COOK ISLANDS GOVERNMENT

2015/16 Half-year Economic and Fiscal Update

Hon. Mark Brown

Minister of Finance

December 2015

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1 STATEMENT OF RESPONSIBILITY

MINISTER OF FINANCE

GOVERNMENT OF THE COOK ISLANDS

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15 December 2015

STATEMENT OF RESPONSIBILITY

I have read the Financial Secretary's Statement of Responsibility and concur with him regarding the preparation of the 2015/16 Half Year Economic and Fiscal Update.

To enable the Ministry of Finance and Economic Management to prepare this Half Year Economic and Fiscal Update, I have ensured that the Financial Secretary has been advised of all Government decisions and other circumstances as at December 2015 of which I was aware and had material economic and fiscal implications.

The 2015/16 Half Year Economic and Fiscal Update have been produced in accordance with the *Ministry of Finance and Economic Management Act 1995/96.*

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

Kia Manuia,

Honourable Mark Brown
Minister of Finance

MINISTRY OF FINANCE AND ECONOMIC MANAGEMENT

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15 December 2015

STATEMENT OF RESPONSIBILITY

This Half Year Economic and Fiscal Update 2015/16 is prepared in accordance with Section 11 and 16 of the *Ministry of Finance and Economic Management Act 1995-96.* Section 16 further states that the Minister shall no earlier than the 1st day of December, nor later than the 31st day of December in each financial year, cause to be published a report containing an economic and fiscal update prepared by the Ministry.

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

The integrity of the disclosures and consistency with the requirements of the *Ministry of Finance and Economic Management Act 1995/96* are warranted in relation to the financial statements included within this Half Year Economic and Fiscal Update 2015/16.

The update incorporates the fiscal and economic implications both of Government decisions and circumstances as at December 2015 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

2 PREFACE

The Ministry of Finance and Economic Management has published through this document both the 2016/17 Budget Policy Statement (BPS) with the 2015/16 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 2016/17 BPS will be published on the 15 December 2015 to enable better aligned planning by government departments and development partners in the 2016/17 Budget going forward.

The BPS states Government's policy intent for the 2016/17 fiscal year going forward including the Government's fiscal policy, its broad strategic priorities for the 2016/17 fiscal year, and any specific outputs and other expenditure that the Government anticipates to be included in the 2016/17 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 2015/16 HYEFU provides an update of the economic and fiscal forecasts made at the time of the 2015/16 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 15 December 2015, the HYEFU will also be published on 15 December 2015 as one document so that the reader is provided with both the Government's priorities and the context with which these priorities and policy intentions are set.

3 2016/17 BUDGET POLICY STATEMENT

3.1 Introduction

The 2016/17 Budget Policy Statement (BPS) not only sets out the budget priorities for the 2016/17 financial year, but also marks the beginning of a new National Sustainable Development Plan (NSDP) cycle. The new NSDP synchronises the NSDP and BPS processes by focusing on a few of the sixteen NSDP goals that will are prioritised in the coming fiscal year for resourcing, to fast track efforts in these specific sectors. This BPS is split into two sections:

- Baseline budgets
- NSDP Goals Prioritised for the 2016/17 fiscal year

In the first six months of 2016 the Government will undertake a series of activities (through the public sector strengthening POBOC) which will assist in improving public financial management, economic governance and the public sector. These activities include:

- undertaking an economic review of the underwrite of Los Angeles and Sydney flights
- upgrading the Cook Islands Financial Revenue Management System Upgrade (Phase 3 of a multi-year/phase initiative)
- scoping of changes required to centralise the Cook Islands Government Financial Management Information Systems (FMIS)
- development the Cook Islands tourism strategy;
- reviewing the medium term infrastructure needs for the education sector in the Cook Islands;
- reviewing expenditure levels in the health sector;
- implementing a corrective action plan to meet ICAO universal safety oversight audit programme (USOAP) findings; and
- Finalising a standard immigration operating procedures.

3.2 Preserving Baseline Budgets for Core Service Delivery

Base funding for core service delivery and economic growth activities will be maintained across the period of the budget and forward estimates (2016/17 to 2019/20).

The Government will continue to protect and invest in health, education, social protection and tourism consistent with the high level policy dialogue agreement with the Government of New Zealand Grant. Base funding for core service delivery and economic growth activities for 2016/17 to 2018/19 were outlined in the 2015/16 Budget. This baseline funding included the revised high level policy partnership support with New Zealand which was assumed to continue for the three years from 2015/16 to 2017/18 and have been consolidated in Appendix 1.

The delivery of these services promotes opportunities for all, ensuring social inclusion, a healthier, better educated, employable and productive population.

Tourism is the primary economic driver of the country (and will likely continue to be so over the long term) thus investment in economic growth activities will continue, with strategies being implemented that ensure the Cook Islands remains competitive and achieves its full potential as a leading sustainable tourism destination.

3.3 NSDP Priorities for 2016/17

The 2016/17 Budget will focus on eight of sixteen development goals from the NSDP, these are:

Goal 1. *Improve Welfare and Reduce inequity and economic hardship*
Goal 2. *Expand economic opportunities for all; improve economic resilience, and productive employment to ensure decent work for all*
Goal 3. *Sustainable management of water and sanitation*
Goal 5. *Ensure access to affordable, reliable, sustainable modern transportation and energy for all*
Goal 7. *Ensure inclusive and equitable quality education and promote life-long learning opportunities*
Goal 10. *A sustainable, engaged Cook Islands People and society*
Goal 14. *Sustainably use the oceans, lagoons and marine resources for sustainable development*
Goal 16. *Promote peaceful and just society for all and practice Good Governance promoting transparency and accountability*

3.3.1 NSDP Goal 1: Improve Welfare reduce inequity and economic hardship

Government will continue with their commitment to improve the plight of vulnerable and elderly Cook Islanders with further increases in welfare payment levels to all beneficiaries.

The government are also committing to improve targeted policy assistance for those worse off by conducting a 'Household Income and Expenditure Survey (HIES). This exercise runs from December 2015 to January 2016 and will provide government data on the persons who are considered to be living in economic hardship and will inform future policy interventions to address this issue.

3.3.2 NSDP Goal 2: Expanding economic opportunities for all, improve economic resilience, and productive employment to ensure decent work for all.

In the 2016/17 financial year the Cook Islands Government will:

- maintain fiscal responsibility and sustainability by ensuring ongoing cash reserves to provide fiscal buffers over the medium term;
- implement the next set of income tax cuts which were outlined in the 2015/16 from 1 January 2017, building on the income tax cuts of 1 January 2016;
- continue to invest in tourism growth and development in the industry through a targeted tourism sector investment strategy

Reduce forecast fiscal deficits and maintain cash reserves

The Government will continue to maintain policies which are consistent with ensuring a positive macroeconomic environment for the Cook Islands. This will be principally driven by ensuring net underlying operating surpluses continue on.

Efforts will be made to reduce forecast fiscal deficits to provide a buffer against external or exceptional factors which may impact adversely on net worth in the future.

This approach will ensure that there is financial capacity to contain rising debt and enable implementation of our capital plan and priorities outlined within the National Infrastructure Investment Plan.

The Government in 2016/17 will commence implementing its policy to formally establish a sovereign wealth fund (SWF) where unbudgeted revenues can be deposited, in the first instance the SWF will include monies from fishing fines and vested assets transferred to the Crown from the Financial Supervisory Commission.

Implementing the next set of income tax cuts

In the 2015/16 Budget the Government announced a two stage approach towards the reduction of income tax for all Cook Islanders workers. These have already been incorporated into the forward estimates of income tax revenue and will see the minimum tax rate reduced to 17 per cent once income exceeds $11,000 per annum. The rate changes are provided in Table 1.

Table 1 – Changes to income tax rates

	Current	1-Jan-16	1-Jan-17
0 - $11,000 exempt	0.0%	0.0%	0.0%
$11,001 - $30,000 18.5%	18.5%	17.5%	17.0%
$30,001 - $80,000 27.5%	27.5%	27.5%	27.5%
$80,001 & above 30%	30.0%	30.0%	30.0%

Tourism marketing baseline funding

An estimated two thirds of the Cook Islands economic income is derived from tourism. The Government will continue to support this sector through the provision of funds to ensure that the Cook Islands remains competitive, and that the tourism sector and related industries can grow with a focus on broadening the market base and maximising returns from the spend in tourism.

This funding is currently provided as a payment on behalf of the Crown (POBOC). The purpose of the tourism growth strategy is to commit to sales and marketing programmes that support the additional long haul air services from Los Angeles to Rarotonga and Sydney to Rarotonga, which are both underwritten by the Cook Islands Government.

3.3.3 NSDP Goal 3: Sustainable management of water and sanitation

Strengthening Institutional Arrangements

The Government will consolidate efforts in this area to successfully complete and support prior investments and commitments to the Te Mato Vai project and WATSAN. Specific initiatives this year include:

- the establishment of a statutory crown agency to operate the Rarotongan water supply system and;
- dedicated investment into remedial measures for the Muri lagoon and a revised sanitation strategy.

3.3.4 NSDP Goal 5: Ensure access to affordable, reliable, sustainable modern transportation and energy for all

Renewable Energy in the Southern Group

The Cook Islands will continues its investment renewable energy. With the Northern Group complete, efforts now centre on the Southern Group and planning to transition Rarotonga and Aitutaki from centralised diesel generation to renewables.

International Civil Aviation Organisation (ICAO) Audit Follow Up

Following on from technical assistance that will be enlisted in early 2016 to address International Civil Aviation Organisation Audit report findings, further investment may be required to support the Ministry of Transport to follow up on recommendations for corrective actions to improve compliance for our aviation sector.

3.3.5 NSDP Goal 7: Ensure inclusive and equitable quality education and promote life-long learning opportunities

The 2015/16 financial year saw the launch of the Ministry of Education’s Statement of Intent (2015-19) which outlines the current priorities of the Ministry leading to the achievement of the Education Master Plan. The current priorities that inform the 2016/17 fiscal year include:

- A literacy focus on Cook Islands Maori development and first/second language transition
- Targeted teacher professional development to embed recent changes in literacy and numeracy and ensure sustainability of investment over the previous 5 years.
- Continuing to upgrade formal teacher qualifications and attract quality new graduates to the profession
- The initial phasing and development of a medium term education infrastructure plan including current work on Apii Nikao and Tereora College

- The development of both physical and human environments that allow for flexible and innovative learning and teaching spaces and the holistic development of the learner.
- Developing responses to equity in learning opportunities for isolated cohorts
- A significant shift in modality of TVET provision to blended delivery through apprenticeships and the enhanced use of ICT.
- Progressive sector management with an enhanced student information system and continued analysis and production of valid data that informs decision making that support progressive sector management.

3.3.6 NSDP Goal 10: A sustainable, engaged Cook Islands People and society

Investing in Immigration

In early 2016 the Government will continue work to strengthen Immigration Cook Islands given the important role it plays in maintaining the integrity of our borders and facilitating entry, residence and exit of people with the skills we need to develop the economy. Further investment will be required in the 2016/17 year to:

- continue developing the Immigration policy and operation procedures;
- strengthen systems and information management;
- provide training and support for staff in utilising modern immigration systems; and
- developing a broader population strategy engaging with the Cook Islands diaspora.

3.3.7 NSDP Goal 14: Sustainably use the oceans, lagoons and marine resources for sustainable development

Reinvesting in our Large Ocean State

The Government is committed to developing an integrated oceans governance strategy which incorporates fisheries, sea bed minerals, black pearls and other oceans related activity to ensure economic returns from those natural resources are pursued in a sustainable manner under the Te Marea Moana Framework. Chief amongst these efforts will be:

- remedial action for lagoon degradation in Muri
- Research on sustainable fishing levels
- Surveys of lagoon health, coral coverage and marine biodiversity

3.3.8 NSDP Goal 16: Promote peaceful and just society for all and practice good governance and promoting transparency and accountability

Public Sector Strengthening

In the previous two budgets the Government has made a considerable effort at investing in systems to assist with productivity in the public sector, this has included:

- implementation of a centralised public sector wide payroll and HRM system;
- the ongoing roll out of a centralised email and IT network;

- implementation of a centralised asset management system; and
- online access to tax payers of the revenue management system.

Additionally the Government has now adopted a public sector strengthening strategy that aspires to achieve excellence across the public sector through a progressive and highly skilled workforce and transformed systems.

The 2016/17 budget will focus on ensuring that the three phase transformation commences with a focus in the first three years (2016 to 2018) on establishing crucial institutional architecture to support a complete transformation from 2019 onwards.

The 2016/17 Budget will focus on efforts on recent efforts to improve operational systems and processes through the use of technology to continue centralisation of corporate services and develop leadership capacity and capability to lead a rationalised public sector. Reviews of every agency will ensure there is capacity and capability to effectively deliver better public infrastructure and services that are relevant and affordable.

Agencies will leverage these processes to achieve productivities which have already been incorporated into baseline estimates. These operational expenditure ceilings are provided at Appendix 1 to the Budget Policy Statement.

Supporting the NSDP through investment in Policy, Planning and Statistics

The new NSDP is focused on more accurate effective measurement of development outcomes to create a more complete and holistic picture of development. There will need to investment in policy development and strategic planning across many sectors (as previously in numerous external evaluations such as the 2014 Peer Review (PIFS, 2014). This will assist in developing a medium term budgeting framework for the CIG augmenting predictability and pro to augment and underpin the NSDP.

The other initiative that is crucial in strengthening the new NSDP framework is the Cook Islands Strategy for the Development of Statistics. This is critical in underpinning efforts around measuring policy outcomes and underpinning efforts to strengthen public service performance. The Cook Islands have already committed to two key efforts in this area, from 2015 through to 2017, specifically:

- the aforementioned household Income and expenditure survey (December 2015 – December 2016) which is being funded with the assistance of development partners; and
- the census (2016/17), for which funding has been already included in the forward estimates.

Land Tenure, Usage and Management

Recent rulings with respect to land tenure occupational rights, and issues raised around public access and land rights through major public good infrastructure such as water supply, sanitation, roads and renewable energy projects outlined that this is a priority that issue that needs to be dealt with in an equitable and sustainable manner.

Improving Infrastructure Management

The development of the Capital Book and the creation of an infrastructure committee have seen a vast improvement in the manner by which the Cook Islands plans its infrastructure.

Following on from the recent report undertaken by the Government will make an effort to improve the allocation of funding towards repairs and maintenance of the nation's infrastructure and providing greater linkages between operational and capital expenditure.

The 2016/17 budget will continue the recent improvement in processes around infrastructure management. Following the recommendations made by the Pacific Regional Infrastructure Facility (PRIF) after an initial analysis of the Cook Islands context.

Chief amongst the issues highlighted in this analysis and other reports, is the need to improve institutional capacity of the relevant institutions to successfully implement the National Infrastructure Plan. This work will include the development of agency for management of Rarotonga water as well as strengthening existing institutions.

To this end the Government will aim to ensure that all significant infrastructure projects include a maintenance plan and estimate of future maintenance with greater support for capacity building for maintenance planning, budgeting and implementation.

Appendix 1 – Baseline Core Services Funding

	2015/16	2016/17	2017/18	2018/19	Total Three Years
Education Agency Baseline Funding (Net appropriation)	14,720,000	14,620,000	14,611,000	11,151,000	40,382,000
University of the South Pacific Fees	285,000	285,000	285,000	285,000	855,000
Scholarships	1,030,000	1,045,000	1,000,000	280,000	2,325,000
Private school funding	2,147,000	2,147,000	2,147,000	2,007,000	6,301,000
Tertiary Training Institutions	760,000	760,000	760,000	760,000	2,280,000
Total Education Recurrent Spending	18,942,000	18,857,000	18,803,000	14,483,000	52,143,000
Capital Schedule - Equipment	448,000	448,000	360,000	110,000	918,000
Less Depreciation	340,864	362,364	362,364	362,364	1,087,092
Total Spending Education Baseline	**19,049,136**	**18,942,636**	**18,800,636**	**14,230,636**	**51,973,908**
Health Agency Baseline Funding (Net appropriation)	11,098,000	11,016,000	11,008,000	10,248,000	32,272,000
Health Trading Revenue	400,000	400,000	400,000	400,000	1,200,000
Pharmaceuticals	668,000	668,000	668,000	668,000	2,004,000
Patient Referrals	550,000	550,000	550,000	550,000	1,650,000
Nursing School	234,000	234,000	234,000	234,000	702,000
NCD Fund	195,000	195,000	195,000	195,000	585,000
Total Health Recurrent Spending	12,745,000	12,663,000	12,655,000	11,895,000	37,213,000
Capital Schedule - Equipment	525,000	275,000	275,000	275,000	825,000
Less Depreciation	654,788	654,788	654,788	654,788	1,964,364
Total Spending Health Baseline	**12,615,212**	**12,283,212**	**12,275,212**	**11,515,212**	**36,073,636**
Social Impact Fund Baseline	931,000	931,000	931,000	281,000	2,143,000
Total Core Service Delivery Baseline	**32,595,348**	**32,156,848**	**32,006,848**	**26,026,848**	**90,190,544**
Tourism Economic Growth Strategy	5,100,000	4,850,000	4,850,000	2,950,000	12,650,000
Total	**37,695,348**	**37,006,848**	**36,856,848**	**28,976,848**	**102,840,544**

Appendix 2 – 2016/17 Budget Baseline Ceilings Operational Costs

Agency	2016/17	2017/18	2018/19	2019/20
Ministry of Agriculture	***$922,000***	***$871,000***	***$871,000***	***$871,000***
Personnel	*$838,000*	*$787,000*	*$787,000*	*$787,000*
Operating	*$85,000*	*$85,000*	*$85,000*	*$85,000*
Audit Office	***$993,000***	***$993,000***	***$993,000***	***$993,000***
Personnel	*$892,000*	*$892,000*	*$892,000*	*$892,000*
Operating	*$100,000*	*$100,000*	*$100,000*	*$100,000*
Crown Law	***$636,000***	***$635,000***	***$635,000***	***$635,000***
Personnel	*$492,000*	*$491,000*	*$491,000*	*$491,000*
Operating	*$144,000*	*$144,000*	*$144,000*	*$144,000*
Ministry of Cultural Development	***$738,000***	***$737,000***	***$736,000***	***$736,000***
Personnel	*$545,000*	*$544,000*	*$543,000*	*$543,000*
Operating	*$194,000*	*$194,000*	*$194,000*	*$194,000*
Business Trade and Investment Board	***$640,000***	***$639,000***	***$639,000***	***$639,000***
Personnel	*$407,000*	*$406,000*	*$406,000*	*$406,000*
Operating	*$233,000*	*$233,000*	*$233,000*	*$233,000*
National Environment Service	***$947,000***	***$946,000***	***$946,000***	***$946,000***
Personnel	*$789,000*	*$788,000*	*$788,000*	*$788,000*
Operating	*$159,000*	*$159,000*	*$159,000*	*$159,000*
Ministry of Finance and Economic Management	***$3,577,000***	***$3,544,000***	***$3,544,000***	***$3,544,000***
Personnel	*$2,866,000*	*$2,833,000*	*$2,833,000*	*$2,833,000*
Operating	*$711,000*	*$711,000*	*$711,000*	*$711,000*
Financial Services Development Authority	***$412,000***	***$412,000***	***$412,000***	***$412,000***
Personnel	*$234,000*	*$234,000*	*$234,000*	*$234,000*
Operating	*$178,000*	*$178,000*	*$178,000*	*$178,000*
Ministry of Foreign Affairs and Immigration	***$1,722,000***	***$1,722,000***	***$1,722,000***	***$1,722,000***
Personnel	*$1,180,000*	*$1,180,000*	*$1,180,000*	*$1,180,000*
Operating	*$542,000*	*$542,000*	*$542,000*	*$542,000*
Head of State	*$217,000*	*$216,000*	*$216,000*	*$216,000*
Personnel	*$183,000*	*$182,000*	*$182,000*	*$182,000*
Operating	*$34,000*	*$34,000*	*$34,000*	*$34,000*
Infrastructure Cook Islands	***$1,861,000***	***$1,859,000***	***$1,859,000***	***$1,859,000***
Personnel	*$1,558,000*	*$1,556,000*	*$1,556,000*	*$1,556,000*
Operating	*$303,000*	*$303,000*	*$303,000*	*$303,000*
Ministry of Internal Affairs	***$1,010,000***	***$1,009,000***	***$1,009,000***	***$1,009,000***
Personnel	*$897,000*	*$896,000*	*$896,000*	*$896,000*
Operating	*$113,000*	*$113,000*	*$113,000*	*$113,000*
Ministry of Justice	***$1,813,000***	***$1,811,000***	***$1,811,000***	***$1,811,000***
Personnel	*$1,413,000*	*$1,411,000*	*$1,411,000*	*$1,411,000*
Operating	*$399,000*	*$399,000*	*$399,000*	*$399,000*
Ministry of Marine Resources	***$1,454,000***	***$1,453,000***	***$1,453,000***	***$1,453,000***

Agency	2016/17	2017/18	2018/19	2019/20
Personnel	*$1,109,000*	*$1,108,000*	*$1,108,000*	*$1,108,000*
Operating	*$345,000*	*$345,000*	*$345,000*	*$345,000*
Office of the Ombudsman	***$273,000***	***$272,000***	***$272,000***	***$272,000***
Personnel	*$210,000*	*$210,000*	*$210,000*	*$210,000*
Operating	*$63,000*	*$62,000*	*$62,000*	*$62,000*
National Parliamentary Services	***$534,000***	***$533,000***	***$533,000***	***$533,000***
Personnel	*$455,000*	*$454,000*	*$454,000*	*$454,000*
Operating	*$80,000*	*$80,000*	*$80,000*	*$80,000*
Cook Islands Pearl Authority	***$442,000***	***$441,000***	***$441,000***	***$441,000***
Personnel	*$207,000*	*$206,000*	*$206,000*	*$206,000*
Operating	*$235,000*	*$235,000*	*$235,000*	*$235,000*
Cook Islands Police	***$3,356,000***	***$3,353,000***	***$3,353,000***	***$3,353,000***
Personnel	*$2,911,000*	*$2,908,000*	*$2,908,000*	*$2,908,000*
Operating	*$446,000*	*$446,000*	*$446,000*	*$446,000*
Office of the Prime Minister	***$1,163,000***	***$1,162,000***	***$1,162,000***	***$1,162,000***
Personnel	*$947,000*	*$946,000*	*$946,000*	*$946,000*
Operating	*$217,000*	*$217,000*	*$217,000*	*$217,000*
Office of the Public Service Commissioner	***$1,639,000***	***$1,637,000***	***$1,637,000***	***$1,637,000***
Personnel	*$1,587,000*	*$1,585,000*	*$1,585,000*	*$1,585,000*
Operating	*$52,000*	*$52,000*	*$52,000*	*$52,000*
Cook Islands Tourism Corporation	***$4,447,000***	***$4,443,000***	***$4,443,000***	***$4,443,000***
Personnel	*$1,420,000*	*$1,416,000*	*$1,416,000*	*$1,416,000*
Operating	*$3,028,000*	*$3,028,000*	*$3,028,000*	*$3,028,000*
Ministry Transport	***$604,000***	***$603,000***	***$603,000***	***$603,000***
Personnel	*$468,000*	*$467,000*	*$467,000*	*$467,000*
Operating	*$136,000*	*$136,000*	*$136,000*	*$136,000*
Cook Islands Seabed Minerals Authority	***$383,000***	***$382,000***	***$382,000***	***$382,000***
Personnel	*$211,000*	*$210,000*	*$210,000*	*$210,000*
Operating	*$172,000*	*$172,000*	*$172,000*	*$172,000*
Prime Minister Support Office	***$403,000***	***$403,000***	***$403,000***	***$403,000***
Personnel	*$294,000*	*$294,000*	*$294,000*	*$294,000*
Operating	*$110,000*	*$110,000*	*$110,000*	*$110,000*
Deputy Prime Minister Support Office	***$215,000***	***$215,000***	***$215,000***	***$215,000***
Personnel	*$130,000*	*$130,000*	*$130,000*	*$130,000*
Operating	*$85,000*	*$85,000*	*$85,000*	*$85,000*
Minister Mark Brown Support Office	***$277,000***	***$275,000***	***$273,000***	***$273,000***
Personnel	*$195,000*	*$193,000*	*$191,000*	*$191,000*
Operating	*$82,000*	*$82,000*	*$82,000*	*$82,000*
Minister Kiriau Turepu Support Office	***$180,000***	***$180,000***	***$180,000***	***$180,000***
Personnel	*$123,000*	*$123,000*	*$123,000*	*$123,000*
Operating	*$57,000*	*$57,000*	*$57,000*	*$57,000*
Minister Nandi Glassie Support Office	***$180,000***	***$180,000***	***$180,000***	***$180,000***

Agency	2016/17	2017/18	2018/19	2019/20
Personnel	*$102,000*	*$102,000*	*$102,000*	*$102,000*
Operating	*$78,000*	*$78,000*	*$78,000*	*$78,000*
Minister Albert Nicholas Support Office	***$186,000***	***$186,000***	***$80,000***	***$80,000***
Personnel	*$69,000*	*$69,000*	*$69,000*	*$69,000*
Operating	*$117,000*	*$117,000*	*$11,000*	*$11,000*
Leader Of Opposition Support Office	***$195,000***	***$195,000***	***$195,000***	***$195,000***
Personnel	*$147,000*	*$147,000*	*$147,000*	*$147,000*
Operating	*$48,000*	*$48,000*	*$48,000*	*$48,000*

4 FISCAL UPDATE

Table 4.1 Fiscal Indicators Summary

	FY14/15 Actual	FY15/16 Budget	FY15/16 HYEFU	FY16/17 proj.	FY17/18 proj.	FY18/19 proj.
Statement of Financial Performance						
Taxation Revenue ($m)	100.8	102.9	103.2	102.8	104.4	105.6
Social Contributions ($m)	0.0	0.0	0.0	0.0	0.0	0.0
Other Operating Revenue ($m)	27.4	37.4	38.1	34.3	34.1	24.6
Total Operating Revenue ($m)	**128.2**	**140.4**	**141.3**	**137.2**	**138.6**	**130.3**
Total Operating Revenue Percentage of GDP	34.8	37.6	38.5	35.8	34.9	31.7
Tax Revenue Percentage of GDP	27.4	27.6	28.1	26.9	26.3	25.7
Personnel ($m)	**46.3**	**48.5**	**48.7**	**48.0**	**47.9**	**46.7**
Percentage of Total Operating Revenue	36.1	34.6	34.4	35.0	34.6	35.8
Total Operating Expenditure ($m)	**122.1**	**138.8**	**140.5**	**137.3**	**135.9**	**125.6**
Percentage of GDP	33.2	37.2	38.3	35.9	34.2	30.5
Percentage of Operating Revenue	95.2	98.9	99.4	100.1	98.1	96.4
Reappropriation of Previous Year's Capital ($m)	0.0	0.0	0.0	0.0	0.0	0.0
Underlying Operating Balance ($m)	**6.16**	**1.59**	**0.79**	**-0.18**	**2.70**	**4.67**
Percentage of GDP	1.7	0.4	0.2	0.0	0.7	1.1
Non Operating Balance ($m)	-22.4	-29.2	-24.4	-27.4	-16.1	-11.1
Fiscal Balance surplus/deficit ($m) *	**-16.3**	**-27.6**	**-23.6**	**-27.6**	**-13.4**	**-6.4**
Percentage of GDP	-4.4	-7.4	-6.4	-7.2	-3.4	-1.6
Statement of Financial Position ($m)						
Assets ($m)	538.1	593.7	640.4	681.3	711.5	718.6
Liabilities ($m)	134.6	149.1	152.5	153.8	144.4	136.6
Crown Balance ($m)	403.5	444.6	487.8	527.4	567.0	582.0
Percentage of GDP	-109.6	-119.2	-132.9	-137.8	-142.8	-141.5
Statement of Borrowings ($m)						
Gross Debt end of FY ($m)	90.5	109.7	113.1	118.7	110.4	102.6
Percentage of GDP	24.6	29.4	30.8	31.0	27.8	25.0
Net Crown Debt, end of FY ($m)	47.6	66.6	69.7	74.7	66.4	59.8
Percentage of GDP	12.9	17.9	19.0	19.5	16.7	14.5
Loan Repayment Reserves Held ($m)	16.6	16.9	17.1	17.8	17.8	16.6
Net Debt Servicing[1] ($m)	5.3	6.3	7.1	8.0	8.4	9.5
Percentage of Total Underlying Revenue	4.2	4.5	5.0	5.8	6.1	7.3
Development Partner Support ($m)						
Grants ($m)	32.4	49.1	36.5	46.1	25.8	5.6
Percentage of GDP	8.8	13.2	10.0	12.1	6.5	1.4
Memo item: Nominal GDP ($m)	*368.0*	*372.8*	*367.0*	*382.7*	*397.2*	*411.3*

[1]*Net debt servicing refers to gross debt servicing minus the interest earnings of the Loan Reserve Fund*

4.1 Overview

The purpose of the Fiscal Update is to provide revisions to the fiscal forecasts estimated at the time of the 2015/16 Budget (June 2015). In updating the fiscal forecasts, the following factors have been considered:

- year-to-date assessment of revenues and expenditure patterns against original Budget estimates for the 2015/16 fiscal year;
- updated economic forecasts and their associated impact on forecasted government revenues; and
- re-evaluation of debt stock and debt servicing based on updated exchange rate movements and new loans.

4.1.1 Year to Date Assessment of revenues and expenditure patterns

Since the 2015/16 Budget published in June, the availability of new data in the first few months of 2015/16 has resulted in the revenue projections being shifted upwards for 2015/16 (largely due to a one-off withholding tax receipt), before moving slightly downwards in future years. In particular, lower than expected collections of company tax has caused the forecasts for tax revenue to be downgraded, despite some improvement to the economic conditions in the later forward years. The net operating surplus for 2015/16 was originally estimated to be $1.592 million. After reviewing four months of actual receipts, tax revenue has been revised upward by $0.3 million for 2015/16, with the increase in withholding tax being offset by lower collections of other taxes. The increase in revenue has been more than offset by increased expenditure in 2015/16, and the overall result is an expected net operating surplus of $0.79 million for 2015/16, $0.179 million deficit in 2016/17, $2.698 million surplus in 2017/18 and $4.674 million surplus in 2018/19.

Crown revenue estimates do not include any assumptions around increased fisheries licence revenue, as at the time of publication negotiations surrounding any new agreements were still ongoing. However, the Government is confident of reaching agreements for both purse seine and long-line fishing which will result in increases to the currently estimated revenues which would improve the fiscal situation from that which is currently presented.

As announced in the 2015/16 Budget, the Cook Islands Government is drafting policy and legislation, in consultation with the community, to establish the Cook Islands Sovereign Wealth Fund (CISWF). The CISWF will invest any short-term gains from the natural capital endowments of the Cook Islands for the benefit of all future Cook Islanders. One of these sources of short-term revenue is from fishing penalties (where a vessel has broken the rules surrounding fisheries management). In December 2015, the Cook Islands received $0.5 million in fishing fines. As the CISWF is not yet in operation, these revenues will be held in reserve, and transferred to the Fund as seed funding upon the passage of enacting legislation.

In the period since the 2015/16 Budget, operating expenditure has increased by $1.72 million due to increased expenditure in conjunction with the 50th anniversary celebrations, use of consultants and compensation of employees.

These revisions suggest that the 2016/17 Budget will be carried out under tight fiscal conditions and there is limited fiscal space for new initiatives in the upcoming budget process for 2016/17. Therefore Crown expenditures will be monitored closely, and Government will need to consider cost saving policies to improve efficiencies.

4.1.2 Updated economic and revenue forecasts

Due to an unexpected one-off increase in withholding tax collected in the first few months of the year, tax revenue for 2015/16 has been revised slightly upward, despite lower than expected collections across the other taxes. These lower than expected collections have resulted in downward revisions across the remaining forward years, however. There is some offsetting impact coming from improved economic conditions forecast for the later years, compared to estimates made at the time of the 2015/16 Budget. Performance in major tourist markets in the forward years are also expected to have a positive impact on the revenue outlook beyond 2015/16.

Nominal economic growth (which the majority of tax income is derived from) is estimated to be as follows:

- 1.8 per cent growth in 2014/15 (previously 0.5 per cent) due to the increase in public consumption and a fall in imports.
- 0.3 per cent decline in 2015/16 (previously 2.6 per cent growth) due to an increased proportion of government consumption of imported goods and services and a slippage in some capital projects, partially offset by a rebound in tourist arrivals which was evident in the first few months of 2015/16.
- 4.3 per cent growth in 2016/17 (previously 0.7 per cent) due to continued growth in tourism, and capital investments planned for 2015/16 that are likely to slip into 2016/17.

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

Total Crown debt is denominated in a number of currencies, consisting of Chinese Renminbi (RMB - 37 per cent), followed by Special Drawing Right (SDR - 32 per cent), the New Zealand Dollar (NZD - 30 per cent) and Euro (EUR - 1 per cent).

As reported in the 2015/16 Budget, the majority of loans denominated in USD held with the Asian Development Bank (ADB) have been converted into NZD, thereby minimising our risk of exposure to movement in foreign exchange rates.

The NZD depreciated against all major exchange rates between the 2015/16 Budget at the time of this write up. It is worth noting that the NZD/RMB exchange rate depreciated the most (by 20 percent) followed by the NZD/USD exchange rate (with a 16.3 per cent depreciation), leading to a large unrealised foreign exchange loss on the overall loan portfolio.

The Government continues to adopt 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 continued global instability.

4.2 Fiscal Responsibility Ratios

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

- ensuring that unless Crown debt is at prudent levels, operating expenses will be less than operating revenues (Government will run an operating surplus);
- achieving and maintaining levels of Crown net worth that provide a buffer against factors which may impact adversely on net worth in the future;
- 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 (MFEM) quantifies these principles through the Fiscal Responsibility Ratios (FRR) as reported in the 2015/16 Budget. The current performance, and expected performance, of each of the FRR's are discussed below.

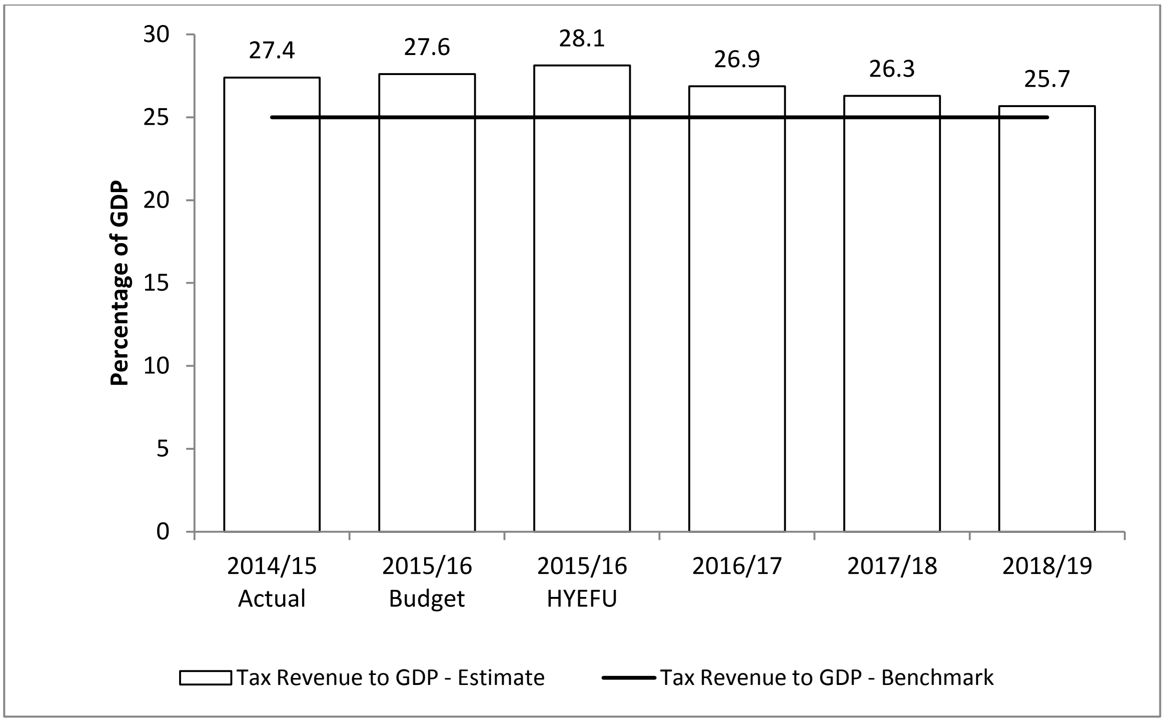
4.2.1 Tax Revenue to GDP

This ratio establishes boundaries on the collection of revenue and ensures government limits the diversion of resources away from the private sector. The benchmark that current and previous governments have agreed to work within is to maintain collections to within 25 per cent of GDP. The expected performance against this benchmark is illustrated in the chart below.

Current forecasts estimate that the Government has exceeded the benchmark by a small margin (28.1 per cent in 2015/16) and will remain above the target going forward, although the size of the gap declines. The reason for this increase from previous years is the tax reform that the Government endorsed in late 2013, which included the tax rate of VAT being increased to 15 per cent and the rate of PAYE being reduced. As some of the new revenue was used to compensate social welfare beneficiaries, the effective tax rate increased above the revenue target. Additionally, withholding tax for the 2015/16 year is currently $1.8 million above the forecast level at the time of the 2015/16 Budget, which explains the 0.5 percentage point difference between the Budget and current estimates as well as the unusually high ratio in 2015/16.

However, the Government intends to further lower the income tax rate from 18.5 per cent in 2015 to 17.5 per cent from 1 January 2016, and 17 per cent from 1 January 2017, reducing the effective tax rate closer to the 25 per cent target.

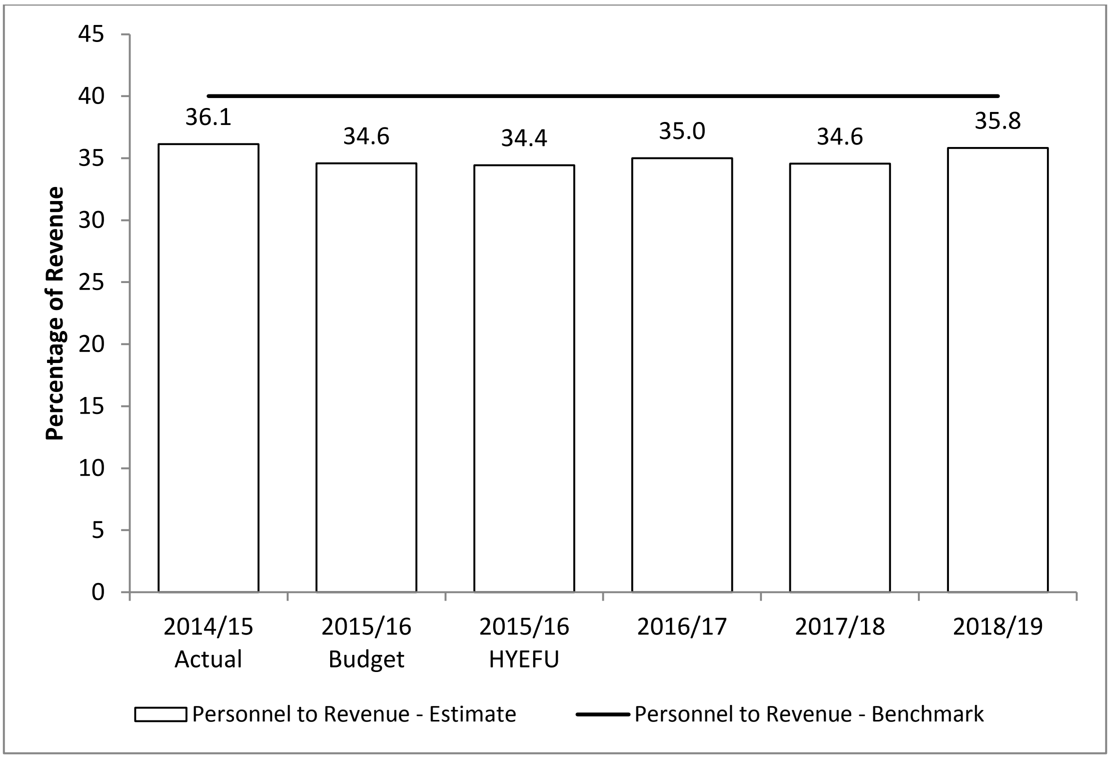
Chart 4.1 Tax Revenue to GDP 2014/15 to 2018/19



4.2.2 Personnel Expenditure to Tax Revenue

This ratio is aimed at controlling the expansion in the size of the public sector. The benchmark that current and previous governments agreed to work within is maintaining the expenditure on personnel within 40 per cent of total revenues. As is illustrated in Chart 4.2 below, currently this target is being achieved.

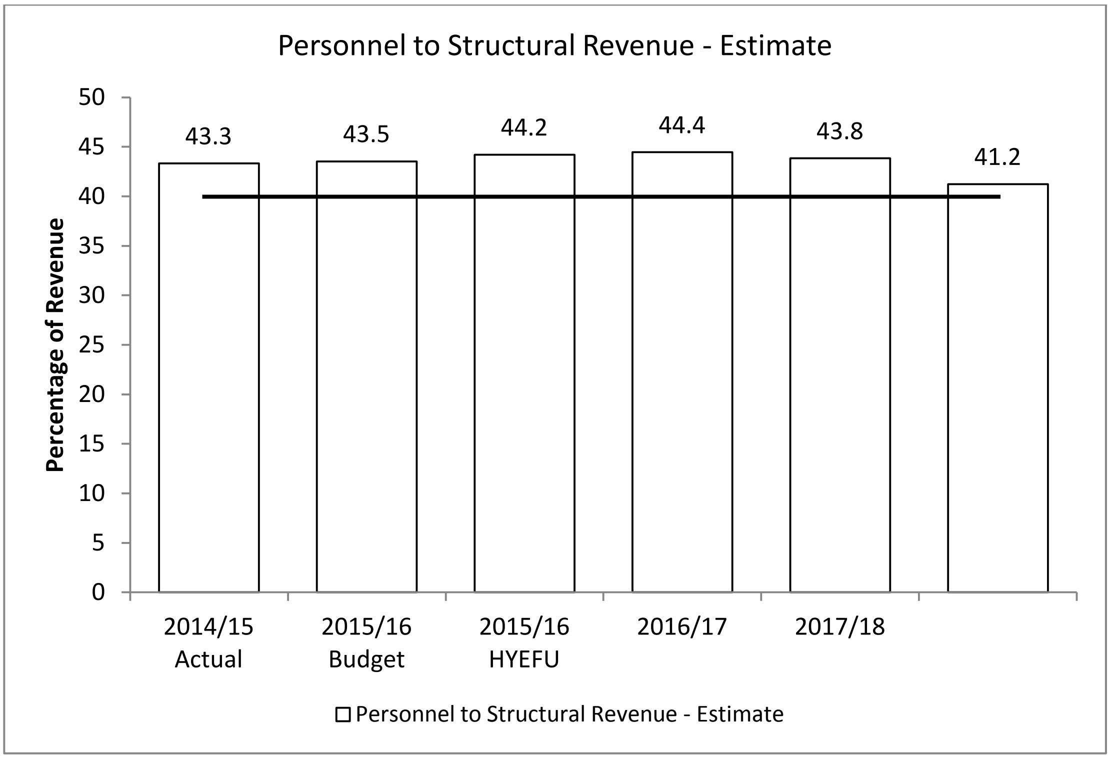
Chart 4.2 Personnel Expenditure to Total Underlying Revenue 2014/15 to 2018/19



However, as personnel spending is a structural spending component, and some of the revenue included in the ratio for Chart 4.2 is not structural in nature, it is useful to consider the ratio shown in Chart 4.3 as well. This ratio compares total 'Compensation of Employees' (a Government Financial Statistics measure of personnel expenditure, which includes personnel funded through POBOCs) with structural revenue to indicate the level of personnel spending as a proportion of structural revenue[1].

[1] Structural revenue is estimated to be locally sourced (non-grant) revenue, excluding withholding tax, revenues from seabed mining and fishing revenue. While fishing revenues are likely to be smoother over longer time horizons, due to large changes in recent times, it has been excluded here.

Chart 4.3 Compensation of Employees to Structural Revenue - Estimate 2014/15 to 2018/19



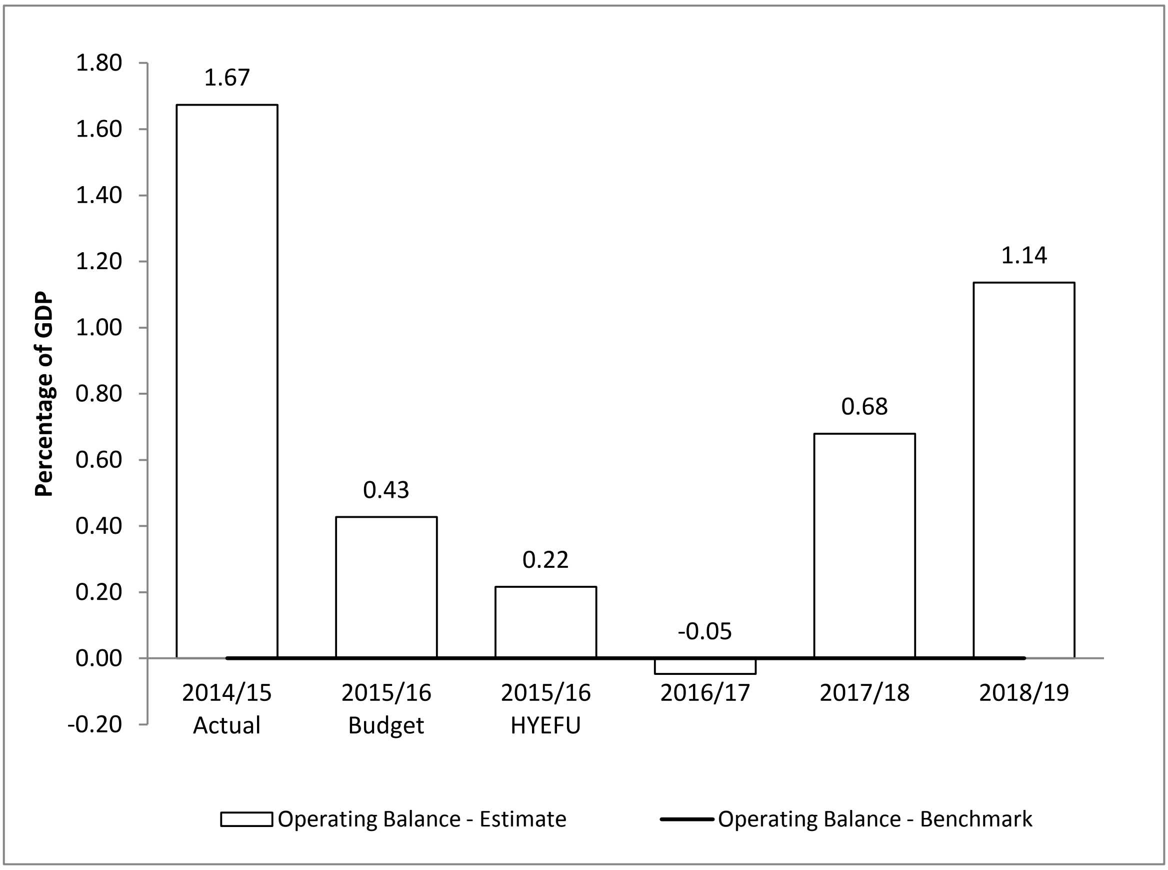
Part of the ongoing public financial management improvements will be to identify a more suitable ratio than the current Personnel-to-Revenue measure, and Chart 4.3 offers a different perspective on the challenge of maintaining fiscal sustainability.

4.2.3 Underlying Net Operating Balance

Maintaining a positive operating balance indicates that Government is able to afford the operational costs of performing the functions of government from its own revenue streams. The Government has set a benchmark of running an operating surplus in each Budget. As illustrated below, it is anticipated that Government has an underlying surplus of $0.8 million for 2015/16.

Going forward, changes in expenditure and revenue estimates are predicted to result in an underlying deficit of $0.2 million in 2016/17, followed by surpluses of $2.7 million in 2017/18, and $4.7 million in 2018/19.

Chart 4.4 Underlying Operating Balance 2014/15 to 2018/19

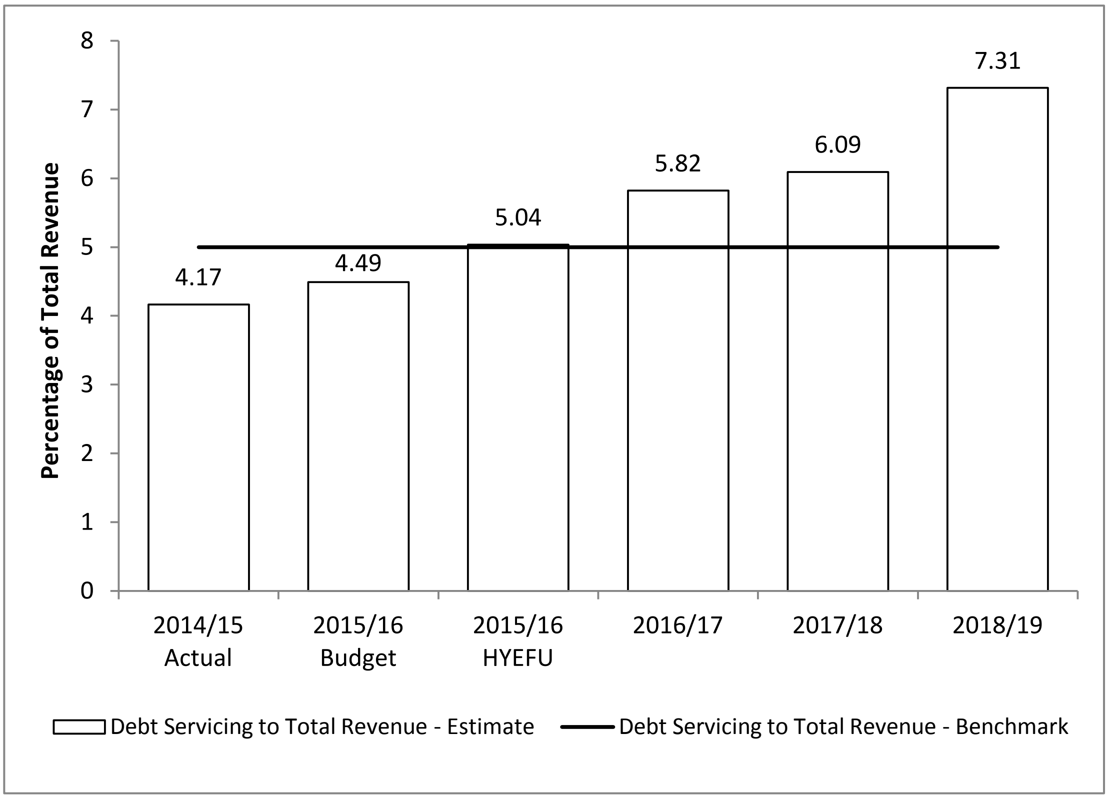


4.2.4 Debt Servicing to Revenue

Debt servicing to total revenue measures the ability of Government to service its debt obligations from revenue collected. Debt servicing includes both interest and principle. The figure shown below represents the debt servicing payment going out of the Loan Repayment Fund (LRF), minus any interest earnings of the LRF (rather than the amount paid into the LRF in the specified year). The ratio of debt servicing over the short to medium term is breached from 2015/16 onward. Further details around debt sustainability can be found in the debt section below.

The large correction from the 2015/16 Budget presentation is due to an error in the Budget document where debt servicing was incorrectly calculated. This has since been corrected.

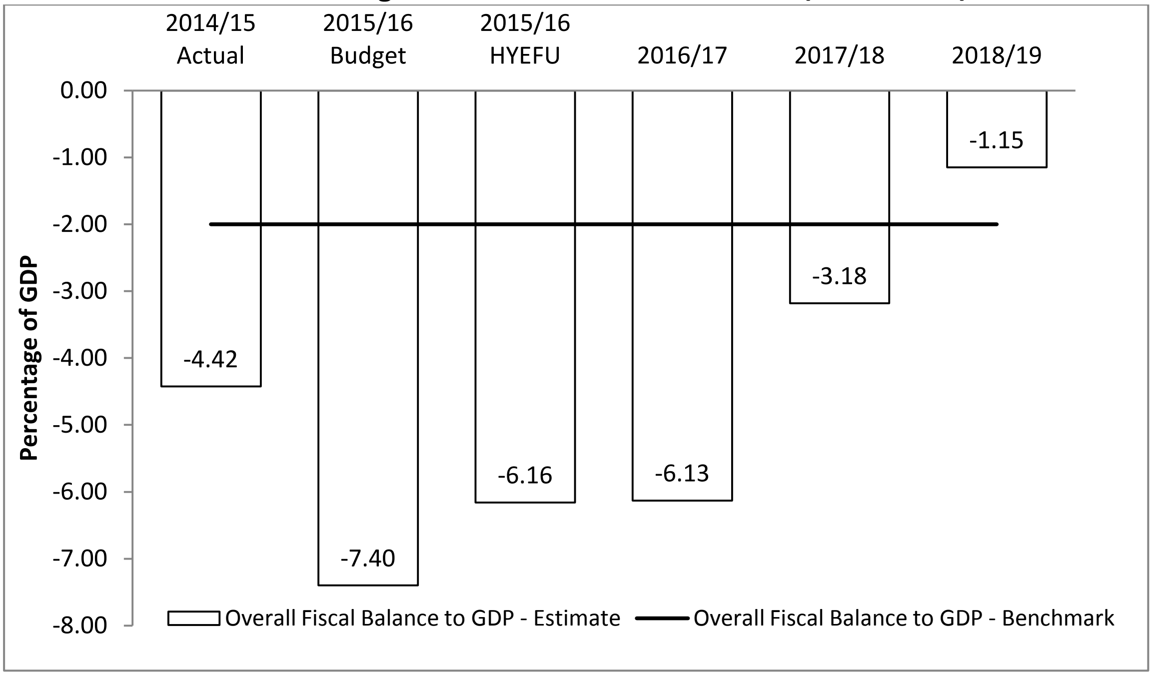
Chart 4.5 Debt Servicing to Revenue 2014/15 to 2018/19



4.2.5 Overall Budget Balance to GDP

The Overall Balance is the operating balance less non-operating expenditure (purchase of assets and repayment of liabilities). Where the budget overall balance is in deficit, it must be serviced through lending or a drawdown of reserve funds. The benchmark is set to be maintained within -/+2 per cent of GDP to ensure that government does not accumulate debt too quickly, and taken together with the debt servicing to total revenue and net debt to GDP ratios, ensures that debt is managed and taken on within sustainable levels. As the chart below illustrates, the Government breaches the overall Budget balance in the short term due to large scale infrastructure projects which are financed by a combination of concessional lending and using cash reserves. This is expected to be a relatively short term trend due to the short term nature of the projects in question, as evidenced by a smaller overall deficit in 2016/17, 2017/18 and 2018/19.

Chart 4.6 Budget Overall Balance to GDP 2014/15 to 2018/19

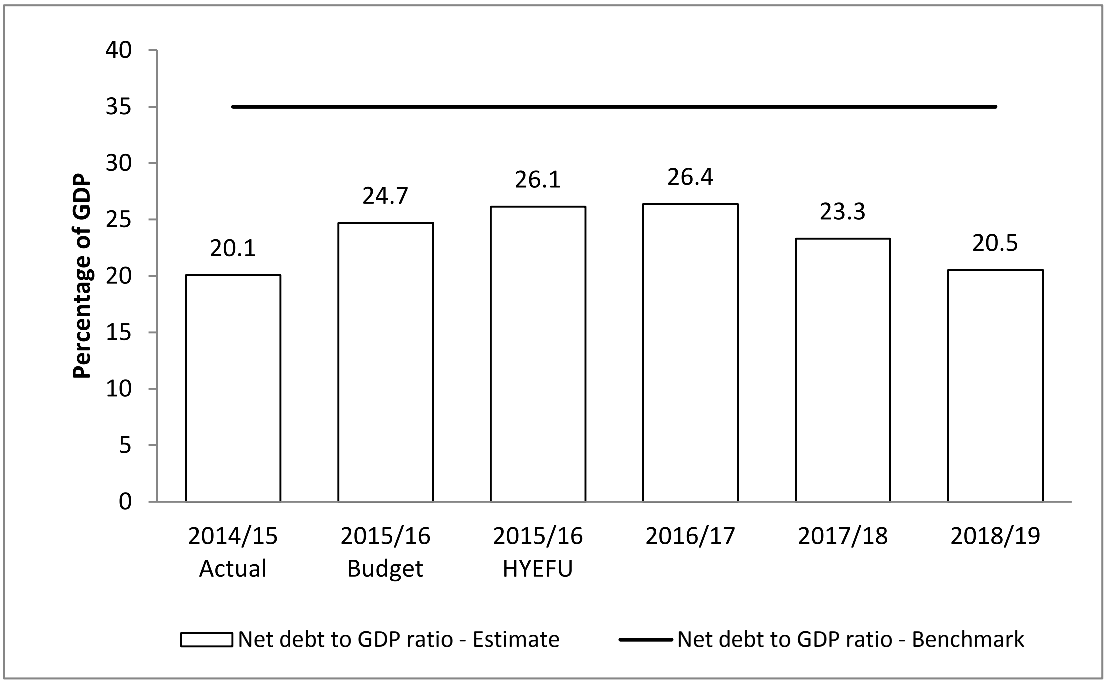


4.2.6 Net Debt to GDP

Net debt (taken here to be gross debt obligations, including currency on issue, net of the funds in the LRF) to GDP measures the level of debt relative to national income, and is intended to control the overall level of debt taken on by Government including SOE's. The limit agreed to by Government is to maintain net debt within 35 per cent of GDP. This would represent total borrowings of $129 million estimated in 2015/16. The Government is well within the net debt benchmark over the short and medium term.

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

Chart 4.7 Net Debt to GDP Ratio 2014/15 to 2018/19



The Cook Islands has adopted a conservative approach towards the definition of net debt. The internationally accepted definition of net debt is total gross debt (all public sector debt and currency on issue) less total financial assets corresponding to those debt instruments (this means like for like, for example cash). Under this definition the Cook Islands net debt position would be around $76.9 million or 21.0 per cent of GDP in 2015/16.

5 ECONOMIC UPDATE

5.1 Introduction

The Cook Islands is a small open economy largely dependent on tourism, in which it has a natural comparative advantage. Consumer preferences and economic growth in the major tourist source market of New Zealand (and to a lesser extent, Australia) has a major impact on domestic economic performance. Any international developments affecting New Zealand will eventually impact on the Cook Islands. Not only is New Zealand the Cook Islands largest trading partner and source of tourism, but changes in the New Zealand dollar will also impact on domestic markets and inflation. Recently, as tourism growth has slowed, large capital works have also become a driver for economic growth. The completion of these projects will present challenges for maintaining the economic stimulus of construction activity in future years.

Despite being one of the remotest countries in the world, and one of the smallest (even by Pacific standards), the Cook Islands is one of the most prosperous countries per capita in the Pacific, behind New Zealand and Australia. The Cook Islands has enjoyed a sustained period of economic prosperity following the rapid growth of the tourism industry and a series of public sector reforms following the economic crisis of the mid-nineteen nineties. The economic dependency on tourism has benefitted the Cook Islands greatly. Despite this success, the lack of economic diversity or economies of scale make any progress fragile and reversible. Labour market constraints across various areas of the economy also present major limitations on economic growth; an issue that is worsened by continued depopulation. In October 2015, the Asian Development Bank released *The Cook Islands: Stronger Investment Climate for Sustainable Growth,* which recognised that some key challenges facing the Cook Islands are related to the strength of public sector performance, regulation around foreign investment, land reforms and improvements to core infrastructure services in terms of quality and sustainability.

The reliance on imports to support local consumption makes the Cook Islands extremely vulnerable to external price shocks – particularly in regards to fuel, as transport and energy costs affect the price of almost all goods. Global fuel prices, through their impact on the cost of transportation, remain the key risk to inflation. Despite the impact of transportation costs, resulting from the reliance on imports to support household consumption, offsetting factors such as lower household costs (such as rent and utilities) results in a cost of living broadly comparable to New Zealand.

Despite the large imbalance in goods trade, the Cook Islands enjoys a large current account surplus, owing to the significant contribution of estimated tourism receipts (which are counted as a service export).

Global economic growth remains modest and somewhat inconsistent, with growth diverging across the world. In September 2015, the International Monetary Fund (IMF) revised its forecast for global economic growth in 2015 to 3.1 per cent, a slight downward revision, while in 2016 the IMF expects global growth of 3.6 per cent. These forecasts reflect the downward revisions to forecasts for developing economies, partially offset by upward revisions to those for advanced economies. Overall, the risks to the forecast remain on the downside as China takes steps to rebalance its economy, productivity growth remains slow and any risks to oil production remain through conflict in the Middle East.

While the price of oil has not fallen as dramatically as it did in 2014, forecasts are for the price to remain low and fall slightly over the next two years. While this will reduce economic growth in oil exporting nations, it will ultimately lead to lower prices for fuel globally (including in the Cook Islands). Recent geopolitical outcomes such as a deal struck with Iran may pave the way for further oil production, leading to even greater downward pressure on oil prices.

At the time of publication, New Zealand and Australia had not updated their official forecasts since the release of their respective 2015/16 Budgets.

Since the 2015/16 Budget, total tourism arrivals were significantly higher than expected, with lower than expected Australian arrivals for May and June being offset by higher arrivals from New Zealand and other markets. However, in July, August and October Australian arrivals were much higher than expected at Budget. Overall, these changes have led to upward revisions to forecast tourist arrivals in 2015/16.

As there is no published GDP data for 2014/15 available, the forecasting methodology has been applied to the 2014/15 data, using partial indicators where available to form the best estimates.

Nominal GDP (which includes inflation) is now estimated to have increased by 1.8 per cent in 2014/15, an upwards revision from the forecast of 0.5 per cent growth forecast at the time of the 2015/16 Budget. Nominal growth is expected to decline slightly by 0.3 per cent in 2015/16, due to higher government consumption imports, offset by rebounding tourism growth. Estimated growth increases again to 4.3 per cent growth in 2016/17 due to additional capital investment, and continued strong growth in tourism, before maintaining growth of 3.8 per cent in 2017/18 on the back of strong tourism forecasts. As prices in the economy (as measured by the GDP deflator) are forecast to increase faster than nominal GDP a decline in real GDP (after removing inflation) is expected in 2015/16. This is due to the estimated impacts of world commodity prices growing faster than the overall domestic economy.

New economic data became available after the finalisation of the forecasts presented here, but prior to publication. Due to time constraints, this new data will not be included until future Budget estimates.

Tourist growth has been revised upward from the forecasts at the 2015/16 Budget due to higher than anticipated arrivals from most source markets. This increases pressure on the capacity constraints that are now expected to begin reducing growth in the peak month of July from 2016 onwards. Growth in visitor arrivals is expected to increase from a decline of 0.9 per cent in 2014/15 to a 1.6 per cent increase in arrivals in 2015/16, due mainly to stronger growth out of New Zealand and a recovery in the numbers of Australian tourists. The forecast for 2016/17 also reflects these increased numbers, at 1.6 per cent growth again.

Inflation as measured by the Cook Islands Consumer Price Index (CPI) was 3.0 per cent in 2014/15. Due mainly to the depreciation of the New Zealand dollar, inflation is expected to decline to around 2.5 per cent per annum over of the remainder of the period. The year average CPI is forecast to increase by 2.5 per cent in 2015/16 reflecting the exchange rate effects, before increasing by 2.6 per cent in 2016/17, as some rebound in the currently low oil price is expected.

Table 5.1 Summary of Economic Indicators

	2013/14 *Actual*	2014/15 *Est*	2015/16 *Est*	2016/17 *Proj*	2017/18 *Proj*	2018/19 *Proj*
Economic Activity						
Nominal GDP ($'000)	361,568	368,023	367,036	382,717	397,163	411,265
Percentage change (YOY)	-2.0	1.8	-0.3	4.3	3.8	3.6
Real GDP (2006 Prices, $'000)	275,733	277,761	270,199	272,794	276,290	279,970
Percentage change (YOY)	-1.2	0.7	-2.7	1.0	1.3	1.3
Inflation						
Percentage change (YOY)	1.6	3.0	2.5	2.6	2.4	2.4
Construction/Capital Investment						
Commercial Building Approvals ($'000)	2,861	2,861	2,861	2,861	2,861	2,861
Residential Building Approvals ($'000)	7,982	6,651	6,374	6,110	5,856	5,613
Public Works ($'000) (includes Dev Partners)	11,994	8,342	19,755	24,479	19,269	11,050
Productive Sector Indicators						
Visitor Arrivals	122,854	121,772	123,753	125,681	126,999	128,407
Percentage change (YOY)	1.6	-0.9	1.6	1.6	1.0	1.1
Estimated Visitor Expenditures ($'000)	249,745	239,481	256,479	267,705	276,770	286,466
Pearl Exports ($'000)	211	291	251	251	251	251
Fish Exports ($'000)	20,786	20,686	20,636	20,636	20,636	20,636
External Sector						
Merchandise Trade Balance ($'000)	(120,225)	(109,469)	(113,831)	(117,728)	(116,249)	(117,872)
Services Trade Balance ($'000)	249,745	239,481	256,479	267,705	276,770	286,466
Exchange Rate (USD/NZD Average)	0.830	0.786	0.626	0.617	0.632	0.655
Financial Sector (at end of financial year)						
Government Net Debt Position ($'000)	N/A	62,118	87,551	83,888	76,141	65,529
Private and Public Enterprise Deposits ($'000)	175,338	192,266	-	-	-	-
Private and Public Enterprise Loans ($'000)	246,141	248,730	-	-	-	-

* No attempt has been made to estimate public or private deposits or loans due to breaks in the data series

5.2 Gross Domestic Product (GDP)

After two successive years of negative growth in the real GDP (removing the impact of inflation) of the Cook Islands, this measure is estimated to have grown by 0.7 per cent in 2014/15. This growth is driven primarily by growth in public consumption, particularly in operating expenditure, as well as a fall in imports to the Cook Islands which suggests a greater demand for locally produced goods and services. This growth is partially offset by a reduction in tourist arrivals for the first time in over a decade. From 2015/16 onward, a key driver of economic growth is anticipated to be capital investment, as the Cook Islands Government, along with development partners, invests in several key projects.

Recent GDP estimates highlight the sensitivity of the Cook Islands economy to relatively small changes in single industries or the implementation schedules of public capital projects. This is particularly important in the coming years, where the level of public capital investment will be the highest on record.

Nominal GDP is estimated to have risen 1.8 per cent during 2014/15, as compared to an estimate of 0.5 per cent made at the time of the 2015/16 Budget. This is driven by the same factors as real GDP (public consumption and a fall in imports), with an additional contribution from price growth also included.

Over the forecast years, nominal GDP growth is estimated to contract slightly by 0.3 per cent in 2015/16 due to an increased proportion of government consumption of imported goods and services, partially offset by a rebound in tourist arrivals which was evident in the first few months of 2015/16.

In 2016/17, growth is expected to increase again, by 4.3 per cent as tourism remains relatively strong, and technical assumptions around the capacity constraints of capital investment see some of the investment planned for 2015/16 slip into 2016/17. The assumption around capital slippage has only been introduced to the economic modelling framework during this round of estimates, hence the significant revision to GDP in 2016/17.

Table 5.2 GDP growth revisions

	2014/15		2015/16		2016/17	
	2015/16 Budget	2015/16 HYEFU	2015/16 Budget	2015/16 HYEFU	2015/16 Budget	2015/16 HYEFU
Nominal GDP growth (per cent)	0.5	1.8	2.6	-0.3	0.7	4.3
Real GDP growth (per cent)	-1.2	0.7	1.4	-2.7	-1.6	1.0
Implicit GDP deflator (percentage change)	1.7	1.0	1.2	2.5	2.3	3.3

Real GDP is forecast to follow a similar pattern to nominal growth but as it removes the impact of inflation, the negative growth rate in 2015/16 is more pronounced.

Since the 2015/16 Budget there have been some technical changes in the method to forecast the GDP deflator, which have resulted in a more robust framework. The negative growth rates of Real

GDP reflect higher forecasts of the GDP deflator (that is, higher price growth, mainly from commodity prices and exchange rate impacts) than at the 2015/16 Budget.

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

- poor budget execution of the public sector capital investment planned across the Cook Islands – in particular, any unexpected delays in the implementation of the renewable energy or water projects;
- the preferences of New Zealand and Australian tourists moving towards other competing tourism markets in the Pacific or Asia, or choosing to tourist within their respective countries;
- an economic slowdown in New Zealand and/or Australia;
- the domestic labour market failing to increase through a decline in migrant labour entering the Cook Islands to fill job vacancies, or Cook Islanders continuing to leave the local market;
- external price shocks to our major import categories (fuel or food supplied by New Zealand); and
- any reductions in projected assistance from development partners.

On the upside, key risks are:

- inflation levels may not be as high as forecast, which would impact on the GDP deflator, and ultimately, real GDP. This may come as a result of further falls in global fuel prices, or an unexpected appreciation in the New Zealand dollar;
- the unknown impact of the entry of Jetstar into the aviation market. If this creates a significant increase in the number of arrivals to the Cook Islands, it would be expected to increase GDP above that which is currently forecast; and
- there may be new development projects or capital works come on line that are currently unbudgeted.

Chart 5.1 Real GDP at 2006/07 prices, 2004/05 to 2018/19 ($'000)

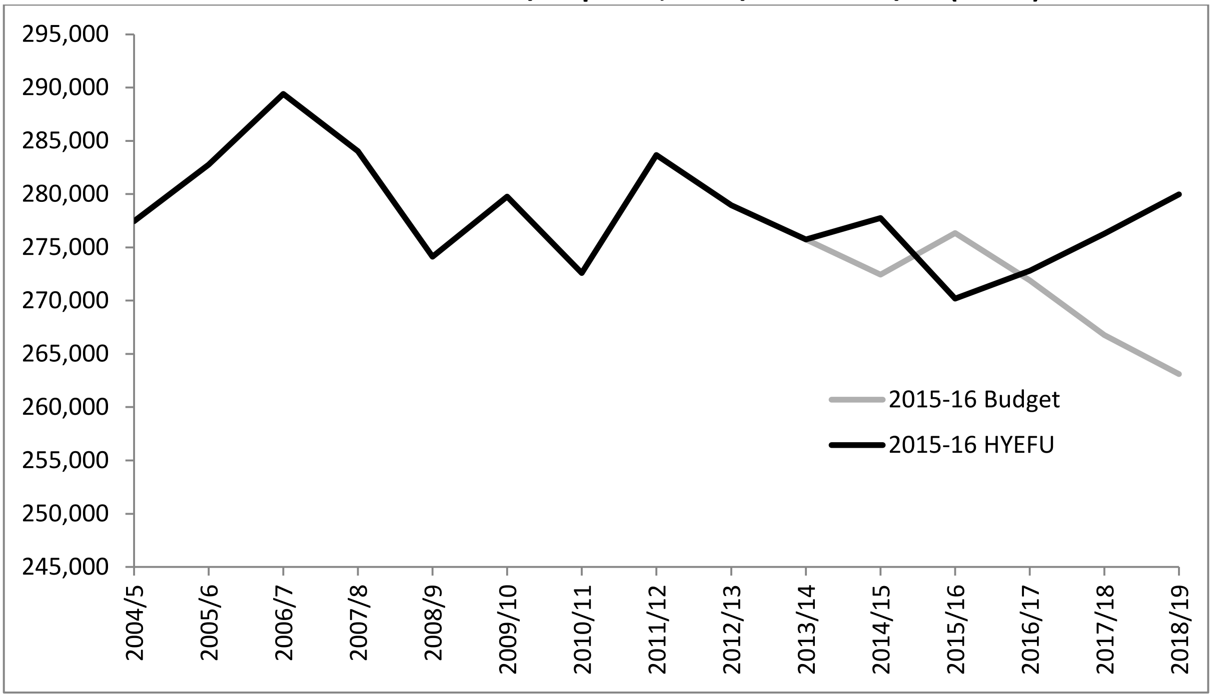
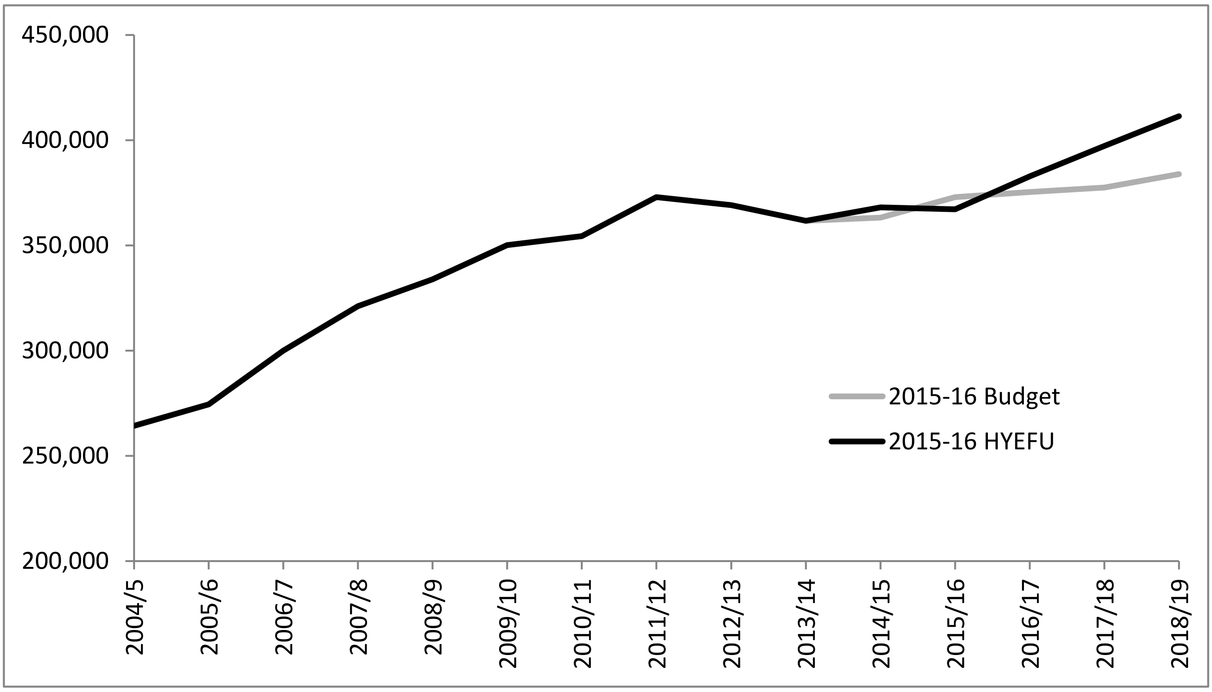


Chart 5.2 Nominal GDP at current prices, 2004/05 to 2018/19 ($'000)



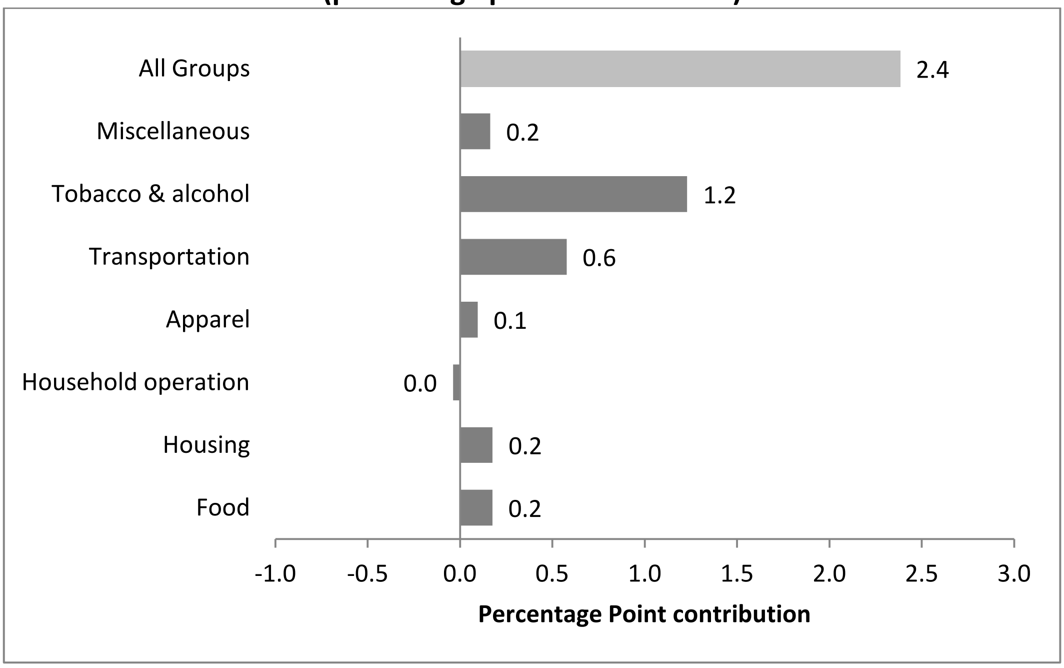
5.3 Consumer Price Index (CPI)

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

At the time of publication, the most recent CPI data available was for the September quarter 2015, which showed inflation had risen by 0.2 per cent when compared to the September quarter 2014. This relatively low rate of inflation suggests that the impact of the NZD depreciation in early 2015 has had little effect on local prices, although the depreciation between May 2015 and September 2015 may yet have been felt by the local economy.

Average annual inflation, which is the measure of inflation over the current year compared with inflation over the previous year, up to the September quarter 2015 was 2.4 percent. This growth in prices was driven by an 11.7 per cent increase in tobacco and alcohol prices (contributing 1.2 percentage points to overall inflation, see Chart 5.3) and a 3.2 per cent increase in transport prices (contributing 0.6 percentage points).

Chart 5.3 Contribution to September quarter 2015 year average inflation (percentage point contribution)



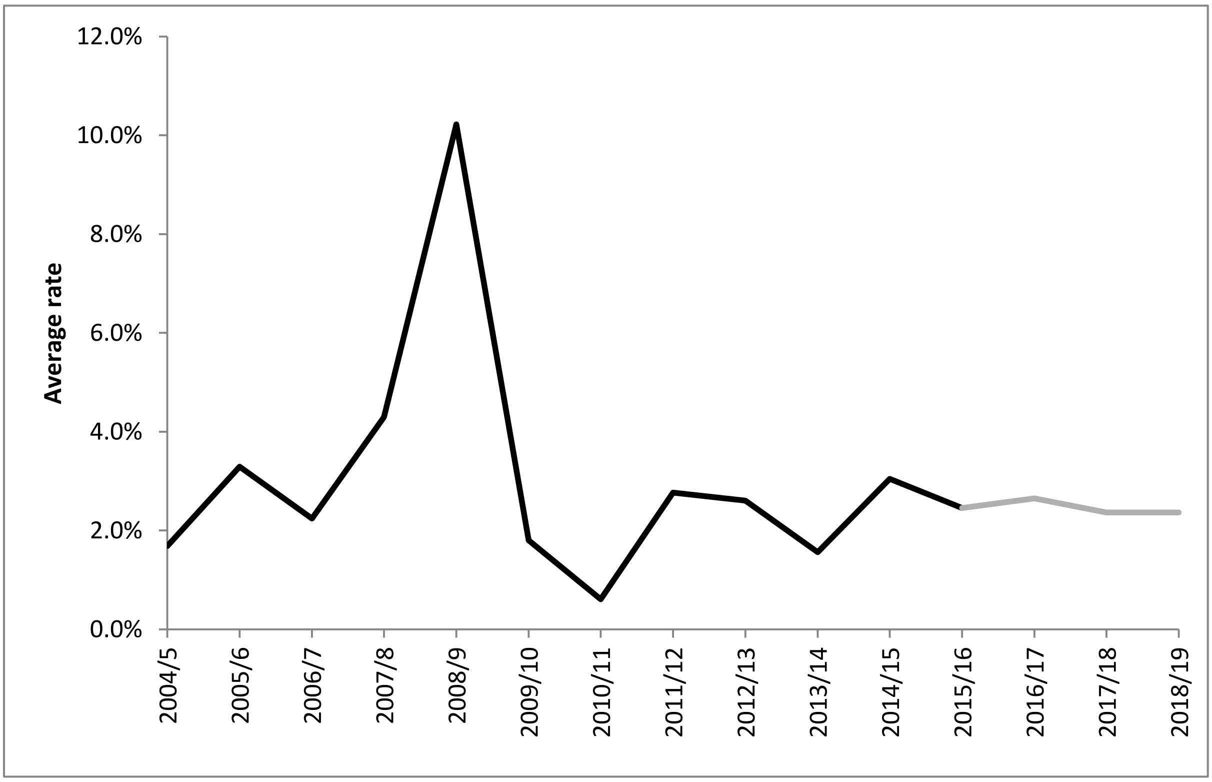
As shown in Chart 5.4, year average inflation is estimated to decline from an average annual rate of 3.0 per cent in 2014/15 to 2.5 per cent in 2015/16. This measure of inflation is expected to remain around two and a half per cent per year over the rest of the period; close to the New Zealand target rate.

Growth in the CPI for 2014/15 reflects a combination of two notable factors: the increase of tobacco excise; and the depreciation of the NZD. The increase of tobacco excise of 33 per cent on 1 July 2014, along with the VAT increases on 1 April 2014 which were only fully recognised in year average data for 2014/15, has put upward pressure on the CPI, as shown in Chart 5.4. The recent depreciation in the value of the NZD has increased inflationary pressure overall, shown in the broad increases across all groups of the CPI. However, as these two factors appear likely to have less impact going forward (as the currency depreciation looks to have largely occurred, and the tobacco excise increase has moved to a more modest five per cent annually), this pressure on prices is expected to decrease in 2015/16.

The major factor which has affected CPI forecasts in the Budget year is the depreciation of the NZD, which raises the cost of imports to the Cook Islands. Depreciation in the latter half of 2014/15 has continued briefly into the early part of 2015/16, though most of the expected decline appears to have occurred, and the International Monetary Fund (IMF) expects that the decline will stabilise between USD 0.64 and USD 0.66 in 2016. The inflationary pressure brought on through the lower NZD is partially offset through recent declines in global fuel prices, however, the IMF anticipates that some of the oil price reduction will be reversed from 2017/18 onwards.

These forecasts are subject to both the up and downside risks which could result in outcomes that differ from the expected. One significant risk that could move in either direction is the movements in the NZD. If the NZD were to fall further, this would increase inflation in New Zealand and the Cook Islands, while an appreciation would be likely to lead to lower levels of inflation. Another major risk factor for consumer prices is any movements in global fuel prices, through their impact on transport costs. Large increases in fuel prices would be likely to lead to higher than expected inflation, as was experienced in 2008/09.

Chart 5.4 Consumer Price Index (CPI), year average, 2004/05 – 2018/19



5.4 Tourism

Tourism remains the largest industry in the Cook Islands, accounting for around 60 per cent of the economy. The Cook Islands experienced record tourism arrival numbers almost every year from 2001 to 2013/14. However, recent years have seen a consistent slowing of tourist growth. In 2010/11 and 2011/12, total visitor growth was 8.4 and 7.4 per cent, respectively. However, this slowed in 2012/13 and 2013/14 to 3.5 and 1.6 per cent, before a 0.9 per cent decline in 2014/15.

The strong growth experienced previously from New Zealand and Australian markets likely peaked over 2010 to 2012 and a return to double digit growth in the near term is unlikely; which was reflected in the conservative forecasts in the 2015/16 Budget. However, visitor arrivals in recent months (after the Budget) have been higher than expected, – particularly from New Zealand, most likely due to the 50th anniversary celebrations.

New Zealand remains by far the largest market at 67 per cent of total arrivals in 2014/15, with Australia having a smaller, but significant share (17 per cent).

Reflecting the recent increases in major source markets, tourist arrivals are forecast to return to solid, if unspectacular, growth of 1.6 per cent in 2015/16, continuing at this rate in 2016/17. Growth over the later forecast years is anticipated to remain close to one per cent in each year.

Current calendar year-to-date arrivals (Jan-Oct) are 2.7 per cent higher than the similar period in 2014, and the first four months of 2015/16 (Jul-Oct) are 4.8 per cent higher than the same period last year. In large part, this reflects increased numbers of arrivals due to the 50th anniversary celebrations (which appears to have also increased arrivals in June. The exact nature of the distortionary impact of the 50th celebrations is not yet clear, however a downside risk to the forecasts remains that the large number of arrivals in July and August caused other tourists to be shifted to alternative times, such as September and October. If this is the case, arrivals may experience slower growth in future years, as 2015/16 is artificially inflated.

The average stay is estimated at around eight days, with this average heavily influenced by the level of New Zealand and Australian arrivals and the month of travel. The average daily spend (including accommodation) is estimated to be around $210-240 per visitor (including children), but varies by time of year and by tourist source market.

Chart 5.5 Total monthly visitor arrivals (12 month moving average) 2006-2018

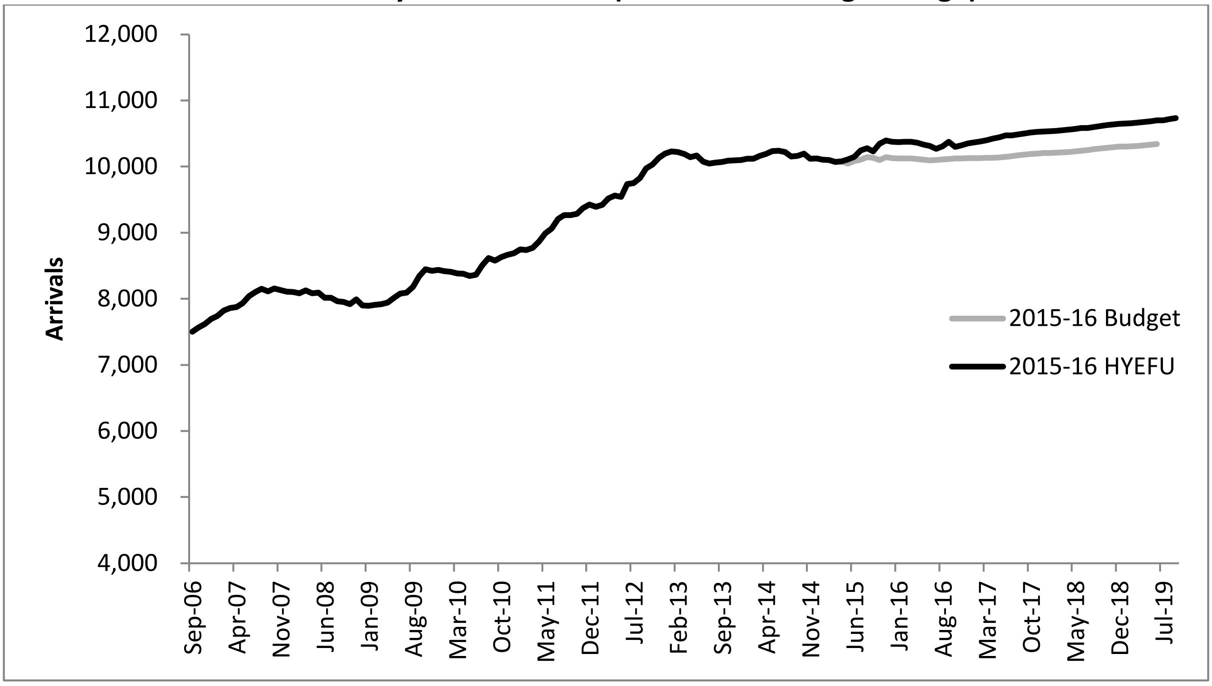
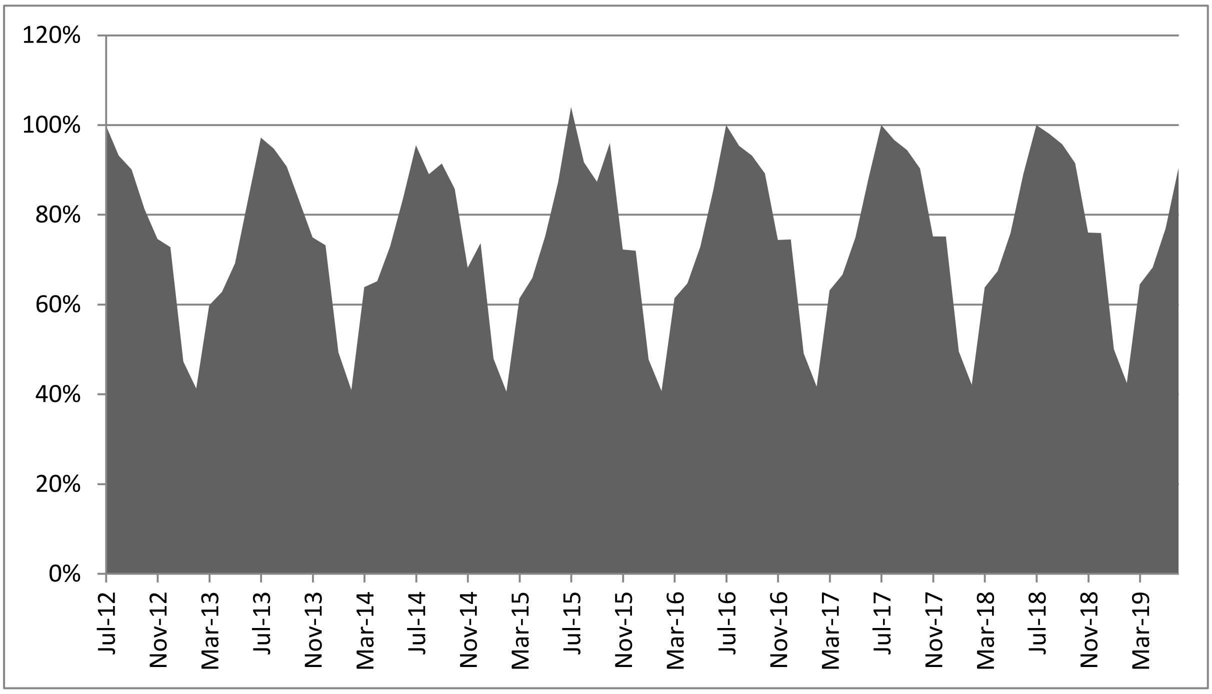


Table 5.3 Estimated total tourism numbers by quarter 2013/14 to 2018/19

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2013/14	39,031	31,902	21,294	30,627	122,854
2014/15	38,102	31,435	20,694	31,541	121,772
2015/16	39,084	33,172	20,696	30,801	123,753
2016/17	39,841	32,876	21,266	31,699	125,681
2017/18	40,190	33,229	21,470	32,109	126,999
2018/19	40,560	33,619	21,688	32,541	128,407

It was evident in the lead up to the Pacific Island Leaders Forum in July/August 2012, and again around the 50th anniversary celebrations in July/August 2015, that capacity constraints are an issue in Rarotonga. As the celebrations in July 2015 involved many visitors staying in informal accommodation (such as with family or in community halls), July 2012 continues to be the benchmark for the maximum number of tourist arrivals that Rarotonga can be expected to reasonably handle until new capacity comes online. A presentation of the capacity utilisation is provided at Chart 5.6 Tourism capacity utilisation by month – 2012/13 to 2018/19

Chart 5.6 Tourism capacity utilisation by month – 2012/13 to 2018/19



Due to the upward revision in the arrival forecasts, capacity constraints are expected to be more binding than forecast in the 2015/16 Budget. In particular, due to the high number of arrivals in July 2015, expectations of future July arrivals are constrained by the imposed capacity limit. The growth in arrivals has been focussed largely during the peak season, which will result in increased pressure for new investments to come online in a timely manner. Increasingly, arrivals are being loaded onto the latter half of the calendar year.

While growth has been relatively muted in 2013/14, and declined in 2014/15, the capacity of the tourism sector (be it management capacity or additional capital investment) needs to expand if growth in arrivals are expected to continue. The overall Tourism Corporation strategy of increasing arrivals in non-peak times may be able to increase the capital returns of the industry in the short term, thereby encouraging more investment, but increases in value offerings or capacity will be required to sustain growth in the longer term.

5.4.1 New Zealand

New Zealand continues to be the Cook Islands leading market for visitors, accounting for an estimated 67 per cent of the total market (or 82,217) in 2014/15.

Over the past ten years, New Zealand arrivals have grown an average of 7.0 per cent a year – a phenomenal level of growth with New Zealand arrivals almost doubling over that period (increasing by 94 per cent). Outbound tourism from New Zealand only grew 28.7 per cent over the ten years to 2015, an average of 2.6 per cent a year. This represents a large shift in New Zealand tourist preferences towards the Cook Islands over other destinations. This is supported by the results of the visitor survey in 2014 which estimates that 47 per cent of visitors from New Zealand are return visitors – an impressive achievement for the tourism industry of the Cook Islands.

However, in the past two years, the share of New Zealanders travelling to the Cook Islands (as a proportion going to Oceania, outside of Australia) has started to decline, as New Zealand tourists return to Fiji. The Cook Islands' share of New Zealand travellers in Oceania (not including Australia) peaked at 25 per cent of the market in 2011/12 and 2012/13, and fell to around 23 per cent in 2014/15.

Similarly, growth in arrivals slowed further in 2013/14 and 2014/15, with arrivals from New Zealand only increasing 0.5 per cent and 2.4 per cent respectively, down from the peak of 13 per cent growth in 2010/11.

After rebounding to increase by 2.4 per cent in 2014/15, New Zealand arrivals are expected to increase by 1.5 per cent in 2015/16, an upward revision of 0.5 per cent from Budget. This is due to higher than expected arrivals in most months since the release of the Budget, especially in May, July and October, which were all record levels for those months. Arrivals in 2016/17 are forecast to grow by 2.6 per cent, an upward revision of over 2 percentage points from Budget, which reflects a continuation of strong recent growth, even after allowing for the one-off impacts of the 50th celebrations in July and August. There is also likely to be some impact from the entry of Jetstar to the market, along with the addition of a Christchurch to Rarotonga route by Virgin Australia, increasing access for New Zealand tourists to the Cook Islands. In the later forecast years, arrival growth from New Zealand is expected to remain just below two per cent per year. These forecasts are based on recent performance of New Zealanders visiting the Cook Islands and of overall New Zealand outbound tourism.

Chart 5.7 New Zealand monthly visitor arrivals (12 month moving average) 2006-2018

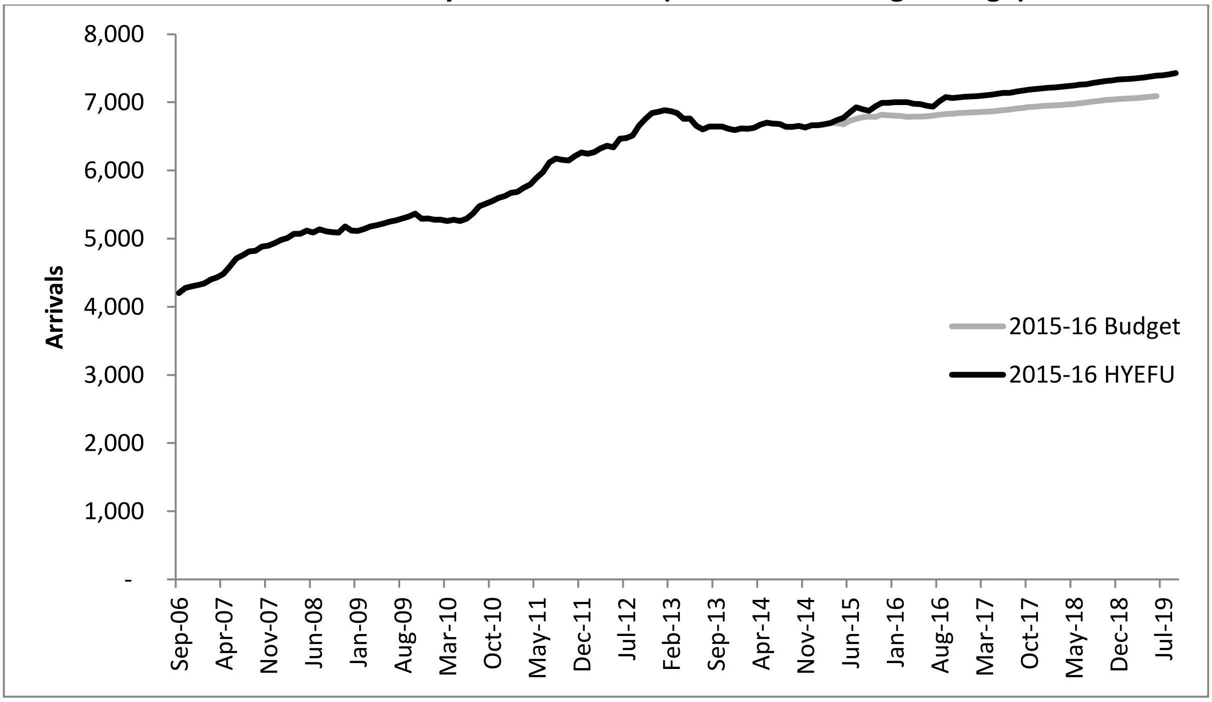


Table 5.4 Estimated New Zealand tourism numbers by quarter 2013/14 to 2018/19

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2013/14	28,382	19,323	11,666	20,880	80,251
2014/15	27,788	19,625	12,061	22,743	82,217
2015/16	28,084	21,040	12,152	22,141	83,417
2016/17	29,582	21,088	12,389	22,573	85,632
2017/18	29,996	21,499	12,630	23,013	87,139
2018/19	30,434	21,918	12,877	23,462	88,691

5.4.2 Australia

The Australian market is the second largest tourism market to the Cook Islands, accounting for approximately 17 per cent of the total market share.

Australia has been experiencing a boom in outbound tourism growth. In the last ten years Australian outbound tourism has grown by 97 per cent, an average of 7.0 per cent a year. To compare, Australian arrivals to the Cook Islands over the last ten years have increased 71 per cent, or an annual average of 5.5 per cent. While the growth in tourist arrivals from Australia has been impressive, the main driver of this appears to be the overall growth in Australian outbound tourists, rather than the Cook Islands increasing its market share. However, 2014/15 was a year of relatively slow growth for Australian outbound tourism, and forecasts by Tourism Research Australia expect this slower growth of around 3 per cent to continue for the next decade or so.

After growing an impressive 7.0 per cent in 2012/13 and a more modest 2.9 per cent in 2013/14, Australian arrivals into the Cook Islands declined significantly in 2014/15 – a fall of 9.1 per cent. However, recent data on Australian arrivals has been quite strong, with the three months to September 2015 being 7.4 per cent higher than in the same period in 2014/15.

For 2015/16, Australian arrivals are expected to rebound from the 2014/15 fall, and increase by 2.1 per cent. This reflects the very strong growth in Australian arrivals in the early months of the 2015/16 year, which account for an increase of around 1,500 arrivals when compared with forecasts as at Budget. However, this rapid growth is expected to level off in 2016/17, with a marginal decline in arrivals of 0.1 per cent. The level of arrivals is then expected to decline again, by 1.2 per cent in 2017/18, before stabilising over the remaining forecast years. This decline and stabilisation is occurring despite Australian outbound growth being forecast to achieve 3 per cent per year due to Oceania falling as a share of total outbound Australian tourism, and the Cook Islands falling as a share of that Oceania-bound tourism.

An upside possibility to this relatively conservative forecast surrounds the entry of Jetstar to the market, providing another carrier with strong network and alternate alliance links to Australia.

The expected change from a Boeing 767 to a Boeing 787 on the underwritten Sydney route presents an opportunity to improve fare competitiveness and flight capacity with other destinations in the region (notably Fiji), but also presents a financial sustainability risk of the current underwriting strategy if arrival numbers are unable to meet expected targets.

Chart 5.8 Australia monthly visitor arrivals (12 month moving average) 2006-2018

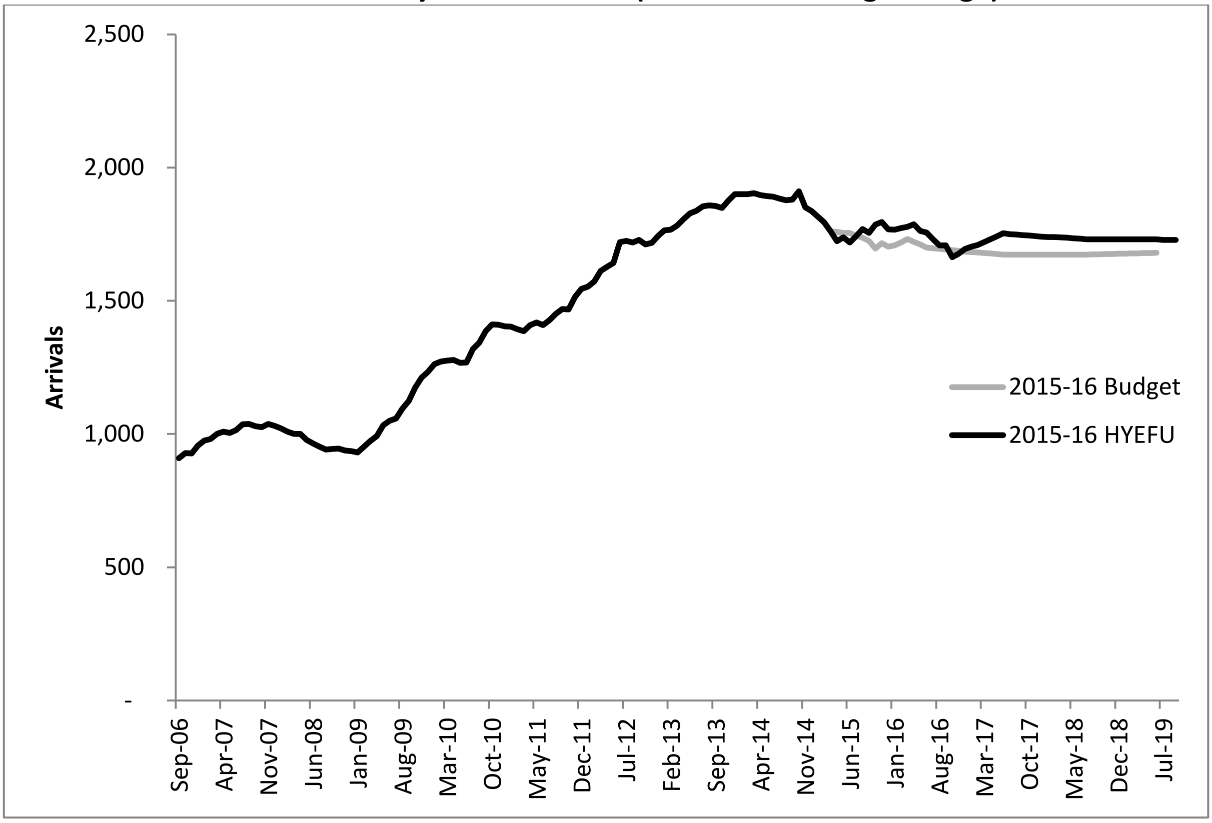


Table 5.5 Estimated Australian tourism numbers by quarter 2013/14 to 2018/19

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2013/14	6,064	7,068	4,196	5,362	22,690
2014/15	5,927	6,548	3,286	4,866	20,627
2015/16	6,363	6,706	3,399	4,598	21,066
2016/17	5,789	6,548	3,702	5,007	21,046
2017/18	5,702	6,479	3,663	4,954	20,798
2018/19	5,674	6,477	3,662	4,953	20,766

5.4.3 Other markets

Non-core markets remain relatively flat or declining, except for the United States, in which growth has been relatively strong in recent years. Arrivals from other markets fell 4.9 per cent in 2014/15, offsetting any growth in 2013/14. This was mainly due to a large decrease in 'other' markets (those outside the US, Canada, Europe, Asia and French Polynesia), combined with some small declines in Canadian and European arrivals.

While arrivals from the United States are expected to grow by over four per cent in the next two years, the Canadian market is expected to continue its decline from the historic highs experienced in 2000/01. Whilst the market has shown some recent resilience, growth moving forward is expected to be relatively flat, although improved economic recoveries in North America holds some promise for potential growth. The European market is also expected to continue its decline over the coming years, with continued economic issues for most of the EU countries likely to contain any future growth. European arrivals are expected to fall 2.6 per cent in 2015/16 on the back of relatively weak growth in the European area, before slowing to a 2.0 per cent decline in 2016/17, and decline by around 1.5 per cent from then onwards. Despite recent growth, Asia and smaller markets continue to remain relatively minor contributors.

Key risks and opportunities in the non-Asian markets relate to the future of the underwritten route to Los Angeles. The significant increase in capacity and associated reduction in per-seat cost presents an opportunity to keep fares low and encourage greater arrivals from those markets, but if growth does not improve, the additional expense of the larger aircraft could risk the financial sustainability of the current strategy.

Chart 5.9 Other major markets monthly arrivals (12 month moving average) 2006-2018

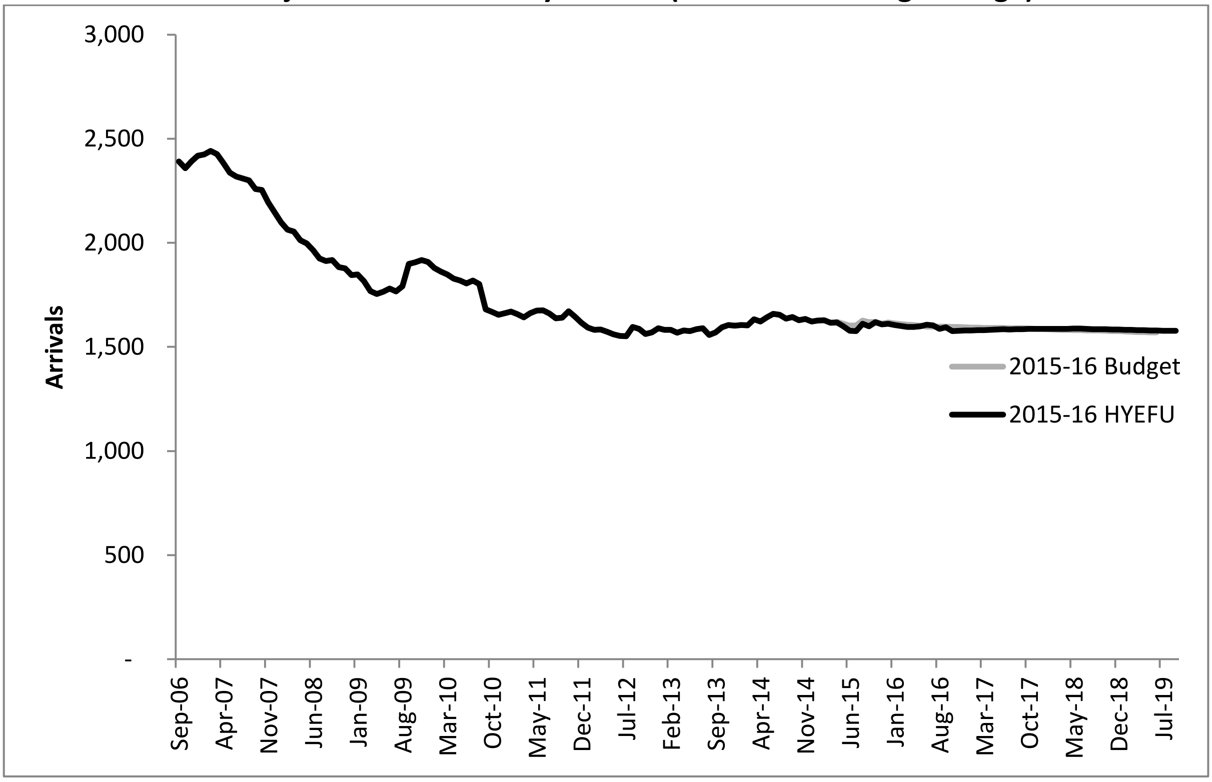


Table 5.6 Estimated tourism arrivals for other markets by quarter 2013/14 to 2018/19

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2013/14	4,585	5,511	5,432	4,385	19,913
2014/15	4,387	5,262	5,347	3,932	18,928
2015/16	4,637	5,426	5,145	4,062	19,270
2016/17	4,495	5,239	5,175	4,119	19,028
2017/18	4,493	5,251	5,177	4,142	19,062
2018/19	4,453	5,224	5,149	4,126	18,952

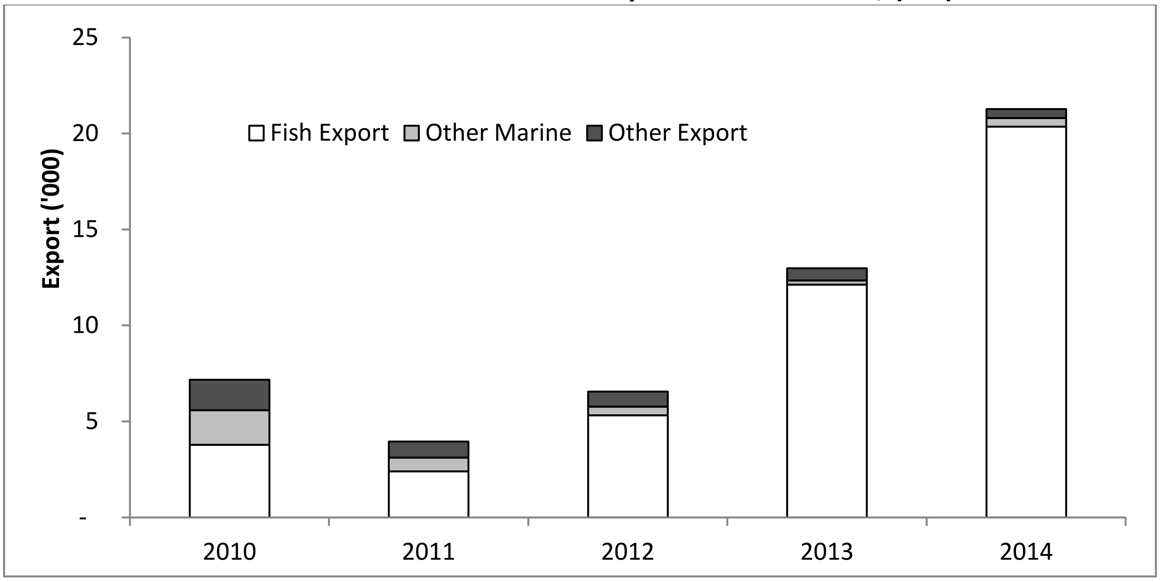
5.5 Marine Resources

The Cook Islands' marine sector is predominantly made up of tuna fisheries. In 2014 marine related exports accounted for 96 per cent of the value of Cook Islands goods exports: with fish exports amounting to $20.4 million of the total $21.3 million. This was a significant increase on the $12.1 million exported in 2013 and the $5.4 million in 2012. [2]

Fisheries exports for 2015 are forecast to reach $21 million due to the strengthening of the USD against the NZD.

In 2014, other marine exports include live fish for aquarium trade ($0.091 million) and black pearls ($0.364 million).

Chart 5.10 Fisheries exports 2010 to 2015, ($m)



The main benefit to the Cook Islands economy from fishing activities continues to be the licensing revenue from treaties and fishing licenses. Revenue for 2014/15 was $12.6 million, consisting of:

- $9.5 million collected for the purse seine fishery;
- $1.7 million from longline fishing license fees; and
- $1.3 million for out of court settlements for fisheries infringements.

The growth in revenue has come from the purse seine fishery, where the Cook Islands has been assigned a total of 1,250 fishing days for the 2015 calendar year under the allocation provided through the Western Central Pacific Fisheries Commission (WCPFC).

The purse seine fishery is likely to remain a significant source of direct revenue for government. The Cook Island total allowable effort of 1,250 days equates to revenues of around $15 million dollars per annum.

[2] Fish exports (as counted by the Cook Islands Statistics Office) includes any catch landed at Avatiu harbour and excludes fish caught in Cook Islands waters that are offloaded in Pago Pago. The catch landed in Avatiu does not necessarily need to be processed onshore, and includes catch that is simply trans-shipped from one vessel to another. As such, the value of fish exports to the Cook Islands economy is likely to be less than what exports suggest, as the value of the catch is not captured by local production.

For the calendar year 2015, the Government entered into purse seine fishing access agreements with three fishing companies, in addition to the existing purse seine treaty with the US. Of these, two are Korean companies who are in joint partnership with the Government of Kiribati and the third is a privately owned New Zealand company. These fishing licences are sold on a per-day basis, at a rate of USD $8,105 per day, and represent a significant source of revenue to the Budget.

For the 2016 calendar year, the US treaty payments are expected to increase to an average price of $16,000 per day with 250 days committed so far. In addition the government is negotiating an agreement with the European Union with an equivalent price of $19,000 per day for 125 days during the 2016 calendar year.

Revenue for the 2015/16 year so far totals $2.8 million, this consists of:

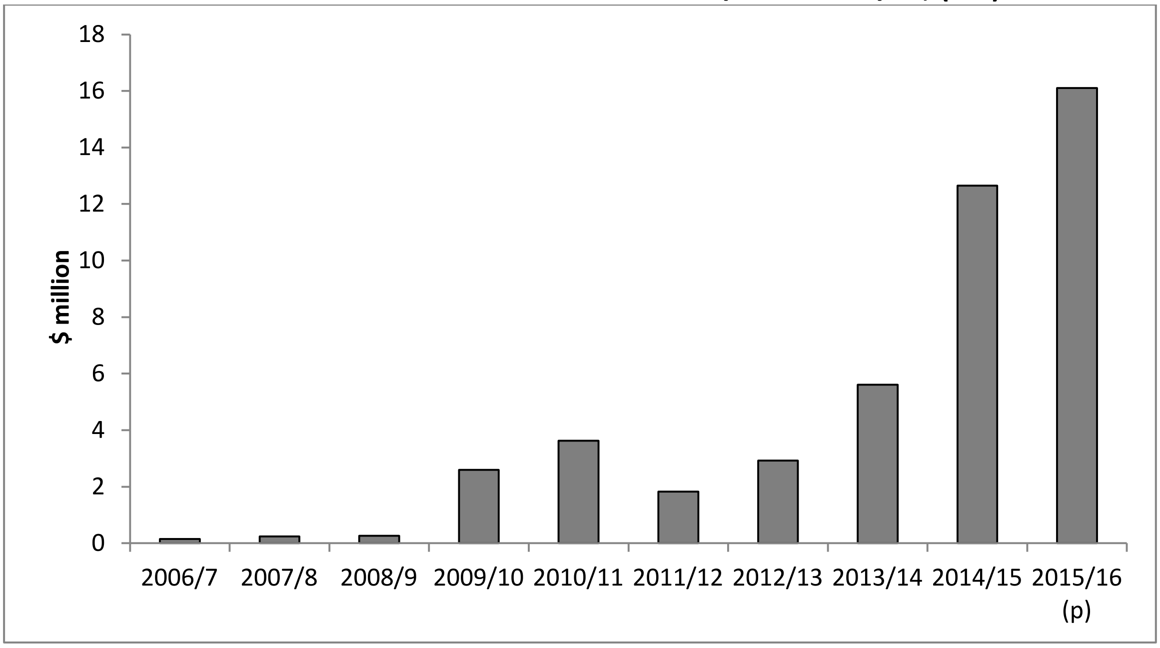
- $2.5 million collected for the purse seine fishery; and
- $0.3 million collected from the longline fishery

Total Revenue from fishing related activities for 2015/16 year is forecast to reach $16.1 million, assuming the EU partnership is approved and access agreements are renewed, this consists of:

- $14.2 million collected for the purse seine fishery
- $1.9 million collected for the longline fishery

Budgeted fisheries revenue for 2015/16 were estimated to reach $9.8 million, and if the agreements being negotiated are completed, the latest estimates from the Ministry of Marine Resources will exceed that forecast by $6.3 million[3].

Chart 5.11 Fisheries revenue 2005/06 to 2014/15, ($m)



[3] This includes revenue from the EU purse seining agreement that is still to be confirmed and as such has not been included in total revenue estimates.

5.5.1 Fishing

The Cook Islands EEZ is divided into a Northern and Southern fishery, with the majority of fishing taking place in the Northern fishery where the waters are more stable and productive. The main fishing grounds are from Penrhyn in the east to Pukapuka in the west, and north of Suwarrow.

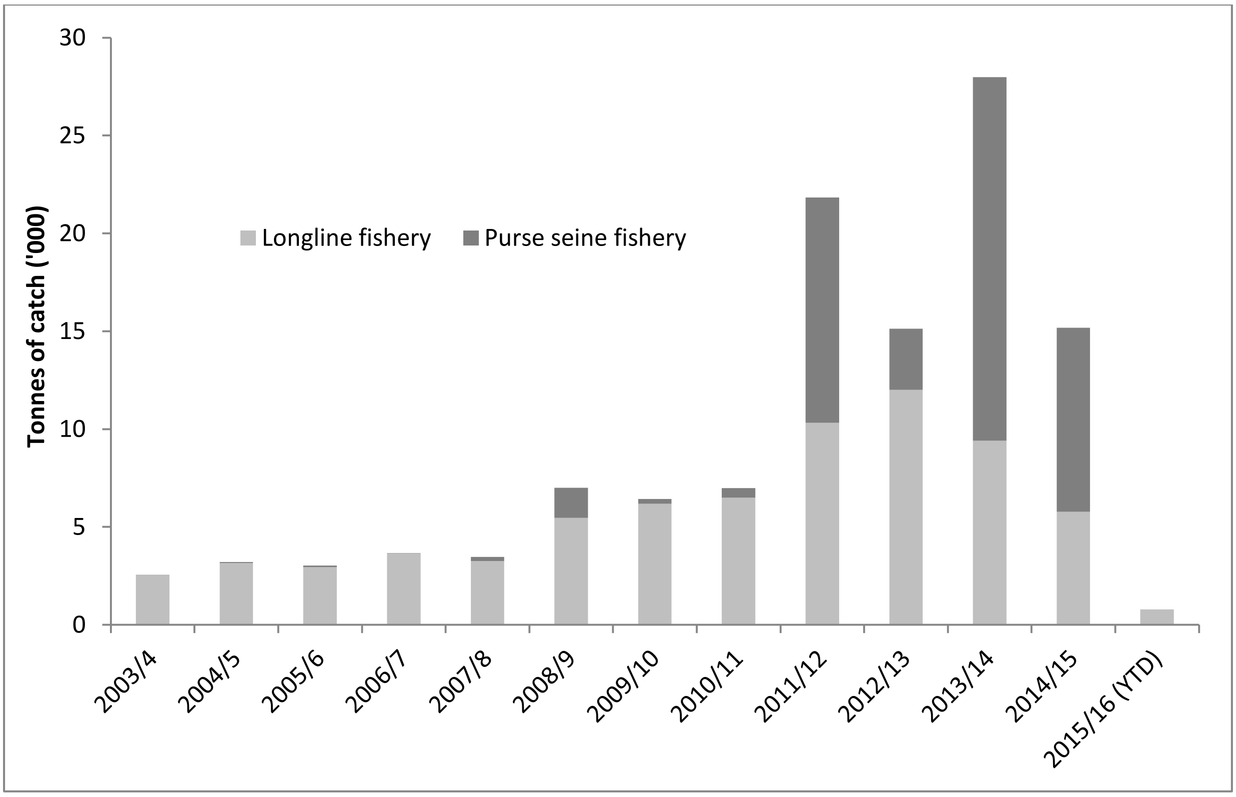
Traditionally, the Cook Islands EEZ has mainly been a longline fishery targeting albacore tuna, which is offloaded frozen to the cannery in Pago Pago where most of the long line fishing vessels are based.

The longline catches had increased steadily to a peak of 12,009 tonnes in 2012 when undertaking exploratory fishing for bigeye tuna. In 2014/2015, catches from longlining declined to 5,779 tonnes as the fishery reverted back to its regulated albacore catches.

Purse seining has become increasingly important to the overall catch effort, expanding from around 500 tonnes in 2010/11, to 9,400 tonnes in 2014/2015.

The total commercial catch for all vessels in 2014/2015 was 15,179 tonnes (Chart 5.12 Fishery Catch in the Cook Islands Exclusive Economic Zone (tonnes)

Chart 5.12 Fishery Catch in the Cook Islands Exclusive Economic Zone (tonnes)



Albacore and yellowfin tuna were the major species caught by the longline fishery in 2014/15. In 2014/15 skipjack tuna accounted for 92 per cent and by-catch bigeye tuna 2 per cent of the total purse seine catch.

Table 5.7 Fishery Catches in the Cook Islands EEZ by Species (tonnes)

	2013/2014			2014/15			2015/2016 (YTD)	
	Longline	*Purse Seine*	*Local*	*Longline*	*Purse Seine*	*Local*	*Longline*	*Purse Seine*
Albacore	5,544	0	1	3,380	0	1.85	473	n/a
Bigeye	655	392	<1	599	95	0.11	52	n/a
Yellowfin	2,193	1,179	180	1,040	361	61.8	142	n/a
Skipjack	121	16,203	10	188	8,933	11.2	25	n/a
Other	891	807	80	572	11	70.1	86	n/a
Total	**9,404**	**18,581**	**270**	**5,779**	**9,400**	**145.06**	**778**	**n/a**

In 2015, 69 vessels have licensing arrangements with the Cook Islands, including 23 active licensed longliners, 42 purse seiners (including the US treaty fleet) and 4 Cook Island flagged vessels that operate exclusively on the high seas (Table 5.8). In 2015 the catch data for the 301 local artisanal and game-charter fishing boats was also reported (Table 5.8).

Table 5.8 Number of active fishing vessels

Licensed and active vessels	2012	2013	2014	2015
Offshore fishery				
Long liner	60	45	36	23
Purse seiner	16	17	18	42
Other commercial	4	4	5	4
Total	**80**	**66**	**59**	**69**
Local artisanal and game fishery		223	302	301

The estimated landed catch value for 2014 was $79 million, an increase of around $30 million compared to 2013. The increase mainly reflects a weakening of the NZD against the USD and JPY, as well as greater volumes arising from the purse seine fishery.

Albacore longline prices increased slightly from the lows experienced in 2013. However, purse seine skipjack tuna prices have reduced from the peaks observed in 2012 and 2013. The landed value for the local and artisanal catches (assuming an average price of $8 per kilogram of round weight) is $2 million dollars as demonstrated in Table 5.9.

Table 5.9 Landed value of fishery catches ($m)

Landed value	2012	2013	2014
Longline fishery	40	32	44
Purse seine fishery	25	15	33
Local artisanal and game fishery		2	2
Total	**65**	**49**	**79**

One domestic commercial fishing company (with two Cook Islands flagged vessels) operate in the southern Cook Islands waters, and offloads its fresh catch at Rarotonga. The catch is either sold locally or exported by airfreight. In 2015, 154 tonnes of fresh catch (provisional) was offloaded compared to 194 tonnes in 2014. The volume of air freight exported decreased from 23 tonnes in 2014 to just 10 tonnes in 2015.

In 2013 a Chinese owned fishing company based in Rarotonga, with Chinese flagged vessels fishing in the Northern Fishery, began offloading its frozen catch into Rarotonga for export by sea freight. In 2014 1,822 tonnes were offloaded and in 2015, 363 tonnes were offloaded.

Although there is potential for filleting and packaging super frozen tuna, little onshore processing of catch takes place in Rarotonga.

Table 5.10 Catch Landed into Avatiu port (tonnes)

	2013	2014	2015
Cook Islands flagged vessels			
Fresh catches offloaded	105	194	154
Fresh catches to be exported by airfreight	15	23	10
Chinese flagged vessels			
Frozen by-catch sold locally	23	18	0
Frozen catches to be exported by seafreight	121	1,882	363
Total	**264**	**2,117**	**527**

The Government is considering changes to licensing of longline fishery vessels to ensure that the total catch remains within sustainable limits. The current regime does not limit the catches per license holder. The Government will look at developing a longline quota system to limit individual license holders to within a total allowable catch (TAC).

It is expected that this approach will limit the albacore catch to 9,600 tonnes, which is less than the peak catch of 10,000 tonnes caught in 2012. The albacore TAC is the catch limit which the Cook Islands has agreed to under the Tokelau agreement signed in December 2014 with other Pacific Island countries. A similar approach for bigeye will reduce the total catch to 2,500 tonnes of bigeye tuna, down from 3,000 tonnes caught in 2012.

The local fishery remains an important economic activity for game-charter operators, semi-commercial sales and subsistence fishing. The local fishery recorded good catch rates in 2014 with increased catches attributed to the deployment of fish aggregating devices (FADs). In 2015/16 the Government will expand the deployment of FADs to the remaining southern islands where waters are less productive and highly seasonal in order to increase local catch volumes. This programme is on track to also continue with the deployment of FADs to the northern atolls. Currently there are 25 FADs units that are active throughout the Cook Islands.

5.5.2 Pearls

Cook Islands pearls are sold on both domestic and international markets. The performance of the Cook Islands pearl industry is mainly assessed on the export trends due to the difficultly in quantifying the size of the domestic market.

The value of exports declined from $1.6 million in 2009/10 to $0.142 million in 2013, before improving to $0.364 million in 2014. The production base in terms of seeded oysters has remained relatively low with around 10 active farmers and a further 14 farmers operating at minimal levels. Compliance with the lagoon management plan (to improve environmental management and farming practices) is contributing to the improved quality of pearls being produced.

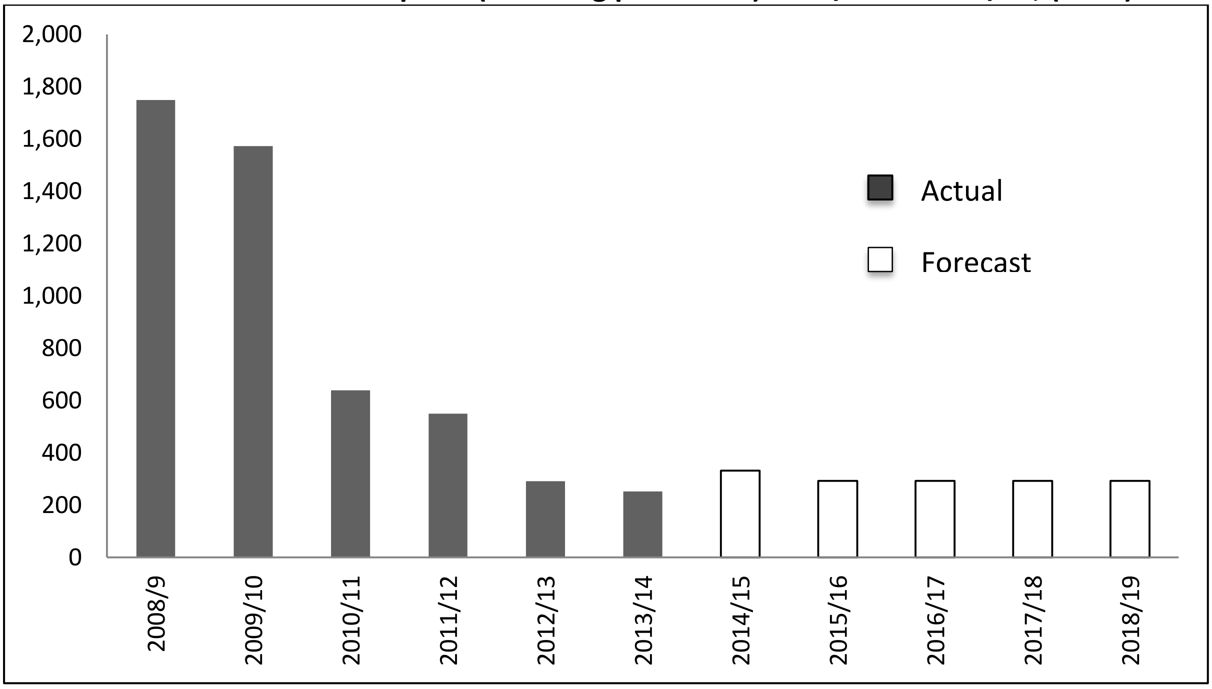
Declining export figures since 2009 suggest that an increasing proportion of pearls are being sold on the domestic market where prices are better, and greater value added opportunities are available.

Higher levels of production are expected after new farming materials have been provided by the Governments of New Zealand and China. Current levels of production are estimated to stay at modest levels of around 200,000 farmed oysters. Seeding and harvest records collected from pearl farmers indicate that in 2014 there was a sizable increase in the number of saleable pearls: 37,000 pearls compared to 19,000 pearls in 2013. These stocks are expected to boost the levels of domestic sales and export in 2014/15.

Table 5.11 Pearl production, 2009-2014

Year	Farmed shells	Seeded shells	Saleable pearls
2009	40,429	16,716	3,005
2010	77,544	61,351	11,182
2011	153,980	137,112	5,271
2012	239,333	207,576	13,199
2013	151,993	105,802	19,065
2014	198,575	120,916	37,169

Chart 5.13 Pearl Exports (including pearl shell) 2008/09 to 2018/19, ($000)

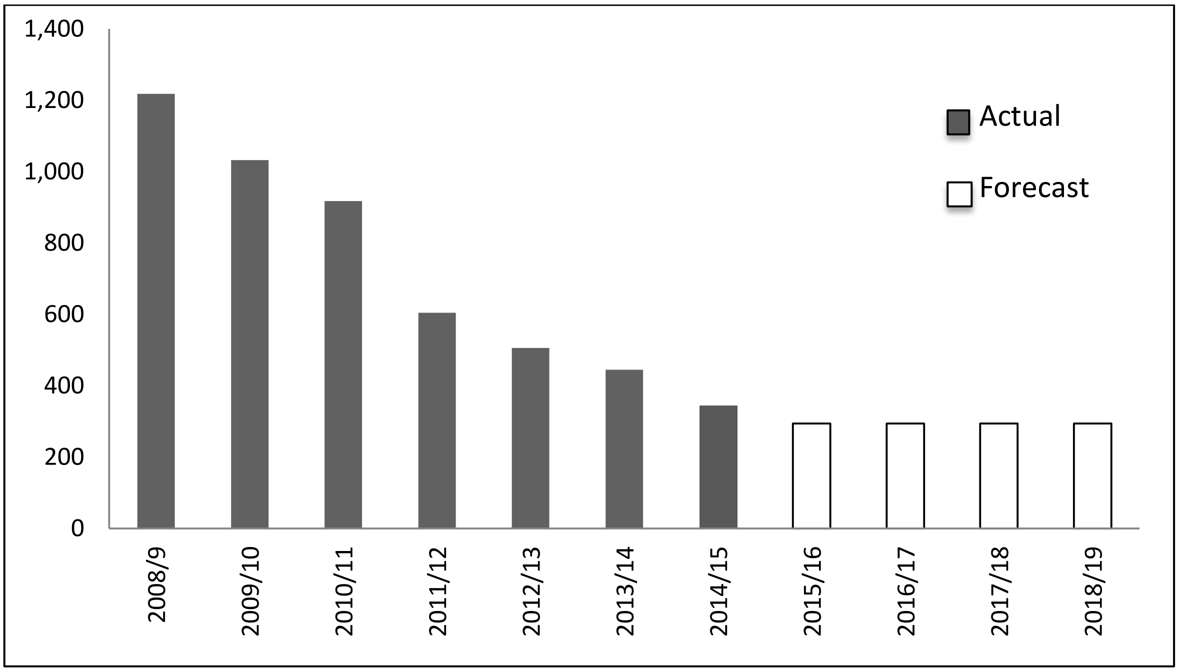


5.6 Agriculture

The Agriculture sector accounted for 3.3 per cent of GDP in 2013/14, an increase from 2.6 per cent in 2012/13. Agricultural exports decreased marginally across the same period (2013/14), suggesting that this boost in production was all directed at the local market. Indeed, much of the decline in exports was due to greater servicing of domestic demand rather than declines in production, as agricultural output (as measured by GDP) has been consistent of the past 5 years but exports have fallen due to lower returns and challenges to technical barriers to trade (compliance issues). Certainly, while tourism and the associated demand for food has increased markedly over the past ten years, imports of food items have not increased by as much as would be expected. This supports the case that local production is competitive with imports in terms of the price and quality of products that are currently being supplied.

The Cook Islands has considerable potential for increased local agricultural production (drinking coconuts, root crops, ornamentals, tropical fruits, vegetables, hydroponics vegetables, processing and value adding products, including handicraft products). However, there are numerous constraints that limit further growth in this sector including: substandard biosecurity treatment facilities for international market access and compliance to the importing country's requirements; labour shortages; high fuel costs; high local wages; low water supply; coordination failures in supply chains; land issues; higher financial returns in other industries; and high costs of transportation to get produce to markets (from the Outer Islands to Rarotonga, or from Rarotonga to abroad).

Chart 5.14 Agriculture Exports 2008/09 to 2018/19, ($000)



Export forecasts continue to decline due to lower maire exports, however there is some potential for future growth in the export of noni due to demand from Japan and China. The Ministry of Agriculture is investing in vanilla production and value adding for the local market as well as promoting noni production. Six thousand noni seedlings are being raised to cater for farmers needs on Rarotonga and four thousand seedlings are being cultivated for the Outer Islands (Atiu, Mangaia and Mitiaro). In addition to these measures, the Ministry of Agriculture is providing support for the revitalisation of the coffee industry in Atiu for export and supporting measures to export off-season pineapples and vegetables under the FAO Technical Corporation Program (TCP) 2015 to 2017.

With regards to domestic production, there has been a marked increase in the number of hydroponic and semi hydroponic, biological/organic, and aquaponic systems in Rarotonga, Atiu, Mauke, Manihiki and Aitutaki for the supply of salad products. These products include lettuce, tomato, capsicums, herbs, spring onions, bok choi and some other summer vegetables that cater for the high demands from the local restaurants, supermarkets and hotels. Together with household consumption, the size and growth in the tourism market suggests that there are still numerous opportunities to fill domestic demand requirements. The recent arrival of small agricultural machinery from China will further strengthen the local production and consistency of supplies.

5.7 Goods Exports and Imports

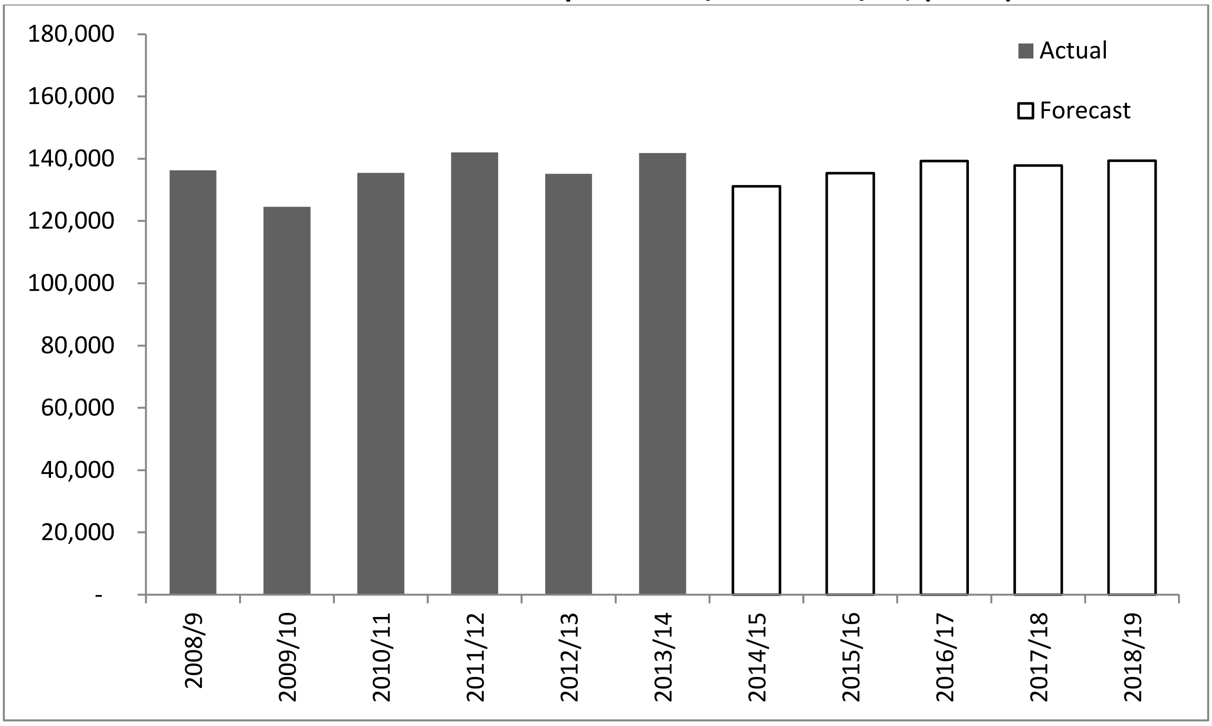
5.7.1 Goods Imports

Data from the 12 months through to March 2015 shows that imports decreased by 9.1 per cent from the year to March 2014. This large fall in the value of imports is predominately a reflection of a reduction in mineral and fuel imports, as a result of lower oil prices, and lower imports of machines, transport and equipment – which is a volatile series due to capital projects. The decline in machinery imports is assumed to be a return to trend from the high number of capital projects that began in 2013/14 (boosting the level of imports in that year).

Imports are expected to grow by around 3 per cent in 2015/16 and 2016/17, and then fall in the later forecast years, due to further reductions in machinery and crude materials from a reduced investment pipeline.

New Zealand continues to be the leading supplier of imports into the Cook Islands, accounting for approximately two-thirds of total imports in 2014.

Chart 5.15 Value of total imports 2008/09 to 2018/19, ($'000)



For 2013/14, it is estimated that import leakage from the Cook Islands was approximately 40 per cent – or more simply, that for every dollar spent in the Cook Islands economy, 40 cents went to foreign production. This is because of the Cook Islands heavy reliance on imported products to meet local demand (including that derived from the tourism industry). As imports are forecast to fall slightly from the levels experienced in 2013/14, while the economy is forecast to grow, this ratio is expected to decline over the next two years.

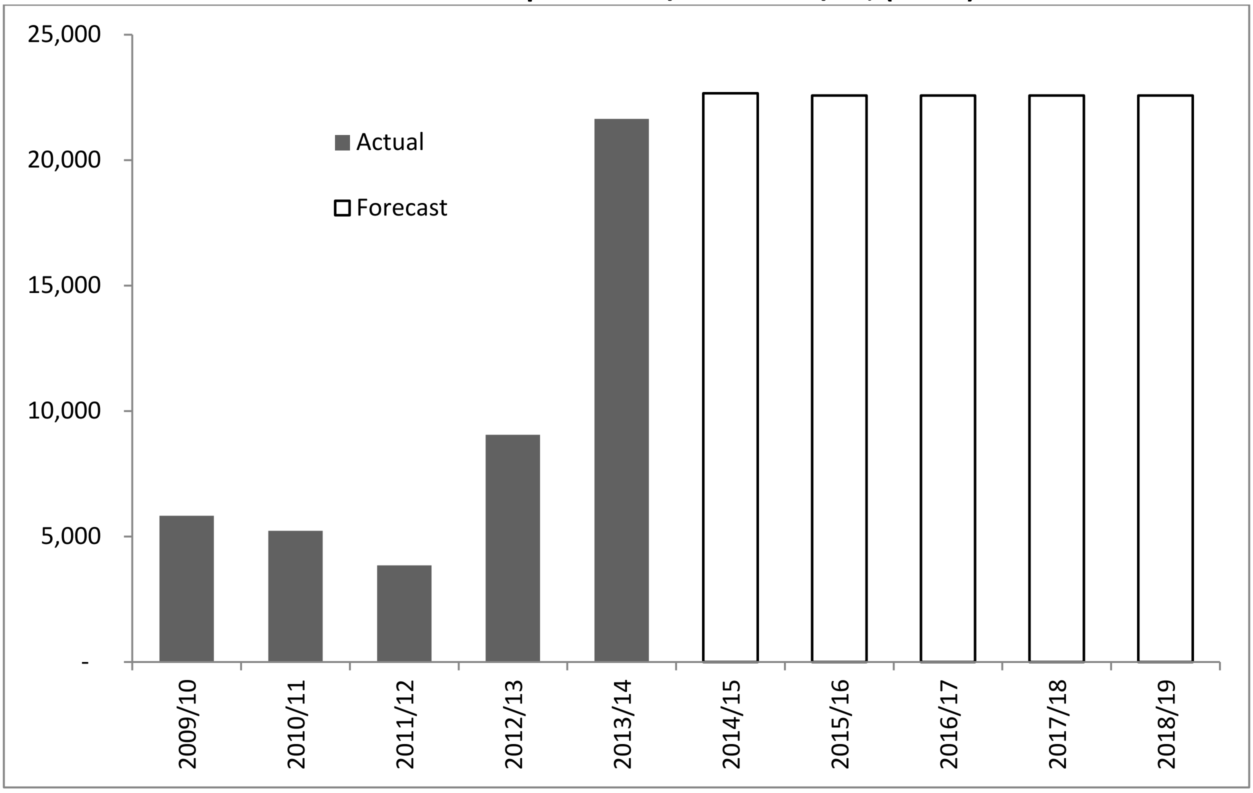
5.7.2 Goods Exports

At the time of publication, complete data for the 2014/15 year was not available, but data for the nine months to March 2015 show an increase of 6.1 per cent in exports when compared with the same period a year earlier. This increase is primarily driven by fresh and chilled fish exports, with some small contributions from pearls and live fish. There is a partial offsetting factor with a further decline in noni exports.

For 2013/14, it is estimated that for every dollar earned in the economy, over 70 cents is derived from foreign sources (although this is almost exclusively driven by tourism, with a small contribution from goods exports).

It is expected that total goods exports will decline marginally in 2015/16, due largely to declines in non-fish exports, before remaining at that level for the forecast period. If current fishing licence arrangements are expanded, these forecasts will need to be revised to accommodate the additional fish exports.

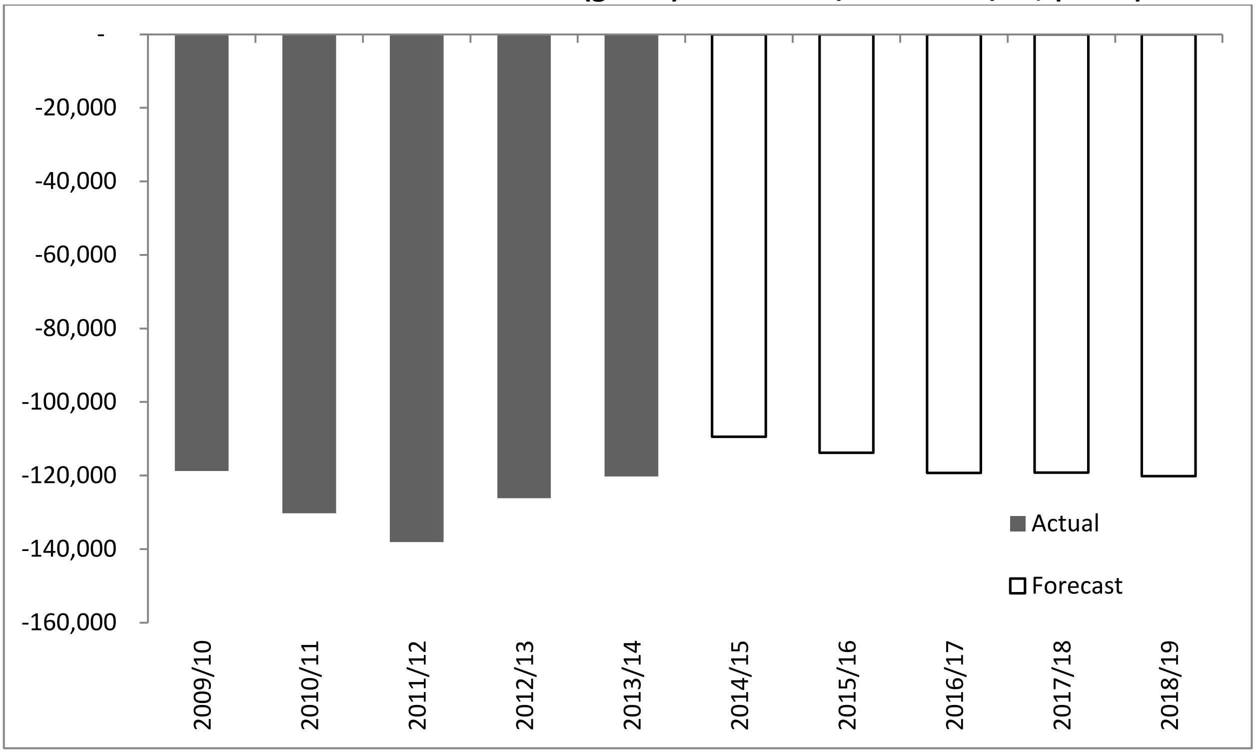
Chart 5.16 Total exports 2009/10 to 2018/19, ($'000)



5.7.3 Balance of Trade

A negative merchandise balance of $109.5 million is estimated for 2014/15, widening further to a deficit of $113.8 million in 2015/16. The deterioration is largely driven by an increase in the import of capital machinery and crude materials, versus a stable forecast for exports.

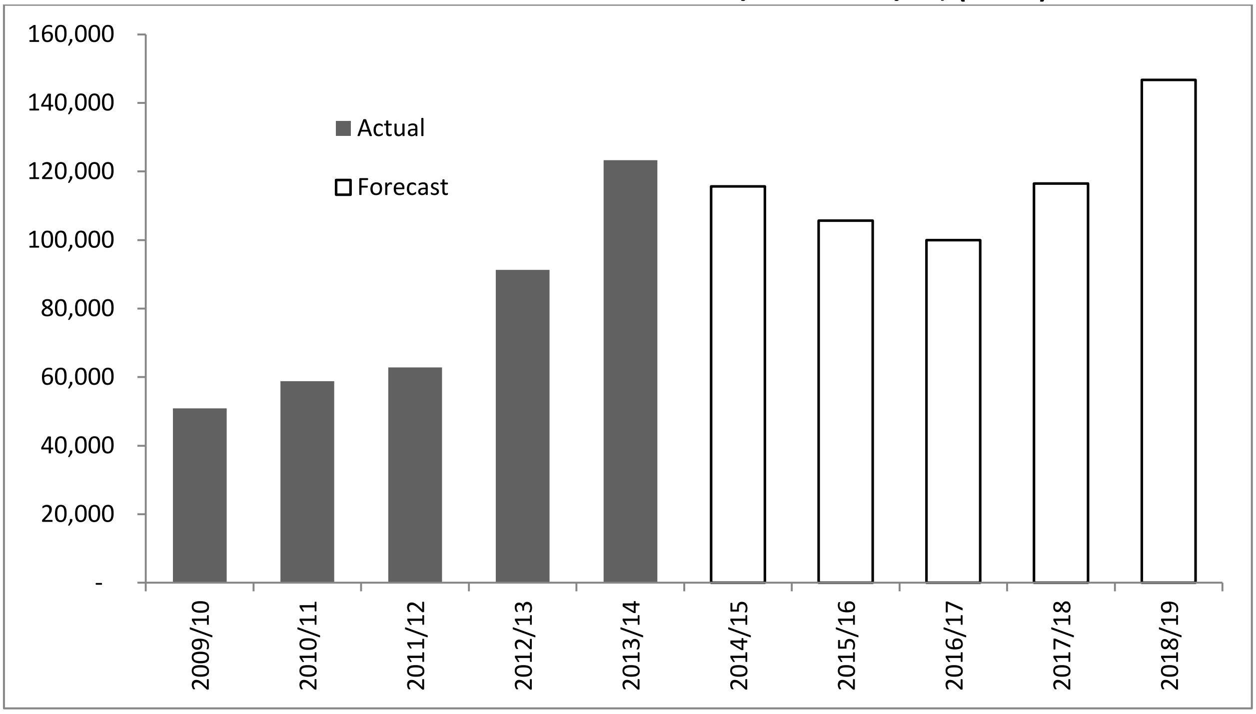
Chart 5.17 Balance of Merchandise (goods) Trade 2009/10 to 2018/19, ($'000)



Tourism dominates the services trade, with estimates for tourism spending reaching $239.5 million for 2014/15, and $256.5 million in 2015/16.

When the estimated services trade is included, the forecast balance of trade is a surplus of $115.6 million for 2014/15, and $105.6 million in 2015/16. This trade surplus is expected to grow in line with increases in tourism spending rising faster than the associated increases in imports (as at least a portion of tourism spending is attributable to local labour and business owners) over the later forecast years.

Chart 5.18 Overall Balance of Trade 2009/10 to 2018/19, ($'000)



5.8 Banking and Finance

The Reserve Bank of Australia reports that there exists a degree of caution in financial markets over recent months, as concerns remain around Greek membership of the Eurozone, and fluctuations in Chinese equity markets. The US Federal Reserve has continued to signal that the conditions necessary to increase interest rates in the US are expected to be met soon, though this has long been expected by markets. The relative stability in developed markets, in particular the US, along with a falling oil price, has drawn international financial markets back towards developed economies at the expense of emerging economies.

Domestically, there have been positive developments, with significant reductions in non-performing loans on the balance sheets of the three domestic banks. The proportion of gross lending which is classified as non-performing has fallen by more than half in the past two years - from 15.4 per cent of total lending in March 2013, to 7.2 per cent in June 2015. These measures should allow the banks greater confidence in their overall lending portfolios.

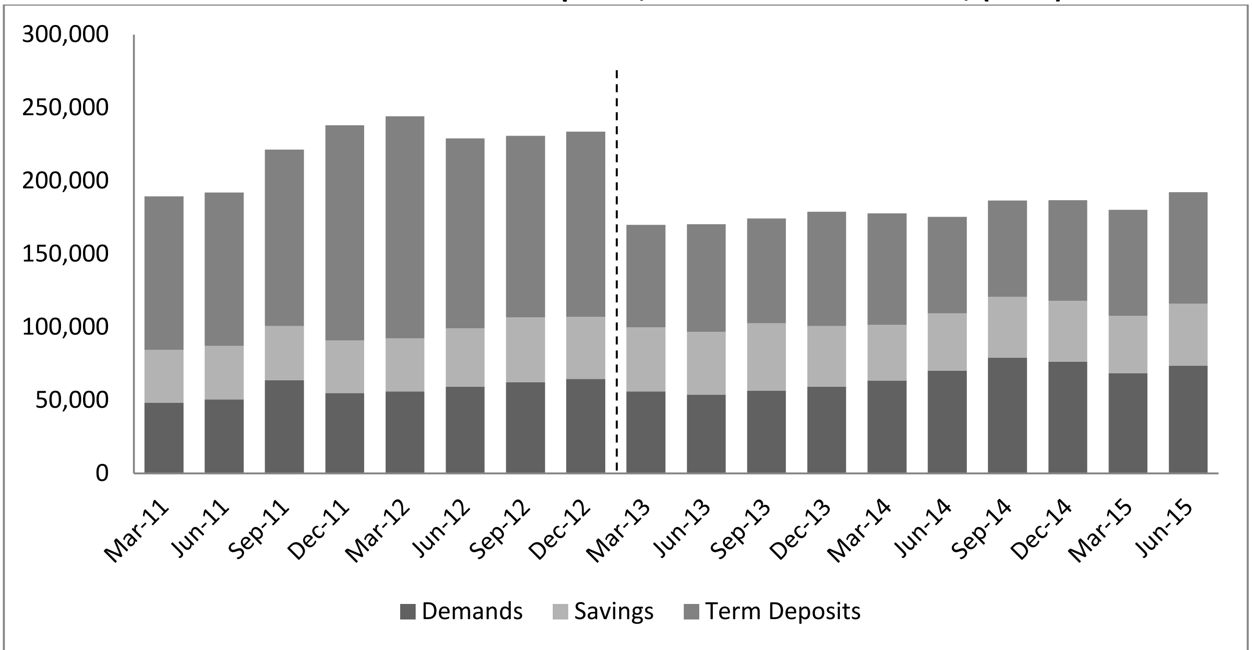
Although there has been progress with interbank settlement, the implementation of the Banking Review remains slow.

5.8.1 Deposits

Due to a revision in the historical series from the 2013 calendar year, it is difficult to make meaningful comparisons prior to 2013. This revision includes the re-classification of codes where balances owed to other banks have now been removed from term deposits and hence the dramatic decrease in reported deposits from December 2012 to March 2013.

Total deposits increased $16.9m between June 2014 and June 2015, to a total of $192.3 million. At $115.9 million, non-term deposits are the second-highest on record (after the level of $120.6 million recorded in September 2014).

Chart 5.19 Total Value of Deposits, June 2011 to June 2015, ($000)

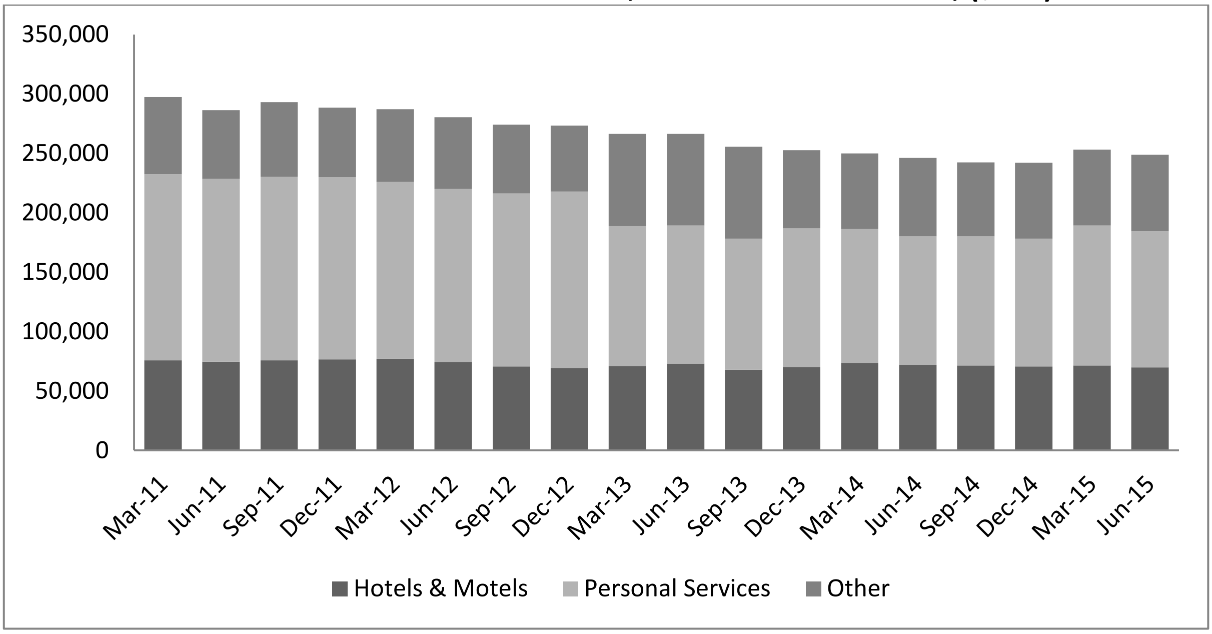


5.8.2 Loans

The overall total value of loans has been in a slow but steady decline since 2008, due largely to declines in personal credit. However, this trend was slightly reversed in the March and June quarters of 2015, with the March quarter showing the highest level of loans since September 2013, and the June quarter representing 1.1 per cent growth in the total value of loans over the past year. This recent increase in the value of loans suggests that recent moves by the banking sector to remove non-performing loans from their balance sheet is having an impact.

The on-going portfolio of non-performing loans, (although significant progress has been made on reducing these loans) together with lenders engaging in credit rationing, is expected to weigh on loan growth going forward. Demand for credit is also assumed to remain weak, with most industries showing little change (or small declines) in overall levels of credit in the past five years.

Chart 5.20 The Total Value of Loans, June 2011 to June 2015, ($000)



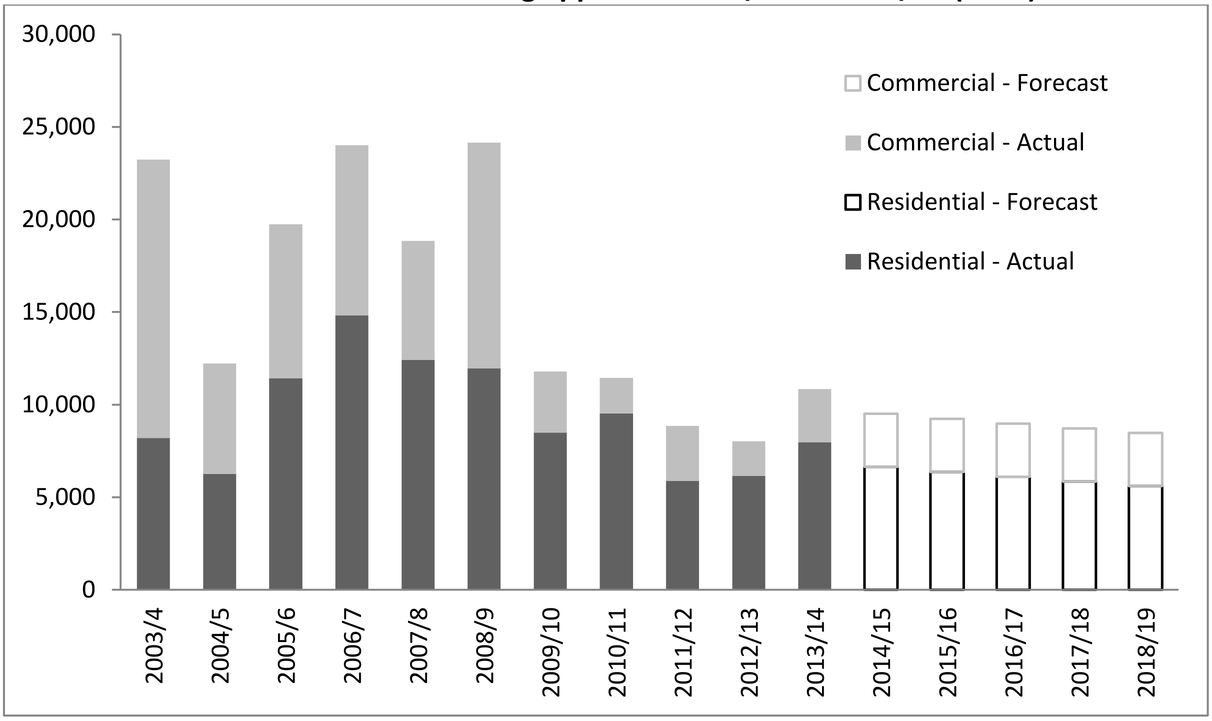
5.8.3 Housing and Construction

The value of building approvals has been in a steady decline since 2008/09 driven by both commercial and residential construction, though 2013/14 saw the first increase in building approvals since 2008/09.

The value of approvals in the year to March 2015 rose 22.2 per cent for residential construction when compared with the same period a year earlier, to a total value of $9.9 million. Residential activity is currently estimated to decline slowly over the forward years, continuing the profile of recent years after the 2013/14 spike.

Commercial building approvals were not forecast due to their volatility and sometimes long lead time before construction begins.

Chart 5.21 Value of building approvals 2003/04 to 2018/19 ($000)



5.9 Financial Services Industry

The financial services industry is estimated to collect fees of a net value of $1.5 million for services undertaken in 2015/16. The estimated value is higher due to changes in USD exchange rates, as registration fees are generally denominated in USD.

There is a decline in trust registrations, which can be attributed in part to the closing of HSBC Trustee (Cook Islands) Limited. However, it is projected that the number of trust registrations will increase with the establishment of new trustee companies in the Cook Islands. T & F (Cook Islands) Limited is one such trustee company recently established in 2015, and the FSC is considering other new trustee company applications. Foundation registrations have increased exponentially but are still relatively small in number, and expected to continue growing. Captive Insurance is the newest service, with legislation passed in June 2013. The first Captive registration occurred in April 2015.

New products and services, as well as amended legislation for existing services, are part of the effort to grow and diversify client markets. The International Trusts Act is in the process of being reviewed and updated. Focus continues on promotion of the Cook Islands in Asia, particularly for trusts, foundations, and companies. Promotion of Captive Insurance in the next year will be targeted to the Australian and New Zealand corporate markets, as well as to existing clients.

The industry continues to comply with international regulatory standards. At the end of 2013, numerous amendments to existing industry legislation were enacted to address areas of improvement highlighted in the country's 2012 OECD Global Forum Phase One Peer Review. The Phase Two Peer Review took place in May 2014 and a positive report was adopted at the Global Forum's session in early 2015. New legislation has also been passed to allow banks and trustee companies to comply with international tax information exchange agreements (namely FATCA out of the United States) and each financial institution has registered under FATCA. In October 2015 the Cook Islands announced its commitment towards implementing the automatic exchange of information (AEOI) for tax purposes by 2018. The Cook Islands currently has 21 tax information exchange agreements in place. 2015/16 will see a follow up report to the Asia Pacific Group Mutual Evaluation Report on Anti-Money Laundering and Know Your Customer laws and practices ("MER"). The next MER is expected to be conducted with an on-site inspection in late 2017 and the report adopted and made public in July 2018.

5.10 Sensitivity Analysis

There are several risks surrounding the forecasts presented. Modelling alternate scenarios assists officials in planning for possible contingencies should the outlook change and these risks become realised. Four scenarios which are viewed as most likely to affect the forecasts have been modelled and are summarised below:

Scenario 1: **Capital projects experience slippage similar to that experienced in the last two years** – Capital projects contribute a substantial amount to the local economy and missed deadlines delay the economic benefit from wages, contractor fees, and the benefit of the completed infrastructure.

Scenario 2: **Limited capacity to deliver capital projects** – There are concerns that there is not the local capacity to deliver the volume of capital projects scheduled for 2015/16. The capital plans for both 2015/16 and 2016/17 are higher than previous years and may present issues for local contractors to absorb or tender for the new projects.

Scenario 3: **A significant reduction in expected tourism arrivals** – if tourism arrivals from key markets are significantly weaker than anticipated through the remainder of 2015/16, the tourism arrivals will need to be revised downwards.

Scenario 4: **The impact of Jetstar's arrival to the market, and Virgin Australia commencing flights from Christchurch** – the exact impact of Jetstar beginning to offer flights between Auckland and Rarotonga (with connections to other New Zealand and Australian sources) could have a large impact on arrivals from those two markets. The additional flight from Christchurch as serviced by Virgin Australia may also add to overall capacity for tourists from the South Island.

Table 5.12 Sensitivity Analysis of economic forecasts

		Impact on total revenue in...	
Scenario	**Impact on nominal GDP in 2015/16 (percentage contribution)**	**2015/16 ($000)**	**2016/17 ($000)**
Scenario 1: Slippage in capital projects	-2.6	-2,142	-566
Scenario 2: Limited capacity for projects	-1.4	-1,151	-1,246
Scenario 3: Weak tourist arrivals	-1.9	-1,866	-8,963
Scenario 4: New airlines/routes impact[4]	4.1	1,509	3,125

[4] As Jetstar does not begin flying to Rarotonga until March 22, 2016, these reflect the impact on 2016/17 in order to show a full year impact. This result is based on a range of technical assumptions surrounding the number of new arrivals, and the amount of these that would be 'new' arrivals, versus arrivals using the new service that would otherwise have still travelled to the Cook Islands.

6 GOVERNMENT FINANCIAL STATISTICS OPERATING STATEMENT

The Government Financial Statistics (GFS) Operating Statement reflects the financial performance of Government and discusses general trends and revisions of forecasts for operating revenues, operating expenditures and the resultant operating balance. The GFS operating statement encompasses all funds managed at the general government level including the Loan Repayment Fund.

Table 6.1 GFS Operating Statement

Statement of Government Operations	2014/15 Actuals	2015/16 Forecast	2016/17 Forecast	2017/18 Forecast	2018/19 Forecast
REVENUE	**160,659**	**168,005**	**174,381**	**159,648**	**135,871**
Taxes	100,847	103,222	102,827	104,408	105,592
Social contributions	20	44	44	44	44
Grants	32,428	36,542	46,753	30,594	5,632
Current	8,385	19,367	21,699	21,577	3,902
Capital	24,043	17,175	25,054	9.017	1,730
Other revenue	27,365	28,697	24,757	24,602	24,602
EXPENSE	**130,456**	**152,268**	**151,430**	**149,854**	**129,477**
Compensation of employees	49,339	52,965	52,270	52,183	49,577
Use of goods and services	33,530	42,732	43,553	42,986	28,076
Depreciation	9,237	9,147	11,809	11,802	11,391
Interest	2,168	2,282	2,438	2,287	2,095
Subsidies	17,842	21,603	21,453	20,703	19,813
Grants	-	-	-	-	-
Social benefits	16,596	19,199	19,073	19,030	17,661
Other expense	1,744	4,339	834	863	863
NET OPERATING BALANCE	**30,203**	**16,238**	**22,951**	**9,793**	**6,393**
Plus NON CASH APPROPRIATIONS					
Depreciation	9,237	9,147	11,809	11,802	11,391
CASH SURPLUS/(DEFICIT) FROM OPERATING TRANSACTIONS	**39,440**	**25,385**	**34,760**	**21,595**	**17,784**
CASH TRANSACTIONS IN NONFINANCIAL ASSETS					
Net Cash Applied to the Acquisition of Fixed Assets	45,836	40,791	42,805	17,913	5,629
Gross transactions in Non-Financial Assets	55,073	49,938	54,614	29,715	17,020
Less Non Cash Transactions in Non-Financial Assets (Depreciation)	(9,237)	(9,147)	(11,809)	(11,802)	(11,391)
NET (BORROWING)/LENDING	**(6,396)**	**(15,907)**	**(8,045)**	**3,682**	**12,155**
CASH APPLIED TO THE NET ACQUISITION OF FINANCIAL ASSETS	**(9,334)**	**(3,505)**	**(1,752)**	**(1,501)**	**2,567**
Domestic Transactions	(9,361)	(3,505)	(1,752)	(1,501)	2,567
Foreign Transactions	27	-	-	-	-
CASH APPLIED TO THE NET INCURRENCE OF LIABILITIES	**(3,100)**	**(10,374)**	**(3,846)**	**6,513**	**7,789**
Domestic Transactions	-	-	-	-	-
Foreign Transactions	(3,100)	(10,374)	(3,846)	6,513	7,789
NET CASH FINANCING TRANSACTIONS	**(12,433)**	**(13,879)**	**(5,598)**	**5,012**	**10,356**
Statistical discrepancy with financial statements	(6,037)	1,527	2,446	1,330	(1,800)

6.1 GFS Net Operating Balance

The GFS net operating balance is the balance of operating revenues less operating expenditure by the Government and its development partners. The GFS net operating balance in 2015/16 is estimated to be a $15.7 million.

Going forward, changes in expenditure and revenue estimates are predicted to result in a $23.0 million operating balance in 2016/17, $9.8 million in 2017/18, and $6.4 million in 2018/19.

6.1.1 GFS Operating Revenue

Operating revenues are made up of taxation receipts (63 per cent in 2014/15), grants from other governments (20 per cent) and other revenues, which include agency trading revenues, interest and dividend receipts (17 per cent). These revenue streams are used to finance the on-going operational expenditure of government, with surpluses used for investing activities such as infrastructure development projects (where apparent).

At the time of the Budget published in June 2015, GFS Operating revenues in 2015/16 were estimated to tally to $179.6 million, of which $102.9 million was expected to be collected in taxes for 2015/16.

Since June 2015, total movements in operating revenue have resulted in a downward revision of operating revenues by $11.1 million to $168.5 million, predominately due to decreased grant funding, as well as some parameter variations.

For 2015/16, tax revenue is anticipated to be $0.3 million higher than previously forecast, due to a one-off collection of withholding tax, partially offset by lower than anticipated collections of other taxes in the first few months of the year. The actual for 2014/15 reflects actual monies received that were not reported at the previous update. Total fines received by MFEM in 2014/15 amounted to $1.225 million. Income tax is expected to reach $22 million in 2015/16, with company tax falling to around $10 million.

Company taxes are expected to decrease in 2015/16 due to the continuing write down in some non-performing assets and other factors reducing profitability in the banking sector.

6.1.2 GFS Operating Expenditure

Operating expenditure is made up of compensation of employees (38 per cent in 2014/15), use of goods and services (26 per cent), social benefits (13 per cent), subsidies (14 per cent), depreciation (7 per cent), and other expenses including interest expenses (3 per cent).

Since the time of the Budget published in June 2015, total movements in operating expenditure have resulted in an upward revision of operating expenditure by $1.8 million to $152.3 million in 2015/16, due to policy decisions. This increase is, predominantly in goods and services which are mainly driven by an increase in government spending associated with the 50th anniversary celebrations, use of consultants and compensation of employees. There has also been some reclassification of expenditure between categories, mostly removing items from the 'other' category.

6.2 GFS Non-Operating Items

Cash Transactions in Non-Financial Assets outlines the transactions relating to capital, the details of which are outlined in further depth at each Budget in Budget Book 3 (Capital). This spending includes public works, purchase of plant and equipment and investments in ICT. Large purchases of non-financial assets, mainly in infrastructure (renewable energy, Te Mato Vai, and others) continue in 2015/16 and 2016/17. Total purchases of non-financial assets (excluding depreciation) will rise to an estimated $42.8 million in 2016/17. This reflects both Cook Island Government funded capital spending and ODA capital spending.

The Net Borrowing/Lending Requirement outlines whether there is sufficient cash from current revenue to cover the costs of the ongoing operations of government and capital. The net borrowing requirement is the addition of the cash operating transactions and the cash transactions in non-financial assets – a positive number indicates a surplus which can be accumulated to reserves, a deficit requires borrowings or depletion of reserves. Consistent with the large capital works currently underway, the net borrowing requirement is $15.4 million in 2015/16. This requirement is serviced by a combination of cash and debt financing, with net cash transactions contributing $3.5 million and net debt finance (new loans minus repayments) contributing $10.4 million. There is also a small statistical discrepancy which arises out of timing differences between assets and liabilities.

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

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

7 CROWN DEBT AND NET WORTH

7.1 Gross Debt owed by the Crown

Total gross debt owed by the Crown as at 30 June 2016 is now estimated to be $113.1 million, a variance of $4.0 million from the 2015/16 Budget. Table 7.1 Reconciliation on 2015/16 Loan Movement shows the movement was due to the drawdown of new loans of $15.6 million, and also changes in the exchange rate, with all major trading currencies appreciating against the New Zealand dollar (NZD).

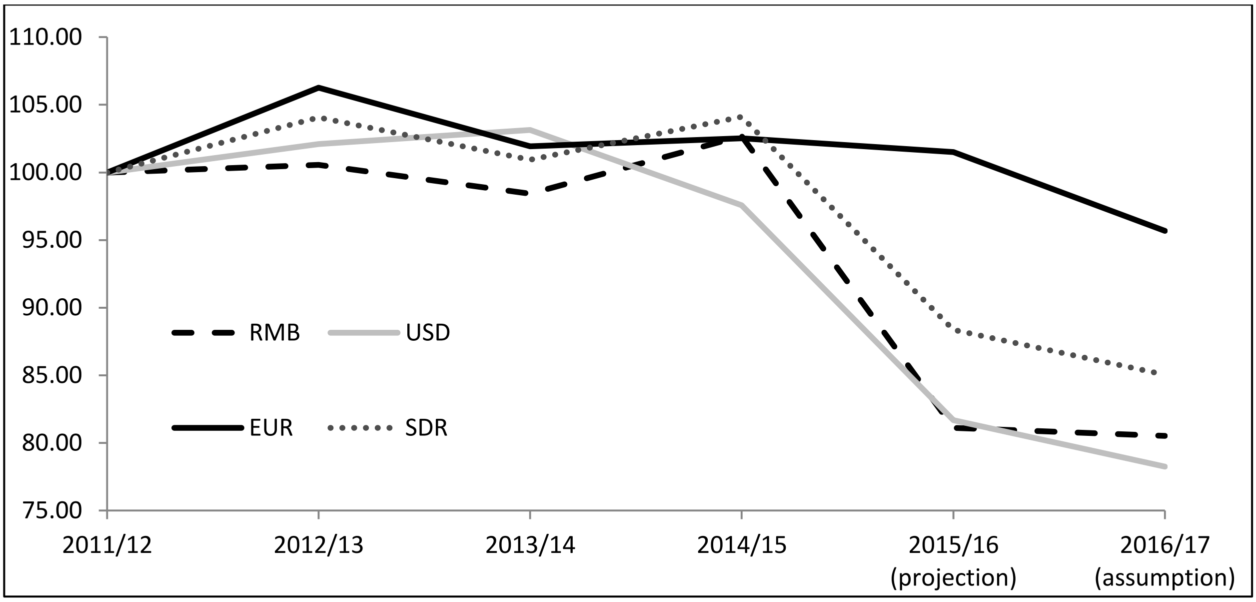
The renewable energy project is also expected to commence the drawdown of the $12.98 million ADB loan towards the end of 2015/16 (during the construction phase of the project).

Table 7.1 Reconciliation on 2015/16 Loan Movement

Movement Reconciliation	**$ Million**
Initial estimated gross debt for 30 June 2016 (2015/16 Budget)	109.1
Movement during the period	
Unrealised exchange (gain)/loss	4.0
Estimated gross debt for year ending 30 June 2016	**113.1**

The exchange rates assumptions for the 2015/16 Budget have been recommended by Bancorp Treasury Services Ltd ("Bancorp"). Historical changes in major exchange rates against the NZD are reflected in Chart 7.1.

Chart 7.1 Changes in Major Exchange Rates (indices – 2011/12 = 100)



The cause for this unfavourable movement in exchange rate (in terms of outstanding debt) from 2014/15 to 2015/16 was a 16.3 per cent appreciation of the US dollar (USD) against the NZD, a 21.0 per cent appreciation of the Chinese Renminbi (RMB), a 15.1 per cent appreciation of the Special Drawing Right (SDR), and a 1.0 per cent appreciation of the Euro (EUR).

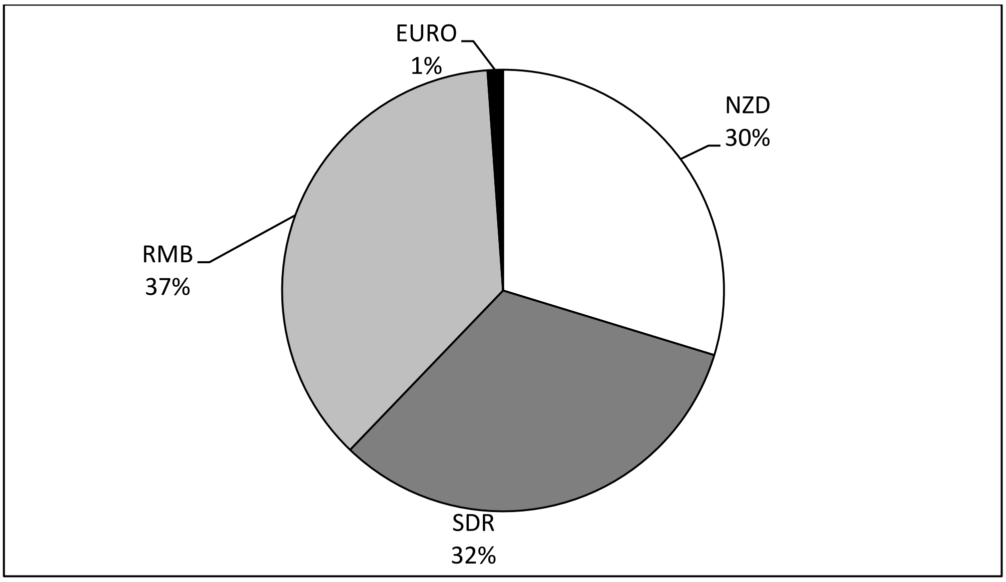
Table 7.2 shows the movement between exchange rates recommended by Bancorp to underline the estimates contained in the 2015/16 HYEFU, compared with those used in the 2015/16 Budget. In the 2014/15 year, the Crown converted all USD loans held with the Asian Development Bank (ADB) to NZD. The movement in the exchange rate for the USD is still monitored as all SDR loans held with the ADB are repaid in a USD equivalent.

Table 7.2 Exchange Rate Assumptions – 2015/16 and 2016/17

	2015/16		2016/17	
Currency	**2015/16 Budget**	**2015/16 HYEFU**	**2015/16 Budget**	**2015/16 HYEFU**
EUR	0.700	0.610	0.700	0.575
USD	0.700	0.658	0.700	0.630
RMB	4.500	4.150	4.500	4.120
SDR	0.505	0.468	0.505	0.450

The NZD depreciated against all major currencies in which Government debt is denominated, apart from the EUR. Total Crown debt is mainly denominated in foreign currencies, with only 30 per cent of debt in local currency. Of the remaining 70 percent denominated in foreign currencies, RMB is at 37 per cent, followed closely by SDR at 32 per cent, and EUR at 1 per cent.

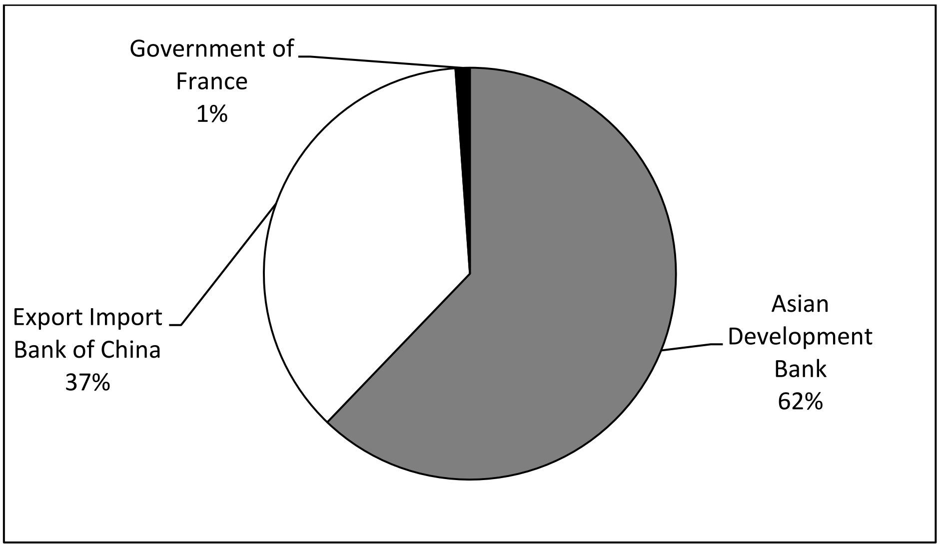
Chart 7.2 Projected Composition of Crown Debt as at 30 June 2016 by Currency



7.2 Gross Debt by Lenders

The gross debt by lender is estimated as:

Chart 7.3 Gross Debt Estimates by Lender



As illustrated in Chart 7.3, the Crown has borrowings from three major lenders: the ADB (62 per cent), the Export Import bank of China (EXIM Bank) (37 per cent) and the Government of France (1 per cent).

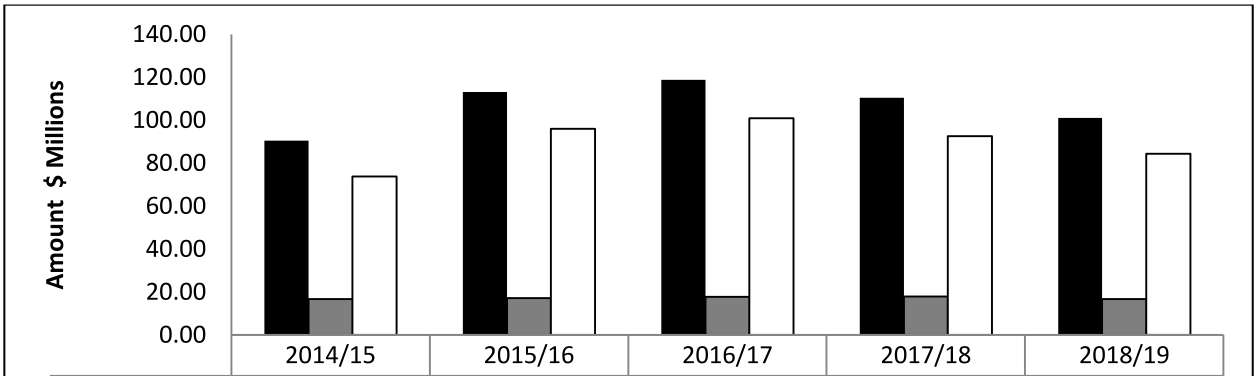
The EXIM Bank share of the overall borrowing portfolio is estimated to increase to 37 per cent in the 2015/16 fiscal year due to the planned loan drawdown of approximately RMB 50 million (approx. NZD12.3 million) to complete the Rarotonga Water Ring Main project.

The loan agreement with the ADB for a loan of NZD12.980 million for renewable energy development in the Southern Group is expected to be drawn down across the 2015/16 and 2016/17 fiscal years, which will increase the share of debt owed to the ADB.

7.3 Crown Debt burden

Total gross Crown debt gradually reduces in the outer years as principal gets repaid, on the assumption that Government is not undertaking new loans. The Loan Reserve Fund (LRF) however, does not reduce until after the forward estimates, due to grace periods on the most recently drawn down loans.

Chart 7.4 Cook Islands overall debt burden



	2014/15	2015/16	2016/17	2017/18	2018/19
■ Gross Debt	90.46	113.07	118.73	110.41	101.01
■ Loan Reserve	16.64	17.13	17.79	17.83	16.62
□ Net Debt	73.82	95.94	100.94	92.57	84.39

7.4 Status of Government Loans

Table 7.3 Status of Government loans estimated at 30 June 2015 shows that the total amount drawn down to 30 June 2016 is $113.07 million, which includes $3.245 million of the $12.980 million loan from the ADB for Southern Group renewable energy project.

The draw-down of the remainder of this loan will increase gross debt to a peak of $118.7 million by 30 June 2017.

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

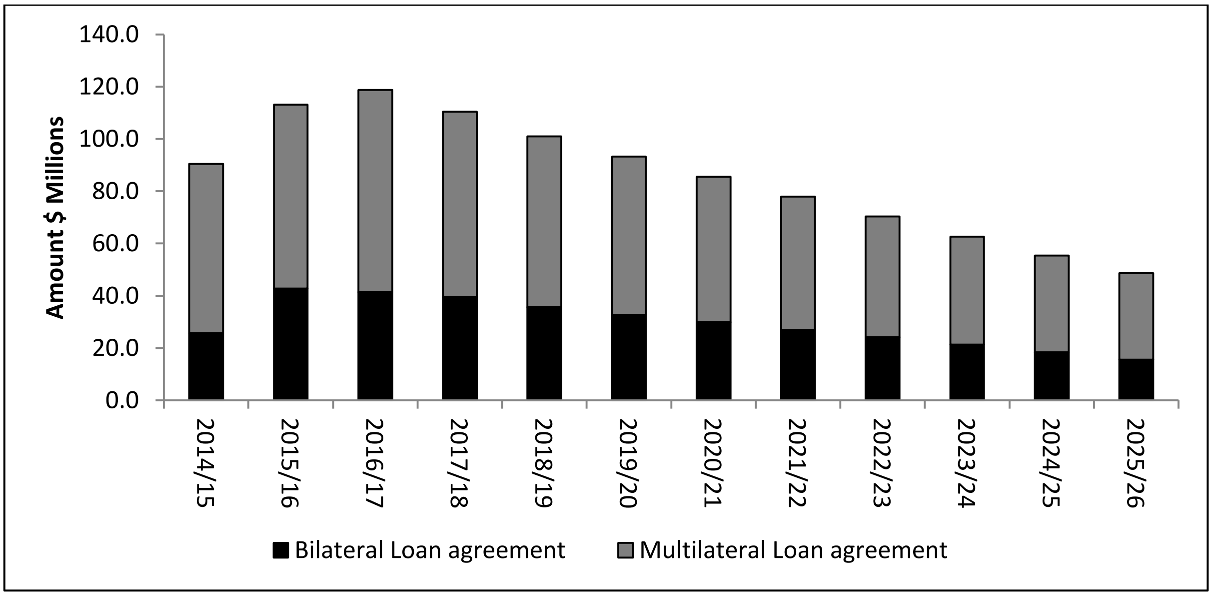


Chart 7.5 Current Bilateral and Multilateral Estimate Loans Outstanding Next 10 Years shows the bilateral and multilateral amount of Crown borrowings from 2014/15 to 2025/26.

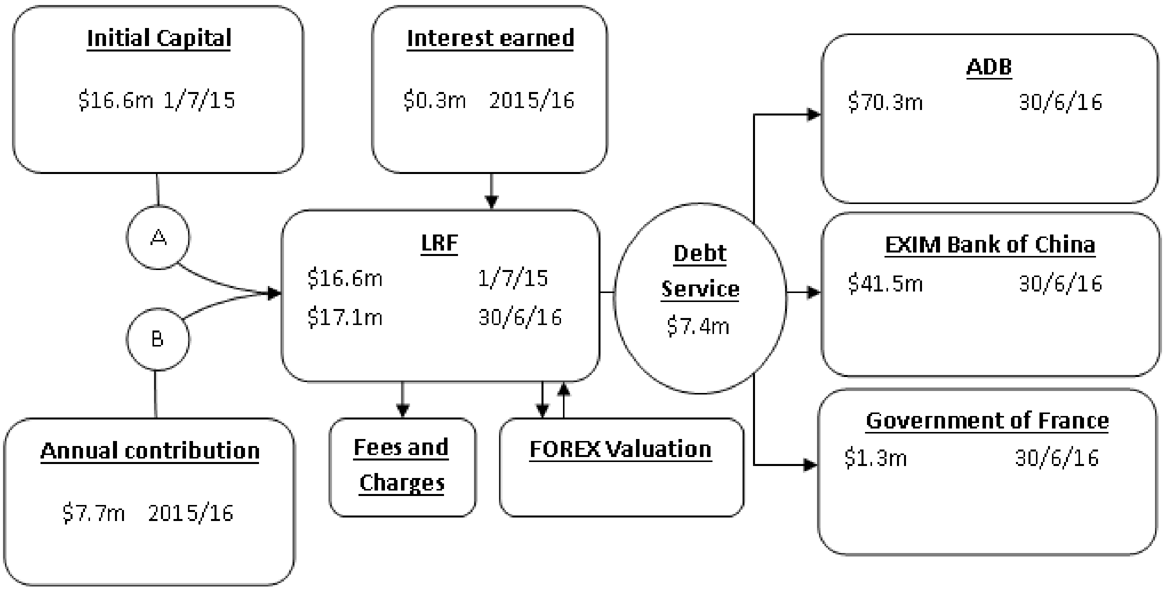
Table 7.3 Status of Government loans estimated at 30 June 2015

Loans drawn down	Date loan taken	Original loan amount (000)	Current balance (NZD,000)	Expected date of repayment
ADB 461 (SF) Multi Project	November, 1980	SDR 1,000	527	August, 2020
ADB 567 (SF) CIDB Project	July, 1982	SDR 1,500	492	April, 2022
ADB 849 (SF) 2nd Multi-Project	December, 1987	SDR 2,067	1,816	August, 2027
ADB 1031 (SF) Outer Islands Telecom Project	October, 1990	SDR 3,541	4,304	August, 2030
ADB 1155 (SF) 2nd CIDB Project	March, 1992	SDR 939	1,085	December, 2031
ADB 1171 (SF) Emerg. Telecom Rehab Project	August, 1992	SDR 291	373	June, 2032
ADB 1309 (SF) Pearl Industry Dev. Project	December, 1994	SDR 336	418	August, 2034
ADB 1317 (SF) Educ'n Dev Project	February, 1995	SDR 1,836	2,549	August, 2034
ADB 1380 (SF) 3rd CIDB Project	January, 1996	SDR 1,538	2,139	September, 2035
ADB 1466 (SF) Economic Restructure Program	September, 1996	SDR 3,430	4,726	September, 2036
ADB 1588 (SF) Cyclone Emergency Rehab Project	January, 1997	SDR 475	793	January, 2038
Restructured French Loans	January, 1999	Euro 5,413	1,842	September, 2018
ADB 1832 (SF) Waste Mgt Project	December, 2001	SDR 1,695	2,155	June, 2033
ADB 2174 (SF) Cyclone Emergency Assist Project	June, 2005	SDR 1,895	3,222	June, 2045
China - Multi-Functional Indoor Sports Stadium	August, 2008	RMB 74,100	11,148	August, 2028
ADB 2472 (OCR) Avatiu Port Development Project*	September, 2009	NZD 10,058	9,796	November, 2033
ADB 2473 (SF) Avatiu Ports Development project	September, 2009	SDR 8,346	8,203	November, 2040
ADB 2565 OCR Economic Recovery Support Program 1*	January, 2010	NZD 11,053	9,546	October, 2024
ADB 2739 (OCR) Amendment Avatiu Port project*	December, 2011	NZD 5,290	5,322	November, 2035
China - Rarotonga Water Ring Main Upgrade	December, 2012	RMB 118,000	12,757	December, 2032
ADB 2946 OCR Economic Recovery Support Program 2	December, 2012	NZD 7,250	7250	December, 2028
Total loans drawn down			**90,464**	
Debt Committed but not yet drawn				
ADB Renewable Energy Project	December, 2014	NZD 12,980	12,980	December, 2039
Total proposed new debt			**12,980**	
Total loans commitment			**103,444**	

7.5 Loan Reserve Fund (LRF)

In February 2014, the Parliament of the Cook Islands passed the Cook Islands Loan Repayment Fund Act 2014 formally creating an LRF. The aim of the LRF is to quarantine funds previously accumulated for loan repayments and to prevent them from being utilised for anything outside of debt servicing requirements. The LRF Act also ensures a framework for the prudential management of all sovereign public debt and ensures the timely allocation of money from the Budget for debt servicing.

Figure 7.1 Loan Reserve Fund movements 2015/16



The LRF currently has sufficient funds to fully cover all debts owed by or on behalf of SOEs to lenders. These SOEs include the Bank of the Cook Islands, Te Aponga Uira, and Telecom Cook Islands Limited.

The tender for the analytical services of the LRF was awarded to the New Zealand Company Bancorp, with transactional services and account management being awarded to ANZ in a competitive tender process. Bancorp's fees are outlined in the table below.

Table 7.4 Loan Reserve Fund Statement

	2014/15	2015/16	2016/17	2017/18	2018/19
Opening LRF balance	**16,211**	**16,641**	**17,133**	**17,786**	**17,831**
Contribution to LRF principle	3,928	5,424	6,726	6,726	6,726
Contribution to LRF interest	1,844	2,246	1,970	1,823	1,645
Interest earned (avg 2 percen)	455	315	343	356	357
Total transfer into the LRF	**6,227**	**7,986**	**9,039**	**8,905**	**8,728**
Repayment of SOE loans					
Principal	1,161	1,370	1,469	1,450	878
Interest	176	133	125	108	93
Total repayment from LRF	**1,337**	**1,503**	**1,594**	**1,558**	**971**
Repayment of other debt					
Principal	2,136	3,781	4,420	5,064	6,911
Interest	2,324	2,149	2,313	2,179	2,002
Total repayment other debt	**4,460**	**5,930**	**6,733**	**7,243**	**8,913**
Other service fees	-	60	60	60	60
LRF stock balance	**16,641**	**17,133**	**17,786**	**17,831**	**16,615**

Table 7.4 Loan Reserve Fund Statement illustrates the movement in the LRF in the next five years. The transfers into the LRF have increased from $6.23 million in 2015/16 at the 2014/15 Budget to $7.670 million due to the new loan from the ADB for the Southern Group renewable energy project and to compensate for movements in exchange rates. For accounting purposes, this transfer is divided into two components: a debt interest obligation ($2.246 million) and a debt principle repayment ($5.424 million); these are the estimated required payments into the LRF. The transfers out of the LRF for principle and interest are the estimated debt servicing requirements at the time of the Budget and are subject to exchange and drawdown variations.

7.6 Net Debt

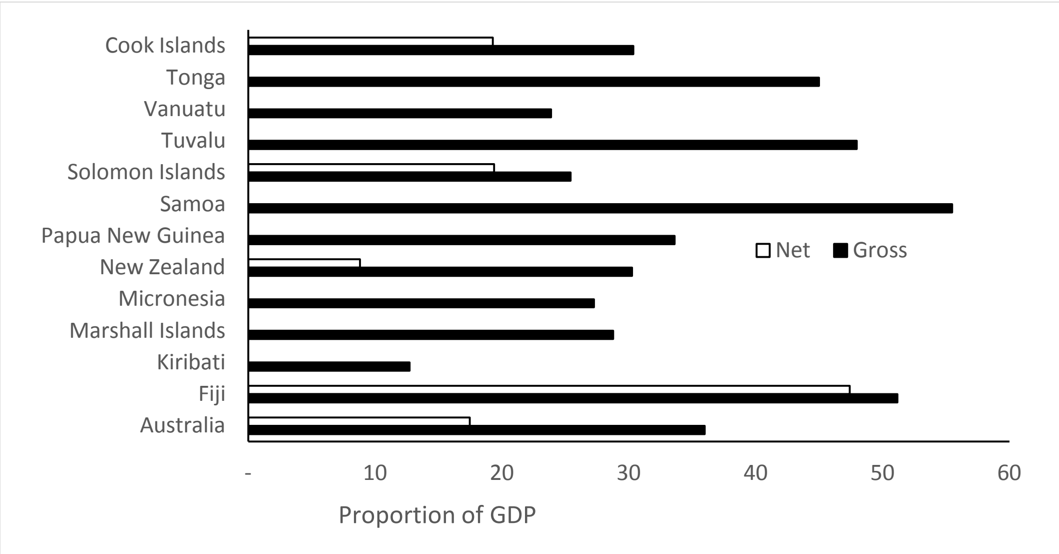
The Cook Islands has adopted a conservative approach towards the definition of net debt and is in a low debt position when compared internationally.

The internationally accepted definition of net debt is total gross debt (all public sector debt and currency on issue) less total financial assets corresponding to those debt instruments (this means like for like, for example cash). Under this definition the Cook Islands net debt position would be only $76.9 million or 21.0 per cent of GDP in 2015/16.

Gross Debt + Currency on Issue = ($113.1 million) + ($4.1 million)	=	($117.2 million)
Less		
Financial Assets (Cash reserves and Loan Repayment Fund)	=	($40.2 million)
Net Debt	=	($76.9million)

International comparisons of net debt are made on the basis of the international definition of net debt. On this basis the Cook Islands has one of the lower debt profiles in the Pacific including Australia and New Zealand.

Chart 7.6 Regional Comparison of public debt profiles[5]



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

However for the purpose of prudent fiscal management, the Cook Islands excludes cash reserves and currency issued from the net debt definition. For the purposes of this Chapter, 'Net Debt' in the Cook Islands is equivalent to total gross debt net of the LRF (the difference between the total gross debt and monies held in the LRF).

Net debt under this more conservative definition is estimated to be $95.9 million (26.1 per cent of GDP) by the end of June 2016, an increase of $3.7 million since the 2015/16 Budget.

Table 7.5 Current Borrowing Statement

Current Statement	**2014/15 Proj**	**2015/16 Proj**	**2016/17 Proj**	**2017/18 Proj**	**2018/19 Proj**
Statement of Borrowings	$m	$m	$m	$m	$m
Gross Crown Debt, End of FY	90.5	113.1	118.7	110.4	101.0
... net of loan reserves, End of FY	73.8	95.9	100.9	92.6	84.4
as percentage of GDP	20.1%	26.1%	26.4%	23.3%	20.5%
Loan Repayment Reserves Held	16.6	17.1	17.8	17.8	16.6
Gross Debt Servicing	5.8	7.4	8.3	8.8	9.9
Net Debt Servicing	5.3	6.3	7.1	8.0	9.5
... as percentage of Total Revenue	4.2%	5.0%	5.8%	6.1%	7.3%

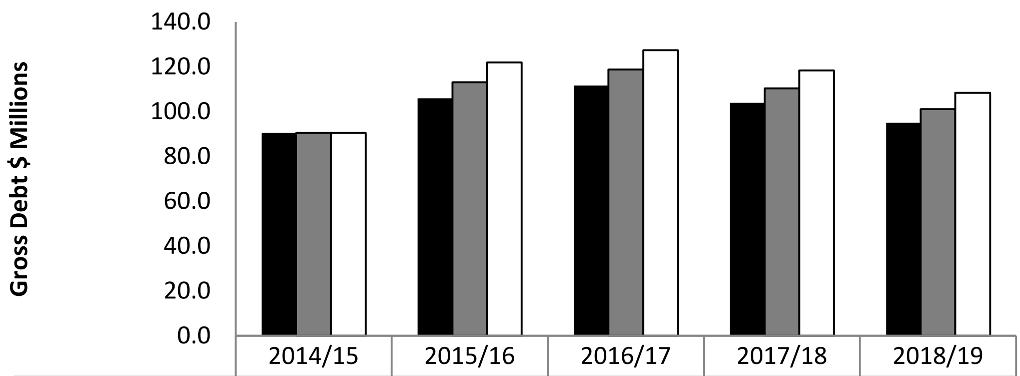
7.7 Crown Debt Sensitivity Analysis

Table 7.6 Base rate used in 2015/16 for budget assumption with +/- 10 per cent

Foreign Exchange Currency	-10%	Budget assumption rate	+10%
RMB	3.7350	4.1500	4.5650
USD	0.5918	0.6575	0.7233
SDR	0.4208	0.4675	0.5143
EUR	0.5490	0.6100	0.6710

The largest risk to the Crown's ultimate debt liability is the long term level of the NZD against the currencies in which the Crown's loans are denominated. The sensitivity analysis demonstrates the impact of a 10 per cent appreciation or depreciation in the NZD to determine the impact on the gross borrowings and the debt servicing cost.

Chart 7.7 Sensitivity of Total Crown Gross Debt

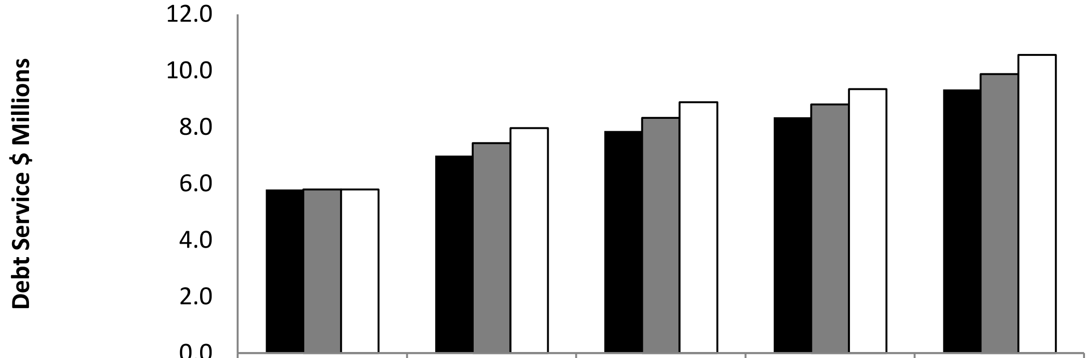


	2014/15	2015/16	2016/17	2017/18	2018/19
Increase by 10%	90.5	105.8	111.7	103.9	95.1
Base Rate	90.5	113.1	118.7	110.4	101.0
Decrease by 10%	90.5	121.9	127.3	118.4	108.3

If the NZD/USD exchange rate was to depreciate by 10 per cent, gross Crown debt as at the end of the June 2016 year would increase by an estimated $8.8 million.

If the NZD depreciated by 10 per cent, this would reduce the opportunity for further borrowings and increase the Crown's debt servicing costs to unsustainable levels.

Chart 7.8 Sensitivity of Gross Debt Servicing Costs



	2014/15	2015/16	2016/17	2017/18	2018/19
■ Increase by 10%	5.8	7.0	7.9	8.4	9.3
■ Base Rate	5.8	7.4	8.3	8.8	9.9
□ Decrease by 10%	5.8	8.0	8.9	9.3	10.6

The impact of the 10 per cent increase or decrease on debt servicing cost is relatively consistent to the impact on gross debts. Any decision to commit to further borrowings should be assessed carefully due to the sensitivity of the NZD.

7.8 Fiscal Debt Responsibility Ratios

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

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

Chart 7.9 Net Debt as a proportion of GDP

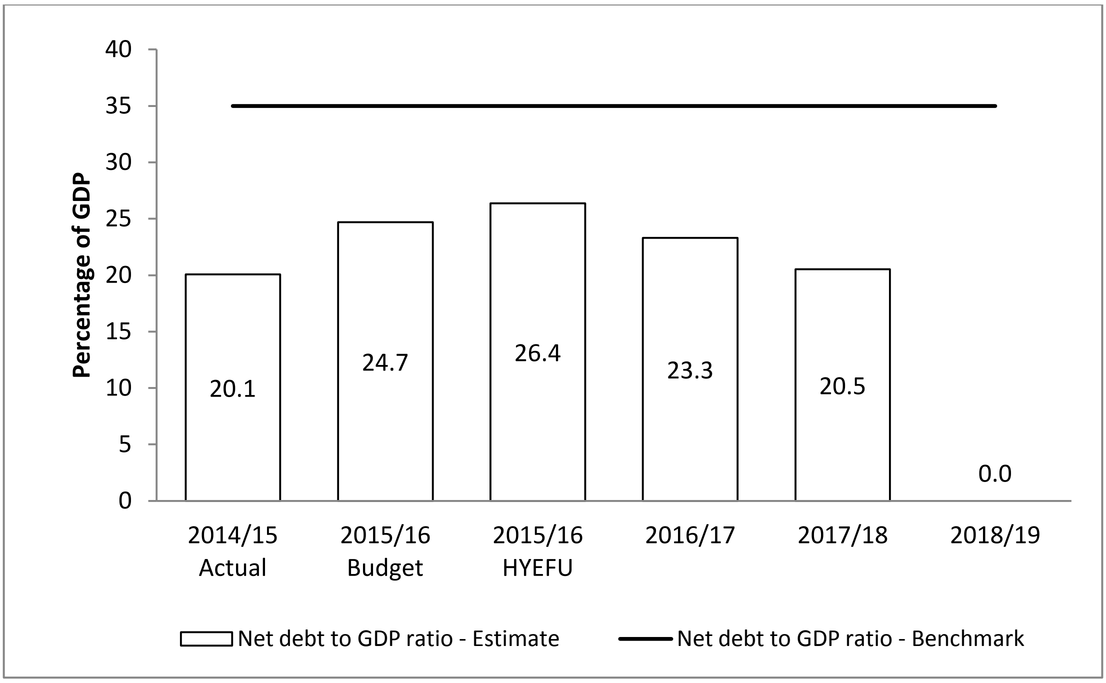
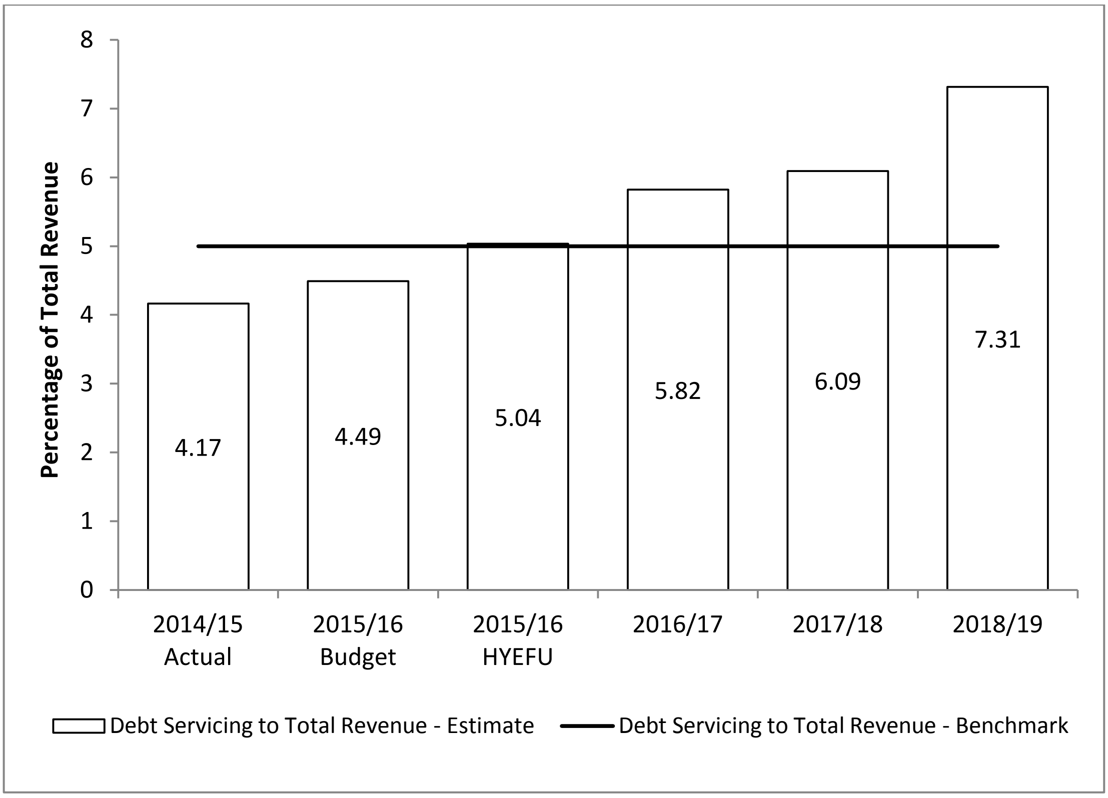


Chart 7.10 Net Debt Servicing as a proportion of Total Revenue



Government is well within its fiscal responsibility ratio threshold of 35 per cent net Crown debt to GDP. However, the commitment for debt servicing to remain under 5 per cent of total revenue will be breached across most of the forward estimates.

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

There is a question of the appropriateness of the five per cent debt servicing to revenue level and whether it is in fact too low. The net debt servicing to total revenue ratio controls the servicing of debt, which includes interest and principal payments. It primarily ensures that there are sufficient means to service debt from the operating revenue. Taken together with the tax revenue envelope, this ratio measures how much debt servicing is crowding out other components of government spending.

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

7.9 Long term debt projections

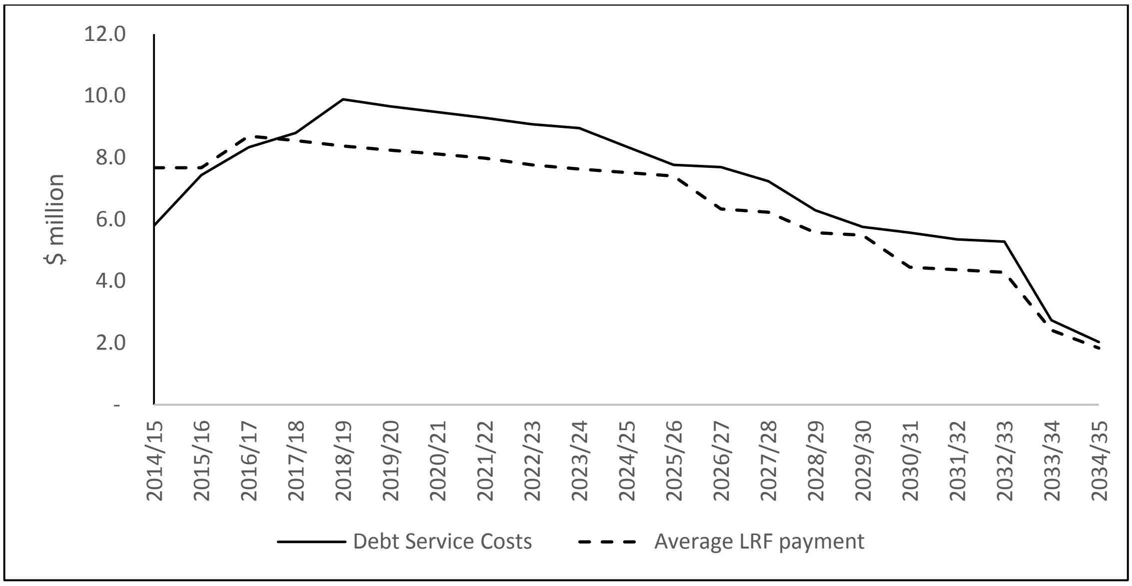
Proposals to take on new loans must be treated under transparent processes as required by the MFEM Act 1995/96 and the LRF Act 2014.

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

While there are no new loan agreements planned over the forward estimates, it is important to take note of the obligations relating to the current debt stock.

7.9.1 Servicing the current debt stock

Chart 7.11 Long-Term Debt Servicing ($ million)



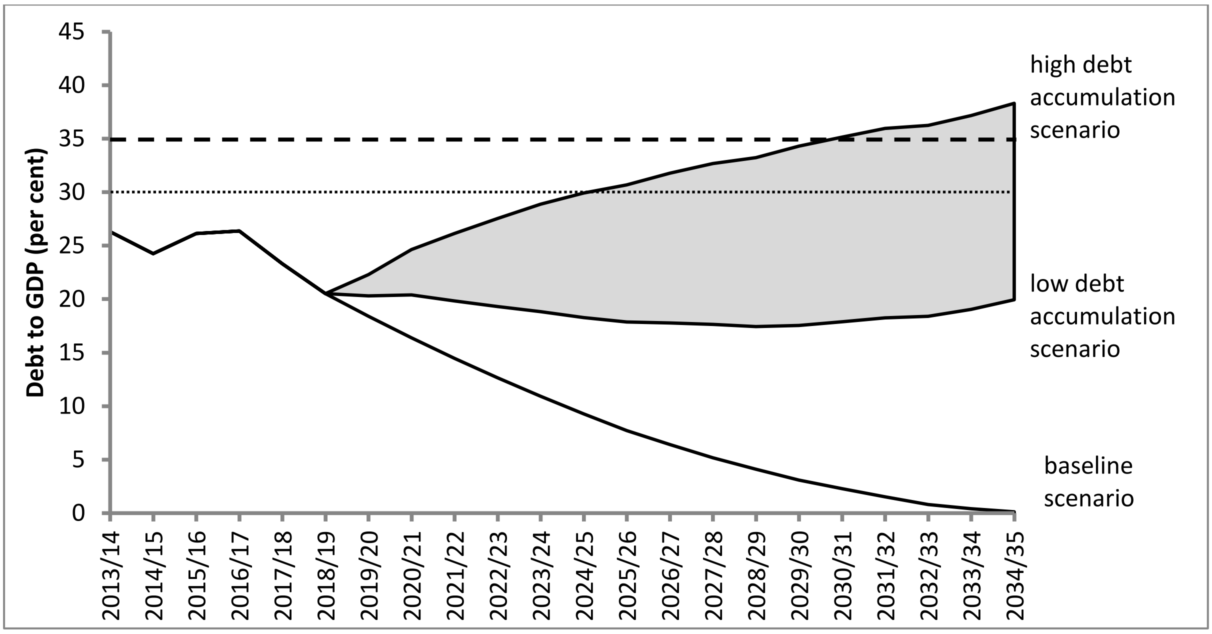
The LRF payments are smoothed in order to reduce the volatility to Government cash reserves from new debt obligations and exchange rate shocks. Therefore, the payments made into the LRF will not always match the debt servicing profile. For example, despite the debt servicing profile peaking at $9.9 million in 2018/19, the cost to the Government only peaks at $8.7 million in 2016/17 due to this effect.

The payments into the LRF then fall in a stepped manner as the current loan stock is repaid.

7.9.2 Debt projections

It is important to note the difference between the profile of the *current* debt stock and the *expected* debt profile. In evaluating the capacity to take on new debt-funded initiatives, it is important to estimate what the likely evolution of the debt profile is over time. While this chapter relates mainly to the current or near-term debt commitments, it is unlikely that that Government will not take on new debt relating to other infrastructure needs.

Chart 7.12 Net debt projection – 20 years



The graph above outlines three debt accumulation scenarios. [6]

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

The high debt accumulation scenario assumes that operational spending continues to grow at recent trends and that economic growth follows its long-term average. Capital is not allowed to fall below the amount of depreciation (current capital is fully replaced). Under this set of assumptions, cash reserves are depleted by operational deficits, and capital needs become increasing financed by debt financing. The recent increase in fisheries revenue means that despite pressure building within both the operational and capital budget, the 35 per cent debt:GDP ratio is breached as late as 2026/27.

The low debt accumulation scenario assumes that net operating surpluses are achieved over the medium term, with these surpluses being diverted into financing the capital budget in preference to debt financing. This becomes increasingly difficult over the long term however, with growth in expenditures outpacing revenue and the need for capital replacement keeping the pressure on the cash reserve. Debt financing of the capital program again becomes a dominant feature of the Budget from around 2030 onwards.

Both of these scenarios suggest that current expectations of expanding operational budgets cannot coexist with the recent levels of capital spending. At some point in the future, either capital or operational spending will need to be scaled back to match revenue growth. Importantly, neither scenario assumes major capital works beyond those already scheduled, despite major infrastructure needs still being prevalent after the current projects are

[6] The two frameworks for fiscal forecasting were developed in conjunction with the Asian Development Bank (the ADB Fiscal Management Model) and the International Monetary Fund (Fiscal Analysis and Forecasting workshop, Fiji, March 2014). An evaluation of the economic and fiscal modeling frameworks was undertaken in 2015 and a report is expected in early 2016.

completed. On the other hand, neither scenario includes major cost-saving initiatives in personnel nor operating, although both scenarios show that in the absence of strong revenue growth, such savings plans would eventually be necessary.

Another important consideration is the health of the cash reserve. The recent capital spending has diminished the capital reserve by investing in major infrastructure. Cash reserves should recover over the medium term if now new major initiatives are planned that involve the use of the Government cash reserve.

Of particular risk are the renewable energy projects in the Pa Enua. Combined, the northern and southern projects have cost as much as Te Mato Vai, but attracted little attention due to the use of donor grant funding. However, while the initial investment from the Cook Islands Government has only been the $12.98 million ADB loan, the replacement costs for the systems over future decades will be much higher. If not managed correctly, the Government will not have sufficient reserves to replace such a system in 10 to 15 years' time, and may have to rely on larger loans to fund the replacement capital.

7.10 Other State Owned Enterprise Debt

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

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

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

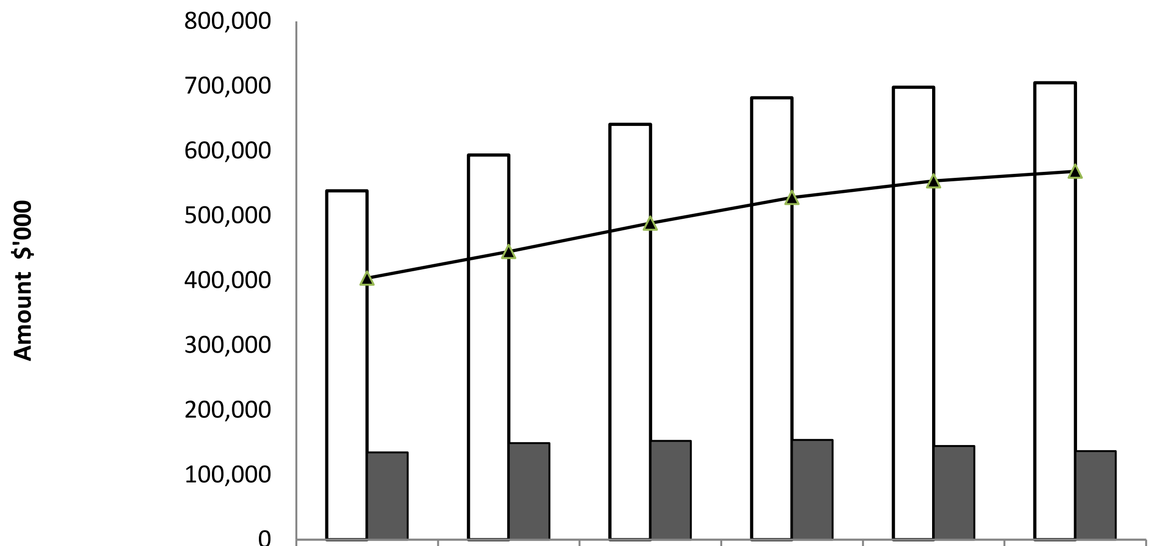
The loan is secured by registered mortgage debenture over the assets and undertakings of the Airport Authority. A financial covenant will apply where the amount of EBITDA generated less dividend paid will at all times be greater than twice the annual debt servicing commitments. The Covenant will be measured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

TAU has also indicated it is considering new borrowings to finance new investments in electricity generation and supply assets including infrastructure aimed at improving renewable energy distribution and supply.

7.11 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 7.13 - Net Worth 2014/15to 2018/19, ($000)



	Budget 2014-15	Budget 2015-16	HYEFU 2015-16	Projected 2016-17	Projected 2017-18	Projected 2018-19
Total Assets	538,070	593,729	640,856	681,777	697,978	705,099
Total Liabilities	134,599	149,134	152,537	153,844	144,417	136,580
Net Crown Balance	403,471	444,595	488,319	527,933	553,561	568,519

The estimated net worth of the Crown at December 2015 has increased from the 2015/16 Budget Estimates of $444.6 million to $488.3 million. This is a net movement of $43.7 million. This was a result of increases in the forecast physical assets.

The Crown’s net worth will increase from 2016/17, as long as there is an estimated operating surplus. Also, a major contributor to the forecast upward trend is the decrease in borrowings, and an injection to the Crown’s asset from aid donor funding.

Higher than anticipated cash balances at the end of 2014/15, and further technical adjustments, have resulted in a significant improvement to the cash position of the government since the 2015/16 Budget as seen in the Statement of Financial Position.

8 OVERSEAS DEVELOPMENT ASSISTANCE (ODA)

8.1 ODA Flows

Total ODA contribution from development partners was estimated at $49.1 million in the Budget 2015/16. To date actual spend is $13.3 million for the half year from July to December 2015.

ODA activities are progressing steadily, and key achievements have been made in the first half of 2015/16, with the adoption of an updated ODA Policy (the “Cook Islands Development Partners Policy”), and endorsement of the national activity management system (“Te Tarai Vaka”)[7]

8.1.1 Development Partners Policy

The updated Development Partners Policy expands upon the previous ODA Policy, broadening the scope to include different types of development funding arrangements, or “total official support for development” (TOSD). The Policy recognises the private sector, civil society, non-governmental organisations, traditional leaders, Pa Enua and elected officials as key development partners. It reaffirms the Government’s leadership and management of not only development support through ODA, but also other forms of development assistance (such as Climate Finance and South-South Cooperation) which are not categorised as ODA but are expected to make a significant contribution to development in the Cook Islands.

The Policy also addresses the Cook Islands graduation from ODA eligibility, stating that while the Cook Islands is expected to graduate in the medium term, as a Small Island Developing State (SIDS), development progress can be easily lost due to vulnerability to the impacts of climate change and external economic shocks. Therefore the Cook Islands will continue to work through diplomatic channels to remain eligible for ODA as a SIDS special case.

8.1.2 Te Tarai Vaka

Te Tarai Vaka (TTV) has been endorsed as the Cook Islands activity management system to provide environmental, social and fiduciary safeguards for all development partner initiatives. All projects over $150,000 are required to manage projects using TTV policies, guidelines and templates; from the concept note at the planning phase, through to implementation, monitoring and evaluation. The Development Coordination Division is responsible for training and roll-out to partner agencies, which is on-track for completion this year.

[7] See website http://www.mfem.gov.ck/ams

8.2 ODA Activities

A noteworthy achievement for ODA delivery in the Cook Islands was the signing of a Performance Based Budget Support Grant Funding Agreement (PBBS-GFA) with New Zealand in early November, which marks a shift to a more mature development partnership with New Zealand. The PBBS-GFA commits the Cook Islands to achieving performance milestones in tourism, health, education and provides technical assistance tagged to public sector and public financial management reforms. The PBBS-GFA will be reviewed in June 2016 to determine appropriate options for budget support arrangements moving forward.

Other areas of progress include Te Mato Vai, which is well ahead of schedule with Stage One (upgrade of ring mains) nearly complete. The tender for material supply for the commissioning of the new ring main has been awarded and work will commence in the third quarter (Jan-Mar 2016). Stage Two involving upgrading of water intakes, laying of trunk mains, and water treatment is on schedule to commence in the third quarter, and the installation of customer meters is to commence in May 2016.

The Southern Renewable Energy program which includes EU, PEC and GEF 6 grants and ADB loan, is progressing to plan with contracts awarded for the Project Management Unit and PEC Coordinator (Japan-Pacific Environment Community). Two milestone payment deliverables have also been completed by Entura, the Project owners' engineers, and it is anticipated that two additional milestones will be completed by the end of Dec 2015.

A general assessment of macroeconomic stability, progress in public financial management, transparency, and accountability, allowed for disbursement of €1.0 million in December 2015 under the European Union (EU) Budget Support Programme (EDF 10). Specific sanitation sector targets for a variable payment of €0.5 million were not achieved, however, reprogramming of the funds for technical assistance to the sector (focusing on funding a sanitation master plan) is soon to be finalised with the EU. Sanitation sector targets for the next budget support contract with the EU for €1.4 million under EDF 11 have been finalised and the financing agreement now awaits processing by the EU. Ministerial signing is expected to take place by March 2016.

Additionally, improvements are expected in UN Programme delivery and reporting with a decision made between UNDP and the Development Coordination Division to establish a UN Programmes Coordinator in the Cook Islands.

The Water Tank Subsidy Programme has been another notably successful project using a public-private partnerships model to support installation of water catchment tanks for Rarotonga residents.

Cabinet has approved a second extension of the programme to 30 June 2016 in order to complete installation and processing of applications. Just over 1,500 water tanks have been installed on Rarotonga, out of a target of 2,000 tanks expected to be recorded by the end of the programme.

Programs and projects that are delayed or tracking slowly include the Sanitation Upgrade Programme with New Zealand, which has faced slow implementation, but is beginning to come back on track through addressing issues with management, processes and structure. Uncertainties around the necessity for sewerage reticulation have also slowed the implementation of activities.

Progress was made with signing of the Letters of Exchange with China in October 2015 for allocation of the China grant fund to support the Apii Nikao project. However, construction will likely not commence until 2016/17.

Since the June 2015/16 budget there have been some development partners committing additional funds. These are:

- 50th Anniversary gift of $11.7 million from New Zealand to upgrade Tereora College.
- Support from SPC totaling $.29 million for the National Statistics Office to conduct the Household Income and Expenditure Survey.
- 50th Anniversary grant of $.014 million from Thailand, handed over to the Tereora College horticulture programme.

Upcoming opportunities for programme and project funding include:

- The Japan Non-Project Grant Aid counterpart fund will have approximately $1 million available from 2016/17 for mutually agreed activities between the Cook Islands and the Government of Japan that contribute to socio-economic development.
- The Delegated Cooperation Agreement between Australia, New Zealand and the Cook Islands, which funded Gender and Disabilities activities will conclude in June 2016. New opportunities are anticipated with the next funding agreement with Australia.
- The UNFPA Biennium Workplan will conclude in December 2015 and a new support arrangement is expected to be developed to deliver technical assistance in the areas of sexual and reproductive health, gender and population.

Greater access to climate change financing opportunities is anticipated with MFEM's recent submission to the UN Adaptation fund for accreditation as a National Implementing Entity (NIE). The initial NIE application was submitted in December 2014, with follow-up submissions in April 2015 and October 2015. MFEM is engaging in an ongoing dialogue on improving national systems for direct access to the Fund.

The Government continues its commitment to foster partnerships with local and international partners through the Development Partners Meeting. This meeting aims to create a focused space to share inclusive views on development, innovations for more effective development and demonstrate the credibility of Cook Islands national systems in a manner that increases coordinated development efforts across organisations. The meeting has been held annually every February, but will now shift to a biannual event at a time more convenient for participation of all development partners including China.

9 ASSUMPTIONS UNDERLYING THE FISCAL PROJECTIONS

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

- Operating Revenues are forecasted on the basis of recent trends in economic activity as well as one off considerations.
- GDP data is updated to June 2014 (provisional estimates) and trade data is updated to the March quarter 2015; early, provisional data was available (not publicly released) in the final days of the forecasting process but is not included here – they will be included in future updates. The data sets used were those available as at 20 November 2015.
- Nominal GDP is expected to grow by:
  - 1.8 per cent in 2014/15
  - -0.3 per cent in 2015/16
  - 4.3 per cent in 2016/17
  - 3.8 per cent in 2017/18
  - 3.6 per cent in 2018/19
- The general model used to forecast nominal economic growth is based on the expenditure national accounting measure and uses estimates of public sector consumption and investment (including aid assistance), net merchandise trade, total tourism spending, domestic investment, and domestic consumption.
  - Tourism expenditure is the largest single component of the forecasts, and is based on:
    - An average stay of 7.7 days for New Zealand arrivals, 8.3 for Australia, 7.5 for USA, 8.6 for Canada, 8.5 for the UK and Europe, 6.3 for Asia, and 8.2 for other – an overall average of around 7.8 days depending on the composition of total arrivals in any given month. This data was collected from the Customs and Immigration database of arrivals and departures, which uses the passport numbers of visitors to determine how long an individual passport holder is in the country.
    - Average visitor spend of NZD 210-240.00 per day, which is estimated from quarterly visitor surveys and a CPI indexation of a basket of tourist services.
  - Public consumption is the second largest single item and is estimated based on the personnel and operating appropriation for both Government and aid spending. Public investment is also a significant component of the model, and is estimated based on capital plans (including ODA investment), for which a realisation (or completion) rate is applied to capital projects to allow for project slippage from one year to the next, and issues of capacity. This rate is assumed to be around 40 per cent in the first year and 36 per cent in the second year.

        - Government consumption expenditure is based on the Operating Estimates for 2014/15, Appropriation for 2015/16, and existing government policy, and is expected to grow as follows:
            - 4.5 per cent in 2014/15
            - 3.4 per cent in 2015/16
            - 10.1 per cent in 2016/17 (due to timing of capital projects)
            - -1.4 per cent in 2017/18
    - Domestic (private) consumption is the next largest single item and is estimated based on consumption patterns as observed through the VAT series, along with expected inflation and population changes. The methodology derives a "consumption per head per day" metric and scales back to the full population.
- Growth in prices measured through movements in the Consumer Price Index are projected based on global commodity prices and exchange rate movements as forecast by the IMF and World Bank (used to construct a 'Tradables' series), as well as historical trends for non-tradable components of the CPI basket. Growth in the CPI has been, and is expected to be:
    - 3.0 per cent in 2014/15
    - 2.5 per cent in 2015/16
    - 2.6 per cent in 2016/17
    - 2.4 per cent in 2017/18
    - 2.4 per cent in 2018/19
- Operating Expenditure movements in the outer years are based on actual commitments and are modeled through the Medium Term Budgeting Framework.
- The level of borrowings is based on exchange rates provided by Bancorp, derived using Consensus Economics forecasts.

10 FINANCIAL STATEMENTS

10.1 Financial Statements as at 31 December 2015

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

10.1.1 Statement of Financial Performance

10.1.2 Statement of Financial Position

10.1.3 Statement of Cash flows

10.1.4 Statement of Borrowings

10.1.5 Summary of Revenue Levied on Behalf of the Crown

10.1.6 Statement of Financial Risks

Statement of Financial Performance

For the year ending 31 December 2015

	Budget 2014-15 ('000)	Budget 2015-16 ('000)	HYEFU 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)	Projected 2018-19 ('000)
Revenue						
Taxation revenues	100,847	102,914	103,222	102,827	104,408	105,592
Other revenue						
Revenue on behalf of the Crown	16,397	27,092	28,292	23,998	23,870	14,345
Sale of goods and services	6,261	5,720	5,720	5,720	5,720	5,735
Interest	2,708	2,569	2,569	2,587	2,561	2,561
Dividends	1,999	2,020	2,020	2,020	2,020	2,020
Total Revenue	***128,212***	***140,315***	***141,823***	***137,152***	***138,578***	***130,253***
Expenditure						
Appropriations to agencies	65,028	70,849	70,960	70,279	69,866	65,814
Payments on behalf of Crown	44,526	54,594	56,257	51,976	51,060	45,412
Debt-servicing interest	2,168	2,285	2,282	2,438	2,287	2,095
Building maintenance	1,800	1,798	1,798	1,798	1,798	1,798
Infrastructure depreciation	2,920	2,920	2,920	3,682	3,682	3,682
Other expenditure	5,629	6,314	6,313	7,158	7,187	6,778
Total Expenditure	***122,071***	***138,760***	***140,530***	***137,331***	***135,880***	***125,579***
NET OPERATING SURPLUS / (DEFICIT) *	***6,141***	***1,555***	***1,293***	***-179***	***2,698***	***4,674***

**** Net Operating Surplus/(Deficit) balance vary to Operating Revenue and Expenditure Statement for the year ended 31 December 2015 due to the difference in treatment of Debt -servicing interest.***

Statement of Financial Position
As at 31 December 2015

	Budget 2014-15 ('000)	Budget 2015-16 ('000)	HYEFU 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)	Projected 2018-19 ('000)
Assets						
Cash and equivalents	45,046	36,391[8]	41,049	38,644	37,098	40,881
Loan reserves	16,641	16,903	17,133	17,786	17,831	16,615
Trust accounts	6,384	7,052	7,210	7,891	11,819	18,252
Inventory	4,395	4,395	4,395	4,395	4,395	4,395
Tax receivables	16,713	16,462	16,713	16,237	16,237	16,237
Debtors and other receivables	10,699	10,699	10,699	10,699	10,699	10,699
Advances to SOEs	26,206	26,206	26,206	26,206	26,206	26,206
Investment in SOEs	146,733	146,733	146,733	146,733	146,733	146,733
Plant, property, and equipment	265,253	328,888	370,718	413,186	426,960	425,081
Total Assets	***538,070***	***593,729***	***640,856***	***681,777***	***697,978***	***705,099***
Liabilities						
Creditors and other payables	35,625	30,954	30,954	26,607	25,501	25,451
Trust liabilities	8,510	8,510	8,510	8,510	8,510	8,510
Borrowings	90,464	109,670	113,073	118,727	110,406	102,619
Total Liabilities	***134,599***	***149,134***	***152,537***	***153,844***	***144,417***	***136,580***
Net Crown Balance	***403,471***	***444,595***	***488,319***	***527,933***	***553,561***	***568,519***

[8] Due to some technical changes in the accounting for cash payments, these balances will not reflect the amounts published in the 2015/16 Budget. These amounts reflect the information in the 2015/16 Budget, updated to reflect these changes.

Statement of Cashflows

For the year ending 31 December 2015

	Budget 2014-15 ('000)	Budget 2015-16 ('000)	HYEFU 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)	Projected 2018-19 ('000)
Cashflows from Operating Activities						
Cash provided from:						
Taxation and levies	100,847	102,914	103,222	102,827	104,408	105,592
Collection of tax arrears	231	251	0	476	0	0
Sale of goods and services	6,261	5,720	5,720	5,720	5,720	5,735
Interest	2,708	2,569	2,569	2,587	2,561	2,561
Dividends	1,999	2,020	2,020	2,020	2,020	2,020
Other income	16,397	27,092	28,292	23,998	23,870	14,345
	128,443	*140,566*	141,823	137,628	138,578	130,253
Cash applied to:						
Appropriations to agencies (less depn)	61,811	67,075	67,186	66,490	66,084	62,034
Payments on behalf of Crown	44,526	54,594	56,257	51,976	51,060	45,412
Debt-servicing interest	2,168	2,285	2,282	2,438	2,287	2,095
Building maintenance	1,800	1,798	1,798	1,798	1,798	1,798
Other expenditure	-3,814	10,985	10,984	11,505	8,293	6,828
	106,491	*136,737*	*138,507*	*134,207*	*129,522*	*118,167*
Net Operating Activity Cashflows	***21,952***	***3,829***	***3,316***	***3,421***	***9,056***	***12,086***
Cashflows from Investing Activities						
Cash provided from:						
Subsidiary loan repayments	0	0	0	0	0	0
	0	*0*	*0*	*0*	*0*	
Cash applied to:						
Capital expenditure	17,078	23,667	24,295	17,317	8,962	3,965
Advances to Subsidiaries	0	0	0	0	0	0
	17,078	*23,667*	*24,295*	*17,317*	*8,962*	*3,965*
Net Investing Activity Cashflows	***-17,078***	***-23,667***	***-24,295***	***-17,317***	***-8,962***	***-3,965***
Cashflows from Financing Activities						
Cash provided from:						
Loans drawn down	6,397	9,485	15,525	9,735	0	0
Cash drawn from loan reserves	6,227	7,986	7,926	8,979	8,845	8,668
	12,624	*17,471*	*23,451*	*18,714*	*8,845*	*8,668*
Cash applied to:						
Loan repayments	3,297	4,508	5,151	5,889	6,514	7,789
Loan reserves	430	1,113	492	653	45	-1,216
Other reserves	149	668	826	681	3,928	6,433
	3,876	*6,289*	*6,469*	*7,223*	*10,487*	*13,006*
Net Financing Activity Cashflows	***8,748***	***11,182***	***16,982***	***11,491***	***-1,642***	***-4,338***
Net cash movements	13,622	-8,656	-3,997	-2,405	-1,547	3,783
Add: Opening Cash and Equivalents	31,425	45,046	45,046	41,049	38,644	37,098
Closing Cash and Equivalents	***45,046***	***36,391***	***41,049***	***38,644***	***37,098***	***40,881***

Statement of Borrowings

For the year ending 31 December 2015

	Budget 2014-15 ('000)	Budget 2015-16 ('000)	HYEFU 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)	Projected 2018-19 ('000)
Total Gross Borrowings	***90,464***	***109,670***	***113,073***	***118,726***	***110,405***	***102,617***
Assets Held Against Borrowings:						
Advances to subsidiaries	26,206	26,206	26,206	26,206	26,206	26,206
Loan reserves	16,641	16,903	17,133	17,786	17,831	16,615
Total Assets Held Against Borrowings	***42,847***	***43,109***	***43,339***	***43,992***	***44,037***	***42,821***
Net Borrowings of the Government	***47,617***	***66,561***	***69,734***	***74,734***	***66,368***	***59,796***

Revenue Levied on Behalf of the Crown (ROBOC)

For the year ending 31 December 2015

	Budget 2014-15 ('000)	Budget 2015-16 ('000)	HYEFU 2015-16 ('000)	Projected 2016-17 ('000)	Projected 2017-18 ('000)	Projected 2018-19 ('000)
Taxation						
Income tax	19,836	22,201	19,747	19,924	20,441	20,843
Company tax	11,740	10,625	10,547	11,047	11,374	11,621
Import levies	10,409	11,956	11,971	11,856	11,724	10,810
Departure tax	8,561	7,817	8,496	8,918	9,299	9,671
VAT	48,078	50,316	50,605	51,082	51,569	52,646
Withholding tax	2,223	0	1,856	0	0	0
Total Taxation Revenue	***100,847***	***102,914***	***103,222***	***102,827***	***104,408***	***105,592***
Other Crown Revenue						
FSDA	344	262	262	262	262	262
FSC Vested Assets	556	260	260	0	0	0
Immigration Fees	652	584	584	584	584	584
IMO Subscription - Maritime Cook Islands	0	63	63	63	63	63
Court Services	50	50	50	50	50	50
Instant Fines	24	20	20	20	20	20
Fishing Licences	8,064	3,807	3,807	7,538	7,538	7,538
Fisheries Catch Revenue	1,777	1,700	1,700	1,700	1,700	1,700
Fisheries - US Treaties (purse seing)	1,046	4,280	4,280	780	780	780
Fishing Fines	1,225	0	500	0	0	0
Research Fee	2	1	1	1	1	1
Permits	16	24	24	24	24	24
Banana Court - dividend	10	10	10	10	10	10
Bank of the Cook Islands – dividend	279	481	481	481	481	481
Ports Authority - dividend	0	0	0	0	0	0
Punganga Nui Market - dividend	0	0	0	0	0	0
Te Aponga Uira - dividend	300	319	319	319	319	319
Extraordinary SOE Dividends	60	60	60	60	60	60
Telecom Cook Islands - dividend	1,350	1,150	1,150	1,150	1,150	1,150
Numismatics	298	500	500	500	500	500
Drivers Licences	125	180	180	180	180	180
Motor Vehicle Registration	1,032	875	875	875	875	875
Interest on balances	1,732	1,885	1,885	1,885	1,885	1,885
Interest on loans to subsidiaries	976	684	684	702	676	676
Foreign Investment Fees	27	26	26	26	26	26
Upper Air Management Agreement	764	510	510	510	510	510
Shipping Registration	77	231	231	231	150	150
International Shipping Licence	15	10	10	10	10	10
Liquor Licencing	28	30	30	30	30	30
Tattslotto Grants	130	120	120	120	120	120
Censorship Fees	5	12	12	12	12	12
Circulating Currency - Coins	137	100	100	100	100	100
Sale of NZ coins	0	961	961	0	0	0
Sale of Circulating Currency Cook Islands Coins	0	3,142	3,142	809	762	762
Smelting of Old Coins	0	135	135	0	0	0
Employer Liabilities	0	44	44	44	44	44
Motor Vehicle Dealers	3	5	5	5	5	5
Justice Unclaimed Rental Monies	0	0	0	0	0	0
Higher Modality Partnership NZ		7,910	8,600	8,175	8,130	0
Public Sector Strengthening processes and systems MFEM	0	1,250	1,260	1,350	1,390	0
Total Other	***21,104***	***31,681***	***32,881***	***28,606***	***28,447***	***18,927***
Total ROBOC[9]	***121,951***	***134,595***	***136,103***	***131,433***	***132,855***	***124,519***

[9] This amount will not match the Statement of Financial Performance as it does not include Trading Revenue

Statement of Fiscal Risks

As at 31 December 2015

		('000)
Quantifiable Contingent Liabilities		
Guarantees and indemnities	10.1.6.1.1.1	500
Uncalled capital		1,741
Legal proceedings and disputes		4,356
Total Quantifiable Contingent Liabilities		***6,598***

Guarantees and indemnities relate to the following:

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

Uncalled Capital

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

Legal Proceedings and Disputes

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

Financial liabilities relating to Island Governments

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

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

Unpaid invoices are a potential risk that would be difficult to mitigate without tighter financial controls than those imposed on other Government agecies. Island Administrations are fully covered by the MFEM Act, MFEM financial policies and procedures, and are accountable to the National Audit Office and the Cook Islands Parliament.

11 STATEMENT OF ACCOUNTING POLICIES

There have been no changes since the Budget 2015/16. There are no major changes to accounting policies anticipated in the foreseeable future.

11.1 Basis of Preparation

11.1.1 Reporting Entity

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

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

A schedule of the entities included in these financial statements is detailed on page 64.

11.1.2 Statement of Compliance

These financial statements in Chapter 17 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).

11.1.3 Measurement Base

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

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

11.2 Significant Accounting Policies

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

Recent Standards

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

STANDARDS	**EFFECTIVE DATE**
IPSAS 28 Financial Instruments: Recognition and Measurement	1/01/2013
IPSAS 29 Financial Instruments: Presentation	1/01/2011
IPSAS 30 Financial Instruments: Disclosure	1/01/2013

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

11.2.1 Basis of Consolidation

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

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

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

11.2.2 Associate

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

11.2.3 Revenue

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

Revenue Levied through the Crown's Sovereign Power

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

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

11.2.4 Revenue Earned Through Operations

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

Fines

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

Investment Income

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

Gains

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

Dividends

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

Aid Revenue

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

11.2.5 Expenses

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

Welfare Benefits

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

Grants and Subsidies

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

Losses

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

Foreign Currencies

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

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

Aid Expenses

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

Depreciation

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

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

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

11.2.6 Non-Current Assets

Plant, Property, and Equipment

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

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

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

Disposals

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

Additions

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

Work in Progress

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

Infrastructure Assets

Infrastructure assets are recorded at cost less accumulated depreciation.

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

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

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

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

- Power network
- Harbours & ports
- Airports

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

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

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

Intangible Assets

Intangible assets are software acquisition costs.

Intangible assets are recorded at cost less accumulated amortisation.

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

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

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

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

Software, databases: 3 - 5 years

Cash and Cash Equivalents

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

Receivables and Advances including Debtors and Other Receivables

Receivables and advances are recorded at cost.

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

Inventories

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

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

Investments

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

Banking portfolio investments

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

Provision for doubtful debts

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

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

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

Aid Assets

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

11.3 Liabilities

11.3.1 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.

11.3.2 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.

11.3.3 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.

11.3.4 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.

11.3.5 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.

11.3.6 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.