Reaching the capacity limit in the first quarter is expected to have a flow on effect to other quarters going forward by encouraging tourists to travel to the Cook Islands during other periods, due to ease of access to accommodation, decreased costs etc.

Figure 7.8 below highlights the capacity limitations being experienced in the Cook Islands. During 2017/18 maximum capacity was expected to be reached in 3 months of the year, with 90 per cent capacity expected to be reached during a further 2 months. As of October 2017, shown in table above (Table 7.3), 100 per cent capacity has not been reached, despite being extremely close in July, reaching 16,408 tourist arrivals (99.6 per cent capacity). In every other month tourist arrivals have been over 90 per cent. In the years going forward it is expected that maximum capacity will be reached during 5 months of each year.

The current Tourism strategy is to encourage higher visitor numbers during the low and shoulder seasons, this will serve to increase tourism arrivals, while avoiding placing additional pressure on capacity during the high season. This strategy also intends to diversify the visitor market by attracting visitors from the northern hemisphere. This would serve to decrease the strong reliance on the New Zealand market and decrease vulnerability to shifts in the New Zealand economy.

In the meantime, further investment in infrastructure, including tourist accommodation, will be required to accommodate increasing tourist numbers in the future. The government has already made some investment in public infrastructure throughout 2017/18 in the form of projects such as the Muri Road Widening and the Aitutaki Road projects. These projects are still in progress but they are expected to increase safety for the community and tourists, as well as decrease decongestion. There has been signs that the industry has gained confidence in attracting more visitors in the form of investment in room stock, however a lot more will need done for the country to capitalize on the expected higher levels of arrivals.

Figure 7.8 Tourism capacity utilization by month – 2015 to 2022



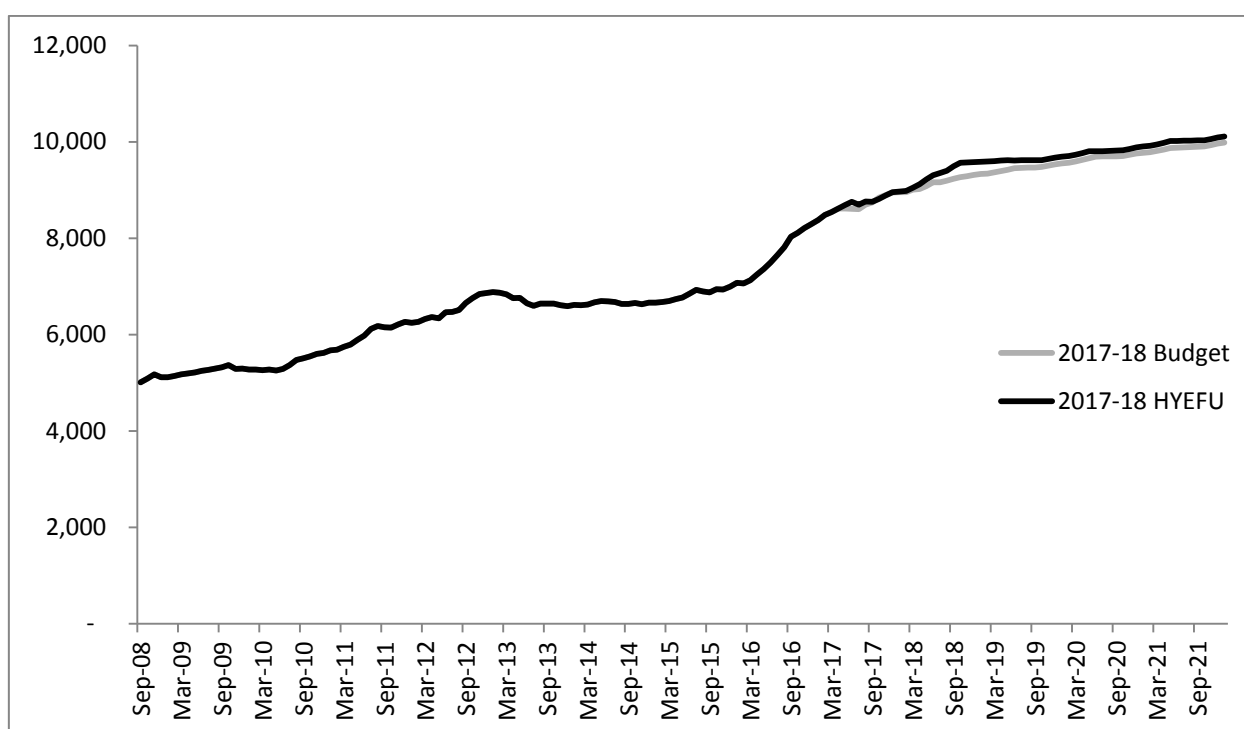
7.6.1 New Zealand

Growth in the New Zealand market in 2016/17 was much higher than expected which saw New Zealand visitors continuing to make the strongest contribution to tourist arrival numbers at around 68 per cent. As at 2017/18 Budget, New Zealand arrivals were expected to reach 109,900 over 2017/18. The expected number of New Zealand tourists has decreased since the beginning of this financial year due to the actual number of New Zealand tourists for every month being slightly lower than previously estimated, despite arrivals being above the 2016/17 figures.

The Cook Islands is receiving an increasingly larger share of New Zealand tourists to Oceania (excluding Australia) with the Cook Islands receiving 24.8 per cent of all New Zealand visitors in 2016, second only to Fiji. However, there is always a risk of increased competition from other Pacific islands that could negatively impact tourist numbers.

The introduction of Jetstar to the Cook Islands' market and the direct flight from Christchurch with Virgin Australia have had a positive impact on New Zealand visitor numbers. The introduction of the route from Christchurch during the peak season has increased access to the South Island market by increasing the competitiveness of ticket prices to the Cook Islands. Further investigation is needed to more accurately establish the impact of these changes and whether they should be expected to continue over the long-term.

Figure 7.9 New Zealand monthly visitor arrivals (12 month moving average) 2008-2021



An increase in New Zealand visitors to the Cook Islands is expected going forward. Growth is projected to be 3.0 per cent in 2017/18 before slowing down to around 1.7 per cent in 2021/22.

Table 7.4 Estimated New Zealand tourism numbers by quarter 2015/16 to 2020/21

| | Qtr 1 | Qtr 2 | Qtr 3 | Qtr 4 | Total |
|---------|--------|--------|--------|--------|---------|
| 2015/16 | 28,084 | 21,089 | 13,627 | 27,112 | 89,912 |
| 2016/17 | 34,563 | 24,188 | 16,657 | 29,664 | 105,072 |
| 2017/18 | 34,591 | 25,600 | 16,700 | 31,300 | 108,200 |
| 2018/19 | 36,200 | 26,300 | 16,900 | 31,500 | 110,800 |
| 2019/20 | 36,200 | 26,900 | 17,500 | 32,100 | 112,700 |
| 2020/21 | 36,100 | 27,300 | 17,800 | 32,500 | 113,700 |

7.6.2 Australia

Australia is the second largest tourism market for the Cook Islands, making up 16 per cent of total arrivals, however growth has tended to be quite cyclical in recent years.

After experiencing a 9.1 per cent decrease in arrivals in 2014/15, Australian visitor numbers recovered to achieve an increase of 13.4 per cent in 2015/16. Growth continued in 2016/17, albeit at a lower rate of 5.1 per cent. The Australian market saw an increase in visit numbers of 8.5 per cent between January and October, as compared to 2016, in part due to the introduction of Jetstar which allowed greater access to other markets in Australia other than Sydney.

The Cook Islands has seen significant growth in Australian visitors over the past ten years, with growth averaging 7.7 per cent per year. Tourism Australia forecasts that outbound tourist numbers will continue to grow in Australia, from 3.9 per cent in 2016/17 to 4.0 per cent in 2017/18 and 4.2 per cent in 2018/19. Growing tourist departures in Australia give an indication that tourist arrivals from Australia may increase in the years to come.

Figure 7.10 Australia monthly visitor arrivals (12 month moving average) 2008-2021

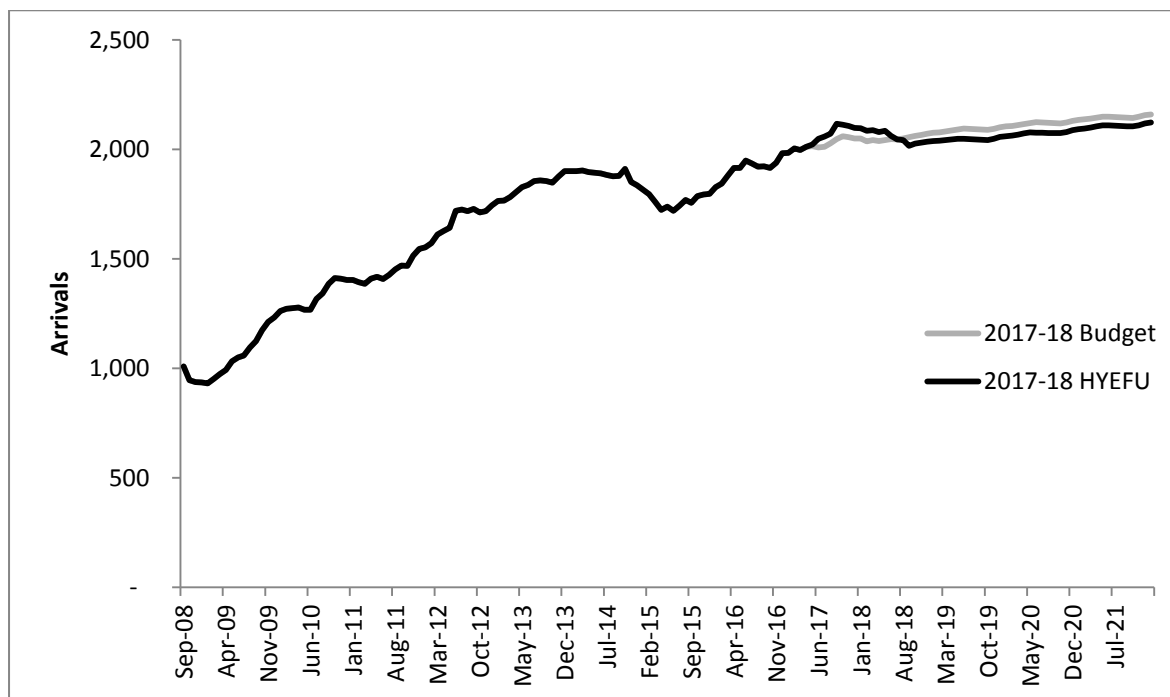


Table 7.5 Estimated Australian tourism numbers by quarter 2015/16 to 2020/21

| | Qtr 1 | Qtr 2 | Qtr 3 | Qtr 4 | Total |
|---------|-------|-------|-------|-------|--------|
| 2015/16 | 6,363 | 7,043 | 4,299 | 5,684 | 23,389 |
| 2016/17 | 6,051 | 7,762 | 4,473 | 6,292 | 24,578 |
| 2017/18 | 6,881 | 7,700 | 4,500 | 6,300 | 25,309 |
| 2018/19 | 6,900 | 8,100 | 4,600 | 6,400 | 26,000 |
| 2019/20 | 7,000 | 8,400 | 4,800 | 6,600 | 26,800 |
| 2020/21 | 7,100 | 8,700 | 5,000 | 6,800 | 27,700 |

7.6.3 Other markets

The strong growth experienced in other markets in 2015/16 has continued into 2016/2017 with a growth rate of 17.2 per cent. Growth is expected to continue, albeit at a slower rate over the forward estimates.

Arrivals from the United States increased by 16 per cent in 2015/16, 26.5 per cent in 2016/17 and projected growth of 6.4 per cent in 2017/18. By 2020/21 the growth rate for US tourists is

expected to slow to around 2 per cent. The impacts of the new and larger Boeing 777-200 aircraft on the underwritten route between Rarotonga and Los Angeles has yet to be quantified and has not been included in the forecasts. On current forecasts, arrivals from the United States are projected to surpass the historic peak in US arrivals experienced in the early 2000s during the 2017/18 financial year.

As with the United States, there has been very strong growth in Canadian visitors in the past two years. Growth in 2016/17 totaled 29.2 per cent, up from growth of 9.9 per cent in 2015/16. Over the long term the rates are expected to return to a relatively static position by 2020/21. However, unlike the United States, Canada still has much ground to gain before surpassing the peaks experienced in the early 2000s.

Downside risks to the North American market largely center on the long-term plans for the underwritten route which is currently out for tender, as well as any unfavorable political and economic developments in the region. However, a strengthening US dollar should have a positive impact on tourist numbers.

Visitor numbers from Europe grew by 6.8 per cent in 2015/16 after a decrease of 1.6 per cent in 2014/15. Growth has continued through 2016/17 with arrivals expanding by 11.8 per cent, it is expected that growth will continue at slower rates until 2018/19.

Strong growth has been seen in arrivals from Asia, albeit from a low base. Arrivals increased by 31.5 per cent in 2015/16 and increased further to 2,055 visitors (growth of 27.6 per cent) in 2016/17.

After a strong increase of 36.7 per cent in visitors from French Polynesia in 2015/16 arrivals took a heavy turn in 2016/17 when tourist arrival decreased by 12 per cent. Growth is expected to return to positive in 2017/18.

Figure 7.11 Other major markets monthly arrivals (12 month moving average) 2008-2021

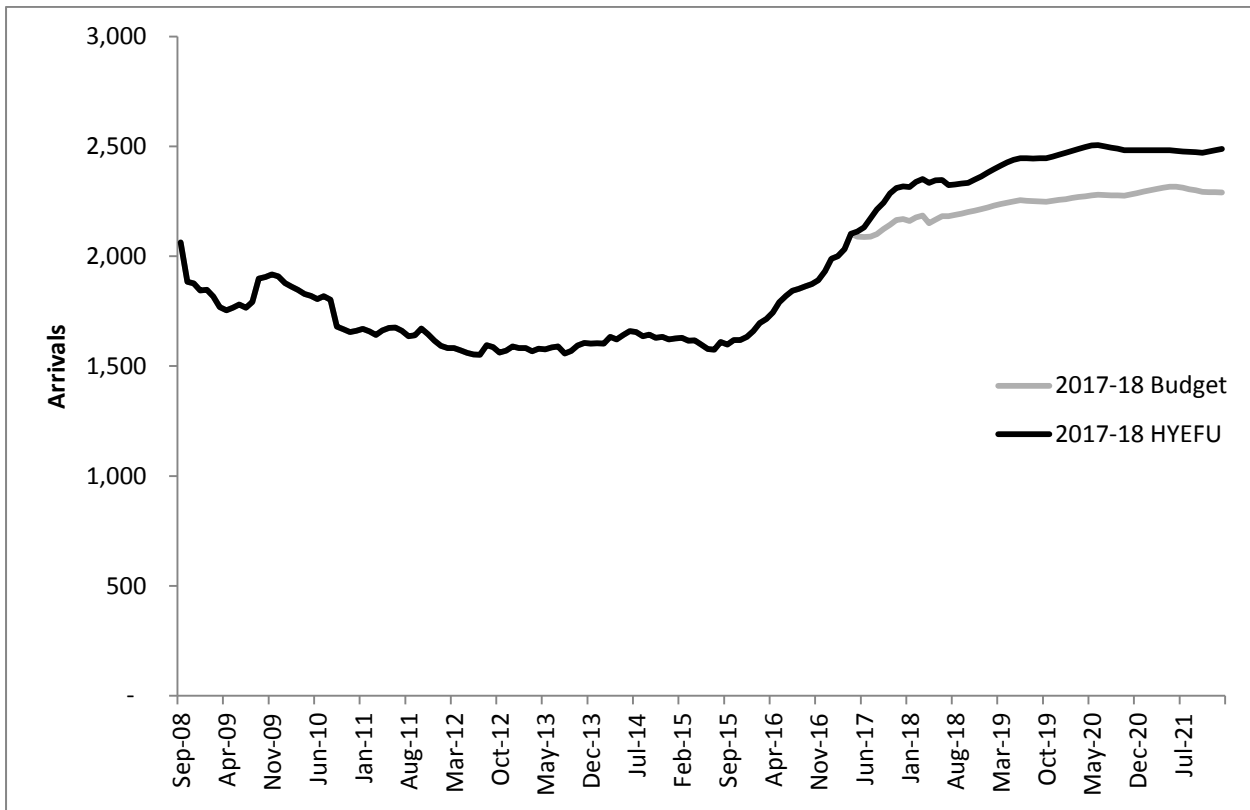


Table 7.6 Estimated tourism arrivals for other markets by quarter 2015/16 to 2020/21

| | Qtr 1 | Qtr 2 | Qtr 3 | Qtr 4 | Total |
|---------|-------|-------|-------|-------|--------|
| 2015/16 | 4,637 | 5,681 | 6,335 | 5,182 | 21,835 |
| 2016/17 | 5,156 | 6,514 | 7,531 | 6,379 | 25,580 |
| 2017/18 | 6,505 | 7,100 | 7,400 | 6,100 | 27,178 |
| 2018/19 | 6,300 | 7,500 | 8,000 | 6,500 | 28,300 |
| 2019/20 | 6,300 | 7,600 | 8,200 | 6,600 | 28,700 |
| 2020/21 | 6,200 | 7,600 | 8,200 | 6,600 | 28,500 |

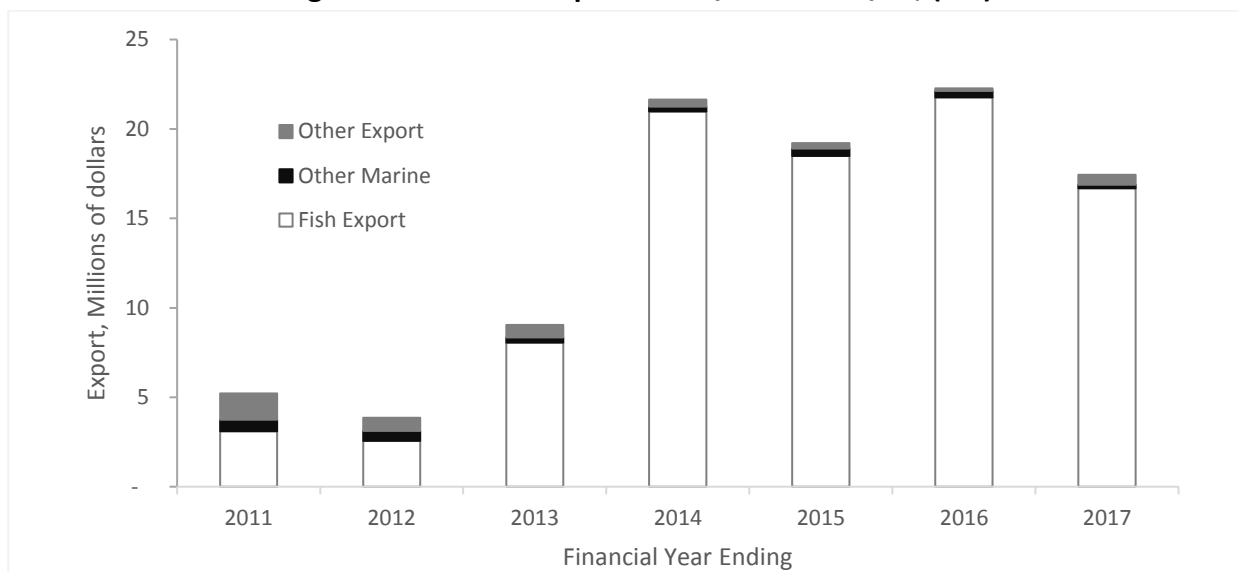
7.7 Marine Resources

7.7.1 Exports and Revenues

In the past three years the value of marine exports has averaged around twenty million dollars annually, accounting for ninety-eight percent of total goods exports.

In 2016/17, fish accounted for \$16.5 million of the total marine exports of \$16.7 million. Other marine exports included, \$169,000 of black pearls, and \$42,000 worth of mother of pearl shell products (Figure 7.12).

Figure 7.12 Marine exports 2010/11 to 2016/17, (\$m)



The main benefit to the Cook Islands Government from fishing activities is revenue from treaty arrangements, license fees and the sale of catch quotas. Revenue from fisheries activities in 2016/17 totalled \$18.5 million.

In December 2016 new longline regulations for the Quota Management System (QMS) were enacted. Under the QMS a total allowable catch of 9,750 tonnes of albacore tuna and 3,500 tonnes of bigeye tuna per calendar year has been set. The quota system was implemented in January 2017, with revenue returns within the 2016/17 financial years of approximately \$3 million per year received, exceeding previous licensing arrangements which returned around \$2.4 million per year.

A significant portion of revenue comes from the purse seine fishery, where the Cook Islands has been assigned a total of 1,250 fishing days for the 2017 calendar year by the Western Central Pacific Fisheries Commission (WCPFC).

During 2016, the US and Pacific Island states negotiated a new US Multilateral Treaty with a six year term. Under the agreement the Cook Islands will commit 350 fishing days annually before the start of the calendar year. In 2017, the US acquired 323 fishing days under this pool. In

addition, the US fishing industry also entered into bilateral arrangements for 200 additional fishing days for vessels which have not acquired pooled days or whose days are short.

In January 2017, the Government licensed two Spanish purse seine fishing vessels under the European Union Sustainable Fisheries Partnership Arrangement. Under the 5 year agreement there is a 4 year protocol for fisheries access allowing up to 7,000 tonnes per year to be fished by EU Purse Seiners. This arrangement accounts for 158 of the 1,250 vessel days assigned annually by WCPFC.

Funds provided under the EU protocol are also collected by government as an aid contribution to the provision of government fisheries policies. These funds have been used to improve monitoring, encourage and develop local fishermen, and recruit marine specialized professionals.

The EU vessels have not elected to fish the extent of the tonnage which the Partnership allows for and currently only ten fishing days have been fished. Despite this the full amount of policy support contribution, license fees and access fees have been received.

For the 2017 calendar year, the average price per fishing day is expected to be between \$11,500 and \$13,500, depending on exchange rates which affect the US Treaty; and the EU fisheries partnership.

Fisheries revenue for 2017/2018 was projected at \$12.7 million:

- \$4.0 million from the longline quota system;
- \$1.2 million from the US treaty equal shares;
- \$4.4 million from the US treaty annual pool;
- \$1.8 million from the US treaty bilateral arrangements;
- \$1.3 million from the EU agreement.

Between the 2017/18 fiscal period of July-October the fisheries revenue received has been approximately \$2.8 million.

7.7.2 Fishing Activities

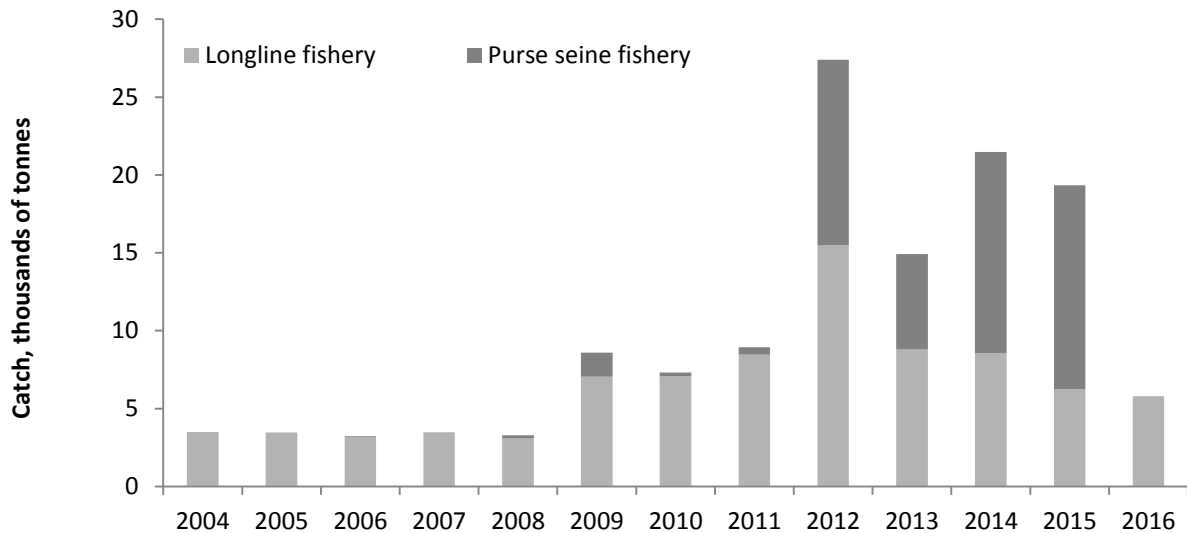
The Cook Islands EEZ is divided into the Northern and Southern fishery grounds, with the majority of fishing activity taking place in the Northern fishery which is more stable and productive. The Northern fishery borders are from Penrhyn in the east to Pukapuka in the west, and south to Suvarrow.

The longline albacore fishery catch is generally unloaded or transshipped in Apia, Samoa or Pago Pago, American Samoa. However, recent transshipment activities have been carried out in Pukapuka, and been supervised by Cook Islands Fisheries Officers.

The long line catch peaked at 15,500 tonnes in 2012 during exploratory fishing for bigeye tuna. This has declined to 5,795 tonnes in 2016 as the fishery has reverted back to its regulated

albacore catches. Over the same period purse seining has become the dominant fishery in the Cook Islands, rapidly expanding from 476 tonnes in 2010 to a peak of 13,080 tonnes in 2015 (Figure 7.13).

Figure 7.13 Fishery Catch in the Cook Islands Exclusive Economic Zone



The Cook Islands also supports a small local fishery of artisanal and game charter operators. In 2015, 142 tonnes was caught by local fishers, increasing to 163 tonnes in 2016.

Albacore and yellow fin tuna together accounted for around 80 per cent of species caught by long line in 2016; with a decrease in yellow fin in 2016 compared to 2015 (Table 7.7). With the increase in purse seining, it is expected that Skipjack will be the most caught species overall in 2016, once the purse seining data is included.

Table 7.7 Fishery Catches in the Cook Islands EEZ by Species (tonnes)

| | 2014 | | | 2015 | | | 2016 | |
|--------------|-----------------|--------------------|--------------|-----------------|--------------------|--------------|-----------------|--------------|
| | <i>Longline</i> | <i>Purse Seine</i> | <i>Local</i> | <i>Longline</i> | <i>Purse Seine</i> | <i>Local</i> | <i>Longline</i> | <i>Local</i> |
| Albacore | 6,098 | 0 | 1 | 3,816 | 0 | 2 | 2,434 | 2 |
| Bigeeye | 534 | 217 | <1 | 576 | 204 | 0 | 354 | 0 |
| Yellowfin | 1,025 | 431 | 180 | 1,190 | 823 | 71 | 808 | 117 |
| Skipjack | 85 | 5,479 | 10 | 134 | 11,874 | 12 | 123 | 14 |
| Other | 927 | 0 | 80 | 541 | 0 | 57 | 363 | 30 |
| Total | 8,669 | 6,127 | 271 | 6,257 | 12,901 | 142 | 4,082 | 163 |

In 2016, a total of 90 licensed vessels were managed by the MMR. These include 47 long liners, 33 purse seiners, 2 high seas trawlers and 8 bunker vessels. In addition there were 285 local artisanal and game charter fishing boats reporting catches to the MMR (Table 7.8).

Table 7.8 Number of active fishing vessels

| Licensed and active vessels | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|--------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Offshore fishery | | | | | | |
| Long liner | 60 | 45 | 36 | 38 | 47 | 55 |
| Purse seiner | 16 | 17 | 18 | 65 | 33 | 16 |
| Other commercial (Bunkers, Trawlers) | 4 | 4 | 5 | 5 | 10 | 8 |
| Total | 80 | 66 | 59 | 108 | 90 | 79 |
| Local artisanal and game fishery | | 223 | 302 | 301 | 285 | 195 |

The estimated value of catches from the Cook Islands EEZ for 2015 was \$63 million dollars, based on Pacific Forum Fisheries Agency (FFA) estimates (Table 7.9); a decrease of \$16 million in value of catch from 2014, despite significantly higher catches in 2015. The decrease is largely due to different methodology used by FFA in 2014 and 2016 to estimate catch values. The exchange rate of NZD to USD and Japanese Yen are also important factors.

Table 7.9 Landed value of fishery catches (\$m)

| Landed value | 2012 | 2013 | 2014 | 2015 |
|----------------------------------|-------------|-------------|-------------|-------------|
| Longline fishery | 40 | 32 | 44 | 30 |
| Purse seine fishery | 25 | 15 | 33 | 30 |
| Local artisanal and game fishery | | 2 | 2 | 3 |
| Total | 65 | 49 | 79 | 63 |

One domestic commercial fishing company, with three Cook Islands' flagged vessels, operates in the southern Cook Islands waters, and offloads its fresh catch at Rarotonga for sale in the domestic market and to be exported (Table 7.10). For Cook Islands' flagged vessel, an estimated 179 tonnes of fresh catch was offloaded in 2016 from domestic sale compared to 188 tonnes in 2015.

Landed frozen catch by Chinese flagged vessels in Rarotonga totalled nearly 400 tonnes in 2016, up from 363 tonnes in 2015. In 2014, the total catch landed by Chinese vessels was 1,900 tonnes.

Table 7.10 Catch Landed into Avatiu port (tonnes)

| | 2013 | 2014 | 2015 | 2016 |
|---|------------|--------------|------------|------------|
| Cook Islands flagged vessels | | | | |
| Fresh catches offloaded | 105 | 194 | 188 | 179 |
| Fresh catches to be exported by airfreight | 15 | 23 | 115 | 125 |
| Chinese flagged vessels | | | | |
| Frozen by-catch sold locally | 23 | 18 | 0 | 0 |
| Frozen catches to be exported by seafreight | 121 | 1,882 | 363 | 399 |
| Total | 264 | 2,117 | 666 | 703 |

The small scale fishery remains an important economic activity for game-charter operators, semi-commercial sales and artisanal fishermen. Catch data per island is expected in the near future, with better information anticipated as a result of a fuel subsidy program instituted by MMR.

The Fisheries Development Facility (FDF) is a grant scheme administered by MMR and funded by a development fee of \$10,000 charged to each foreign fishing license. 2016 is the fifth year that the FDF has been in operation. In 2016, \$300,000 was made available to support the local fishers comprising \$100,000 for the Cook Islands Fishing Association, \$150,000 in small grants to individuals and \$50,000 for the fishing clubs of the Pa Tokerau (Northern Group).

An ongoing program to expand the deployment of Fish Aggregate Devices (FADs) complements the support of FDF. Nine FAD deployments were completed in 2016 bringing the total number of devices to 25 FADs. The program costs an estimated \$100,000 annually.

10 Fish Aggregating Devices (FADs) were deployed from June 2017 to November 2017, all in the southern Cook Islands. Two each in Atiu and Mangaia, and 6 in Rarotonga.

7.7.3 Black Pearls

The Pearl Industry in the Cook Islands has declined markedly over the past 15 years. Total pearl exports reached an all-time high in 2000 at just over \$18 million, however the industry saw a decline in the value of total exports as of 2003, following unregulated farming practices, poor oyster health conditions and bacterial disease. Since its peak in 2000, the industry reached a low of \$191,000 in 2013. The industry has rebounded somewhat in recent years, however its value remains very low.

French Polynesia continues to be the major supplier of raw and finished black pearl products to the international market, keeping prices relatively low.

In the Cook Islands there has been a distinctive shift by farmers towards sales on the domestic market, with a focus on visitors. As a result, export values are no longer representative of levels of production.

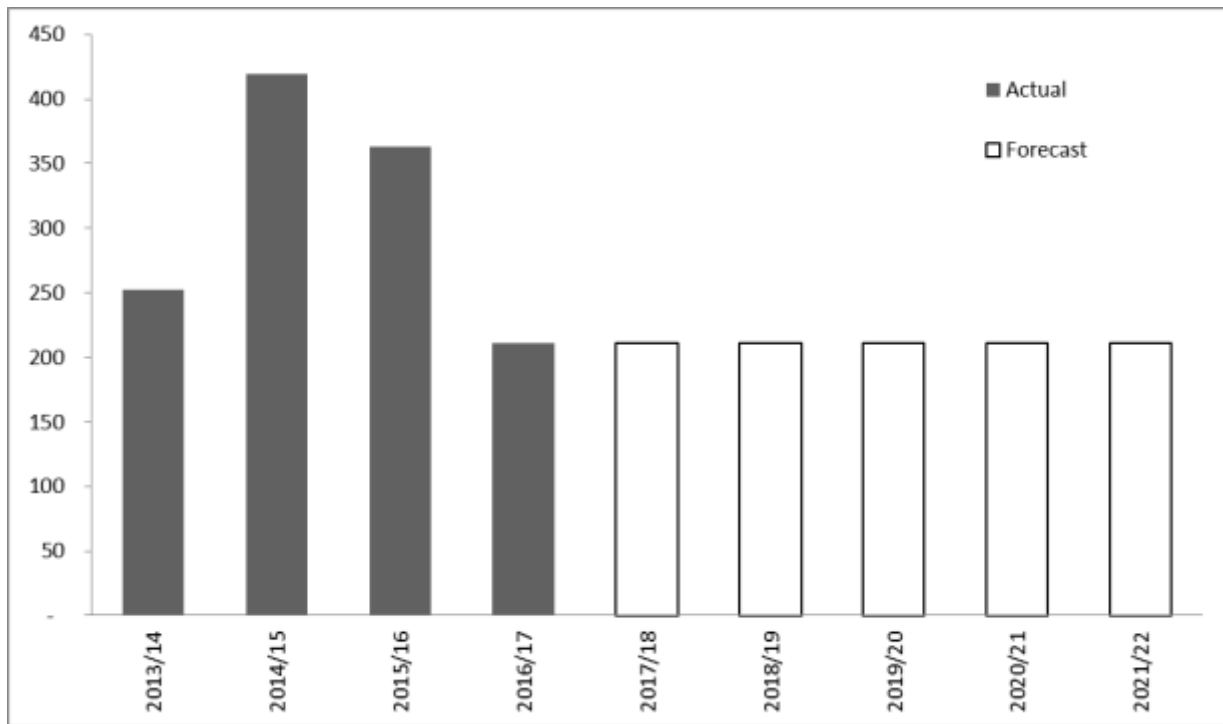
The total levels of production based on seeding and harvest reports submitted by farmers to MMR indicate that annual production levels average just below 200,000 farmed oysters (Table 7.11).

Table 7.11 Pearl production, 2009-2016

| Year | Total farmed oysters | Total shells seeded | Total shells harvested | Total saleable pearls |
|------|----------------------|---------------------|------------------------|-----------------------|
| 2010 | 59,373 | 87,822 | 16,193 | 11,182 |
| 2011 | 173,501 | 89,850 | 39,318 | 17,856 |
| 2012 | 252,286 | 172,755 | 41,718 | 20,199 |
| 2013 | 153,918 | 108,053 | 44,699 | 20,987 |
| 2014 | 245,671 | 127,528 | 88,359 | 40,611 |
| 2015 | 143,142 | 67,477 | 48,720 | 21,459 |
| 2016 | 60,965 | 28,149 | 40,769 | 17,835 |

In 2016 the value of pearl exports increased to \$297,000, up from \$158,000 in 2015. The export of pearl shell, also known as Mother-of-Pearl, was \$42,000 in 2016, down from 2015 exports of \$167,000. It is common for exports of pearl shells to fluctuate annually as stockpiles are replenished after exports.

Figure 7.14 Pearl Export, 2013/14 -2021/22



7.7.4 Water Quality Monitoring

The lifestyle and economy of the Cook Islands is largely dependent on healthy marine and freshwater ecosystems. Growing visitor arrivals place increasing stress on marine and freshwater environments. Routine monitoring of water quality parameters is crucial in managing water resources effectively.

Regular water quality monitoring is undertaken on the islands of Rarotonga, Aitutaki and Manihiki. Three key water quality parameters (bacterial counts, water clarity and nutrient concentration) are reported and graded against standards of reference according to the National Sustainable Development Plan 2016 – 2021. Results are important for stakeholders such as pearl farmers in Manihiki to advise when water conditions are, or are not, suitable for farming activities. The monthly water quality data is also available publicly on MMR’s website at www.mmr.gov.ck, as another reporting avenue.

Overall, the water quality monitoring shows a gradual improvement in most of the parameters that are tested for the three islands. Recent data for Rarotonga suggests that water quality of samples collected in Muri continue to improve towards national standards. This is thought to be the result of better sanitation and new building regulations. These improvements decrease the risks to the tourism industry.

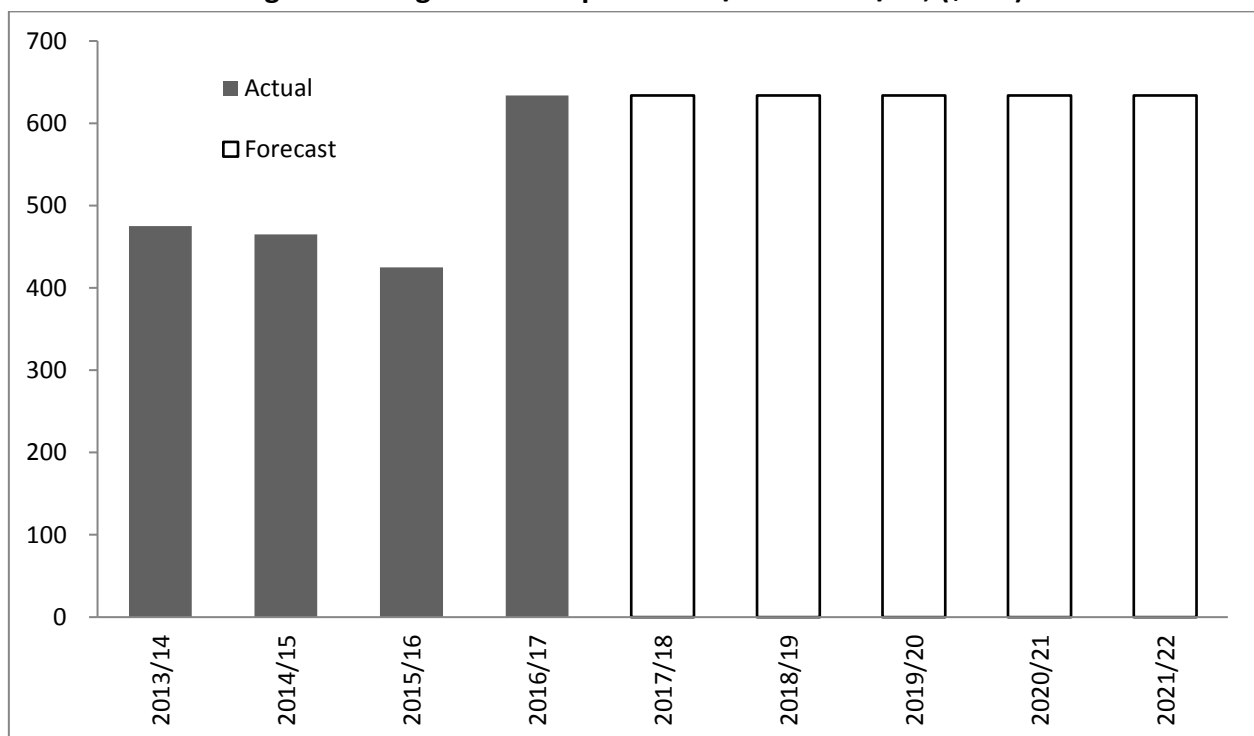
7.8 Agriculture

The Agricultural sector accounted for 3.3 per cent of nominal GDP in 2016/17. Agricultural exports grew significantly in 2016/17 following decreases in 2014/15 and 2015/16. Agricultural exports have shifted from focussing on Maire Lei exports (terminated in 2016) and coffee production to growth in demand for Nono.

Negative impacts have been felt from challenges related to technical barriers to trade (i.e. Quarantine is unable to treat Agricultural products in compliance to international export standards, SPS requirements and other trade related issues). However, the better information storade systems are being established to ensure that more robust information and resources are available to help understand the various trends in the agricultural industry.

Noni Juice export remains the main export commodity products from Cook Islands, exporting mainly to Japan, China and recently to South Korea. Noni exports have grown by 61 per cent over 2016/17 to a level of \$631,000. Minor export volume of processed Agriculture products such as Virgin Coconut Oil (VCO), Vanilla extracts, A-Grade Vanilla beans, Tamanu seed oil extracts are some of the new and increasing in demand export products.

Figure 7.15 Agriculture Exports 2013/14 to 2021/22, (\$000)



A range of initiatives in Rarotonga and the Pa Enua have been established to improve the supply of fruit and vegetable products by strengthening up-stream supply chains. The Ministry of Agriculture’s provisioning of fruit and vegetable nursery products to all growers on Rarotonga and the Pa Enua is one example of this. This aims to support local production in competing with

imported produce, such as Capsicums, Tomatoes, Broccoli, Sweet corn, other leafy vegetables, etc., helping to create a comparative advantage for our growers.

The United Nations (UN) Food and Agriculture Organization (FAO) continues to support MOA's nursery program, providing technical assistance and material in 2016, and a large supply of seeds and assorted vegetables for 2017. The supply is sufficient enough to provide the country with seedlings and nursery products for the next two seasonal cycles. Varieties supplied include lettuces, Chinese cabbages, watermelons, cucumbers, tomatoes, eggplants, and capsicums.

The Biosecurity Division continues to protect our Borders and carried out routine Surveillance and Trapping work on Fruit Flies on Rarotonga and selected Pa Enua to ensure our security, economic growth and uphold the 2008 Biosecurity Act against pests invasion.

The Livestock Division of the Ministry, continues to support small livestock and poultry production in Rarotonga and the Pa Enua, to help farmers meet the needs of domestic consumers. The Ministry of Agriculture is also engaged in upskilling livestock farmer's knowledge in local meat production, (Goats and Pork), to ensure the quality of local meat competes well with imports.

Domestic hydroponic and summer vegetable production continues to grow, bridging the gap in fruit and vegetable supply value chains during the 'production off-season'. There has also been an increase in the number of hydroponics and summer house facilities on Rarotonga and Aitutaki and Northern Pa Enua. The FAO continues to provide support to hydroponic and summer house vegetable producers on how best to manage their farming systems and be economically sustainable.

The Cook Islands has considerable potential for increased local agricultural production (products such as drinking coconuts, Nono, Vanilla, Maire, Coffee & Cocoa in Atiu/Mauke root crops, ornamentals, tropical fruits, vegetables, honey production, hydroponics vegetables, processing and value adding products, including handicraft products). Despite these potentials, however, there are numerous constraints that limits further beneficial growth in the Agriculture sector; this includes: substandard Biosecurity Treatment Facilities, to meet our SPS requirements for international market access and compliance to importing/exporting country's Quarantine requirements for Fruit Flies; other pests, and issues related to labour shortages; and in some cases higher level local wages. Other constrains includes: low or lack of Agriculture water access and supply; in-experience and failures in supply chains coordination; and high costs of transportation to get produce to markets.

The Ministry of Agriculture is investing in and establishing 8 Vanilla Shade Houses for production and higher value adding for export and selling of these valued products on the local market, for economic growth. Six Vanilla Shade Houses have been completed, and are planted and fully operational. Vanilla plants are growing well, with some unusually blooming within 8 months. The last two of the Shade Houses are expected to be completed by January or February 2018.

The Ministry of Agriculture is providing planting-material support towards the FAO Fruit Tree and Vegetable Model Orchard Farms, successfully Implemented by the Cook Islands Chamber of Commerce in their Agribusiness training programme (via FAO Grant Fund from Head Office in Rome) to revitalise Agricultural Fruit Tree Production and training of Growers, on Measures/Treatments for local off-season Pineapples, Mangoes, Delicious cactai – Dragon Fruit, Rambutan, Longan, Fig, Passion Fruit, Citrus, Abiu, etc. and vegetable production in support of Food Security and Tourism in Rarotonga, and Pa Enea under the FAO Technical Corporation Program (TCP) Country Programme Framework (CPF 2015 to 2017) and the new FAO CPF that will be rolling-out in 2018 (i.e. CPF 2018 to 2022).

7.9 Goods Exports and Imports

7.9.1 Goods Imports

Import data for 2016/17 shows that imports grew by 2.6 per cent, down from forecast growth of 10.2 per cent as at Budget 2017/18. This forecast number was influenced by the significant increase in building approvals during 2016/17.

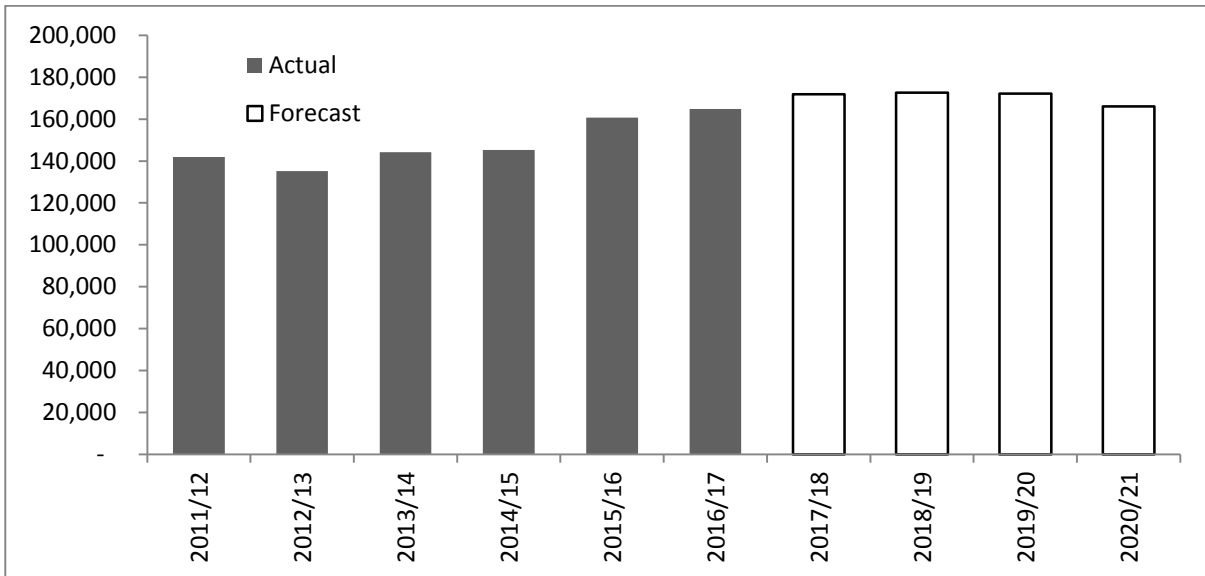
The surge in building approvals was expected to contribute to 33.2 per cent growth in machines, transport and equipment as well as an expected 59.1 per cent growth in crude materials. The actual number showed that machines, transport and equipment, and crude materials, only grew by 7.2 per cent and 21.7 per cent respectively. The significant differences are a result of delays in capital projects in 2016/17, particularly public works. The surge in building approvals was not expected to have a significant impact on basic manufacturing. However, actuals show a 33.6 per cent growth rate in manufacturing, up from the 2.5 per cent growth forecast.

Imports of food and live animals grew by 11.8 per cent from \$36.1 million in 2015/16 to \$40.4 million in 2016/17. In addition, the import of chemicals grew by 11.3 per cent.

A decrease in the value of imports was seen in more sectors than usual. The value of mineral and fuel imports decreased by 34.1 per cent in 2016/17 due to lower fuel prices. Other imports decreased by 51.0 per cent, miscellaneous manufactured goods decreased by 1.0 per cent and beverages and tobacco imports decreased by 3.4 per cent.

Going forward imports are expected to grow in 2017/18 by 4.3 per cent due to the expectation of strong construction growth, the rollover of capital projects and an increase in visitor arrivals. Import growth is expected to slow down from 2018/19 once current planned capital projects conclude, and growth in tourism arrivals starts to slow. In the case that new capital projects arise over the forwards, imports would be expected to increase in line with these largely due to sourcing of raw materials and required machinery from overseas.

Figure 7.16 Value of total imports 2011/12 to 2020/21, (\$'000)



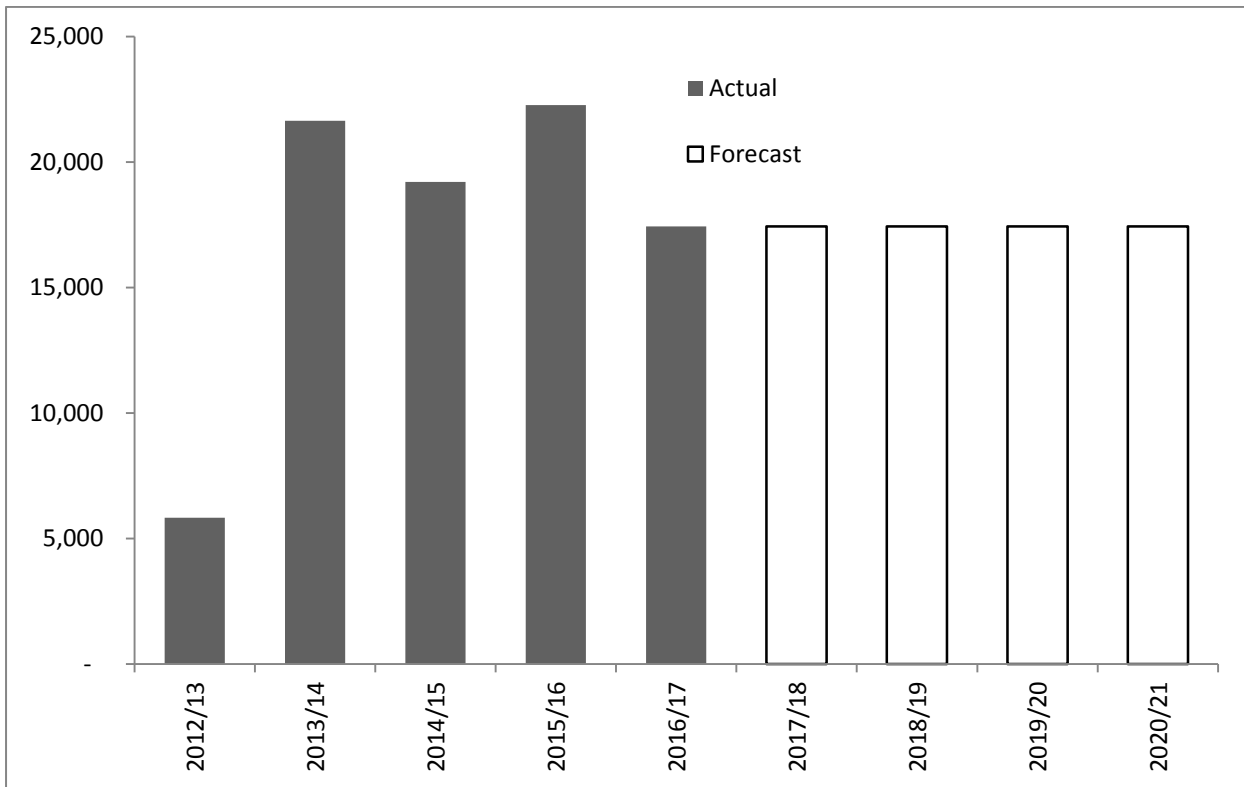
In 2016/17, import leakage was 39 per cent, that is, for every dollar spent in the Cook Islands economy, 39 cents flowed overseas. This is lower than the forecast figure of 41 per cent.

7.9.2 Goods Exports

The total value of Goods exports in 2016/17 was \$17.5 million, a decrease of 21.7 per cent from 2015/16. This is largely attributed to a decrease in the export value of fresh and chilled fish from \$21.5 million in 2015/16 to \$16.5 million in 2016/17, a decrease of \$0.1 million in basic manufacturing, a decrease of 27.1 per cent in crude materials, and a 21.6 per cent decrease in food and live animals.

September quarter 2016 fish exports are significantly lower than previous quarters, resulting in a downward revision of fishing exports for 2016/17. The overall impact of this is consistently lower forecasts for fishing exports going forward.

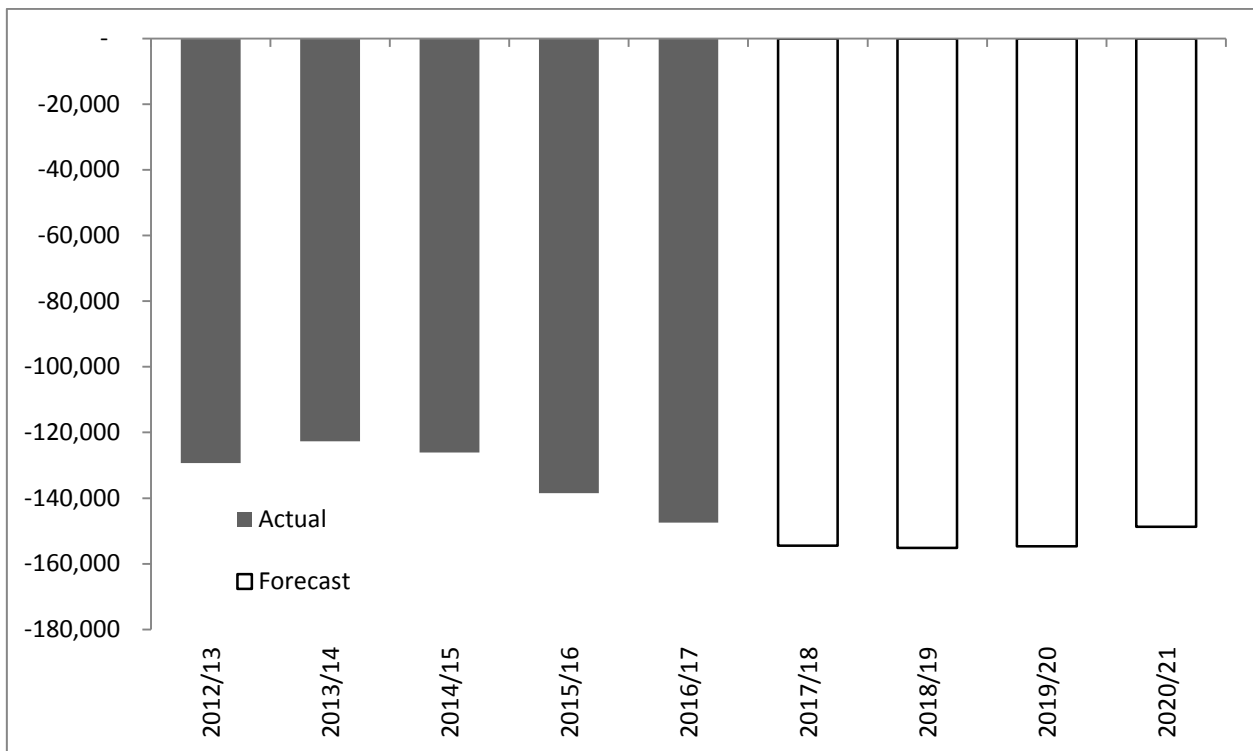
Figure 7.17 Total exports 2012/13 to 2020/21, (\$'000)



7.9.3 Merchandise Balance and Balance of Trade

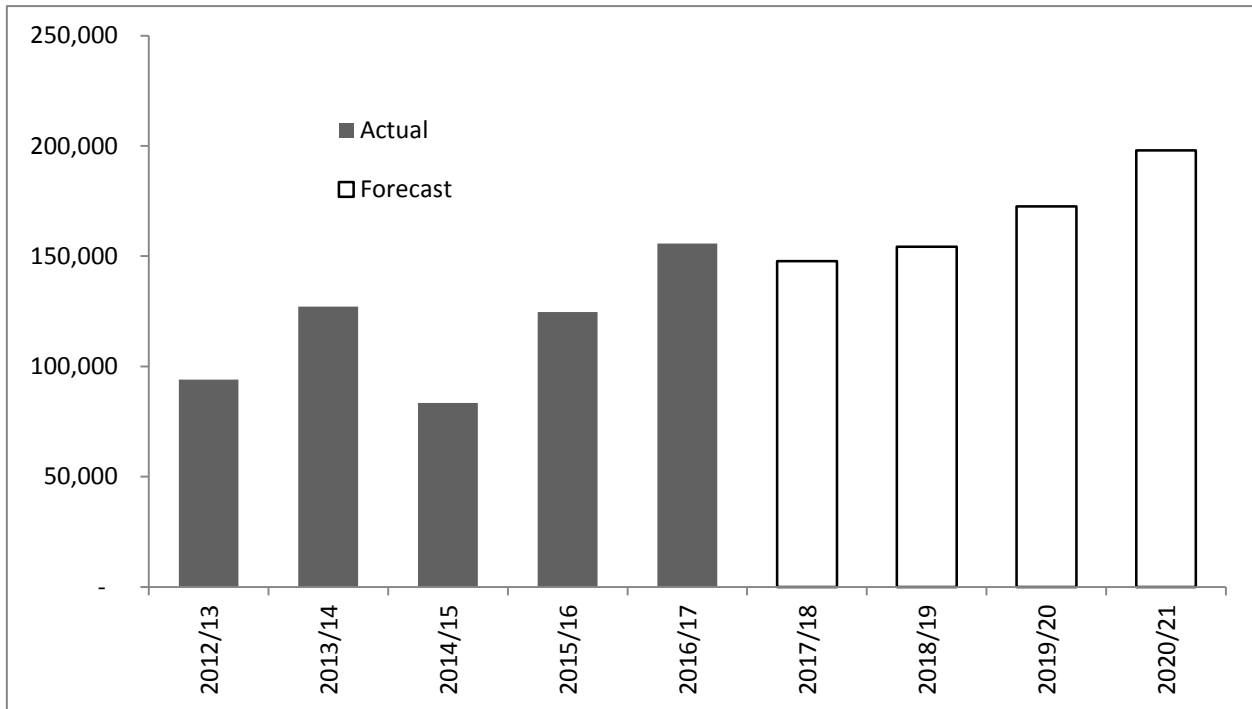
Due to lower than expected growth in imports, a negative merchandise balance of \$147.5 million was achieved as opposed to the \$157.9 million that was expected in 2016/17. Despite this, the merchandise balance worsened from a deficit of \$138.5 million in 2015/16. The increase in imports in 2017/18 and 2018/19 is expected to worsen the balance to \$154.5 million in 2017/18 and \$155.2 million in 2018/19, before improving slightly over the forwards following a decrease in capital projects. Exports are expected to remain stable going forward.

Figure 7.18 Balance of Merchandise (goods) Trade 2012/13 to 2020/21, (\$'000)



Despite the worsening in the merchandise balance, the trade balance overall, due to the strong services exports from tourism, is highly positive. Net exports increased from \$124.7 million to \$155.8 million in 2016/17. After growing by 24.9 per cent in 2016/17, the overall balance of trade is expected to fall slightly in 2017/18 and increase going forwards until 2020/21.

Figure 7.19 Overall Balance of Trade 2012/13 to 2020/21, (\$'000)



7.10 Banking and Finance

The global financial market has continued to improve throughout the first months of the 2017/18 financial year, with expectations of stronger consumer prices and economic growth going forward.

In the United States, the Federal Open Market Committee (Fed) at its most recent meeting, the Fed decided to maintain the target federal funds rate at 1-1.25 per cent. This was on the back of continued strengthening in the labor market conditions and inflation. The Fed expects that economic conditions will evolve in a manner that will need gradual increases in the federal funds rate.

The Reserve Bank of Australia has left the cash rate at 1.5 per cent for the year so far due to an improving global economy. Labor markets are tightening and growth has continued to be above-trend in a number of advanced economies. With the strong ties to the Chinese economy, Australia is vulnerable to changes in the Chinese economy. An increase in spending on public infrastructure and property construction has supported growth in China, and is in part, supporting the Australian economy. The slow wage growth along with an improvement in the outlook for non-mining business investment is also supporting the Australian economy through the increased contribution to GDP growth. One risk that was noted by the RBA is the high household debt levels. Household consumption may suffer due to the high levels of household debt and the low levels of growth in household incomes.

New Zealand Reserve Bank, like Australia, has decided to leave the cash rate at 1.75 per cent. The New Zealand Reserve Bank has not changed the official cash rate since November 2016, and has indicated that they intend to keep it this way for some time. In saying this, it is uncertain to how much impact the new government will have on future estimates. With a new government comes new government policies in four areas. The areas that may be effected by the new government include: new government spending; the KiwiBuild programme; tighter visa requirements; and increases in the minimum wage. The new government policies on housing are expected to reinforce low house price inflation. This is expected to gradually decrease pressure on the housing sector.

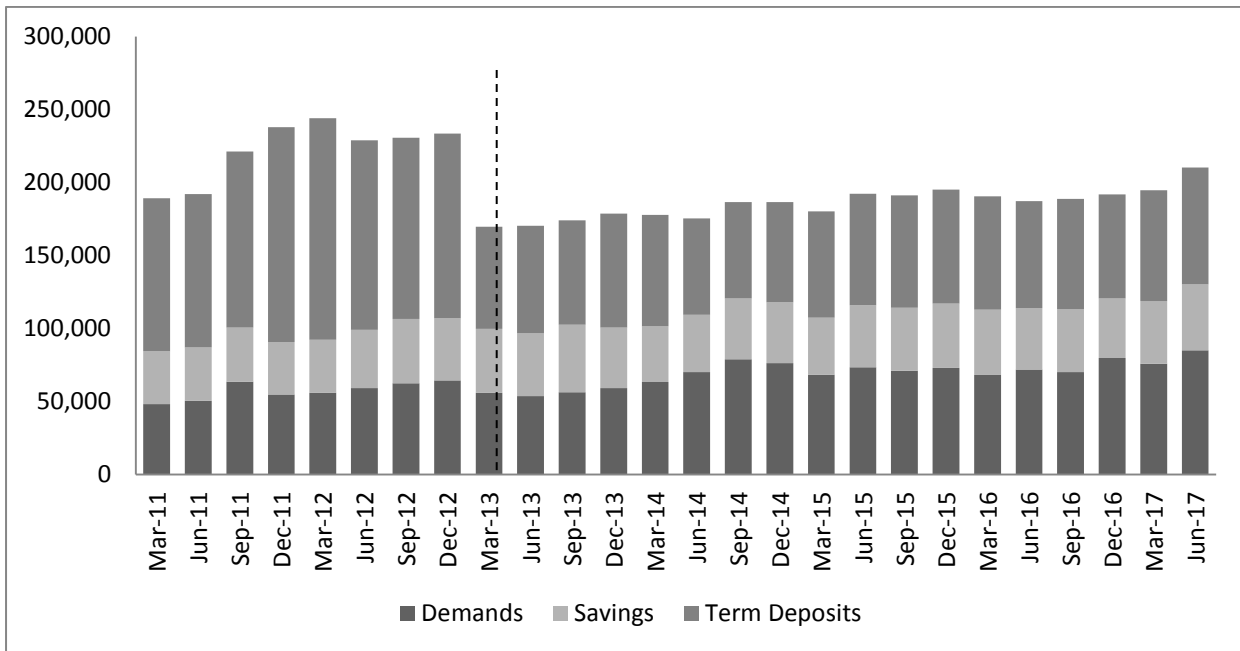
In Asia, China is expecting improvement in their economy throughout the rest of 2017/18. All of this due to the easing of previous policies and supply side reforms. Going forward it is expected that the government will sufficiently maintain expansionary policy mix

In the Cook Islands, the proportion of non-performing loans (NPL) to total gross lending has decreased through the September quarter of 2017/18 to 5.5 per cent, from 7.6 per cent in the same quarter of 2016. Further monitoring and analysis needs to be undertaken on this to assess the likely causes and implications.

7.10.1 Deposits

Deposits have remained relatively stable since September 2014 at between \$180 million and \$196 million. Total deposits for 2016/17 were \$785.5million. Term deposits were fairly stable throughout the year, hovering between \$71 million and \$75 million, in June however we saw a rapid increase in term deposits to just under \$80 million. This is the highest level achieved since December 2012 and is in part due to an increase in government term deposits.

Figure 7.20 Total Value of Deposits, March 2011 to June 2017, (\$'000)



7.10.2 Loans

After increasing significantly in the March quarter 2016 to \$311 million, the value of loans has continued to decrease slowly over each quarter reaching a level of \$289 million in June 2017. Note that these figures include foreign lending, revisions to Banking data will be made prior to the 2018/19 Budget.

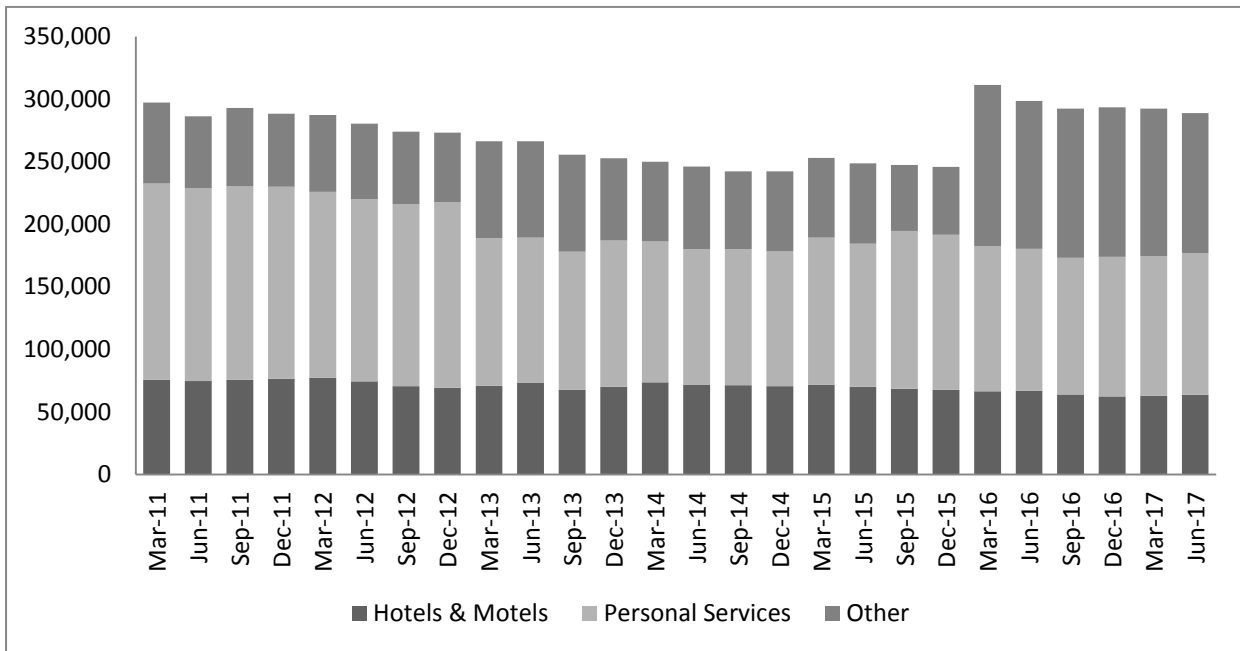
When compared with June quarter 2016, lending to both hotels and motels and personal services have decreased, by 4.91 per cent (to \$63.7 million) and 0.13 per cent respectively (\$113.1 million). Loans to hotels and motels are now among the lowest levels since adjustments were made to classifications in 2013, which makes prior years incomparable.

Other loans have increased significantly after a new loan was entered into in March 2016 quarter in the finance and business sector. Since March 2016, the value of finance and business sector loans decreased to \$61 million in March 2017 and decreased again to \$53 million in June 2017. These decreases are partly due to foreign lending.

Loans in the retail and trade sector also increased in the March 2016 quarter, from \$7.2 million to \$12 million (an increase of 66 per cent). This has remained fairly stable through to June 2017, decreasing only slightly to \$11.5 million.

Further information is required to undertake comprehensive analysis on the loans data.

Figure 7.21 The Total Value of Loans, March 2011 to June 2017, (\$000)

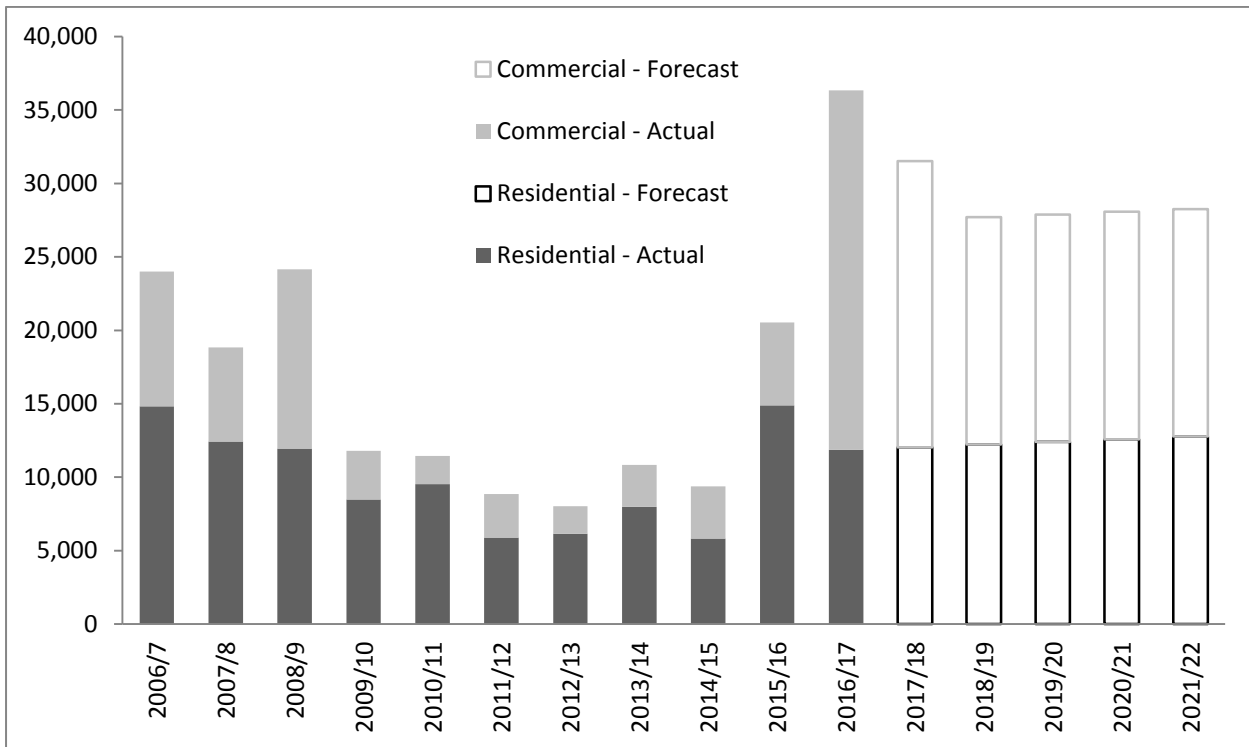


7.10.3 Housing and Construction

The value of building approvals increased dramatically in 2016/17, by a growth rate of 77 per cent to \$36 million. The spike in these number is due a large community project approval during the June quarter. Without these community projects, building approvals would have been \$4.8 million in the June quarter, as opposed to \$18.9 million. It is expected that this spike in community building approvals will not occur in the next year. It is for this reason that building approvals for 2017/18 are expected to decrease. Despite this, building approvals in the 2017 September quarter are higher than those of the 2016 September quarter. This lends support to the idea that greater investment is taking place to increase the supply of holiday homes, allowing locals to capture excess tourist numbers.

Commercial building approvals are up significantly, an increase of 333.3 per cent, in 2016/17. These are due in part to approvals for Apii Nikao and Tereora College, with both undertaking major redevelopment in 2016/17 and 2017/18. Approvals have also been sought for a number of hotel expansions and new developments. These include 10 building approvals for tourist accommodation with a value of \$5.3 million. These developments indicate that the tourism sector is expanding to meet the increases in arrivals, however more will be required if capacity constraints are to be reduced.

Figure 7.22 Value of building approvals 2006/07 to 2021/22 (\$000)



7.11 Financial Services Industry

The financial services industry is estimated to collect fees of a net value of \$1.5 million for services undertaken in 2017/18. The estimated value is affected by changes in USD exchange rates, as registration fees are generally denominated in USD.

Foundation registrations have increased but are still relatively small in number, and expected to continue growing. Captive Insurance is the newest service, with legislation passed in June 2013. The first Captive registration occurred in April 2015 and slow growth is anticipated given the nature of the global captive industry.

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 Trusts Act is in the process of being reviewed and updated. Focus continues on promotion of the Cook Islands in Asia, particularly for trusts, foundations, and companies.

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 One Peer Review. The Phase Two Peer Review took place in May 2014 and a positive report was adopted at the Global Forum's session in early 2015. 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) and each financial institution has registered under FATCA. In October 2015 the Cook Islands announced its commitment towards implementing the automatic exchange of information (AEOI) for tax purposes by 2018 and legislation to this effect was passed in 2016.

In its' continued efforts to diversify markets and mitigate the risks associated with heavy reliance on business sourced from North America, the Financial Services Development Authority has increased its focus on Asia, including the hosting of the first Cook Islands Financial Services Conference in Hong Kong in November 2017. The conference received substantial support from the Cook Islands financial services industry.

The financial services industry in the Cook Islands accounts for approximately 5% of total employment in the Cook Islands. The industry continues to improve in implementing international standards and was chosen by international bodies, such as the World Bank, as the jurisdiction of choice to establish the Pacific Catastrophe Risk Insurance Facility in 2016. The financial services industry continues to serve as an important contributor to the Cook Islands economy as an industry that has a low environmental-footprint, and encourages gainful employment of highly educated and qualified.

7.12 Sensitivity Analysis

There are several risks surrounding the forecasts presented. Modeling alternate scenarios assists officials in planning for possible contingencies should the outlook change and these risks are realized. Three scenarios which are viewed as most likely to affect the forecasts have been modeled and are summarized below:

Scenario 1: Capital projects experience slippage – Capital projects contribute a substantial amount to the local economy and missed deadlines delay the economic benefit from wages, contractor fees, and the benefit of the completed infrastructure. In scenario 1, we assume six month delays on major projects underway and private capital spending as the absorptive capacity of CIG and local contractors nears saturation point.

Scenario 2: Continued tourism growth – The visitor numbers from the end of 2015 year to mid-2017 have reached historic levels. In this scenario, we assume that strong growth in arrivals that occurred in 2016/17, at 14.9 per cent will be replicated in 2017/18.

Scenario 3: A decline in visitor arrivals – Scenario 3 modeled the impact of a 1% decline in arrivals (based on similar drop that occurred in 2014/15) on the national economy. This scenario assumes an external shock, such as a tropical cyclone on Rarotonga or an economic recession in New Zealand, as the catalyst for reduced tourism numbers.

Table 7.12 Sensitivity Analysis of economic forecasts

| Scenario | Impact on nominal GDP in 2017/18 (percentage contribution) | Impact on total revenue in... | |
|---|---|-------------------------------|--------------------|
| | | 2017/18 (\$000) | 2018/19 (\$000) |
| Scenario 1: Capital slippage | -2.9% | -2,877 | 0 |
| Scenario 2: Continued tourism growth | 8.2% | 9,384 | 11,826 |
| Scenario 3: Decline in visitor arrivals | -3.2% | -3,700 | -7,242 |

8 Crown Debt and Net Worth

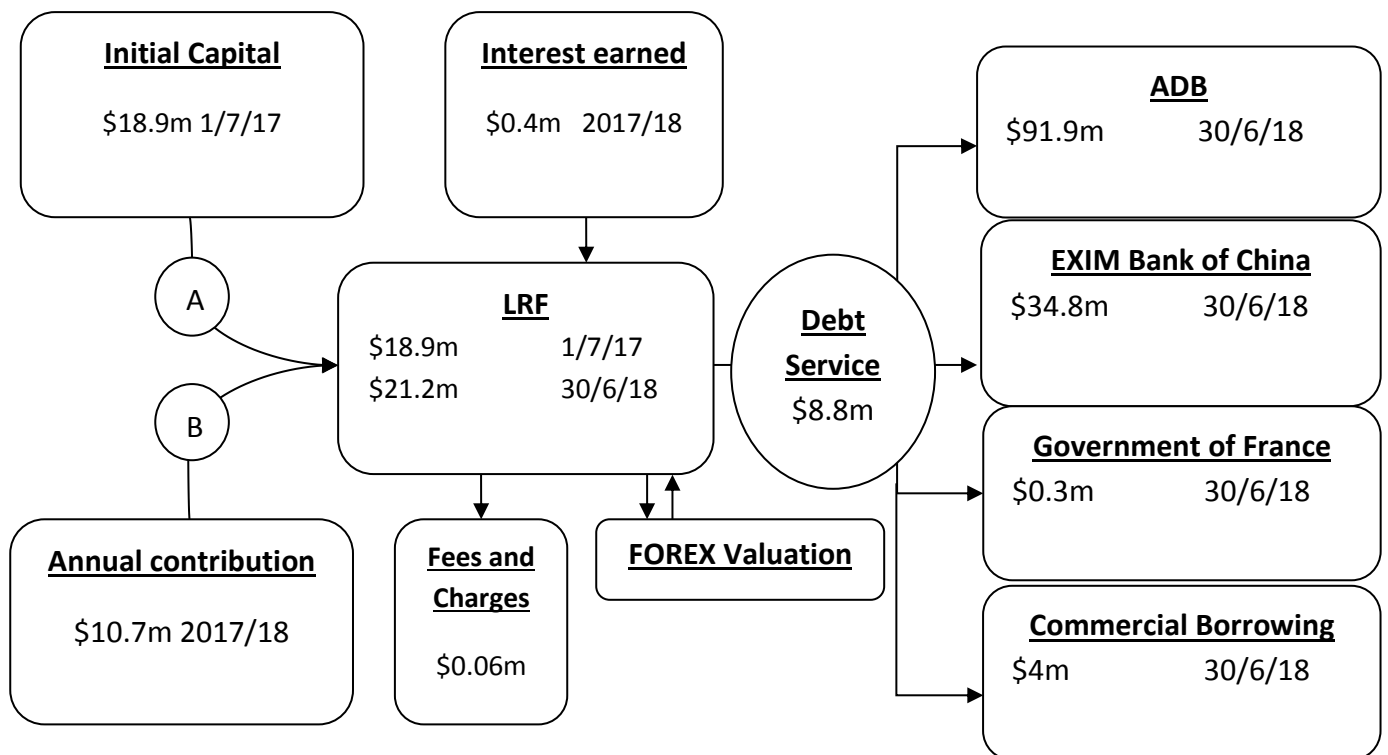
8.1 The Loan Reserve Fund (LRF)

In February 2014, the Parliament of the Cook Islands passed the Cook Islands Loan Repayment Fund Act (LRF Act) 2014 formally creating a Loan Repayment Fund (LRF). The aim of the LRF is to quarantine funds previously accumulated for loan repayments and to prevent them from being utilised for anything outside of debt servicing requirements. The LRF Act also ensures a framework for the prudential management of all sovereign public debt and ensures the timely allocation of money from the Budget for debt servicing. Since its enactment, the LRF has become the official means by which the Cook Islands Government (Crown) manages its debt portfolio.

In the 2017/18 Budget, funds were appropriated to the LRF, satisfying Section 32 of the MFEM Act (showing the appropriation for borrowing expenses and debt repayment). Under the LRF Act, these payments can only be used for debt servicing obligations, and hence, the funds held in the LRF can only be used to settle debt obligations, as per Section 61 of the MFEM Act (they do not require a Budget appropriation, as they have already been appropriated for in previous periods).

The figure below explains these movements.

Figure 8.1 Loan Repayment Fund movements 2017/18²



² Note that these numbers do not include any provision for the DRM Loan to be drawn down.

The New Zealand Company, Bancorp Treasury Services Limited (Bancorp), currently holds the tender for the analytical services of the LRF. While transactional services and account management were awarded to the ANZ Bank, Cook Islands, in a competitive tender process. Bancorp's fees are included in the table below.

Table 8.1 Loan Reserve Fund Statement (NZD '000)³

| | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|
| Opening LRF balance | 17,255 | 18,904 | 21,200 | 20,875 | 20,535 |
| Contribution to LRF principle | 6,893 | 8,619 | 8,723 | 8,357 | 8,357 |
| Contribution to LRF interest | 1,710 | 2,063 | 2,060 | 2,032 | 2,032 |
| Transfer in | 8,603 | 10,682 | 10,784 | 10,388 | 10,388 |
| Interest earned (avg 2%) | 223 | 378 | 424 | 417 | 411 |
| Total transfer in | 8,826 | 11,060 | 11,208 | 10,806 | 10,799 |
| Repayment of SOE debt | | | | | |
| Principal | 698 | 732 | 732 | 747 | 747 |
| Interest | 79 | 149 | 138 | 130 | 119 |
| Total repayment from LRF | 777 | 881 | 870 | 877 | 866 |
| Repayment of other debt | | | | | |
| Principal | 4,199 | 5,027 | 7,494 | 7,288 | 9,060 |
| Interest | 2,142 | 2,795 | 3,109 | 2,921 | 2,706 |
| Total repayment other debt | 6,340 | 7,823 | 10,602 | 10,209 | 11,766 |
| Other service fees * | 60 | 60 | 60 | 60 | 60 |
| LRF stock balance | 18,904 | 21,200 | 20,875 | 20,535 | 18,642 |

The LRF is used as a tool to smooth debt repayments, payments are smoothed in order to reduce volatility to the Crown's cash reserves from new debt obligations and exchange rate shocks, and to decrease vulnerability to external shocks.

The table above illustrates the final balance of the LRF for 2016/17, and the new estimates for the current budget year and the three forward years. The figures include provisions for two new loans, which have been signed but are yet to be drawn down, the Manatua Submarine Cable and the Airport International Landing System loan. The figures do not include any provisions related to the Disaster Recovery Mechanism (DRM) loan from the ADB, which is only triggered in the event of a catastrophe.

Positive exchange rate movements in 2016/17 resulted in lower principal and interest repayments from the LRF in the same year. This has had a subsequent positive impact on the LRF balance which was \$18.9m at the end of the 2016/17 fiscal year, up from \$18.3m estimated at 2017/18 Budget. Higher LRF closing balances are seen into the forwards.

Transfers into the LRF have increased in 2017/18 due to the taking on of the two new loans. The transfer in for 2017/18 is \$10.7m, up from \$8.6m in 2016/17. This transfer is divided into two components: a debt interest obligation (\$2.06 million) and a debt principal repayment (\$8.62 million) in 2017/18; these appropriations are complimented by estimated interest revenue

³ Note that this table differs from the other LRF balances in this chapter due to the exclusion of the NZ\$13.95 million DRM Loan. This is included as a contingent liability in other parts of the chapter.

of \$0.38 million. Transfers in to the LRF will increase again in 2018/19 to \$10.8m. From 2019/20 the transfers into the LRF will fall in a stepped manner as the loan stock is repaid.

The transfers out of the LRF for principal and interest obligations are the estimated debt servicing requirements at the time of the HYEPU and will be subject to foreign exchange rate and debt drawdown variations.

Due to the smoothing nature of the LRF, payments made into the LRF do not match the debt servicing profile. For example, while Crown contributions to the LRF peak in 2018/19 at \$10.8 million, the debt servicing profile peaks at \$12.6 million in 2020/21.

The LRF currently has sufficient funds to fully cover all debts owed by or on behalf of SOEs to official lenders, with the notable exception of loans relating to the redevelopment of Avatiu Port, which is being managed by the Ports Authority. These SOEs include the Te Aponga Uira, and Telecom Cook Islands Limited (Bluesky). The Bank of the Cook Islands (BCI) is a financial institution, and is considered separately due to its specialised nature. The Airport Authority is due to sign a loan for the purchase of an International Landing System during 2017/18, the LRF has sufficient funds to fully cover this debt as well.

8.2 Gross Debt owed by the Crown⁴

Total gross debt owed by the Crown as at 30 June 2018 is now estimated to be \$143.5 million⁵, a variance of \$0.3 million from the 2017/18 Budget (\$6.7 million when considering methodological changes since budget). Table 8.2 shows the movement which was due to favourable exchange rate movements against the USD.

Table 8.2 Reconciliation on 2017/18 Loan Movement

| Movement Reconciliation | \$ Million |
|--|-------------------|
| Initial estimated gross debt for 30 June 2018 (2017/18 Budget) | 150.2 |
| Movement during the period | |
| Unrealised exchange (gain)/loss | (0.3) |
| Methodological change since Budget | (6.4) |
| Estimated gross debt for year ending 30 June 2018 | 143.5 |

The exchange rates assumptions for the 2017/18 HYEPU have been recommended by Bancorp. Estimated changes in major exchange rates against the New Zealand Dollar (NZD) are reflected in the table below.

⁴ All debt figures include the

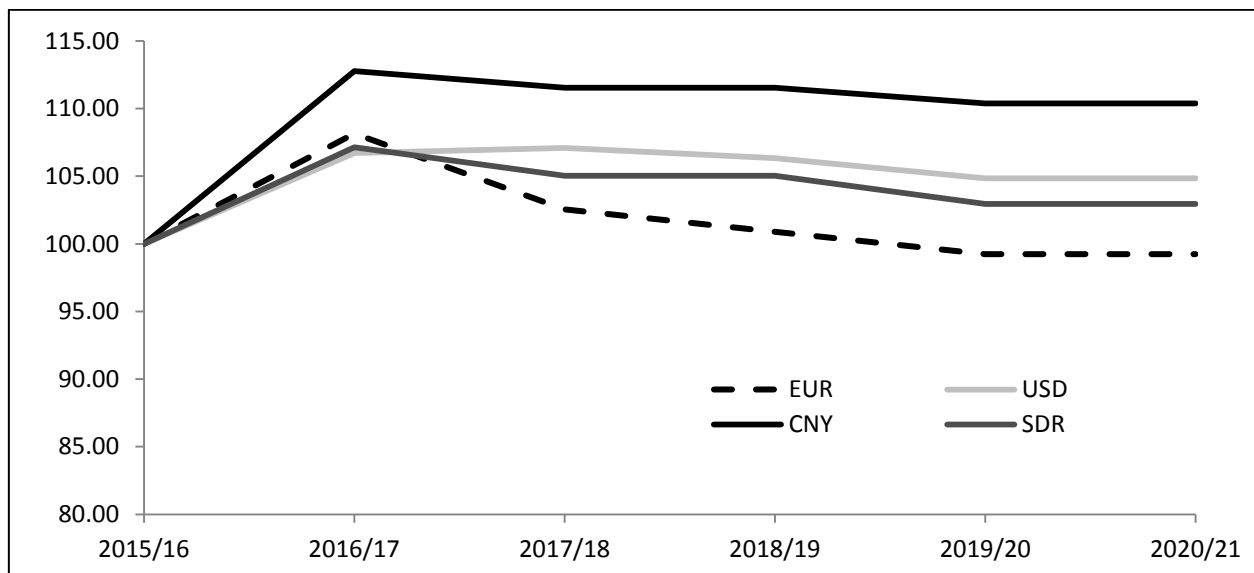
⁵ These figures differ from the 2017/18 Budget due to a change in methodology.

Table 8.3 Exchange Rate Assumptions – 2017/18 and 2018/19

| Currency | 2017/18 | | 2018/19 | |
|----------|----------------|---------------|----------------|---------------|
| | 2017/18 Budget | 2017/18 HYEFU | 2017/18 Budget | 2017/18 HYEFU |
| | EUR | 0.6500 | 0.6200 | 0.6300 |
| USD | 0.6900 | 0.7150 | 0.6800 | 0.7100 |
| RMB | 4.8500 | 4.8000 | 4.9500 | 4.8000 |
| SDR | 0.5000 | 0.5000 | 0.5000 | 0.5000 |

The New Zealand dollar is now forecast to be stronger against the US Dollar in 2017/18 and 2018/19, than estimated in the 2017/18 Budget. However, it is expected to be weaker against the Euro and slightly weaker against the Renminbi (RMB).

Figure 8.2 Estimated Changes in Major Exchange Rates (indices – 2015/16 = 100)



When assessing recent trends in the major currencies against the New Zealand Dollar, it is clear in Figure 8.2 that the value of the NZD is expected to have peaked in 2016/17, and will slowly depreciate, while expected to stay above the 2015/16 levels for most currencies, with the notable exception of the Euro. The depreciation of the NZD against the Euro will not be of significance after 2018/19, as all loans in Euro will be fully paid down.

In the 2014/15 year, the Crown converted both US dollar (USD) loans held with the Asian Development Bank (ADB) to NZD, leaving all outstanding debt with the ADB in either SDR or NZD. The Special Drawing Right is a basket of currencies composed of the Chinese Renminbi, the US dollar, euro, Japanese yen and pound sterling.

Following this change, the new loan for the undersea cable is the only debt explicitly denominated in USD. The movement in the NZD exchange rate against the USD is still closely monitored, as all SDR loans held with the ADB are repaid in a USD equivalent. It is for this reason

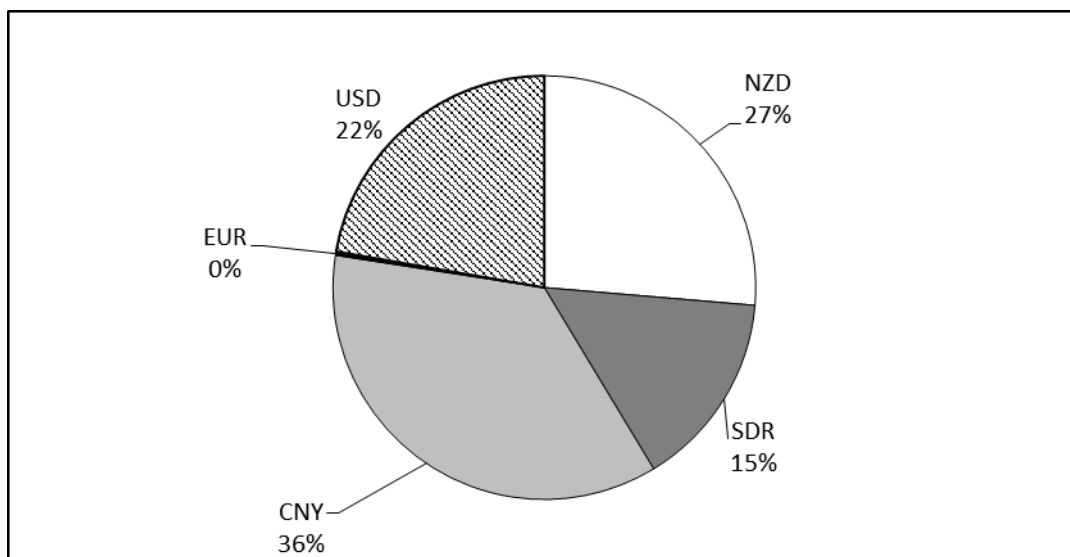
that the revised forecast for the US Dollar has had a positive impact on the value of outstanding loans in 2017/18.

From 2018/19 the impact of the revised forecasts for the Chinese Renminbi is seen through an increase in the NZD equivalent of principal and interest payments, and subsequent increase in payments to the LRF.

8.2.1 Debt held directly by the Crown

Directly held Crown debt (that is, debt not held by or on behalf of State-Owned Enterprises (SOEs), or in the DRM Loan) is mainly denominated in foreign currencies, with 27 per cent of debt in local currency. Of the remaining 73 per cent denominated in foreign currencies, CNY is at 36 per cent, followed by the USD at 22 per cent (for the undersea cable), SDR at 15 per cent, and euro (EUR) at 0 per cent. Changes in this since the 2017/18 Budget are the result of a change in the methodology and the impact of foreign exchange movements, resulting in a change in the value of the outstanding loan.

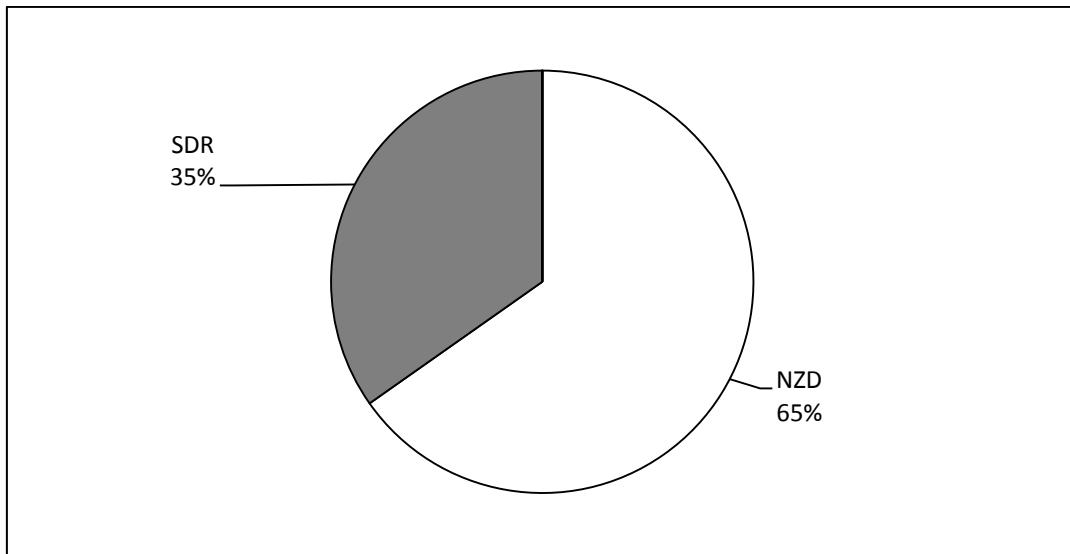
Figure 8.3 Projected Composition of Direct Crown Debt as at 30 June 2018 by Currency



8.2.2 Contingent & SOE debt

Debt held by, or on behalf of SOEs, as well as the DRM loan from the ADB, is mainly denominated in New Zealand dollars (NZD), comprising 65 per cent of the total contingent debt. The remaining 35 per cent is held wholly in SDR.

Figure 8.4 Projection Composition of Contingent Crown Debt as at 30 June 2018 by Currency

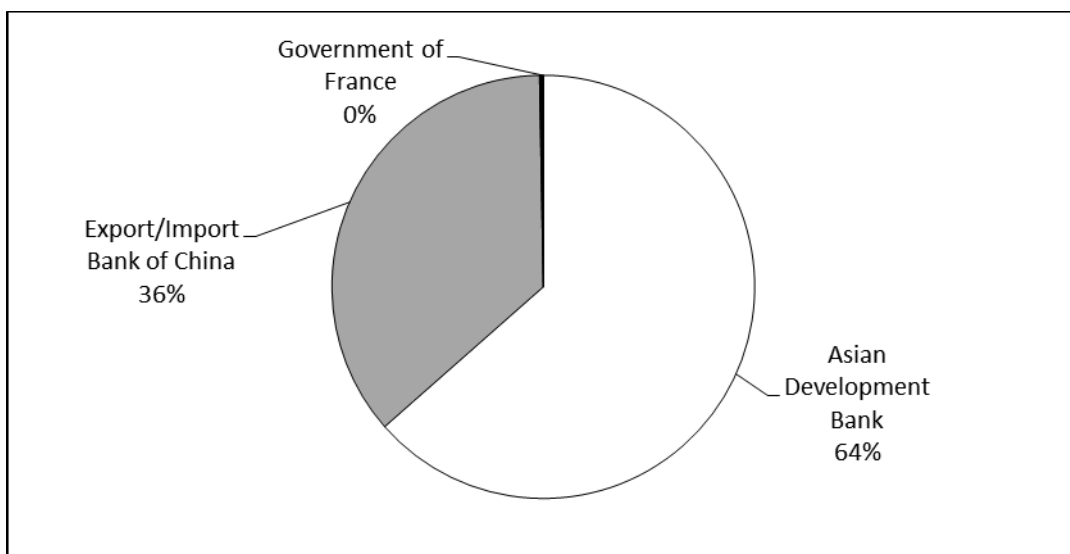


8.3 Gross Debt by Lenders

8.3.1 Debt held directly by the Crown

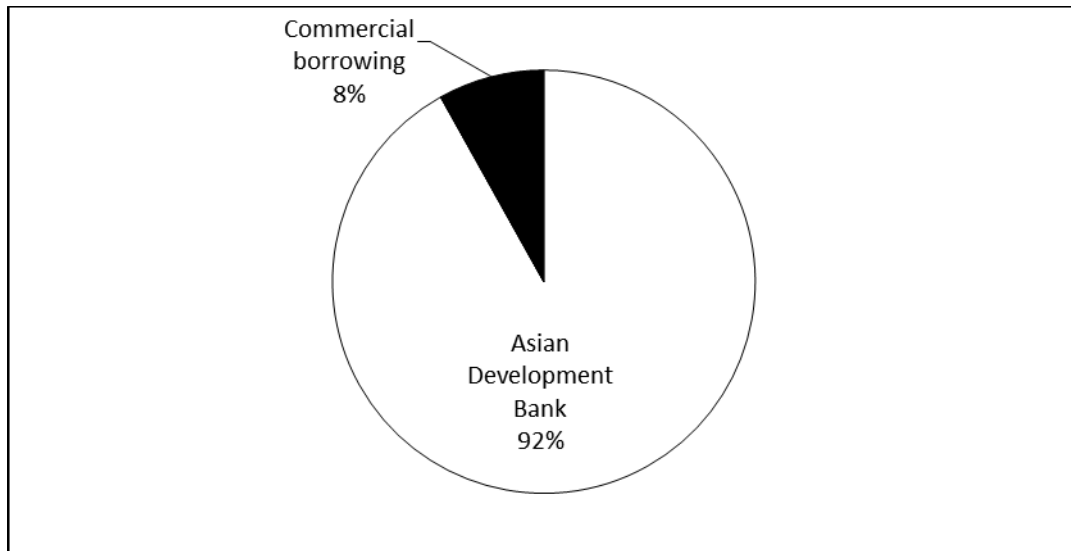
Gross direct Crown debt is held by two key lenders, the Asian Development Bank and the Export/Import Bank of China. As illustrated in Figure 8.5, 64 per cent of the Crown's direct borrowings is from the ADB, while 36 per cent is from the Export Import Bank of China (EXIM Bank). As the loan from the Government of France draws to an end, this comprises less than 1 per cent of Crown lending.

Figure 8.5 Gross Direct Crown Debt Estimates by Lender, 30 June 2018



8.3.2 Contingent & SOE debt

Figure 8.6 Gross Contingent Crown Debt Estimates by Lender



Contingent debt, and debt held by SOEs, is overwhelmingly dominated by the ADB (92 per cent). The commercial loan recently signed (and soon to be drawn down) by the Airport Authority for the International Landing System, comprises the remaining 8 per cent of SOE and contingent debt.

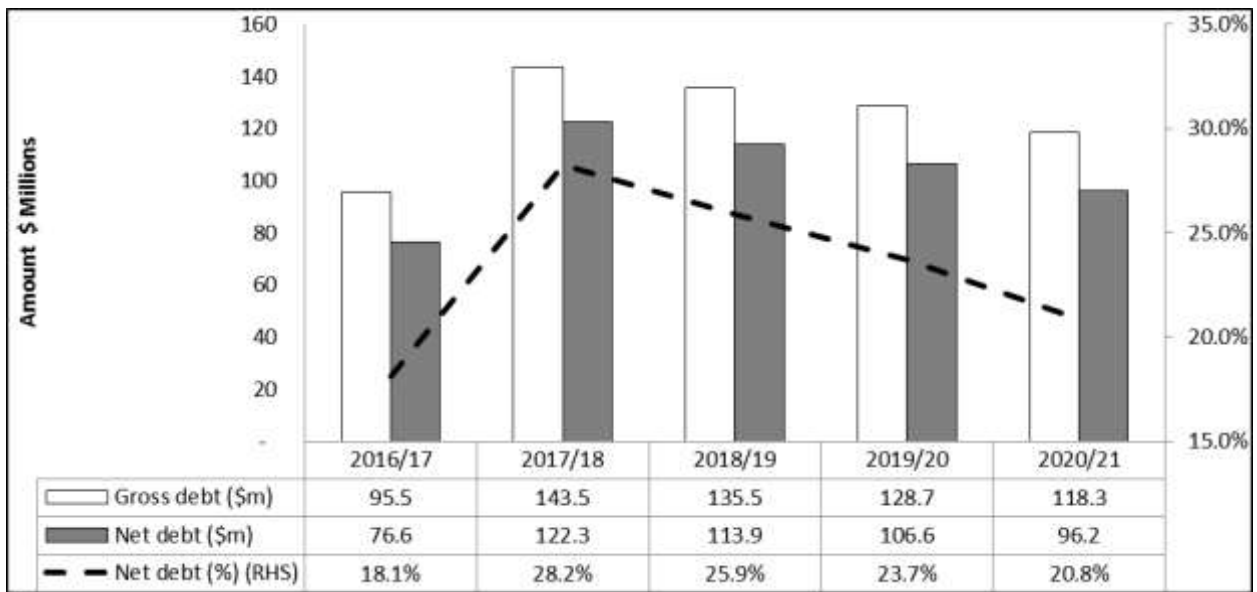
8.4 Crown Debt burden

Total gross (direct Crown and contingent) debt was \$95.5 million as at 30 June 2017. This is significantly lower than expected in the 2017/18 Budget due to;

- The DRM loan not having been drawn down (\$13.95 million)
- The Renewable Energy loan only being partially drawn down (\$1.2 million of \$12.98 million)
- Change in methodology used to calculate outstanding loans
- Positive exchange rate fluctuations

Total gross debt peaks in 2017/18 with the signing of the two new loans (Manatua cable and International Landing System) and the inclusion of the DRM. This gradually reduces in the outer years on the assumption that principal is repaid and the Government does not undertake new loans.

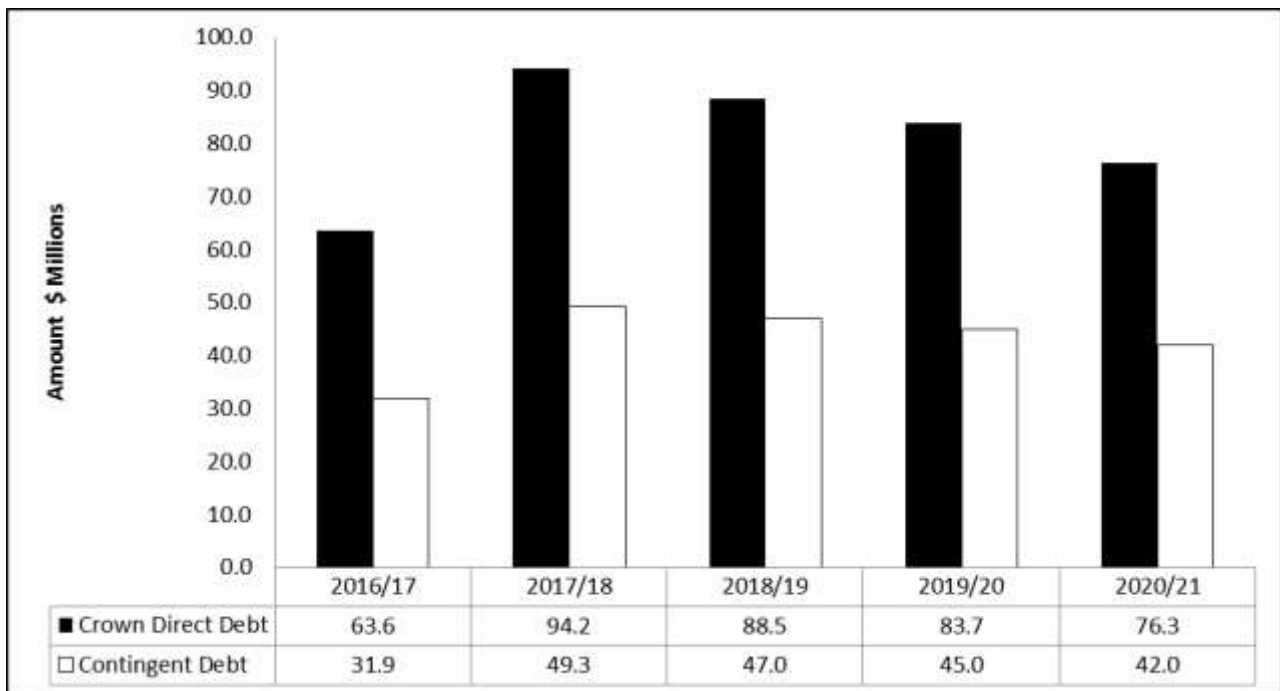
Figure 8.7 Cook Islands overall debt burden



Net debt (debt net of LRF) follows the same trend as gross debt, due to the peaking of the LRF balance in 2017/18. As a percentage of GDP, net debt peaks at 28.2 per cent, 1.8 per cent below the Government’s debt target of 30 per cent. Net debt as a per cent of GDP is expected to slowly decrease to 20.8 per cent in 2020/21.

As can be seen in the chart below, around two-thirds of the total gross debt is directly attributable to the Crown, with the remaining third relating to SOE and contingent debt.

Figure 8.8 Breakdown of Total Gross Debt

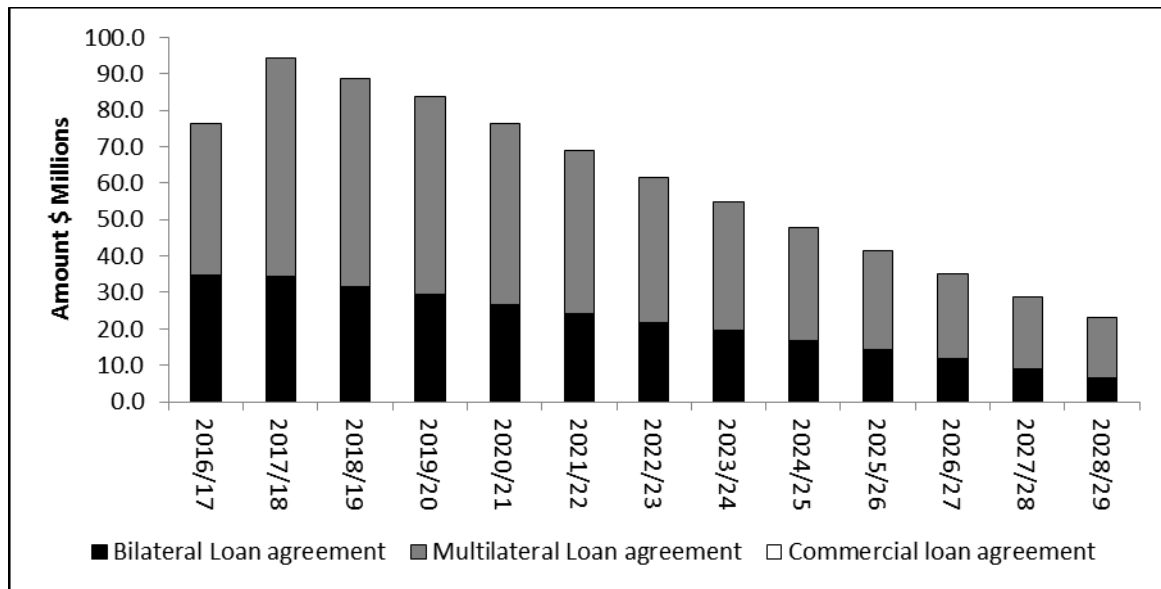


8.5 Status of Government Loans

Figure 8.9 below summarises the debt profile of existing Crown loan agreements over the next 10 years, as divided between multilateral lenders (only the ADB) and bilateral lenders (predominantly China’s EXIM Bank).

The impact of major projects such as the Southern Renewable Energy Project and the new loans can be seen in the peak in 2017/18, with debt declining thereafter. The figures presented include estimated movements in exchange rates, as per the Bancorp forecasts.

Figure 8.9 Sources of Outstanding Direct Crown Debt Next 10 Years



Outstanding contingent Crown debt is largely held by the ADB, with a small portion of SOE debt held in a commercial agreement.

Figure 8.10 Sources of Outstanding Contingent Crown Debt Next 10 Years

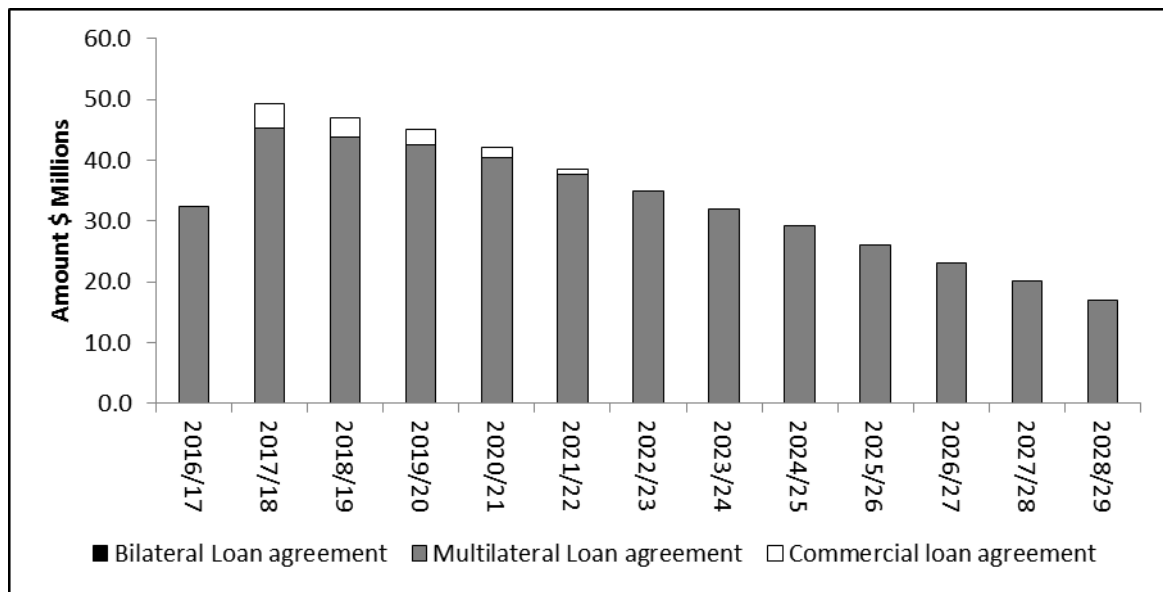


Table 8.10 shows the estimated balance of each loan as at 30 June 2018.

This table assumes the full draw down of the \$13.95 million loan from the ADB for Disaster Risk Management, which is committed and signed, but will only be drawn down in the event of a natural disaster. As this loan (and some others) are not fully drawn down, quarterly financial reporting and previous actuals may not match the below estimates, all figures presented here are an estimate of the loan to be repaid in future periods.

Table 8.4 Status of Government loans, estimated at 30 June 2018

| Loans drawn down | Date loan taken | Original loan amount (000) | Balance (NZD,000) | Expected date of repayment |
|---|------------------------|-----------------------------------|--------------------------|-----------------------------------|
| ADB 461 (SF) Multi Project | November, 1980 | USD 1,000* | 263 | August, 2020 |
| ADB 567 (SF) CIDB Project | July, 1982 | USD 1,500* | 309 | April, 2022 |
| ADB 849 (SF) 2nd Multi-Project | December, 1987 | SDR 2,150 | 1,521 | August, 2027 |
| ADB 1031 (SF) Outer Islands Telecom Project | October, 1990 | SDR 3,578 | 3,824 | August, 2030 |
| ADB 1155 (SF) 2nd CIDB Project | March, 1992 | SDR 1,085 | 978 | December, 2031 |
| ADB 1171 (SF) Emerg. Telecom Rehab Project | August, 1992 | SDR 349 | 338 | June, 2032 |
| ADB 1309 (SF) Pearl Industry Dev. Project | December, 1994 | SDR 272 | 390 | August, 2034 |
| ADB 1317 (SF) Educ'n Dev Project | February, 1995 | SDR 1,852 | 2,377 | August, 2034 |
| ADB 1380 (SF) 3rd CIDB Project | January, 1996 | SDR 1,977 | 2,037 | September, 2035 |
| ADB 1466 (SF) Economic Restructure Program | September, 1996 | SDR 3,430 | 4,643 | September, 2036 |
| ADB 1588 (SF) Cyclone Emergency Rehab Project | January, 1997 | SDR 583 | 812 | January, 2038 |
| Restructured French Loans | January, 1999 | Euro 5,413 | 271 | September, 2018 |
| ADB 1832 (SF) Waste Mgt Project | December, 2001 | SDR 1,695 | 1,979 | June, 2033 |
| ADB 2174 (SF) Cyclone Emergency Assist Project | June, 2005 | SDR 1,895 | 3,337 | June, 2045 |
| China - Multi-Functional Indoor Sports Stadium | August, 2008 | RMB 74,100 | 9,492 | August, 2028 |
| ADB 2472 (OCR) Avatiu Port Development Project* | September, 2009 | NZD 10,309 | 9,140 | November, 2033 |
| ADB 2473 (SF) Avatiu Ports Development project | September, 2009 | SDR 4,524 | 8,473 | November, 2040 |
| ADB 2565 OCR Economic Recovery Support Program 1* | January, 2010 | NZD 11,053 | 6,532 | October, 2024 |
| ADB 2739 (OCR) Amendment Avatiu Port project* | December, 2011 | NZD 5,290 | 5,079 | November, 2035 |
| China - Rarotonga Water Ring Main Upgrade | December, 2012 | RMB 118,000 | 24,522 | December, 2032 |
| ADB 2946 OCR Economic Recovery Support Program 2 | December, 2012 | NZD 11,053 | 5,740 | October, 2027 |
| ADB 3913 Renewable Energy Project | December, 2014 | NZD 12,980 | 12,541 | June, 2036 |
| ADB - Loan for Undersea Broadband Cable | November, 2017 | USD 15,000 | 20,979 | 2031 |
| Commercial - Loan for Rarotonga Airport Equipment | November, 2017 | NZD 4,000 | 4,000 | 2022 |
| ADB - Disaster Risk Management | | USD 10,000 | 13,950 | *Contingent |
| Total loans commitment | | | 143,527 | |

*Note these loans have been converted to NZD

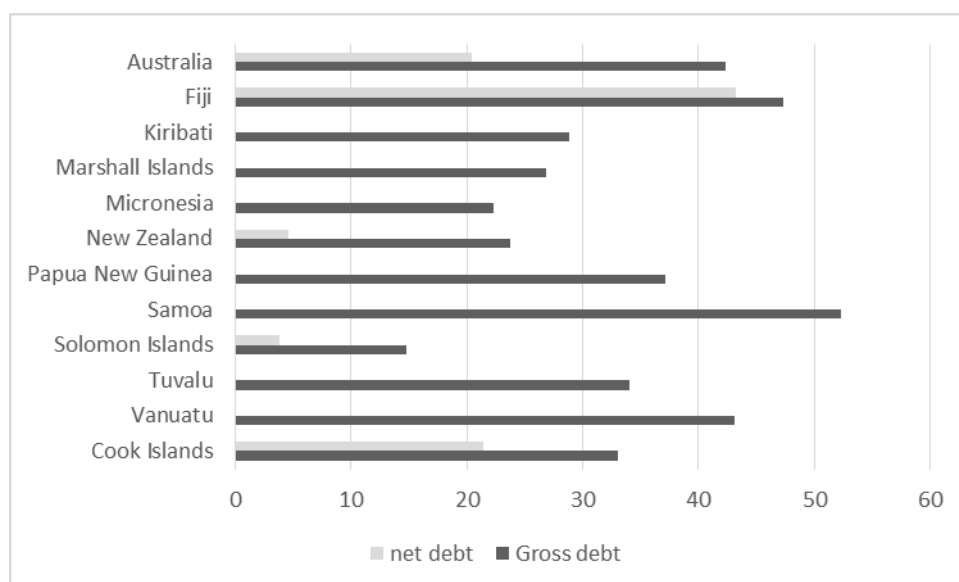
8.6 Net Debt

The internationally accepted definition of net debt is total gross debt (all public sector debt and currency on issue) less total financial assets corresponding to those debt instruments (this means like for like, for example cash). Under this definition the Cook Islands net debt position would be only \$114.1 million or 25.4 per cent of GDP in 2017/18.

| | | |
|---|---------------------------------------|-------------------|
| Gross Debt + Currency on Issue = | (\$143.5 million) + (\$4.1 million) = | (\$147.6 million) |
| Less Financial Assets (Cash reserves and Loan Repayment Fund) = | | (\$55.2 million) |
| Net Debt = | | (\$92.5 million) |

International comparisons of net debt are made on the basis of the international definition of net debt. On this basis, the Crown's debt profile sits in the upper-mid-range of Pacific nations, including Australia and New Zealand.

Figure 8.11 Regional Comparison of public debt profiles⁶



However for the purpose of prudent fiscal management, the Crown excludes cash reserves and currency issued from the net debt definition. For the purposes of this Chapter, the Crown's 'Net Debt' is equivalent to total gross debt, net of the LRF (the difference between the total gross debt and funds held in the LRF). This is closer to the internationally accepted definition of net debt.

⁶ The data for Australia (obtained from the IMF) is federal government only, and the levels of debt for all levels of government would be higher than presented.

Net debt under this more conservative definition is estimated to be \$122.3 million (28.2 per cent of GDP) by the end of June 2018, lower than that expected at 2017/18 Budget, largely due to a change in the methodology and a change in drawdown schedules. This is significantly higher than net debt in 2016/17 due largely to the new loans being entered into, and the absence of need for the DRM contingent loan in 2016/17.

It must be noted that debt servicing figures in Table 8.5 differ from those discussed above, as this assumes drawdown of the DRM loan, and includes associated servicing costs.

Table 8.5 Current Borrowing Statement (\$m)

| Current Statement | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|---|----------------|----------------|----------------|----------------|----------------|
| Gross Crown Debt, start of FY | 115.8 | 149.3 | 143.8 | 136.8 | 128.7 |
| Gross Crown Debt, end of FY | 95.5 | 143.5 | 135.5 | 128.7 | 118.3 |
| <i>Direct Crown Debt</i> | 63.6 | 94.2 | 88.5 | 83.7 | 76.3 |
| <i>SOE debt</i> | 31.9 | 35.4 | 33.1 | 31.0 | 28.7 |
| <i>Contingent (Disaster) debt</i> | 0 | 14.0 | 14.0 | 14.0 | 13.4 |
| Loan Repayment Reserves Held, end of FY | 18.9 | 21.2 | 21.7 | 22.1 | 20.5 |
| Crown debt net of loan reserves, end of FY | 76.6 | 122.3 | 113.9 | 106.6 | 97.9 |
| Crown debt net of loan reserves, as % of GDP | 18.1% | 28.2% | 25.9% | 23.7% | 21.2% |
| Gross Debt Servicing | 7.1 | 8.7 | 11.7 | 11.3 | 13.5 |
| ... as percentage of Total Revenue | 4.3% | 5.5% | 7.8% | 7.4% | 8.6% |
| <i>Direct Crown Debt</i> | 5.1 | 6.3 | 8.1 | 7.7 | 9.3 |
| <i>SOE debt</i> | 2.1 | 2.4 | 3.4 | 3.4 | 3.3 |
| <i>Contingent (Disaster) debt</i> | 0.0 | 0.0 | 0.3 | 0.3 | 0.9 |
| Net Debt Servicing | 4.3 | 5.9 | 8.8 | 8.5 | 10.6 |

8.7 Debt Headroom

As the Crown has recently signed additional loans to fund an Instrument Landing System (ILS) for Rarotonga Airport (through the Airport Authority) and a fibre-optic submarine cable (Manatua Submarine Cable), it is important to consider the impact that these loans will have on the Crown's capacity to service additional borrowing. It is also important to consider the impact that the DRM loan will have should it be drawn down at short notice.

These loans, if drawn in the 2017/18 year as assumed (with the submarine cable loan drawn down across two years), would increase net debt to \$122.3 million (gross debt of \$143.5 million) by 30 June 2018, leaving approximately \$7.7 million of room before the more conservative MFEM target of 30 per cent net debt to GDP is reached. With regard to the Crown's prudential 35 percent threshold this leaves headroom of \$29.3 million.

This analysis assumes full draw down of the DRM loan, which would occur only if a disaster occurs, and is the reason for the five percentage point gap between the MFEM target and the Crown's prudential threshold. As well as this, this analysis assumes that loans currently held by SOEs are unable to be serviced by those entities.

8.8 Crown Debt Sensitivity Analysis

Table 8.6 Base rate with +/- 10 per cent

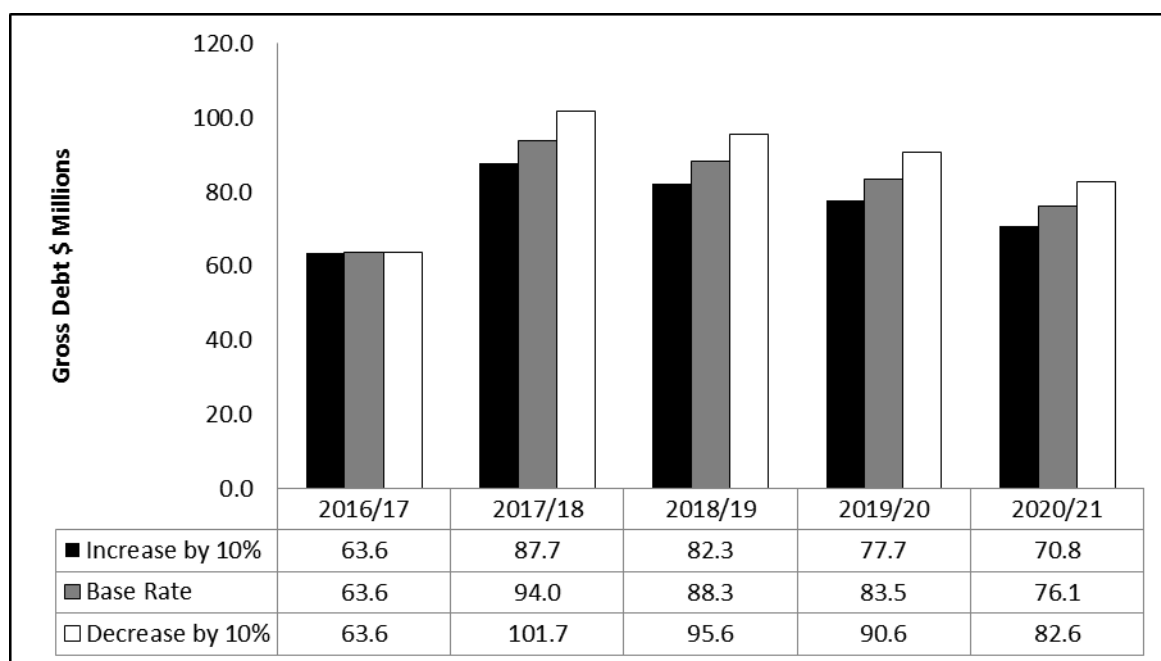
| Foreign Exchange Currency | -10% | HYEFU assumption rate | +10% |
|---------------------------|--------|-----------------------|--------|
| RMB | 4.3200 | 4.8000 | 5.2800 |
| USD | 0.6435 | 0.7150 | 0.7865 |
| SDR | 0.4500 | 0.5000 | 0.5500 |
| EUR | 0.5580 | 0.6200 | 0.6820 |

One of the ongoing risks to the Crown's debt liability is the value of the NZD against the currencies in which the Crown's loans are denominated. The sensitivity analysis demonstrates the impact of a 10 per cent appreciation or depreciation in the NZD to determine the impact on the gross borrowings and the debt servicing cost.

8.8.1 Direct Crown Debt

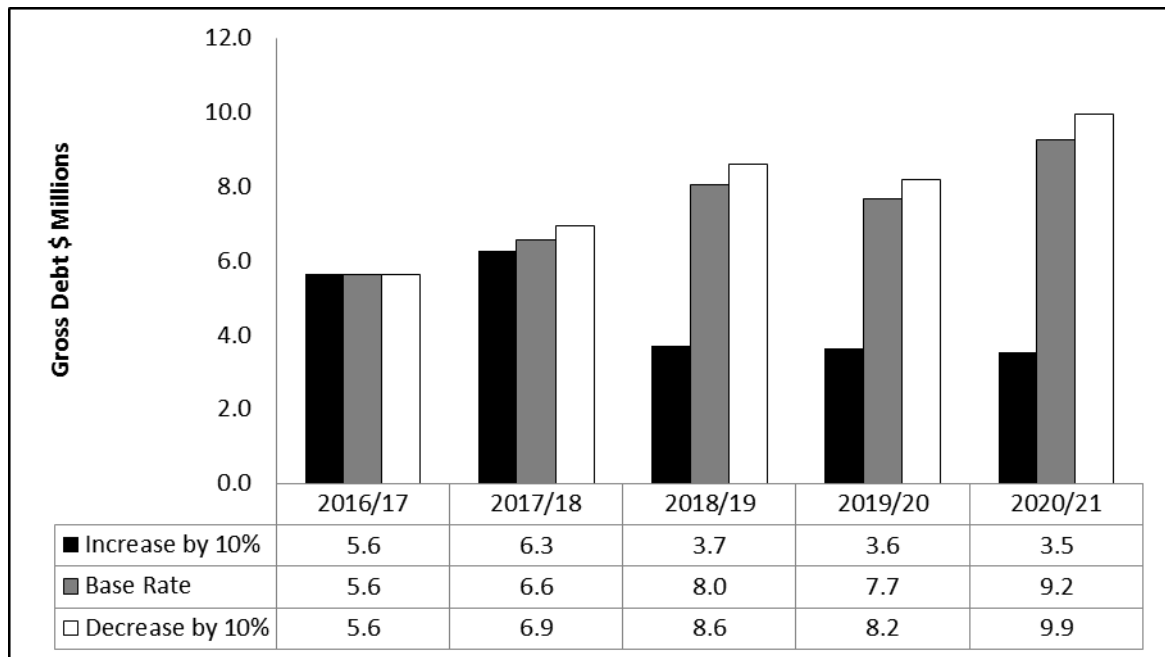
If the NZD exchange rate was to depreciate by 10 per cent against foreign currencies, direct Crown debt as at the end of the June 2018 year would increase by an estimated \$7.7 million.

Figure 8.12 Sensitivity of Direct Crown Gross Debt to NZD movements, end of FY



A 10 per cent decrease in the foreign currency value of the NZD would increase debt servicing costs to the LRF by \$0.3 million.

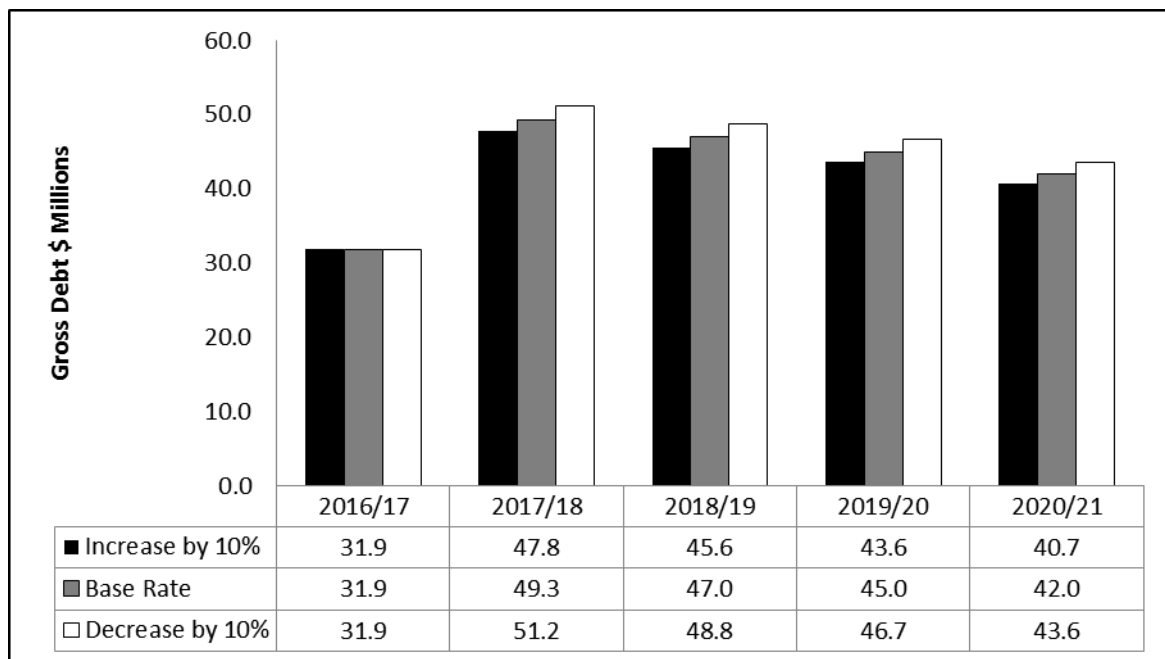
Figure 8.13 Sensitivity of Direct Crown Debt Servicing Costs to NZD movements, start of FY



8.8.2 SOE & Contingent Debt

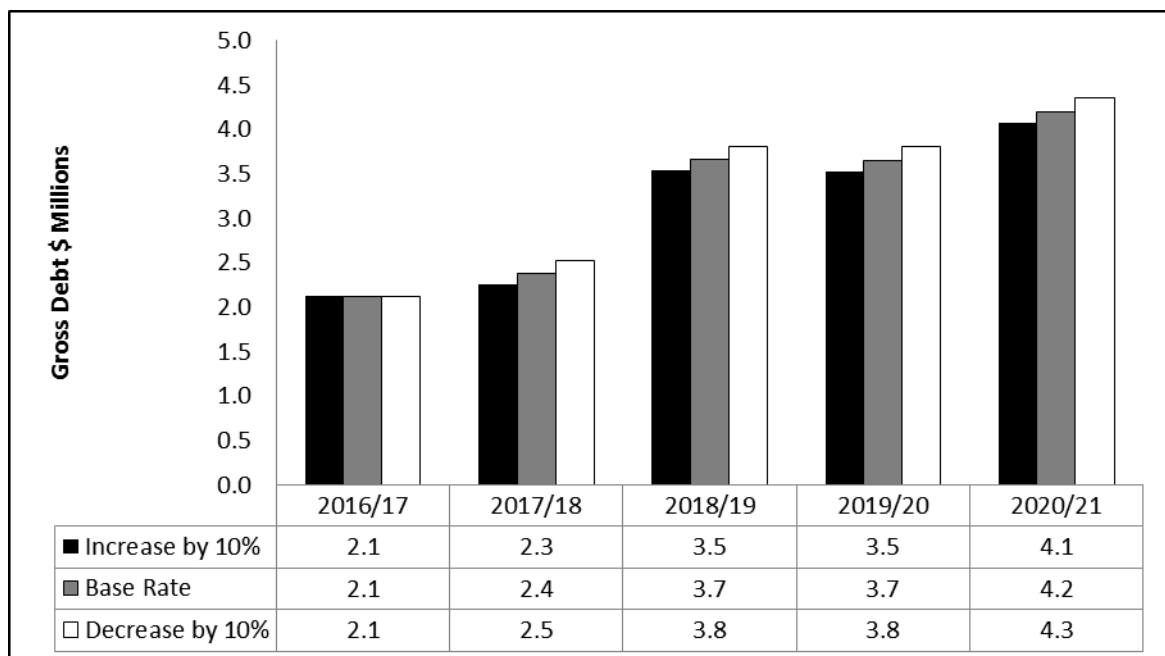
If the NZD exchange rate was to depreciate by 10 per cent against foreign currencies, SOE and contingent Crown debt as at the end of the June 2018 year would increase by an estimated \$1.9 million.

Chart 8.14 Sensitivity of Contingent Crown Gross Debt to NZD movements, end of FY



A 10 per cent decrease in the foreign currency value of the NZD would increase debt servicing costs to the LRF by \$0.1 million.

Figure 8.15 Sensitivity of Contingent Crown Debt Servicing Costs to NZD movements, end of FY



Over recent years, the accumulation of interest earnings held within the LRF has allowed for a small exchange rate buffer. At the 2017/18 Budget, this buffer was around \$7 million. With a stronger than expected NZD, this buffer has increased to around \$8 million.

8.9 Long term debt projections and fiscal risks

Proposals to take on new loans must be treated under transparent processes as required by the MFEM Act 1995/96 and the LRF Act 2014.

The LRF Act requires MFEM to analyse and report to the Parliament and the public on the impact of new borrowing in the context of Government lending policy, including the amortisation schedule, the impact on debt service burden of the government over the life of the loan, and an assessment of the sustainability of aggregate government debt. Reports should be made in advance of loan agreements being finalised.

8.9.1 Debt projections

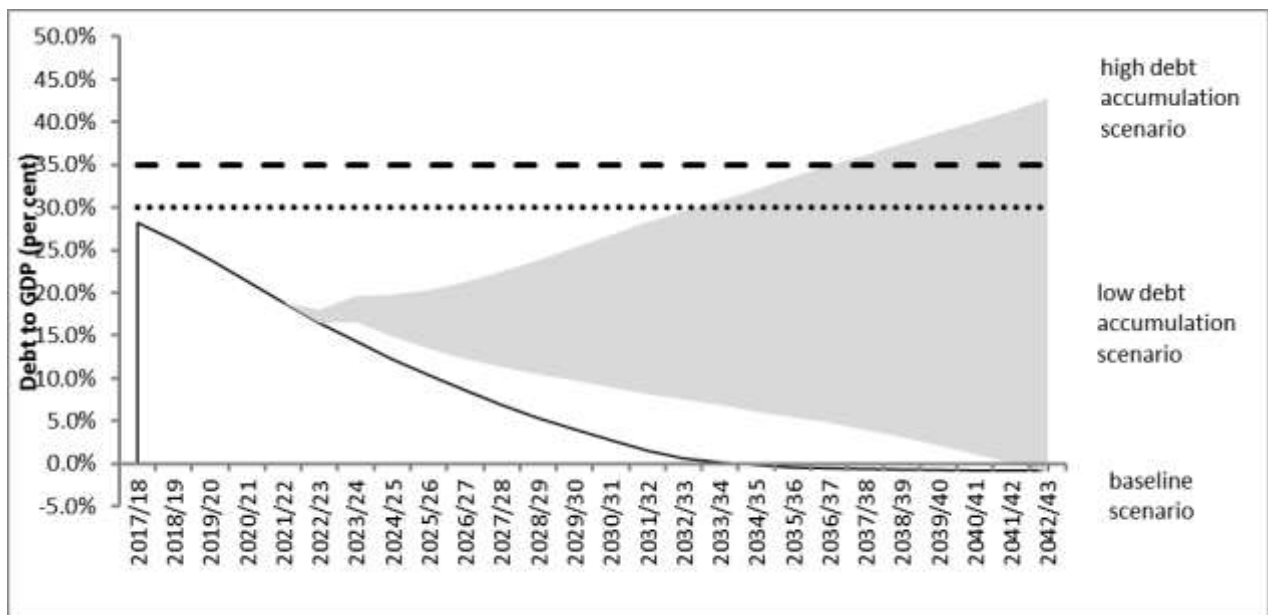
The following projections are designed to present an estimate the potential evolution of the debt position of the Cook Islands Government over the next 20 years. These do not model any specific projects, but can be considered as a indicative guide.

These scenarios assume that the contingent loan (DRM loan) from the ADB is fully drawn down across the forward estimate years (2017/18 to 2020/21). The DRM facility provides a disaster assistance loan to assist reconstruction efforts in the aftermath of a catastrophic weather event. This is not a liability on the Crown until such an event occurs, but does represent a contingent liability. All projection scenarios include the drawdown of this loan but, for the purposes of assessing debt sustainability, this should be considered to sit between the benchmarks of 30 and 35 per cent net debt to GDP (as this is the purpose of both the contingent loan, and the five per cent 'cushion').

The loans held by SOEs (as distinct from those held on behalf of SOEs, where the SOEs have discharged their debts to the Crown) also represent a contingent liability to the Crown, and are considered as such throughout the projection scenarios.

In addition to cataloguing the known investment programmes and associated borrowings, it is also important to estimate what the likely evolution of the debt profile is over time. The figure below estimates three debt accumulation scenarios.

Figure 8.16 Net debt projection – 20 years



The baseline scenario is the evolution of the current debt over time. The estimates are those outlined in the current debt agreements, with the repayment schedules already mapped out over the next 20 to 30 years. This includes the contingent DRM loan.

Both the high and low debt accumulation scenarios assume that operational spending remains within prudent forecasts, producing modest operational surpluses. If this were not to be the case, the debt projections would be higher in both cases. Both scenarios also assume current loan terms of fifteen years, with a three year grace period in each case.

The high debt accumulation scenario assumes that the growth of capital investment continues at growth five percentage points above Nominal GDP. As this is significantly lower than the increase in planned capital investment in recent years, there remains an element of conservatism in this outlook. However, this scenario is designed to represent one in which the level of the Crown’s infrastructure investment in the Cook Islands is continually growing. This also assumes that ninety per cent of net capital investment (that is, capital investment less depreciation) is funded by debt, at interest rates of 2.5% per annum. Under this scenario, as can be seen in the chart above, debt increases rapidly over the projection period, with the MFEM prudential target of 30 per cent net debt to GDP being breached around 2032, and the 35 per cent ‘hard limit’ being breached around 2035.

The low debt accumulation scenario assumes that the Crown’s capital investment is limited to (in broad terms) maintaining the existing level of capital stock. This means that total capital investment is assumed to grow in line with long term depreciation (considered to be five per cent for these purposes) and price growth of manufactures⁷. This shows a much

⁷ From IMF databases

lower rate of debt accumulation, which does not threaten the benchmark debt to GDP ratios.

In all modelled scenarios, it is assumed that replacement costs for the Northern and Southern Renewable Energy Projects are provisioned for through the tax base or by user charges. A similar assumption is made for the Rarotonga Water Network. The replacement costs for such systems are therefore neutral on the modelling presented here. Similarly, any costs incurred related to sanitation in Muri are assumed to be met through sources other than debt, and are not included here.

8.9.2 Conclusion

Both of the low and high debt scenarios suggest that some key planned infrastructure projects can be accommodated within current debt limits, but there is a need to remain prudent about future borrowing, and prioritise amongst competing capital projects.

Fundamentally, expectations of expanding operational budgets cannot coexist with the recent high levels of capital spending. At some point in the future, either capital or operational spending will need to be scaled back to match revenue growth.

Importantly, neither the low debt and high debt scenario assumes expansion in operational spending in excess of revenue growth. As the population of the Cook Islands ages, and public expectations about social safety nets change, this assumption may no longer be valid, which would increase pressure on the debt sustainability through the financing of operational needs by debt.

Notably, projects such as the Tereora College rebuild are not factored into these estimates. This project is assumed to be financed largely by donors. Other, more aspirational projects are also not factored into these estimates, such as the renewable energy project for Rarotonga. Loan financing either of these projects would significantly degrade the Crown's ability to stay within its debt limits.

8.10 Other State Owned Enterprise Debt

The Airport Authority is due to draw down on a loan from the commercial sector to fund an upgrade of the Instrument Landing System at Rarotonga International Airport. This loan will also cover costs associated with sealing of the runway and the building of a new cargo shed.

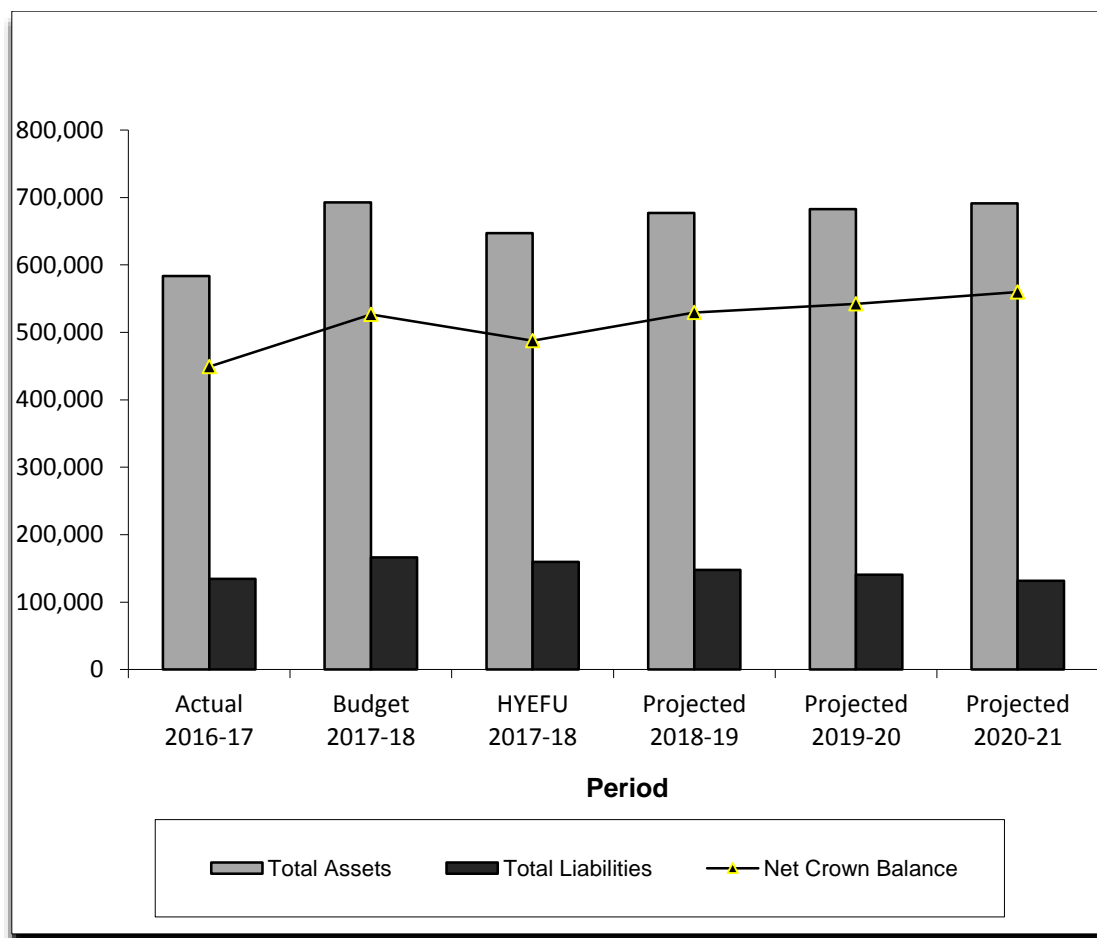
The loan is to be secured by registered mortgage debenture over the assets and undertakings of the Airport Authority. A financial covenant will apply where the amount of EBITDA generated less dividend paid will at all times be greater than twice the annual debt servicing commitments. The Covenant will be measured annually in arrears.

Since the enactment of the LRF Act, all new debt (including SOE debt) must go through a full debt sustainability analysis, and be approved by Cabinet (via the Minister of Finance), on the advice of the Financial Secretary.

8.11 Net Worth

The Cook Islands 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.

Figure 8.17 - Net Worth 2016/17 to 2020/21 (\$'000)



The estimated net worth of the Crown at half year 2017/18 has decreased slightly since the 2017/18 Budget from \$526.5 million to \$487.7 million. This is a net decrease of \$38.8 million. This was primarily a result of the decrease in property plant and equipment compared to 2017/18 Budget caused by the low completion rate of capital projects in 2016/17.

The Crown's net worth will increase from 2018/19, as long as there is an estimated operating surplus, and capital projects are completed as scheduled. Another major contributor to the forecast upward trend is the decrease in borrowings in the outer years, and an injection to the Crown's asset from aid donor funding.

Higher than anticipated cash balances at the end of 2016/17 have also resulted in a improvements to the cash position of the government since the 2017/18 Budget as seen in the Statement of Financial Position.

9 ODA Half Year Economic and Fiscal Update

Official Development Assistance was appropriated at the total value of \$78 million in the 2017/18 Budget in June. This value includes the Budget Sector Support Grant Funding Arrangement with New Zealand which is currently treated as Revenue on behalf of the Crown (ROBOC) through Treasury and distributed to core ministries (Education, Health and Tourism). Additional programmes have been included in the 2017/18 HYEFU to factor in programmes under 3rd Party Spend and new ODA programmes that were not included at the time of the 2017/18 Budget publication. Current estimated spend to date is reported at \$23.9 million which covers the period from July to November 2018.

The narrative below provides an update on specific donor programmes and key initiatives driven by the Development Coordination Division.

Table 9.1 ODA September 2017 Update

| | |
|--|-----------|
| FY2017/18 ODA Budget (NZ\$'000) | \$77,762 |
| FY2017/18 HYFEU estimated spend to date (NZ\$'000) | \$23,973 |
| ODA conversion rate November 2018 (%) | 47 |
| Number of Development Partners | 44 |
| In country incl NZ, ADB and UN affiliates | 18 |
| Overseas Development Partners incl affiliates | 26 |
| Number of ODA Programs/Projects | 70 |
| Approved Third Party Programs/Projects | 28 |
| Cook Islands Government Budget Support | 2 |
| Approved Grants including Small Grants | 40 |

ODA Graduation

In July 2017, the OECD agreed to provide the Cook Islands until the end of 2018 to develop GNI data. Since this time, the National Statistics Office of the Ministry of Finance and Economic Management (MFEM) has been working closely with MFAT and the International Monetary Fund's Pacific Financial and Technical Assistance Centre (PFTAC) on the development of this data.

At this stage, revisions are being made to our GDP (economic growth may not have been as strong as we thought). In addition, flows out of the country have been picked up that suggest that GNI will be lower than GDP. Therefore, it is possible that the Cook Islands will not graduate. Much more work needs to be undertaken over the next 12 months to determine the level of the Cook Islands' economic development. The Cook Islands

Government acknowledges with appreciation the support of the Government's of New Zealand and Australia, as well as the IMF for the support provided.

In addition to the work being done on the Cook Islands economic data, the Cook Islands Government is undertaking an analysis on the sectors that would be affected in the event of graduation to inform a possible transition plan in the event of graduation.

Manatua Cable

In early April 2017 an agreement with the Government of Niue, French Polynesia and Samoa was signed to facilitate the design, construction, operation and maintenance of the regional submarine cable system that will connect these countries, which the islands of Rarotonga and Aitutaki will be connected to. A memorandum of understanding was also signed by the countries for the planning and implementation of the Manatua cable system, and a Project Steering Group (PSG) was formed to prepare the project and establish a Construction & Maintenance Agreement (C&MA) detailing overall management of the Manatua cable system.

The Government of New Zealand, represented by the Ministry of Foreign Affairs and Trade (MFAT), are providing a grant of NZD15 million to the Cook Islands government to support the project. The Cook Islands government have requested ADB support to finance the "Cook Islands" share of the cost. ADB have set aside an OCR Loan allocation of up to USD15million to assist in (a) financing the sections that connect Rarotonga and Aitutaki to the main section of the cable system; (b) finance construction of the landing stations in Rarotonga and Aitutaki, (c) finance the setting up a Project Management Unit (PMU) to support the implementing agency and (d) to co-finance the main section of the cable system proportionate with the Cook islands' share.

ADB is providing technical and legal support to Cook Islands to prepare the project with the local focal point. Procurement will take place in the fourth quarter of 2017/18. After completion of the social and environmental impact assessments the submarine cable is expected to be operational towards the end of 2018, or early 2019.

Te Tarai Vaka (TTV) Activity Management System Simplification

This is a project approved under the NZ Performance Based Budget Support Incentive Payment. The review is now set for completion by the end of 2017 with technical assistance from local expertise the Voyager Group Consultancy. The suites of about eight existing TTV policies have been merged to one TTV overarching policy. This also includes a process map for ease of reference in using the new and improved TTV.

Together with a working group consisting of CIIC, OPM, OPSC, ICI and MFEM representatives, this work includes a review to ensure that TTV is fit for purpose within the

machinery of the Cook Islands Government. In particular, clarity is required for the approval processes for any government and development partner development programmes/projects proposals, planning and implementation designs. Mapping of approval process also took into consideration the approval processes before Cabinet endorsement through the Central Agencies Committee, National Sustainable Development Committee, Budget Support Committee, Infrastructure Committee and relevant Project Governance Groups.

The condensed version of the existing TTV templates and guidelines suite has been released for trial in November 2017. Training for key users is in the pipeline. Thereafter, official endorsement of the new TTV will be launched on the MFEM website in 2018.

9.1 NEW ZEALAND PROGRAMMES

9.1.1 Cook Islands Core Sector Support (CSS)

The goal of CSS is to enhance the Cook Islands self-sufficiency by enabling predictable, efficient and effective delivery of priority development objectives coupled with practical policy reform. The arrangement is a trial of performance based budget support funding modality. The GFA goal aligns with our (recently-signed) Joint Commitment for Development (JCFD) objectives of improving economic growth, strengthening human capacity, and enhancing overall economic self-sufficiency.

The Core Sector Support Grant Funding Arrangement (GFA) which replaces the PBBS was signed in November 2016 and is valued at \$20.1 million inclusive of funding allocated through the previous PBBS. It is allocated over the 2016/17 and 2017/18 fiscal year. It is also designed to assist the Cook Islands' in enhancing economic self-reliance into the future. The Activity will provide:

- predictable funding for health and education to ensure the quality of core services delivered to New Zealand citizens;
- predictable funding to the tourism sector to maintain and safeguard economic growth; and
- funding for specialist technical assistance and/or to procure specific outputs relating to the implementation of the Cook Islands Public Sector Strategy and broader Public Sector strengthening and reform.

Expenditure on Outputs 1, 2 and 3 will be reflected in the 2018/19 Budget. An update on output 4 programmes is provided below.

Total estimated spend to date for overall core sector program is \$4,893,968 inclusive of direct budget support to Ministry of Education, Cook Islands Tourism and the Ministry of Health.

Online Companies Registry:

The Ministry of Justice is currently awaiting Parliament's passing of the Companies Bill. There are indications that the cost of the system may be higher than anticipated, however this will be confirmed.

Audit House Keeping TA:

This is underway with audit files being compiled for the Pa Enea and ICI for the 2016 accounts, this quarter. Currently more focus is being directed towards working with ICI in resolving audit issues identified by the Audit Office, more ministries should be covered in the next half of the fiscal year.

Ministry of Transport International Compliance:

In addition to the engagement of a Fixed Term Director of Civil Aviation, the Pacific Aviation Safety Organisation (PASO) has been engaged to review and update civil aviation rules for the Cook Islands, this is aimed to be completed in the last quarter of this fiscal year.

Occupational Health and Safety Legislation Review:

Advertisement has begun for communications strategy (Part 4) of the Terms of Reference (TOR). Situational Analysis, policy and legislation review have commenced, with approach to market being conducted now.

Prison review and warden training:

TOR is in the stage of finalisation between OPM, New Zealand (NZ) Corrections and MFAT, procurement will be direct between Corrections and MFAT. Corrections will assess and evaluate the prison utilizing Core Sector Support funding. Implementation arrangements will then be agreed to between MOJ, MFAT and Corrections. Assessment expected to commence Jan-Feb 2018.

Asset Management Stocktake:

TOR finalized with work to be in two phases, a project steering group (PSG) has been formed and approved by NZ, procurement will be managed by NZ with project delivery being managed by the PSG.

Foreign Direct Investment (FDI):

TOR has been finalized with procurement underway, it is envisaged that work will commence January 2018.

Public Expenditure Reviews of the economic, social, and environmental sectors:

MFEM is undertaking expenditure reviews of the economic, social and environmental sectors in the Cook Islands to ensure that baseline funding is appropriate for the outputs required from the relevant Ministries. TORs have been finalized and procurement is anticipated to begin in the second quarter.

Resourcing for CIG Annual Audit backlogs:

The TOR is currently in its final revision with a few amendments to project delivery, to be completed by CIAO, update on plan to incentivize staff to stay/bond graduates to CIAO.

Ministry of Transport International Compliance

TOR finalization is still pending from Maritime, priority changed to implementing the Quality Management System, with SPC working on legislation review of Search and Rescue provisions.

Revenue Management System Phase 4 – CUSMOD

Tax Amnesty Business requirements and Technical Specifications were signed off by MFEM in early 2017/18, with Tax Amnesty construction phase and system in place. Construction of phase 4 system is completed with testing currently underway. The project completion date was targeted for December 2017 but this could shift out to the beginning of 2018.

Financial Management Information Systems (FMIS)

The FMIS project is currently in the final phases of contract awarding stage, a recommended supplier has been selected. An FMIS is targeted to have fully incorporated Ministries/Agencies in 2019. Significant spends are estimated to occur in early 2018.

9.1.2 Tereora College Redevelopment (Phase 1)

Executing Agency: Cook Islands Investment Corporation

Landholdings has completed about 90% of the contract works. In the coming month, it is expected the installation of interior windows and door frames, fixtures, paint work, ceilings and linings as well as tiling and carpeting work will continue. The handover is still on schedule to take place towards the end of January 2018.

Of the \$10.85 million grant from New Zealand, the Cook Island Government received \$4.05 million in 2015/16, \$5.75 million in 2016/17, with the remaining \$1.05 million to be expected in 2017/18.

Total estimated spend to date in 2017/18 is \$2,550,000 for the construction of buildings and associated works and components (furnishing, equipment, utilities, landscaping, etc).

9.1.3 Manihiki Lagoon Clean-Up

Executing Agencies: MFEM, MMR and Manihiki Island Government

The Manihiki Lagoon Clean-up Project was successfully completed in August 2017. The project was designed to remove abandoned pearl farming materials and other waste products from the lagoon in an effort to improve pearl production and quality. The final completion reports from the Contractor (Pacific Divers Ltd), Project Manager (Raymond Newnham of Ora Moana Ltd) and the Manihiki Island Government have been endorsed and final payments disbursed respectively.

A total of 33 farms were cleaned with a total of 232.8 tonnes of materials removed which was made up of 67.7km of ropes and 8841 floats. The bulk of the waste removed were ropes and floats with bio-fouling growing on them. Other materials removed were roofing iron, tyres, household utensils, plastic piping and kerosene stoves.

The dive team worked for 90 days on the lagoon. The work programme was well planned and implemented efficiently and effectively. The volume of materials removed averaged over 2.5 tonnes a day.

Some of the positive results of the project include:

- The removal of the abandoned materials and the bio-fouling growing on those materials, which has reduced the competition for food for the pearl oysters.
- Active farmers are wanting to expand in to some of the cleaned up areas
- An upskilling of the Manihiki residents involved with the project. Seven divers achieved advanced open water certification.

Public consultation as well as public awareness programmes were conducted throughout the project implementation period. The Manihiki Island Government (MIG) were the point of contact for farmers who were listed on the abandoned farms list for any enquiries or issues. Any objections were resolved by the MIG.

All stakeholders involved in this project established a good working relationship and worked in harmony. The MIG now have the equipment used for the project and the trained divers, so are capable of completing the removal of debris on all the abandoned farms in the Manihiki lagoon. Total estimated spend to date in 2017/18 is \$100,139.

9.2 EUROPEAN UNION PROGRAMMES

9.2.1 EU Budget Support

The European Union (EU) continues its Official Development Assistance via the budget support modality. The 10th cycle of funding (EDF10) has now concluded with focus moving

to the 11th cycle (EDF11) of funding to continue with its incentivized budget support to allocate funding using national systems up until the year 2020.

The EU have continued its budget support under the 11th EDF with a maintained focus on improving the Sanitation Sector. This was ratified through the signing of the Financing Agreement (EDF11) in September 2017. The Cook Islands government will be receiving a fixed tranche of EUR 1.35 million for budget support for the Sanitation Sector. A further \$50,000 has been earmarked for evaluation of the effectiveness of the program. These funds are estimated to be accessed in the 2019/20 Fiscal Year, and have been targeted for the Ministry of Health to support programmes in sanitation. Particularly related to resource mobilisation, sanitation upgrades, strengthening compliance and capacity building. It has been agreed that the primary focus of this program would be to assist in reviewing and making more robust plans to upgrade sewerage systems by commercial properties in compliance with the regulations (2014) established by the Ministry of Health.

The EU funded two Technical Assistance (TA) programmes under the 10th EDF. The first TA proposal relates to interdisciplinary studies to be carried out on the Muri Lagoon area, this programme is expected to be completed in the second quarter of the financial year. The second TA for feasibility studies for a Centralised Laboratory on Rarotonga was completed with the Central Lab Implementation Plan and Feasibility Studies report endorsed by the relevant agencies in the last quarter.

There have been no spends for the Cook Islands under the Pacific Island Integration Technical Assistance Project (PITAP) for the quarter under the 10th EDF which is accessed from the regional indicative package. There is no specific country allocation. It is organized so that funds are expended on regional initiatives as EU recognizes that National Indicative Packages are available to Member States for national specific priorities. With the completion of the 10th EDF round, focus has now moved to the 11th EDF.

Estimated Total spend to date is NZD\$20,000

9.2.2 EU Partnership Multiyear Fisheries Policy Support

The Sustainable Fisheries Partnership Agreement includes an annual fisheries sector contribution of EURO 350,000 by the European Commission under the 4 year protocol. The policy sector support is channelled through the Multi-Annual Sectoral Support Programme. The first tranche of the protocol was received by the CIG to begin implementation of programmes in the matrix by the Ministry of Marine Resources.

Total spend to date estimated by MMR is NZD\$188,026

9.2.3 EU-GIZ ACSE Northern Island Water Project Phase II

The 35.5 million Euro regional European Union (EU) programme Adapting to Climate Change and Sustainable Energy (ACSE) is funded out of the 10th European Development Fund (EDF 10).

The project aims to improve the resilience of Penrhyn, Nassau and Palmerston to natural disasters (including drought proofing) by increasing their capacity to collect, store and manage their precious water resources.

Total cost of project is \$400,000 Euro. Initial funds from GIZ were received in May 2016 however, there were delays in the recruitment of an In-country coordinator. This position was finally filled and confirmed in October 2016.

Currently two separate tenders are being carried out. One tender is for the supply and delivery of water catchment materials to the islands of Nassau, Penrhyn and Palmerston. The supply and construction works will be carried out through a partnership relationship between the Office of the Prime Minister, Infrastructure Cook Islands, Island Governments and the Island Communities of the Northern Cook Islands.

The second tender is for the design, fabrication, delivery and installation of tank lids for thirteen water tanks on the islands of Penrhyn, Palmerston and Nassau. The tender team are currently working through tender bids to finalise their recommendation to the Tender Committee. It is envisaged that once these tenders are confirmed, the bulk of project funding will be fully utilised.

Total estimated spend to date \$15,182

9.3 Secretariat of the Pacific Communities (SPC) Programmes

9.3.1 Cook Islands Household Income & Expenditure Survey

The Statistics Office has completed all required field operations for one year data collection that started in November 2015. This is the most resource intensive survey which requires visits to households throughout the Cook Islands over a two week period rather than one visit like the Census. Field data collection issues were experienced in Aitutaki and Manihiki. Rarotonga field work supervisors have had to step in and assist with data audit checks required of field work supervisors from these two islands.

Data entry and verification of data collected is also in process and continues to be in collaboration with the Statistics Programme at SPC and is likely to be completed by end of November 2017.

Thereafter preliminary analysis including poverty analysis will be done with survey results target release date in Quarter 3, 2018.

Total spend to date estimated is NZD\$360

9.4 UNITED NATIONS ADMINISTERED PROGRAMMES

FAO Improved production, processing and marketing of agricultural produce

The actual title for this FAO programme should be FAO Multi Country Programming Framework (CPF) 2013-2017 – not the above as published in the National Budget ODA Schedule FY2017/18. Project activities reporting is only for that through Ministry of Agriculture. This programme ends in December 2017.

For 2013-2017, this is the focus under the Pacific Multi Country Programming Framework (CPF) with the aim to improve agriculture produce supply chain and increase in households engaged in agriculture for own use and for sale. The 2013-2017 CPF is set to end in December 2017 with projects completion reports published annually by FAO. The Cook Islands benefits from this regional programme with through its national programmes for Technical Cooperation Programme (TCP) and Telefoods Projects.

Under the Technical Cooperation Programme (TCP), these are for projects with estimated minimum project funding of US\$30,000 requiring FAO and Government agreement. Since 2013, eight projects have been approved with four projects successfully completed. For 2017, there are four key projects as follows:

Ministry of Agriculture leads two projects year-long projects. The review and redraft of Ministry of Agriculture Act 1978 is currently underway with a total approved budget of US\$68,035. This fund is primarily for the provision of an international and a national consultant as well as FAO technical support. The second project is towards improving the capacity of domestic farmers and agro-processors to supply the domestic markets with safe and nutritious foods. This means enhancing the contribution of agriculture to the Cook Islands economy and livelihoods by directing efforts towards matching production to the Cook Islands largest market – tourism.

In progress also is technical assistance for the Port State Measure Agreement, a project with the Ministry of Marine Resources. A feasibility study of World Trade Organisation compliant pricing policy for controlling nutrition related health problems is also another project but with the Ministry of Health.

Under the TeleFood Projects, these are for small grants projects up to US\$10,000 for farmer groups in the area of vegetable farming, livestock, fishing ventures and such and are administered by Ministry of Agriculture. Up to four project bids have been successful with implementation completed. Three projects completed are: cultivation of Pitaya (dragon fruit for food security on Rarotonga and the Pa Enea (US\$9,811); Establishment of back yard gardens for food security programme (US\$8,295) and Nursery and shade house for

production of vegetable seedlings, fruit trees, flowering trees and plants, medicinal trees and plants for sustainable and self-sufficient food security (US\$9,281).

The fourth project is now complete and was towards empowering youth through crops and ornamental production (US\$10,000). The Telefoods Projects has now come to an end.

This first CPF is ending in December 2017 with negotiations in priority areas completed and ready for activation in 2018. The next CPF will run for five years (2018-2022).

FAO Regional Funding

Apart from the above national FAO Programme, the Cook Islands continues to also have access to regional FAO Technical Cooperation Programme primary the project for Strategies and capacity building in Pacific SIDS to address Climate Change Impacts on Jurisdictional Claims.

The Cook Islands has also accessed the FAO Trust Fund Projects through the Chamber of Commerce programme for Training of young farmers towards farming for business.

FAO has also provide capacity building and support to ensure Cook Islands political and operational level attendance at regional and international meetings and teleconferences in the area of agriculture and fisheries.

GEF Small Grants Programme

The Cook Islands Global E GEF Small Grants Programme (SGP) was established in 2005 and until 2015 was part of the SGP Samoa. As of late 2014, The Cook Islands Red Cross Society now serve as the SGP host institution with the GEF SGP Cook Islands now a separate programme. The Operational Phase 6 country programme strategy aims to “effectively support creation of global environmental benefits and the safeguarding of global environment through community and local solutions that complement and add value to national and global level action”. Focus of support for community based organised activities are on conservation of biodiversity, waste management, prevention of land degradation, capacity building and awareness programmes to address climate change through community based support. OP6 budget funds are estimated at US\$250,000. After a two year hiatus from sub regional issue beyond the control of the Cook Islands the following are OP5 community projects approved and/or in progress this period or have been successfully completed following endorsement by the GEF SGP National Steering Committee and approved by UNOPS.

| Cook Islands Expenditure OP5 | | | |
|---|--|---------------------------|--------------------|
| Grantee | Project Title | Grant Amount (USD) | Status |
| Te Ipukarea Society | Reduction of POPs and green house gas emissions through improvements in waste management in the Cook Islands | 49,920 | <i>In Progress</i> |
| Te Ipukarea Society | Bird conservation and monitoring & predator removal | 49,980 | <i>In Progress</i> |
| Kau Wo Wolo/ Pukapuka People's Fund | Lau: Pukapukan Indigenous Knowledge on Climate Change | 49,821 | <i>In Progress</i> |
| Lokal Creative Inc | Lokal Magazine: Te 'Akaora'anga | 20,260 | <i>In Progress</i> |
| Aitutaki Conservation Trust | Enviroloo Project in Aitutaki | 27,000 | <i>In Progress</i> |

Participation Programme (UNESCO)

Every year, UNESCO provides the Cook Islands financial assistance through the Ministry of Education. To date, the Cook Islands have received a total of NZD109,510 and the funds have been allocated according to the following Participation Programmes.

- Cook Islands to attend the Pacific Festival to Guam which has been fully expended with the National Commission, the Ministry of Education is awaiting a completion report from the Ministry of Cultural Development, budget allocation \$27,447.82.
- Providing funding through the Ministry of Education for “woman as instigators of imene tuki” as a project to record the Imene Tuki. This has commenced with work starting on the recording and mastering of the CD, budget allocation \$27,166.67.
- Activity for the project on the Maungaroa National Heritage Site is well underway. The publication has been changed from print to DVD. There are still some further supplies to be purchased for securing work at the site however the delivery of this project is on schedule, budget allocation \$27,447.82.
- The project on Sexual Health for Youth is underway with CIFWA planning a series of workshops for teachers and then out to the community, budget allocation \$27,447.82.

All activities have until December 2017 to complete expected outcomes.

Green Climate Fund Readiness

The Cook Islands have been successful in accessing readiness support from the Green Climate Fund for the strengthening of the National Designated Authority under readiness 1 programme, however the funding for this support has come to an end in August 2017.

The GCF required DCD and OPM to submit a full completion report in order to access the final 10% disbursement of funding. This report was completed by DCD and submitted to the GCF in September.

The second readiness programme which focuses on the below:

- to continue to strengthen the National Designated Authority,
- to develop a Country Programme, and
- to support MFEM in gaining direct access to the fund.

Readiness two commenced in October 2017 with the launching of a consultation stakeholder meeting including the Pa Euna island representatives. This workshop is named the “Green Climate Fund Fostering Resilience” and took place on Friday 27th October. The workshop is a follow on from the first workshop called the Brilliant Resilient which was held in May 2016. And one of the main outputs of the workshop was too review the project proposal ideas that were developed during the May 2016 workshop in the context of the GCF with the hopes of;

- Identifying if they are still relevant;
- Determining if they should be included in the GCF Cook Islands Country Programme;
- Refine the project proposal ideas.

In addition, this workshop hoped to improve our stakeholders understanding of:

- What the GCF is;
- What has currently taken place to date under the GCF at the national level with regards to accreditation and readiness support;
- Provide clarity on the process to access GCF funds;
- Provide clarity on the development of a GCF Country Programme.

Total estimated spend to date is \$170,00.

UNDP Ridge to Reef

The quarterly Biodiversity Steering Committee meeting was held in October whereby an update of all stakeholders involved with the Ridge to Reef programme provided their updates to members of the Committee.

A third quarterly progress report was also provided to members of the Committee which highlighted key activities involving the Ridge to Reef project. Such activities included GEF Expanded Constituency Workshop (ECW) for Pacific which was held in July 2017 in Tonga. The workshop gave the team practical ideas around the GEF programme with highlights for GEF 7. Following that was a GEF Ridge to Reef Programme, Regional Programme Steering Committee Meeting which was also held in Tonga from end July to first week of August.

The Regional R2R Postgraduate Programme run by James Cook University in Townsville, Australia was held immediately after the Steering Committee Meeting. There are 8 successful applicants that are currently undertaking this programme. Mainly to ensure harmonisation amongst agencies as well as provide the opportunity to build capacity in Ridge to Reef approaches.

Another key activity during this quarter was the UNDP Project Implementation Review. This is annual report to ensure tracking of project implementation. Overall performance was deemed moderately unsatisfactory noting key areas for improvement. UNDP have also secured the services of the National Audit Office to conduct an Internal Control Audit of National Environment Services. This commenced on 11th September and is still ongoing. The purpose of this Audit is to look at internal NES controls and report back to UNDP based on the agreed TOR for the management and delivery of the Ridge to Reef project. This also includes NBSAP and ABS project.

The Ministry of Agriculture (MoA) underwent a Tender process in this quarter to purchase equipment for each of the Pa Enea. The completion and procurement of this will be reprogrammed for Quarter 4. Training workshops of sustainable agriculture practices has been carried out on Mauke and Atiu. In addition, MoA sent soil samples to New Zealand in Quarter 2 for testing the nutrient content of the different soil types from Avana to Paringaru as this area used to be a citrus heavy area in the early 60's and 70's. The analysis sheds some light on the soil makeup of the area that may also support findings that may be affecting Muri Lagoon. Muri being a focus area for the Ridge to Reef project with all partners.

One major highlight of this quarter is the Marae Moana Act 2017 was passed in Parliament on the 12th of July 2017.

Cook Islands Tourism have completed 5 x videos for R2R Tourism Mana Tiaki programme and is available on social media as well as through the Cook Islands Television. CIT are also supporting the Koka Lagoon Tours coral planting programme as well as an education and awareness programme during their lagoon cruise within the Tikioki raui areas.

The House of Ariki Ra'ui Coordinator position has been re-advertised as the previous coordinator resigned. An appointment is yet to be confirmed.

The Ministry of Marine Resources has appointed 2 x Marine Scientists as well as appropriate equipment to carry out project activities for Component 1 – Strengthening protected areas management. MMR are also going through the selection process to recruit a Consultant to carry out stakeholder analysis. This is to help develop and implement an Aitutaki Lagoon Master Plan using Ridge to Reef approaches. In addition, a joint meeting with MMR facilitated by Acting DCD Manager between NES R2R staff was held to resolve financial reporting issues. The positive outcome of the meeting will ensure MMR and NES collaborate when reporting on funds including budget codes are adhered to within the UNDP reporting timeframes.

Spend for this period is \$356,538 and a direct payment made by UNDP on behalf of NES R2R \$35,880.

Total estimated spend to date is \$392,418.

UNDP Adaptation Fund Strengthening the Resilience of our Islands and Communities to Climate Change (SRIC)

The SRIC programme has been progressing extremely well. For the quarter, a total of 61 projects have been reported and 5 projects completed.

Projects 61

Small Grants –19

Agriculture & Marine – 5

Water – 5

Coastal Protection – 19

Tourism – 13

The SRIC team have participated/supported a total of 9 workshops/event this quarter – Te Ipukarea Society Weather Stations in Schools (Manihiki), Ministry of Agriculture Workshop in Mauke, Mitiaro, Atiu and Mangaia, BTIB BCI Trade Day in Rarotonga, Ministry of Agriculture Coconut Tree Banding Workshop in Mauke, Raurau Akamatutu Workshop in Aitutaki and EMCI DRM Workshop in Mangaia.

The communications component of SRIC has been extremely active through Media and Print, specifically via the Cook Islands Radio, Cook Islands TV and the Cook Islands News Paper. SRIC's reach on social media has been huge this quarter compared to previous quarters. The summary to date of Social Media activity on Facebook is a reach of 139,001. The total likes are now currently 2,829 which is a great achievement.

International Print this quarter highlighted two SRIC-CC Projects that have been featured in the 10th Anniversary Adaptation Fund online on the Young Farmers in Mangaia and the Life Jackets in Palmerston.

Total estimated spend to date is NZD\$474,000

UNDP Nagoya Protocol

Cook Islands Audit Office is currently auditing the NES projects including Nagoya Protocol, Ridge to Reef and National Biodiversity Planning to Support the implementation of the CBD 2011-2020 Strategic Plan in the Cook Islands. The Mandatory Project Implementation Review (PIR) has also been completed for the Nagoya Protocol project.

An unsatisfactory rating was noted in the PIR and progress to June 2017 is sufficiently off track by project closure date of 05th July 2018. In order to achieve significant project milestones, the project will need to be extended by 12 months to compensate for the excessive time taken to procure a Project Coordinator. In addition, the delays in development of the legislation and regulatory framework under Component 1 has affected the implementation of much of the project as many activities particularly Component 2 rely on this policy and legislation being finished in order to proceed. Technical assistance has been sought from UNDP's Global ABS project to support the national consultant/s on ABS policy due to be procured in Quarter 4.

Progress has been made under Component 3 such as agreeing in principle on a benefit sharing mechanism between the Koutu Nui, CIMTECH/Matheson Enterprises and partners and agreeing on the Raui Network Trust Fund in concept, which will be established once the policy and legislation is in place.

A policy analyst consultant position has been created to develop the ABS policy as well as a Legislative consultant to draft the ABS legal instrument. It is envisaged that these positions will be filled in Quarter 4.

Another key activity for this quarter is the procurement of a Mass spectrometer. Matheson Enterprises has engaged the services of Cawthron Research Institute – a recognised international expert in the area of scientific and technical capabilities, and Infrastructure to provide support in the procurement of the Mass Spectrometer. The Institute is currently sourcing the quotes from multinational companies, determining model types and assisting in quality assurance assessments and will also provide the initial and ongoing training and support required to the procurement of the equipment which is being reprogrammed for completion in the next quarter.

Spend for this period is \$19,818.89 as well as a direct payment from UNDP to Mathesons Enterprise of \$285,633.

Total estimated spend to date is NZD\$305,452

UNDP National Biodiversity Planning to Support the implementation of the CBD 2011-2020 Strategic Plan in the Cook Islands

The 5th Draft National Report to the convention on biological diversity is now prepared for Cabinet Submission and will be going through the endorsement process. This was based on the feedback from the NBSAP workshop last quarter as well as one on one meetings held. However, additional information is needed from key stakeholders as the PM is unable to commit sufficient time to fill in the gaps within the document, particularly in the marine and agriculture areas.

The current consultancy that NBSAP have with Maureen Hilyard on the Cleaning House Mechanism is still in progress. A framework for the Biodiversity CHM is available but still needs input from key Biodiversity stakeholders to share and update information/links as well as media releases. It is expected that this work would be complete by Quarter 4.

NBSAP is reaching the project closing phase with only 10% of funds remaining which will be returned to UNDP to continue expenditure on behalf of NES via direct payments with UNDP. Funds have already been committed to ongoing activities such as the completion and printing of the final NBSAP document.

Total estimated spend to date is \$58,560.

UNDP Pacific Regional Ridge to Reef – Infrastructure Cook Islands (ICI)

Infrastructure Cook Islands (ICI) have appointed Keu Mataroa as the Project Manager for the Pacific Regional Ridge to Reef project. This project is a test site of Muri Lagoon/Area under the Regional programme. A GEF Ridge to Reef Programme, Regional Programme Steering Committee meeting was held in Tonga from 31st July to 04th August 2017. This project is testing the integration of water, land and forest and coastal management to preserve ecosystem services, store carbon, improve climate resilience and sustain livelihoods in Pacific Island Countries. The meeting was held to ensure harmonisation of the R2R Star with that of the R2R IW programme represented by Programme Manager Keu Mataroa and ICI Secretary Ngametua Pokino.

Total estimated spend to date is \$22,145.

UNDP Preparation of the Third National Communication under UN Framework Convention on Climate Change (UNFCCC)

Climate Change Cook Islands welcomed consultants Srikanth Subbaro and Bob Lloyd to Rarotonga in September for their first visit. They are working on the GHG and MIT component in the Third National Communication Report. Their visit consisted of a presentation at the platform meeting on Tuesday 12th September at the New Hope Church and discussions throughout the week with relevant stakeholders. The project coordinator is currently organising their second and last visit where they will run a technical training workshop and provide a draft for the GHG and MIT component.

The Third National Communication program printed 10 copies of the Rarotonga Fore Reef Community Survey 2016 report in September.

In October the project coordinator travelled to Aitutaki and assisted with the Raurau Akamatutu workshop (Climate Change, food security and awareness)

The Third National Communication program with Climate Change Cook Islands has advertised for a consultant to undertake work on the report with the Project coordinator in October.

The Project Coordinator has also taken up the financial assistant and administration role after discussion with Cook Islands Climate Change officer Celine Dyer and UNEP contact Suzanne Lekoyiet.

Third NATCOM financial report show year to date spend from June – September is \$43,000. No update has been provided since then.

World Health Organisation Technical Cooperation Biennium Budget Support

The Cook Islands country budget allocation support agreed priority programmes (Categories 1 to 5 excluding Polio and Outbreak and crises response) for the 2016-2017 biennium is US\$388,800. Human resources development including fellowships aligned to the Clinical Workforce Development Plan utilise 50% of the total budget. With the remaining 50% focusing towards Communicable Diseases, Non-communicable Diseases (implementation of National Health Strategy and the National Strategy and action plan for NCDs) Promoting Health through Life and Preparedness Surveillance and Response.

A review of the National Health Strategy is in the pipeline with emphasis on avoiding duplication of effort especially in the water and sanitation areas with WHO identified to provide technical assistance. Review and the development of new National Health Strategy has been completed

Ministry of Health September 2017 month financial report show year to date spend at \$148,397.

9.5 INDIA GRANT FUND

A total of USD\$690,846 (equivalent to NZD\$966,000) was granted for the 16 approved grassroots projects of India Grant Fund 2016/2017 Round. The main focal area of the grant funding from the Government of India is to support, promote, and/or develop social, economic and/or cultural and development cultural, economic and social development and sustainability. An additional prerequisite was the alignment to Te Kaveinga Nui Framework National Sustainable Development Plan 2016-2020.

Out of the 16 approved projects, 4 projects have been completed to date. The remaining 12 projects are still being implemented and progress reports are provided according to Grant Funding Arrangement requirements. It is envisaged that these projects will be completed before the next round of funding begins next year in 2018.

Total estimated spend to date is NZD\$156,821

9.6 KOREA GRANT FUND

The Republic of Korea Government has allocated Official Development Assistance (ODA) through the Korean Small Grants Programme to the Cook Islands for amounts up to USD \$200,000 annually.

Under the current funding round for 2017/18, a proposal at the value of USD \$200,000 for a medical waste incinerator for the Rarotonga Hospital was submitted in February 2017 for consideration by the Korean Government.

To date, no spend has been reported.

9.7 CHINA PROGRAMMES

Renovations Projects for the Indoor Sports Arena, Ministry of Justice, and Police Headquarters buildings

Following the signing of the Letters of Exchange for the three renovations projects in May 2017, between the Cook Islands Government (CIG) and the People's Republic of China Government, further developments resulted.

In September, CIIC hosted two working groups from China who were on island to conduct technical and structural inspections on the three buildings that will undergo renovations. The teams consisted of engineers specializing in electrical, structural, water supply and drainage, heating and ventilation as well as construction costing. The preliminary results from these inspections were discussed and signed off between CIIC and the Chinese working group.

The Implementation Agreement for this project was finalised and signed on the 16th October 2017. The renovations project is expected to commence in the last quarter of the 2017/18FY. Total spend to date is estimated at NZD\$7,586,666.

Apii Nikao Construction

The construction of the Apii Nikao School is progressing well with the project expected to be completed by the third quarter of the 2017/18FY.

Total estimated spend to date NZD\$12,950,000

9.8 FORUM FISHERIES AGENCY (FFA)

Project Development Fund – US Fisheries Treaty

The US Multilateral Treaty for fisheries includes an annual allocation of US\$150,000 per Pacific Island party development fisheries projects. Funds are held in trust by the treaty with FFA with direct administration by Ministry of Marine Resources (MMR).

The Ministry of Marine Resources has received funding that includes Fishing Aggregate Device (FAD) support, operational equipment support for MMR staff in the Northern Group islands, Young Professional Scheme, Artisanal fishery e-monitoring and professional development supported targeted for fisheries officers at the regional and international levels.

This also included operational support in hosting the Thirteenth Regular Session of the Scientific Committee of the Commission for the Conservation and Management of Highly Migratory Fish Stocks in the Western and Central Pacific Ocean held in Rarotonga during the month of August.

Total estimated spend to date NZ\$148,397

9.9 MULTILATERAL PROGRAMMES

Pacific Information and Communication Technology Investment Planning and Capacity Development Facility (Phase 2)

Previously called “E-Government” this TA has now evolved into a recently approved USD1 million regional project with sub-projects in the Cook Islands. The three outcomes of the overall TA are (i) advancing ICT Policy and regulatory frameworks, (ii) developing ICT applications and (iii) adopting technology innovations and protections against cybercrime.

The Cook Islands TA will support (i) government to assess the current situation of ICT with recommendations towards necessary developments (infrastructure, hardware and software, organizational structure, human resources and policies and legislation) for the implementation of full-scale e-government processes; and (ii) a pilot implementation of the recommended services in the sector.

Online Registry

ADB provides TA support towards the Ministry of Justice pursuit of a legislative package to support private sector development in the Cook Islands. The new Companies Act will streamline company formation and make ongoing compliance easier for businesses to operate in the Cook Islands. The new Personal Property Securities Act will make it easier for local entrepreneurs to obtain credit using movable property (not land) as collateral so as to expand their business opportunities. The amendments to the Finance Incorporated Societies Act will modernize the process to incorporate and bring more transparency to the operations of these entities for their members.

The proposed legislation package is part of an ongoing effort by the Ministry of Justice to make it easier to do business in the Cook Islands. A key to this effort is to establish an electronic, fully online registry that will allow citizens to incorporate and maintain their businesses over the internet, eliminating the need to personally visit the Ministry of Justice to submit their paperwork. The legislation also contemplates that standardized forms will be set out in regulations, which will allow citizens to easily complete their filings by simply filling in the blanks on the appropriate form. The information collected in these forms will exactly match what the online registry will require, so citizens can choose to either complete the paper forms or to directly enter the information via the online service.

Taken together, all of these changes will lead to far greater efficiencies and less expense for all business in the Cook Islands. However, there are steps that must be taken first so as to properly implement this online registry and the new forms, and the first step is to pass the legislation that supports this reform and these bills are currently under parliamentary review. ODA funds of \$161,000 and capital funds of \$260,000 are budgeted to support project implementation once the bills are passed.

Renewable Energy

It is Government's ambition to increase power generation from renewable sources and enhance the government's institutional capacity for implementing the Cook Islands Renewable Energy Chart Implementation Plan (CIRECIP), 2012–2020, which sets a target of supplying electricity from renewable energy sources on all inhabited islands by 2020.

The goal of the Renewable Energy Programme Support is to establish a solid foundation for renewable energy sector development and operations in the Cook Islands.

The Southern Group Renewable Energy Programme is in progress with the Cook Islands Renewable Energy Sector Project (COO46453-002). Phase 1 (Atiu, Mauke, Mitiaro and Mangaia) construction is underway with significant progress being made.

The tender for the Rarotonga Battery Energy Storage (BESS) funded by GEF6 grant funding was awarded to MPower Limited on 1 June 2017 for a fixed price of USD3,092,768. The design phase is well underway this quarter.

The Phase 2 Aitutaki tender documents closed at the end of the quarter with 7 bids being received. CIG approved NZ2.8million for the Aitutaki RE project appropriated in the

2017/18 capital budget and this together with savings from the current Phase 1 contracts is expected to see sufficient funds available for this project.

An additional US\$12mil Grant was agreed by the Green Climate Fund Board in December 2016 to implement 3 battery storage sites in Rarotonga. Procurement documents are being prepared by Entura for this tender and will be advertised in quarter two.

The second semi-annual Safeguard Monitoring Report was submitted this quarter for the period 1 January – 30 June 2017 documenting social and environmental safeguard monitoring activities. Environmental monitoring during this period included onsite monitoring of Mitiaro and Aitu by the Project Owner Engineer, Environmental Specialist and Safeguards Monitoring Specialist.

The Government has formalised during this quarter the acquisition of the nine substations/transformer land sites, including compensation payments of NZD1,000 per site as agreed by the landowners to be paid by the Office of the Prime Minister from the current budget allocation.

Total estimated spend to date is NZD\$1,039,546

9.9.1 Sanitation Upgrade Programme (Mei te Vai Ki te Vai)

Master plan and road Map

Since the approval of the terms of reference and scope of the Masterplan, the PMU has been implementing the data collation and review, and is in the process of preparing the masterplan report and drafting activities.

The preparation of the masterplan is progressing in accordance with the program.

Environmental investigations and monitoring

Bore Drilling

Bore drilling is currently underway to investigate the quality of groundwater entering the lagoon. Preparations for the investigations on quality and flow patterns of the lagoon and stream waters are currently underway. The results of these investigations will be available early in 2018.

Muri Wastewater concept design.

The concept design report has been completed and has been peer reviewed. The next steps required to proceed to a detailed design have been identified for CCC approval.

Crown Corporate Entity (CCE) Establishment

The discussion paper for the Establishment of the Crown Corporate Entity (CCE) was presented to the CCC meeting on the 5th November. The establishment of the new Crown Corporate Entity (CCE) is now being driven by CIIC. CIIC are in the process of recruiting the position for CEO and will set up the board. The new CEO, once employed, will take the lead in the establishment of the CCE including resourcing and preparation of policies.

Total estimated spend to date in 2017/18 is \$1,192,369.

9.9.2 Te Mato Vai (TMV)

Stage 1

CCECC completed the Stage 1 Ringmain Construction Works in December 2016. November 2017 is month eleven of the twelve-month CCECC maintenance period. There are outstanding works required to be carried out by CCECC before the maintenance period expires, minor works such as road sealing and replacement of cracked hydrant chamber covers are required to be done.

On 18 April 2017 two pipe pressure tests were conducted at selected test sites. One failed and one passed. The PMU wishes to pipe pressure test 18 more sites. If found to be defective CCECC will rectify at cost.

The CIG will engage a third party to undertake the pressure tests, Landholdings showed interest and is the only local company capable of doing these tests, with a minimum of 10 tests to be carried out.

The limited timeframe for this service to take place requires the Cook Islands Government to seek this input from Opus International Consultants Ltd who both the Cook Islands Government (CIG) and China Civil Engineering Construction Corporation (CCECC) agree will provide independent expert advice, based on prior input/advice provided.

Opus International Consultants (Eric Thorn) have recommended an additional test to be carried out, a material test of the defected hydrant tee; this test will provide evidence why the hydrant tee failed in Avana.

Commissioning Contract

The wider stage 1 commissioning contract was advertised on 19 July and tenders closed on 31 August 2017. The Contract for the 'Commissioning of the Ring Main for the Te Mato Vai Project Stage 1' has been awarded to Landholdings Ltd. Physical works are due to commence in January 2018

Land Negotiation support

A forward work plan for the geotechnical and survey works is being developed and the PMU have been liaising with Tim Arnold regarding this process. The advising of affected landowners regarding the survey and site works will begin in the next reporting period.

Stage 2 works contract

A letter of award was sent to McConnell Dowell on 03 August 2017, with a contract signed early September. Survey and ground investigations have commenced.

The ground investigation works have been completed for all 10 intakes. Initial topographical surveys were undertaken at all 10 intake sites. Sporadic surveying will continue as required throughout the design phase as design is progressed and locations of assets and pipe-work proposed. Improvements to stream crossings are proposed at 26 stream crossings. It is anticipated that these works will be carried out in November/December, to provide safe and robust access to the intake sites for construction and beyond. Landowners will be notified of the proposed works, letters will be delivered personally to them and if they have queries, they can discuss them with the project team.

Total estimated spend to date in 2017/18 is \$ 4,328,186

Aid Effectiveness

The Aid Effectiveness budget is drawn from the interest earned on development partner trust accounts and is used by the MFEM to support the implementation of the official development assistance policy. The programme currently contributes to several projects including the following: annual meeting of development partners, development of Te Tarai Vaka, surge capacity to catch up and standardise Crown financial statements, training and set-up of project financial management software. The Aid Effectiveness funds was also utilised to commission a national consultant to prepare completion reports for programmes and the Islands submission of the Cook Islands assessment in accordance to the Global Partnership for Effective Development Co-operation Monitoring Framework. The framework assesses our country systems and measuring aid effectiveness principals as outlined in the ODA Policy 2015 of the Cook Islands in accordance to international standards.

Funding, in the interim, will also be allocated to support the new Finance Manager post within the Development Coordination Division, increasingly required within office to uphold fiduciary standards of ODA funds.

Total estimated spend to date is \$18,845.

9.10 NEW/EXISTING PROGRAMMES APPROVED FOR IMPLEMENTATION (Not included in ODA 2017/18 Publication)

Australia Pacer Plus

Late confirmation from the regional implementing agency meant that the inclusion of Pacer Plus funds of AU\$25k from Australia Government was not included in the financial year 2017/18. This grant is for communications and consultations in the Cook Islands on Pacer Plus 2017/18. Based on the outcomes of consultations, the next steps will be to submit Cook Islands proposal to the regional funds available for Pacer Plus which has a total contestable funding budget of AU\$7million.

Pacer Plus is a comprehensive Free Trade Agreement (FTA) between 14 members of the Pacific Islands Forum: Australia, Cook Islands, Federated States of Micronesia, Kiribati, Republic of Marshall Islands, Nauru, New Zealand, Niue, Palau, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu.

A FTA means the parties reduce duties and other regulations of commerce that restrict trade. According to WTO practice, the FTA parties are expected to enter into reciprocal commitments to liberalise 'substantially all trade'. FTA parties however maintain their individual trade policies vis-à-vis third parties with no requirement to have a common external tariff. In Pacer Plus context, this gives policy space to most Forum Islands Countries, as their tariffs are generally higher than those of Australia and New Zealand. This will not affect the right of the parties to levy internal taxes or changes on goods, provided the non-discrimination principle is observed. Meaning that parties may impose taxes on goods, provided the taxes on imported products are not different from the taxes imposed on like or similar domestic products.

New Zealand Funded Scholarships

These cover Tertiary Scholarships NZ, Tertiary Scholarships Pacific Regional, TPD: Training and Professional Development and Commonwealth Scholars these are recorded as 3rd party grants as they are managed directly by New Zealand.

Total estimated spend to date is \$60,019.

10 Statements of Fiscal Responsibility

10.1 Statement of Fiscal Responsibility (Operating)

| | 2016/17 Actual | 2017/18 Budget Estimate | 2017/18 HYEFU Estimate | 2018/19 Projection | 2019/20 Projection | 2020/21 Projection |
|--|-----------------------|-------------------------------|------------------------------|-----------------------|-----------------------|-----------------------|
| Operating Revenue | | | | | | |
| Taxation Revenue | 124,898 | 118,409 | 123,633 | 125,417 | 128,953 | 131,549 |
| Other Crown Revenue | 22,108 | 17,326 | 17,643 | 14,188 | 12,188 | 12,068 |
| Trading Revenue | 7,820 | 6,169 | 6,169 | 6,169 | 6,169 | 6,169 |
| Interest on Loans to Subsidiaries | 1,286 | 733 | 733 | 715 | 694 | 694 |
| Dividends | 382 | 1,787 | 1,672 | 1,759 | 1,885 | 1,967 |
| Interest on Balances | 2,140 | 1,740 | 1,740 | 1,740 | 1,740 | 1,740 |
| Core Sector Support | 7,730 | 7,766 | 7,766 | 0 | 0 | 0 |
| Total Operating Revenue (excluding Bonus) | 166,363 | 153,930 | 159,356 | 149,988 | 151,628 | 154,187 |
| <i>Performance Based Budget Support - Bonus</i> | | | | | | |
| <i>Payment</i> | <i>1,877</i> | <i>604</i> | <i>604</i> | <i>0</i> | <i>0</i> | <i>0</i> |
| <i>Total Operating Revenue (including Bonus)</i> | <i>168,240</i> | <i>154,534</i> | <i>159,960</i> | <i>149,988</i> | <i>151,628</i> | <i>154,187</i> |
| Operating Expenditure | | | | | | |
| Ministry Outputs | 99,955 | 113,847 | 116,138 | 105,583 | 104,611 | 102,171 |
| <i>Personnel</i> | <i>47,522</i> | <i>52,534</i> | <i>52,634</i> | <i>51,556</i> | <i>51,772</i> | <i>51,773</i> |
| <i>Operating</i> | <i>20,321</i> | <i>19,464</i> | <i>20,396</i> | <i>16,464</i> | <i>16,477</i> | <i>16,477</i> |
| <i>Administered Payments</i> | <i>27,698</i> | <i>37,565</i> | <i>38,824</i> | <i>33,281</i> | <i>32,079</i> | <i>29,639</i> |
| <i>Depreciation</i> | <i>4,413</i> | <i>4,284</i> | <i>4,284</i> | <i>4,282</i> | <i>4,282</i> | <i>4,282</i> |
| POBOC | 23,087 | 25,120 | 25,362 | 23,931 | 24,094 | 24,094 |
| Airport Authority subsidy | 0 | 0 | 0 | 0 | 0 | 0 |
| Airport Authority Capital | 0 | 0 | 0 | 0 | 0 | 0 |
| Bank of the Cook Islands - social assistance subsidy | 0 | 0 | 0 | 0 | 0 | 0 |
| Concession Loan Fund - Top Ups | 0 | 0 | 0 | 0 | 0 | 0 |
| Cook Islands Primary Schools 50 year Saver | 0 | 0 | 0 | 0 | 0 | 0 |
| Public Sector Strengthening | 0 | 0 | 0 | 0 | 0 | 0 |
| Ports Authority - subsidy | 0 | 0 | 0 | 0 | 0 | 0 |
| Te Aponga Uira - social assistance subsidy | 0 | 0 | 0 | 0 | 0 | 0 |
| Debt Interest Contribution to LRF | 1,710 | 2,063 | 2,063 | 2,060 | 2,032 | 2,032 |
| Asset Management (CIIC) | 0 | 0 | 0 | 0 | 0 | 0 |
| Crown Infrastructure Depreciation | 3,682 | 4,603 | 4,603 | 4,603 | 4,603 | 4,603 |
| Transfer to Emergency Response Trust Fund | 604 | 50 | 50 | 50 | 50 | 50 |
| Depreciation Contingency Fund | 2,362 | 3,957 | 3,957 | 4,066 | 4,066 | 4,066 |
| <i>Chinese Equipment</i> | <i>663</i> | <i>663</i> | <i>663</i> | <i>663</i> | <i>663</i> | <i>663</i> |
| <i>Rarotonga Water Network</i> | <i>299</i> | <i>694</i> | <i>694</i> | <i>803</i> | <i>803</i> | <i>803</i> |
| <i>Northern Pa Enea Renewable Energy System</i> | <i>400</i> | <i>400</i> | <i>400</i> | <i>400</i> | <i>400</i> | <i>400</i> |
| <i>Southern Pa Enea Renewable Energy System</i> <i>(excl. Aitutaki)</i> | <i>0</i> | <i>1,200</i> | <i>1,200</i> | <i>1,200</i> | <i>1,200</i> | <i>1,200</i> |
| <i>Other Assets</i> | <i>1,000</i> | <i>1,000</i> | <i>1,000</i> | <i>1,000</i> | <i>1,000</i> | <i>1,000</i> |
| Contingency Funds - Operating | 582 | 100 | 200 | 100 | 100 | 100 |
| Contributions to CISWF | 0 | 0 | 0 | 0 | 0 | 0 |
| Total Operating Expenses | 131,981 | 149,740 | 152,373 | 140,392 | 139,556 | 137,116 |
| Operating Surplus/(Shortfall) (excluding Bonus) | 34,382 | 4,190 | 6,983 | 9,596 | 12,072 | 17,070 |
| <i>Operating Surplus/(Shortfall) (including Bonus)</i> | <i>36,258</i> | <i>4,794</i> | <i>7,587</i> | <i>9,596</i> | <i>12,072</i> | <i>17,070</i> |

10.2 Statement of Fiscal Responsibility (Non-Operating)

| | 2016/17 Actual | 2017/18 Budget Estimate | 2017/18 HYEFU Estimate | 2018/19 Projection | 2019/20 Projection | 2020/21 Projection |
|---|-------------------|-------------------------------|------------------------------|-----------------------|-----------------------|-----------------------|
| Reductions in Net Borrowings | | | | | | |
| Loan Disbursements | 533 | 10,870 | 22,246 | 10,563 | 0 | 0 |
| Contribution to Loan Reserve Fund | 8,603 | 10,682 | 10,682 | 10,784 | 10,389 | 10,389 |
| | 8,070 | (188) | (11,564) | 220 | 10,389 | 10,389 |
| Capital Expenditures | | | | | | |
| Ministries and Outer Islands (Including CIIC Capital) | 13,639 | 44,904 | 60,266 | 40,747 | 24,587 | 16,065 |
| <i>Infrastructure Capital Investment in SOEs</i> | 0 | 0 | 0 | 0 | 0 | 0 |
| Airport Authority | 0 | 0 | 0 | 0 | 0 | 0 |
| Te Aponga Uira | 0 | 0 | 0 | 0 | 0 | 0 |
| Contingency Funds - Capital Expenditure | 50 | 0 | 0 | 0 | 0 | 0 |
| | 13,689 | 44,904 | 60,266 | 40,747 | 24,587 | 16,065 |
| Foreign Aid | | | | | | |
| Receipts | (25,404) | (69,392) | (69,392) | (31,996) | (15,263) | (422) |
| Expenditure | 25,404 | 69,392 | 69,392 | 31,996 | 15,263 | 422 |
| | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Committed Considerations | | | | | | |
| Transfer to Reserve Trust Fund | 624 | 592 | 618 | 627 | 645 | 658 |
| ADB Share Capital | 0 | 0 | 0 | 0 | 0 | 0 |
| Disaster Response Fund | 604 | 50 | 50 | 50 | 50 | 50 |
| | 1,228 | 642 | 668 | 677 | 695 | 708 |
| Total Non-Operating balance | (22,987) | (45,359) | (49,370) | (41,644) | (35,671) | (27,162) |
| To be Funded by | | | | | | |
| Operating Surplus | 34,382 | 4,190 | 6,983 | 9,596 | 12,072 | 17,070 |
| Depreciation | 10,458 | 12,845 | 12,845 | 12,950 | 12,950 | 12,950 |
| <i>of which: R.E. Capital Replacement</i> | <i>400</i> | <i>1,600</i> | <i>1,600</i> | <i>1,600</i> | <i>1,600</i> | <i>1,600</i> |
| Unencumbered Cash Reserves | (2,243) | 17,592 | 18,810 | 8,264 | 210 | (13,298) |
| Contribution to Loan Reserve Fund | 8,603 | 10,682 | 10,682 | 10,784 | 10,389 | 10,389 |
| Economic Recovery Support Program | 206 | 0 | 0 | 0 | 0 | 0 |
| Transfer to Emergency Response Trust Fund | 604 | 50 | 50 | 50 | 50 | 50 |
| Total Funding Items | 52,409 | 45,359 | 49,370 | 41,644 | 35,671 | 27,162 |
| Net Surplus/Shortfall | 29,421 | 0 | 0 | 0 | 0 | 0 |

11 FINANCIAL STATEMENTS

11.1 Financial Statements for year-end June 2018

The forecasted financial estimates of the Crown are set out in the following order.

11.1.1 Statement of Financial Performance

| | Actual 2016-17 | Budget 2017-18 | HYEFU 2017-18 | Projected 2018-19 | Projected 2019-20 | Projected 2020-21 |
|--|-------------------|-------------------|------------------|----------------------|----------------------|----------------------|
| | ('000) | ('000) | ('000) | ('000) | ('000) | ('000) |
| Revenue | | | | | | |
| Taxation revenues | 124,898 | 118,409 | 123,633 | 125,417 | 128,953 | 131,549 |
| Other revenue | | | | | | |
| Revenue on behalf of the Crown | 31,715 | 25,696 | 26,013 | 14,188 | 12,188 | 12,068 |
| Sale of goods and services | 7,820 | 6,169 | 6,169 | 6,169 | 6,169 | 6,169 |
| Interest | 3,426 | 2,473 | 2,473 | 2,455 | 2,434 | 2,434 |
| Dividends | 382 | 1,787 | 1,672 | 1,759 | 1,885 | 1,967 |
| Total Revenue | 168,240 | 154,534 | 159,960 | 149,988 | 151,628 | 154,187 |
| Expenditure | | | | | | |
| Appropriations to agencies | 99,955 | 113,847 | 116,138 | 105,583 | 104,611 | 102,171 |
| Payments on behalf of Crown | 23,087 | 25,120 | 25,362 | 23,931 | 24,094 | 24,094 |
| Debt-servicing interest | 1,710 | 2,063 | 2,063 | 2,060 | 2,032 | 2,032 |
| Infrastructure depreciation | 3,682 | 4,603 | 4,603 | 4,603 | 4,603 | 4,603 |
| Depreciation contingency fund-renewable energy | 400 | 1,600 | 1,600 | 1,600 | 1,600 | 1,600 |
| Other expenditure | 3,148 | 3,111 | 3,211 | 2,616 | 2,616 | 2,616 |
| Total Expenditure | 131,981 | 150,344 | 152,977 | 140,391 | 139,556 | 137,115 |
| NET OPERATING SURPLUS / (DEFICIT) | 36,258 | 4,190 | 6,983 | 9,597 | 12,072 | 17,071 |

11.1.2 Statement of Financial Position

| | Actual 2016-17 | Budget 2017-18 | HYEFU 2017-18 | Projected 2018-19 | Projected 2019-20 | Projected 2020-21 |
|--------------------------------|-------------------|-------------------|------------------|----------------------|----------------------|----------------------|
| | ('000) | ('000) | ('000) | ('000) | ('000) | ('000) |
| Assets | | | | | | |
| Cash and equivalents | 60,093 | 23,838 | 33,873 | 15,628 | 5,733 | 7,574 |
| Loan reserves | 18,904 | 19,929 | 21,200 | 20,876 | 20,535 | 18,643 |
| Renewable Energy reserves | | 1,600 | 1,600 | 3,200 | 4,800 | 6,400 |
| Trust accounts | 7,718 | 8,569 | 8,386 | 9,063 | 9,758 | 10,466 |
| Inventory | 4,395 | 4,395 | 4,395 | 5,495 | 6,595 | 7,695 |
| Tax receivables | 22,500 | 14,060 | 14,060 | 14,360 | 14,960 | 15,860 |
| Debtors and other receivables | 10,699 | 10,699 | 10,699 | 10,699 | 10,699 | 10,699 |
| Advances to SOEs | 26,206 | 28,236 | 28,236 | 28,236 | 28,236 | 28,236 |
| Investment in SOEs | 146,733 | 146,733 | 146,733 | 146,733 | 146,733 | 146,733 |
| Plant, property, and equipment | 286,437 | 434,478 | 378,008 | 422,652 | 434,681 | 438,096 |
| Total Assets | 583,685 | 692,537 | 647,190 | 676,942 | 682,730 | 690,402 |
| Liabilities | | | | | | |
| Creditors and other payables | 31,053 | 21,612 | 21,481 | 17,134 | 16,028 | 15,978 |
| Trust liabilities | 7,718 | 8,251 | 8,386 | 9,063 | 9,758 | 10,466 |
| Borrowings | 95,593 | 136,224 | 129,576 | 121,584 | 114,782 | 104,974 |
| Total Liabilities | 134,364 | 166,087 | 159,443 | 147,781 | 140,568 | 131,418 |
| Net Crown Balance | 449,321 | 526,450 | 487,747 | 529,161 | 542,162 | 558,984 |

11.1.3 Statement of Cash flows

| | Actual 2016-17 | Budget 2017-18 | HYEFU 2017-18 | Projected 2018-19 | Projected 2019-20 | Projected 2020-21 |
|--|-------------------|-------------------|------------------|----------------------|----------------------|----------------------|
| | ('000) | ('000) | ('000) | ('000) | ('000) | ('000) |
| Cashflows from Operating Activities | | | | | | |
| <u>Cash provided from:</u> | | | | | | |
| Taxation and levies | 124,898 | 118,409 | 123,633 | 125,417 | 128,953 | 131,549 |
| Collection of tax arrears | 0 | 0 | 0 | -600 | -900 | 0 |
| Sale of goods and services | 7,820 | 6,169 | 6,169 | 6,169 | 6,169 | 6,169 |
| Interest | 3,426 | 2,473 | 2,473 | 2,455 | 2,434 | 2,434 |
| Dividends | 382 | 1,787 | 1,672 | 1,759 | 1,885 | 1,967 |
| Other income | 31,715 | 25,696 | 26,013 | 14,188 | 12,188 | 12,068 |
| | <u>168,240</u> | <u>154,534</u> | <u>159,960</u> | <u>149,388</u> | <u>150,728</u> | <u>154,187</u> |
| <u>Cash applied to:</u> | | | | | | |
| Appropriations to agencies (less depn) | 95,541 | 109,563 | 111,854 | 101,301 | 100,329 | 97,889 |
| Payments on behalf of Crown | 23,087 | 25,120 | 25,362 | 23,931 | 24,094 | 24,094 |
| Debt-servicing interest | 1,710 | 2,063 | 2,063 | 2,060 | 2,032 | 2,032 |
| Other expenditure | 8,121 | 7,782 | 7,783 | 6,963 | 3,722 | 2,666 |
| | <u>128,459</u> | <u>144,528</u> | <u>147,062</u> | <u>134,254</u> | <u>130,177</u> | <u>126,682</u> |
| Net Operating Activity Cashflows | 39,781 | 10,006 | 12,898 | 15,134 | 20,551 | 27,505 |

11.1.4 Statement of Borrowings

| | Actual 2016-17 | Budget 2017-18 | HYEFU 2017-18 | Projected 2018-19 | Projected 2019-20 | Projected 2020-21 |
|---|-------------------|-------------------|------------------|----------------------|----------------------|----------------------|
| | ('000) | ('000) | ('000) | ('000) | ('000) | ('000) |
| Total Gross Borrowings | 95,593 | 136,224 | 129,576 | 121,584 | 114,782 | 104,974 |
| Assets Held Against Borrowings: | | | | | | |
| Advances to subsidiaries | 26,206 | 28,236 | 28,236 | 28,236 | 28,236 | 28,236 |
| Loan reserves | 18,904 | 19,929 | 21,200 | 20,876 | 20,535 | 18,643 |
| Total Assets Held Against Borrowings | 45,110 | 48,165 | 49,436 | 49,112 | 48,771 | 46,879 |
| Net Borrowings of the Government | 50,483 | 88,059 | 80,140 | 72,472 | 66,010 | 58,096 |

11.1.5 Summary of Revenue Levied on Behalf of the Crown

| | Actual 2016-17 ('000) | Budget 2017-18 ('000) | HYEFU 2017-18 ('000) | Projected 2018-19 ('000) | Projected 2019-20 ('000) | Projected 2020-21 ('000) |
|--|-----------------------------|-----------------------------|----------------------------|--------------------------------|--------------------------------|--------------------------------|
| Taxation | | | | | | |
| Income tax | 24,298 | 23,057 | 24,725 | 25,375 | 25,991 | 26,669 |
| Company tax | 16,155 | 12,900 | 14,628 | 14,724 | 15,657 | 15,532 |
| Import levies | 14,330 | 13,548 | 13,464 | 13,097 | 13,120 | 13,132 |
| Departure tax | 10,234 | 10,159 | 10,703 | 11,218 | 11,638 | 11,975 |
| VAT | 58,124 | 58,745 | 59,628 | 61,004 | 62,546 | 64,241 |
| Withholding tax | 1,757 | 0 | 485 | 0 | 0 | 0 |
| Total Taxation | 124,898 | 118,409 | 123,633 | 125,417 | 128,953 | 131,549 |
| Other Crown Revenue | | | | | | |
| Financial Services Levy | 324 | 262 | 262 | 262 | 262 | 262 |
| FSC Return of Excess | 0 | 0 | 0 | 0 | 0 | 0 |
| FSC Vested Assets | 0 | 0 | 0 | 0 | 0 | 0 |
| Immigration Fees | 886 | 587 | 860 | 860 | 860 | 860 |
| IMO Subscription - Maritime Cook Islands | 64 | 66 | 66 | 66 | 66 | 66 |
| Court Services | 37 | 50 | 50 | 50 | 50 | 50 |
| Instant Fines | 67 | 20 | 40 | 40 | 40 | 40 |
| Fishing Licences/ Catch Revenue | 16,509 | 11,505 | 11,505 | 8,000 | 6,000 | 6,000 |
| Fisheries - US Treaties (purse seing) | 1,548 | 1,200 | 1,200 | 1,200 | 1,200 | 1,200 |
| Fishing Fines | 487 | 0 | 0 | 0 | 0 | 0 |
| Research Fee | 2 | 1 | 1 | 1 | 1 | 1 |
| Permits | 27 | 24 | 24 | 24 | 24 | 24 |
| Dividends | | | | | | |
| Banana Court - dividend | 0 | 10 | 8 | 10 | 10 | 10 |
| Bank of the Cook Islands - dividend | 183 | 248 | 198 | 284 | 410 | 491 |
| Ports Authority - dividend | 0 | 0 | 0 | 0 | 0 | 0 |
| Te Aponga Uira - dividend | 35 | 319 | 255 | 255 | 255 | 255 |
| Extraordinary SOE Dividend | 0 | 60 | 60 | 60 | 60 | 60 |
| Telecom Cook Islands (Bluesky) - dividend | 163 | 1,150 | 1,150 | 1,150 | 1,150 | 1,150 |
| Numismatics | 354 | 350 | 350 | 400 | 400 | 400 |
| Border Management Fees | 0 | 120 | 120 | 120 | 120 | 0 |
| Drivers Licences | 87 | 70 | 100 | 100 | 100 | 100 |
| Motor Vehicle Registration | 888 | 875 | 875 | 875 | 875 | 875 |
| Interest on balances | 2,140 | 1,740 | 1,740 | 1,740 | 1,740 | 1,740 |
| Interest on loans to subsidiaries | 1,286 | 733 | 733 | 715 | 694 | 694 |
| Foreign Investment Fees | 26 | 26 | 26 | 26 | 26 | 26 |
| Upper Air Management Agreement | 545 | 746 | 746 | 746 | 746 | 746 |
| Shipping Registration | 61 | 268 | 268 | 268 | 268 | 268 |
| International Shipping Licence | 10 | 10 | 10 | 10 | 10 | 10 |
| Liquor Licencing | 42 | 60 | 60 | 60 | 60 | 60 |
| Tattslotto Grants | 140 | 120 | 120 | 120 | 120 | 120 |
| Censorship Fees | 2 | 10 | 4 | 4 | 4 | 4 |
| Circulating Currency - Coins | 0 | 876 | 876 | 876 | 876 | 876 |
| Employer Liabilities | 0 | 75 | 75 | 75 | 75 | 75 |
| Motor Vehicle Dealers | 3 | 5 | 5 | 5 | 5 | 5 |
| Justice Unclaimed Rental Monies | 0 | 0 | 0 | 0 | 0 | 0 |
| Performance Based Budget Support - Core Funding | 7,730 | 7,766 | 7,766 | 0 | 0 | 0 |
| Public Sector Strengthening-processes and systems MFEM | | | | | | |
| Total Other | 35,522 | 29,956 | 30,158 | 18,402 | 16,506 | 16,468 |
| Total Revenue Levied on Behalf of Crown | 160,420 | 148,365 | 153,791 | 143,819 | 145,459 | 148,018 |
| Performance Based Budget Support - Bonus Payment | 1,877 | 604 | 604 | | | |
| Total Revenue Levied on Behalf of Crown - including Bonus Payment | 162,297 | 148,969 | 154,395 | 143,819 | 145,459 | 148,018 |

11.1.6 Statement of Financial Risks

| Quantifiable Contingent Liabilities | ('000) |
|--|---------------|
| Guarantees and indemnities | 500 |
| Uncalled capital | 1,645 |
| Legal proceedings and disputes | 4,356 |
| Total Quantifiable Contingent Liabilities | 6,501 |

The total quantifiable contingent liabilities are estimated at \$7.5 million in 2014/15. This is made up of the guarantees and indemnities outlined below. Possible liabilities stemming from the Outer Island Governments are also discussed.

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 up to \$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.

Uncalled Capital

The Government also holds \$1.6 million in the Asian Development Bank - Cook Islands Government Property Corporation. This takes the form of 88 uncalled shares with a par value of USD 13,500 each.

Legal Proceedings and Disputes

Total quantifiable risk to the Crown under legal proceedings and disputes is \$4.4 million.

Financial liabilities relating to Island Governments

Currently, MFEM has not approved any of the Island Governments to take out any contract or security that could result in a potential liability for the Crown.

In terms of public liability or other indemnity, the Island Administrations are not treated differently to other government agencies. The capacity for the Island Administrations to generate such liabilities is estimated to be low. No risk mitigation has been undertaken to ameliorate risk any more than for other government bodies that are based in Rarotonga.

Unpaid invoices are a potential risk that would be difficult to mitigate without tighter financial controls than those imposed on other Government agencies. Island

Administrations are fully covered by the MFEM Act, MFEM financial policies and procedures, and are accountable to the National Audit Office and the Cook Islands Parliament.

12 Statement of Accounting Policies

There have been no changes since the Half Year Economic and Fiscal Update 2016/17. There are no major changes to accounting policies anticipated in the foreseeable future.

12.1 Basis of Preparation

12.1.1 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 64.

12.1.2 Statement of Compliance

These financial statements in Chapter 11 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).

12.1.3 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.

12.2 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:

| <u>STANDARDS</u> | <u>EFFECTIVE DATE</u> |
|---|-----------------------|
| IPSAS 28 Financial Instruments: Recognition and Measurement | 1/01/2013 |
| IPSAS 29 Financial Instruments: Presentation | 1/01/2011 |
| IPSAS 30 Financial Instruments: Disclosure | 1/01/2013 |

These new standards have been issued but are not yet effective for the consolidated Crown accounts as the preparation of the 30 June 2013 accounts are currently in progress – the 30 June 2012 consolidated accounts were completed and audited on 29 April 2015. The Crown will have to consider these new standards in future years. Crown has not yet determined the effect of these new standards.

12.2.1 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.

12.2.2 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.

12.2.3 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. |

12.2.4 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.

12.2.5 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 |

12.2.6 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 or 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.

12.2.7 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.

12.2.8 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.

12.2.9 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.

12.2.10 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.

12.2.11 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.