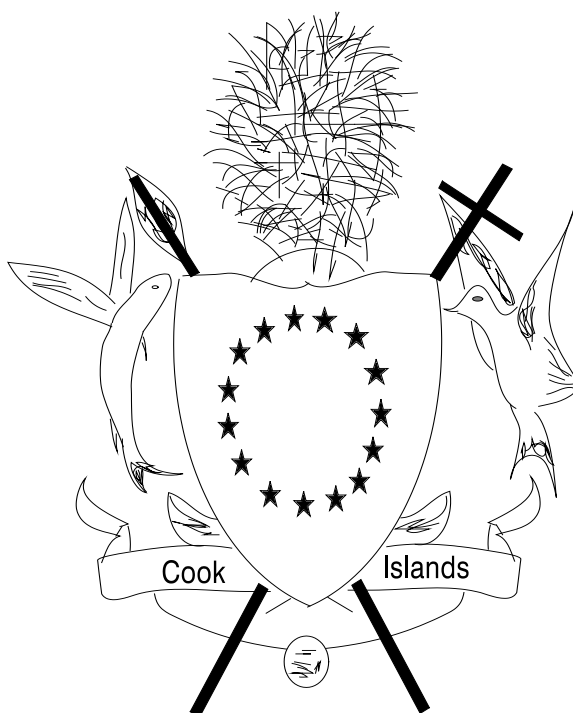


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**The Cook Islands**  
**2012/2013**  
**BUDGET POLICY STATEMENT**  
**AND**  
**2011/2012**  
**HALF YEAR ECONOMIC AND FISCAL**  
**UPDATE**

---



Government of the Cook Islands

1 December 2011

[www.mfem.gov.ck](http://www.mfem.gov.ck)

**COOK ISLANDS GOVERNMENT**  
**BUDGET POLICY STATEMENT 2012/2013**  
**AND**

**HALF YEAR ECONOMIC AND FISCAL UPDATE 2011/2012**

**TABLE OF CONTENTS**

	<b>Schedule</b>	<b>Page</b>
<b>Statement of Responsibility</b>		
Minister of Finance		1
Financial Secretary		2
<b>Preface</b>		3
<b>1.0 Budget Policy Statement 2012/2013</b>		
1.1 Introduction		4
1.2 Medium Term Fiscal Policy		5
1.3 Broad Strategic Priorities for 2012-2013		11
1.4 Government Intentions for Budget 2012-2013		11
1.5 Conclusion		15
<b>2.0 Economic Update</b>		
2.1 Gross Domestic Product (GDP)		17
2.2 Sensitivity Analysis		19
2.3 Consumer Price Index (CPI)		21
2.4 Tourism		22
2.5 Marine Resources		26
2.6 Agriculture		29
2.7 Exports and Imports		31
2.8 Banking and Finance		33
2.9 Assumptions Underlying the Economic Forecast		36
<b>3.0 Fiscal Update</b>		
3.0 Overview		38
3.2 Operating Statement		43
3.3 Debt		47
3.4 Net Worth		48
3.5 Overseas development assistance flows		49
3.6 Specific Fiscal Risks		50
3.7 Assumptions Underlying the Fiscal Projections		52
3.8 Statement of Accounting Policies		53
<b>4.0 Financial Statements</b>		
4.0 Statement of Financial Performance	11	55
4.1 Statement of Financial Position	12	56
4.2 Statement of Cash Flows	13	57
4.3 Statement of Borrowings	14	58
4.4 Revenue Levied on Behalf of the Crown	15	59
4.5 Statement of Fiscal Risks	16	60



**MINISTER OF FINANCE**  
**GOVERNMENT OF THE COOK ISLANDS**  
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**1 December 2011**

**STATEMENT OF RESPONSIBILITY**

Traditionally the Ministry of Finance and Economic Management publishes the Budget Policy Statement on the 31<sup>st</sup> of March and the Half Year Economic and Fiscal Update on the 31<sup>st</sup> of December annually.

In September 2011 the Government decided to expand the budget process from September to June which revised the dates in which key budget milestones are met. A key milestone set therefore was to bring forward the publishing of the Budget Policy Statement 2012-13 to 1 December 2011.

The Ministry of Finance has sought legal advice to consolidate the Half Year Economic and Fiscal Update 2011/12 and the Budget Policy Statement 2012-13 so as to keep within the requirements of the MFEM Act. This publication by the Ministry of Finance and Economic Management therefore presents a consolidated Half Year Economic and Fiscal Update and Budget Policy Statement as per the key milestones of the budget process 2012/13 as one publication now named the Half Year Economic and Fiscal update 2011/12 and Budget Policy Statement 2012/13.

I have read the Financial Secretary's Statement of Responsibility and concur with him regarding the preparation of the Half Year Economic and Fiscal Update 2011/12 and the Budget Policy Statement 2012/13.

This Half Year Economic and Fiscal Update 2011 and Budget Policy Statement (BPS) was prepared in accordance with the *Ministry of Finance and Economic Management Act 1995-96*.

Section 16 of the Ministry of Finance and Economic Management Act states that the Minister of Finance 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. Section 11 of the Act further states that the Minister of Finance shall no later than the 31st day of March cause a Budget Policy Statement to be published.

To enable the Ministry of Finance and Economic Management to prepare this Half Year Economic and Fiscal Update and Budget Policy Statement, I have ensured that the Financial Secretary has been advised of all Government decisions and other circumstances as at December 2011 of which I was aware and had material economic or fiscal implications.

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

A handwritten signature in black ink, appearing to read 'Mark B' followed by a flourish.

Honorable Mark Brown  
**Minister of Finance**



**MINISTRY OF FINANCE AND ECONOMIC MANAGEMENT**  
**GOVERNMENT OF THE COOK ISLANDS**

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**1 December 2011**

**STATEMENT OF RESPONSIBILITY**

This Half Year Economic and Fiscal Update 2011-12 and Budget Policy Statement (BPS) 2012-13 is prepared in accordance with Section 16 and 11 of the *Ministry of Finance and Economic Management Act 1995-96*.

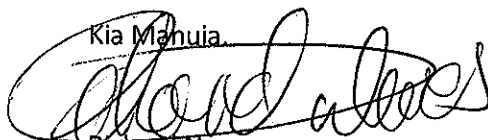
Section 16 of the Act states that the Minister shall no earlier than the 1<sup>st</sup> day of December nor, later than the 31<sup>st</sup> day of December in each financial year, cause to be published a report containing an economic and fiscal update prepared by the Ministry. Further Section 11 of the Act states that the Minister of Finance shall no later than the 31<sup>st</sup> day of March cause to be published a Budget Policy Statement.

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 financial statements included within this Half Year Economic and Fiscal Update 2011-12 and Budget Policy Statement 2012-13.

The update incorporates the fiscal and economic implications both of Government decisions and circumstances as at December 2011 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  
  
Richard Neves  
**Financial Secretary**

## **PREFACE**

As a first, the Ministry of Finance and Economic Management has published through this document both the 2012/13 Budget Policy Statement (BPS) with the 2011/12 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 2012/13 BPS will be published on the 1 December 2011 to enable better aligned planning by government departments and development partners in the 2012/13 Budget going forward.

The BPS states Government's policy intent for the 2012/13 fiscal year going forward including the Government's fiscal policy, its broad strategic priorities for the 2012/13 fiscal year, and any specific outputs and other expenditure that the Government anticipates to be included in the 2012/13 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 2011/12 HYEFU provides an update of the economic and fiscal forecasts made at the time of the 2011/12 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 1 December 2011, the HYEFU will also be published on 1 December 2011 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.

# 2012/2013 BUDGET POLICY STATEMENT

## 1.0 INTRODUCTION

As this Government approaches its second year as the leaders of this humble country, we continue our course to transform the Cook Islands into a nation of higher living standards with focused policy directions that are active, collaborative and sustainable.

Following a period of subdued growth, our pledge to the country in 2011/12 was to make policy interventions that are aimed towards boosting economic growth in the short to medium term and develop pathways for continued strategic development. Major programs aligned to this pledge include the hosting of an economic summit with the development of the economic taskforce recommendations, the initiation of the tourism destination development strategy, and the development of the National Sustainable Development Plan 2011-2015 (NSDP) that encompasses all sectors.

As a result of planned developments in the tourism industry, economic growth over recent months has shown that these planned interventions are providing immediate returns to the economy and to those that underpin it, with growth in visitors over the same period in the previous year coming in at 5.2 per cent to date and is expected to continue over the remainder of this fiscal year. As a result, nominal economic growth over 2011/12 is now estimated to come in at 8.7 per cent by year end, pushing up growth in 2012/13 to 4.3 per cent and levelling off at 3.5 per cent over the medium term. This is a very positive outlook for the Cook Islands economy and its people, and will allow associated returns to the Government to be used on supporting policy interventions aligned to the newly released NSDP over the medium term.

It is noted however that this growth is largely positioned under a context where our major trading partners will continue to grow. Our growth projections will need to be revised downwards in the event a second global economic crisis driven by developments in Europe is realised which significantly impacts our major trading partners.

Given this risk, the Government has taken a cautious approach and determined that an appropriate response is to recognise the extent of growth over the medium term, and positioning our policy such that not all of these estimated surpluses will be exhausted in the short term. The Government intends to consolidate some of this growth into reserve so that any negative impacts can be absorbed by the reserve as opposed to scaling back government programs to the community in the event revenue streams do not eventuate. Government's fiscal policy is captured in Section 1.1.

Government also recognises through the NSDP that there are various development needs at hand that need to be prioritised and realised over the medium term. Budgets over the medium term will be focused to ensure the implementation of the NSDP 2011-2015 and the outcomes of the Economic Summit 2011. The broad strategic priorities of government are captured under section 1.2 below.

To ensure effectiveness, this 2012/2013 BPS is action-orientated and strengthens the recent efforts undertaken during the 2011/2012 financial year. The intentions for the 2012/13 Budget are captured in Section 1.3.

This BPS is set out in the following order:

- 1) medium term fiscal policy;
- 2) 2012/2013 Budget key strategic priorities; and
- 3) intentions for 2012/2013 Budget.

## **1.1 MEDIUM TERM FISCAL POLICY**

The *Ministry of Finance and Economic Management Act 1995-96* (“the Act”) requires Government to state or reaffirm its long-term objectives for fiscal policy in the annual Budget Policy Statement.

Part III Section 23(2) of the Act sets out the long term fiscal principles to ensure a positive macroeconomic environment for the Cook Islands. These principles as set out in the Act are as follows:

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

Government must pursue its policy objectives within the financial context established by these principles which are quantified in fiscal responsibility ratios (FRR). The FRR are regularly reviewed and establish the parameters for the Budget, with a particular focus on the level of expenditure on Crown debt.

Given the fiscal setting, and in recognition that Government intends to pursue new policy initiatives at each Budget going forward, this Government will carry out the following fiscal policy from 2012/13.

### Provisioning Future Budget Allowances

The Government will commit a further \$0.624m per annum for new policy initiatives from 2012/13 onwards. For the 2013/14 and 2014/15 Budgets the Government has provisioned a further \$0.923m and \$2.464m per annum respectively. These provisions are only indicative and may change, particularly if budgetary settings change.

If the budgetary impacts of new policy initiatives are above the provision then these will be required to be financed through reprioritising expenditure or increasing Crown revenue, or user charges.

### Allowing a portion of budget surpluses to flow through to cash reserves

After allowing for Budget provisions an operating balance surplus of \$2.9 million in 2012/13 is projected to grow to \$5.8m in 2014/15. At this stage, the Government is intentionally taking a conservative fiscal approach to these surpluses, as :

- the economic and fiscal update in 2012/13 Budget (in May 2012) will provide a better estimate as to whether these projections will materialise. Nevertheless, barring a significant increase in the projected surplus, our bias is to not adjust the future Budget

allowances.

- The significant uncertainty in the global economic outlook. The current European debt crisis could affect two of the Cook Islands' major tourism sources – New Zealand and Australia, causing further weakness in their economic growth. This creates uncertainty for the Cook Islands economy. An update of the economic outlook will be provided at the time of the 2012/13 Budget.
- Crown revenues are highly dependent upon receipts from the tourism sector. New Zealand arrivals have recently grown significantly. We anticipate this growth will be sustained but we want to continue to monitor this to ensure it does not reverse. The recent Australian growth has been strong which is due to good loadings on the new Sydney : Rarotonga flight. But again, we want to see this consolidate over the next 6 months.

For these reasons, it is the Government's intention to allow the majority of the projected surplus to pass through into cash reserves – thereby further improving the Cook Islands net worth levels.

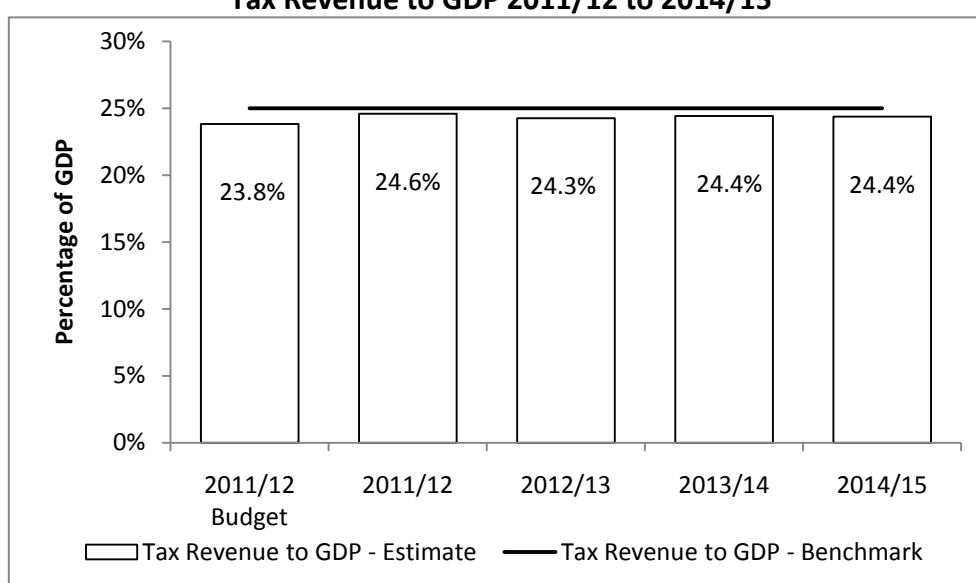
### Maintain Fiscal Responsibility Ratios

There have been no changes to the FRR benchmarks since the 2011/12 Budget. Performance of each of the FRR's are discussed below.

#### ***Tax Revenue to GDP***

This ratio sets the revenue boundary and ensures government limits the diversion of resources away from the private sector. The benchmark government agrees to work within is maintaining collections within 25 per cent of GDP. The expected performance against this benchmark is illustrated in Chart 1.1.1 below. This indicates that based on current estimates, Government has maintained its tax regime within appropriate limits and this is expected to continue over the medium term.

**Chart 1.1.1**  
**Tax Revenue to GDP 2011/12 to 2014/15**



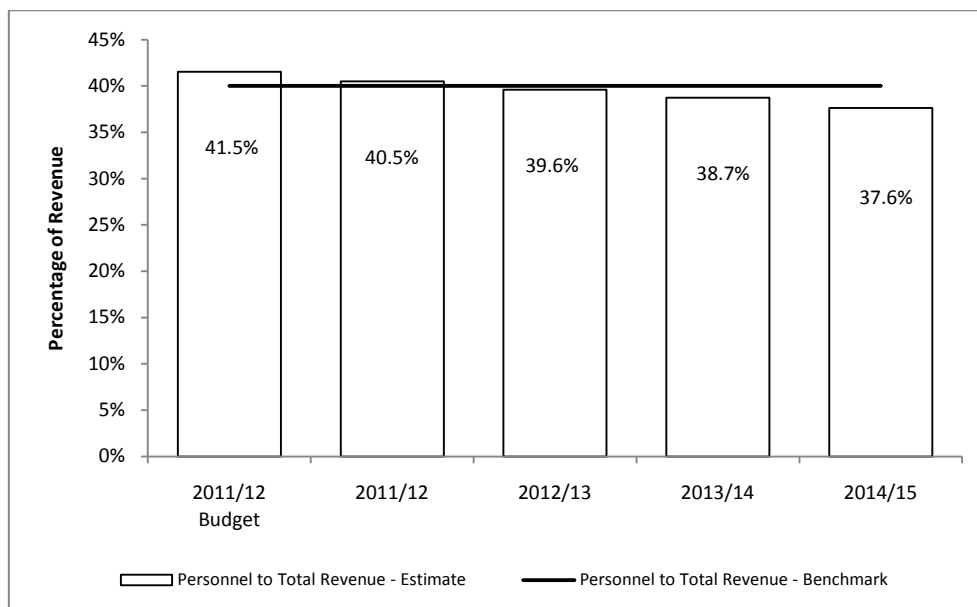
#### ***Personnel to GDP***

This ratio is aimed at controlling the expansion in the size of the public service as the largest expenditure item of Government. The benchmark government agrees to work within is



maintaining expenditure on personnel within 40 per cent of total revenues. As illustrated in Chart 1.1.2 in 2011/12 government is expected to exceed this limit in the short term, however over the medium term it is expected to come within the benchmark on the basis that the economy continues to expand as forecasted.

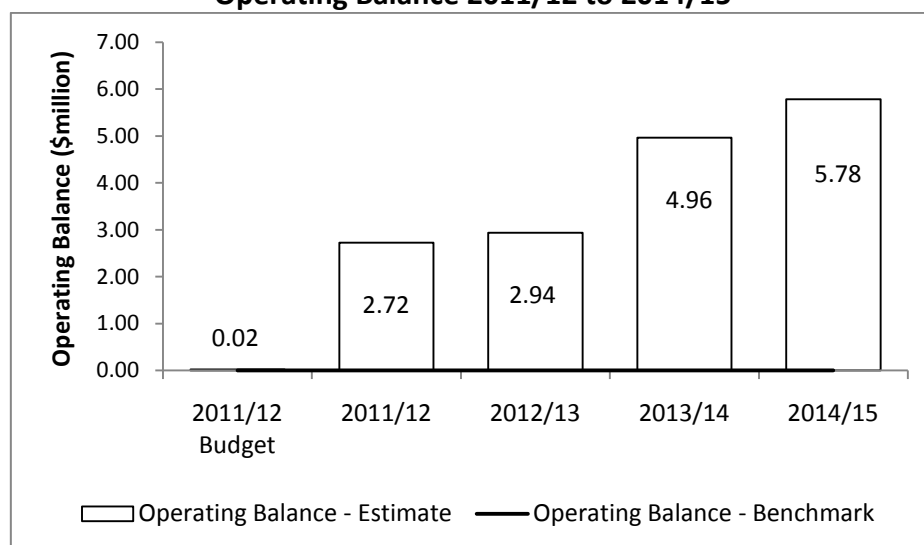
**Chart 1.1.2  
Personnel Expenditure to Revenue 2011/12 to 2014/15**



### **Operating Balance**

Maintaining a positive operating balance indicates that Government is able to afford the operational costs of performing the functions of government from its own revenue streams. Government has set a benchmark of running a operating surplus in each Budget. As illustrated below, Government is estimated to maintain within this benchmark over the short and medium term.

**Chart 1.1.3  
Operating Balance 2011/12 to 2014/15**

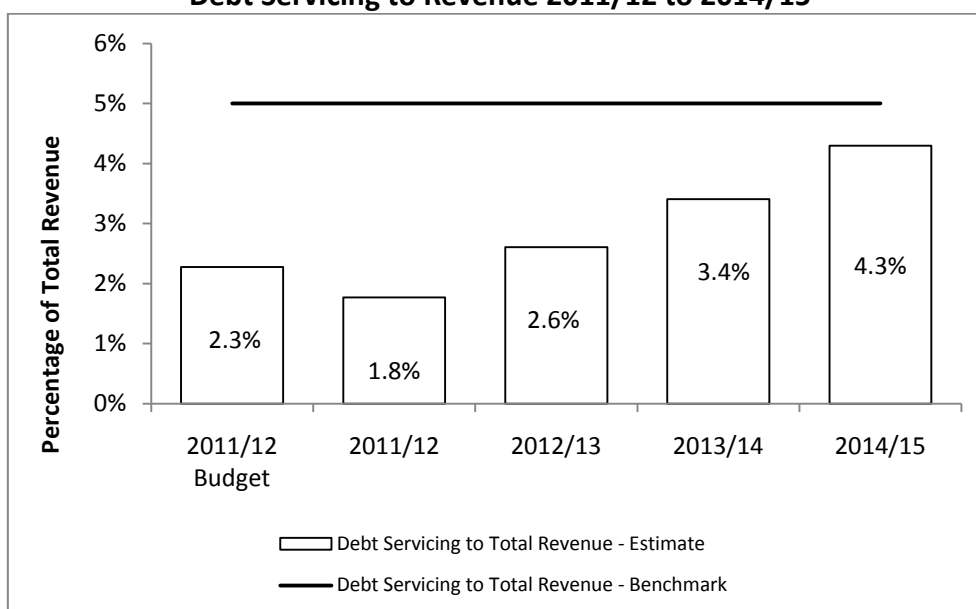


### **Debt Servicing to Revenue**

Debt servicing to total revenue measures the ability of Government to service its debt obligations from revenue collected. Debt servicing includes both interest, principle, and is

now net of drawdowns of loan reserves to more accurately reflect the ability of Government to service its debt obligations. The benchmark set is to maintain within five per cent of revenue. With this amendment to the ratio the level of debt servicing against benchmarks within the short to medium term is maintained within the benchmark as shown in Chart 1.1.4.

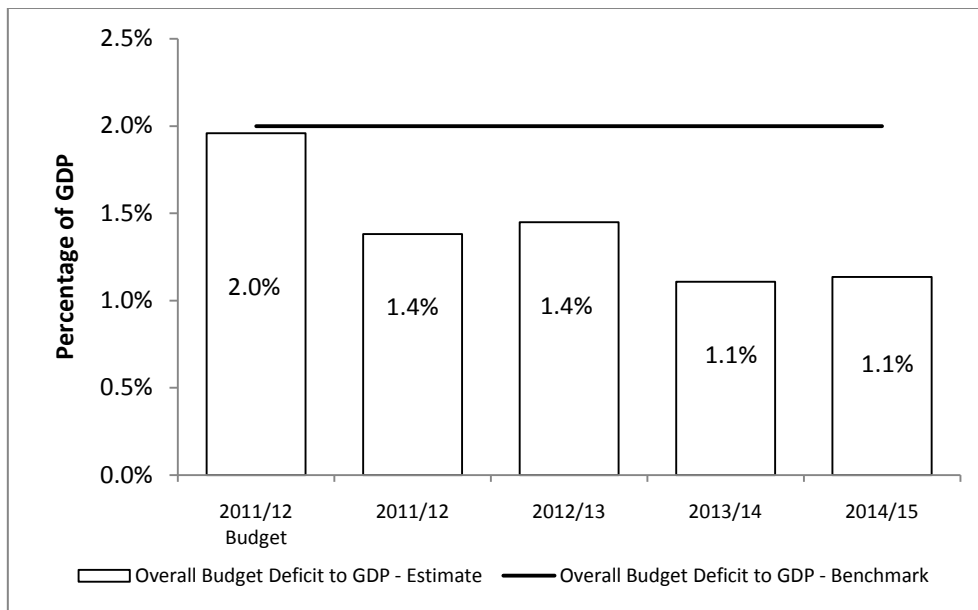
**Chart 1.1.4  
Debt Servicing to Revenue 2011/12 to 2014/15**



***Budget Overall Deficit to GDP***

Budget Overall Deficit is the operating balance less non-operating expenditure (purchase of assets and repayment of liabilities). Where the budget overall balance is in deficit, it must be serviced through lending or payment through reserve funds. The benchmark is set to be maintained within  $\pm 2$  per cent to ensure that government does not accumulate debt too quickly, and taken together with the debt servicing to total revenue and net debt to GDP ratios ensures that debt is managed and taken on within sustainable levels. Chart 1.1.5 illustrates that Government expects to maintain within the benchmark limits over the short to medium term.

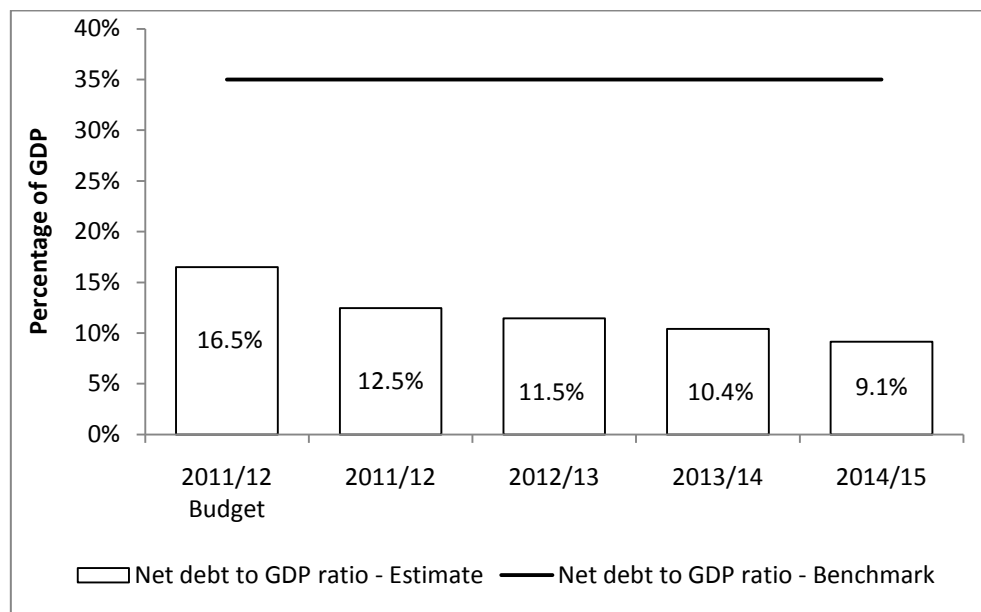
**Chart 1.1.5**  
**Budget Overall Deficit to GDP 2011/12 to 2014/15**



**Net Debt to GDP**

Net debt to GDP measures the level of debt relative to national income and is intended to control the overall level of debt taken on by Government. The benchmark agreed to by Government is to maintain net debt within 35 per cent of GDP, around \$132 million estimated in 2011/12. Chart 1.1.6 illustrates that Government is well within the benchmark over the short and medium term. The significant reduction since the time of the 2011/12 Budget is due to a revaluation of debt based on favourable exchange movements.

**Chart 1.1.6**  
**Net Debt to GDP Ratio 2011/12 to 2014/15**



The Government will undertake the following fiscal strategies to ensure the FRR are achieved whilst providing some room for further policy initiatives.

- Running a modest budget surplus which will be passed through to cash reserves, while still providing for additional Budget spending in the short to medium terms. New budget initiatives will be supplemented by identifying initiatives that can be funded through efficiencies gained in other areas of government operations.
- Actively engage with donor partners to align development assistance to this policy statement and our longer term priorities outlined in our National Sustainable Development Plan 2011-2015; and
- Continue to put a portion of total tax receipts into the reserve trust fund building a buffer to protect the net worth of the Crown.

## 1.2 BROAD STRATEGIC PRIORITIES

The broad strategic priority areas in this 2012/13 Budget Policy Statement are reflective of the goals of the NSDP 2011-2015 as follows, to:

1. continue economic development, ensuring a vibrant Cook Islands economy;
2. invest in infrastructure to provide for further economic growth;
3. ensure our energy security for the long term;
4. provide opportunity for all who reside in the Cook Islands through social development;
5. build resilient and sustainable communities;
6. maintain ecological sustainability;
7. apply the principles of good governance; and
8. institute law and order, ensuring a safe, secure, just and stable society.

The adoption of these priority areas and goals from the NSDP into the 2012/13 Budget Policy Statement is to ensure there is a clear linkage between the Budget and the realisation of the NSDP goals.

The emphasis on the NSDP priority areas for development demonstrates the Government's move towards a sectoral approach for development. This will lead to improved coordination across government, better performance and allow government to focus on initiatives that ensure coordinated sustainable development in the medium to long term.

## 1.3 INTENTIONS FOR 2012/2013 BUDGET

### 1. Economic Development – A vibrant Cook Islands economy

#### *Actions that we are already committed to and will continue to pursue in 2012/2013*

- 1.1 Focus on increasing volume, yield and dispersal of tourists beyond Rarotonga to the Pa Enua through the development and implementation of the Destination Development Strategy.
- 1.2 Create an environment which continues to be conducive to economic development through the development and implementation of robust policies which encourage business' to start, grow and thrive.
- 1.3 Establish the policy, legislative frameworks and international arrangements which will provide the underlying support growth of a formal cultural and creative industry.
- 1.4 Putting in place the legislative framework to encourage competition across the economy.

#### *New Directions for 2012/2013*

- 1.5 Conduct an analysis on the cost of doing business in the Cook Islands. This will lead to the development and implementation of policies that will reduce cost and time for undertaking business in the Cook Islands
- 1.6 Develop and implement programs to encourage research and development in innovative value adding products and services in agriculture and marine resources.
- 1.7 Work with key stakeholders to identify specific education and training programmes to bridge priority skill gaps and respond to the growing needs of the labour market.

### 2 Infrastructure – Infrastructure for economic growth, sustainable livelihoods and resilience

### ***Actions that we are already committed to and will continue to pursue in 2012/2013***

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- 2.1 Continue upgrading our ports in the Pa Enea.
- 2.2 Commence major investment in water and sanitation water supply and sanitation assets
- 2.3 Upgrade sanitation systems
- 2.4 Develop an asset management plan for all government physical infrastructure assets.

### ***New Directions for 2012/2013 Budget***

---

- 2.5 Complete the design phase for Aitutaki Port and Civic Centre to upgrade the assets and compliment the Destination Development Strategy, and commence work on the Tauhunu port.
- 2.6 Undertake feasibility studies for the upgrade of airstrips in the Pa Enea with an initial focus on Aitutaki, Atiu, Mangaia and Manihiki.
- 2.7 Consider the options for managing the stock of government housing across all islands.

## **3. Energy – Energy Security**

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### ***Actions that we are already committed to and will continue to pursue in 2012/2013***

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- 3.1 Strengthening the institutional arrangements for renewable energy including better coordination of the sector to implement national renewable energy targets (50/15 and 100/20).
- 3.2 Advancing renewable energy and upgrading electricity infrastructure to compliment and accommodate the move towards sustainable renewable energy sources.

## **4. Social Development – Opportunity for all people who reside in the Cook Islands**

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### ***Actions that we are already committed to and will continue to pursue in 2012/2013***

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- 4.1 Continue the implementation of the Education Master Plan.
- 4.2 Finalise the review of the vulnerable in our society and commence the implementation of any approved recommendations.
- 4.3 Continue the implementation of the Cook Islands National Strategy and Action Plan to prevent and control non-communicable diseases.

### ***New Directions for 2012/2013 Budget***

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- 4.4 Develop policy interventions targeting the improvement of the wellbeing of youth, persons with disabilities, mentally ill, the displaced in our community and our elderly.

## **5. Resilience – A resilient and sustainable Cook Islands**

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### ***Actions that we are already committed to and will continue to pursue in 2012/2013***

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5.1 Finalise and implement the National Action Plan for Disaster Risk Management (DRM) and Climate Change Adaptation (CCA).

## **6. Ecological Sustainability**

### ***Actions that we are already committed to and will continue to pursue in 2012/2013***

6.1 Implement the integrated water resources management process.

6.2 Strengthen regulatory frameworks and compliance capacity for waste and sanitation storage systems, treatment systems and general practices that will improve our sanitation and therefore stream and lagoon water quality

6.3 Implement the National Waste Strategy with the purpose of achieving zero waste in the medium to long term

### ***New Directions for 2012/2013 Budget***

6.4 Streamline efforts to integrate environmental conservation and management by ensuring a coordinated effort of 'ridge to reef' and ocean management.

## **7. Governance – Good Governance**

### ***Actions that we are already committed to and will continue to pursue in 2012/2013***

7.1 Commence the implementation of the whole of government approved functional review recommendations.

7.2 Development of a Statistics Master Plan that facilitates capturing accurate data that is relevant, timely and informs policy interventions and planning across all sectors.

7.3 Strengthen our regional and international relations, and in doing so successfully host the Pacific Islands Leaders Forum 2012.

7.4 Develop and implement governance tools and frameworks that improve the overall performance of the public service.

7.5 Implement the e-government framework to improve information streamlining across government and access to information by the general public.

7.6 Increase accountability and transparency by implementing the Government Public Financial Management Roadmap 2012-2015 including the re establishment of the Parliamentary Finance and Expenditure Select Committee

### ***New Directions for 2012/2013 Budget***

7.7 Explore and implement potential incentives to encourage professionals to work in the Pa Enea.

## **8. Law and Order – A safe, secure, just and stable society**

***Actions that we are already committed to and will continue to pursue in 2012/2013***

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8.1 Public confidence and satisfaction with policing through greater community engagement and increased presence in the community, crime and crash prevention, and intelligence led policing

8.2 Establish an effective, automated border management system to meet the needs of all border management agencies which is supported by modern legislation.



## CONCLUSION

The 2012/2013 Budget marks the start of a more focused approach on what can realistically be achieved within a fiscal year, and at the same time contribute to longer term development outcomes.

Not every function of government is covered in 2012/13 Budget Policy Statement 2012/2013 with the recognition that many functions of government remain essential and core responsibilities to our community.

This Budget aims to ensure greater predictability of performance and allocation of resources towards the development outcomes that our communities' desire and what we can realistically deliver within our budgetary constraints and potential assistance from our development partners.

We, your elected Government, look forward to pushing boundaries and meeting our country's strategic needs over the medium term; please join us on this journey.

A handwritten signature in black ink, appearing to read 'Mark Brown', followed by a period.

Honourable Mark Brown

**Minister of Finance**

## 2.0 ECONOMIC UPDATE

The Cook Islands economy grew moderately in 2009/10 following a period of contraction in 2008/09. Stronger growth over the forecast horizon is anticipated, however, there are risks to this growth. The forecasted growth relies on the current global uncertainty not creating further contractions in our major tourism markets – which could potentially lead to a negative growth shift in the number of visitors expected to the Cook Islands. This economic update also provides a sensitivity analysis on what might happen to growth rates if this were to eventuate.

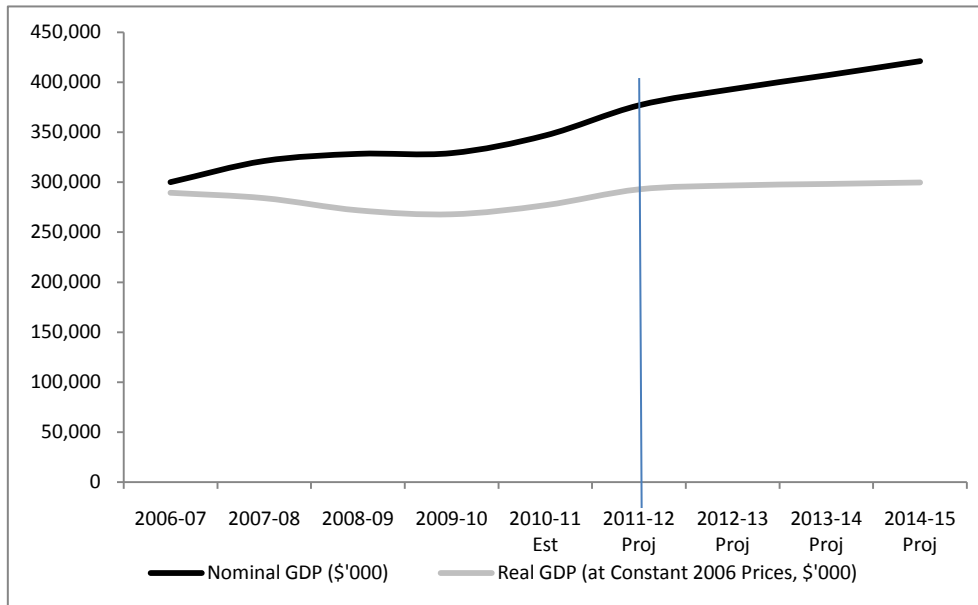
The tourism industry performance measured by growth in visitor arrivals continues to perform very well. Arrivals from New Zealand have grown by a further 10 per cent in the last year – despite sluggish economic growth in New Zealand. The Australian market continues to be a strong emerging market on the back on a new Sydney-Rarotonga direct flight, which started in July 2011. Projections made at the time of the 2011/12 Budget have been revised to take in to account actual data to October 2011 which has tended to outperform our forecasts across all markets. The Sydney-Rarotonga connection has had strong loadings of around 75 per cent, which is expected to grow slightly over the forecast horizon. Total visitors to the Cook Islands in 2010/11 were 108,500. By 2014/15, this number is expected to be 124,500.

Price rises measured through the Consumer Price Index (CPI) have been revised upwards slightly from 2011/12 Budget reflecting higher GDP growth rates which will place additional pressure on prices. Actual CPI growth to June 2011 has been 2.1per cent and this is expected to increase to 3 per cent over the forecast horizon. This represents a long run average CPI for the Cook Islands economy. Revisions to CPI have been reflected in the growth rates for nominal projections on GDP, trade, and banking and finance.

## 2.1 Gross Domestic Product (GDP)

Actual nominal GDP grew by 2.8 per cent higher than the 2009 calendar year – driven by good growth in the Electricity and Water Supply (20 per cent) and the Wholesale and Retail Trade (22 per cent), offset by a 16 per cent reduction in the Transport and Communication sector.

**Chart 2.1.1: Nominal and Real Gross Domestic Product (GDP), 2006/07 to 2014/15, (\$'000)**

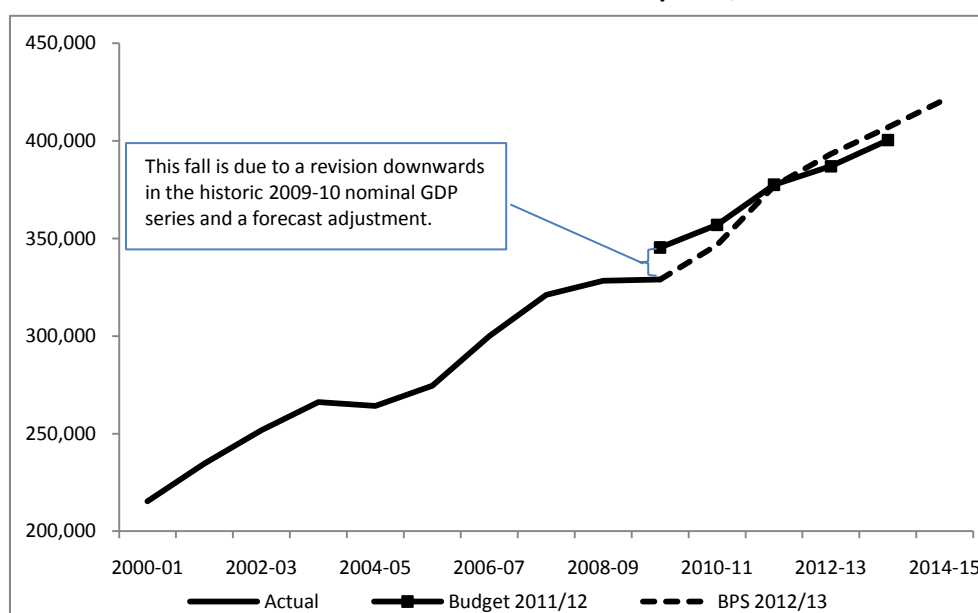


### 2.1.1 Nominal GDP

Nominal GDP in 2010 was \$333.6 million<sup>1</sup>. In the Cook Islands movements in nominal GDP are predominantly driven by movements in tourism and government expenditures, and export receipts.

Forecasts in GDP have been based on movements in these particular components out to 2014/15.

**Chart 2.1.1.1: Nominal GDP at current prices, \$'000**



<sup>1</sup> GDP statistics are reported on a calendar year while the forecasts are produced on a July-June fiscal year.

Movements in tourism expenditure are based on the:

- expected growth in visitor arrivals ;
- estimates for the average length of stay; and
- average daily spend per visitor.

Nominal GDP growth has been revised up in this 2011/12 Half Year Economic and Fiscal Update and the 2012/13 Budget Policy Statement compared to the estimates produced in 2011/12 Budget.

Nominal growth is now expected to be 5.4 per cent in 2010/11, 8.7 per cent in 2011/12 and 4.3 per cent in 2012/13. After this point we assume growth reverts to a long run average of 3.5 per cent over 2013/14 to 2014/15.

The change in the forecasted growth rate is predominantly driven by an increase in expected tourist arrivals. This, in turn, is driven by far stronger growth in New Zealand visitors since the 2011/12 Budget was finalised – which is now expected to continue. Australian arrivals have also performed strongly against forecast.

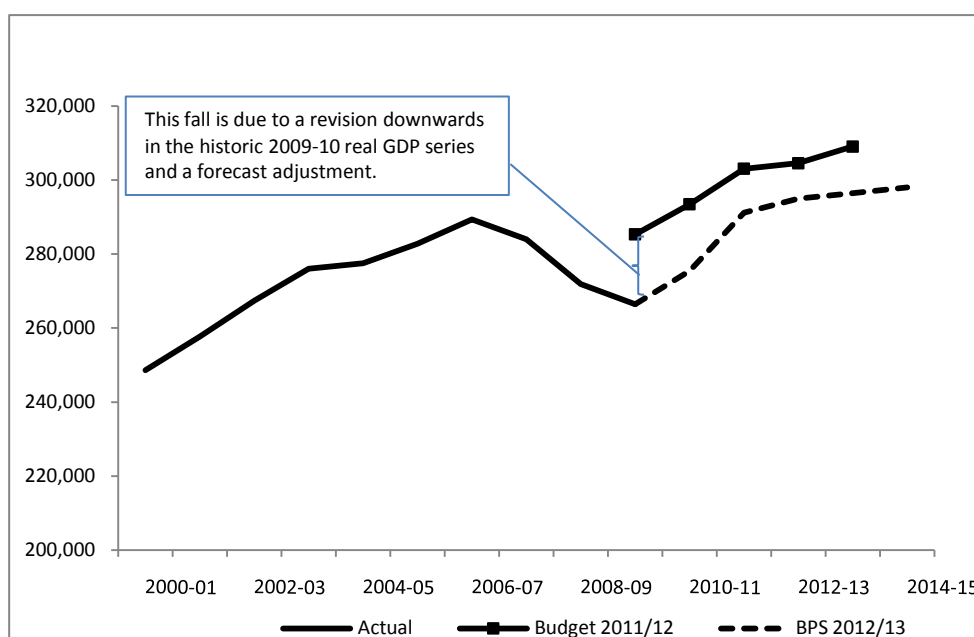
The export sectors' contribution to nominal GDP continues to be very small (approximately 1.5 per cent, the small increase in exports over the forecast horizon will have an immaterial effect on driving GDP growth.

Government expenditures are projected to be similar to those appropriations that were agreed in 2011/12 Budget.

### 2.1.2 Real GDP

Real GDP measures the value of output within the economy expressed at constant prices (2006) and removes the impact of price rises which are contained within the nominal GDP estimate.

**Chart 2.1.2.1: Real GDP (at constant 2006 prices, NZD'000)**



After a period of relatively stable growth, the economy contracted over 2008/09 and 2009/10 by 4.3 per cent and 2.0 per cent in real terms respectively predominantly due to the impacts of the global economic crisis on general demand for the economy's output and the continual increase in the value of imports as an outflow.

The economy in real terms was valued at \$266.4 million in 2009/10 reflecting real negative growth of 2.0 per cent estimated from 2008/09.

Noting that the Cook Islands economy is primarily driven and based on the tourism industry, flow on effects of the Tourism Growth Strategy to all other sectors within the economy is expected to improve incomes significantly in the outer years.

Growth in real GDP in 2010/11 was be 3.4 per cent, 5.7 per cent in 2011/12, 1.3 per cent in 2012/13 and 0.5 per cent in 2013/14 and 2014/15

## 2.2 Sensitivity Analysis

The economic forecasts for the Cook Islands do have an element of risk around them.

A second global contraction affecting major destination markets might alter the number of tourists coming to the Cook Islands. Following the global financial crisis the growth rates of tourists from New Zealand and Australia was flat.

The sensitivity analysis assumes no growth in New Zealand and Australian visitor numbers.

**Table 2.2.1: Sensitivity Analysis – GDP effect**

		2010/11	2011/12	2012/13	2013/14	2014/15
Nominal GDP Growth	BPS 2012/13	5.4%	8.7%	4.3%	3.5%	3.5%
	Alternate scenario	5.4%	7.1%	1.5%	1.6%	2.6%
	<i>Difference</i>	<i>0.0%</i>	<i>-1.6%</i>	<i>-2.8%</i>	<i>-1.9%</i>	<i>-0.9%</i>
Real GDP Growth	BPS 2012/13	3.4%	5.7%	1.3%	0.5%	0.5%
	Alternate scenario	3.4%	4.1%	-1.5%	-1.4%	-0.4%
	<i>Difference</i>	<i>0.0%</i>	<i>-1.6%</i>	<i>-2.8%</i>	<i>-1.9%</i>	<i>-0.9%</i>

As a consequence reduced growth rate would result in lower revenue levels and almost eliminating the current net operational surpluses which are currently being forecast.

**Table 2.2.2: Sensitivity Analysis – Income effect**

		2010/11	2011/12	2012/13	2013/14	2014/15
Total Tax Revenue (\$000)	BPS 2012/13	\$87,044	\$92,683	\$96,335	\$99,385	\$102,734
	Alternate scenario	\$87,044	\$91,592	\$93,011	\$94,274	\$96,574
	<i>Difference</i>	<i>\$0</i>	<i>-\$1,090</i>	<i>-\$3,324</i>	<i>-\$5,111</i>	<i>-\$6,161</i>

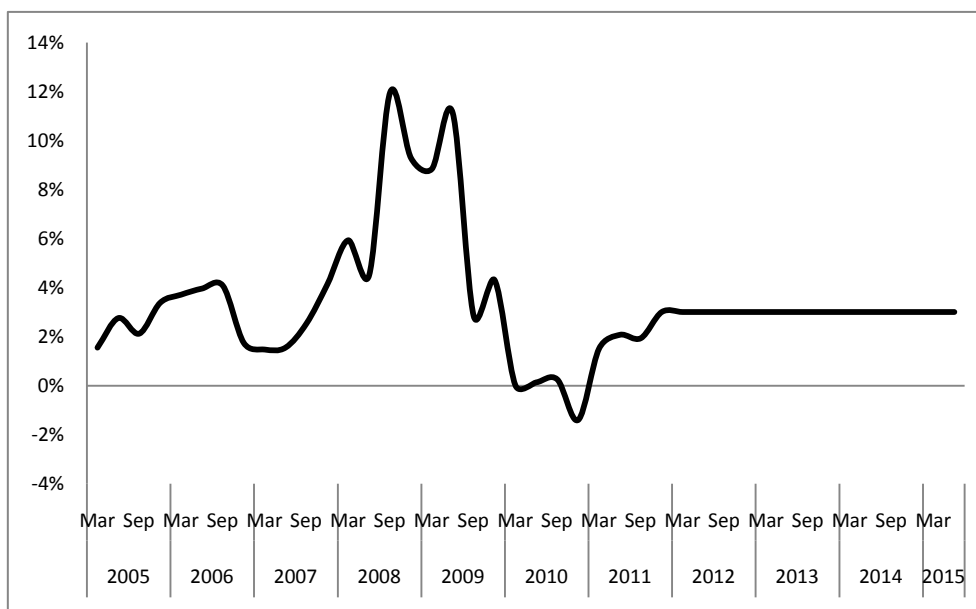
**Table 2.3: Economic Indicators**

<b>Economic Indicators</b>					
	<b>2010/11</b>	<b>2011/12</b>	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>
	<i>Actual</i>	<i>Est.</i>	<i>Proj.</i>	<i>Proj.</i>	<i>Proj.</i>
<b>Economic Activity</b>					
Nominal GDP (\$'000)	346,700	376,900	393,200	407,000	421,200
% Change	5.4%	8.7%	4.3%	3.5%	3.5%
Real GDP (at Constant 2006 Prices, \$'000)	275,400	291,200	295,000	296,500	298,000
% Change	3.4%	5.7%	1.3%	0.5%	0.5%
<b>Inflation</b>					
Consumer Price Index (base Dec. 2006 = 100)	120.7	124.3	128.0	131.8	135.8
% Change	2.1%	3.0%	3.0%	3.0%	3.0%
<b>Construction/Capital Investment</b>					
Commercial Building Approvals (\$'000)	1,900	2,300	2,400	2,500	2,600
Residential Building Approvals (\$'000)	9,500	9,700	9,700	10,400	10,400
<b>Productive Sector Indicators</b>					
Visitor Arrivals	108,500	115,900	118,800	121,800	124,500
% Change	9.6%	6.8%	2.5%	2.5%	2.2%
Estimated Visitor Expenditures (\$'000)	230,100	255,900	270,200	282,500	294,600
Pearl Exports (\$'000)	640	640	640	1,000	1,500
Fish Exports (\$'000)	3,100	3,300	3,400	3,600	3,800
<b>External Sector</b>					
Merchandise Trade Balance (\$'000)	(363,500)	(395,700)	(412,800)	(426,900)	(441,400)
Services Trade Balance (\$'000)	301,300	333,400	351,000	366,100	381,200
Exchange Rate (US\$per NZ\$, November 2011)	0.787	0.787	0.787	0.787	0.787
<b>Financial Sector (at end of financial year)</b>					
Private and Public Enterprise Deposits (\$'000)	192,000	205,600	208,700	212,000	217,700
Private and Public Enterprise Loans (\$'000)	513,600	550,200	558,400	567,300	582,300

## 2.3 Consumer Price Index (CPI)

Inflation in the Cook Islands is measured by the Consumer Price Index (CPI) which is produced on a quarterly basis<sup>2</sup>.

**Table 2.3.1: Consumer Price Index (CPI) moving average, 2005 - 2015, (\$'000)**



Inflation at the end of 2010/11 rose 2.1 per cent in the June quarter compared to the same quarter in the previous year, driven predominantly by increases in food, household, apparel and transport prices.

Global food prices have continued to steadily increase over the year while fuel prices fluctuated sharply in the past six months. Given the lag in the transmission of higher commodity prices to the Cook Islands, it is expected that inflation will increase going forward and will grow in line with the expected global price increases.

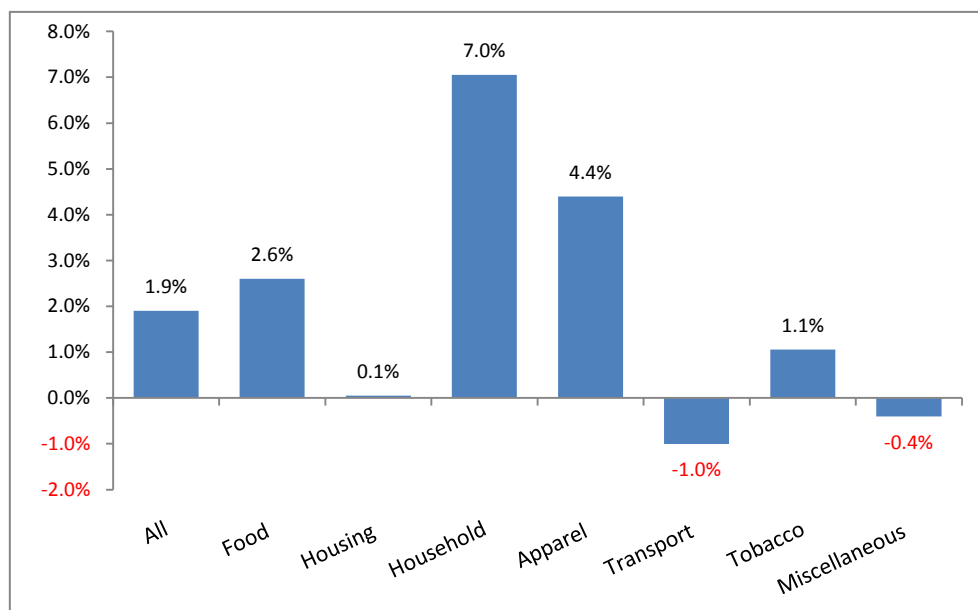
The latest CPI data indicates that the September 2011 quarter is up 0.4 per cent on the June quarter and 1.9 per cent over the September quarter in the previous year. The most significant contributions to inflation in the year to September are highlighted below.

Positive movements due to a;

- 7.0 per cent increase in the Household group reflecting large increase in the fuel and light subgroup by 16.4 per cent and to a lesser extent home furnishings and household appliances by 3.8 per cent,
- 4.4 per cent increase in the Apparel group, and
- The Food group increased by 2.6 per cent, the tobacco and alcohol group 1.1 per cent and the housing group by 0.1 per cent.

<sup>2</sup> Undertaken by visiting 56 outlets and focusing on 205 specific items.

**Table 2.3.2: Percentage change in CPI Groups, September 2010 to September 2011**



These positive movements were offset by reductions in

- The transport group down by 1.0 per cent due to the decrease in prices of international airfares in the overseas travel subgroup down by 17.1 per cent and,
- A 0.4 per cent decrease in the miscellaneous group.

Going forward it is expected that prices will grow by 3.0 per cent in 2011/12 and to continue in to the outer years.

## 2.4 Tourism

The tourism sector accounts for approximately 70 per cent of GDP. The Government has made some significant decisions towards supporting and stimulating activity within the sector and its flow on benefits across the wider economy in the past year and going forward.

Tourism expenditures are calculated based on the number of visitor arrivals by the average spend per visitor. This is based on the assumption that on average each visitor stays in the Cook Islands 10 days and spends an average of \$223 per day. Average spend per day is assumed to increase by 2 per cent in each outer year.

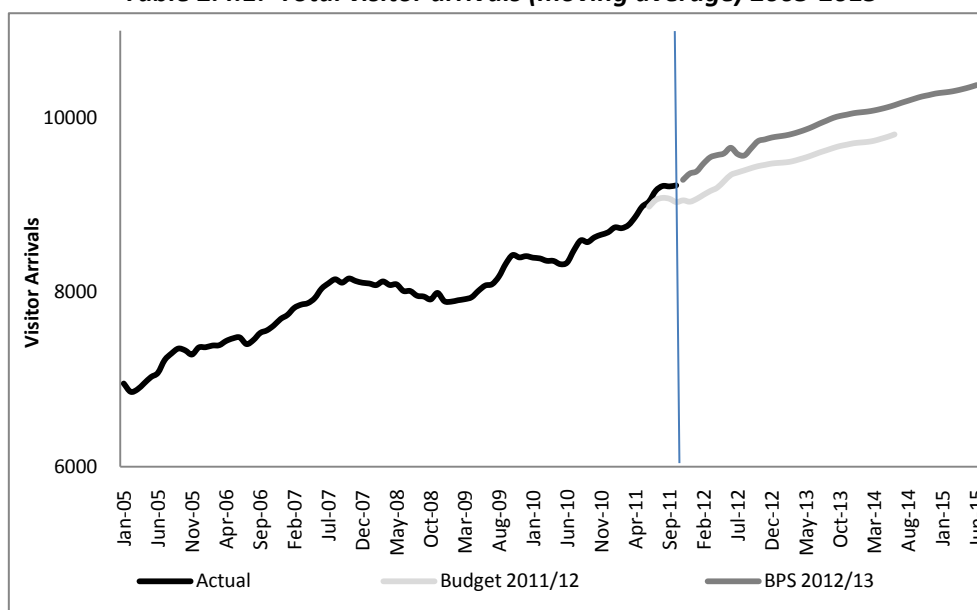
The major tourist markets in the Cook Islands are New Zealand (64.0 per cent), Australia (16.0 per cent), Europe (10.0 per cent) and North America (4.0 per cent).

In May 2011, 2010/11 visitor arrivals was estimated to reach 107,800<sup>3</sup> by year end, actual data indicate total visitor arrivals reached approximately 108,501 reflecting an 8.4 per cent growth over the previous year. This growth was largely driven by the impact of the trial run Sydney to Rarotonga direct flight over July – October 2010 and the increase of visitors from the New Zealand market.

<sup>3</sup> At 2011/12 Budget total visitor arrivals in 2010/11 was published as 106,000. Statistics have revised the historical series up to 107,800.



**Table 2.4.1: Total visitor arrivals (moving average) 2005-2015**



The 2011/12 Budget was tabled with revised visitor arrivals and included the removal of the Nadi direct flight. The commencement of the direct flight to Sydney from July 2011 was included as was the Los Angeles direct flight. At the time of the 2011/12 Budget the total estimated arrivals in 2011/12 was estimated at 111,500, a 4.2 per cent increase over the previous year and between 2.4 per cent and 2.5 per cent growth estimated in the outer years.

This update provides a further revision to Budget 2011/12 estimates to take in to account higher than forecasted growth in actual visitor arrivals to October 2011. Total visitors are now expected to be 115,900 rising to 124,500 by 2014/15 representing growth of 6.8 per cent in 2011/12, 2.5 per cent in 2012/13 and 2013/14 and 2.2 per cent in 2014/15.

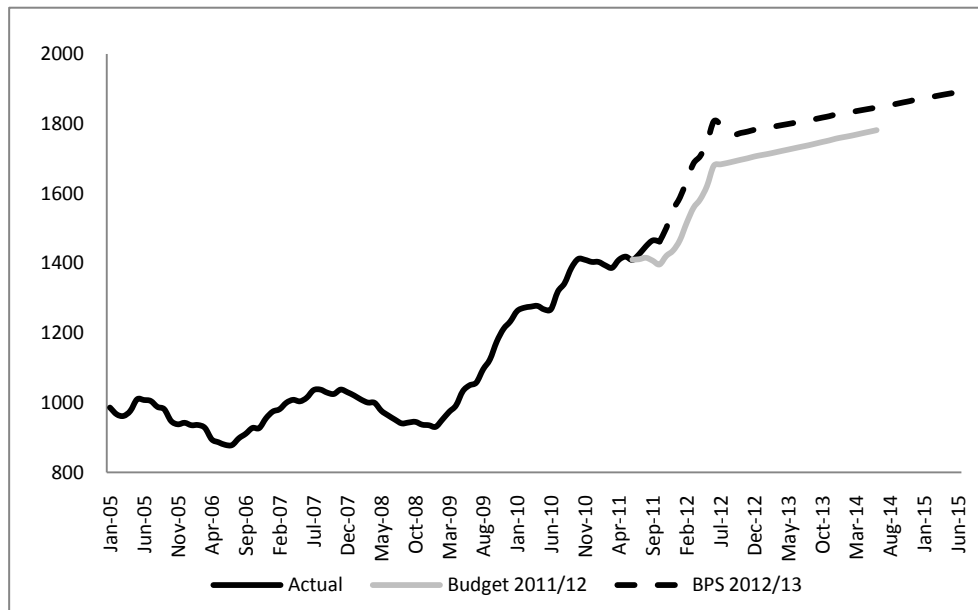
These revised estimates have been incorporated into the forecasts for nominal GDP and thus have impacted on the taxation revenues that support the budget estimates.

## Major Markets

### New Zealand

New Zealand continues to be the Cook Islands biggest market for visitors accounting for around 70 per cent of the total market. As previously reported in the 2011/12 Budget, the New Zealand market had slower growth in 2008/09 through to 2009/10. In May 2011 it was expected that the growth of the New Zealand market over 2009/10 to 2010/11 would be 11.7 per cent - instead it reached 12.0 per cent.

**Table 2.4.2: New Zealand visitor arrivals (moving average) 2005-2015**



To October 2011 growth on the same months in the previous year has been 5.5 per cent and this is expected to continue to grow for the remainder of the year. Tourism Cook Islands believes that this growth in visitors from the New Zealand market is due to the continuous marketing that the corporation has been undertaking in the country in the past few months.

Anecdotal evidence suggests that expenditure patterns of this market is relatively lower in comparison to other markets therefore significant growth in this market is anticipated to translate into a lighter level of growth in the economy.

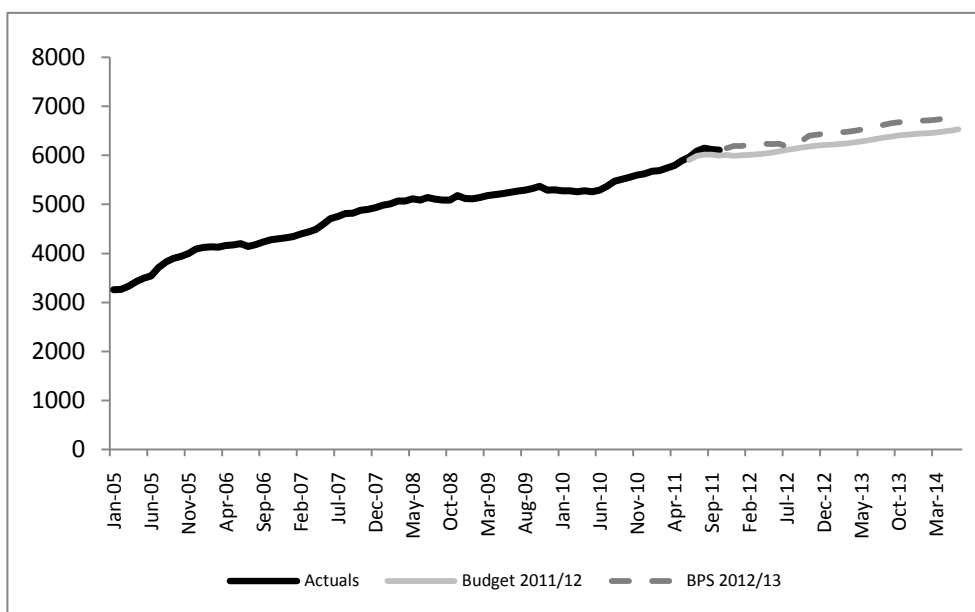
Based on the performance of the market over recent years, growth going forward has been revised upwards from the time of the budget to 4.6 per cent in 2011/12, 5.1 per cent in 2012/13, 3.5 per cent in 2013/14 and 3.0 per cent in 2014/15.

#### *Australia*

The Australian market accounts for 16 per cent of the total market share of visitors to the Cook Islands. Since the commencement of the weekly direct flight established in July 2011 from Sydney this market has experienced increased growth. Forecasts for 2011/12 are now estimated to be 28.2 per cent before returning to moderate growth of around 2.0 per cent per annum.

Actual loadings for the first four months were approximately 76 per cent on average, at the time of the 2011/12 Budget it was expected that loadings for the new Sydney-Rarotonga flight would be around 70 per cent. This forecast update maintains the same as loadings assumptions used at the 2011/12 Budget.

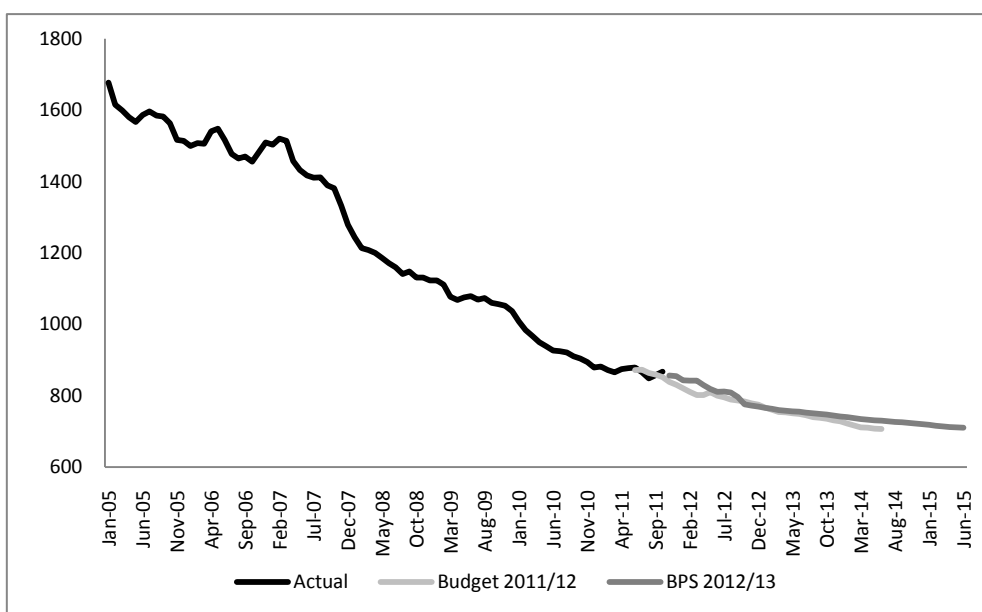
**Table 2.4.3: Australia visitor arrivals (moving average), 2005-2015**



The total level of tourism from this market is expected to increase from 16,909 in 2010/11 to 21,675 in 2011/12 reflective of a full year of the direct flight.

*Europe*

**Table 2.4.4: Europe visitor arrivals (moving average) 2005-2015**



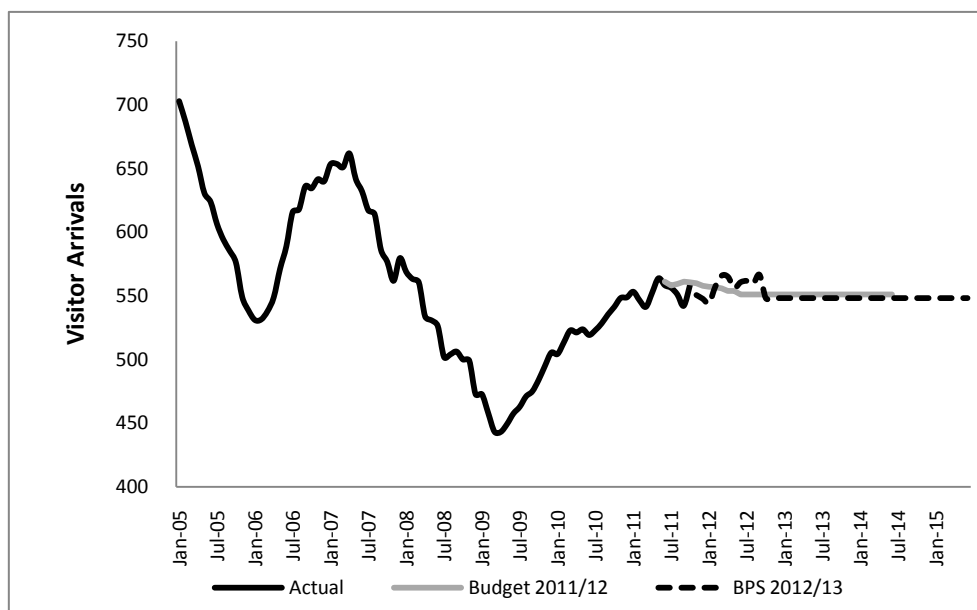
Since 2000/01 when a record 25,000 visitors came from this market, visitors from Europe have constantly declined at an average of 8.0 per cent per annum mainly due to a dwindling UK market.

At year end 2010/11, the European visitors declined 5.2 per cent below the levels reached in 2009/10 which continues to exhibit the downward trend in visitors from this market.

The decline in visitors from the European market is expected to continue in 2011/12 and on to the outer years. Growth in the outer years is expected to be conservative and remain static pending market indications going forward.

### North America

**Table 2.4.5: North American market visitor arrivals (moving average), 2005-2015**



There has been very little growth in visitor focus market by the Cook Islands Tourism Corporation with increased marketing dollars channelled into this market over recent months. The linkage between North America and the Cook Islands is via the Los Angeles route.

Visitor arrivals from North America to the end of 2010/11 were estimated to be around 6,734<sup>4</sup> with actual arrivals being recorded at 6,701. With basically very little growth seen in this market in the last 12 months, we take a conservative forecast by holding the growth constant over the forecast horizon.

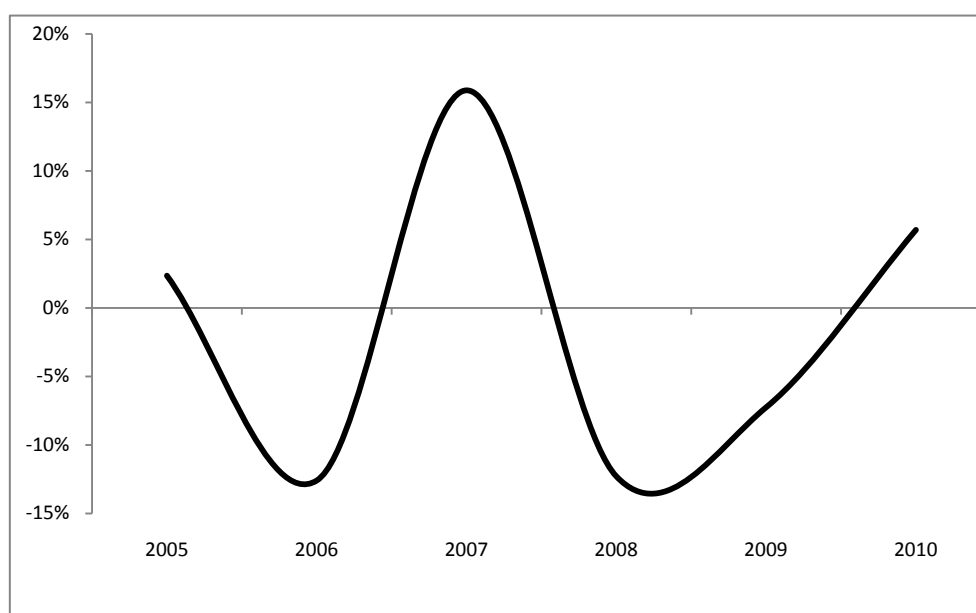
## 2.5 Marine Resources

The Cook Islands marine sector continues to predominantly be made up of the tuna and albacore fisheries and black pearls.

In 2010 the marine sector grew by 6.0 per cent to contribute \$8.0 million to the GDP noting that within the year the performance of the Marine Sector is measured on the basis of exports earnings.

<sup>4</sup> At Budget 2011/12 visitors from North America was published to reach 4,430. Cook Islands Statistics Office have revised the historical series up to 6,734.

**Chart 2.5.1: GDP Marine Sector Growth, 2005-2010, (\$'000)**



The total actual value of marine exports for 2010/11 was \$3.7 million well below the forecast of \$4.9f million– the reduction is driven by lower than expected pearl exports over the period. The detail of total exports from this sector is outlined in sections 2.5.1 (Fishing) and 2.5.2 (Pearl) of this update.

Going forward the export of the marine sector is expected to grow at 4.0per cent driven by expected increases in fisheries exports.

### **2.5.1 Fishing**

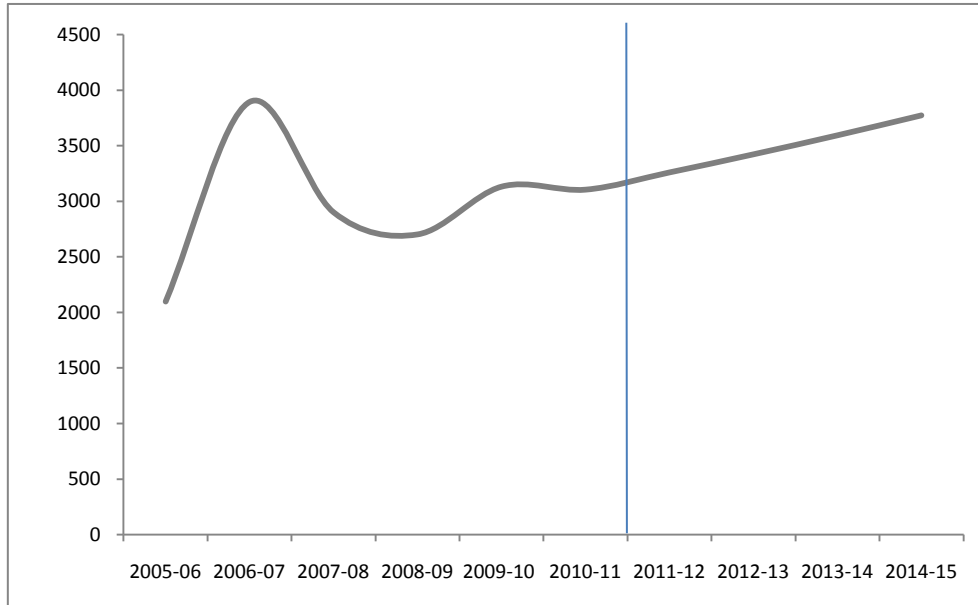
The Cook Islands fishing industry continues to be serviced by the Northern and Southern fleets, with 36 licensed vessels servicing both fleets.

As reported in previous updates, the Northern fishery lands the majority of its catch in Pago Pago with the remaining dispersed in smaller markets in Japan, Thailand and Brazil while the Southern fishery service is expanding the local market on Rarotonga.

Fish exports in the the first quarter of 2011/12 have recorded positive growth on the June quarter with \$1.0 million in exports.

Noting the high volatility of exports over the previous year, the Ministry of Marine Resources (MMR) expects the prospects for growth in 2011/12 to increase as fleets are encouraged to process their catches out of Rarotonga as per the rebate scheme introduced by the Ministry in recent months. As a result of this emphasis on exports, it is anticipated that airfreight exports out of Rarotonga of around seven tonnes of fresh fish per week will occur as well as regular containerised freezer shipments from the Rarotonga Port. Progress of this initiative will be assessed over 2011/12.

**Table 2.5.1.1: Fish Exports 2005/06 to 2014/15, (\$'000)**



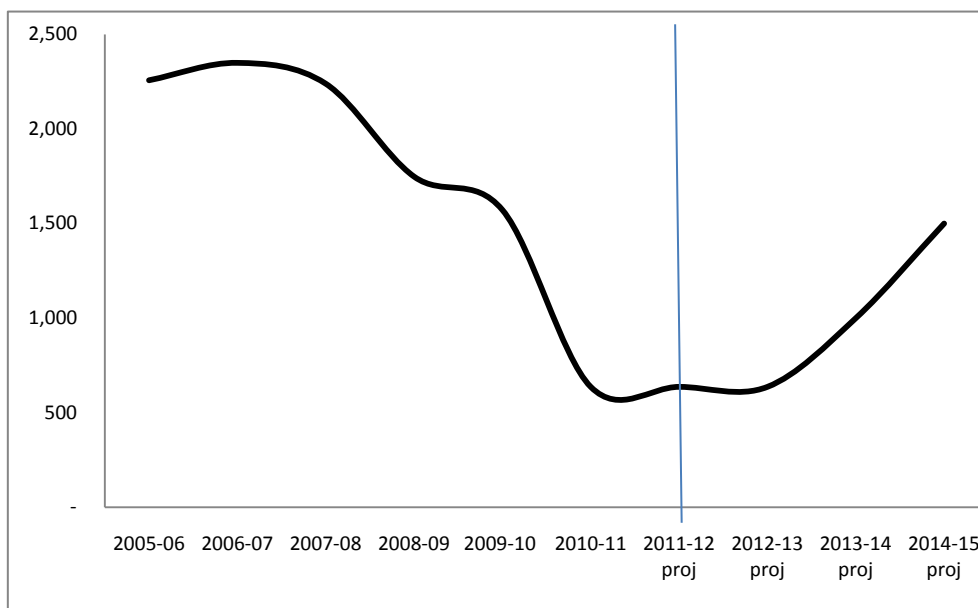
By 2014/15 it is anticipated that processing and containerised exports out of Penrhyn may also take place with a program rolled out under MMR.

Forecasts for fisheries exports remain positive given the trend to date. Going forward it is expected that exports will grow at five per cent per annum in line with returns from the MMR rebate scheme and the increased number of vessels offloading catch in Rarotonga for processing.

**2.5.2 Pearl**

Cook Islands pearls are sold on the domestic and international markets, however as stated in previous updates, it is difficult to quantify the size of the domestic market. The performance of the industry is heavily focused and assessed on the export trends of the industry over time.

**Chart 2.5.2.1: Pearl Exports 2005/06 to 2014/15, (\$'000)**



Pearl exports continue to be down since 2008/09. In 2009/10 pearl exports decreased by 10.1 per cent from 2008/09 and decreased a further 59.5 per cent from \$1.6 million in 2009/10 to \$0.6 million in 2010/11. Not only is pearl exports decreasing in value over previous year, it is also losing share of total exports out of the Cook Islands. In 2009/10 pearl exports accounted for 27.0 per cent of total exports while in 2010/11 this has been recorded at only 12.2 per cent.

The Cook Islands Pearl Authority has taken on a New Zealand Aid (NZ Aid) program with the intention to stimulate growth through implementing key production, marketing, capacity building, and programme management initiatives. Funding from this program has been drawn down and is expected to be rolled out from 2011 through to 2013 noting that the time lapse in which results are to be seen is 18 months from the time of seeding the oyster shells with a new influx of pearls expected to enter the market from 2013. As a result the value of the industry under this program is expected to remain flat until 2013/14 and grow to \$1.5 million by 2014/15.

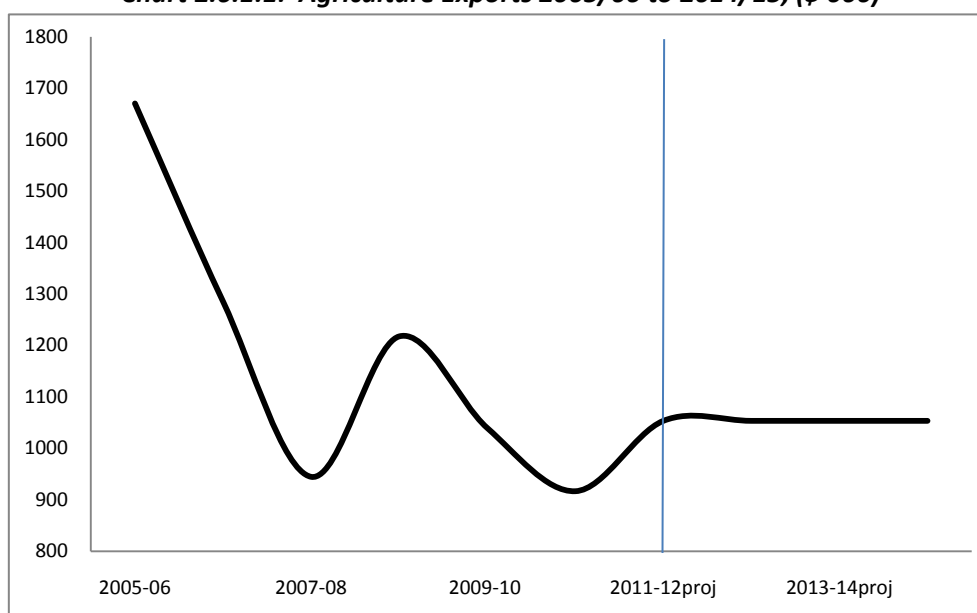
## 2.6 Agriculture

Agriculture is a largely informal sector in the Cook Islands economy and its total contribution to the economy is difficult to quantify. The latest GDP estimate indicate that the sector accounted for 2.9 per cent of GDP equating to \$9.3 million in 2009, then declined slightly to 2.7 per cent of GDP, approximately \$9.1 million in 2010. The supply and demand for agriculture produce is predominantly based in Rarotonga with a minor volume exported to international markets.

Constraints to successfully expanding production to meet the growing demand of both the local and international market continue to be local enterprise, labour shortages, water supply and high costs of transportation from the production source to the market (Rarotonga and international markets). The success of this venture and the consistency of supply to the market are dependent on remedying the constraints.

### 2.6.1 Export Market

**Chart 2.6.1.1: Agriculture Exports 2005/06 to 2014/15, (\$'000)**



The export of agriculture produce for 2010/11 was estimated to total \$0.6 million at the time of the budget in July, however actual data reflects a much higher value of exports at \$0.9million consisting

of noni (\$0.8million) and maire eis (\$0.1 million) exported to markets in Japan and Hawaii respectively.

Despite projections for a decrease in noni exports earlier in 2011, promising export figures have indicated the bounce back of the Japanese importers in demanding Cook Islands produce and the re-exportation of the product.

Going forward this is expected to continue, meanwhile noting the dominance of the noni product in the agriculture export sector, the Ministry of Agriculture (MoA) has indicated that re-exportation of the pawpaw fruit is scheduled to begin in February 2012 which would also contribute to strong exports in this sector.

### ***2.6.2 Domestic Market<sup>5</sup>***

Fresh fruit and vegetables are the main agricultural produce traded on the domestic market. Anecdotal evidence suggest that the growth in the tourism industry will further increase the demand for fresh produce however it is noted that surplus demand continues to be met through imported produce from overseas markets.

Further growth in demand for fresh produce is expected to come from solid growth in the tourism industry. There is potential to strategically increase production to cater for the expectation of increased demand and at the same time reduce the import substitution gap. If concentrated efforts are not made to increase domestic supply, reliance on imported produce will continue to deepen and limit the spread of economic returns to the agriculture industry from the higher number of expected visitors.

Until the private sector re-orientates itself to fill the gap of import substitution, projections are that growth in imported produce will increase in line with growth in the economy.

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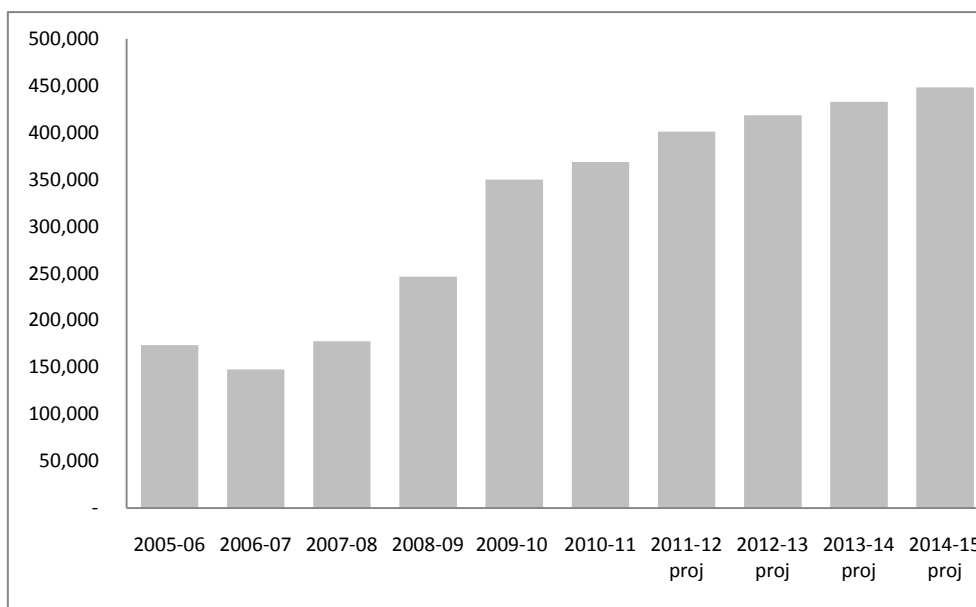
<sup>5</sup> 2011/12 Budget Estimates, pg 37



## 2.7 Exports and Imports

### 2.7.1 Imports<sup>6</sup>

**Chart 2.7.1.1: Value of total imports 2005/06 to 2014/15, (\$'000)**



The historic tonnage unloaded at Cook Island ports increased from 2009/10 to 2010/11 by 7.7 per cent - providing the best proxy that import volumes should have continued to grow by similar levels. Import data will be updated in time for 2012/13 Budget so a full commentary will be provided at that point.

The import leakage for the Cook Islands is estimated at around 58 per cent, representing \$0.58 leaking out of the economy for every \$1 spent in the Cook Islands. This is because of the Cook Islands heavy reliance on imported products to meet local demand including demand driven by the tourism industry. In 2010 the Cook Islands imported a total of \$408.0 million worth of merchandise.

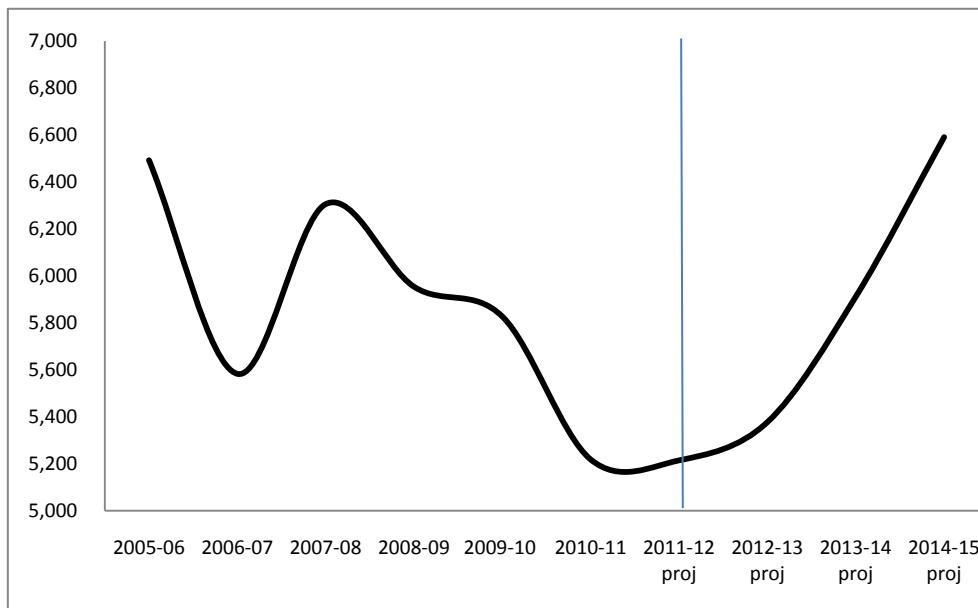
Import volumes were predominantly made up of minerals, oil (36.7 per cent), machinery, transport and equipment (17.4 per cent) and miscellaneous manufactured goods (14.4 per cent). Over 50 per cent of all products are imported from New Zealand followed by other suppliers in Fiji and Australia.

Projections for imports from 2010/11 will continue to be in line with nominal GDP. The expected increase in visitor numbers will place a higher demand for imported produce. A market gap presents itself and moves to fill this demand through local produce will relieve some pressure on the deepening of the trade deficit through import substitution, potentially pulling down the import leakage.

<sup>6</sup> 2011/12 Budget, pg 37

## 2.7.2 Exports

**Chart 2.7.2.1: Total exports 2005/06 to 2014/15, (\$'000)**



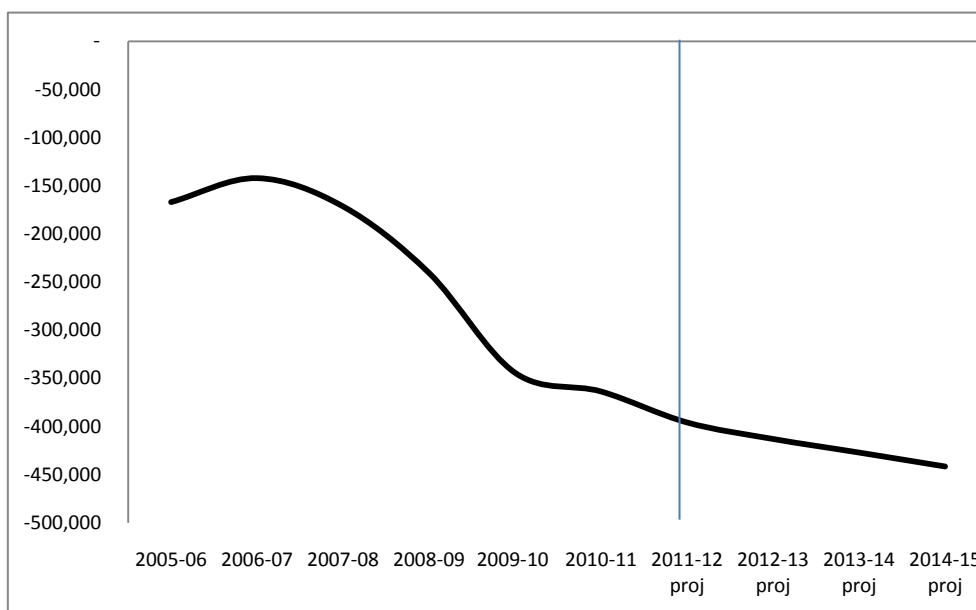
Total exports for 2010/11 year were \$5.2 million, a 10.5 per cent reduction from 2009/10, driven by a substantial fall in the value of pearl exports from \$1.6 million to \$0.6 million, offset slightly by an increase in other exports.

Export projections for 2011/12 for each of the export sectors have been revised to reflect actual data to the September quarter 2011. Overall exports are assumed to contract slightly by 0.1 per cent in 2011/12 before growing by 3.1, 9.9 and 11.5 per cent over the following three forecast years.

Pearl exports are assumed to remain static for two years before growing to \$1.5 million by 2014/15. Fish exports are expected to grow by 5 per cent per annum right across the forecast horizon, growing the current level of fish exports from \$3.1 million to \$3.8 million by 2014/15.

### 2.7.3 Balance of Trade (BOT)

Chart 2.7.3.1: Balance of Trade 2005/06 to 2014/15, (\$'000)



The balance of trade for 2011/12 is forecast to reach a deficit of \$395.7 which is 5.6 per cent deeper than 2010/11. This revision of the balance of trade is based on actual export data collected to the September quarter 2011. Going forward this is expected to grow in line with nominal GDP.

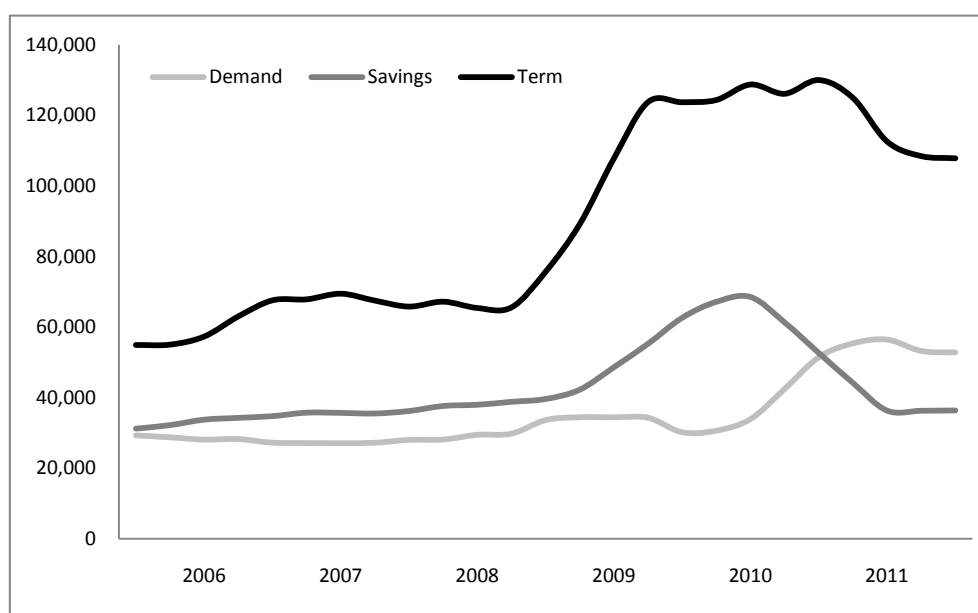
## 2.8 Banking and Finance

Net foreign Assets (NFA) in the Cook Islands banking sector has increased since 2011/12 Budget from \$13.6 million in the June 2011 quarter to \$46.4 million in the September quarter, primarily due to an increase in balances held with domestic banks and finance institutions abroad and a decrease in foreign liabilities.

### 2.8.1 Deposits

Overall deposits since the December quarter 2010 have increased from \$185.7 million to \$221.3 million in the September 2011 quarter - an increase of 19.2 per cent over this period. This is predominantly due to recent increases in on-demand savings and term deposits.

**Chart 2.8.1.1: Deposits 2005/06 to 2010/11, (\$'000)**



The recent increase, driven by the term deposits and savings categories, is predominantly due to private sector contributions to the banking system. Going forward, deposits are expected to grow in line with nominal GDP.

Going forward, deposits are expected to grow in line with nominal GDP.

### **2.8.2 Withholding Taxes**

Government has reintroduced withholding taxes from September 2011 on interest income earned from bank deposits.

Subjecting interest income from registered banks to withholding tax is a change to a previous decision to exempt such income from income tax. Taxing interest income is common throughout most developed countries and the implementation of this is relatively simply applied through the banks. The interest withholding tax is 15per cent of interest paid.

This tax is expected to collect \$1 million per annum although the expected revenue in 2011/12 only has been revised down to \$586,000 due to the Government decision to pro-rata the tax impost to the proportion of the term deposit that has been held by the bank after 1 July 2011.

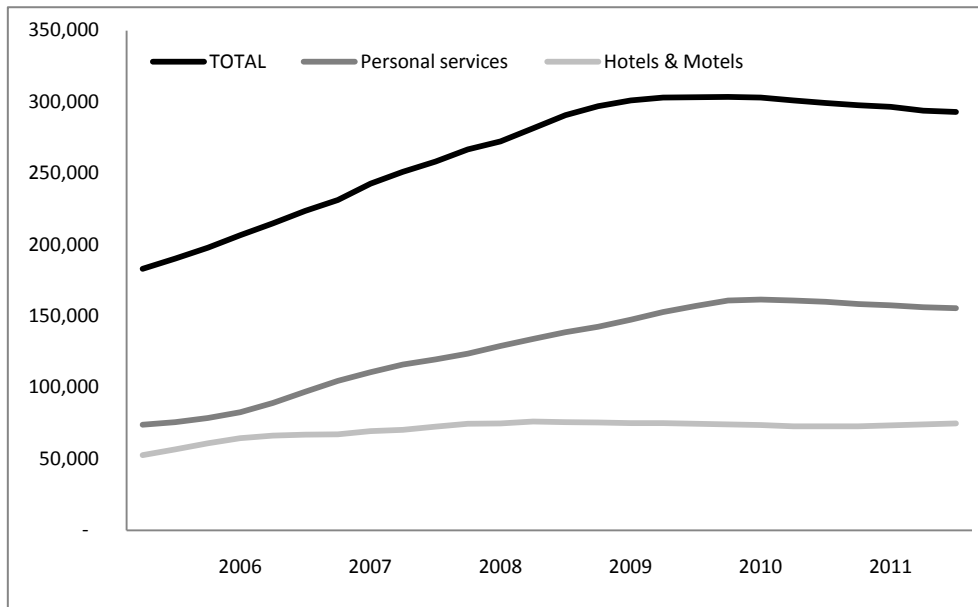
### **2.8.3 Loans**

After a period of increased borrowing from 2004-2008, total loans has remained fairly constant. This likely reflects a lack of confidence about expansion during and after the global financial crisis in 2008. Since 2008 businesses have been consolidating their loan position rather than vigorously pursuing new expansion opportunities.

Total loans are expected to rise over the forecast horizon but not quite by the level of growth in nominal GDP as the current global economic outlook continues to create impact negatively on confidence levels.

The level of personal loans has remained constant since 2009, again likely due to the softer economic growth and therefore lower consumer confidence. This appears to be consistent with the stagnant growth in the residential building sector over the past two years.

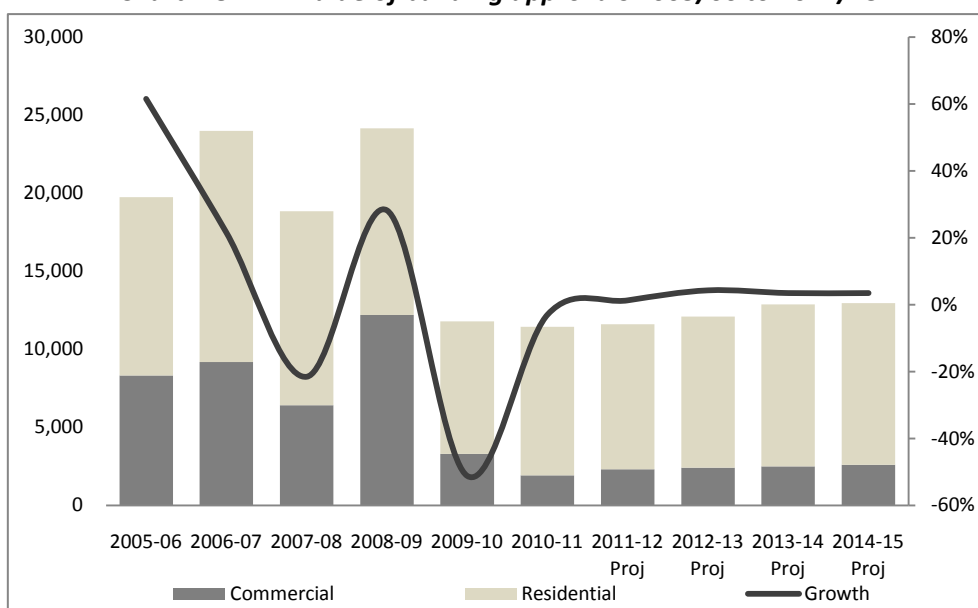
**Chart 2.8.3.1: Loans 2005 to 2011 moving average, (\$'000)**



### 2.8.4 Housing and Construction

The trends and movements in the construction industry indicate a current subdued level of investor confidence within the economy, resulting in less new developments. Total investments in the September quarter 2011 amounted to \$2.3 million. For the last four quarters residential construction has accounted for 80 per cent of all construction. Year on year to the September quarter total construction has declined 1.5 per cent indicating a very subdued construction market. Growth is expected to turn positive – in line with growth in nominal GDP.

**Chart 2.8.4.1: Value of building approvals 2005/06 to 2014/15**



## **2.8.5 Financial Services Industry**

The financial services industry is estimated to collect fees to a net value of \$1.3 million for services undertaken in 2011/12. Fees payable are generally denominated in US dollars which mean that income collected is subject to currency exchange fluctuations. The legislative arm of the industry estimates 2 per cent annual growth in the number of new international companies and trusts registrations will be reflected in fees collected in the outer years on the assumption that the 0.80USD/1\$rate holds.

## **2.9 Assumptions Underlying the Economic Forecast**

The assumptions underlying the economic forecasts are outlined within each of the individual section in the Economic Update. GDP is updated to the 2010 calendar year while all other data is updated to the September 2011 quarter. Visitor arrivals have been updated to October 2011. All forecasts for the 2011/12 and outer years have been revised and documented in their individual sections.

The key assumptions are as follows:

- The growth in the Cook Islands GDP is explained by tourism expenditures, government expenditures and export receipts.

### Tourism Expenditures

- Average visitor stays in the Cook Islands 10 days
- Average visitor spent in the Cook Islands of \$223 per day increasing by 2 per cent in each outer year in line with general price rises.
- Visitor arrivals grew by 9.6per cent in 2010/11 is assumed to grow by 6.8per cent in 2011/12, 2.5per cent in 2012/13, and then grow at 2.5per cent and 2.2per cent in the outer years.

### Government Expenditures

- Government expenditure is based on appropriations and forecasts that reflect existing government policy which incorporates various one off expenditure items detailed in the 2011/12 Budget Estimates.
- Expenditures for 2011/12 are assumed to grow by 2.8per cent. Further out, this expenditure is expected to grow by 0.9per cent in 2012/13, 0.7per cent in 2013/14 and 4.4per cent in 2014/15.

### Export receipts

- Pearl : static for 2011/12, rising to \$1.5 million by 2014/15
- Fish : 6.6 per cent in 2011/12, 3.3 per cent in 2011/12, going forward growth is expected to come in at \$200,000 per financial year
- Other: -13 per cent in 2011/12, static going forward
- Overall exports are assumed to grow at -0.9 per cent in 2011/12, 3.2 per cent in 2012/13, 11.0 per cent and 11.5 per cent in the outer years.

- Nominal GDP is calculated based on growth in tourism expenditures, government expenditures and export receipts. Based on the above assumptions Nominal GDP is therefore estimated to grow at 8.7 per cent in 2011/12, 4.3 per cent in 2012/13, and then revert to a long run growth rate of 3.5 per cent.

- Nominal GDP is deflated based on the CPI to calculate Real GDP. Real GDP is expected to grow by 5.7 per cent in 2011/12 and to increase by 1.3 per cent in 2012/13 followed by more moderate growth of 0.5 per cent in 2013/14 and 2014/15.
- The Consumer Price Index (CPI) is estimated to have grown by 2.1 per cent in 2010/11. Based on moderate GDP growth and historical CPI trends, our best estimate is that CPI will remain at 3.0 per cent per annum over the forecast horizon.
- Growth in the banking and finance sector and housing and construction are expected to grow in line with Nominal GDP forecasts.

The above assumptions are based on past growth rates within the Cook Islands economy and economic predictions for regional and world growth in 2011/12 and the out years.

## **3 FISCAL UPDATE**

### **3.1 OVERVIEW**

The purpose of the Fiscal Update is to provide necessary revisions to fiscal forecasts that underpinned the 2011/12 Budget in July 2011, and as a result provide an analysis for fiscal responsibility and a revised set of accounts for 2011/12, 2012/13, 2013/14 and 2014/15 providing a basis for the next budget. In updating the fiscal forecasts the following factors have been considered:

- updated economic forecasts which have a direct impact on forecasted government revenues;
- year to date assessment of revenues and expenditure patterns against original 2011/12 Budget Estimates;
- re-evaluation of debt stocks based on updated exchange rate movements; and
- Government budget policy on the use of operating surpluses going forward.

#### ***Updated economic forecasts which have a direct impact on forecasted government revenues***

Projected revenue has been revised up compared to 2011/12 Budget due to more favourable forecasts in nominal GDP growth, which is due to higher estimates in tourism growth. Tourism is expected to continue to grow, driven by growth in the New Zealand market and the Australian market as a result of the new Sydney-Rarotonga connection. Therefore, nominal GDP is forecast to grow strongly by 8.7 per cent in 2011/12, 4.3 per cent in 2012/13. Growth is then expected to revert back to a long run trend of around 2.5 per cent per annum from 2013/14.

#### ***Year to Date Assessment of revenues and expenditure patterns***

At the time of the 2011/12 Budget (July 2011), the net operating surplus for 2010/11 was estimated to be \$0.1million. A \$2.5million surplus was recorded driven primarily by higher than expected tax receipts over the month of June 2011.

This growth has followed through into 2011/12 where year to date revenues have come in \$2.2million above initial cash flow estimates, with expenditures continuing to be maintained within budget limitations. The growth in revenues is driven by higher than forecast economic growth from the tourism industry with visitor arrivals over June 2011 to October 2011 exceeding original forecasts by 5.2 per cent (2,300 tourists).

This presents a positive outlook for the Government's fiscal stance over the coming months and is reflected in higher forecasted growth in revenues going forward. Part of this increase is absorbed by downward movements in revenue items including, interest earned on government deposits (from 2012/13) and interest earned on loans to subsidiaries. There are fluctuations within other revenues however overall other revenues are generally on track and will be reviewed in detail before the start of the 2012/13 budget process.



### ***Re-evaluation of debt stocks based on updated exchange rate movements***

Debt data has been re-valued since the 2011/12 Budget to reflect changes in exchange rates.

A favourable movement in average exchange rate for the USD for the year ended October 2011 (average exchange rate of 0.7865) has resulted in a reduction in our debt portfolio, and has also pushed down loan repayments and debt servicing interest over the medium term.

As a result of the above, both revenue and expenditure forecasts for 2011/12 to 2014/15 have been revised upwards from those reported in the 2011/12 Budget Estimates. However, in light of global economic uncertainty, there is some caution around the forecasts.

The Government has adopted a prudent fiscal stance due to the vulnerability which would arise in the event that one or both of our major trading partners (New Zealand and Australia) are impacted by a second bout from the global economic crisis.

### ***Government budget policy on the use of operating surpluses going forward***

In its 2012/13 Budget Policy Statement, Government has explicitly stated that it notes the caution in the global economic environment.

Government will not seek to expend the higher levels of budget surpluses that have come about based on year to date activity. It will look to provision approximately half for policy initiatives over the next three years and allow the balance to be transferred into general cash reserves.

This provides for a healthy level of operating surplus; puts aside appropriate provisions for future budgets, and places government in a more favourable net worth position in a time of uncertainty. This is Government's stated fiscal policy over the medium term.

To control the impacts of fiscal policy 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;
- managing prudently the fiscal risks facing the Crown; and
- pursuing policies that are consistent with a reasonable degree of predictability about the level and stability of tax rates for future years.

The Ministry of Finance and Economic Management quantifies these principles through the Fiscal Responsibility Ratios (FRR) as reported in the 2011/12 Budget. The table below shows the benchmarks of these ratios and performance in 2010/11 and expectations for 2011/12 based on revised forecasts:

**Table 3.1: Fiscal Responsibility Ratios**

	Type	Purpose	Benchmark	FY09/10	FY10/11	FY11/12	FY11/12	Comment
				Estimate	Estimate	Budget	Estimate	
				\$m	\$m	\$m	\$m	
<b>A Fiscal Envelope Ratio</b>								
1	Tax Revenue to GDP	Sets the revenue boundary and ensures government limits the diversion of resources away from the private sector	25.0%	26.5%	25.1%	23.8%	24.6%	Currently levels are appropriate given one off tax receipts despite inclusion of change in government policy to implement withholding taxation on interest income.
<b>B Expenditure Control Ratios</b>								
2	Personnel to Total Revenue	Controls expansion in the size of the public service	40.0%	40.3%	41.1%	41.5%	40.5%	Concerning and will require policy action over the medium term.
3	Operating Balance	As required under the MFEM Act (\$'000)	0	0.7	2.5	0.0	2.7	Current levels are appropriate. However levels must be tracked closely over the medium term.
<b>C Prudential Ratios</b>								
4	Debt Servicing to Total Revenue	Measures ability to service debt	5%	4.0%	1.8%	2.3%	1.8%	Current levels are appropriate. However this must be tracked closely when new loans are considered. Note formula adjustment to be net of loan reserves drawdown's to better reflect the ability of government to service debt.
5	Budget Overall Deficit as % of GDP	Moderate the rate of debt accumulation	+/-2%	1.8%	1.4%	2.0%	1.4%	Current levels as per the 2010/11 budget are appropriate given the balance of expenditure is financed through loan and reserve funds rather than increased borrowings. However this must be tracked closely when new loans are considered.
6	Net Debt to GDP ratio	Measures the level of debt relative to national income	35.0%	20%	12%	17%	12.5%	Current levels are appropriate and are expected to stay around the same levels despite the inclusion of ADB loans in 2011/12. However this must be tracked closely when new loans are considered. Government is also considering a consolidation of this ratio.

It must be noted that since the time of the 2011/12 Budget there has been a revision in the calculation of the debt servicing to total revenue ratio which measures the ability of the Crown to service its debt from its revenue streams. Given government has built up and has begun to draw down on its loan reserves to service a portion of its debt in addition to using total revenues, the formula will net off draw downs on loan reserves. This better reflects the ability of government to service its debt within revenue streams and as such has improved this ratio over the medium term.

**Table 3.2: Fiscal Indicators**

<b>Fiscal Indicators</b>							
	<b>FY09/10</b> Actual	<b>FY10/11</b> Estimate	<b>FY11/12</b> Budget	<b>FY11/12</b> Estimate	<b>FY12/13</b> Proj	<b>FY13/14</b> Proj	<b>FY14/15</b> proj
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
<b>Statement of Financial Performance</b>							
Taxation Revenue	87.1	87.0	90.0	92.7	95.4	99.4	102.7
Other Revenue	6.3	7.3	5.4	5.4	5.4	5.2	5.2
Ministry Trading (net revenue)	5.4	5.2	5.2	5.2	5.2	5.2	5.2
Interest and Dividend	4.6	5.9	5.5	5.5	4.5	4.5	4.5
<b>Total Operating Revenue</b>	<b>103.4</b>	<b>105.4</b>	<b>106.1</b>	<b>108.7</b>	<b>110.6</b>	<b>114.3</b>	<b>117.6</b>
Total Revenue as % of GDP	31.4%	30.4%	28.1%	28.9%	28.1%	28.1%	27.9%
Tax Revenue as % of GDP	26.5%	25.1%	23.8%	24.6%	24.3%	24.4%	24.4%
<b>Personnel</b>	<b>41.7</b>	<b>43.3</b>	<b>44.1</b>	<b>44.1</b>	<b>43.8</b>	<b>44.3</b>	<b>44.3</b>
as % of Total Revenue	40.3%	41.1%	41.5%	40.5%	39.6%	38.7%	37.6%
<b>Provision for New Policy</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>0.6</b>	<b>1.5</b>	<b>4.0</b>
<b>Total Operating Expenditure</b>	<b>102.7</b>	<b>102.8</b>	<b>106.1</b>	<b>106.0</b>	<b>107.6</b>	<b>109.3</b>	<b>111.8</b>
as % of GDP	31.2%	29.7%	28.1%	28.1%	27.4%	26.9%	26.6%
as % of Operating Revenue	99.3%	97.6%	100.0%	97.5%	97.3%	95.7%	95.1%
<b>Operating Balance</b>	<b>0.7</b>	<b>2.5</b>	<b>0.0</b>	<b>2.7</b>	<b>2.9</b>	<b>5.0</b>	<b>5.8</b>
as % of GDP	0.2%	0.7%	0.0%	0.7%	0.7%	1.2%	1.4%
Non Operating Balance	(6.5)	(7.4)	(7.4)	(7.9)	(8.6)	(9.5)	(10.6)
<b>Overall Surplus/(Deficit)</b>	<b>(5.8)</b>	<b>(4.9)</b>	<b>(7.4)</b>	<b>(5.2)</b>	<b>(5.7)</b>	<b>(4.5)</b>	<b>(4.8)</b>
as % of GDP	1.8%	1.4%	2.0%	1.4%	1.4%	1.1%	1.1%
<b>Statement of Financial Position</b>							
Assets	352.2	355.7	350.8	374.1	377.7	382.2	386.5
Liabilities	129.7	101.2	122.3	112.4	109.1	104.8	99.3
Crown Balance	222.5	254.5	228.5	261.6	268.5	277.4	287.2
as % of GDP	67.6%	73.4%	60.5%	69.4%	68.3%	68.2%	68.2%
<b>Statement of Borrowings</b>							
Net Crown Debt, end of FY	67.2	40.5	62.3	47.0	45.1	42.3	38.5
as % of GDP	20.4%	11.7%	16.5%	12.5%	11.5%	10.4%	9.1%
Loan Repayment Reserves Held	22.0	20.5	19.1	19.1	17.6	16.2	14.8
Net Debt Servicing <sup>1</sup>	4.2	1.9	2.4	1.9	2.9	3.9	5.1
as % of Total Revenue	4.0%	1.8%	2.3%	1.8%	2.6%	3.4%	4.3%
Memo item: Nominal GDP	329.0	346.7	377.5	376.9	393.2	407.0	421.2

<sup>1</sup>Note change in formula since the 2011/12 Budget Estimates. Net Debt Servicing is now net of draw downs of loan reserves used to service SOE debt payments.

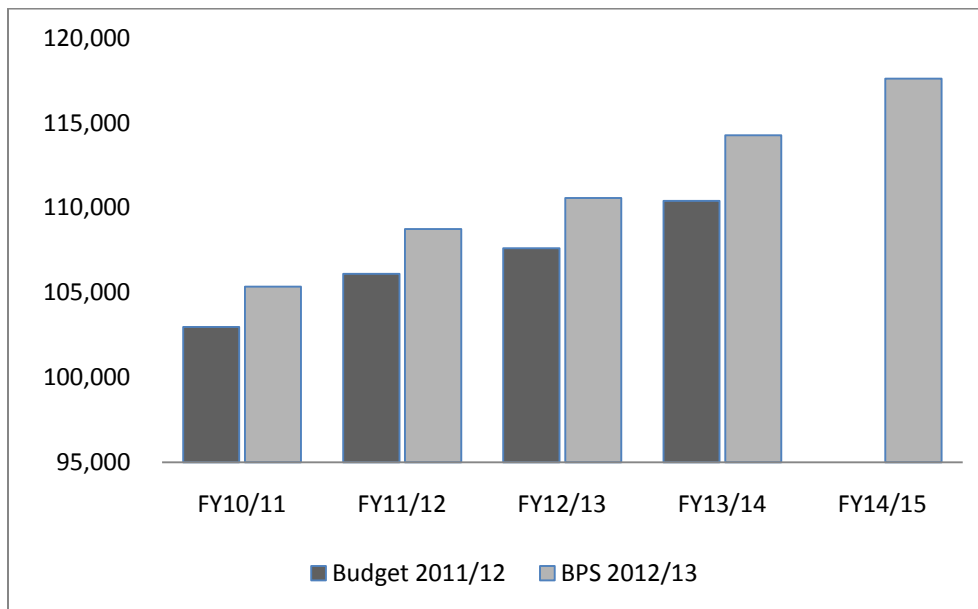
## 3.2 OPERATING STATEMENT

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

### 3.2.1 Operating Revenue

Operating revenues are made up of taxation receipts (85 per cent), other revenues collected on behalf of the crown (5 per cent), ministry trading revenue (5 per cent) and interest and dividend receipts (5 per cent). These revenue streams are used to finance the ongoing operational expenditure of government, with surpluses used for investing activities (where apparent).

**Chart 3.2.1.1: Total Operating Revenue 2010/11 to 2014/15, (\$000)**



#### *2010/11*

At the time of the 2011/12 Budget, operating revenues were estimated to total \$103.0 million, of which \$84.7million was expected to be collected in taxes over 2010/11 financial year.

Since this time movements in taxation revenues have been realised and resulted in the upward revision of operating revenues in 2010/11 by \$2.4 million to \$105.4 million, due to higher than anticipated visitor numbers.

#### *2011/12*

Original projections for operating revenues at the time of the 2011/12 Budget were expected to increase by 3.0 percent mainly driven by higher visitor volumes as a result of the Sydney-Rarotonga connection, the inclusion of withholding tax, and slight increases in ministry trading revenue and interest on loans to subsidiaries. Given the re-estimation of 2010/11 operating revenues and a revision upward in forecasted revenues for 2011/12, total operating revenues

are now expected to grow at a higher rate of 3.2 percent off a higher base reflecting healthy year to date performance. Slight reductions in interest on loans to subsidiaries due to exchange rate movements have also been factored in. Movements in other operating revenues are expected to have a limited net impact to date.

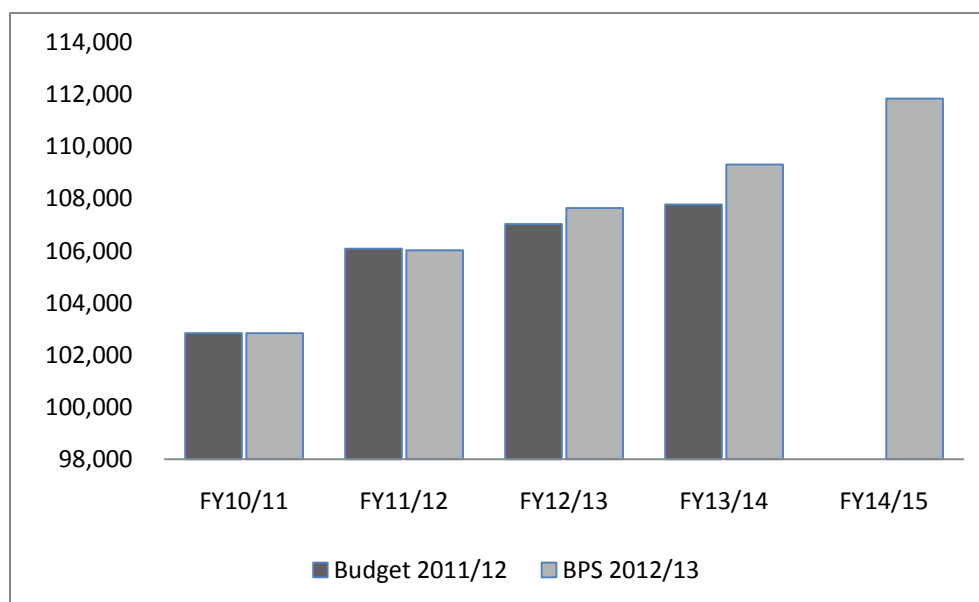
The revenue collections as a result is an upward revision of taxation revenues places overall revenues for the outer years at \$3.0 million and \$3.9 million higher than original estimates respectively.

### 3.2.2 Operating Expenditure

Operating expenditure is made up of Ministry outputs (60 per cent), payments on behalf of the Crown (33 per cent) and for other operating expenditure (7 per cent).

The Appropriation 2011/12 passed in July 2011 determined an overall upper limit on all expenditure of \$172.097 million of which 62 per cent is operating expenditure.

**Chart 3.2.2.1: Total Operating Expenditure 2010/11 to 2014/15, (\$000)**



Operating expenditures at the time of the 2011/12 Budget were estimated at \$106.1 million in July 2011, these have been revised downwards slightly to reflect favourable exchange rate movements on the debt servicing interest payments.

Actual year to date expenditure has been maintained within 2011/12 Budget Estimates. This presents an overall saving of 6 per cent in appropriations to date. Expenditure is expected to remain within budget limitations by year end based on current commitments by government.

As per the 2012/13 Budget Policy Statement (BPS) higher level of net operating surpluses going forward and therefore an increased level of spending in the 2012/13 Budget going forward; Government has determined that it would put aside a portion of these surpluses earmarked for

policy decisions over the medium term. This is discussed in section 3.2.3 *Operating Balance* below. The balance is expected to pass through to cash reserves given recent global uncertainty.

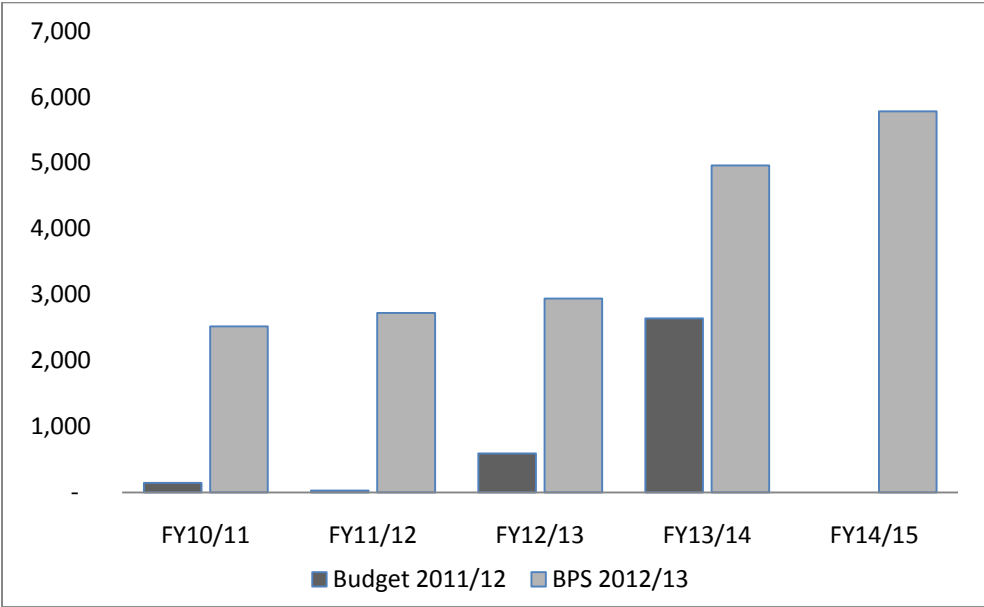
The fiscal responsibility ratio, personnel expenditure is above the benchmark ratio (of 40 per cent) in this update by 0.5 per cent. There are pressures to reduce current personnel levels over time therefore policy action is required.

**3.2.3 Operating Balance**

The operating balance is the balance of operating revenues minus operating expenditure as prescribed by the MFEM Act. Given the analysis provided in sections 3.2.1 and 3.2.2, the net operating balance in 2011/12 has been revised to a surplus of \$2.7million.

Going forward, the upward revision to nominal GDP growth (as discussed in section 2.1.1 *Nominal GDP*) lifts the level of operating surplus to \$3.6 million, \$6.5 million and \$9.8 million in the outer years respectively prior to the provisioning of funds for policy initiatives. Government therefore anticipates that the budget surpluses will come in as demonstrated in the below chart 3.2.3.1 *Net Operating Surpluses 2010/11 to 2014/15*.

**Chart 3.2.3.1: Net Operating Surplus 2010/11 to 2014/15, (\$000)**



Changes to the operating balance and the overall budget balance since the time of the 2011/12 Budget are shown below:

**Table 3.2.3.1 : Changes to Forecasts since 2011/12 Budget Estimates (\$000)**

	2011/12	2012/13	2013/14	2014/15
<b>Net Operating Balance - 2011/12 Budget</b>	<b>31</b>	<b>593</b>	<b>2,639</b>	<b>NA</b>
Change to Operating Revenues	2,639	2,966	3,855	
Change to Operating Expenses	-53	-5	-15	
<b>Net Operating Balance as at 2011/12 BPS</b>	<b>2,723</b>	<b>3,564</b>	<b>6,509</b>	<b>9,792</b>
<b>Net Overall Budget Balance - 2011/12 Budget</b>	<b>2</b>	<b>-693</b>	<b>1,404</b>	<b>NA</b>
Change to Non-Operating Revenues	-287	-287	-76	
Change to Non-Operating Expenses	-428	-336	-605	
Change to Financing Items	2,692	2,867	3,766	
<b>Net Overall Budget Balance as at 2011/12 BPS</b>	<b>2,834</b>	<b>2,223</b>	<b>4,489</b>	<b>6,684</b>

As stated in the 2012/13 Budget Policy Statement, the Government intends to utilise approximately half of this surplus (after capital purchases, loan repayments and non operating expenditures) over the next three budgets and allow the remaining balances to flow through to the cash reserves due to the uncertainty surrounding the global economy and likely negative impacts if a second bout of an economic crisis was to eventuate. This is demonstrated in the table below.

**Table 3.2.3.2: Net Overall Surplus and New Policy Provisions 2012/13 to 2014/15 (\$000)**

	2012/13	2013/14	2014/15	Total
Net Overall Budget Balance as at BPS	2,223	4,489	6,684	13,396
<i>2012/13 Budget</i>	<i>624</i>	<i>624</i>	<i>624</i>	<i>1,872</i>
<i>2013/14 Budget</i>		<i>923</i>	<i>923</i>	<i>1,846</i>
<i>2014/15 Budget</i>			<i>2,464</i>	<i>2,464</i>
<b>Total Policy Provision</b>	<b>624</b>	<b>1,547</b>	<b>4,011</b>	<b>6,182</b>
Increase in Cash Reserves	1,599	2,942	2,673	7,214



### 3.3 DEBT

#### **Gross Debt**

Government's total borrowings were estimated at \$107.6 million for the fiscal year ending 30 June 2012. This gross debt figure has now been re-valued to \$93.6 million, a \$14.0 million variance to reflect a debt restructure in currencies and also to reflect the favourable movement in average exchange rate for the USD for the year ended October 2011 (average exchange rate of 0.7865).

**Table 3.3.1: Borrowings by Lender and Share (\$000)**

<b>Asian Development Bank</b>	\$ 75,184	80%
<b>EXIM Bank of China</b>	\$ 13,933	15%
<b>Government of France</b>	\$ 3,636	4%
<b>Government of New Zealand</b>	\$ 818	1%
<b>Total Gross Debt (NZD)</b>	\$ 93,571	100%

No new borrowings have been undertaken since the 2011/12 Budget. The majority of debt comes from the Asia Development Bank (ADB) which accounts for almost 80 per cent of the total loans outstanding, followed by Export-Import Bank of China at 15 per cent. These outstanding loans are granted in various currencies such as Special Drawing Rights (SDR), US Dollars (USD), Yuan Renminbi, Euro, and New Zealand Dollars (NZD). Most loans are to be repaid in their USD equivalent mainly for exchange risk management purposes.

#### **Loan Reserves**

Government holds loan reserves which have been built up over the years from the repayments of on-lent loans to State Owned Enterprises (SOEs). It is predicted that Crown loan reserves will reduce in outer years and are estimated to stand at \$19.1 million by the end of June 2012. The stock of loan reserves will continue to reduce in the outer years as repayments are made on loans that were on-lent to SOEs.

#### **Net Debt**

Net debt is the difference between Crown gross debt and the on-lending of loans to SOEs (including the stock of loan reserves). Net Debt was estimated to be approximately \$62.3 million (16.5 per cent of GDP) for the fiscal year ending 30 June 2012 at the time of the Budget Estimates 2011/12 and has now been re-valued at \$47.0 million (12.5 per cent of GDP) to reflect the movement in exchange rates.

This ratio to GDP is considered well within the fiscal responsibility benchmark of 35 per cent as outlined in the Fiscal Responsibility Ratios.

The objective of this ratio is to control and set a limit of the level of net debt (debt carrying capacity) and measure this against national income. Based on this ratio, the current net debt

carrying capacity of the Cook Islands is \$132.0 million. As stated, current level is well within the fiscal responsibility principles stipulated in the MFEM Act.

This percentage is expected to reduce over the outer years as growth in the economy improves and repayments of existing debt continue, despite reductions in loan reserves in outer years.

### ***Debt Servicing to Total Revenue***

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

The current benchmark on debt servicing to total revenue ratio is 5 per cent. The original budget published the debt servicing to total revenue ratio at 3.4 per cent for the fiscal year 2011/12. This has been revised down to 1.8 per cent in this half year fiscal update to reflect the effect of utilising the loan reserves to pay for the SOE loans due as explained above. Incorporating the use of loan reserves provides a more realistic picture of Government's ability to service its debts.

### ***Future Borrowings***

The current status of Crown borrowing is fiscally manageable in terms of compliance to the 35 per cent limit on how much can be borrowed. Government expects this ratio to improve in the outer years in the event that there are no future borrowings and GDP continues to increase.

Although debt to GDP is well within the threshold, careful attention needs to be drawn to the ability of Government to fund the associated operating expenses (including maintenance and capital operating expenses) from operating revenue generated. The demand for upgrading infrastructure projects for sustainable economic growth and social activities is always a priority for Government and therefore any future borrowings must be approached cautiously.

All borrowing proposals must be made under transparent processes as required by the MFEM Act 1995-96, evidenced by well researched business cases and funded through a user pays system where possible.

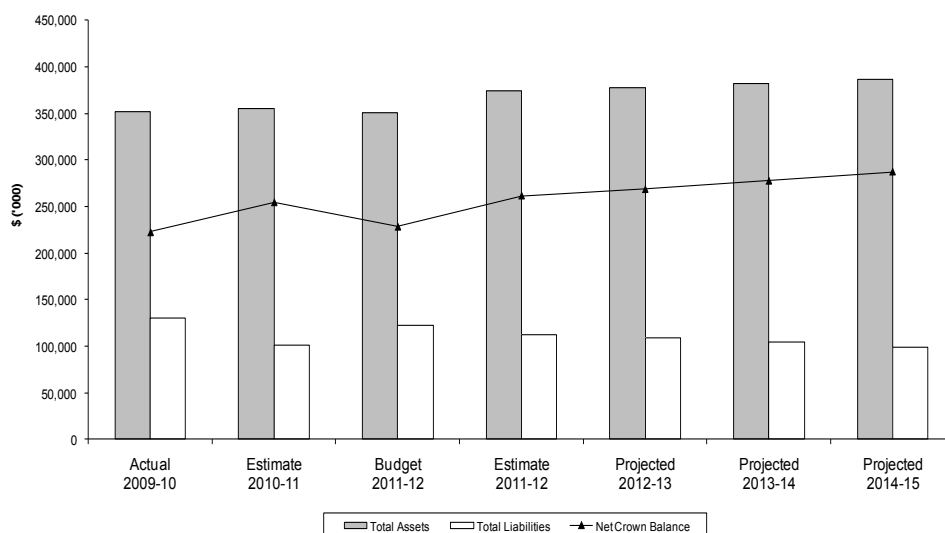
The fiscal responsibility ratios will prudently assist Government to manage the growth of its future borrowing plans.

## **3.4 NET WORTH**

Government's net worth is the difference between Crown assets and Crown liabilities providing a snapshot of government's ability/inability to service all its creditors. There are currently no clear guides to determining an optimal level of public sector net worth; however analysing the

government's net worth and what causes it to change can lead to understanding the need for appropriate policies.

**Chart 3.4.1: Net Worth 2009/10 to 2014/15, (\$'000)**



The estimated net worth of the Crown at June 2012 has increased from the 2011/12 Budget of \$228.5 million to \$261.6 million. This is a net movement of \$31.1 million. Factors contributing to the difference are an increase in the forecasted surplus by \$2.7 million, borrowings restatement of \$26 million (more details in the borrowings/debt section), and other minor adjustments and restatements.

The Crown's net worth will continue to increase in the outer years as long as there is an estimated operating surplus. Also a major contributor to the forecast upward trend is the injection to the Crown's asset from aid donor funding. It is estimated that an annual average of 10 percent of donor funding is capital asset.

### 3.5 OVERSEAS DEVELOPMENT ASSISTANCE (ODA) FLOWS

Total ODA contribution from development partners was estimated at \$43.9 million at the time of the 2011/12 Budget. There have been no significant changes in the level of ODA flows estimated for 2011/12.

In terms of the overall ODA environment, there have been constructive developments in policy with Cabinet approval of the Official Development Assistance policy. The intention of the policy is to guide Government and development partners on how to manage development assistance in the Cook Islands.

In a continued effort to maintain effective dialogue for development assistance planning, the Government has arranged earlier in the budget process a Donor Roundtable meeting to take place in January 2012 in preparation for the 2012/13 Budget. The 2012/13 Budget Policy Statement, the National Sustainable Development Plan 2011-2015, the Cook Islands Government Public Financial Management Roadmap 2012-2015, the Public Sector Functional Review, the Preventative Infrastructure Master plan, the Energy Chart and Climate financing will be a selection of priorities that will frame discussions with donor partners at the Roundtable meeting.

It is anticipated that new ODA funding will roll-in from AusAid approximately \$600,000 for Climate Change adaptation and approximately \$156,000 from Japan for Grassroots Human Security projects. It is also noted that aid funding directed towards the marine resources industry of approximately \$180,000 is also available and requires appropriation. It is expected that the new funding levels will be included in subsequent appropriations. Further, based on year-to-date expenditures it is likely appropriated aid funding under the Peoples Republic of China grant intended for programs in 2011/12 will be carried forward into subsequent appropriations.

### **3.6 SPECIFIC FISCAL RISK**

The total quantifiable contingent liabilities are estimated at \$24.4 million in 2011/12. This is made up of the following:

#### **Guarantees and Indemnities**

- The Government has accepted the commercial risk such that in the event that the Rarotonga/Los Angeles and Rarotonga/Sydney flights incur losses, Government will cover these losses.
- At the time of the 2011/12 Budget Estimates total losses were estimated to be \$11.0 million of which \$10.0 million would be likely paid out in 2011/12 with the balance recognised as a contingent liability. Both contracts will continue to be tracked closely and if necessary an adjustment may be required to the appropriation in the event the routes do not perform as projected. It is noted that MFEM is also sourcing an independent economic analysis of both connections and underwrites over the next quarter.
- The settlement with Apex Agencies Limited (operating as TOA Petroleum, TOA) dated 11 December 2009 provided a guaranteed minimum EBITA (Earnings before Interest, Tax, Depreciation and Amortisation) of \$1.2 per annum. If TOA makes a profit of less than \$1.2 million in a given year (or even a loss) the Crown will make a top up payment to \$1.2 million. That is the Crown's potential liability could exceed \$1.2 million in a given year. An estimate of the potential liability is \$1.6 million as was appropriated in 2011/12 and

therefore not recognised as a contingent liability. There has been no change since the time of the 2011/12 Budget Estimates.

- The Government has entered into a program under the New Zealand Aid Programme focused on Pearl Sector Support run through the Cook Islands Pearl Authority. Through the program the CIG has agreed to guarantee up to \$0.5 million as security for loans associated with the Pearl Production Credit Scheme. The full guarantee has been included as a contingent liability. There has been no change since the time of the 2011/12 Budget Estimates.
- The Government has awarded a works contract of \$2.9 million on 15 March 2011 to construct the Pukapuka cyclone shelter. The \$2.9m contract is funded by the EU (\$1.8 million, 60.25 per cent) and CIG (\$1.1m, 39.75 percent). The EU do not pre-finance projects and only disburse their funding portion once the project is complete. As part of the contract award, CIG has agreed to provide up to \$1.8m Limited Government Guarantee to enable the contractor to pre-finance the project and be used as security to mobilise equipment and personnel. The guarantee is expected to be cancelled on the 31st December 2011 on the completion of the project and will be removed in subsequent Fiscal Updates. The guarantee is only on the EU financing portion and is included as a contingent liability.

#### Uncalled Capital

- The Government also holds \$4.5 million in uncalled capital shares comprising of \$1.7 million in the Asian Development Bank and \$2.8 million in the Bank of the Cook Islands.

#### Legal Proceedings and Disputes

- Total quantifiable risk to the Crown under legal proceedings and disputes is \$15.2 million.
- \$14.5 million relates to contingency in recognition of the lawsuit filed against the government regarding its shipping policy in October 2002. However it is not anticipated that any payment will be made on this claim, and \$2.1million in relation to smaller legal claims against government departments. This has been revised upwards since the time of the 2011/12 Budget Estimates to include an updated list of smaller legal claims against government departments to date.

### 3.7 Assumptions Underlying the Fiscal Projections

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

Operating Revenues are forecasted on the basis of growth in the economy adjusted for one off considerations.

GDP is updated to the 2010 calendar year while all other data is updated to the September 2011 quarter. Growth in the Cook Islands over the medium term is based on the updated data recorded to date.

Real GDP is expected to grow by

- 5.7 per cent in 2011/12
- 1.3 per cent in 2012/13
- 0.5 per cent in 2013/14
- 0.5 per cent in 2014/15

Reflecting adjustments to CPI, Nominal GDP is expected to grow by

- 8.7 per cent in 2011/12
- 4.3 per cent in 2012/13
- 3.5 per cent in 2013/14
- 3.5 per cent in 2014/15

The assumptions made that underpin the economic growth are that movements in nominal GDP are based on movements in tourism expenditure, public expenditure and export receipts.

Tourism expenditure is based on

- Average Stay of 10 days
- Average spend NZD223.00 per day

Government expenditure is based on the operating Estimates for 2011/12, Appropriation for 2012/13 and existing government policy to grow as follows

- 2.8 per cent in 2011/12
- 0.9 per cent in 2012/13
- 0.7 per cent in 2013/14
- 4.4 per cent in 2014/15

Growth in prices measured through movements in the Consumer Price Index is expected to be higher than that estimated at the time of the 2011/12 Budget and outlined as follows:

- 2.0 per cent in 2011/12
- 3.0 per cent in 2012/13
- 3.0 per cent in 2013/14
- 3.0 per cent in 2014/15

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

The level of borrowings is based on average exchange rates in October 2011

### **3.8 Statement of Accounting Policies**

There have been no changes since the 2011/12 Budget Estimates. There are no major changes to accounting policies anticipated in the foreseeable future.

<p style="text-align: center;"><b>Financial Statements</b> As at 30 June 2012</p>
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The forecasted financial estimates of the Crown are set out on the following pages.

**Statement of Financial Performance**

**Statement of Financial Position**

**Statement of Cashflows**

**Statement of Borrowings**

**Summary of Revenue Levied on Behalf of the Crown**

**Statement of Financial Risks**



## Schedule 11

<b>Statement of Financial Performance</b> For the years ending 30 June
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	Actual 2009-10 ('000)	Actual 2010-11 ('000)	Budget 2011-12 ('000)	Estimate 2011-12 ('000)	Projected 2012-13 ('000)	Projected 2013-14 ('000)	Projected 2014-15 ('000)
<b>Revenue</b>							
Taxation revenues	87,125	87,045	90,000	92,676	95,399	99,376	102,726
Sale of goods and services	5,413	5,155	5,200	5,193	5,193	5,193	5,193
Interest	2,065	2,652	2,500	2,422	2,059	2,057	2,055
Dividends	2,510	3,213	3,000	3,051	2,483	2,483	2,483
Other revenue	6,321	7,293	5,400	5,407	5,447	5,162	5,162
<b>Total Revenue</b>	<b>103,434</b>	<b>105,358</b>	<b>106,100</b>	<b>108,749</b>	<b>110,581</b>	<b>114,271</b>	<b>117,619</b>
<b>Expenditure</b>							
Appropriations to agencies	63,615	64,095	63,900	63,858	63,487	64,014	64,014
Payments on behalf of Crown	23,115	30,274	35,100	35,093	35,828	35,998	35,998
Debt-servicing interest	947	879	1,000	971	996	947	1,012
Building maintenance	1,957	1,800	1,300	1,300	1,800	1,800	1,800
Infrastructure depreciation	2,397	2,950	2,500	2,469	2,659	2,756	2,756
Other expenditure	10,712	2,841	2,300	2,335	2,871	3,794	6,258
<b>Total Expenditure</b>	<b>102,743</b>	<b>102,839</b>	<b>106,100</b>	<b>106,026</b>	<b>107,641</b>	<b>109,309</b>	<b>111,838</b>
<b>NET OPERATING SURPLUS / (DEFICIT)</b>	<b>691</b>	<b>2,519</b>	<b>0</b>	<b>2,723</b>	<b>2,940</b>	<b>4,962</b>	<b>5,781</b>

## Schedule 12

Statement of Financial Position							
As at 30 June							
	Actual 2009-10 ('000)	Estimate 2010-11 ('000)	Budget 2011-12 ('000)	Estimate 2011-12 ('000)	Projected 2012-13 ('000)	Projected 2013-14 ('000)	Projected 2014-15 ('000)
<b>Assets</b>							
Cash and equivalents	38,200	41,021	17,700	43,022	44,648	47,590	50,264
Loan reserves	22,034	20,505	19,100	19,076	17,641	16,216	14,791
Trust accounts	5,741	6,177	9,800	6,840	7,317	7,814	8,327
Inventory	1,509	1,509	1,100	1,509	1,509	1,509	1,509
Tax receivables	21,361	21,361	13,800	21,361	21,361	21,361	21,361
Debtors and other receivables	4,181	4,181	4,400	4,181	4,181	4,181	4,181
Advances to SOEs	21,483	21,196	26,200	27,492	27,492	27,281	27,048
Investment in SOEs	146,733	146,733	146,900	146,733	146,733	146,733	146,733
Plant, property, and equipment	90,962	92,985	111,800	103,870	106,772	109,511	112,251
<b>Total Assets</b>	<b>352,204</b>	<b>355,668</b>	<b>350,800</b>	<b>374,084</b>	<b>377,654</b>	<b>382,196</b>	<b>386,465</b>
<b>Liabilities</b>							
Creditors and other payables	13,683	13,683	7,000	13,683	13,683	13,683	13,683
Trust liabilities	5,239	5,239	7,700	5,239	5,239	5,239	5,239
Borrowings	110,747	82,231	107,600	93,525	90,204	85,833	80,369
<b>Total Liabilities</b>	<b>129,669</b>	<b>101,153</b>	<b>122,300</b>	<b>112,447</b>	<b>109,126</b>	<b>104,755</b>	<b>99,291</b>
<b>Net Crown Balance</b>	<b>222,535</b>	<b>254,515</b>	<b>228,500</b>	<b>261,637</b>	<b>268,528</b>	<b>277,441</b>	<b>287,174</b>

## Schedule 13

### Statement of Cashflows For the years ending 30 June

	Actual 2009-10 ('000)	Estimate 2010-11 ('000)	Budget 2011-12 ('000)	Estimate 2011-12 ('000)	Projected 2012-13 ('000)	Projected 2013-14 ('000)	Projected 2014-15 ('000)
<b>Cashflows from Operating Activities</b>							
<u>Cash provided from:</u>							
Taxation and levies	87,125	87,045	90,000	92,676	95,399	99,376	102,726
Collection of tax arrears	0	0	0	0	0	0	0
Sale of goods and services	5,413	5,155	5,200	5,193	5,193	5,193	5,193
Interest	2,065	2,652	2,800	2,422	2,059	2,057	2,055
Dividends	2,510	3,213	3,000	3,051	2,483	2,483	2,483
Other income	6,321	7,293	6,300	5,407	5,447	5,162	5,162
	<u>103,434</u>	<u>105,358</u>	<u>107,300</u>	<u>108,749</u>	<u>110,581</u>	<u>114,271</u>	<u>117,619</u>
<u>Cash applied to:</u>							
Appropriations to agencies (less depn)	60,704	60,903	60,500	60,574	60,283	60,744	60,744
Payments on behalf of Crown	23,115	30,274	35,100	35,093	35,828	35,998	35,998
Debt-servicing interest	947	879	1,000	971	996	947	1,012
Building maintenance	1,957	1,800	1,300	1,300	1,800	1,800	1,800
Other expenditure	10,712	2,841	2,300	2,335	2,871	3,794	6,258
	<u>97,435</u>	<u>96,697</u>	<u>100,200</u>	<u>100,273</u>	<u>101,778</u>	<u>103,283</u>	<u>105,812</u>
<b>Net Operating Activity Cashflows</b>	<b>5,999</b>	<b>8,661</b>	<b>7,100</b>	<b>8,476</b>	<b>8,803</b>	<b>10,988</b>	<b>11,807</b>
<b>Cashflows from Investing Activities</b>							
<u>Cash provided from:</u>							
Subsidiary loan repayments	143	287	300	0	0	211	233
	<u>143</u>	<u>287</u>	<u>300</u>	<u>0</u>	<u>0</u>	<u>211</u>	<u>233</u>
<u>Cash applied to:</u>							
Capital expenditure	20,072	4,709	3,400	12,239	4,814	4,814	4,814
Advances to Subsidiaries	20,523	0	0	6,296	0	0	0
	<u>40,595</u>	<u>4,709</u>	<u>3,400</u>	<u>18,535</u>	<u>4,814</u>	<u>4,814</u>	<u>4,814</u>
<b>Net Investing Activity Cashflows</b>	<b>-40,452</b>	<b>-4,422</b>	<b>-3,100</b>	<b>-18,535</b>	<b>-4,814</b>	<b>-4,603</b>	<b>-4,581</b>
<b>Cashflows from Financing Activities</b>							
<u>Cash provided from:</u>							
Loans drawn down	38,724	0	0	14,334	0	0	0
Cash drawn from loan reserves	0	1,529	0	1,429	1,435	1,425	1,425
	<u>38,724</u>	<u>1,529</u>	<u>0</u>	<u>15,763</u>	<u>1,435</u>	<u>1,425</u>	<u>1,425</u>
<u>Cash applied to:</u>							
Loan repayments	3,227	2,511	2,800	3,040	3,321	4,371	5,464
Loan reserves	1,100	0	0	0	0	0	0
Other reserves	456	435	500	663	477	497	514
	<u>4,783</u>	<u>2,946</u>	<u>3,300</u>	<u>3,703</u>	<u>3,798</u>	<u>4,868</u>	<u>5,978</u>
<b>Net Financing Activity Cashflows</b>	<b>33,941</b>	<b>-1,417</b>	<b>-3,300</b>	<b>12,060</b>	<b>-2,363</b>	<b>-3,443</b>	<b>-4,553</b>
Net cash movements	-512	2,822	700	2,001	1,626	2,942	2,673
Add: Opening Cash and Equivalents	38,711	38,200	20,600	41,021	43,022	44,648	47,590
<b>Closing Cash and Equivalents</b>	<b>38,200</b>	<b>41,021</b>	<b>21,300</b>	<b>43,022</b>	<b>44,648</b>	<b>47,590</b>	<b>50,264</b>

## Schedule 14

<b>Statement of Borrowings</b> As at 30 June
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	Actual 2009-10 ('000)	Estimate 2010-11 ('000)	Budget 2011-12 ('000)	Estimate 2011-12 ('000)	Projected 2012-13 ('000)	Projected 2013-14 ('000)	Projected 2014-15 ('000)
<b>Total Gross Borrowings</b>	<b>110,747</b>	<b>82,231</b>	<b>107,600</b>	<b>93,525</b>	<b>90,204</b>	<b>85,833</b>	<b>80,369</b>
<b>Assets Held Against Borrowings:</b>							
Advances to subsidiaries	21,483	21,196	26,200	27,492	27,492	27,281	27,048
Loan reserves	22,034	20,505	19,100	19,076	17,641	16,216	14,791
<b>Total Assets Held Against Borrowings</b>	<b>43,517</b>	<b>41,701</b>	<b>45,300</b>	<b>46,568</b>	<b>45,133</b>	<b>43,497</b>	<b>41,839</b>
<b>Net Borrowings of the Government</b>	<b>67,230</b>	<b>40,530</b>	<b>62,300</b>	<b>46,957</b>	<b>45,071</b>	<b>42,336</b>	<b>38,530</b>

## Schedule 15

<b>Revenue Levied on Behalf of the Crown</b> For the years ending 30 June
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	Actual 2009-10 ('000)	Estimate 2010-11 ('000)	Budget 2011-12 ('000)	Estimate 2011-12 ('000)	Projected 2012-13 ('000)	Projected 2013-14 ('000)	Projected 2014-15 ('000)
<b>Revenue Levied on Behalf of the Crown</b>							
Income tax	26,400	25,155	25,926	26,572	27,454	28,328	29,319
Company tax	9,895	9,942	9,245	10,308	10,753	11,129	11,519
Import levies	10,183	11,066	11,381	12,030	12,549	12,988	13,443
VAT	35,229	34,979	36,400	37,010	37,310	39,455	40,836
Departure tax	5,418	5,903	6,071	6,170	6,333	6,476	6,609
Withholding Tax	0	0	1,000	586	1,000	1,000	1,000
<b>Total Revenue Levied on Behalf of the Crown</b>	<b>87,125</b>	<b>87,045</b>	<b>90,022</b>	<b>92,676</b>	<b>95,399</b>	<b>99,376</b>	<b>102,726</b>

## Schedule 16

### STATEMENT OF FISCAL RISKS

Guarantees and Indemnities	3,300,000
Uncalled Capital	4,500,000
Legal Proceedings & Disputes	16,564,465
<b>TOTAL QUANTIFIABLE CONTINGENT LIABILITIES</b>	<b>24,364,465</b>

**Guarantees and Indemnities relate to the following:**

The Government of the Cook Islands has accepted the commercial risk such that any losses incurred by Air New Zealand in respect to the service provided on the direct flights from Sydney to Rarotonga and Los Angeles to Rarotonga return during the term of the existing agreements shall be met by the Government of the Cook Islands. The best information available at the present time is that any loss will be as estimated at \$11million. This has been appropriated in the budget at \$10.0million with the balance of \$1.0million recognised above as a contingent liability. This is as per the Budget 2011/12 and will be reviewed after 6 months (January 2012).

The settlement with Apex Agencies Limited (operating as TOA Petroleum, TOA) dated 11 December 2009 provided a guaranteed minimum EBITA (Earnings Before Interest, Tax, Depreciation and Amortisation) of \$1,200,000 per annum for a period of 8 years. Thus if TOA makes a profit of less than \$1.2million in a given year (or even a loss) the Crown will make a top up payment to \$1.2million. That is the Crown's potential liability could exceed \$1.2million in a given year. An estimate of the potential liability has been estimated at \$1,560,000 and is appropriated and therefore not recognised as a contingent liability.

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

The Cook Islands Government (CIG) awarded a works contract of NZ\$2.9m on 15 March 2011 to construct the Pukapuka cyclone shelter. The \$2.9m contract is funded by the EU (\$1.8m, 60.25%) and CIG (\$1.1m, 39.75%). The EU do not pre-finance projects and only disburse their funding portion once the project is complete. As part of the contract award, CIG has agreed to provide up to \$1.8m Limited Government Guarantee to enable the contractor to pre-finance the project and be used as security to mobilise equipment and personnel. The guarantee is expected to be cancelled on the 31st December 2011 on the completion of the project and will be removed in subsequent Fiscal Updates. The guarantee is only on the EU financing portion and is included as a contingent liability.

Uncalled capital relates to shares in the Asian Development Bank and in the Bank of the Cook Islands

Legal Proceedings and Disputes relates to the Shipping Case and other smaller cases against the Crown.

# STATEMENT OF ACCOUNTING POLICIES

## BASIS OF PREPARATION

### Reporting Entity

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

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

### Statement of Compliance

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

### Measurement Base

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

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

## 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>
A.	IPSAS 25 Employee Benefits	1/01/2011
B.	IPSAS 26 Impairment of Cash Generating Assets	1/04/2009
C.	IPSAS 27 Agriculture	1/04/2011
D.	IPSAS 28 Financial Instruments: Recognition and Measurement	1/01/2013

E.	IPSAS 29 Financial Instruments: Presentation	1/01/2011
F.	IPSAS 30 Financial Instruments: Disclosure	1/01/2013
G.	IPSAS 31 Intangible Assets	1/04/2011

These new standards have been issued but are not yet effective for the Crown. The Crown will have to consider these new standards in future years. Crown has not yet determined the effect of these new standards.

## **Basis of Consolidation**

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

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

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

## **Associate**

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

## **Revenue**

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

### ***Revenue Levied Through the Crown's Sovereign Power***

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

<b>Revenue Type</b>	<b>Revenue Recognition Point</b>
Individual Income Tax	When an individual earns income that is subject to PAYE or provisional tax. This also includes withholding taxes.



Company Income Tax	When the corporate community earns taxable income.
Value Added Tax	When the liability to the Crown is incurred. For example, the liability arising from sales in June being paid in July however recognised as revenue in June.
Customs levies	When goods liable to duty are assessed, except for Oil Companies which are accounted for when the liability to the Crown is incurred.
Departure Tax	When departure tax coupons are purchased.
Other Revenue	When the debt to the Crown arises.

### ***Revenue Earned Through Operations***

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

### ***Fines***

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

### ***Investment Income***

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

### ***Gains***

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

### ***Dividends***

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

### ***Aid Revenue***

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

## **Expenses**

### ***General***

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
Buildings and improvements	10 years
Coastal protection	25 years
Power distribution network	20 years
Roading network	30 years
Water network	15 years
Airport runways	15 – 100 years
Harbour and ports structures	10 – 20 years
Waste management facilities	15 years

## **Non-Current Assets**

### ***Plant, Property, and Equipment***

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

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

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

### ***Disposals***

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

### ***Additions***

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

### ***Work in Progress***

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

### ***Infrastructure Assets***

Infrastructure assets are recorded at cost less accumulated depreciation.

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

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

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

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.

### ***Intangible Assets (continued)***

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
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### ***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.

### ***Provision for doubtful debts (continued)***

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

### ***Aid Assets***

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

## **Liabilities**

### ***Borrowings***

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

### ***Pension Liabilities***

Pension liabilities, in respect of the contributory service of current and past Members of Parliament, are recorded at the latest (30th June 1997) actuarial value of the Crown's liability for pension payments. There are no pension liabilities accruing to the Crown as a result of Government employees' membership of the Government Superannuation Fund (New Zealand).

### ***Employee Entitlements***

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

***Other Liabilities***

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

***Aid Liabilities***

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

**Cash Flow**

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

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

**Leases**

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

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

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

**Commitments**

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

**Contingent Liabilities**

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

## **CHANGES IN ACCOUNTING POLICIES**

### **Plant, Property, and Equipment**

For the financial year beginning 1<sup>st</sup> July 2007, the Crown has voluntarily changed the accounting policy surrounding the carrying value of plant, property, and equipment (PPE). The new policy records all PPE as cost less accumulated depreciation/amortisation and impairment whereas the previous policy required certain SOE assets to be carried at revalued amounts.

IPSAS 3 – Accounting Policies, Changes in Estimates, and Errors provides that for a change in accounting policy, retrospective adjustments are to be done through one of two allowed approaches:

- benchmark approach in which the value of the adjustment is taken through opening retained earnings; or
- alternative approach in which the value of the adjustment is brought through the current year's profit.

IPSAS 3 allows for a prospective application using either of the approaches above in the event that it is impracticable or impossible to determine accurate values relating to adjustments required.

As the historical adjustments cannot be determined in any practicable and timely manner, and those values that are available to the Crown are incomplete and unverifiable, including them into the financial statements would not be beneficial and would not provide more reliable information to be presented. As such, the Crown has adopted the prospective application to this change in policy. Therefore, the effect of this change in policy will be reflected from this accounting period going forward.