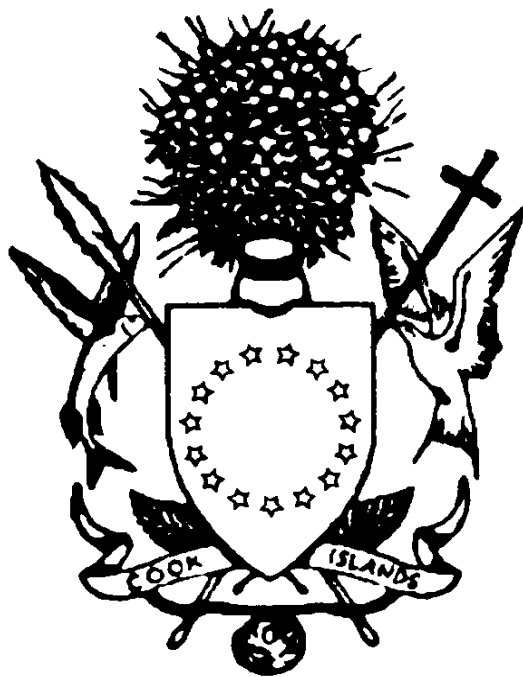


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**COOK ISLANDS GOVERNMENT**

**2016/17 Half-year Economic and  
Fiscal Update**

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**Hon. Mark Brown**  
**Minister of Finance**  
**December 2016**

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## MINISTER OF FINANCE

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**15 December 2016**

### **STATEMENT OF RESPONSIBILITY**

I have read the Financial Secretary's Statement of Responsibility and concur with him regarding the preparation of the 2016/17 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 2016 of which I was aware and had material economic and fiscal implications.

The 2016/17 Half Year Economic and Fiscal Update have been produced in accordance with the Ministry of Finance and Economic Management Act 1995/96.

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

Kia Manuia,

A handwritten signature in blue ink, appearing to read 'Mark Brown', on a light green background.

Honourable Mark Brown

**Minister of Finance**



## MINISTRY OF FINANCE AND ECONOMIC MANAGEMENT

### GOVERNMENT OF THE COOK ISLANDS

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**15 December 2016**

### **STATEMENT OF RESPONSIBILITY**

This Half Year Economic and Fiscal Update (HYEFU) 2016/17 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 1<sup>st</sup> day of December, nor later than the 31<sup>st</sup> day of December in each financial year, cause to be published a report containing an economic and fiscal update prepared by the Ministry.

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 2016/17 HYEFU.

The update incorporates the fiscal and economic implications both of Government decisions and circumstances as at December 2016 that were communicated to me, and of other economic and fiscal information available to the Ministry in accordance with the provisions of the *Ministry of Finance and Economic Management Act 1995/96*.

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

Kia Manuia,

Garth Henderson

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

**Financial Secretary**

## 2 PREFACE

The Ministry of Finance and Economic Management has published through this document both the 2017/18 Budget Policy Statement (BPS) with the 2016/17 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 2017/18 BPS will be published on the 15 December 2016 to enable better aligned planning by government departments and development partners in the 2017/18 Budget going forward.

The BPS states Government's policy intent for the 2017/18 fiscal year going forward including the Government's fiscal policy, its broad strategic priorities for the 2017/18 fiscal year, and any specific outputs and other expenditure that the Government anticipates to be included in the 2017/18 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 2016/17 HYEFU provides an update of the economic and fiscal forecasts made at the time of the 2016/17 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 2016, the HYEFU will also be published on 15 December 2016 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 2017/18 BUDGET POLICY STATEMENT**

The 2017/18 Budget will progress the Government's programmes and priorities in line with the implementation of the National Sustainable Development Plan 2016-2020 (NSDP). The alignment of the Budget to the NSDP goals is fundamental if we are going to realise the aspirations of our people in the long term. It continues to demonstrate Government's commitment to improving on our scorecard for development. Therefore, Budget 2017/18 will concentrate on:

- NSDP Goal 1. Improve welfare, reduce, inequity and economic hardship;
- NSDP Goal 2. Expand economic opportunities, improve economic resilience and productive employment to ensure decent work for all;
- NSDP Goal 4. Sustainable management of water and sanitation;
- NSDP Goal 5. Build resilient infrastructure and Information Communications Technologies to improve our standard of living;
- NSDP Goal 6. Improve access to affordable, reliable, sustainable, modern energy and transport;
- NSDP Goal 7. Improve health and promote healthy lifestyles;
- NSDP Goal 13. Strengthen resilience to combat the impacts of climate change and natural disasters
- NSDP Goal 15. Ensure a sustainable population engaged in development by Cook Islanders for Cook Islanders; and
- NSDP Goal 16. Promote a peaceful and just society and practice good governance with transparency and accountability.

Efforts on the realisation of these goals will also have ripple effects on:

- NSDP Goal 8. Ensure inclusive and equitable quality education and promote life-long learning opportunities;
- NSDP Goal 9: Accelerate gender equity, empower all women and girls, and advance the rights of youth, the elderly and disabled;
- NSDP Goal 11. Promote sustainable land use, management of terrestrial ecosystems, and protect biodiversity; and
- NSDP Goal 12. Sustainable management of oceans, lagoons and marine resources.

As such, existing and additional resources in 2017/18 will not only be directed to the implementation of these NSDP Goals, but will also be centred on the Government's pledge to:

- Sensibly manage our finances
- Build a vibrant and more equitable economy
- Deliver better public services; and
- Develop infrastructure that is resilient and environmentally sound.

### **3.1 SENSIBLY MANAGING OUR FINANCES**

The Government will continue to implement policies which are consistent with providing a positive macroeconomic environment. This will be principally driven by ensuring net underlying operating surpluses continue on. This will ensure that there remains a prudent fiscal and cash buffer in case of exceptional factors which may require emergency government action, such as natural disasters. This will be further supported by government actions to provide appropriate insurance cover through institutions such as the Pacific Catastrophe Risk Assessment Funding Initiative (PCRAFI) and the Asian Development Bank (ADB). These efforts will contribute towards the achievement of NSDP Goal 13.

Steps will also be taken toward implementing the Government's 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.

To better manage your finances, the Government will work towards gaining greater balance between operating and capital expenditure without compromising our delivery in services, building resilient infrastructure and maintaining environmental integrity. In doing so, Government will work hard on ensuring that greater outcomes can be derived from its base funding. Any new expenditure must have clearly identified benefits for our people. There will be no unnecessary spending.

### **3.2 BUILDING A VIBRANT AND MORE EQUITABLE ECONOMY**

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.

A key part of the Government's strategy going forward to ensure the achievement of NSDP Goal 2, is to examine the relationship between economic growth and its social impacts to ensure an equitable distribution of economic benefits with the Pa Enua. Efforts to expand and diversify the economic base by encouraging new business and growth for existing businesses will be encouraged. Furthermore, the Government will develop an employment strategy that improves employment conditions, address population sustainability, migration

and economic growth. The Government will work in partnership with the private sector to provide alternative options for infrastructure investment. In addition, the Government will research the role played by and the net benefits to the Cook Islands from Foreign Direct Investment, to ensure that it capitalises on benefits for our people.

Furthermore, Government will be implementing a tax debt relief package, which will reduce existing taxation debt servicing focus on existing business and shift attention on productivity and growing enterprise.

### **3.3 DELIVERING BETTER PUBLIC SERVICES**

The Government will continue to invest in health, education, social protection, and other key sectors to achieve NSDP Goals 7, 8, 9 and other goals, with the support of our development partners, including the Government of New Zealand. In this budget, we will invigorate our efforts in youth at risk and the mentally ill; primary health care and prevention; and avoidance of Non Communicable Diseases (NCDs), accelerating achievement of NSDP Goal 7.

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

In addition, the Government in 2017/18, will review the welfare system to protect and improve livelihoods of the most vulnerable, which will contribute to NSDP Goals 1 and 9.

NSDP Goal 16, will also receive attention in this Budget. We will work to address recruitment, retention, capacity building and performance improvement through the Public Sector Strategy and Implementation Plan. Furthermore, we will look to strengthen selected agencies, as well as conduct public expenditure reviews to boost service delivery. To improve implementation we will work to strengthen our capabilities in planning and project management. There will be a greater focus on communication, coordination and collaboration between Government agencies, as well as, greater accountability and transparency to ensure that the desired development outcomes of our people are realised. In this regard, there will be concentration on strengthening central agencies to deliver on the NSDP, national policies and objectives including the examination of baselines to improve productivity, efficiency and effectiveness.

The Government recognises that informed decision making is critical. Therefore, we will develop our national statistics system through the implementation of the Cook Islands National Strategy for the Development of Statistics and Implementation Plan.

Underpinning this Budget, is development for Cook Islanders by Cook Islanders (NSDP Goal 15). In this regard, the Government will develop a broader Population Policy and Strategy.

Furthermore, we will continue to improve our Border Management System, as well as providing training and support for staff in utilising modern immigration systems.

### **3.4 DEVELOPING INFRASTRUCTURE THAT IS RESILIENT AND ENVIRONMENTALLY SOUND**

Since assuming office, the Government has placed significant attention on infrastructure development and its positive relationship with the natural environment. This Budget will continue to implement Te Mato Vai, as well as water security in the Pa Enea with the assistance of our development partners. To complement the efforts in developing physical water infrastructure, we will establish effective institutional arrangements to manage the Rarotonga water supply system. The Government will also build on previous sanitation efforts, with particular focus on the Muri/Avana area, while also laying the foundation for addressing overall waste management issues across the country. These efforts will not only address NSDP Goal 4, but have positive impacts on NSDP Goals 11 and 12.

A primary focus of Budget 2017/18, will be to effectively manage infrastructure development across our islands, with the perspective of acknowledging realistic capabilities for implementing NSDP Goal 5. In 2017/18, we will better plan, improve management, engage smarter with potential funding sources and execute more effectively our developments in Infrastructure, including harnessing opportunities through climate change financing. This will ensure ripple effects in the attainment of all of our NSDP goals.

Renewable energy remains a priority of Government with implementation of renewable energy systems in the Southern islands, as well as increased storage for Rarotonga, with the assistance of our development partners to achieve NSDP Goal 6. Also in line with the achievement of NSDP Goal 6, the Government will investigate and support viable transport options for the Pa Enea.

The 2017/18 Budget will also see the management of the construction and implementation of our own submarine cable (in partnership with our neighbours), as well as telecommunication sector reforms. Moreover, we will build on our improvements in the use of ICT to conduct Government business. These efforts will again contribute to the accomplishment of NSDP Goal 6.

### **3.5 CONCLUSION**

The past five budgets have steered the Cook Islands on a pathway of development that we can be assured of a solid future for generations to come. Budget 2017/18 will continue our momentum towards the achievement of our national goals maximising benefits for our people through added value endeavours. This will be a budget of reflection and action through consolidating our efforts and ensuring that our finances will provide the future we want.

### 3.6 NSDP Goals

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

## 4 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 4.1 GFS Operating Statement**

Statement of Government Operations	2015/16 Actual	2016/17 HYEFU Estimate	2017/18 Projection	2018/19 Projection	2019/20 Projection
<b>REVENUE</b>	<b>170,595</b>	<b>215,988</b>	<b>186,365</b>	<b>163,552</b>	<b>153,547</b>
Taxes	116,270	117,503	119,336	121,363	122,965
Social contributions	(44)	75	75	75	75
Grants	28,161	73,120	41,390	16,293	4,687
Current	15,495	28,226	21,939	5,883	4,587
Capital	12,666	44,894	19,451	10,410	100
Other revenue	26,207	25,290	25,565	25,821	25,821
<b>EXPENSE</b>	<b>137,707</b>	<b>153,662</b>	<b>150,421</b>	<b>134,986</b>	<b>133,559</b>
Compensation of employees	51,654	52,590	52,459	51,091	51,082
Use of goods and services	34,684	50,323	44,251	31,515	30,083
Depreciation	9,056	9,985	11,606	11,712	11,712
Interest	2,571	1,710	1,696	1,688	1,688
Subsidies	11,258	14,708	16,458	15,708	15,708
Grants	-	-	-	-	-
Social benefits	17,408	17,903	18,231	17,763	17,927
Other expense	11,076	6,443	5,719	5,509	5,359
<b>NET OPERATING BALANCE</b>	<b>32,888</b>	<b>62,327</b>	<b>35,945</b>	<b>28,566</b>	<b>19,989</b>
<b>Plus NON CASH APPROPRIATIONS</b>					
Depreciation	9,056	9,985	11,606	11,712	11,712
<b>CASH SURPLUS/(DEFICIT) FROM OPERATING TRANSACTIONS</b>	<b>41,944</b>	<b>72,312</b>	<b>47,551</b>	<b>40,278</b>	<b>31,700</b>
<b>CASH TRANSACTIONS IN NONFINANCIAL ASSETS</b>					
Net Cash Applied to the Acquisition of Fixed Assets	25,808	81,568	53,884	18,860	6,018
Gross transactions in Non-Financial Assets	34,864	91,553	65,491	30,572	17,730
Less Non Cash Transactions in Non-Financial Assets (Depreciation)	(9,056)	(9,985)	(11,606)	(11,712)	(11,712)
<b>NET (BORROWING)/LENDING</b>	<b>16,136</b>	<b>(9,256)</b>	<b>(6,334)</b>	<b>21,418</b>	<b>25,682</b>
<b>CASH APPLIED TO THE NET ACQUISITION OF FINANCIAL ASSETS</b>	<b>11,543</b>	<b>(6,457)</b>	<b>(16,174)</b>	<b>11,518</b>	<b>16,213</b>
Domestic Transactions	11,543	(6,457)	(16,174)	11,518	16,213
Foreign Transactions	-	-	-	-	-
<b>CASH APPLIED TO THE NET INCURRENCE OF LIABILITIES</b>	<b>6,772</b>	<b>(4,329)</b>	<b>9,297</b>	<b>10,750</b>	<b>10,889</b>
Domestic Transactions	-	-	-	-	-
Foreign Transactions	6,772	(4,329)	9,297	10,750	10,889
<b>NET CASH FINANCING TRANSACTIONS</b>	<b>18,315</b>	<b>(10,786)</b>	<b>(6,876)</b>	<b>22,268</b>	<b>27,103</b>
<i>Statistical discrepancy with financial statements</i>	2,179	(1,529)	(543)	851	1,421

## **4.1 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 2016/17 is estimated to be a \$62.3 million.

Going forward, changes in expenditure and revenue estimates are predicted to result in a \$36.0 million operating balance in 2017/18, \$28.6 million in 2018/19, and \$20.0 million in 2019/20.

### **4.1.1 GFS Operating Revenue**

Operating revenues are made up of taxation receipts (64 per cent in 2015/16), grants from other governments (21 per cent) and other revenues, which include agency trading revenues, interest and dividend receipts (15 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 2016/17 Budget published in June 2016, GFS Operating revenues in 2016/17 were estimated to tally to \$203.4 million, of which \$109.6 million was expected to be collected in taxes.

Since June 2016, total movements in operating revenue have resulted in an upward revision of operating revenues by \$12.6 million to \$216.0 million, predominately due to increased tax revenue forecasts.

For the 2016/17 year, tax revenue is anticipated to be \$7.9 million higher than previously forecast, due to increased economic activity, and stronger collections than anticipated at Budget. The actual for 2015/16 reflects actual monies received that were not reported at the previous update.

### **4.1.2 GFS Operating Expenditure**

Operating expenditure is made up of compensation of employees (35 per cent in 2015/16), use of goods and services (30 per cent), social benefits (12 per cent), subsidies (8 per cent), depreciation (6 per cent), and other expenses including interest expenses (9 per cent).

Since the time of the Budget published in June 2016, total movements in operating expenditure have resulted in an upward revision of operating expenditure by \$4.1 million to \$153.6 million in 2016/17, due to policy decisions. This increase is, predominantly in goods and services which are mainly driven by an increase in the amount of funding available under the Core Sector Support agreement with New Zealand.

## **4.2 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 2016/17 and 2017/18. Total purchases of non-financial assets (excluding depreciation) is budgeted to be \$81.6 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 \$9.2 million in 2016/17. This requirement is serviced by a combination of cash and debt financing, with net cash transactions contributing \$5.6 million and net debt finance (new loans minus repayments) contributing \$4.3 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.

### 4.3 Classification of Functions of Government (COFOG)

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

The COFOG has 10 main functions at the highest level and 69 functions at the second (sub-functional) level. Table 4.2 classifies the Budget to the sub-functional level for both Cook Islands Government spending and ODA.

**Table 4.2 Classification of Functions of Cook Island Government 2016/17 HYEFU<sup>1</sup>**

Function of Government	2015/16 Actual	2016/17 HYEFU	2017/18 Projection	2018/19 Projection	2019/20 Projection
<b>Cook Islands Government (CIG)</b>					
<b>Expenditure</b>					
<b>General public services</b>	<b>35,362,464</b>	<b>35,996,016</b>	<b>36,249,011</b>	<b>31,771,253</b>	<b>31,137,961</b>
Executive and legislative organs, financial and fiscal affairs, external affairs	31,136,772	31,871,721	30,835,845	26,366,290	26,374,998
General services	1,316,376	1,433,168	2,733,360	2,733,360	2,733,360
General public services	338,152	981,077	983,727	983,310	341,310
Public debt transactions	2,571,164	1,710,050	1,696,078	1,688,293	1,688,293
<b>Public order and safety</b>	<b>5,647,757</b>	<b>5,864,757</b>	<b>5,723,357</b>	<b>5,751,691</b>	<b>5,601,691</b>
Police services	3,894,023	3,994,023	3,844,023	3,994,023	3,844,023

<sup>1</sup> Discrepancies from the 2016/17 Budget are due to the changes described in the Fiscal Update, and some technical adjustments to the classification



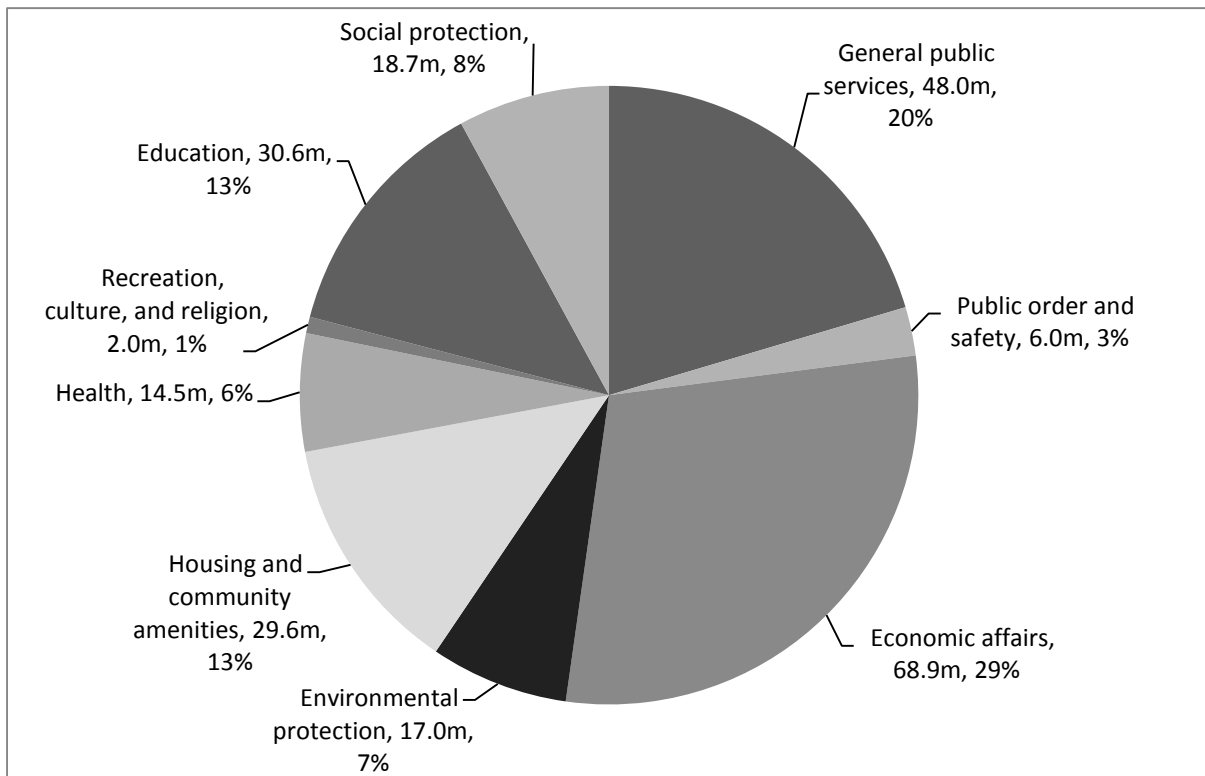
Function of Government	2015/16 Actual	2016/17 HYEFU	2017/18 Projection	2018/19 Projection	2019/20 Projection
Law courts	1,031,216	1,149,716	1,154,016	1,033,184	1,033,184
Prisons	722,518	721,018	725,318	724,484	724,484
<b>Economic affairs</b>	<b>34,770,215</b>	<b>50,568,734</b>	<b>40,865,458</b>	<b>38,235,288</b>	<b>38,081,187</b>
General economic, commercial, and labor affairs	8,827,369	9,595,178	10,885,070	10,758,069	10,758,069
Agriculture, forestry, fishing, and hunting	3,973,326	3,812,081	3,769,230	3,768,605	3,767,667
Fuel and energy	5,059,647	15,781,396	3,504,706	3,302,163	3,299,000
Mining, manufacturing, and construction	314,000	291,140	291,140	291,140	291,140
Transport	344,548	1,378,500	260,120	260,120	260,120
Tourism	16,021,227	19,480,339	21,925,092	19,625,092	19,475,092
Economic affairs n.e.c.	230,099	230,099	230,099	230,099	230,099
<b>Environmental protection</b>	<b>3,914,255</b>	<b>4,833,820</b>	<b>4,953,820</b>	<b>4,173,820</b>	<b>2,430,434</b>
Waste management	221,553	246,554	226,554	126,554	123,168
Waste water management	2,630,673	3,023,237	3,663,237	2,983,237	1,243,237
Protection of biodiversity and landscape	352,591	387,036	387,036	387,036	387,036
R&D Environmental protection	-	500,000	-	-	-
Environmental protection n.e.c.	709,438	676,993	676,993	676,993	676,993
<b>Housing and community amenities</b>	<b>12,583,641</b>	<b>19,678,831</b>	<b>30,853,117</b>	<b>10,004,115</b>	<b>9,752,896</b>
Community development	1,081,623	420,000	485,000	250,000	-
Water supply	2,108,805	8,725,975	21,509,080	2,484,885	2,484,885
Street lighting	-	63,000	-	-	-
Housing and community amenities n.e.c.	9,393,213	10,469,856	8,859,037	7,269,230	7,268,011
<b>Health</b>	<b>13,365,648</b>	<b>14,139,795</b>	<b>13,679,795</b>	<b>12,610,295</b>	<b>12,610,295</b>
Medical products, appliances, and equipment	2,198,153	1,962,300	1,802,300	1,492,800	1,492,800
Hospital services	8,274,859	8,890,237	8,590,237	7,830,237	7,830,237
Public health services	1,737,762	2,115,823	2,115,823	2,115,823	2,115,823
Health n.e.c.	1,154,874	1,171,435	1,171,435	1,171,435	1,171,435
<b>Recreation, culture, and religion</b>	<b>1,542,718</b>	<b>2,007,873</b>	<b>1,907,873</b>	<b>1,906,873</b>	<b>2,006,873</b>
Recreational and sporting services	321,181	419,335	319,335	319,335	419,335
Cultural services	1,221,537	1,588,538	1,588,538	1,587,538	1,587,538
<b>Education</b>	<b>19,121,153</b>	<b>19,801,554</b>	<b>19,305,939</b>	<b>14,984,539</b>	<b>14,989,539</b>
Pre-primary and primary education	75,713	384,000	-	-	-
Tertiary education	1,044,855	1,044,855	1,044,855	1,044,855	1,044,855
Education not definable by level	2,667,027	2,887,827	3,057,027	2,287,027	2,287,027
Education n.e.c.	15,333,557	15,484,872	15,204,057	11,652,657	11,657,657
<b>Social protection</b>	<b>17,678,792</b>	<b>17,851,266</b>	<b>18,010,092</b>	<b>18,171,637</b>	<b>18,335,941</b>
Sickness and disability	416,000	506,400	506,400	506,400	506,400
Old age	11,852,561	12,109,659	12,281,285	12,455,538	12,632,459
Family and children	3,341,286	3,393,307	3,380,032	3,366,824	3,353,682
Housing	87,210	79,200	79,200	79,200	79,200
Social exclusion n.e.c.	287,305	290,373	290,848	291,348	291,873
Social protection n.e.c.	1,694,430	1,472,327	1,472,327	1,472,327	1,472,327
<b>Total CIG Expenditure</b>	<b>143,986,64</b>	<b>170,742,64</b>	<b>171,548,46</b>	<b>137,609,51</b>	<b>134,946,81</b>
<b>Total CIG Expenditure</b>	<b>3</b>	<b>5</b>	<b>2</b>	<b>1</b>	<b>7</b>
<b>Official Development Assistance (ODA) Expenditure*</b>					
<b>General public services</b>	<b>4,244,773</b>	<b>12,021,285</b>	<b>8,521,989</b>	<b>3,751,366</b>	<b>3,607,766</b>
Executive and legislative organs, financial and fiscal affairs, external affairs	2,964,526	9,970,819	7,813,045	3,164,735	3,164,735
Foreign economic aid	1,280,247	1,999,371	708,944	586,630	443,030
General services	-	1,095	-	-	-
General public services	-	50,000	-	-	-
<b>Public order and safety</b>	<b>53,581</b>	<b>108,053</b>	-	-	-
Police services	53,581	-	-	-	-
Fire protection services	-	108,053	-	-	-
<b>Economic affairs</b>	<b>7,578,294</b>	<b>18,349,713</b>	<b>1,084,279</b>	<b>5,428,788</b>	<b>478,788</b>
Agriculture, forestry, fishing, and hunting	1,724,240	587,054	142,600	50,000	-
Fuel and energy	4,591,150	15,058,972	-	-	-

<b>Function of Government</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
	<b>Actual</b>	<b>HYEFU</b>	<b>Projection</b>	<b>Projection</b>	<b>Projection</b>
Mining, manufacturing, and construction	73,000	113,000	40,000	-	-
Transport	610,616	1,996,071	100,000	5,000,000	100,000
Hotel and Restaurants	347,288	307,692	305,344	303,030	303,030
Multi-purpose development projects	232,000	286,923	496,336	75,758	75,758
<b>Environmental protection</b>	<b>1,250,375</b>	<b>12,149,387</b>	<b>5,892,476</b>	<b>1,183,102</b>	<b>64,286</b>
Waste management	775,221	7,312,350	2,183,933	-	-
Waster water management	92,600	92,600	92,600	-	-
Pollution abatement	-	130,759	-	-	-
Protection of biodiversity and landscape	264,765	3,903,293	2,961,990	1,091,658	64,286
Environmental protection n.e.c.	117,790	710,385	653,953	91,444	-
<b>Housing and community amenities</b>	<b>4,759,256</b>	<b>9,964,560</b>	<b>6,223,779</b>	-	-
Housing development	146,500	146,578	-	-	-
Community development	-	-	3,400,000	-	-
Water supply	4,612,756	9,617,982	2,223,779	-	-
Housing and community amenities n.e.c.	-	200,000	600,000	-	-
<b>Health</b>	<b>130,483</b>	<b>362,513</b>	<b>43,937</b>	-	-
Outpatient services	-	11,025	-	-	-
Hospital services	7,438	-	-	-	-
Public health services	112,000	113,000	-	-	-
Health n.e.c.	11,045	238,488	43,937	-	-
<b>Education</b>	<b>295,878</b>	<b>10,755,748</b>	<b>10,515,000</b>	<b>5,410,000</b>	-
Pre-primary and primary education	-	4,765,000	4,765,000	5,410,000	-
Secondary education	200,000	5,750,000	5,750,000	-	-
Education not definable by level	-	90,748	-	-	-
Education n.e.c.	95,878	150,000	-	-	-
<b>Social protection</b>	<b>1,352,090</b>	<b>820,000</b>	<b>600,000</b>	<b>600,000</b>	<b>600,000</b>
Sickness and disability	72,050	100,000	-	-	-
Social protection n.e.c.	1,280,040	720,000	600,000	600,000	600,000
<b>Total ODA Expenditure</b>	<b>19,664,730</b>	<b>64,531,258</b>	<b>32,881,461</b>	<b>16,373,255</b>	<b>4,750,840</b>
	<b>163,651,37</b>	<b>235,273,90</b>	<b>204,429,92</b>	<b>153,982,76</b>	<b>139,697,65</b>
<b>TOTAL PUBLIC EXPENDITURE</b>	<b>3</b>	<b>3</b>	<b>3</b>	<b>6</b>	<b>7</b>

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

Chart 4.1 classifies the combined Cook Islands Government and ODA spending in the 2016/17 HYEFU at the 10 main functional levels.

**Chart 4.1 Classification of Functions of Cook Island Government 2016/17 HYEUFU**



Economic affairs is by far the largest area of total public expenditure at 29 per cent of the total spending, driven by tourism spending through the Cook Islands Government appropriation, and energy infrastructure in the ODA spend.

General public services is next, at around 20 per cent of total public spending, with the Cook Islands Government administration costs being the main driver.

Education is the third largest area of spending at 13 per cent, driven mainly by the Cook Islands Government's own expenditures, but also the construction activity by the Chinese and New Zealand Governments at Apii Nikao and Tereora respectively.

Other major areas of spending are housing and community amenities (which includes general community infrastructure) at 13 per cent, social protection (social welfare) at 8 per cent, and environmental protection at 7 per cent.

## 5 FISCAL UPDATE

**Table 5.1 Fiscal indicators table**

	2015/16 Actual	2016/17 Budget	2016/17 HYEFU	2017/18 Projection	2018/19 Projection	2019/20 Projection
<b>Statement of Financial Performance</b>						
Taxation Revenue (\$m)	116.3	109.6	117.5	119.3	121.4	123.0
Social Contributions (\$m)	0.0	0.1	0.1	0.1	0.1	0.1
Other Revenue (\$m)	33.8	33.1	33.9	34.1	25.8	25.8
<b>Total Operating Revenue (\$m)</b>	<b>150.0</b>	<b>142.8</b>	<b>151.4</b>	<b>153.6</b>	<b>147.3</b>	<b>148.9</b>
Total Operating Revenue Percentage of GDP	35.1	33.4	34.0	33.8	31.8	31.5
Tax Revenue Percentage of GDP	27.2	25.7	26.4	26.3	26.2	26.1
Total Structural Revenue Percentage of GDP	24.2	28.4	24.5	24.2	24.1	23.7
<b>Personnel (\$m)</b>	<b>50.8</b>	<b>53.3</b>	<b>53.3</b>	<b>53.2</b>	<b>51.7</b>	<b>51.7</b>
Percentage of Total Revenue	33.9	37.3	35.2	34.6	35.1	34.7
Percentage of Structural Revenue	40.4	44.0	42.0	41.1	42.0	41.3
<b>Total Operating Expenditure (\$m)</b>	<b>127.4</b>	<b>133.5</b>	<b>134.5</b>	<b>137.2</b>	<b>129.2</b>	<b>129.1</b>
Percentage of GDP	29.8	31.2	30.2	30.2	27.9	27.4
Percentage of Operating Revenue	85.0	93.5	88.8	89.3	87.7	86.7
<b>Operating Balance (\$m)</b>	<b>22.6</b>	<b>9.3</b>	<b>16.9</b>	<b>16.4</b>	<b>18.0</b>	<b>19.8</b>
Percentage of GDP	5.3	2.2	3.8	3.6	3.9	4.2
Capital Expenditure	13.1	36.7	36.7	34.4	8.5	5.9
Depreciation	8.9	10.1	10.1	11.7	11.8	11.8
<b>Fiscal Balance surplus/deficit (\$m) *</b>	<b>18.3</b>	<b>-17.3</b>	<b>-9.7</b>	<b>-6.4</b>	<b>21.4</b>	<b>25.6</b>
Percentage of GDP	4.3	-4.1	-2.2	-1.4	4.6	5.4
<b>Statement of Financial Position (\$m)</b>						
Assets (\$m)	611.5	711.5	696.6	736.7	764.1	776.4
Liabilities (\$m)	133.4	136.1	128.3	113.5	105.6	103.1
Crown Balance (\$m)	478.1	575.3	568.3	623.2	658.5	673.3
Percentage of GDP	111.7	134.6	127.5	137.2	142.2	142.7
Cash & Equivalents (\$m)	31.5	34.9	36.2	19.9	33.7	48.5
Cash & Equivalents (months coverage)	3.2	3.4	3.5	1.9	3.4	5.0
<b>Statement of Borrowings (\$m)</b>						
Gross Debt end of FY (\$m)	95.7	118.9	94.6	83.4	72.6	63.6
Percentage of GDP	22.4	27.8	21.2	18.4	15.7	13.5
Net Crown Debt, end of FY (\$m)	78.1	100.8	77.7	67.5	58.2	52.9
Percentage of GDP	18.3	23.6	17.4	14.8	12.6	11.2
Loan Repayment Reserves Held (\$m)	17.5	18.1	17.0	15.9	14.4	10.7
Net Debt Servicing (\$m)	7.3	7.7	9.0	9.1	9.1	8.7
Percentage of Total Revenue	4.9	5.4	6.0	5.9	6.2	5.8
Percentage of Structural Revenue	5.8	6.3	7.1	7.0	7.4	6.9
<b>Development Partner Support (\$m)</b>						
Grants (\$m)	29.6	60.7	64.5	32.8	16.3	4.7
Percentage of GDP	6.9	14.2	14.5	7.2	3.5	1.0
Memo item:Nominal GDP (\$m)	427.9	427.3	445.7	454.3	463.0	471.9

## 5.1 Overview

The purpose of the Fiscal Update is to provide revisions to the fiscal forecasts estimated at the time of the 2016/17 Budget (June 2016). 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 2016/17 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.

### 5.1.1 Movements from 2016/17 Budget

The following table shows the movements from the 2016/17 Budget to the 2016/17 HYEFU, which are explained in greater detail below.

**Table 5.2 Reconciliation of Operating Statement**

Reconciliation of Operating Revenue and Expense between 2016/17 Budget and 2016/17 HYEFU

	All Values (\$'000)			
Statement of Government Operations	2016/17	2017/18	2018/19	2019/20
<b>Operating balance as at 2016/17 Budget</b>	<b>9,262</b>	<b>7,780</b>	<b>11,685</b>	<b>14,474</b>
<b>Revenue</b>				
<b>Revenue Parameter Changes</b>	<b>7,869</b>	<b>7,672</b>	<b>6,430</b>	<b>5,373</b>
Adjustments to:				
Value Added Tax (VAT)	1,859	2,240	1,679	1,237
Income tax	-493	103	277	337
Import levies	2,904	2,919	3,037	2,943
Company tax	3,125	2,640	1,702	1,092
Departure tax	22	-231	-264	-236
Withholding tax	452	0	0	0
<b>Other Revenue Changes</b>	<b>799</b>	<b>1,000</b>	<b>0</b>	<b>0</b>
ROBOCs	-201	0	0	0
Trading Revenue	0	0	0	0
Transfer of PBBS Bonus payment into Core Support	1,000	1,000	0	0
<b>Total Revenue Changes to 2016/17 HYEFU</b>	<b>8,668</b>	<b>8,672</b>	<b>6,430</b>	<b>5,373</b>
<b>Expenditure</b>				
Expenditure Decisions by Government	1,033	73	73	73
Technical adjustments	0	0	0	0
Reclassifications of expenditure	0	0	0	0
Parameter changes	0	0	0	0
<b>Total Expenditure Changes to 2016/17 HYEFU</b>	<b>1,033</b>	<b>73</b>	<b>73</b>	<b>73</b>
<b>OPERATING BALANCE 2016/17 HYEFU Dec. 2016</b>	<b>16,897</b>	<b>16,379</b>	<b>18,042</b>	<b>19,774</b>
Capital Expenditure	36,673	34,433	8,450	5,918
Depreciation	10,065	11,679	11,784	11,784

<b>FISCAL BALANCE - 2016/17 HYEFU</b>	<b>-9,712</b>	<b>-6,375</b>	<b>21,376</b>	<b>25,640</b>
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### 5.1.2 Year to Date Assessment of revenues and expenditure patterns

Since the 2016/17 Budget published in June, the availability of new data in the first few months of 2016/17 has resulted in upward revisions to the revenue projections for 2016/17 and the outer years. In particular, higher than expected collections of Value Added Tax (VAT), company tax and import levies have caused the forecast for tax revenue to increase. In the 2016/17 Budget, the net operating surplus for 2016/17 was estimated to be \$9.3 million. For the 2016/17 financial year, tax revenue has been revised upward by \$7.9 million, predominately due to increases in forecasted VAT, company tax and import levies. Some changes to funding from New Zealand have also increase the revenue reported here (see below). The increase in revenue has been partially offset by some increased expenditure in 2016/17, with the overall result an expected net operating surplus of \$16.9 million at the 2016/17 HYEFU and \$16.4 million in the 2017/18 year, \$18.0 million surplus in 2018/19 and \$19.8 million surplus in 2019/2020.

Since the 2016/17 Budget, additional current expenditure has been committed towards a number of government priorities, with a total increase of \$1 million in current expenditure.

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

### 5.1.3 Changes to Revenue

At the 2016/17 HYEFU total operating revenue is estimated to reach \$151.4 million; consisting of \$117.5 million in tax revenue and \$33.9 million in non-tax revenue. These estimates include the impact of the following policy changes or initiatives committed to by Government in previous updates:

- five per cent indexation of the levies on tobacco, alcohol, and sweetened drinks;
- lowering the income tax rate for income between \$11,000 and \$30,000 from 18.5 per cent in 2015, and to 17.5 per cent from 1 January 2016;
- The Revenue on Behalf of Crown (ROBOC) estimates, include anticipated revenue from a fishing agreement with the European Union.

**Table 5.3 Parameter Changes to Tax Revenue (\$000)**

	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
VAT	1,859	2,240	1,679	1,237

	2016/17	2017/18	2018/19	2019/20
Income tax	-493	103	277	337
Company tax	3,125	2,640	1,702	1,092
Import levies	2,904	2,919	3,037	2,943
Withholding tax	452	0	0	0
Departure tax	22	-231	-264	-236
<b>Total Changes in Taxation</b>	<b>7,869</b>	<b>7,672</b>	<b>6,430</b>	<b>5,373</b>

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

Total taxation revenue parameter changes are reflected in the table above. Overall movements indicate that tax revenue will be increased substantially from the estimates in the 2016/17 Budget with an increase of \$7.7 million in the forecast for 2017/18.

Income tax was originally forecast at \$22.9 million for 2016/17. Due to lower than anticipated collections in the first quarter of the year, this forecast has been revised downward by \$0.5 million, with slightly higher forecasts in the outer years reflecting higher levels of economic activity, and thus, income.

Company tax has seen the largest upwards revision, with the 2016/17 forecast being increased by \$3.1 million relative to Budget, to reflect higher collections that are a result of the increased economic activity leading to greater profitability. Smaller, but still substantial, upward revisions are also made to the forecasts in the forward years.

As withholding tax is not forecast due to its volatility, receipts from this tax are simply recognised when they are collected, the \$0.5 million collected so far in 2016/17 is recognised here.

VAT is estimated to reach \$57.4 million for 2016/17, a \$1.9 million increase on the \$55.6 million estimated at the time of the 2016/17 budget. This is assumed due to the increase in economic activity with higher numbers of tourist arrivals.

The 2016/17 forecast of import and excise-equivalent duties have been revised upward by \$2.9 million to \$14.3 million. This reflects the strong growth in collections in the first four months of the 2016/17 year. Import levies are expected to decrease in the forward years, in line with the declining import forecasts.

Movements in other revenues:

- Fisheries Revenue is estimated to remain constant at \$10.2 million in 2016/17 and in the forward years. Fisheries revenue is composed of the revenue from both purse seine and long-line fishing, as well as Fishing Licences.
- Financial Services Levy is estimated to decrease to \$0.25 million in 2016/17, a \$0.04 million decrease on the \$0.29 million estimated budget.

- The FSC “Return of Excess” estimate has been revised down to zero, as there are less entities in the sector than anticipated. This is currently expected to be only a single year issue, and the forward years have been left consistent with budget.
- The 2016/17 Budget reported the potential for a \$1 million bonus payment under the terms of the Grant Funding Arrangement (GFA) with New Zealand (Performance Based Budget Support (PBBS)). As a replacement GFA is now in place (details below), this amount has been rolled into the core funding item, which appears as an increase to revenue of \$1 million.

#### **5.1.4 Changes to Expenditures**

Changes in expenditure are made up of two broad types of changes, parameter changes and policy changes. Parameter changes are the result of factors outside of the immediate control of the Government, whereas policy changes reflect the impact of the Government’s decisions, as well as technical and classification changes.

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

Following recent months there has been significant changes in expenditures predominantly expenditure decisions on behalf of the Government.

Since the 2016/17 budget, there has been additional expenditure approved for a number of government priorities, outlined below:

- \$72,000 for implementation of the Short Term Employment Permit Scheme for New Zealand passport holders (StepNZ).
- \$41,000 for an urgent procurement of Genset parts for the Atiu Power Supply.
- \$260,000 to transition the Social Impact Fund to Cook Islands Government funding, after the planned cessation of New Zealand funding.
- \$81,751 for the Serious Crime Investigations Administered Payment to cover unexpected costs associated with cases,
- US\$40,000 (approx. NZ\$56,658) for the technical assistance services provided by IMF-PFTAC
- \$20,000 for the under 20’s Cook Islands Rugby Team to attend the Oceania Rugby under 20’s Trophy Tournament in Fiji
- \$50,000 for the Miss Cook Islands Association



- \$330,000 for Government to continue meeting their obligation and engagements relating to travel and other costs associated with parliamentarians.
- \$10,239 to meet the needs of providing small capital equipment (including vehicles) for government in the 2016/17 year

Under the 2015/16 GFA (known as Performance Based Budget Support) with New Zealand, a significant amount of assistance from New Zealand was incorporated into the budget as budget support, utilising and strengthening the Cook Islands Government systems. As the negotiations surrounding the new GFA (titled Core Sector Support) were ongoing at the time of the 2016/17 Budget, the funding amounts from 2015/16 were assumed to carry on in 2016/17 and 2017/18. Now that the Core Sector Support Agreement has been signed, these amounts can be updated in the 2016/17 HYEPU. Additional funding of \$1.9 million (when compared to the performance bonus-inclusive amount of \$8.6 million) is being provided by New Zealand under this new GFA however some changes to the nature of the funding mean how this is treated for budget and accounting purposes will change as well. For the purposes of the 2016/17 HYEPU, the additional funding is considered to be Official Development Assistance (ODA), with the assumed levels of funding, which have been used in determining ministry appropriations remaining in CIG funding. This has also meant the previously separately reported \$1 million performance incentive bonus is now reported as part of the \$8.6 million. At the 2017/18 Budget, all of this funding will be reported as ODA. These funds will continuously be injected into key areas such as education, health, tourism development and strengthening public financial management and the overall public sector.

### 5.1.5 Core Sector Support Funding

The Core Sector Support (CSS) arrangement with New Zealand replaces the previous Performance Based Budget Support arrangement, and provides \$10.5 million in core funding for each of 2016/17 and 2017/18. The breakdown of how this funding is spent are described in the table below.

**Table 5.4 Core Sector Support**

	2016/17 Budget	2017/18 Budget
<b>Funding received under CSS</b>	<b>10,475,500</b>	<b>10,475,500</b>
Ministry of Health	1,250,000	1,250,000
Ministry of Education <sup>2</sup>	3,980,400	3,980,400
Tourism Corporation	2,500,000	2,500,000
Public Sector Strengthening/Technical Assistance Fund	2,745,100	2,745,100
<b>Total Expenditure from PBBS Funding</b>	<b>10,475,500</b>	<b>10,475,500</b>

<sup>2</sup> The 2016/17 Budget assumed funding of \$4.060 million and \$4.230 million for the Ministry of Education in 2016/17 and 2017/18, respectively. To reach these amounts, the gap between that paid by New Zealand, and that indicated in the Budget will be funded by the Cook Islands Government.

### **5.1.6 Updated economic and revenue forecasts**

Due to a combination of upgrades to economic forecasts and strong collections for VAT, Company tax and import levies in the first few months of the year, tax revenue for 2016/17 has been revised upward, despite being partially offset by small downward revisions to forecast collections across the other taxes. Improved economic conditions forecast for the later years, predominately due to higher numbers of tourists, result in higher revenue forecasts over the budget period.

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

- 7.8 per cent growth in 2015/16 (previously 5.4 per cent) due to the increase in visitor arrivals.
- 4.1 per cent growth in 2016/17 (previously 2.1 per cent growth) due to continued strong growth in tourism, as well as large capital expenditure.
- 1.9 per cent growth in 2017/18 (previously 1.8 per cent) due to continued growth in tourism, and capital investments likely to slip into future years.

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

Total Crown debt is denominated in foreign currencies for the 2016/17 HYEPU, consisting of the New Zealand Dollar (NZD – 42%), followed by the Chinese Renminbi (RMB - 29 per cent), the Special Drawing Right (SDR - 28 per cent), and Euro (EUR - 1 per cent). The NZD appreciated against all major currencies in which Government debt is denominated.

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 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.

## 5.2 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.

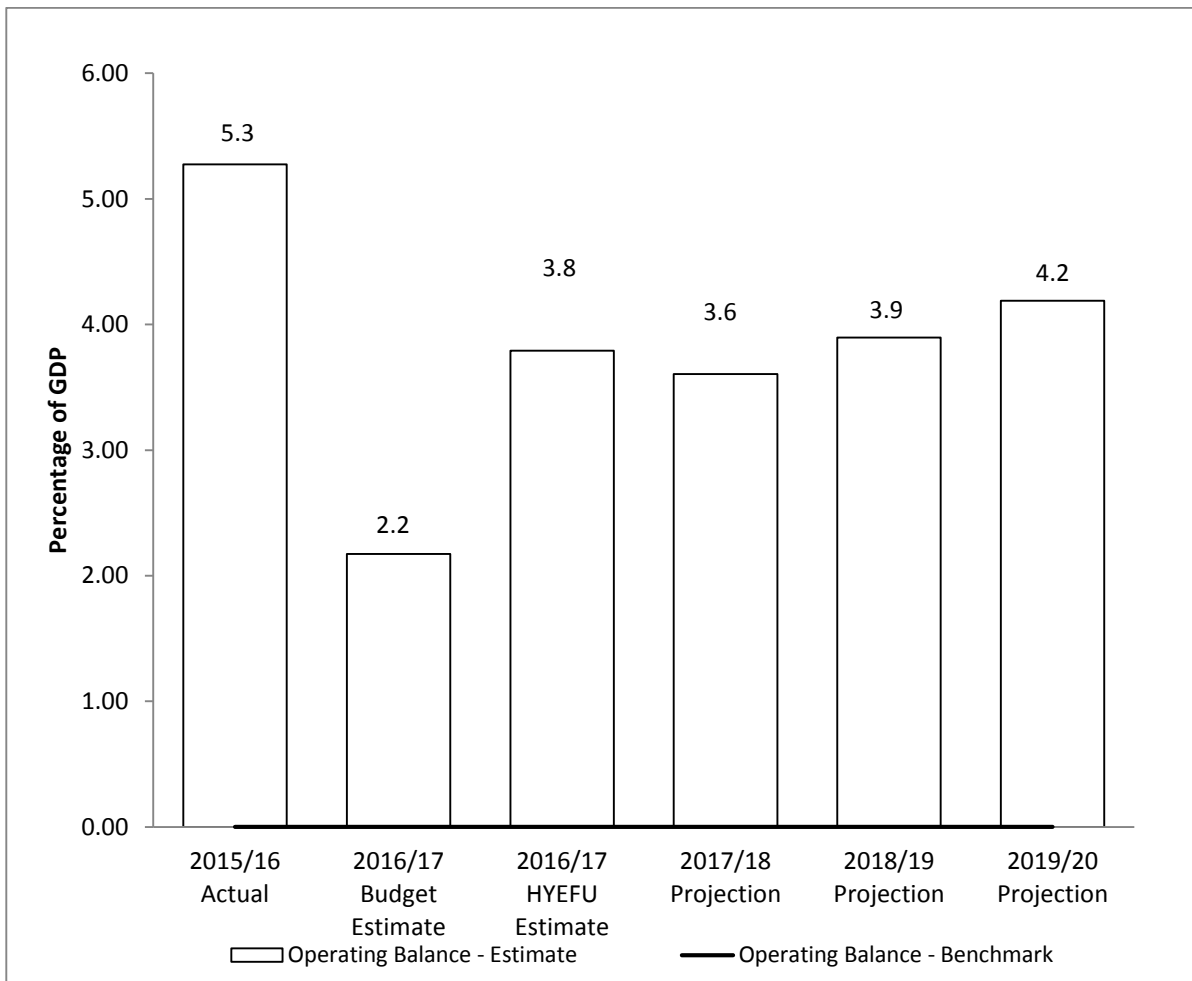
The Ministry of Finance and Economic Management (MFEM) quantifies these principles through the Fiscal Responsibility Ratios (FRR) as reported in the 2016/17 Budget. The current performance, and expected performance, of each of the FRR's are discussed below.

### 5.2.1 Net Operating Balance

Maintaining a positive operating balance indicates that Government is able to afford the operational costs of performing the functions of government from its own revenue streams. The Government has set a benchmark of running an operating surplus in each Budget. As illustrated below, it is anticipated that Government has an operating surplus of \$16.9 million for 2016/17, which is equivalent to 3.8 per cent of GDP.

Going forward, changes in expenditure and revenue estimates are predicted to result in an operating surplus of 3.6 per cent of GDP in 2017/18, followed by surpluses of 3.9 per cent and 4.2 per cent, respectively in 2018/19 and 2019/20.

**Chart 5.1 Operating Balance 2015/16 to 2019/20**



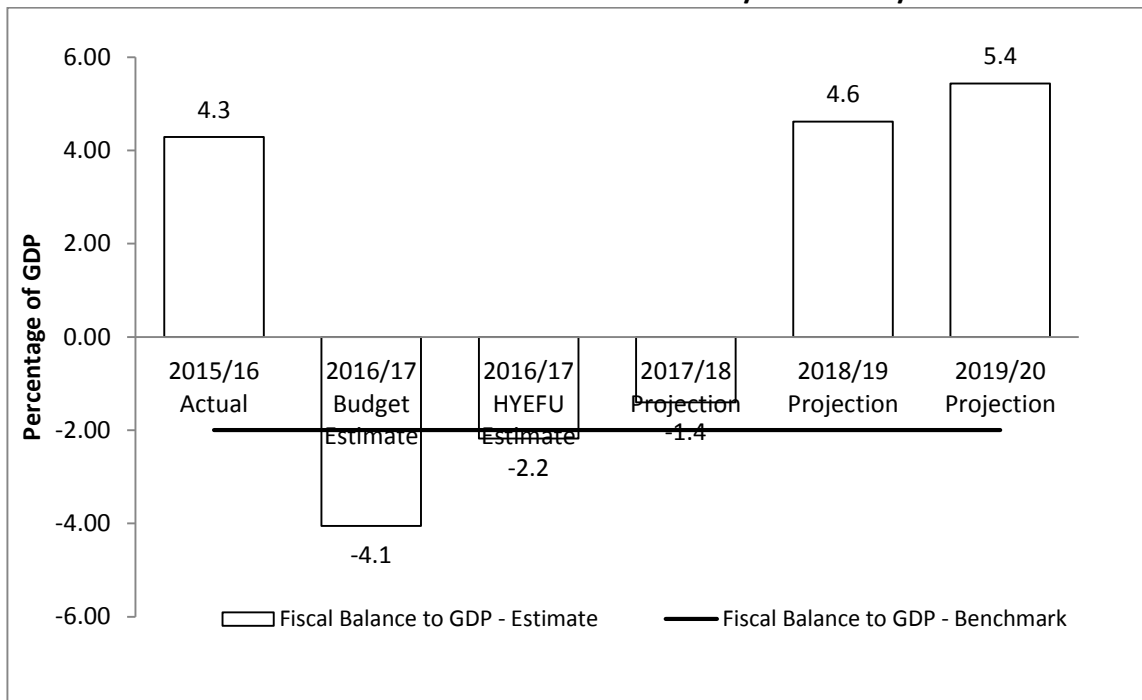
**5.2.2 Fiscal Balance to GDP**

The Fiscal Balance is the operating balance less net capital expenditure (total capital expenditure less depreciation). Where the fiscal balance is in deficit, it must be serviced through lending or a drawdown of reserve funds. The benchmark is set to be maintained within +/-2 per cent of GDP to ensure that government does not accumulate debt too quickly, and taken together with the debt servicing to total revenue and net debt to GDP ratios, ensures that debt is managed and taken on within sustainable levels.

As the chart below illustrates, the Government breaches the fiscal 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 declining fiscal deficits from

2016/17, and fiscal surpluses from 2018/19. However, with significant capital investment projects on the horizon, additional expenditure will occur in these years<sup>3</sup>.

**Chart 5.2 Fiscal Balance to GDP 2015/16 to 2019/20**

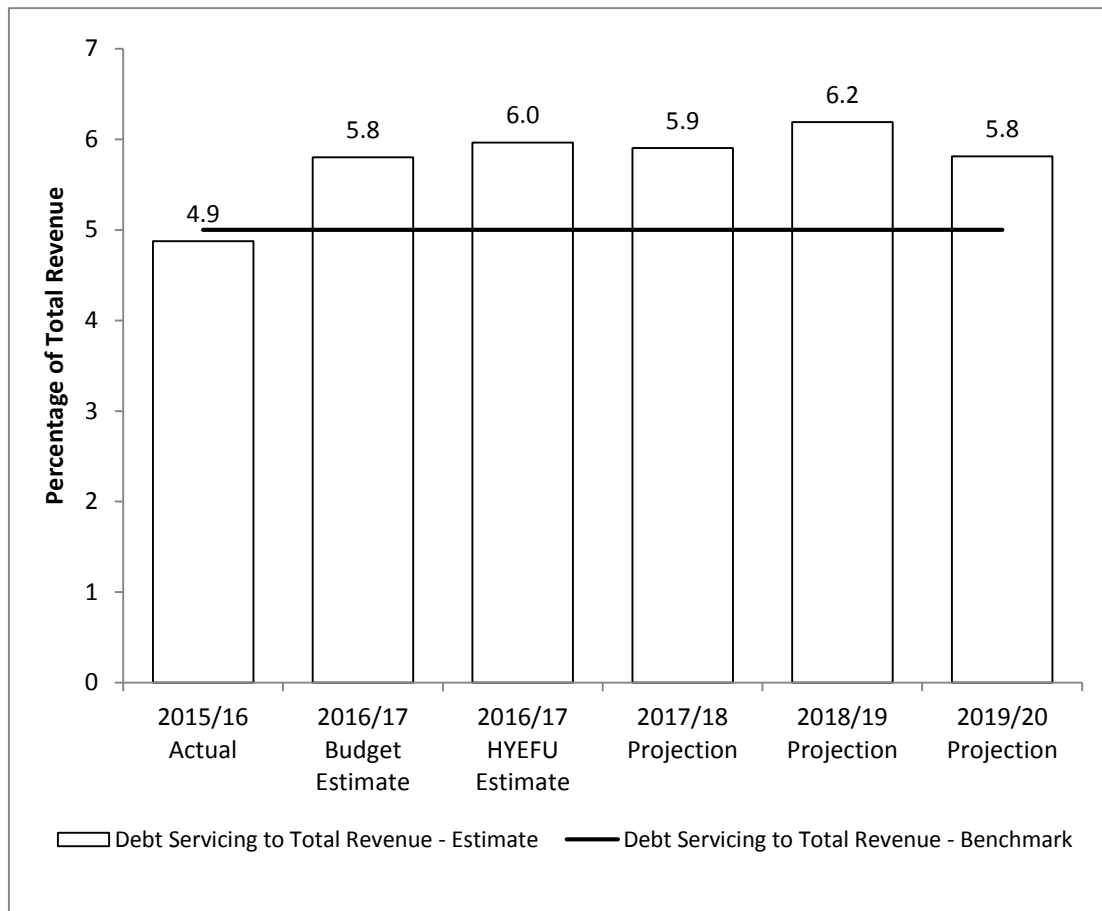


### 5.2.3 Debt Servicing to Revenue

Debt servicing to total revenue measures the ability of Government to service its debt obligations from revenue collected. Debt servicing includes both interest and principle. The figure shown below represents the debt servicing payment going out of the Loan Repayment Fund (LRF), minus any interest earnings of the LRF (rather than the amount paid into the LRF in the specified year). The ratio of debt servicing over the short to medium term is breached from 2016/17 onward. Further details around debt sustainability can be found in the debt section below.

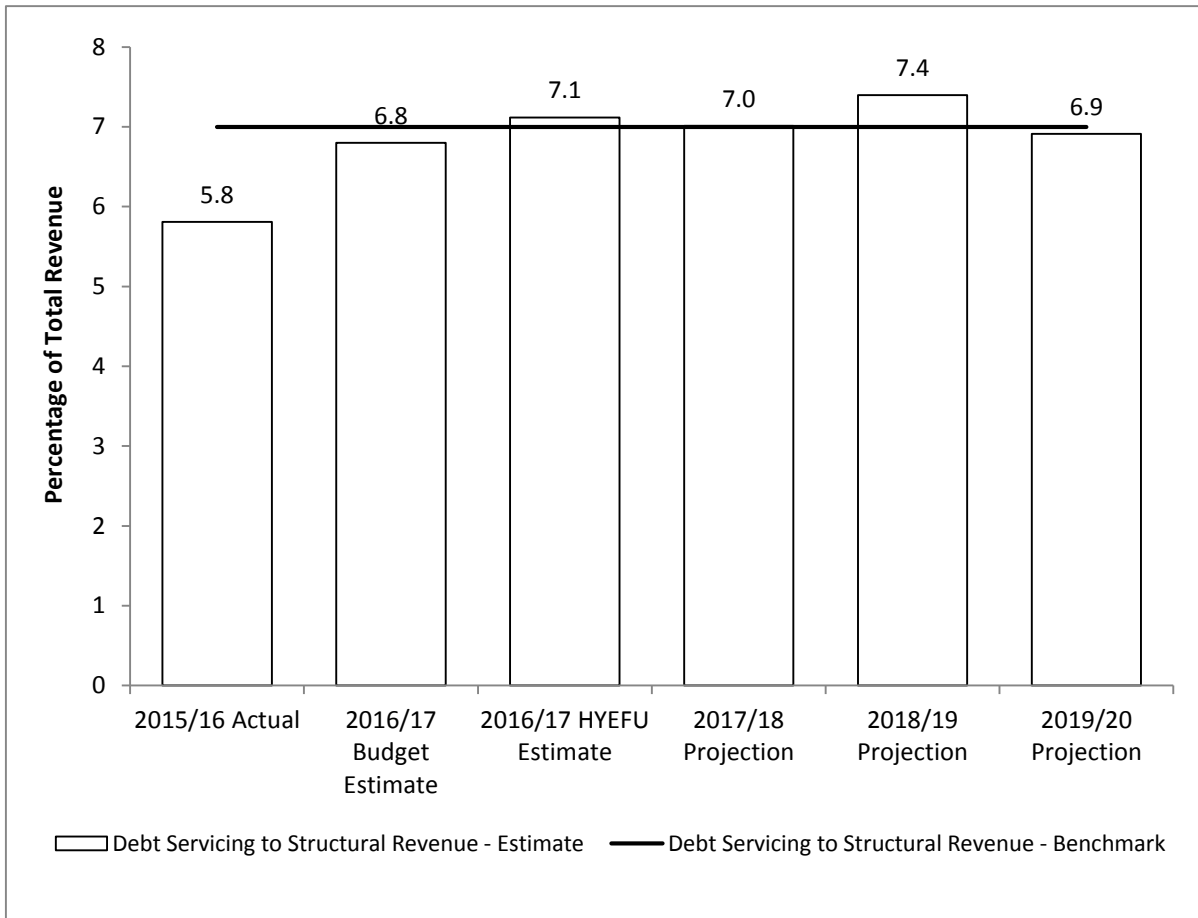
<sup>3</sup> Projects such as the Pacific Connectivity Project (submarine cable) and Sanitation were not finalised at the time of compilation.

**Chart 5.3 Debt Servicing to Revenue 2015/16 to 2019/20**



As with personnel spending above, it is useful to compare debt servicing with structural revenue to form an opinion of government’s ability to meet debt obligations in the longer term. This is displayed below, using the same structural revenue definition as above. When considering debt servicing to structural revenue we must adjust the benchmark level, as structural revenue is, by definition, smaller than total revenue.

**Chart 5.4 Debt Servicing to Structural Revenue**

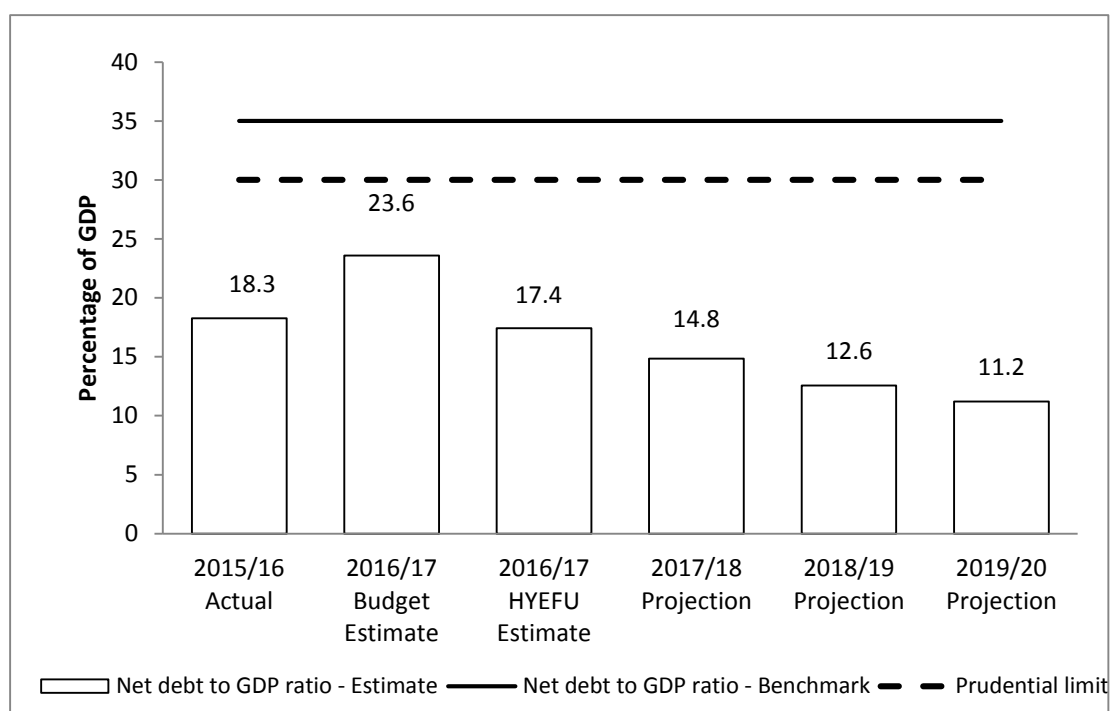


**5.2.4 Net Debt to GDP**

Net debt (taken here to be gross debt obligations, net of the funds in the LRF) to GDP measures the level of debt relative to national income, and is intended to control the overall level of debt taken on by Government including SOE’s. The limit agreed to by Government is to maintain net debt within 35 per cent of GDP. This would represent total borrowings of approximately \$156 million estimated in 2016/17. The Government is well within the net debt benchmark over the short and medium term.

Shown in the graph below is also a 30 per cent debt target that the Government is committed to staying below (this would be equivalent to approximately \$133 million). This ensures that there is at least 5 per cent of GDP available in debt financing should there ever be a major economic or natural disaster before the Government breaches the voluntary debt limit. In November 2016, the Government signed a contingent loan facility with the ADB, which provides up to \$13.95 million by way of a loan in the event of a natural disaster for this purpose.

**Chart 5.5 Net Debt to GDP Ratio 2015/16 to 2019/20<sup>4</sup>**



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 \$72.2 million or 16.2 per cent of GDP in 2016/17.

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 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.

<sup>4</sup> The significant change from the 2016/17 Budget is partially due to some technical corrections in the calculation of debt



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

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

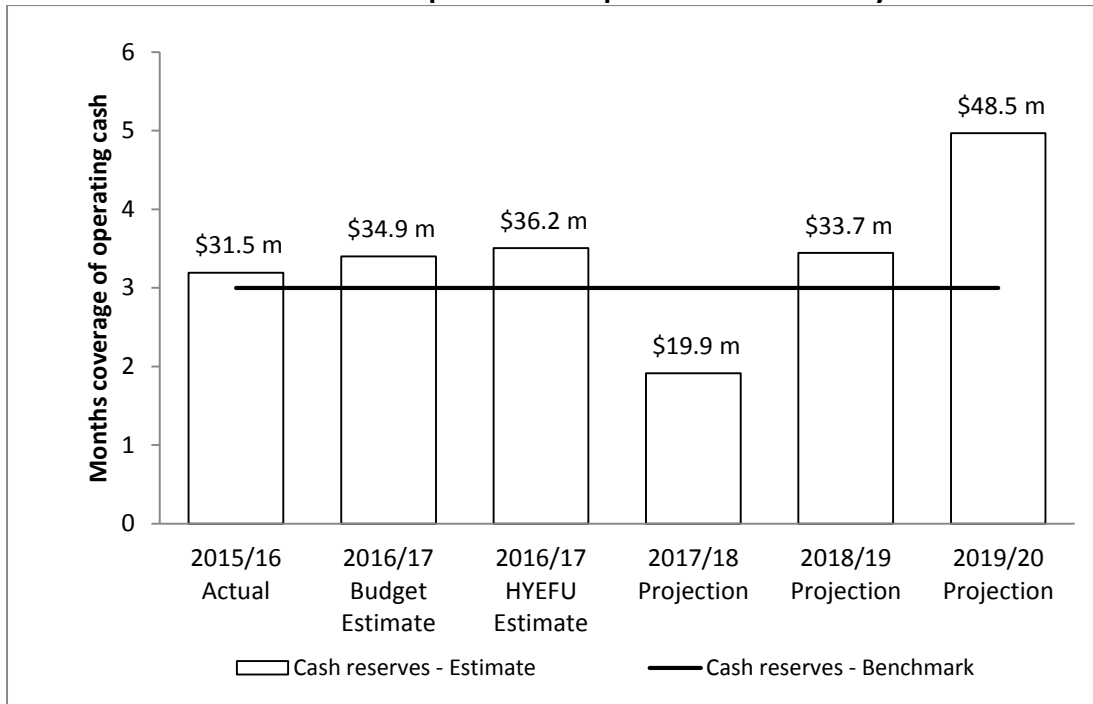
The LRF Act 2014 requires MFEM to analyse and report to the Parliament and the public on the impact of new borrowing in the context of Government lending policy, including the amortisation schedule, the impact on debt service burden of the government over the life of the loan, and an assessment of the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

#### **5.2.5 Cash reserves**

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

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

**Chart 5.6 Months of Operational Expenditure covered by Cash Reserves**



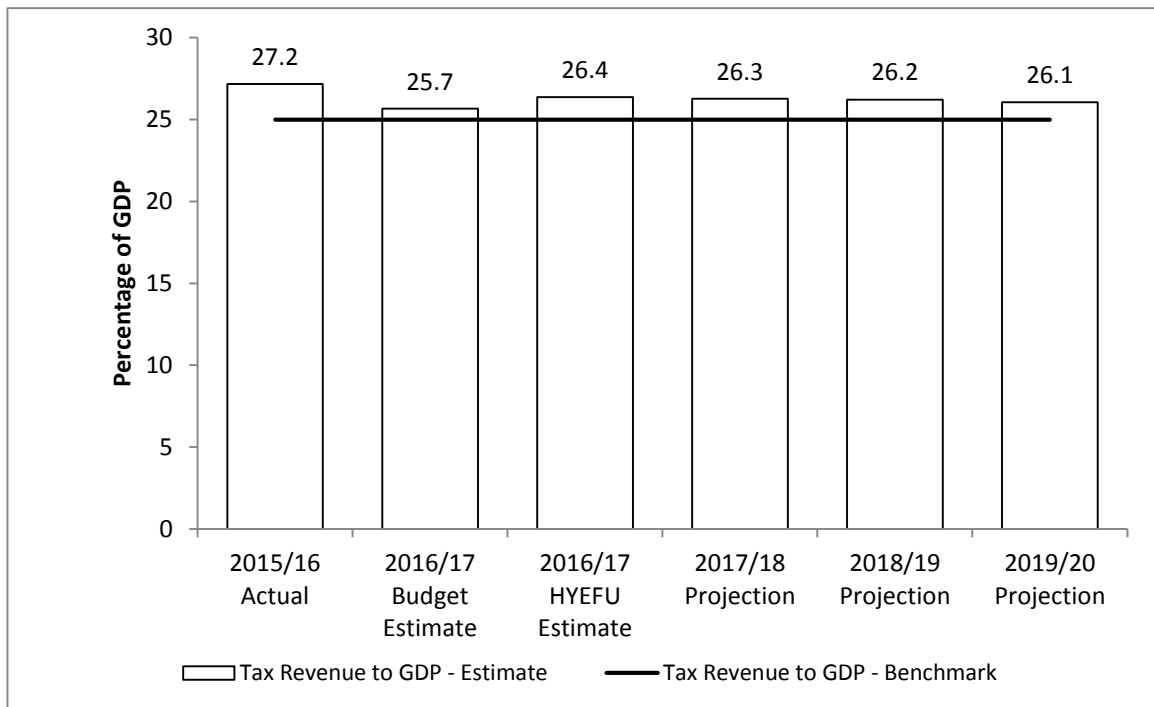
**5.2.6 Tax Revenue to GDP**

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

Current forecasts estimate that the Government is forecast to exceed the benchmark by a small margin (26.4 per cent in 2016/17) and will remain slightly above the target going forward.

However, the Government intends to further lower income taxes for the lowest-earning bracket of taxpayers, keeping the effective tax rate close to the 25 per cent target.

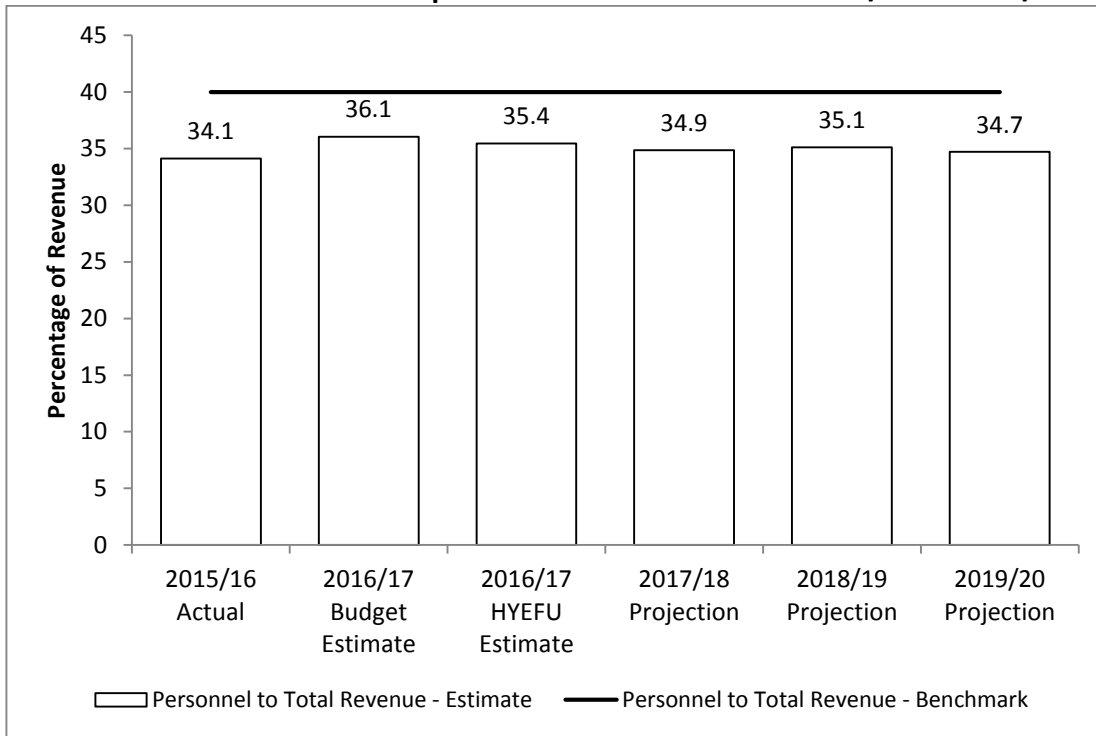
**Chart 5.7 Tax Revenue to GDP 2015/16 to 2019/20**



**5.2.7 Personnel Expenditure to Revenue**

This ratio is aimed at controlling the expansion in the size of the public sector. The benchmark that current and previous governments agreed to work within is maintaining the expenditure on personnel within 40 per cent of total revenues. As is illustrated in Chart 4.8 below, currently this target is being achieved.

**Chart 5.8 Personnel Expenditure to Total Revenue 2015/16 to 2019/20**

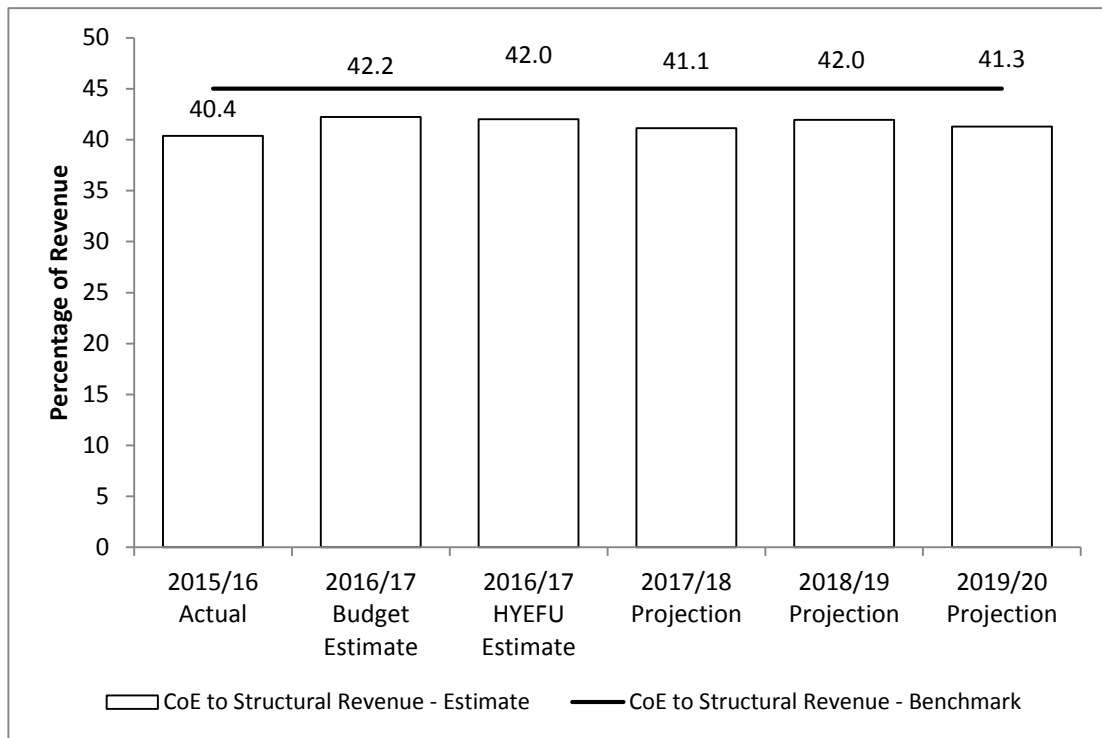


However, as personnel spending is a structural spending component, and some of the revenue included in the ratio for Chart 5.8 is not structural in nature, it is useful to consider the ratio shown in Chart 5.9 as well. This ratio compares total ‘Compensation of Employees’ (a Government Financial Statistics measure of personnel expenditure, which includes personnel funded through Administered Payments and POBOCs) with structural revenue to indicate the level of personnel spending as a proportion of structural revenue<sup>5</sup>.

**Chart 5.9 Compensation of Employees to Structural Revenue - Estimate 2015/16 to**

<sup>5</sup> 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.

### 2019/20



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 5.9 offers a different perspective on the challenge of maintaining fiscal sustainability, with a benchmark ratio of 45 per cent used as an indicator.

### 5.3 Assumptions underlying the fiscal projections

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

- Operating Revenues are forecasted on the basis of recent trends in economic activity as well as one off considerations.
- GDP data is updated to March 2016 (provisional estimates) and trade data is updated to the March quarter 2016; 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 2016.
- Nominal GDP is expected to grow by:
  - 7.8 per cent in 2015/16
  - 4.1 per cent in 2016/17
  - 1.9 per cent in 2017/18
  - 1.9 per cent in 2018/19
  - 1.9 per cent in 2019/20
- The general model used to forecast nominal economic growth is based on the expenditure national accounting measure and uses estimates of public sector consumption and investment (including aid assistance), net merchandise trade, total tourism spending, domestic investment, and domestic consumption.
  - Tourism expenditure is the largest single component of the forecasts, and is based on:
    - Average stays of 8.5 days for New Zealand arrivals, 9.0 for Australia, 8.3 for USA, 10.1 for Canada, 8.8 for Europe (including the UK), 6.7 for Asia, and 10.3 for other – an overall average of around 8.5 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 240 per day, which is estimated from quarterly visitor surveys and a CPI indexation of a basket of tourist services.
  - Public consumption is the second largest single item and is estimated based on the personnel and operating appropriation for both Government and aid spending. Public investment is also a significant component of the model, and is estimated based on capital plans (including ODA investment), for which a realisation (or completion) rate is applied to capital projects to allow for project slippage from one year to the next, and issues of capacity. This is based around the total capital projects over the period, smoothed to follow an estimated profile based on historical realization rates around 40%.

- Government consumption expenditure is based on the Operating Estimates for 2015/16, Appropriation for 2016/17, and existing government policy, and is expected to grow as follows:
  - -5.5 per cent in 2015/16
  - 3.7 per cent in 2016/17
  - 1.5 per cent in 2017/18
  - -1.9 per cent in 2018/19
  - 0.7 per cent in 2019/20
- Domestic (private) consumption is the next largest single item and is estimated based on consumption patterns as observed through the VAT series, along with expected inflation and population changes. The methodology derives a “consumption per head per day” metric and scales back to the full population.
- Growth in prices measured through movements in the Consumer Price Index are projected based on global commodity prices and exchange rate movements as forecast by the IMF and World Bank (used to construct a ‘Tradeables’ series), as well as historical trends for non-tradable components of the CPI basket. Growth in the CPI has been, and is expected to be:
  - -0.05 per cent in 2015/16
  - 1.7 per cent in 2016/17
  - 1.5 per cent in 2017/18
  - 1.7 per cent in 2018/19
  - 1.6 per cent in 2019/20
- 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.

## 6 ECONOMIC UPDATE

### 6.1 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 Island's 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 growth from 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).



The outlook for global economic growth remains modest, but positive, according to the October 2016 World Economic Outlook published by the International Monetary Fund (IMF). Growth is projected to total 3.1 per cent for 2016, before improving slightly to 3.4 per cent in 2017. The subdued outlook for growth strengthens the expectation that global monetary policy will remain accommodative for the longer term. On the back of this, financial market sentiment towards emerging market economies has improved. Concerns about China's near term prospects have reduced due to policy action from the Chinese government. Commodity prices also expected to firm somewhat, after a period of weakened prices. However, prospects differ across countries and regions, with Asia and India, in particular, showing robust growth. In advanced countries, political discontent may be fuelled by continued uncertainty and increase the focus towards anti-integration policies.

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 2016/17. 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) and may explain the low inflation experienced recently. A recent decision by the Organisation of the Petroleum Exporting Countries (OPEC) to reduce production to raise prices will have an impact on global fuel prices. However, the real impact of that decision will take some time to filter through.

Since the 2016/17 Budget, total tourism arrivals for the first quarter of the 2016/17 financial year have continued to display impressive growth. Growth in this quarter was driven primarily by strong arrivals out of New Zealand. It remains to be seen whether the very high visitor numbers over the last 18 months are part of a longer term trend or a short lived, upward deviation from underlying growth due to some outside factor. Overall, the continued growth has led to an upward revision to forecast tourist arrivals for the remainder of 2016/17.

The latest provisional estimates for nominal GDP (which includes inflation) estimate an increase of 7.8 per cent for 2015/16. Nominal growth of 4.1 per cent is expected in 2016/17, due to continuously strong tourism growth, with support from government capital projects and a slight reduction in imports. Forecasted growth in the outer years slows to 1.9 per cent in 2017/18 and thereafter, but continues to be positive due to continued growth in tourism arrivals, albeit at a lower rate. As prices in the economy (as measured by the GDP deflator) declined in 2015/16, Real GDP (removing the impact of inflation) grew by 9.0 per cent – a stronger rate than Nominal GDP. Going forward, inflationary pressures are forecasted to be relatively weak and Real GDP is expected to grow at a robust 3.5 per cent in 2016/17.

Tourist growth has been revised upward from the forecasts at the 2016/17 Budget due to higher than anticipated arrivals from most source markets. This increases pressure on the capacity constraints, although the industry has shown some resilience in providing increased capacity. Growth in visitor arrivals is expected to remain strong from the 11 per cent experienced in 2015/16, to total an estimated a 6.2 per cent in 2016/17, due mainly to

stronger growth out of New Zealand and a recovery in the numbers of Australian tourists. The forecast for the outer years remains at high levels, though the growth rates slow somewhat as a result of these high levels, to between 1.3 and 1.8 per cent per annum.

Inflation as measured by the Cook Islands Consumer Price Index (CPI) remained relatively unchanged in 2015/16, due mainly to depressed global commodity prices, especially oil. Inflation is expected to increase modestly to average around 1.5 to 1.7 per cent per annum over of the remainder of the period from 2016/17 to 2019/20.

**Table 6.1 Summary of Economic Indicators**

	2015/16 Actual	2016/17 Estimate	2017/18 Projection	2018/19 Projection	2019/20 Projection
<b>Economic Activity</b>					
Nominal GDP (\$'000)	427,901	445,652	454,257	462,951	471,909
<i>Percentage change (YOY)</i>	7.8	4.1	1.9	1.9	1.9
Real GDP (at Constant 2006 Prices, \$'000)	339,576	351,337	355,103	356,873	358,779
<i>Percentage change (YOY)</i>	9.0	3.5	1.1	0.5	0.5
<b>Inflation</b>					
<i>Percentage change (YOY)</i>	-0.1	1.7	1.5	1.7	1.6
<b>Construction/Capital Investment</b>					
Commercial Building Approvals (\$'000)	3,554	3,554	3,554	3,554	3,554
Residential Building Approvals (\$'000)	5,605	5,395	5,192	4,997	4,810
Public Works (\$'000) (includes Dev Partners)	22,446	21,470	16,591	12,687	17,914
<b>Productive Sector Indicators</b>					
Visitor Arrivals	135,136	143,552	145,423	148,073	150,431
<i>Percentage change (YOY)</i>	11.0	6.2	1.3	1.8	1.6
Estimated Visitor Expenditures (\$'000)	283,222	298,225	306,426	317,168	327,139
Pearl Exports (\$'000)	301	301	301	301	301
Fish Exports (\$'000)	18,184	18,184	18,184	18,184	18,184
<b>External Sector</b>					
Merchandise Trade Balance (\$'000)	(131,666)	(132,143)	(130,196)	(128,403)	(131,983)
Services Trade Balance (\$'000)	283,222	298,225	306,426	317,168	327,139
Exchange Rate (USD/NZD Average)	0.6640	0.6800	0.6600	0.6600	0.6600
<b>Financial Sector (at end of financial year)</b>					
Government Net Debt Position (\$'000)	74,694	98,533	103,113	94,205	85,531
Private and Public Enterprise Deposits (\$'000)*	0	-	-	-	-
Private and Public Enterprise Loans (\$'000)*	0	-	-	-	-

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

## 6.2 Gross Domestic Product (GDP)

Real GDP (removing the impact of inflation) is estimated to have grown by 9.0 percent in 2015/16.

This growth has been primarily driven by the boom in tourism numbers to the Cook Islands, with arrivals increasing by 11 per cent during the year, with support from government capital spending. From 2016/17 onward, the key driver of economic growth will remain the tourism industry, though this is anticipated to be supported by capital investment, as the Cook Islands Government, along with development partners, invests in several key projects.

Nominal GDP is estimated to have grown by 7.8 per cent during 2015/16. The difference from the Real GDP growth rate is due to weak inflation resulting in the reduction of the cost of transport (including fuel) and other areas of the economy. Over the forecast years, nominal GDP growth is projected to continue growing strongly by 4.1 per cent in 2016/17 due to strong visitor arrivals and technical assumptions around the capacity constraints of capital investment. Capital investment planned for 2015/16 has been carried into 2016/17. Also, as 2016/17 will carry more investment projects than originally planned, there is a distinct likelihood of some projects being pushed into 2017/18 as capacity constraints dictate.

**Table 6.2 GDP growth revisions**

	2015/16		2016/17		2017/18	
	2016/17	2016/17	2016/17	2016/17	2016/17	2016/17
	Budget	HYEFU	Budget	HYEFU	Budget	HYEFU
Nominal GDP growth (per cent)	5.4	7.8	2.1	4.1	1.8	1.9
Real GDP growth (per cent)	6.2	9.0	1.6	3.5	0.8	0.7
Implicit GDP deflator (percentage change)	-0.8	-2.1	0.5	0.2	0.9	1.1

Real GDP is forecast to follow a similar pattern to nominal growth, as inflationary pressures continue to be low. Real GDP is expected to grow by 3.5 percent by 2016/17, mirroring nominal growth over the same period, less modest price growth.

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

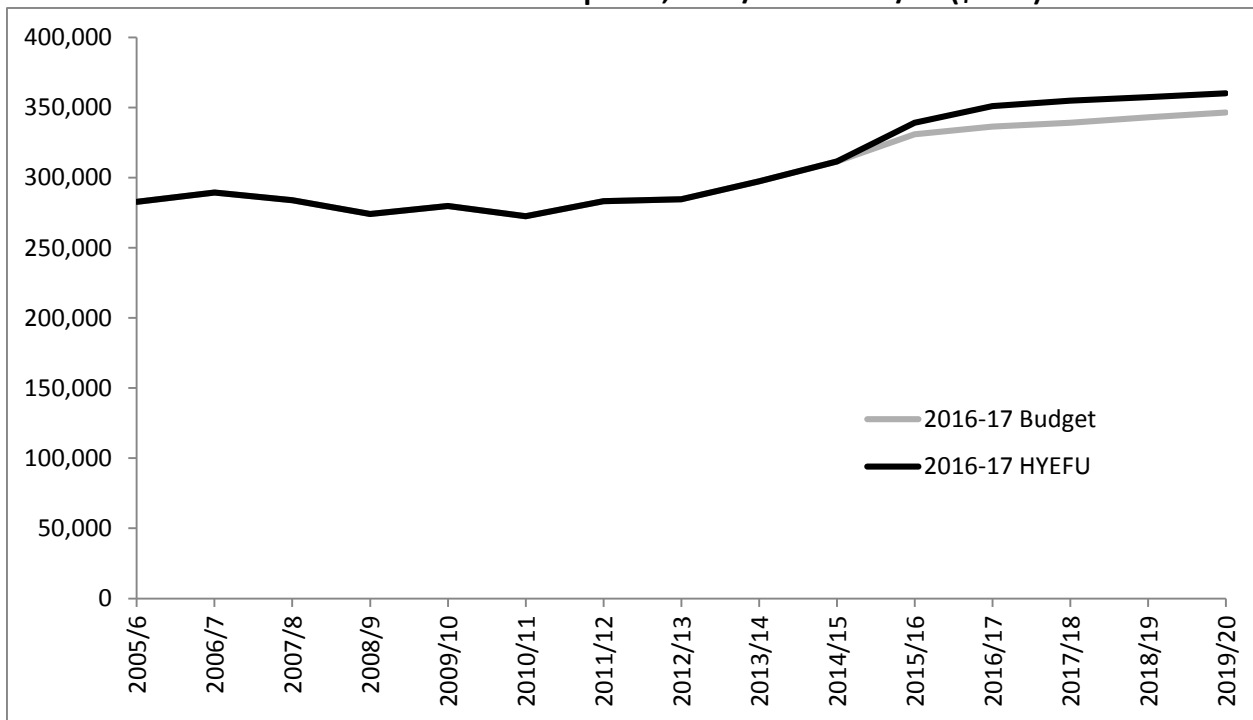
- poor budget execution of the public sector capital investment planned across the Cook Islands – in particular, any unexpected delays in the implementation of the large capital projects planned over the short term;
- the preferences of New Zealand and Australian tourists moving towards other competing 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). Recent developments regarding oil prices may have a detrimental effect in this respect; and
- Any significant reductions in projected assistance from development partners.

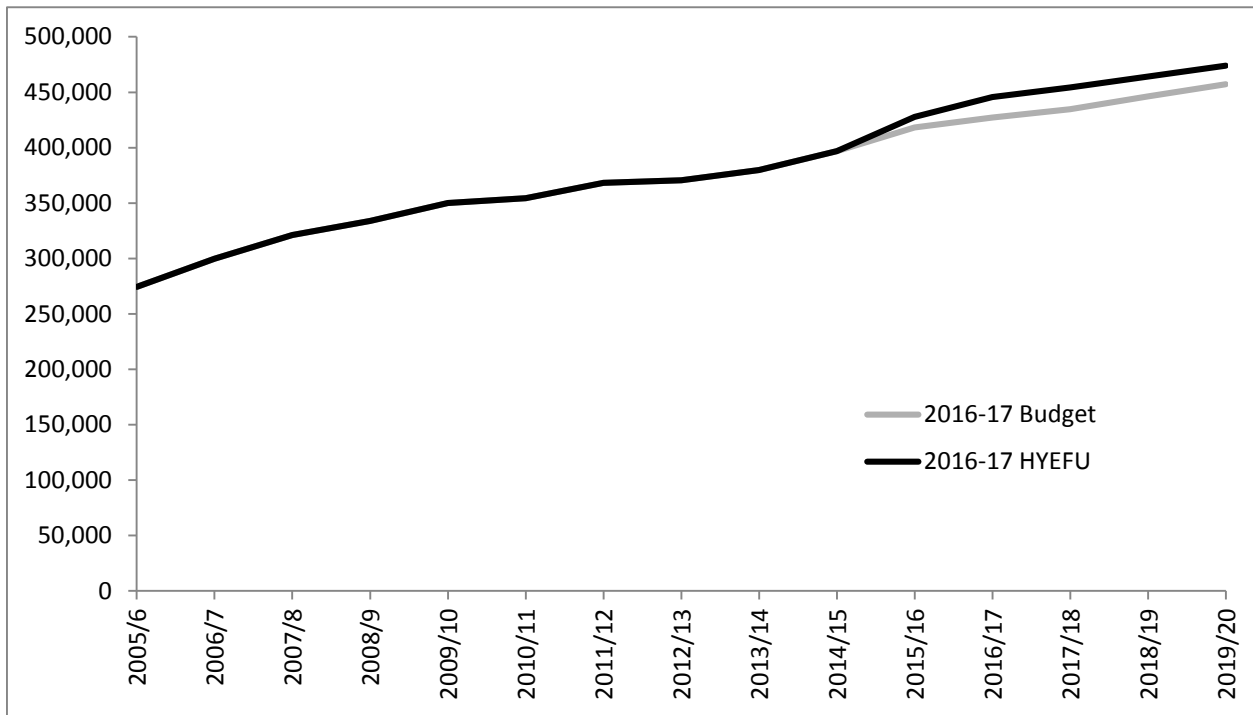
On the upside, key risks are:

- 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;
- There may be new development projects come on line that are currently unbudgeted.
- Strong economic performance out of New Zealand continuing, with a flow on effect on increased and sustained visitor numbers from the country.

**Chart 6.1 Real GDP at 2006 prices, 2005/06 to 2019/20 (\$'000)**



**Chart 6.2 Nominal GDP at current prices, 2005/06 to 2019/20 (\$'000)**



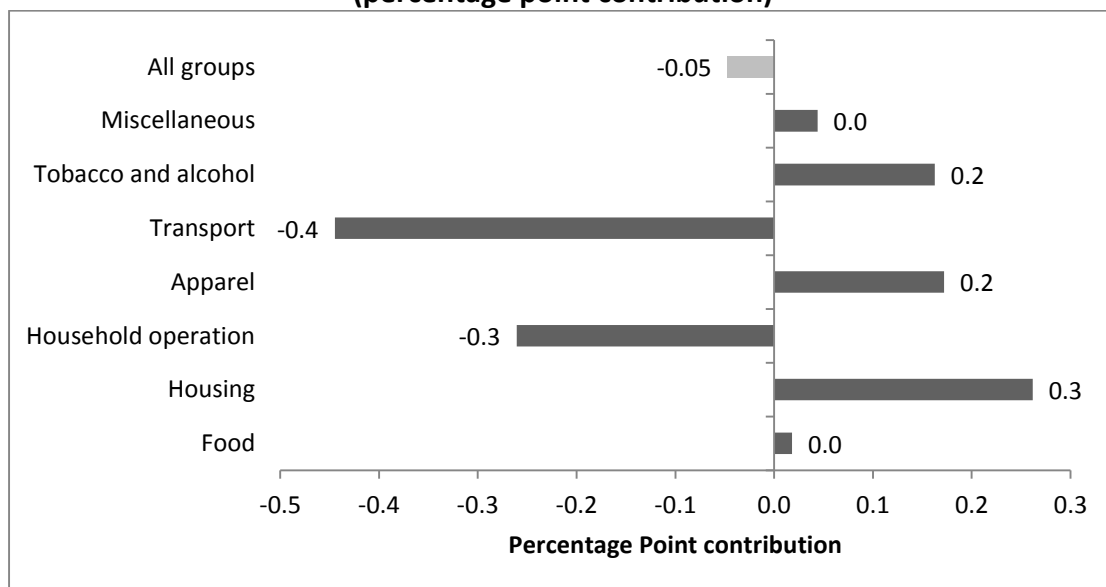
### 6.3 Consumer Price Index (CPI)

Inflation in the Cook Islands is measured by the Consumer Price Index (CPI), which is reported on a quarterly basis. Over the last ten years, the Cook Islands has enjoyed low and relatively stable inflation due to the use of the New Zealand dollar (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 June quarter 2016, which showed that year average inflation was slightly negative at -0.05 per cent. This negative rate of inflation suggests that the impact of low global oil prices may have acted as a damper on inflationary pressures from tobacco and alcohol, which are subject to yearly indexation, and strong consumer spending as a result of high visitor arrivals.

Major contributors to inflation over 2015/16 included apparel, tobacco and alcohol, and housing. Offsetting this was low or negative inflation from food, transport and household operation.

**Chart 6.3 Contribution to June quarter 2016 year average inflation (percentage point contribution)**

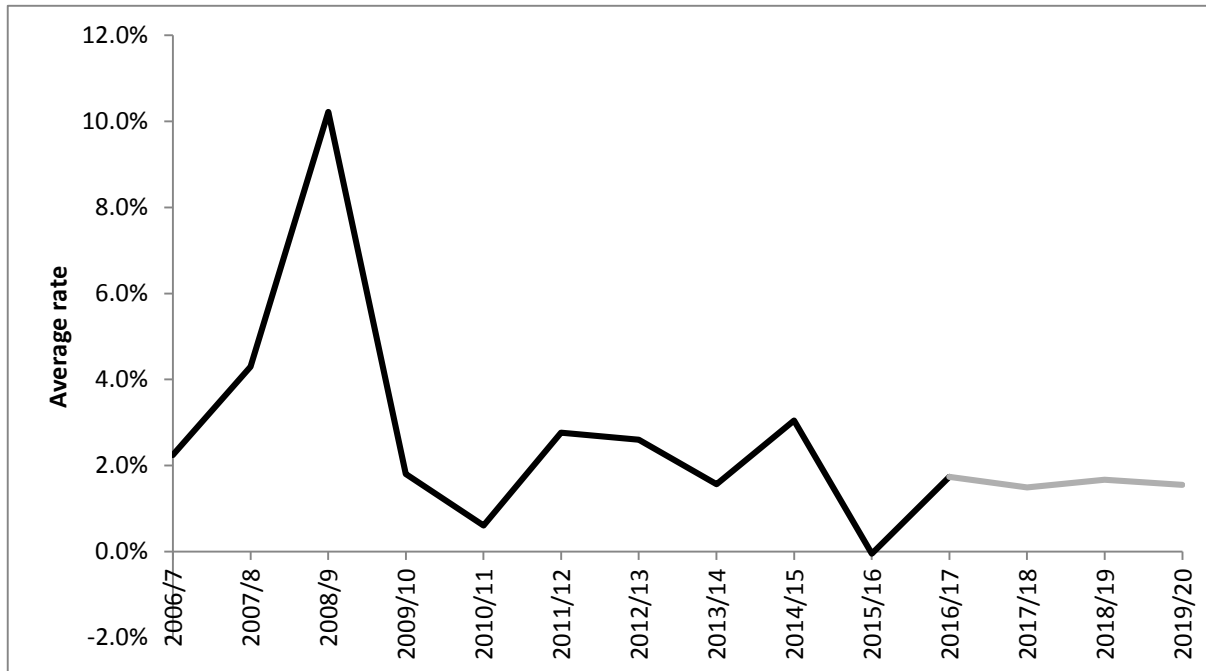


Average inflation is estimated to rebound somewhat to 1.8 per cent in 2016/17 as global commodity prices increase but remain relatively weak. This measure of inflation is expected to remain between one and a half to two per cent per year over later forecasts; slightly below the New Zealand target rate.

These forecasts are subject to both the up and downside risks which could result in outcomes that differ from expectations. One significant risk that could move in either direction is the movements in the New Zealand dollar (NZD). If the NZD were to fall further, this would increase inflation in New Zealand and the Cook Islands, while an appreciation would 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 likely to lead to higher than expected inflation, as was experienced in 2008/09. Recent developments in late 2016 by petroleum exporting nations highlight the risks presented to inflation from price fluctuations.

**Chart 6.4 Consumer Price Index (CPI), year average, 2006/07 – 2019/20**



## 6.4 Tourism

Tourism remains the economic backbone of the Cook Islands, accounting for around 65 per cent of the economy in 2015/16. The Cook Islands experienced record tourism arrival numbers almost every year from 2001 to 2013/14. In succeeding years, however, a consistent slowing of tourist growth was experienced, before a slight decline of 0.9 per cent in 2014/15. In 2015/16 this decline was turned around dramatically, with very strong growth from key markets in particular.

Total arrivals grew by 11 per cent in 2015/16, a significant rebound from the negative growth experienced in 2014/15 and the overall trend of slowing arrivals growth since 2010/11. The turnaround in arrivals was underpinned by particularly strong growth out of New Zealand, with visitors from that country growing by 9.4 per cent, resulting in much higher than expected total arrivals than predicted at the time of the 2016/17 Budget.

The Cook Islands market share of outbound travellers from New Zealand and Australia has remained relatively stable over 2015/16, suggesting much of the recent growth in arrivals from these two markets is due to the general upsurge in outbound travellers to Pacific destinations. Other potential contributors to growth include adverse weather events in competitor markets and the 50<sup>th</sup> constitution celebrations in August 2015, although this doesn't explain much of the growth experienced in the first half of 2016.

The unexpectedly strong arrivals in 2015/16 necessitated an upward revision to the arrival forecasts at the 2016/17 budget. Arrivals for the first quarter of the 2016/17 (July to September) have continued to demonstrate strong growth and arrival growth has been revised higher as a result. Arrivals are projected to grow by 1.8 and 1.6 per cent in 2017/18 and 2018/19, due to the previously increased flight capacity into Rarotonga and maintaining market share out of Australasia. Arrivals growth is then projected to moderate to around 1 to 1½ per cent due to capacity constraints in the peak months and return to longer term travel patterns for key markets

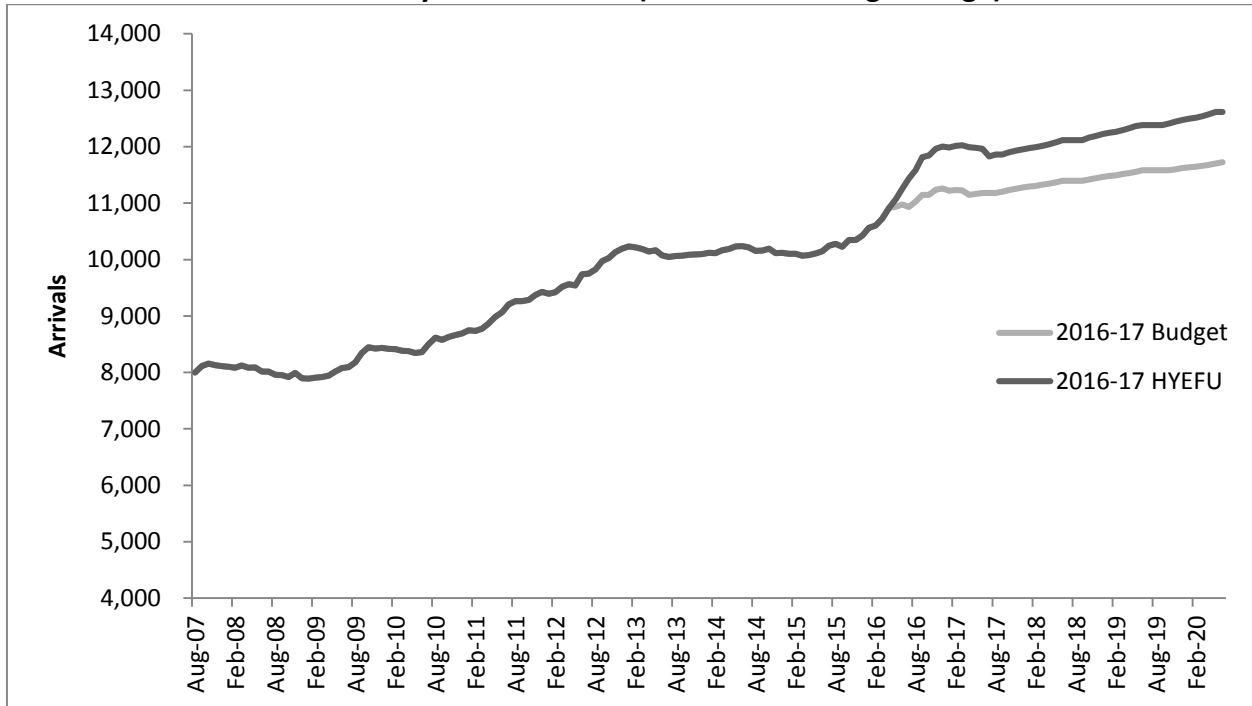
New Zealand remains by far the largest market with a market share of total arrivals of 66 per cent in 2015/16, with Australia having a smaller, but significant share of 17 per cent. Arrivals in for 2015/16 are 11.0 per cent higher than in 2014/15, and the first nine months of 2016 (January to September) are 18.3 per cent higher than the same period last year. Unusually, growth has been particularly strong in the March 2016 quarter, with growth averaging 17.2 per cent over all source markets. Within this period, Australian arrivals have grown by an average of 30 per cent, which is highly unusual for this market, as the majority of Australian travellers arrive in the Cook Islands in the last half of the calendar year. The September quarter of 2016/17 has continued the trend of strong growth, with arrivals growing by 17.1 per cent compared to September quarter 2015/16.

The average stay is estimated at approximately eight days. The visitor stay is heavily influenced by the level of New Zealand and Australian arrivals and the month of travel. The average daily spend including accommodation is estimated at around \$240 per visitor (including children), but varies by travel month and by visitor source market.

A downside risk to the forecasts remains that the large number of arrivals in the latter half of 2016 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 2016 is artificially inflated (particularly for July and August). Offsetting this risk somewhat is that the increased competition and flight capacity into Rarotonga will continue to grow arrivals, and that persistently low fuel prices will continue to support the underwritten flight from Los Angeles and Sydney. It should be noted that the recent agreement by members of the Organisation of the Petroleum Exporting Countries (OPEC) to cut production to increase oil prices will have flow on impacts on the tourism industry through potentially higher airfares. The extent of this impact will become clearer over the coming year.



**Chart 6.5 Total monthly visitor arrivals (12 month moving average) 2007-2020**

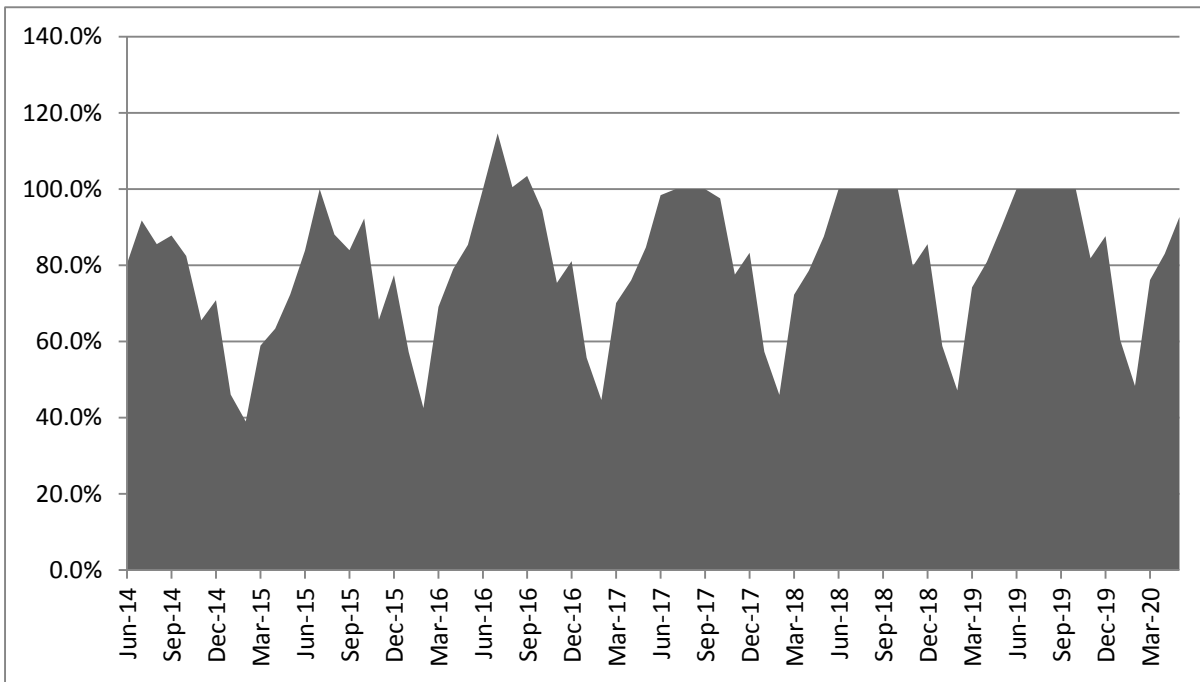


**Table 6.3 Estimated total tourism numbers by quarter 2014/15 to 2019/20**

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2014/15	38,102	31,435	20,694	31,541	<b>121,772</b>
2015/16	39,084	33,813	24,261	37,978	<b>135,136</b>
2016/17	45,770	36,054	24,492	37,236	<b>143,552</b>
2017/18	44,577	37,136	25,223	38,487	<b>145,423</b>
2018/19	44,577	38,174	25,901	39,421	<b>148,073</b>
2019/20	44,577	39,183	26,560	40,111	<b>150,431</b>

It was evident in the lead up to the Pacific Island Leaders Forum in July/August 2012, and again around the 50<sup>th</sup> anniversary celebrations in July/August 2015, that capacity constraints were becoming an issue in Rarotonga. Temporarily, this has been somewhat abated through the strong growth in the holiday home market, however capacity constraints are still a concern in the peak months. July 2012 was previously set as 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 below.

**Chart 6.6 Tourism capacity utilisation by month – 2014/15 to 2019/20**



Due to the significant growth in arrivals experienced over 2015/16, particularly in July 2016 which set the new monthly arrivals record, the previous imposed capacity limit has increased to reflect the strong growth, with July 2015 now considered representative of the cap. This will be further revised going forward.

While growth has been particularly strong over the last 18 months, the formal tourism sector has yet to see any large increases in capacity (be it management capacity or additional capital investment) , which suggests that the informal tourism sector (holiday homes) has taken much of the burden of improving the nations room stock to meet visitor demand for accommodation.

**6.4.1 New Zealand**

New Zealand continues to be the Cook Islands leading market for visitors, accounting for an estimated 66 per cent of the total market (or 89,912) in 2015/16.

Over the past ten years, New Zealand arrivals have grown an average of 5.9 per cent a year – a phenomenal level of growth with New Zealand arrivals increasing by 78 per cent over that period. 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 recent years past, the share of New Zealanders travelling to the Cook Islands (as a proportion going to Oceania, outside of Australia) has remained relatively stagnant. The Cook Islands’ share of New Zealand travellers in Oceania (not including Australia) peaked at 25 per cent

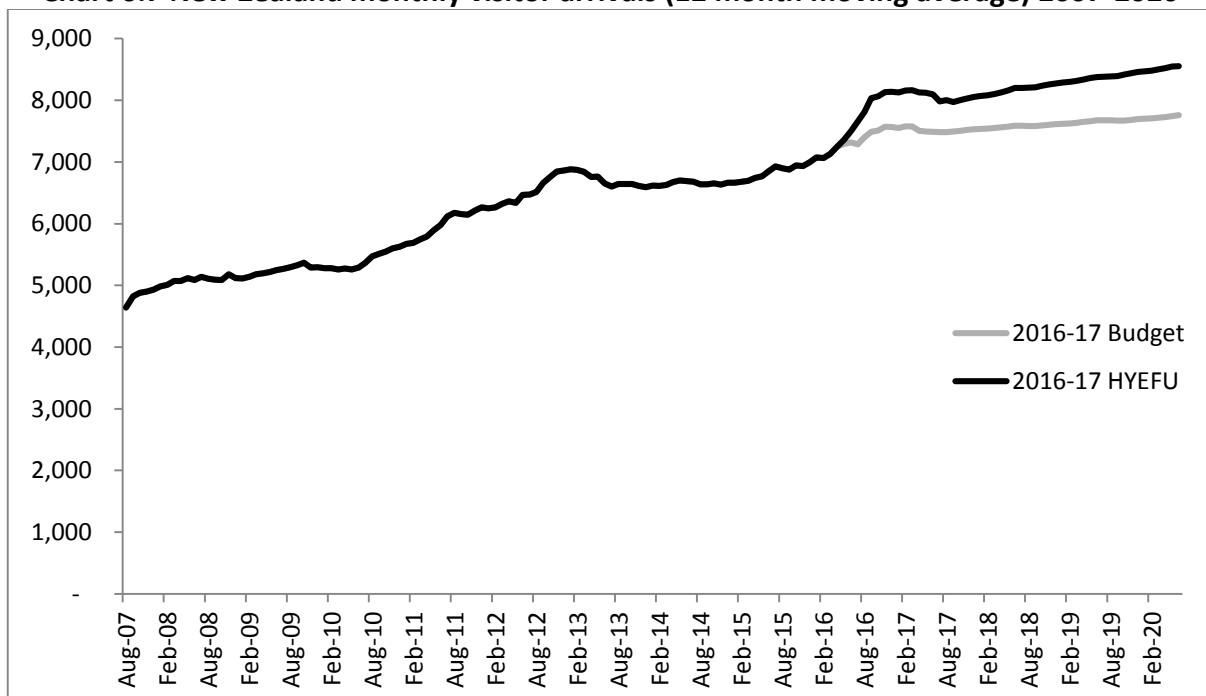
of the market in 2011/12 and 2012/13, and then fell to around 23 per cent in 2014/15. Similarly, growth in arrivals slowed further in 2013/14 and 2014/15, with arrivals from New Zealand only increasing 0.5 per cent and 2.4 per cent respectively, down from the peak of 13 per cent growth in 2010/11.

After a large upswing of arrivals, totalling 9.4 per cent, New Zealand arrivals are projected to increase by 8.1 per cent in 2016/17, a large upward revision from the 2.3 per cent forecasted at budget.

This is due to continuously higher than expected arrivals in the months since the release of the Budget. Arrivals in 2017/18 are forecast to grow by 3.2 per cent, an upward revision of over approximately 2 percentage points from Budget, which reflects a continuation of strong recent growth. The impact of Jet star’s entry to the market and the addition of a peak season Christchurch to Rarotonga route by Virgin Australia may have had a strong influence on the surge in growth from New Zealand. However, it is still too early to precisely identify the extent to which these developments have impacted the industry.

In the later forecast years, arrival growth from New Zealand is expected to remain just below three 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 6.7 New Zealand monthly visitor arrivals (12 month moving average) 2007-2020**



**Table 6.4 Estimated New Zealand tourism numbers by quarter 2013/14 to 2018/19**

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2014/15	27,788	19,625	12,061	22,743	<b>82,217</b>
2015/16	28,084	21,089	13,627	27,112	<b>89,912</b>
2016/17	34,563	22,355	13,909	26,339	<b>97,166</b>
2017/18	33,052	23,330	14,515	27,487	<b>98,384</b>

2018/19	33,170	24,113	15,003	28,259	<b>100,546</b>
2019/20	33,322	24,923	15,507	28,889	<b>102,641</b>

## 6.4.2 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.

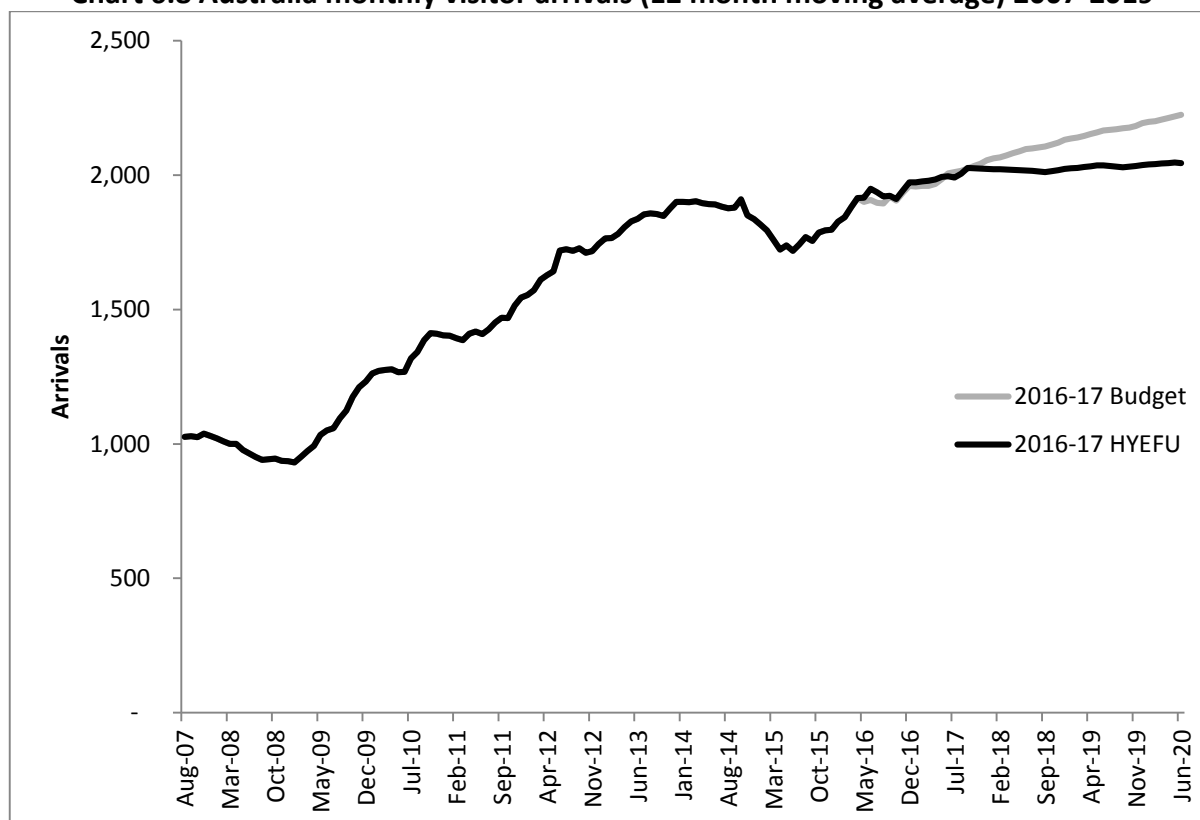
Australia has been experiencing a boom in outbound tourism growth. In the last ten years Australian outbound tourism has more than doubled, an average of 8.3 per cent a year. To compare, Australian arrivals to the Cook Islands over the last ten years have increased 71 per cent, or an annual average of 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.

After growing by 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. Australian arrivals then rebounded significantly in 2015/16, with an impressive increase of 11 per cent experienced compared to the previous year.

For 2016/17, Australian arrivals are expected to continue growing at positive, but lower, levels and increase by 2.4 per cent. This reflects the slowing of growth in Australian arrivals over the September quarter of 2016/17. In the outer years this growth is expected to level off in 2017/18, with a marginal decline to 1.9 per cent growth. Growth is then expected to decline again to 1.4 per cent in 2018/19, before stabilising over the remaining forecast years. This fall in growth 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.

The impending upgrade from a Boeing 767 to a Boeing 777 on the underwritten Sydney route in March 2017 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 6.8 Australia monthly visitor arrivals (12 month moving average) 2007-2019**



**Table 6.5 Estimated Australian tourism numbers by quarter 2013/14 to 2018/19**

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2014/15	5,927	6,548	3,286	4,866	<b>20,627</b>
2015/16	6,363	7,043	4,299	5,684	<b>23,389</b>
2016/17	6,051	7,649	4,362	5,892	<b>23,954</b>
2017/18	6,422	7,601	4,335	5,855	<b>24,212</b>
2018/19	6,352	7,743	4,416	5,934	<b>24,444</b>
2019/20	6,258	7,849	4,476	5,953	<b>24,536</b>

### 6.4.3 Other markets

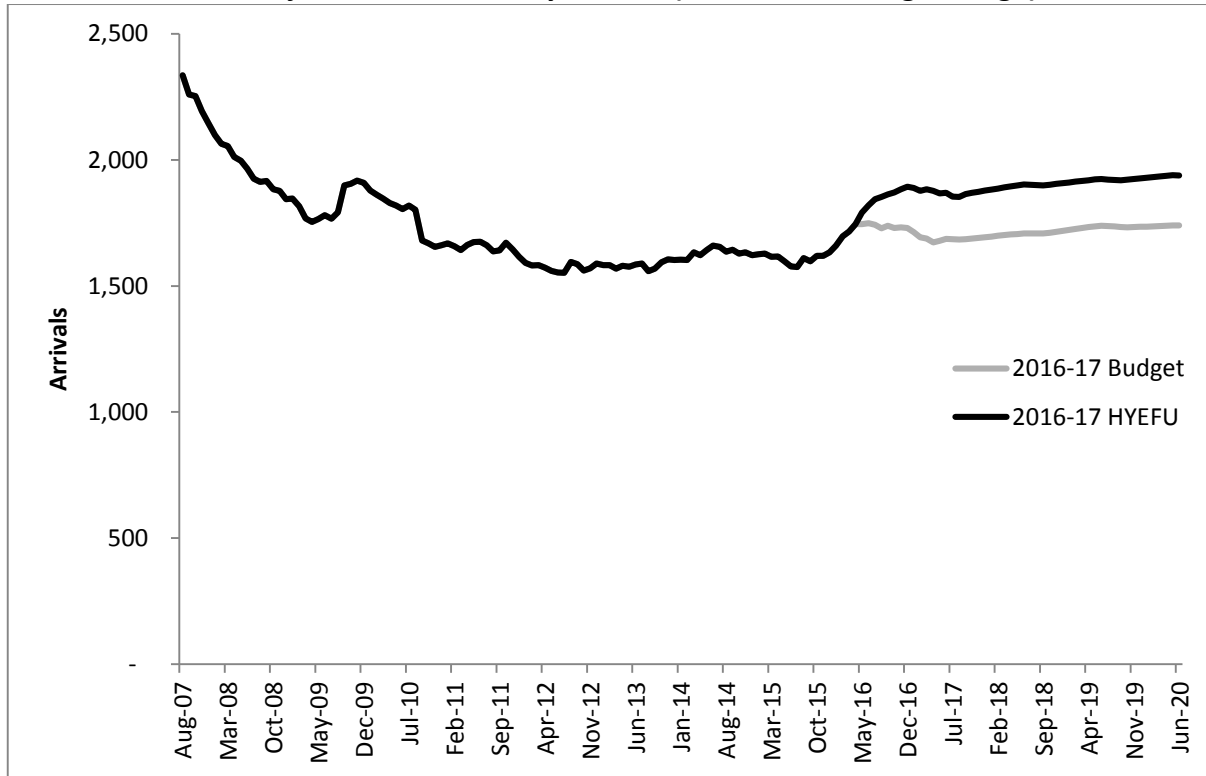
Historically, non-core markets have experienced relatively flat or declining growth, except for the United States, in which growth has been relatively strong in recent years. 2015/16 saw a surprising deviation from this trend, however, with arrivals from other markets growing by a robust 15.4 per cent, offsetting the declines experienced in 2014/15. Most of the growth in 2015/16 was due to arrivals from the United States, Europe and ‘other’ markets (those outside the US, Canada, Europe, Asia and French Polynesia).

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 the early 2000’s. 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 slow growth over the coming years, with continued economic issues for most of the EU countries likely to put a damper on future growth. European arrivals are expected to fall 1.8 per cent in 2016/17 on the back of relatively weak growth in the first quarter of the financial year, before stabilising to

between 1.3 to 1.7 per cent growth from 2017/18, onwards. Despite very strong recent growth, Asia and smaller markets continue to remain relatively minor contributors to total arrivals.

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 increase in higher end seating options presents an opportunity to encourage greater arrivals from the northern hemisphere, but if growth does not improve, the additional expense of the larger aircraft could risk the financial sustainability of the current strategy.

**Chart 6.9 Other major markets monthly arrivals (12 month moving average) 2007-2020**



**Table 6.6 Estimated tourism arrivals for other markets by quarter 2014/15 to 2019/20**

	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
2014/15	4,387	5,262	5,347	3,932	<b>18,928</b>
2015/16	4,637	5,681	6,335	5,182	<b>21,835</b>
2016/17	5,156	6,049	6,221	5,006	<b>22,432</b>
2017/18	5,103	6,205	6,373	5,146	<b>22,828</b>
2018/19	5,055	6,318	6,483	5,228	<b>23,084</b>
2019/20	4,997	6,411	6,577	5,269	<b>23,253</b>

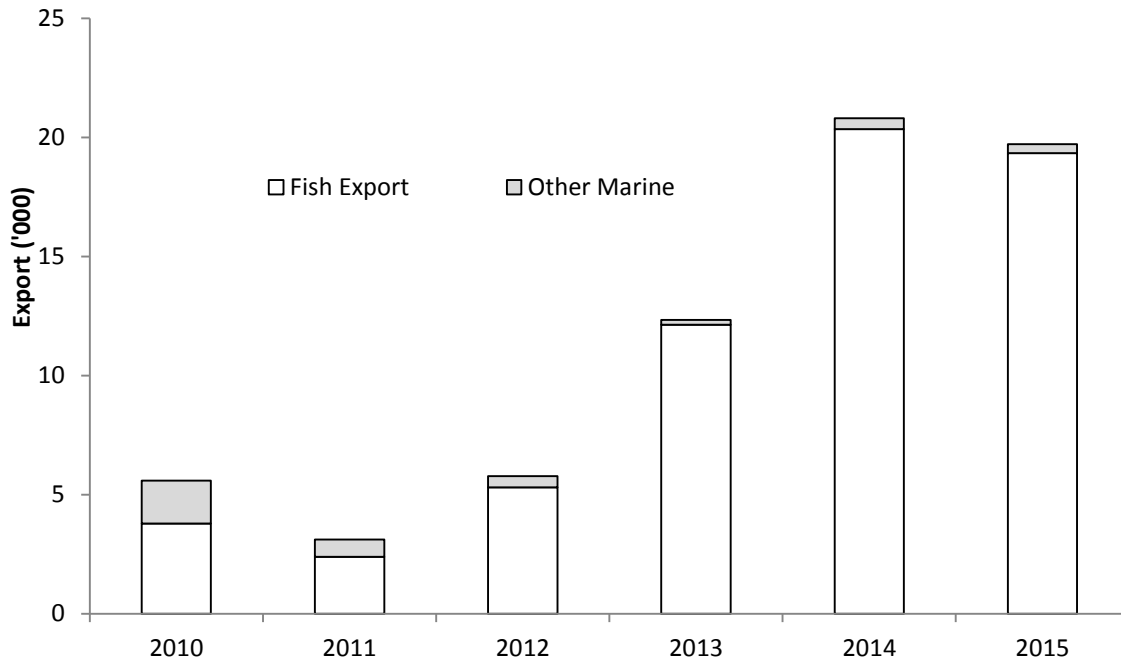
## 6.5 Marine Resources

### 6.5.1 Economic Sector

The Cook Islands’ marine export sector is predominantly made up of pelagic fisheries. In 2015 marine related exports account for the vast majority of Cook Islands goods exports: with fisheries exports totalling over 95 percent of total goods exports. Since 2014, marine exports have averaged around \$20 million dollars per annum and provisional data for March quarter 2016 has marine exports totalling \$6.6 million suggesting that supply (catch) and demand for the nation’s fisheries

products is strong. Other categories of marine exports include live fish for aquarium trade and black pearls and pearl shells. For the first half of 2015 these exports were \$0.05 million and \$0.32 million respectively.

**Chart 6.10 Fisheries and Other Marine Exports 2010 to 2015, (\$m)**



The main benefit to the Cook Islands economy from fishing activities continues to be the revenue from access arrangements, licenses and fines & settlements. Revenue for 2015/16 was \$13.5 million, consisting of:

- \$10.3 million collected for the purse seine fishery;
- \$2.7 million from long line fishing license fees; and
- \$0.5 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 by the Western Central Pacific Fisheries Commission (WCPFC).

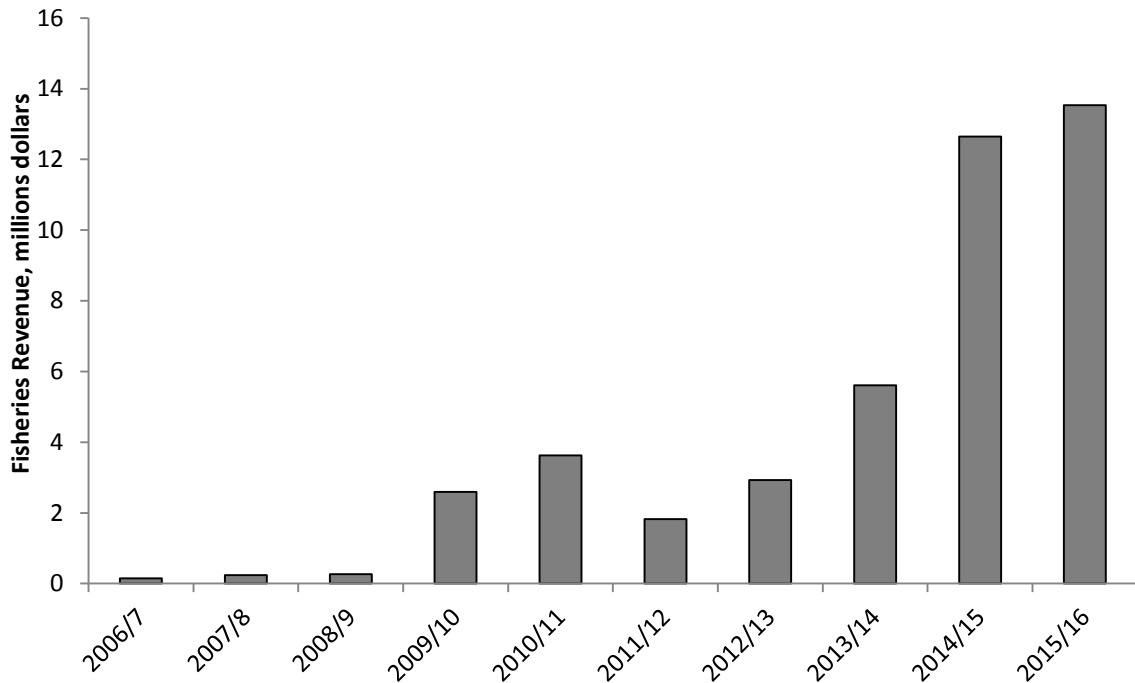
The purse seine fishery is likely to remain the largest source of fishery related revenue. For 2017 calendar year the US treaty payments for a purse seine fishing day are expected to average \$16,000 per day with 350 days committed so far. In addition, the Cook Islands has a fisheries partnership agreement with the European Union with an average price of \$19,000 per day for 125 days.

Total Revenue for 2016/17 calendar year is forecast at \$10.0 million, this consists of:

- \$8.0 million collected for the purse seine fishery
- \$2.0 million collected for the longline fishery

Budgeted fisheries revenue for 2016/17 is \$10.2 million.

**Chart 6.11 Fisheries revenue 2006/07 to 2015/16, (\$m)**



### 6.5.2 Fishing

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

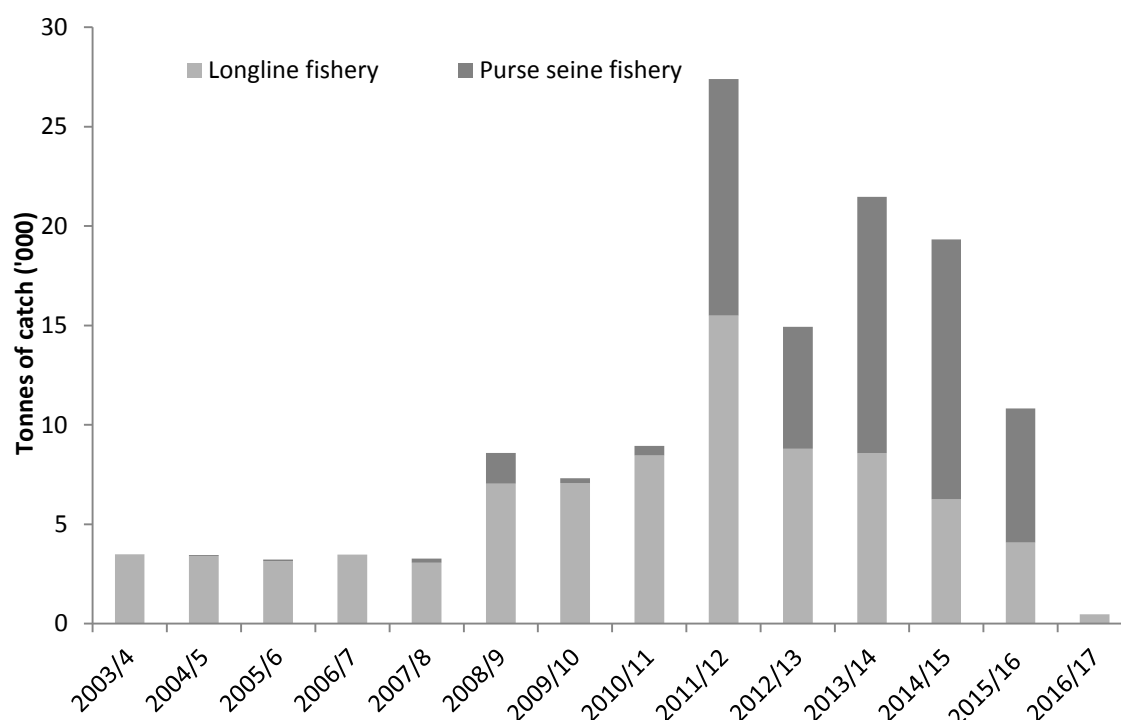
Traditionally, the Cook Islands EEZ has mainly been a long line fishery targeting albacore tuna, which is offloaded frozen to the cannery in Pago Pago where most of the long line fishing fleet is based. However, the importance of long lining has declined markedly in recent years. There has been a distinct shift in fishing methods in the past couple years and purse seine vessels now account for the largest share of fishery catches by a substantial margin.

The long line catch peaked at 15,500 thousand tonnes in 2011/12 during exploratory fishing for bigeye tuna. In 2014/2015 and 2015/16, the long line catch declined to 6,257 and 4,082 tonnes respectively, as the fishery reverted back to its regulated albacore catches. Over the same period purse seining has become the dominant fishery in the Cook Islands, rapidly expanding from 476 tonnes in 2010, to a peak of 13,000 tonnes in 2015/16. Going forward, provisional catch data suggests the purse seine fisheries will continue to experience robust catch numbers in 2016/17, with 6,751 tonnes caught to date.



The total commercial catch for all vessels was 19,158 tonnes in 2014/2015. 2015/16 saw a decline in total catch to 17,080, driven almost entirely by a 30 per cent decrease in the longline catch. However, the purse seine catch remained strong over this period at 13,000 tonnes, maintaining the total catch at a relatively high level.

**Chart 6.12 Fishery Catch in the Cook Islands Exclusive Economic Zone (tonnes)**



Albacore and yellow fin tuna, together, accounted for an average of 27 per cent of the total catch over 2014/15 and 2015/16, the majority of which is caught by the long line fishery, Skipjack tuna accounts for the majority of fish species caught in the Cook islands at almost 70 per cent of the total catch. The purse seine fishery accounted for over 95 per cent of all Skipjack caught in Cook Island waters.

**Table 6.7 Fishery Catches in the Cook Islands EEZ by Species (tonnes)**

	2014/2015			2015/2016			2016/2017 (p)		
	<i>Longline</i>	<i>Purse Seine</i>	<i>Local</i>	<i>Longline</i>	<i>Purse Seine</i>	<i>Local</i>	<i>Longline</i>	<i>Purse Seine</i>	<i>Local</i>
Albacore	3,816	0	2	2,434	0	2	315	0	0
Bigeye	576	204	0	354	13	0	33	13	0
Yellow fin	1,190	823	71	808	533	117	81	74	40
Skipjack	134	11,874	12	123	12,431	14	8	6,660	3
Other	541	0	57	363	21	30	37	4	22
<b>Total</b>	<b>6,257</b>	<b>12,901</b>	<b>142</b>	<b>4,082</b>	<b>12,998</b>	<b>163</b>	<b>474</b>	<b>6,751</b>	<b>65.0</b>

In 2016 there are a total of 120 vessels with licensing arrangements with the Cook Islands, comprising 44 licensed long liners, 66 purse seiners (including the US treaty fleet) and 10 Cook Island flagged vessels that operate exclusively on the high seas (Table 6.8). Only a portion of the licensed purse seiners will fish in the Cook Islands and based on the number of the total number of active offshore fishing vessels managed by the Ministry of Marine Resources (MMR) to 51. In 2015 the catch data for the 301 local artisanal and game charter fishing boats was also reported (Table 6.8).

**Table 6.8 Number of active fishing vessels**

<b>Licensed and active vessels</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>
Offshore fishery					
Long liner	60	45	36	38	44
Purse seiner	16	17	18	65	66
Other commercial	4	4	5	5	10
<b>Total</b>	<b>80</b>	<b>66</b>	<b>59</b>	<b>108</b>	<b>120</b>
Local artisanal and game fishery		223	302	301	318

One domestic commercial fishing company (with two Cook Islands flagged vessels) operates 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 was offloaded compared to 194 tonnes in 2014. The increased catch is due to the company expanding by an additional vessel. 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 value-add manufacturing of marine products, little onshore processing of catch takes place in Rarotonga.

**Table 6.9 Catch Landed into Avatiu port (tonnes)**

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

The local fishery remains an important economic activity for game-charter operators, semi-commercial sales and subsistence fishing. In 2015/16 the government expanded the deployment

of Fish Aggregation Devices (FADs) to the remaining southern islands where waters are less productive and highly seasonal in order to increase local catch volumes. This program is on track to also continue with the deployment of FADs to the northern atolls. Currently there are 25 FAD units that are active throughout the Cook Islands.

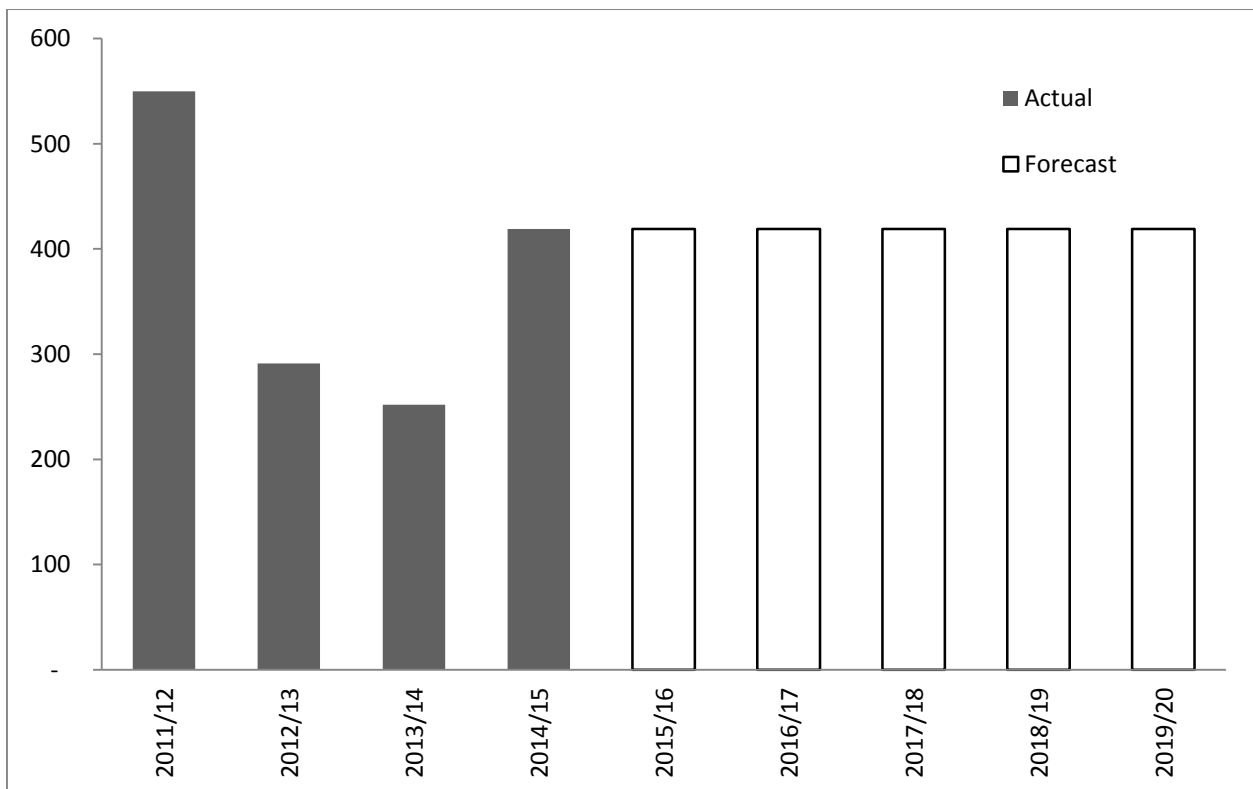
### 6.5.3 Pearls

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 difficulty in quantifying the size of the domestic market.

The value of exports declined from \$1.57 million in 2010 to \$0.14 million in 2013, before improving to \$0.36 million in 2014. However, exports in 2015 fell to \$0.16 million. For the first half of 2016, exports of pearls totalled \$0.22 million, indicating that the industry has rebounded somewhat. 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.

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.

**Chart 6.13 Pearl Exports (including pearl shell) 2011/12 to 2019/20 (\$'000)**

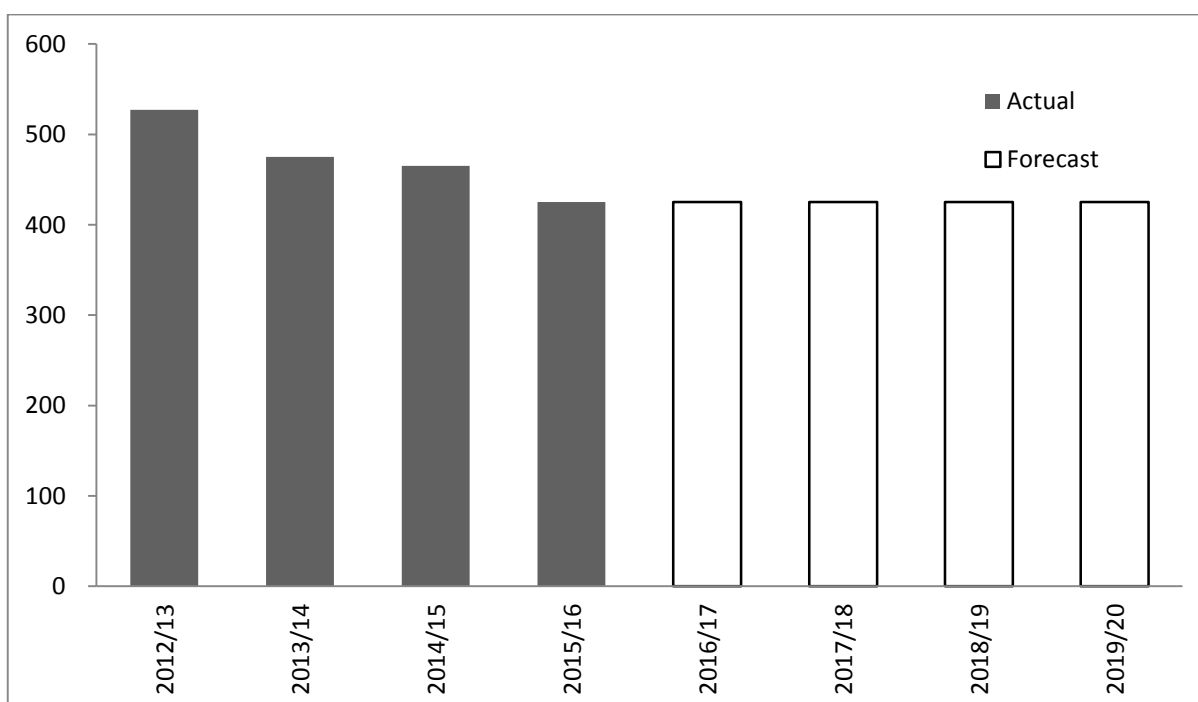


## 6.6 Agriculture

The Agriculture sector accounted for 3.1 per cent of GDP in 2015, a slight decrease of 0.3 per cent from 3.4 per cent in 2014. Agricultural exports over the same period (2014 and 2015) fell noticeably, suggesting that agriculture production is increasingly focused towards the local market. This supports the case that local production is competitive with the imports, in terms of the price and fresh quality of products, which are currently being supplied. 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 over the past 5 years but exports have fallen due to lower returns and various trade barriers. Barriers include compliance issues and quarantine requirements, amongst others. While tourism and the associated demand for food has increased markedly over the past ten years, domestic production has not been able to meet the robust demand for agricultural products and, consequently, the increase demand has been met mainly by increased imports, although the increased local focus appears to show a slight change in recent years.

The Cook Islands has potential for increased local agricultural production (products such as 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 bio-security treatment facilities for international market access and compliance to the importing country's quarantine 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 6.14 Agriculture Exports 2012/13 to 2019/20 (\$000)**



Export forecasts continue to be stagnant, with the termination of fresh mairi exports to Hawaii in July of 2016 as an example of the issues agricultural exports continue to face going forward. However, other products, such as noni, have some potential for future export due to demand from Japan and China, and these products represent possible avenues for exports to expand. The Ministry of Agriculture (MOA) is investing and establishing vanilla production and value-add manufacturing for the local market as well as promoting noni production. Seedlings are being raised to cater for farmers needs on Rarotonga and more seedlings are being cultivated for the Outer Islands (Atiu, Mangaia and Mitiaro). In addition to these measures, MOA is providing support for the revitalisation of root crops (taro) in Atiu for export and supporting measures to export off-season pineapples and vegetables in Rarotonga 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, systems in Rarotonga, Atiu, Mauke, Manihiki, Rakahanga, Pukapuka and Aitutaki for the supply of herbs and salad vegetables. These products include lettuce, tomato, capsicums, herbs, spring onions, bok-choi and other summer vegetables to 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.

## **6.7 Goods Exports and Imports**

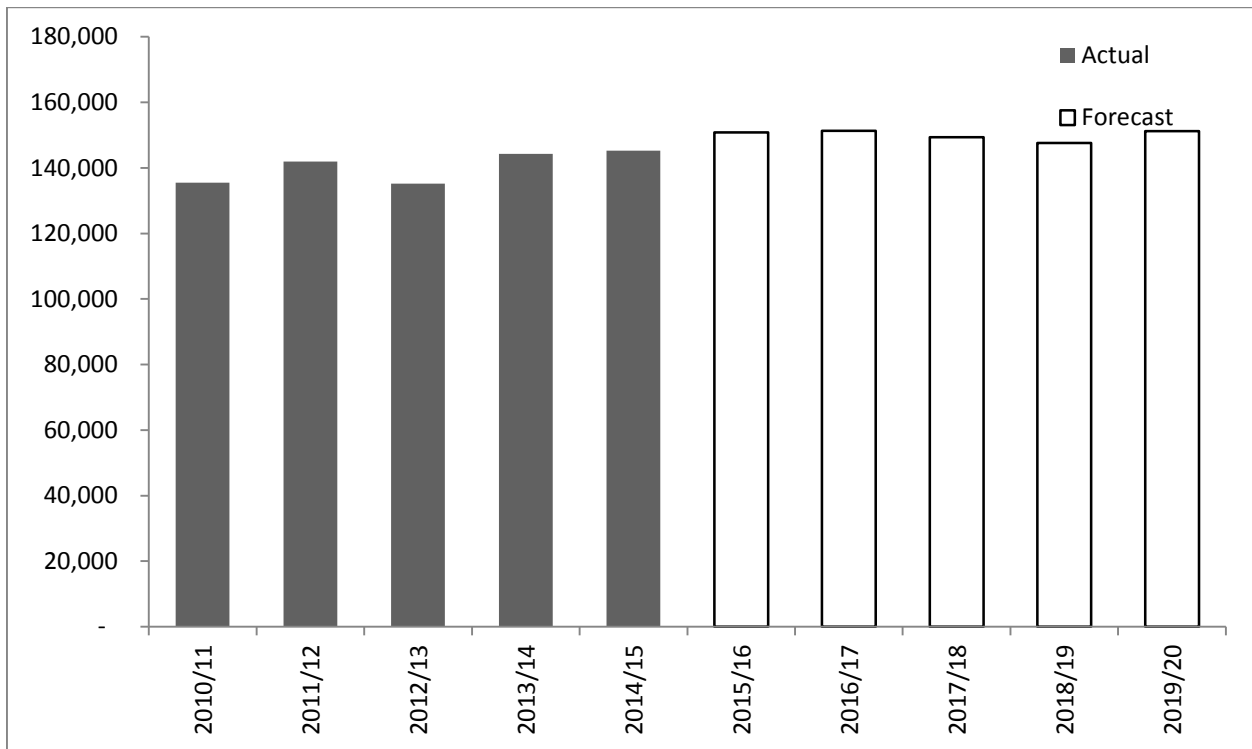
### **6.7.1 Goods Imports**

Data from the 12 months through to March 2016 shows that imports increased by 12.3 per cent. This large increase in the value of imports was predominately driven by beverages and tobacco, and machines, transport and equipment (MTE). The two main factors behind growth are the strong visitor numbers and upswing in capital projects experienced over the year to March 2016.

Growth in imports is expected to slow to 0.3 per cent in 2016/17 and then decline in 2017/16 at -1.3 per cent. In the outer years imports are projected to continue falling before rebounding to moderate positive growth rates toward the end of the forecast period. The projected fall in imports over the later forecast years is 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 almost two-thirds of total imports in the year to March 2016.

**Chart 6.15 Value of total imports 2010/11 to 2019/20, (\$'000)**



For 2015/16, 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 2016/17 onwards (due mainly in part to the completion of capital projects), while the economy is forecast to grow, this ratio is projected to gradually decline over the next two years.

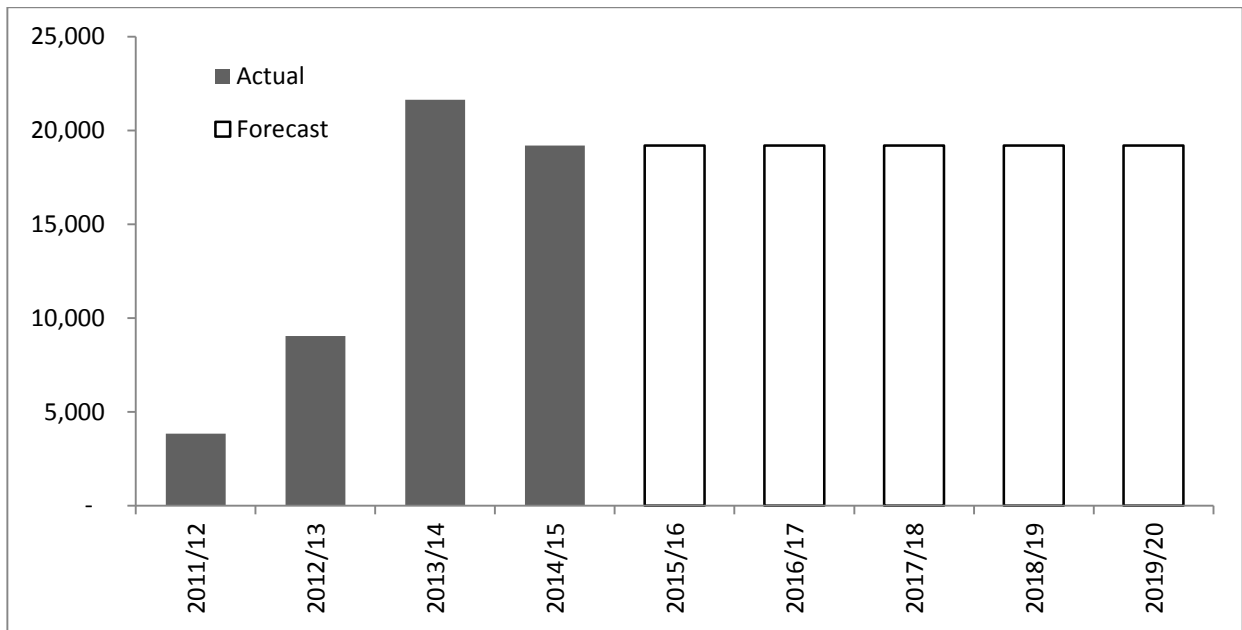
### **6.7.2 Goods Exports**

Provisional data for the 12 months to March 2016 shows export growth slightly negative at -0.4 per cent. Most major export categories experience negative or zero growth, although fish exports (which constitute the vast majority of exports) remained relatively stable, helping to keep the level of exports close to the previous period.

For 2015/16, it is estimated that for every dollar earned in the economy, about 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 remain relatively stable over 2016/17 and onwards. If current fishing licence arrangements are expanded, these forecasts will need to be revised to accommodate the additional fish exports.

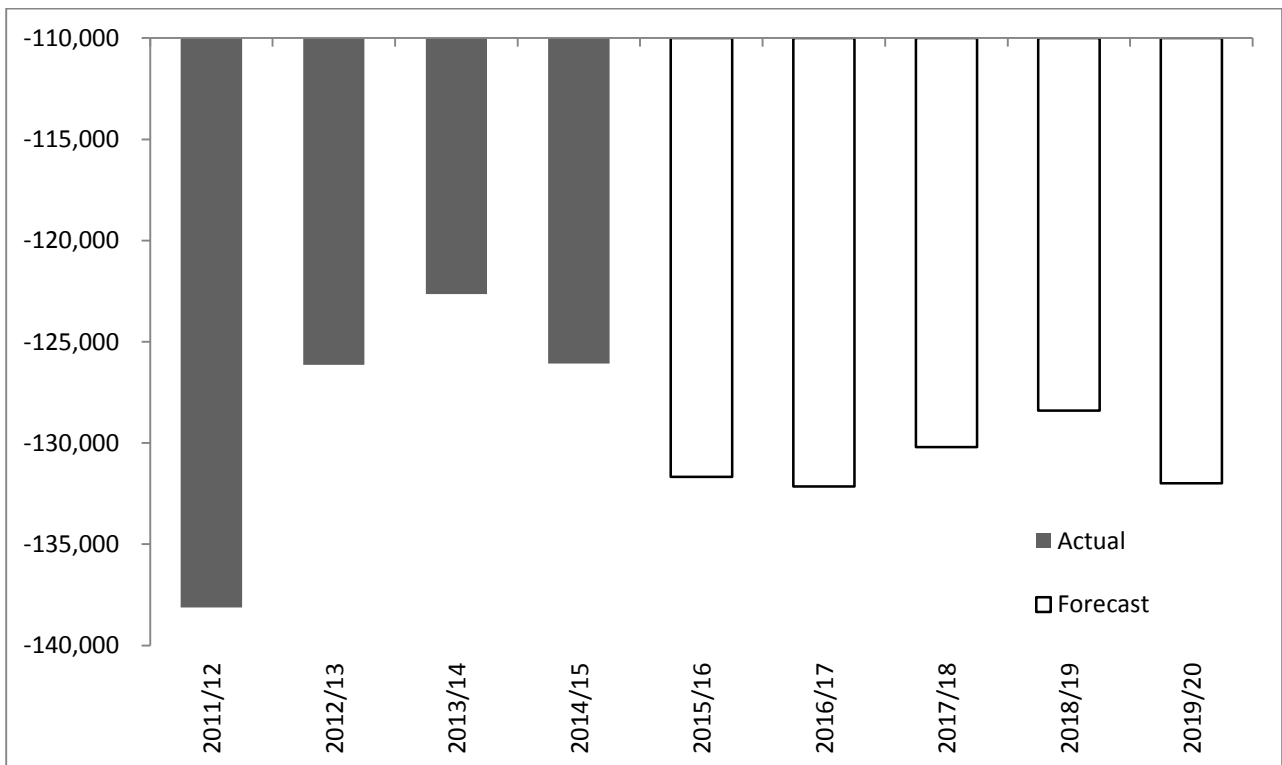
**Chart 6.16 Total goods exports 2011/12 to 2019/20, (\$'000)**



### 6.7.3 Balance of Trade

A negative merchandise balance of \$131.7 million is estimated for 2015/16 and is expected to further increase marginally over the period, following the profile of goods imports. Exports are forecasted to remain relatively stable over this period.

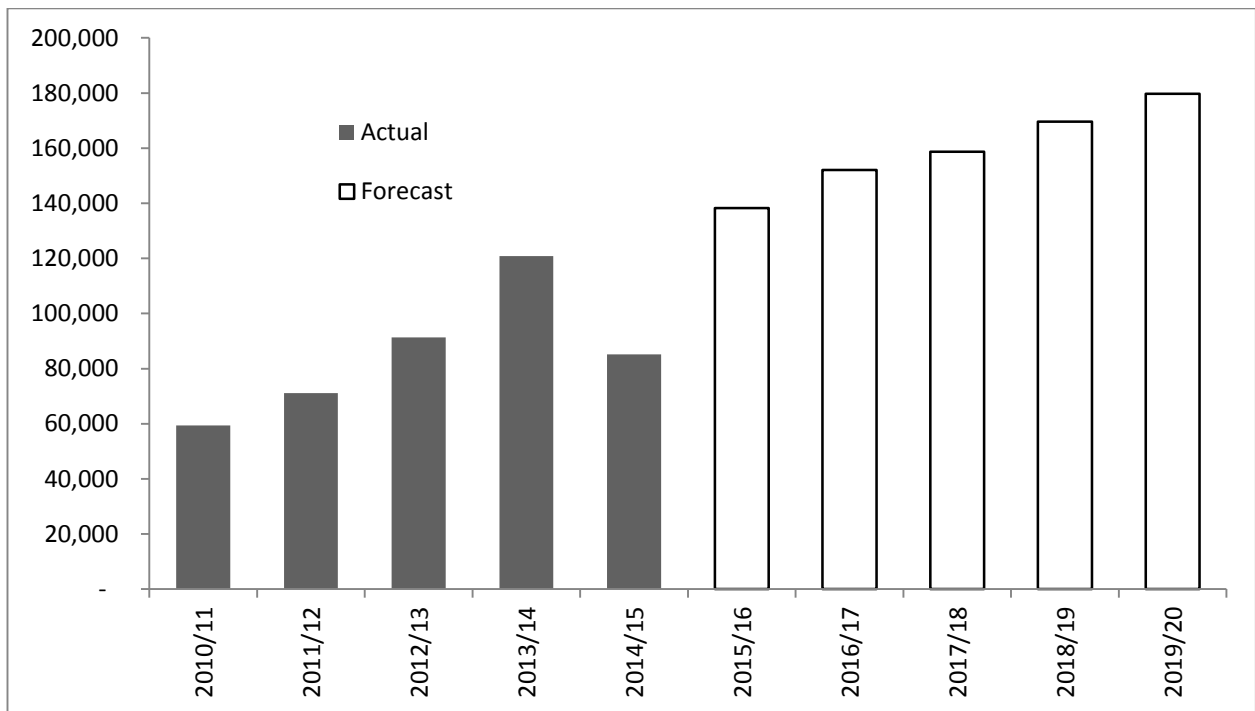
**Chart 6.17 Balance of Merchandise (goods) Trade 2011/12 to 2019/20, (\$'000)**



Tourism dominates the services trade, with tourism spending reaching \$243.4 million in 2014/15, and an estimated \$283.2 million in 2015/16.

When the estimated services trade is included, the estimated balance of trade is a surplus of \$133.8 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 6.18 Overall Balance of Trade 2011/12 to 2019/20, (\$'000)**





## **6.8 Banking and Finance**

Weaker than expected growth in the United States and flow on impacts from the UK's planned "Brexit" (withdrawal from the European Union) have put further downward pressure on global interest rates. Weak inflation and economic stagnation in advanced countries and China's rebalancing of its economy have kept expectations of global growth subdued. As a result, global policy makers have been increasing the push towards more accommodative policies and structural reforms, such as strengthening social safety nets and utilising monetary policy to promote near term growth. This has in turn raised the prospects of interest rates remaining low for an extended time and the flow on impacts on credit availability.

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 since 2013 - from 15.4 per cent of total lending in March 2013, to 7.2 per cent in June 2015. Non-performing loans have grown slightly to 7.55 per cent in September 2016 however remain close to historical lows. These figures should allow the banks greater confidence in their overall lending portfolios.

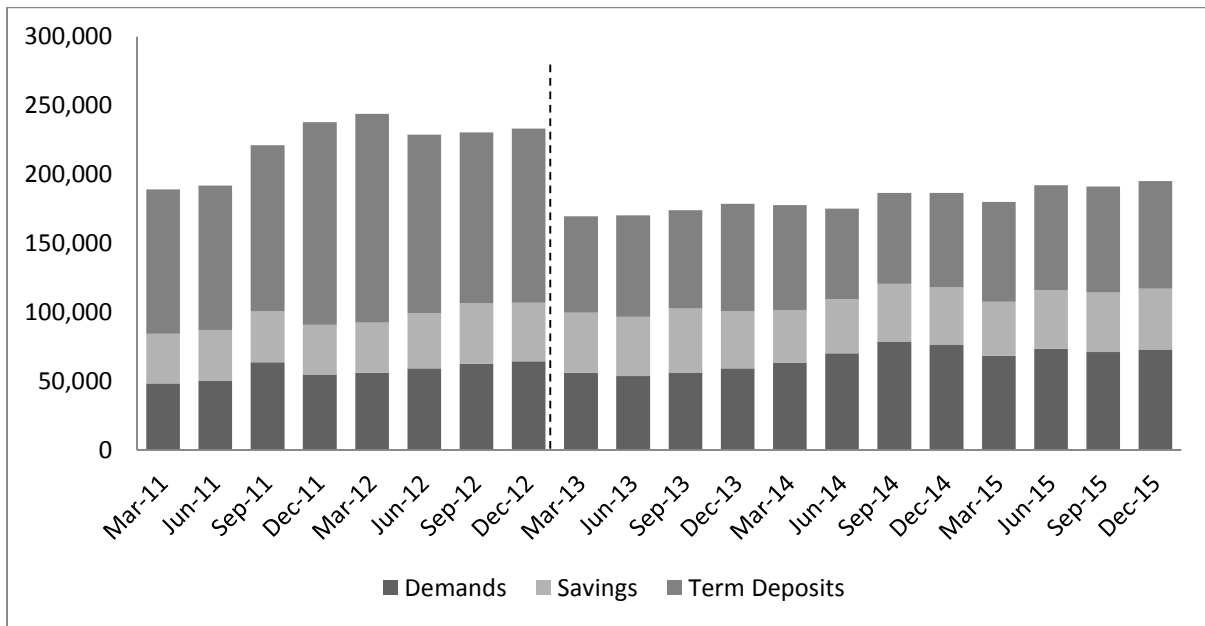
In other non-lending areas, the implementation of the Banking Review recommendations remains slow although there has been progress with interbank settlement.

### **6.8.1 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 \$2.9 million between June 2015 and December 2015, to a total of \$195.2 million. At \$117.1 million, non-term deposits are the second-highest on record (after the level of \$120.6 million recorded in September 2014).

**Chart 6.19 Total Value of Deposits, March 2011 to December 2015, (\$000)**

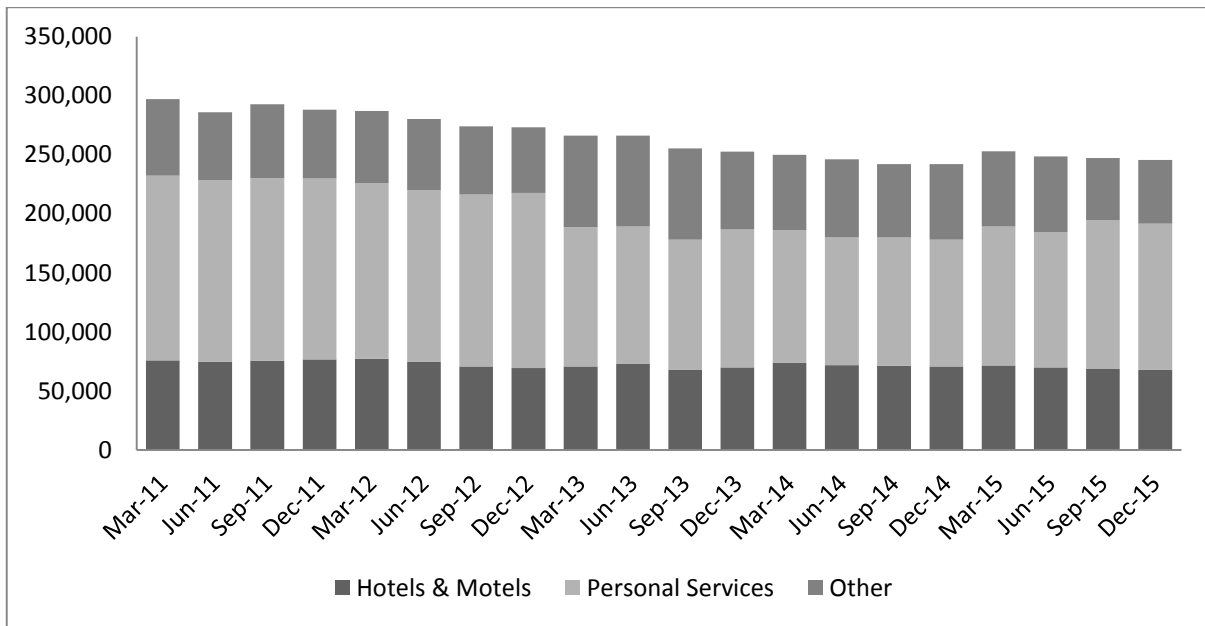


### 6.8.2 Loans

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. These gains were reversed in the September and December quarters of 2015, with total loans falling by 1.2 per cent. There was however a positive increase in lending for personal services, suggesting a change in the lending profile may be developing.

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 6.20 The Total Value of Loans, March 2011 to December 2015, (\$'000)**

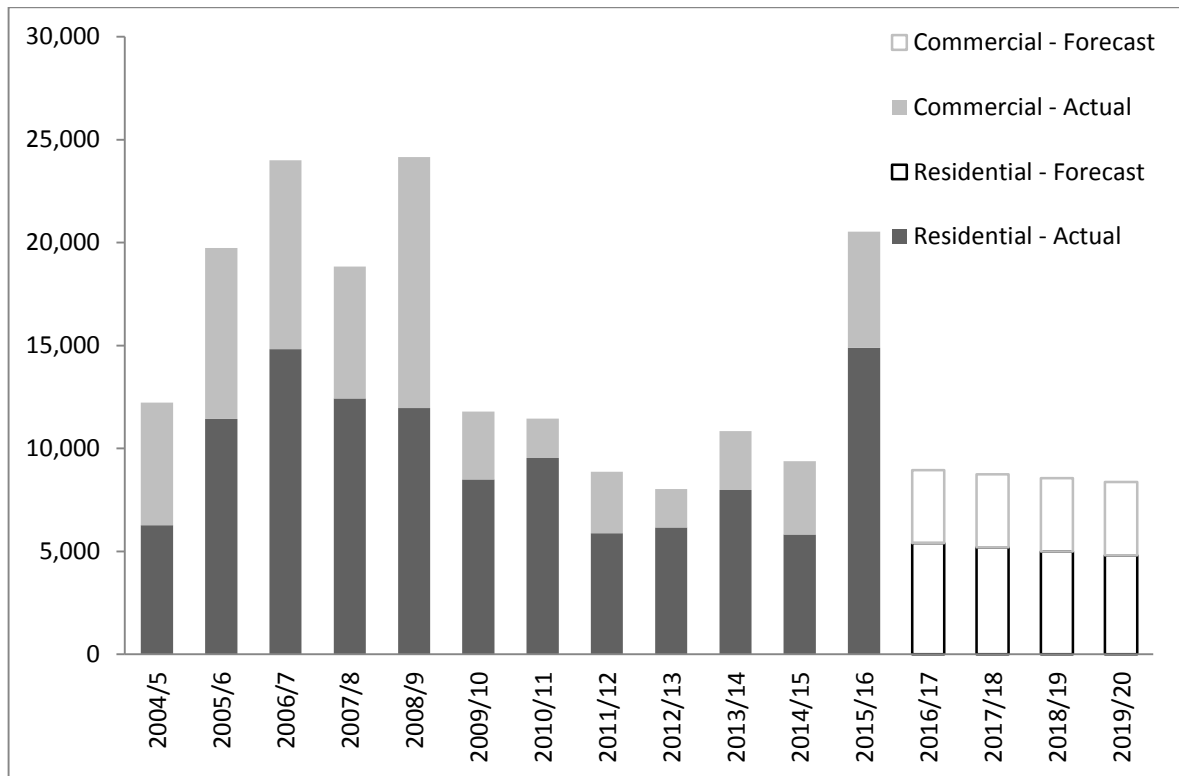


### 6.8.3 Housing and Construction

The value of building approvals has been in a steady decline since 2008/09, with 2014/15 being the notable exception. The value of residential building approvals has increased markedly to \$20.5 million in 2015/16 from \$9.4 million in 2014/15.

Commercial building approvals are not forecast due to their volatile nature and generally long lead in construction times.

**Chart 6.21 Value of building approvals 2004/05 to 2019/20 (\$'000)**



## **6.9 Financial Services Industry**

The financial services industry is estimated to collect fees of a net value of \$1.3 million for services undertaken in 2016/17. The estimated value is higher due to changes in US dollar (USD) exchange rates, as registration fees are generally denominated in USD, but lower than prior projections due to changes in the number of trustee companies and perceived pressures in the global financial services market.

Although three applications for trustee companies in the Cook Islands were approved in the last twelve months, namely Metis Global (Cook Islands) Limited, Te Manga Trustees Limited, and Trustees & Fiduciaries (Cook Islands) Limited, it may take some time to make up for the loss of business from the closure of HSBC Trustee (Cook Island) Limited. Foundation registrations continue to increase but are still relatively small in number. Captive Insurance is the newest service, with legislation passed in June 2013. The first captive registration occurred in April 2015, and the notable Pacific Catastrophe Risk Insurance Facility captive established in 2016.

New products and services, as well as amended legislation for existing services, are part of the effort to grow and diversify client markets. The International Trusts Act is in the process of being reviewed and updated. Focus continues on promotion of the Cook Islands in Asia, particularly for trusts, foundations, and companies.

The financial services industry has had to navigate a number of situations that have increased pressure and demanded greater resources from industry participants. This includes the international implementation of new tax reporting standards and governing legislation (such as the 2014 Trustee Companies Act and FTRA), the continuing negative perceptions and client concerns following international data leaks (such as 2013 Offshore Leaks, 2014 Luxembourg Leaks, 2015 Swiss Leaks, 2016 Panama Papers, and 2016 Bahamas Leaks), the ongoing bank “de-risking” trend that threatens international correspondent banking relationships, the push by large developed countries to eliminate international tax avoidance, and the ongoing development of a 2017 European Union blacklist of non-cooperative jurisdictions in tax matters. The global environment has underscored the need for government’s increased support and resources to develop and promote the Cook Islands’ financial services industry.

## 6.10 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. Three scenarios which are viewed as most likely to affect the forecasts have been modelled and are summarised below:

**Scenario 1:** Capital projects experience greater than anticipated delays (slippage) – Capital projects contribute a substantial amount to the local economy and missed deadlines delay the economic benefit from wages, contractor fees, and the benefit of the completed infrastructure. This scenario increases the extent by which projects planned in 2016/17 are anticipated to be completed in later years.

**Scenario 2:** A large negative shock to New Zealand visitor arrivals- Visitors from NZ have led the surge in total tourism arrivals over 2015/16 and the first half of 2016/17. This scenario looks at the potential impacts a sudden, negative exogenous shock, such as a short, sharp recession or natural disaster, on the NZ economy would have on that country’s tourism visitors to the Cook Islands.

**Scenario 3:** Continued tourism growth – Visitor arrivals have grown dramatically in the past 18 months. Current modelling takes a conservative view that the recent trend will moderate over the forward estimates, as capacity constraints on Rarotonga become a greater issue in peak season. This scenario assumes a much slower moderation.

**Table 6.10 Sensitivity Analysis of economic forecasts**

Scenario	Impact on nominal GDP in 2016/17 (percentage contribution)	Impact on total revenue in...	
		2016/17 (\$000)	2017/18 (\$000)
Scenario 1: Additional capital slippage	-0.01%	-10	- 2
Scenario 2: Negative shock to NZ visitor arrivals	-2.5%	-11,342	-30,436
Scenario 3: Continued tourism growth	1.0%	1,134	2,136

## 7 Crown Debt and Net Worth

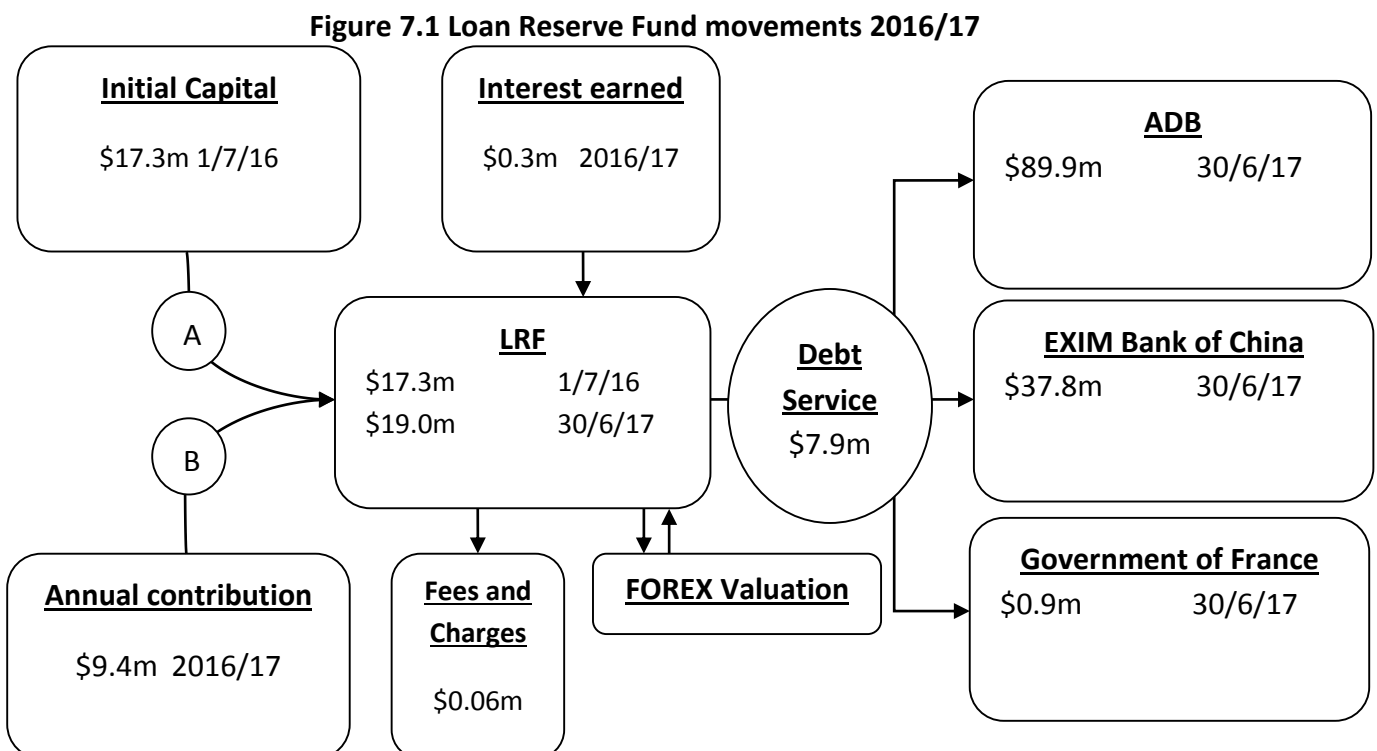
### 7.1 The Loan Reserve Fund (LRF)

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

Since its enactment, the LRF has become the official means by which the Cook Islands Government manages its debt portfolio.

In the 2016/17 Budget, the appropriations shown in Schedule 4 represent the transfer of funds into the LRF, satisfying Section 32 of the MFEM Act (showing the appropriation for borrowing expenses and debt repayment). Under the LRF Act, these payments can only be used for debt servicing obligations, and hence, the funds held in the LRF can only be used to be settled debt obligations, as per Section 61 of the MFEM Act (they do not require a Budget appropriation, as they have already been appropriated for in previous periods).

The figure below explains these movements in a diagram form.



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

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

**Table 7.1 Loan Reserve Fund Statement (NZD '000)**

	2015/16	2016/17	2017/18	2018/19	2019/20
<b>Opening LRF balance</b>	<b>16,641</b>	<b>17,255</b>	<b>18,970</b>	<b>19,500</b>	<b>18,645</b>
Contribution to LRF principle	5,424	7,490	7,551	7,601	7,161
Contribution to LRF interest	2,246	1,888	1,897	1,905	1,863
Transfer in	7,670	9,378	9,447	9,506	9,024
Interest earned (avg 2%)	359	345	379	390	373
<b>Total transfer in</b>	<b>8,029</b>	<b>9,723</b>	<b>9,827</b>	<b>9,896</b>	<b>9,397</b>
Repayment of SOE debt	-	-	-	-	-
Principal	1,367	732	763	796	796
Interest	131	159	155	150	138
<b>Total repayment from LRF</b>	<b>1,498</b>	<b>892</b>	<b>918</b>	<b>946</b>	<b>934</b>
Repayment of other debt	-	-	-	-	-
Principal	3,733	4,366	5,399	6,956	7,276
Interest	2,123	2,690	2,920	2,788	2,619
<b>Total repayment other debt</b>	<b>5,857</b>	<b>7,056</b>	<b>8,319</b>	<b>9,744</b>	<b>9,895</b>
Other service fees *	60	60	60	60	60
<b>LRF stock balance</b>	<b>17,255</b>	<b>18,970</b>	<b>19,500</b>	<b>18,645</b>	<b>17,153</b>

The table above illustrates the movements in the LRF in the next five years. The transfers into the RF have increased from \$8.029 million in 2015/16 to \$9.723 million in 2016/17 due largely to movements in exchange rates and the rescheduling of some debt payments. This transfer is divided into two components: a debt interest obligation (\$1.888 million) and a debt principal repayment (\$7.490 million); these are the estimated required payments into the LRF and are complimented by retained interest revenue of \$0.345 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 match the debt servicing profile. For example, despite the debt servicing profile peaking at \$10.3 million in 2020/21, the cost to the Government only peaks at \$9.9 million in 2018/19 due to the smoothing effect of LRF contributions.

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

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



## 7.2 Gross Debt owed by the Crown

Total gross debt owed by the Crown as at 30 June 2016 is now estimated to be \$132.2 million<sup>6</sup>, a variance of \$12.1 million from the 2016/17 Budget. Table 6.2 shows the movement was mostly due to the signing of the Disaster Risk Management (DRM) loan in November 2016, which can be drawn down in case of a natural disaster, partially offset by favourable exchange rate movements.

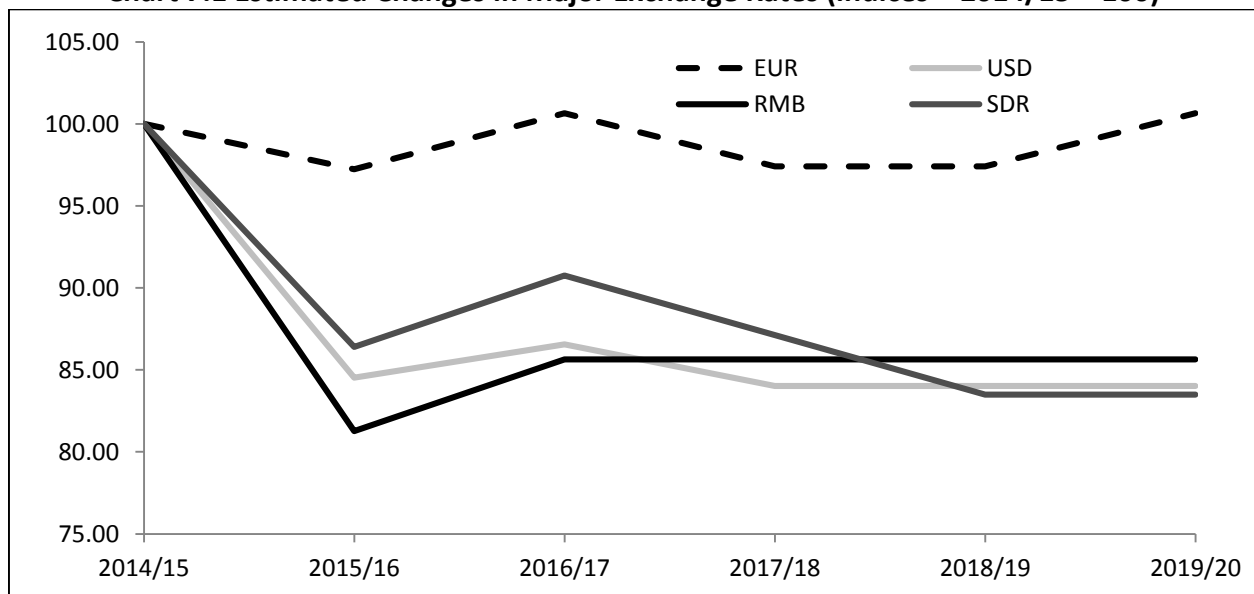
**Table 7.2 Reconciliation on 2016/17 Loan Movement**

<b>Movement Reconciliation</b>	<b>\$ Million</b>
Initial estimated gross debt for 30 June 2016 (2015/16 HYEUFU)	120.2
Movement during the period	
DRM Loan	13.95
Unrealised exchange (gain)/loss	(0.35)
<b>Estimated gross debt for year ending 30 June 2017</b>	<b>132.3</b>

The exchange rates assumptions for the 2016/17 HYEUFU have been recommended by Bancorp.

Estimated changes in major exchange rates against the New Zealand Dollar (NZD) are reflected in the chart below.

**Chart 7.1 Estimated Changes in Major Exchange Rates (indices – 2014/15 = 100)**



The cause for this favourable movement in exchange rate (in terms of outstanding debt) was predominately due to changes in the rate of the Chinese Renminbi (RMB) and the Special Drawing Right (SDR) in the period since the 2016/17 Budget.

In the 2014/15 year, the Crown converted all US dollar (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.

<sup>6</sup> All debt amounts assume full drawdown of the contingent DRM loan

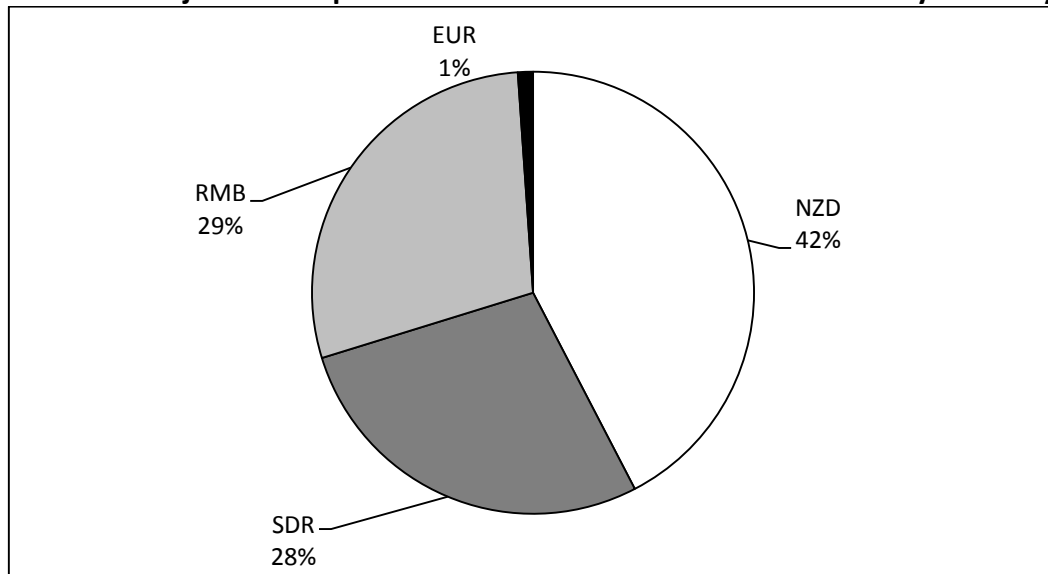
Table 6.3 **Error! Reference source not found.** shows the movement between exchange rates recommended by Bancorp at the time of the 2016/17 HYEFU, compared with those used in the 2016/17 Budget.

**Table 7.3 Exchange Rate Assumptions – 2016/17 and 2017/18**

Currency	2016/17		2016/17	
	2016/17 Budget	2016/17 HYEFU	2016/17 Budget	2016/17 HYEFU
EUR	0.5900	0.6200	0.5600	0.6000
USD	0.6500	0.6800	0.6400	0.6600
RMB	4.3500	4.5000	4.1500	4.5000
SDR	0.4600	0.5000	0.4700	0.4600

The NZD appreciated against all major currencies in which Government debt is denominated. Total Crown debt is mainly denominated in foreign currencies, with 42 per cent of debt in local currency. Of the remaining 58 per cent denominated in foreign currencies, RMB is at 29 per cent, followed closely by SDR at 28 per cent, and euro (EUR) at 1 per cent.

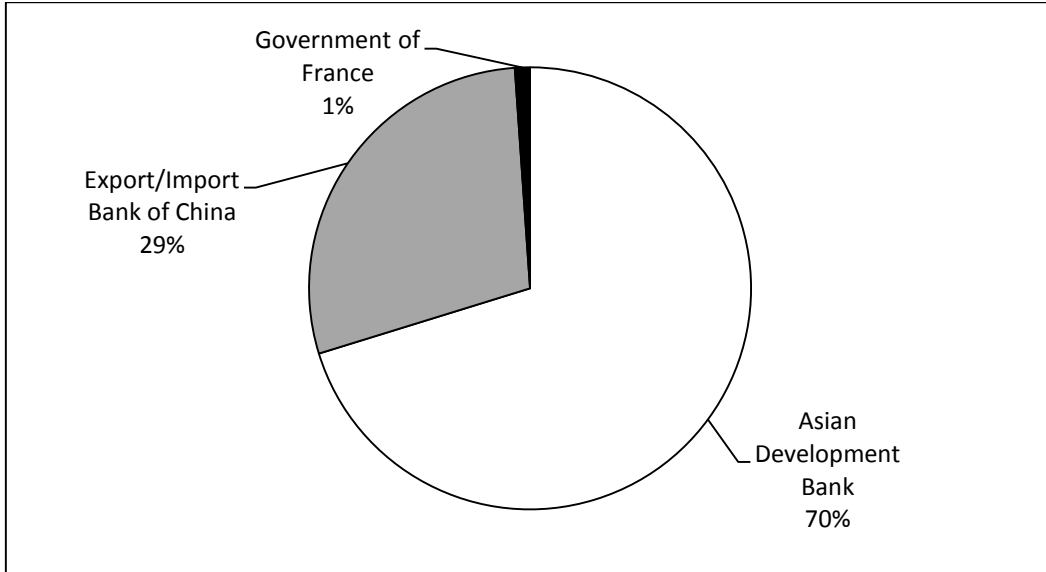
**Chart 7.2 Projected Composition of Crown Debt as at 30 June 2017 by Currency**



### 7.3 Gross Debt by Lenders

The gross debt by lender is estimated as:

**Chart 7.3 Gross Debt Estimates by Lender**

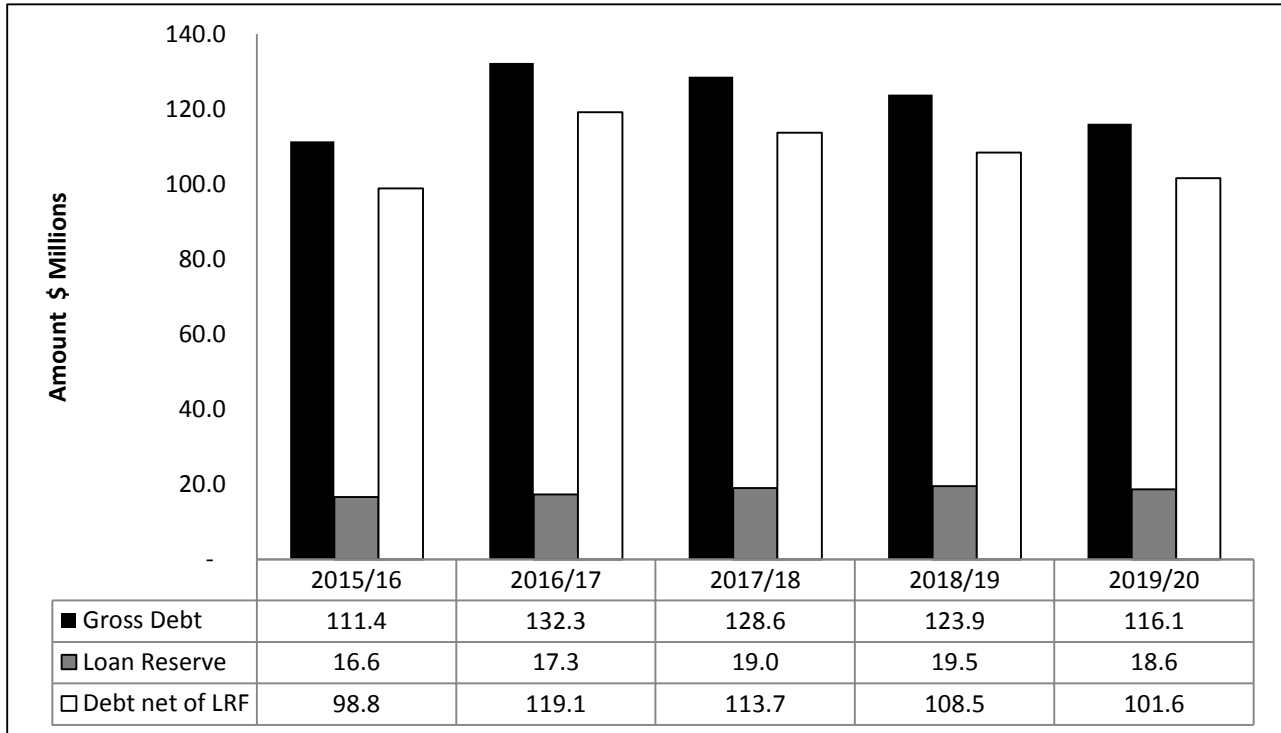


As illustrated in Chart 7.3, the Crown has borrowings from three major lenders: the ADB (70 per cent), the Export Import Bank of China (EXIM Bank) (29 per cent) and the Government of France (1 per cent).

## 7.4 Crown Debt burden

Total gross Crown debt gradually reduces in the outer years on the assumption that principal is repaid, and the Government does not undertake new loans. The LRF follows a similar path, as the grace periods on almost all loans would have expired.

Chart 7.4 Cook Islands overall debt burden



## 7.5 Status of Government Loans

The chart below summarises the debt profile of existing loan agreements over the next 10 years, as divided between multilateral lenders (for the Cook Islands, this is only the ADB) and bilateral lenders (predominantly, China’s EXIM Bank).

The impact of the ADB Southern Group Renewable Energy loan is clearly evident in the peak debt in 2016/17. After 2016/17, the Crown’s loan portfolio declines as loans are repaid. The figures presented include estimated movements in exchange rates, as per the Bancorp forecasts.

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

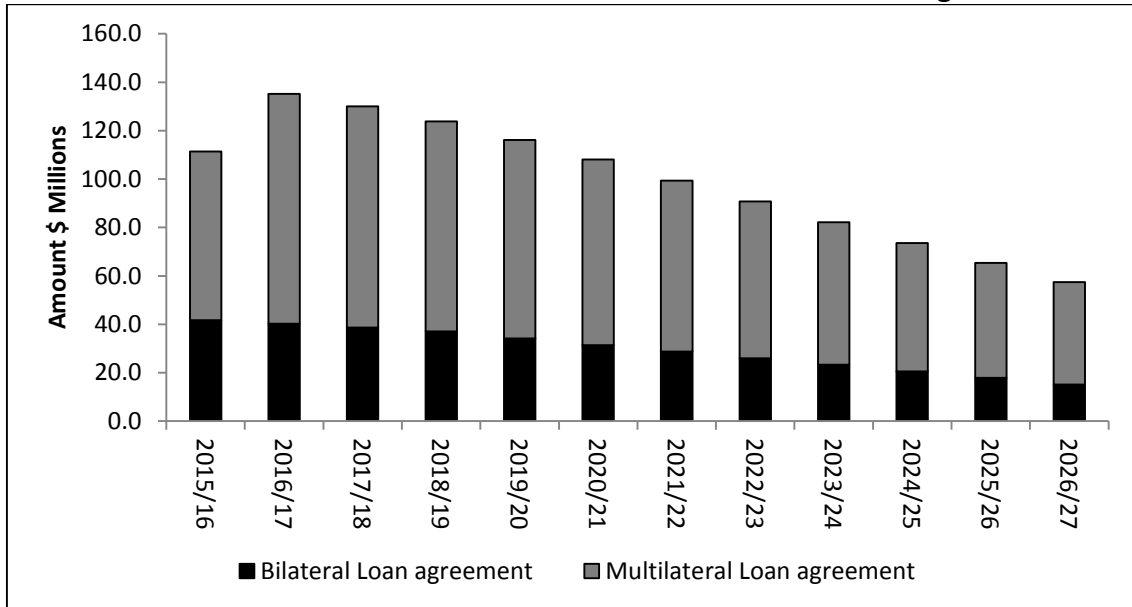


Table 7.4 shows the estimated balance of each loan as at 30 June 2017.

This table includes the full amount for the \$13.950 million loan from the ADB for Disaster Risk Management, which is committed and signed, but will only be drawn down in the event of a natural disaster. As with all loans in a similar situation, as this loan is not fully drawn down, the quarterly financial reporting may not match the Budget estimates, as all figures presented here are an estimate of the amount of the loan to be repaid in future periods.

**Table 7.4 Status of Government loans, estimated at 30 June 2017**

<b>Loans drawn down</b>	<b>Date loan taken</b>	<b>Original loan amount (000)</b>	<b>Current balance (NZD,000)</b>	<b>Expected date of repayment</b>
ADB 461 (SF) Multi Project	November, 1980	USD 1,000	384	August, 2020
ADB 567 (SF) CIDB Project	July, 1982	USD 1,500	403	April, 2022
ADB 849 (SF) 2nd Multi-Project	December, 1987	SDR 2,150	1,751	August, 2027
ADB 1031 (SF) Outer Islands Telecom Project	October, 1990	SDR 3,578	4,302	August, 2030
ADB 1155 (SF) 2nd CIDB Project	March, 1992	SDR 1,085	1,094	December, 2031
ADB 1171 (SF) Emerg. Telecom Rehab Project	August, 1992	SDR 349	378	June, 2032
ADB 1309 (SF) Pearl Industry Dev. Project	December, 1994	SDR 272	431	August, 2034
ADB 1317 (SF) Educ'n Dev Project	February, 1995	SDR 1,852	2,626	August, 2034
ADB 1380 (SF) 3rd CIDB Project	January, 1996	SDR 1,977	2,243	September, 2035
ADB 1466 (SF) Economic Restructure Program	September, 1996	SDR 3,430	5,098	September, 2036
ADB 1588 (SF) Cyclone Emergency Rehab Project	January, 1997	SDR 583	867	January, 2038
Restructured French Loans	January, 1999	Euro 5,413	902	September, 2018
ADB 1832 (SF) Waste Mgt Project	December, 2001	SDR 1,695	2,198	June, 2033
ADB 2174 (SF) Cyclone Emergency Assist Project	June, 2005	SDR 1,895	3,550	June, 2045
China - Multi-Functional Indoor Sports Stadium	August, 2008	RMB 74,100	11,572	August, 2028
ADB 2472 (OCR) Avatiu Port Development Project	September, 2009	NZD 10,309	9,380	November, 2033
ADB 2473 (SF) Avatiu Ports Development project	September, 2009	SDR 4,524	9,219	November, 2040
ADB 2565 (OCR) Economic Recovery Support Program 1	January, 2010	NZD 11,053	7,536	October, 2024
ADB 2739 (OCR) Amendment Avatiu Port project	December, 2011	NZD 5,290	5,184	November, 2035
China - Rarotonga Water Ring Main Upgrade	December, 2012	RMB 118,000	26,222	December, 2032
ADB 2946 (OCR) Economic Recovery Support Program 2	December, 2012	NZD 11,053	6,344	October, 2027
ADB 3913 (OCR) Renewable Energy Project	December, 2014	NZD 12,980	12,980	June, 2036
ADB Disaster Risk Management (DRM) Loan <sup>7</sup>	November, 2016	NZD 13,950	13,950	*Contingent
<b>Total loans commitment</b>			<b>128,613</b>	

<sup>7</sup> This loan is contingent

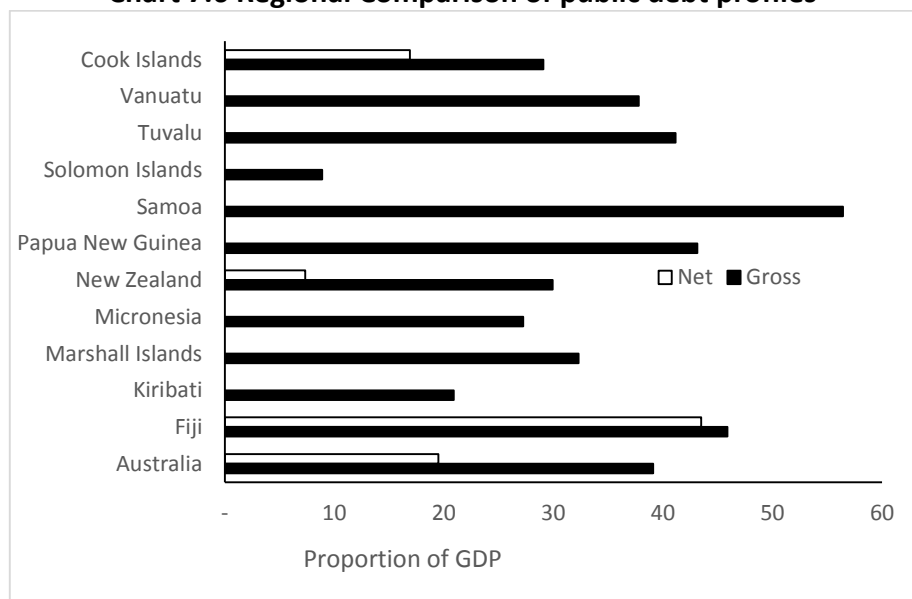
## 7.6 Net Debt

The internationally accepted definition of net debt is total gross debt (all public sector debt and currency on issue) less total financial assets corresponding to those debt instruments (this means like for like, for example cash). Under this definition the Cook Islands net debt position would be only \$80.3 million or 18.0 per cent of GDP in 2016/17.

Gross Debt + Currency on Issue	=	(\$132.3 million) + (\$4.1 million)	=	(\$136.4 million)
Less Financial Assets (Cash reserves and Loan Repayment Fund)	=		=	(\$56.1 million)
Net Debt	=		=	(\$80.3 million)

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<sup>8</sup>**



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,

<sup>8</sup> The data for Australia (obtained from the IMF) is federal government only, and the levels of debt for all levels of government would be higher than presented.

'Net Debt' 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). This is closer to the internationally accepted definition of gross debt.

Net debt under this more conservative definition is estimated to be \$115.0 million (25.8 per cent of GDP) by the end of June 2016, an increase of \$12.0 million since the 2016/17 Budget, although GDP was revised upwards significantly, reducing the percentage of debt to GDP (previously 26.4 per cent).

**Table 7.5 Current Borrowing Statement (\$m)**

<b>Current Statement</b>	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
Gross Crown Debt, start of FY	111.4	132.3	128.6	123.9	116.1
... net of loan reserves, start of FY	94.7	115.0	109.6	104.4	97.5
... net of loan reserves, as percentage of GDP	22.6%	26.9%	25.2%	23.4%	21.3%
Loan Repayment Reserves Held, start of FY	16.6	17.3	19.0	19.5	18.6
Gross Debt Servicing	7.7	9.4	9.4	9.5	9.0
Net Debt Servicing	7.3	9.0	9.1	9.1	8.7
... as percentage of Total Revenue	4.9%	6.0%	5.9%	6.2%	5.8%

## 7.7 Debt Headroom

As Government is currently negotiating (or has recently signed) additional loans to fund an Instrument Landing System (ILS) for Rarotonga Airport (through the Airport Authority) and a fibre-optic submarine cable (Pacific Connectivity Project), it is important to consider the impact that these loans will have on the Government's capacity for additional borrowing. These proposed borrowings, if drawn in the 2016/17 and 2017/18 years (with the submarine cable loan across two years), would increase net debt to \$140.4 million by 30 June 2018, breaching the more conservative MFEM target of 30 per cent net debt to GDP by around \$4.1 million and leaving headroom of \$18.6 million compared to the 35 percent threshold. However, this analysis assumes full draw down of the DRM loan, which is only the case if a disaster occurs, and is the reason for the five percentage point gap between targets, although this is considered to be within the appropriate targets.

## 7.8 Crown Debt Sensitivity Analysis

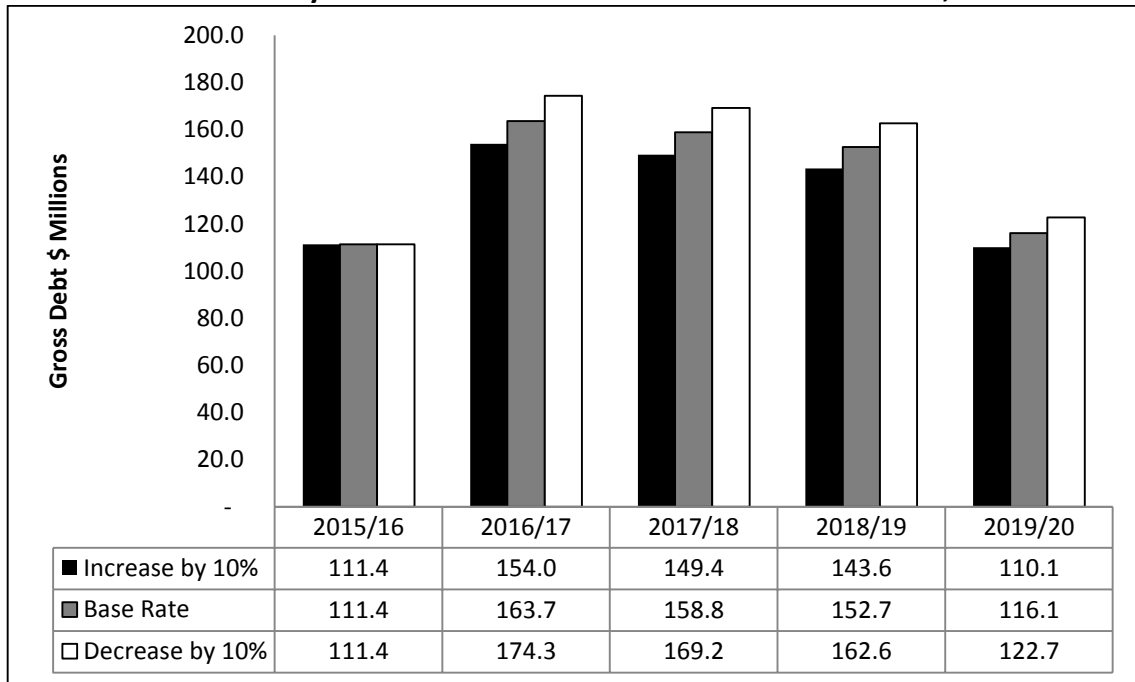
**Table 7.6 Base rate used in 2016/17 for budget assumption with +/- 10 per cent**

<b>Foreign Exchange Currency</b>	<b>-10%</b>	<b>Budget assumption rate</b>	<b>+10%</b>
RMB	4.0500	4.5000	4.9500
USD	0.6120	0.6800	0.7480
SDR	0.4500	0.5000	0.5500
EUR	0.5580	0.6200	0.4500

One of the ongoing risks to the Crown's debt liability is the 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.

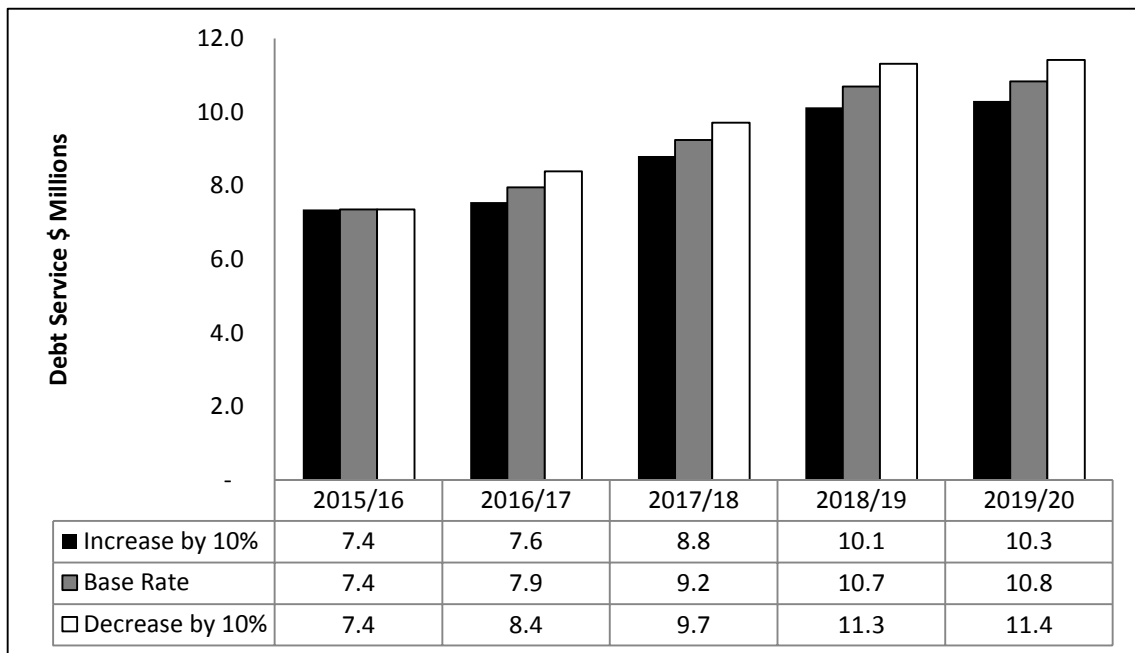


**Chart 7.7 Sensitivity of Total Crown Gross Debt to NZD movements, start of FY**



If the NZD exchange rate was to depreciate by 10 per cent against foreign currencies, gross Crown debt as at the end of the June 2017 year would increase by an estimated \$10.6 million.

**Chart 7.8 Sensitivity of Gross Debt Servicing Costs to NZD movements, start of FY**



A 10 per cent decrease in the foreign currency value of the NZD would increase debt servicing costs to the LRF by \$0.5 million.

Over recent years, the accumulation of interest earnings held within the LRF has allowed for a small exchange rate buffer. At the 2016/17 Budget, this buffer was around \$1.5 million. With recent appreciation in the value of the NZD versus major currencies, and minor adjustments to payment schedules, this buffer has increased to around \$5 million.

## **7.9 Long term debt projections and fiscal risks**

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

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

### **7.9.1 Debt projections**

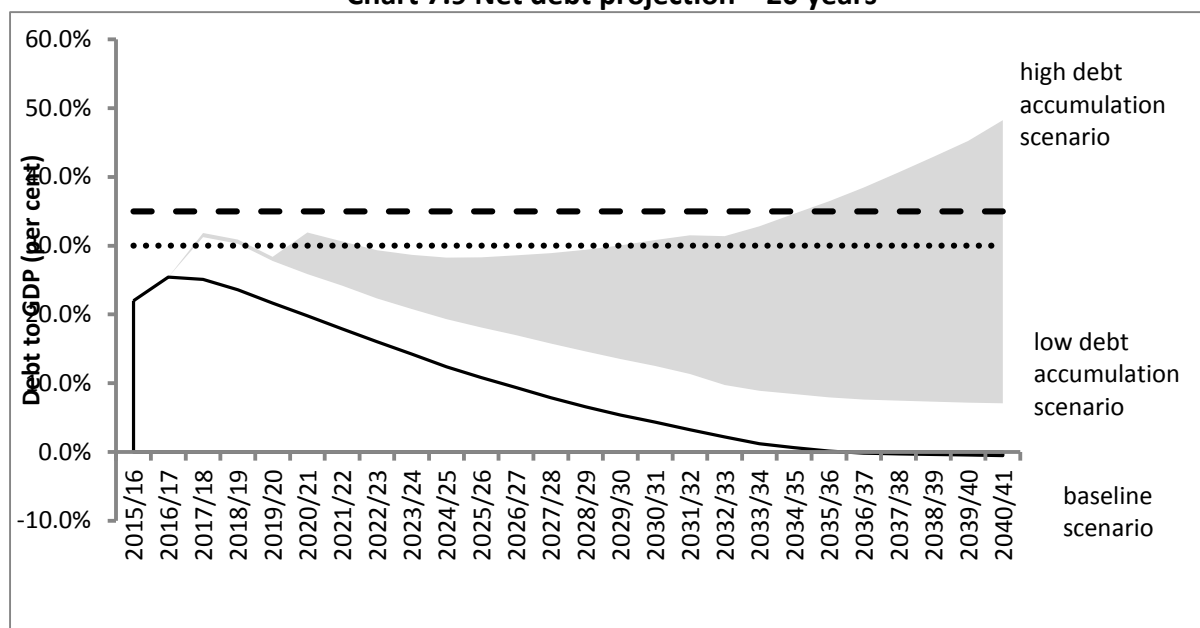
There are two major projects that are currently being planned that will have a significant impact on the Cook Islands debt profile:

- The Pacific Connectivity Project (an ICT submarine cable) – likely to commence in 2016/17 (this is included in the baseline scenario)
- Muri Sewage Reticulation – likely to commence in 2017/18

There is also a contingent loan (DRM loan) that is in place with the ADB. The contingent loan facility provides a disaster assistance loan to assist reconstruction efforts in the aftermath of a catastrophic weather event. This is not a liability on the Crown until such an event occurs, but does represent a contingent liability once signed. All projection scenarios include the drawdown of this loan, however for the purposes of assessing debt sustainability, this should be considered to sit between the benchmarks of 30 and 35 per cent net debt to GDP (as this is the purpose of both the contingent loan, and the five per cent ‘cushion’).

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

**Chart 7.9 Net debt projection – 20 years**



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

For both the high and low debt accumulation scenarios, a loan for Muri Sewage Reticulation is included in the estimates. Consistent with the 2016/17 Budget, the financing need is estimated at \$5 million, with partial contributions from the New Zealand Aid program and Cook Islands Government cash reserves reducing this from a total cost of around \$10 million.

Both the high and low debt accumulation scenarios assume that operational spending continues to live within its means, producing small operational surpluses. If this were not to be the case, the projections would be higher in both cases. Both scenarios also assume current loan terms of fifteen years, with a three year grace period apply.

The high debt accumulation scenario assumes that the growth of capital investment continues at a pace five percentage points faster than that of Nominal GDP. As this is significantly lower than the increase in planned capital investment in recent years, there remains an element of conservatism in this outlook as well. However, this scenario is designed to represent one which the level of infrastructure investment in the Cook Islands is continually growing. This also assumes that ninety per cent of net capital investment (that is, capital investment less depreciation) is funded by debt, at interest rates of 2.5% per annum. Under this scenario, as can be seen in the chart above, debt increases rapidly over the projection period, with the MFEM prudential target of 30 per cent net debt to GDP being breached around 2030, and the 35 per cent ‘hard limit’ around 2035.

The low debt accumulation scenario assumes that capital investment is limited to (in broad terms) maintaining the existing level of capital stock. This means that total capital investment is assumed to grow in line with long term depreciation (considered to be five per cent for these purposes) and price growth of manufactures<sup>9</sup>. This shows a much lower rate of debt accumulation, which never threatens the benchmark debt to GDP ratios.

In all modelled scenarios, it is assumed that replacement costs for the Northern and Southern Renewable Energy Projects are provisioned for through the tax base or by user charges. A similar assumption is made for the Rarotonga Water Network. The replacement costs for such systems are therefore neutral on the modelling presented here.

### **7.9.2 Conclusion**

Both of these scenarios suggest that planned infrastructure projects of The Pacific Connectivity Project and Muri Sewage Reticulation can be accommodated within current debt limits (if the financing needs meet the assumptions above). However, other capital projects will need to be adjusted and prioritized accordingly. Fundamentally, 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 expansion in operational spending in excess of revenue growth. As the population of the Cook Islands ages, and public expectations about social safety nets change, this assumption may no longer be valid, which would increase pressure on the debt sustainability through the financing of operational needs by debt.

Notably, projects such as the Tereora College rebuild are not factored into these estimates: implicitly we have assumed that this project is financed largely by donors. Other, more aspirational, goals are also not factored into these estimates, such as the renewable energy project for Rarotonga. Loan financing either of these projects would significantly degrade the ability of the Cook Islands to stay within its debt limits.

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<sup>9</sup> From IMF databases

## **7.10 Other State Owned Enterprise Debt**

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 were for \$8.1 million repaid over a five year period at 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 Airport Authority has recently undertaken additional borrowings from the ANZ Bank for an upgrade of the Instrument Landing System at Rarotonga International Airport. This loan is for (NZD) \$3.2 million, and will be repaid by the Airport Authority.

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.

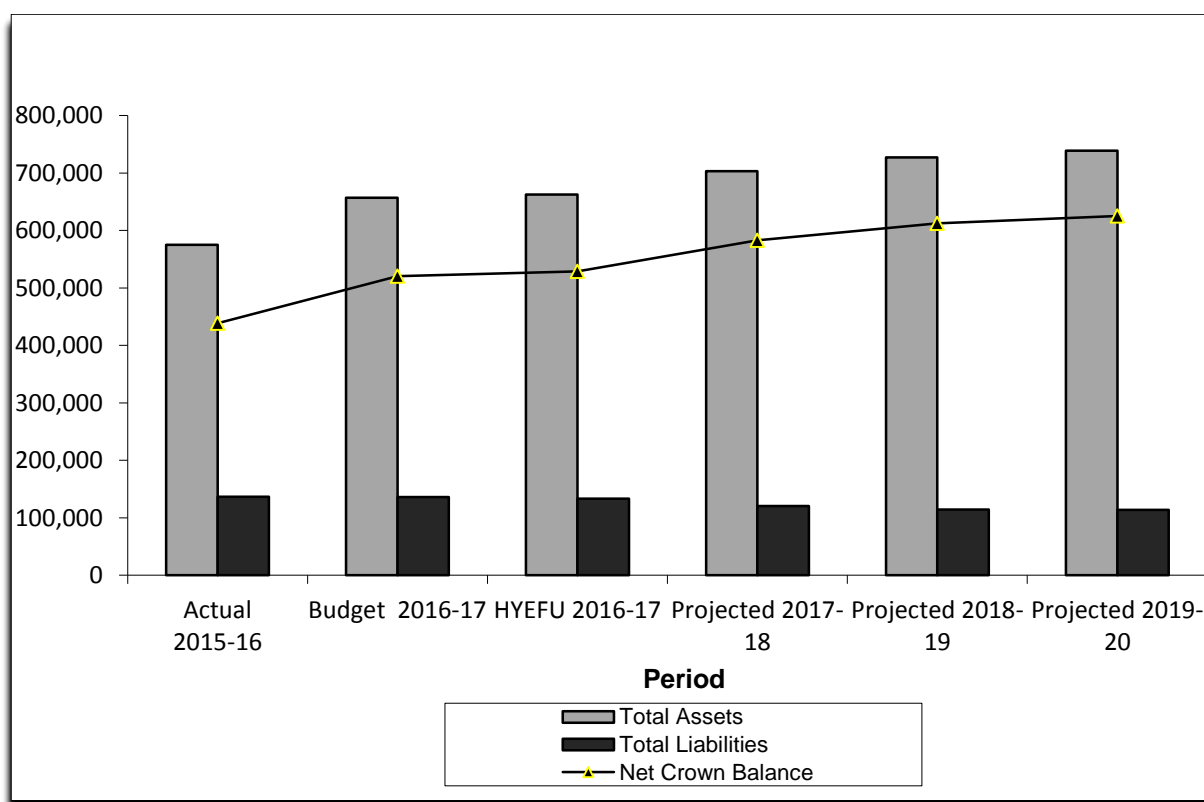
TAU has also indicated it is considering new borrowings to finance new investments in electricity generation and supply assets including infrastructure aimed at improving renewable energy distribution and supply.

Since the enactment of the 2014 LRF Act, all new debt (including SOE debt) must go through a full debt sustainability analysis, and be approved by Cabinet (via the Minister of Finance), on the advice of the Financial Secretary.

## 7.11 Net Worth

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

**Chart 7.10 - Net Worth 2015/16 to 2019/20, (\$'000)**



The estimated net worth of the Crown at June 2017 increased from the 2016/17 Budget Estimate of \$521.9 million to \$528.8 million. This is a net increase of \$6.9 million. This was primarily a result of the improvements in cash balances resulting from higher revenue forecasts.

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 in the outer years, and an injection to the Crown's asset from aid donor funding.

Higher than anticipated cash balances at the end of 2015/16, and further technical adjustments, have also resulted in a improvements to the cash position of the government since the 2016/17 Budget as seen in the Statement of Financial Position.

## 8 ODA HALF YEAR ECONOMIC AND FISCAL UPDATE

Official Development Assistance (ODA) of \$60.7 million<sup>10</sup> was appropriated for in the 2016/17 Budget, an increase from the 2015/16 Budget of \$49 million as a result of increased development assistance from the nations international partners. The estimated ODA spend from July to December 2016 is reported at \$15.5 million representing a 21% spend against the total budget for 2016/17 of \$72 million<sup>11</sup> which includes programmes under 3<sup>rd</sup> Party spends and new ODA programmes.

In the 2015/16 year, 56% of all budgeted ODA was expended, reflecting delays in implementation. Key examples of these delays are in significant capital projects such as Te Mato Vai, Apii Nikao, and the Sanitation Programme. An increased ODA spend for 2016/17 is anticipated as a result of this slippage. The following are updates only on development partner programmes with annual budgets of \$100,000 and over.

### 8.1 NEW ZEALAND PROGRAMMES

#### 8.1.1 Core Sector Support New Zealand (Formerly Performance Based Budget Support)

The Government of the Cook Islands and New Zealand have completed the first trial of the Performance Based Budget Support (PBBS) programme which ended in June 2016. The Cook Islands Government have just recently received a new Grant Funding Arrangement (GFA) which will replace the PBBS GFA. The new GFA is titled Core Sector Support (CSS) and is budgeted for two financial years 2016/17 and 2017/18 at a total value of up to \$21 million. This GFA is in effect and was approved and signed on the 11<sup>th</sup> November 2016.

The GFA still focuses on support towards key sectors such as improving the quality of health and education services, support towards the Tourism Industry and Public Sector capacity and capability development.

**Table 8.1 Core Sector Support**

	2016/17 Budget	2017/18 Budget
<b>Funding received under CSS</b>	<b>10,475,500</b>	<b>10,475,500</b>
Ministry of Health	1,250,000	1,250,000
Ministry of Education <sup>12</sup>	3,980,400	3,980,400
Tourism Corporation	2,500,000	2,500,000
Public Sector Strengthening/Technical Assistance Fund	2,745,100	2,745,100
<b>Total Expenditure from PBBS Funding</b>	<b>10,475,500</b>	<b>10,475,500</b>

<sup>10</sup> This excludes the amounts under the Grant Funding Arrangement (GFA) with New Zealand

<sup>11</sup> Including the full amount of the GFA with New Zealand (at the 2016/17 Budget, this was the Performance Based Budget Support)

<sup>12</sup> The 2016/17 Budget assumed funding of \$4.060 million and \$4.230 million for the Ministry of Education in 2016/17 and 2017/18, respectively. To reach these amounts, the gap between that paid by New Zealand, and that indicated in the Budget will be funded by the Cook Islands Government.

Total spend as at December 2016 is \$4,638,240 which was disbursed upon signing of the GFA.

### **8.1.2 Manihiki Lagoon Clean-Up**

From July – December 2016 period, the main activity involved completing the tender process as well as the awarding of the contract to implement the lagoon clean-up operations. Development Coordination Division (DCD) engaged a Project Manager to coordinate the procurement process, specifically compiling tender documents which were submitted to the Tender Committee in July with approval to proceed on 11 August 2016. Tender advertisement for the lagoon clean up resumed on the date of approval for this work with a required advertising period up to 7th September 2016.

The bids were evaluated by the Tender Panel with a tender report and recommendation for preferred bid submitted to the Tender Committee for approval on 20 September 2016. Delays from extending the advertising period and seeking Tender Committee approval for preferred bid resulted in further delays required the deadline for procurement of a lagoon clean up contractor by end of December 2016. A contract was expected to be signed in December 2016 to commence the clean-up operations in Manihiki immediately, however, this has been further delayed to be finalised in the new year.

The Manihiki Islands Government have signed up to an agreement to conduct the land-based disposal of the materials removed from the lagoon as part of this project with preparations for this work to happen just as soon as lagoon clean up contractor is signed up.

Total spend as at December 2016 is less than \$10,000 reflecting costings associated to prepare the tender process.

### **8.1.3 Pacific Maritime Technical Assistance**

Work continued as per the agreed project plan and time lines. Some key work items completed in the July - September quarter included the following;

Revision of Ministry of Transport (MoT) (Maritime) job descriptions, including provision of key administration items into the revision of the Finance Manager's position following her retirement was completed. The positions were transferred to the new format. The position for Senior Operations Officer, Maritime, will be advertised once the salary level and funding is confirmed.

The oversight policy for the open registry of the Cook Islands, provided by Maritime Cook Islands, was completed. The procedures for the oversight were completed, and are being implemented from 1 September 2016. Implementation will be reviewed after 4 months.

Following agreement from Cabinet for the establishment of the Cook Islands Hydrographic Service, the inaugural CINHCC (Cook Islands National Hydrographic Coordination Committee)



was held 6 September. The work on this item as per the action table for the Voluntary IMO Member State Audit Scheme (VIMSAS) is now complete.

Work continues on updating the action plans for the VIMSAS and the Strategic Plan (Maritime). In addition, the MoT website is nearing completion, with expected launch date in Q4 2016. To promote ongoing capacity building, an International Obligations Oversight Committee (IMOOC) has been implemented, with participation from MoT, MCI and MFAI. The IMOOC has resulted in opportunities to share experiences and learnings with regards to a number of areas related to obligations resulting from various IMO conventions and codes.

Total spend as at December 2016 is \$145,460.

#### **8.1.4 Social Impact Fund**

The Social Impact Fund Grant Funding Arrangements the jointly funded Social Impact Fund (SIF) Grant Funding Arrangements (GFA) with the New Zealand Government ended in June 2016. An independent evaluation of the SIF was undertaken from April 2016 to June 2016 and supported the continuation of SIF. The New Zealand Government has shifted its funding arrangements away from individual project related GFA to direct budget support, the procurement process for the continuation of the SIF has ended. New Zealand contribution of \$600,000 annually to the SIF has been programmed into the new Consolidated Sector Investments GFA supporting direct budget support.

The Cook Islands Government is providing the following funding arrangements to continue the programme, approve an additional appropriation of \$260,000 to the existing SIF POBOC in 2016-17, \$600,000 in 2017-18, \$600,000 in 2019-20 and \$340,000 in 2020-21 and to enable the procurement process for multi-year contracts under the Social Impact Fund to commence in November 2016. The Social Impact Fund (SIF) represents the Cook Islands Government's key mechanism to support CSOs in providing services that meet the needs of society's most vulnerable people.

#### **8.1.5 Tereora College Redevelopment (Phase 1)**

Phase 1 of the Tereora College Redevelopment Project funded by the New Zealand Government was tendered in the July-September quarter. The contract was awarded to Landholdings Ltd in October 2016. It was anticipated that two new buildings would be constructed in the 2017 calendar year however, Landholdings has made headway with the new Technology Centre Building where the ground-floor slab is now expected to be completed before Christmas, a month ahead of schedule. The ground work for the new Student Research Centre and Administration building is expected to take place during the school holidays.

Of the \$10.85 million grant from NZ, the Cook Islands Government (CIG) has received \$4.05 million, which was received in 2015/16. A further \$4.75 million has been received in 2016/17, with the remaining \$2.05 million to be received in 2017/18.

CIIC has expended approximately \$4 million to date. The 2016/17 allocation and balance remaining from 2015/16 will be expended in 2016/17.

With regard to ODA spending to date, \$4.5 million also spent to carry out construction of building and associated works and components (furnishing, equipment, utilities, landscaping, etc).

Landholdings Ltd, who was awarded the stage 1 demolition & earthworks and construction contracts, made headway over the weekend with the new Technology Centre building. The building foundation and ground-floor slab is now expected to be completed before Christmas, a month ahead of schedule. The ground work for the new Student Research Centre and Administration building will take place during the end of year school holidays. This includes the demolition of five existing buildings, relocation of the food-technology building to another part of the school, and diversion of utility lines within the construction site.

The contract for construction is valued at \$11 million which is funded by the New Zealand Government.

### 8.1.6 NZ Third Party Spends

There has been a total spend of \$131,311.27 in third party spends for the below New Zealand funded programmes.

Programme	Quarter Spend July – September (\$)
Targeted Sector Support	12,997.00
Tertiary Scholarships NZ	47,476.60
Tertiary Scholarships Pacific Regional	35,179.56
Commonwealth Scholars	3,360.00
Cook Islands Emergency Response Ambulance	11,779.67
Head of Mission Fund: Cook Islands	20,518.44
<b>TOTAL</b>	<b>\$131,311.27</b>

## 8.2 SECRETARIAT OF THE PACIFIC COMMUNITIES (SPC) PROGRAMMES

### 8.2.1 Cook Islands Household Income & Expenditure Survey

The Statistics Office is on track with field work data collection activities since the start of this one year survey in November 2015. For this quarter training of fieldworkers including data collection have been conducted for Manihiki to represent the Northern Group Islands. Trained data collection personnel conducted rounds 10-13 of the staggered two weeks survey periods for the selected household in Rarotonga and Aitutaki, Mangaia, Atiu in the South. At

the same time data entry and verification of data collected is also in process and in collaboration with the Statistics Programme at SPC.

Total spend as at December 2016 is \$30,588.

## **8.3 UNITED NATIONS ADMINISTERED PROGRAMMES**

### **8.3.1 FAO Improved production, processing and marketing of agricultural produce**

For 2013-2017, this is the focus under the Pacific Multi Country Programming Framework (CPF) with the aim to improve agriculture produce supply chain and increase in households engaged in agriculture for own use and for sale. To date, no monies have been spent nor direct payment to suppliers from this grant. In the pipeline will be negotiations for priority areas for CPF funding for the next 5 years.

### **8.3.2 Green Climate Fund Readiness**

The Green Climate Readiness support focuses on strengthening the National Designated Authority and effectively managing climate finance within the Ministry of Finance and Economic Management. The Readiness support has enabled the Government of the Cook Islands to strengthen the capacity of the National Designated Authority within the Climate Change Cook Islands Division (CCCI), OPM and Development Coordination Division, MFEM through the recruitment of two national consultants to progress the Cook Islands engagement with the Fund.

The Green Climate Fund team have been working on two submissions to the Green Climate Fund, one to develop a country programme readiness proposal which will include national prioritised climate change project proposal ideas and the other is to develop a proposal to the GCF board on direct access to the Green Climate Fund. The Cook Islands have recently been approved by the Green Climate Fund to apply for accreditation under the fast-tracked method as a result of the Cook Islands gaining accreditation to the Adaptation Fund in Washington DC on July 14th 2016 under the streamlined approach. The Fast-track approach is an achievement for the Cook Islands as it means we can apply under special conditions as highlighted in the Fast-track application process.

In hiring the national consultants, the Readiness Support has prompted the development of a second readiness application to the GCF. This is to develop a country programme which will consolidate national priority areas that addresses our national low-carbon development aspirations and to strengthen the resilience of our communities and our economies. This second readiness application will also be applied to assist with the growth and progression of relevant national frameworks and their implementation. The Readiness support has also prompted the strengthening of our institutional processes and in doing so, it has bolstered

national ownership, and it underscores the importance of Implementing Entities proposing partnerships that align with national priorities and vice versa.

The Cook Islands has submitted a second readiness proposal to the GCF secretariat at the value of USD \$600,000 over a period of two years to develop our country programme to consolidate key priorities to be funded through the GCF.

Total spend as at December 2016 is \$59,343.

### **8.3.3 UNDP Ridge to Reef**

Key Activities that led to this were the consultations conducted with various stakeholders that led to more support to these stakeholders in the quarter as well as continued support for both resources and activities. Training (capacity building) was a big component during the quarter with the provision of technical and compliance activities within the PRODOC. Both the National Environment Service (NES) and the Ministry of Marine Resources (MMR) conducted training with their staff to strengthen education and awareness. Resources during this quarter included signage for Protected Natural Areas identified such as Takitumu Conservation Area including materials that led to their installation during the quarter.

Other achievements during Quarter 3 were the purchase of satellite maps for planning purposes during the project lifetime, participation in the 51st Constitution Celebrations float parade, showcasing Ridge to Reef, working with the Department of Conservation from New Zealand on tagging of the Kakerori within TC as well as completion of mooring buoys that will be deployed in Q4 to Manuae and Takutea. A key outcome was the continuous support to the P3DM (Participatory 3Dimensional Modelling) exercise that was held for Mangaia. This is the second demonstration of such a modelling exercise and the first island wide modelling exercise. Supported by SRI CC project, this is envisaged to take up more time by the team to continuously support the rest of the islands P3DM in future. Equipment and building resources were purchased to begin the renovation of Pa Enea office spaces and this exercise will carry on from Q4 also.

It should also be noted that the Infrastructure Cook Islands has also advertised for a Project Manager position, for the delivery of the national components of the GEF Pacific Ridge to Reef Programme. The term of contract is three years whereby closing dates for receiving applications is 23<sup>rd</sup> December 2016.

The Ridge to Reef project spending to date is a total amount of \$296,165

### **8.3.4 UNDP GEF Strengthening the Resilience of our Islands and Communities to Climate Change (SRIC)**

The SRIC programme has been progressing extremely well. For the quarter, a total of 33 projects have been reported, of these projects 7 are new, 18 are continuing and 8 have been completed as listed below:

- a) Aitutaki – Fertilizer
- b) Atiu - Fishing Boat
- c) Manihiki Hydroponic
- d) Mitiaro - Maroro Tu Paiere & Shelter
- e) Palmerston - Worm Fams & Brush Chipper
- f) Pukapuka – Fishing Boat

The SRIC team have carried out a total of 4 workshops. Workshops in this quarter have seen a huge interest of participation in the Pa Enea. The Negotiation Workshop in Rarotonga had 24 participants (22 women and 2 men), the Maroro Tu Workshop had 57 participants (26 woman and 31 men) in Mitiaro, the Raurau Akamatutu in Mitiaro had 57 participants (29 women and 28 men), and the P3D Modelling workshop had 67 participants (46 women and 21 men). Typically workshop participants in the Pa Enea range from 20 to 30 people. There is a huge interest and support from the community for SRIC-CC related workshops and projects in the Pa Enea as they have seen many of these projects in their communities.

The communications component of SRIC has been extremely active through media and print, specifically via the Cook Islands Radio, Cook Islands TV and the Cook Islands News Paper. The SRIC reach on social media has increased markedly this quarter compared to previous quarters. The summary to date of social media activity on Facebook is

- 1st Quarter - 6,201 people reached;
- 2nd Quarter - 45,644 peopled reach; and
- 3rd Quarter - 273,796 people reached.

Further evidence of the social media penetration is the amount of total 'likes' has now reached 2,165.

Total spend as at December 2016 is \$846,879.

### **8.3.5 UNDP Nagoya Protocol**

Contractor services to review and draft the appropriate Access and Benefit Sharing legal framework has been reprogrammed from the 3rd quarter to the next quarter pending further gap analysis of the current legal instruments by Crown Law. CIMTECH-Parnell technology transfer program has also been extended and reprogrammed to the 4th quarter.

Main spends for this quarter includes the 1st instalment of reimbursement for the payment of the Project Coordinator's salary and the costs of the Coordinator's attendance at the Samoa UNDP GEF Project Management Workshop.

Total spend as at December 2016 is \$27,070.

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

After the successful staging of the 1st NBSAP National Workshop by the International Consultant and the Project Coordinator, follow up stakeholder meetings were held throughout the quarter. The Mayor and Island Council of Aitutaki warmly welcomed Dr Dave Butler and the PC on a one-day field trip visit to Aitutaki to review the status of the Island's biodiversity.

The quarter's Biodiversity Project Steering Committee meeting was held on 5 July 2016. All UNDP-GEF Project Coordinators presented their various reports and these were endorsed by the Committee. An in-house Communications Workshop was conducted by Ms Nannette Woonton of SPREP on 12 July 2016.

Final short-listed interviews for the NBSAP Technical Assistance was carried out under group A for Environmental economics, finance and biodiversity mainstreaming on 27th September & group B for Capacity needs assessment for biodiversity management on 13th September 2016. It is planned that final selection and contracts be completed by 10th October 2016. The draft 5th National Report to the CBD was provided by Dr Dave Butler to the Project Coordinator on Monday 26th September 2016. This was duly in accordance to the Contract award. Copies were submitted to the IFD Manager and to UNDP. The PC is working with the Lead Consultant to complete the final parts to the Report. It is planned that this will be completed by the end of Q4 or early Q1 2017.

Total spend as at December 2016 is \$16,579.

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

The National Communications work program picked up after the Brilliant Resilient initiation workshop generated a lot of interest and awareness both in government and the public. The 3rd quarter kicked off to a great start, but unfortunately this did not transpire into concrete actions with the sudden passing away of one of the technical working group team leaders and the resignation of the National Project Coordinator.

However, technical working groups were established, the recruitment processes to outsource the greenhouse gas and mitigation components was 90% completed. Appointment has been held off till the new coordinator is on board. There was active participation at the IPCC

guidelines training workshop in South Korea. Recruitment process for the vacant National Communications Coordinator position was conducted and completed with the successful applicant appointed and due to commence in January 2017. Presentation was made to the Climate Change and Disaster Risk Platform meeting in September on the IPCC workshop.

Total spend as at December 2016 is \$18,818.

### **8.3.8 World Health Organisation Technical Cooperation Biennium Budget Support**

Biannual funding to the Cook Islands is approximately US\$400,000 for 2016-17 calendar years. Human resources development including fellowships aligned to the Clinical Workforce Development Plan. Ongoing focus is also on activities towards non communicable diseases action plans, health promotion, nutrition and tobacco control towards implementation of National Health Strategy and the National Strategy and action plan for NCDs.

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

Despite competing priorities MOH has confidence in full implementation of existing programmes with at least 70% targets to be reached by December for 2016. SPC provides technical service towards implementation of health programmes.

Ministry of Health September 2016 month financial report show a year to date spend at \$120,323.38.

## **8.4 INDIA GRANT FUND**

To date USD \$700,000 (NZD \$975,000) has been spent on projects funded by the Government of India since the inception of the grant in 2006. A further USD \$710,000 (NZD966,000) grant fund request has been submitted to the Government of India for the 2016/2017 round for consideration and is expected to be disbursed in early 2017.

The 2016/2017 process was open for proposals in March 2016, with shortlisted final applications submitted to the National Sustainable Development Committee (NSDC) for prioritisation before submission to the Government of India in August 2016. A few projects from the previous 2013/2014 round were recently completed in 2016 or have yet to be completed due to delays in receiving the funds (disbursed mid 2015), shortage of supplies on island, and other commitments by both project implementers and suppliers towards the 50th Constitution Celebrations.

The 2016/2017 grant round has been endorsed by the India High Commission and is awaiting final assessment by the Government of India; DCD is working closely with MFAI to ensure timely disbursement and finalise a set timeframe for submissions.

DCD met with the High Commissioner His Excellency Vishvas Vidu Sapkal to the Suva office in November and informed that the proposals submitted by the Cook Islands is currently been reviewed by the Embassy and will be in a position to confirm the outcome of funding from India in early 2017.

## **8.5 KOREA GRANT FUND**

In 2014/2015 the Republic of Korea approved a grant application for USD200,000 to the Ministry of Cultural Development for Audio Visual Equipment and Operating Room allocating in July 2015 and completed in November 2015. The proposed upgrades would go towards supporting cultural projects for the Cook Islands 50<sup>th</sup> Constitution Celebrations. The funds were requested and provided as a cash grant with national systems used to procure the equipment.

The grant is open for applications annually up to the value of USD200,000, a proposal for utility vehicles for the Pa Enuva was submitted in 2015/2016 round however missed the deadline and has been resubmitted for the 2016/2017 Round. To date, a final decision on whether the proposal has been accepted is expected in early 2017.

To date, there have been no expenditure as DCD is still awaiting final confirmation from the Korean Embassy.

## **8.6 CHINA PROGRAMMES**

The CIG hosted a Chinese delegation who conducted on-site inspections and feasibility study for maintenance and repairs work on the Ministry of Justice building, National Police Headquarters and Bluesky Sports Arena (formerly Telecom Sports Arena) that were constructed in 2004, 2006 and 2009 respectively by way of grant and concessional loans from the People's Republic of China (PRC). The team was led by Mr. Yuan Wei which comprised of structural, architectural, electrical, heat & ventilation/air conditioning, water and sanitation experts and engineers accompanied by an interpreter.

The outcome of the visit saw the signing of the comprehensive list of contents for repairs and maintenance works on the three buildings between CEO Tutangata and team leader Wei. The Minutes of Talks relating to the renovations of the said buildings were subsequently signed by Financial Secretary Garth Henderson on behalf of CIG and Counselor Zhang on behalf of the PRC.

On Friday 18 November 2016, the Economic and Technical Cooperation Agreement (ETCA) for renovations to the Ministry of Justice, but not limited to this project, was signed by High Commissioner Teremoana Yala on behalf of the CIG and the Chinese Ambassador Wang Lutong for the PRC to support the maintenance works at the value of RMB Yuan 20 million (approx. NZD \$4.2 million).

Ongoing discussions between CIIC, MFAI and the PRC to finalise the Letter of Exchange relating to the repairs and maintenance work on the Ministry of Justice building, National



Police Headquarters and Bluesky Sports Arena continue with the hopes of signing in early 2017 .

During his brief visit to the Cook Islands in November, Counsellor Zhang acknowledged that the Apii Nikao is the last of the major projects that China is involved with and encourages the CIG to identify other priority sectors that may require funding to keep the momentum of cooperation and good relations between the PRC and the Cook Islands.

### **8.6.1 Apii Nikao Construction**

The Cook Islands Investment Corporation (CIIC) received draft preliminary designs for the Apii Nikao School in September, comments were sent to PRCs design team in October regarding amendments to the designs. The PRC design team arrived on Rarotonga in late November to finalise the preliminary design with CIIC. On 5 December 2016, the Apii Nikao Preliminary Design was approved by CIIC.

According to the timelines in the Implementation Agreement for Apii Nikao Rebuild, with the approval of the preliminary designs now signed off, the project will move to the Construction Design phase which is expected to take 4 months for the PRC design team to prepare the construction drawings. A further month has been allowed for approving these drawings, before mobilisation begins.

## **8.7 EUROPEAN UNION PROGRAMMES**

### **8.7.1 Deep Seabed Minerals**

This is a 3rd Party spend through SPC. The EU reports and signs off upon DCD request. This programme is coming to close in 2016 and can be made inactive after 2015/16 budget reporting. Future funding may be available for consideration at the negotiations of EDF 11. Officials from MFEM and MFAI will be attending the high level consultations to discuss regional priorities and also reflecting the Cook Islands National priorities.

### **8.7.2 EU Budget Support**

The European Union (EU) continues its Official Development Assistance via the budget support modality. The unfortunate delay in the implementation of sanitation upgrades resulted in the absence of funding in 2014/15, this has since been remedied with the CIG receiving the final tranche of the EDF 10 budget, €1 million in October 2016. With the 10th cycle (EDF10) approaching its conclusion, focus now moves to the 11th cycle (EDF11) of funding to continue with its incentivized budget support to allocate funding using national systems up until the year 2020. The EU will continue its budget support under the 11th EDF with the continued focus on improving the Sanitation Sector.

There has been no expenditure for the Cook Islands under the Pacific Island Integration Technical Assistance Project (PITAP) for the quarter. This funding is accessed from the regional indicative package under the 10th EDF, so there is no specific country allocation. It

is organized so that funds are expended on regional initiatives as EU recognizes that National Indicative Packages are available to Member States for national specific priorities.

Under the 11th EDF, this may change however this is still being discussed as programming is ongoing.

DCD has submitted all two proposals for utilisation of TA funds from the EU, MFEM received second tranche of the 10th EDF in October, €1 million. There are two submission that will be put forward for Technical Assistance (TA), one has already gone through and this relates to the rehabilitation of the Muri Lagoon. The second TA is for feasibility studies for a Centralised Laboratory.

DCD has sent submissions through for the 11th EDF Funding relating to the Sanitation Sector. The focus of this submission is on upgrading commercial facility sewage systems on Aitutaki and Rarotonga to meet the Public Health Regulations 2014.

### **8.7.3 EU Partnership Multiyear Fisheries Policy Support**

This agreement for sustainable fisheries partnership includes an annual fisheries sector contribution of €350,000 by the European Commission under the 4 year protocol.

To date, the Ministry of Marine Resources reports no expenditure.

## **8.8 FORUM FISHERIES AGENCY (FFA)**

### **8.8.1 Project Development Fund – US Fisheries Treaty**

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

To date, the Ministry of Marine Resources reports no expenditure.

## **8.9 MULTILATERAL PROGRAMMES**

### **8.9.1 Renewable Energy**

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

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

New Zealand funding has been used for the construction of renewable energy infrastructure on Rarotonga and islands of the Northern Group and involves the installation of following renewable energy generation infrastructure.

This project is now completed.

### **8.9.2 The focus now moves to the Southern Group.**

The Renewable Energy Programme is in progress with the Cook Islands Renewable Energy Sector Project (COO46453-002) Phase 1 contract for Atiu, Mauke, Mitiaro, Mangaia, signed during this period with NETCON Limited of New Zealand. This is a major component of this project valued at NZ\$7.7 million and €1 million.

The civil work component for all islands will be tendered in December 2016. As part of the whole project, the rehabilitation of the power upgrade network for two islands of Mitiaro and Mauke will be upgraded. It is anticipated a civil works contract will be signed and work will commence in March 2017.

A draft pre-feasibility study for Aitutaki was presented to the Aitutaki Island Council and Aitutaki Power Supply. Tenders will occur after Phase 1 contracts have been confirmed. The Aitutaki Phase 1 will cost between NZ\$3.5 – 4.5million.

The feasibility study for the Rarotonga Battery Energy Storage (BESS) project was completed this quarter. The tender for this project was released and a contract should be signed early next quarter. This project will be funded under the GEF6 for about NZ\$5.5 million.

During this quarter the TA for the Governance and Management of the Outer Islands Power Supply was undertaken. A consultation workshop was carried and draft cabinet paper was circulated for comments. It is envisaged that a paper will be submitted for Cabinet decision in the next quarter. This TA is funded by New Zealand for \$85,000.

Total spend as at December 2016 is \$1,555,031.

### **8.9.3 Sanitation Upgrade Programme**

The Sanitation Upgrade Programme (SUP), which commenced following completion of the WMI, was designed to install up to a further 1,000 on-site systems on Rarotonga and Aitutaki. The SUP grant arrangement between the Governments of New Zealand and the Cook Islands was signed in June 2014, and the programme was expected to end on 30 June 2018. This \$18 million programme includes funding from New Zealand (\$10 million), the European Union (\$4 million), and the Cook Islands (\$4 million).

The Sanitation Upgrade Programme was a continuation from the Muri Pilot Waste Management Initiative (WMI). The intention of the SUP was to continue with the installation of on-site effluent treatment systems beyond the Muri area. This work has continued but progress was slow.

The slow progress, and doubts about the impact of the programme led New Zealand to suspend its funding towards SUP from September 2015 and the EU to withhold a €500,000 payment. These issues and an extensive outbreak of algae and seaweed growth in Muri Lagoon in late 2015, led to a review the Muri Pilot Waste Management Initiative.

This review was commissioned and conducted in December 2015. The recommendations of this review were largely in accord with other reports and suggested that a reticulated collection, treatment and disposal system was the only effective way to completely remove domestic and commercial wastewater from the Muri lagoon environment. The report highlighted gaps in the on-site Sanitation Upgrade Programme which may be a contributor to the slow delivery of the programme. Cabinet accepted this report's findings and recommendation and directed MFEM to negotiate the redirection of funds with the development partners towards this end.

Following a request received from of the Cook Islands Government, NZ MFAT engaged Calibre Consulting in June 2016 to develop a plan to achieve Cabinets directives. Calibre has completed this work and broadly itemised two parallel work streams, (1) an institutional/organizational work stream, and (2) a technical work stream.

For the technical work stream, as a first step, Calibre identified that essential Project Preparatory Technical Assistance (PPTA) is required to be in a position to provide Cabinet with the additional information it has previously requested. Work to be carried out will includes site investigations, full assessment of collection, treatment disposal options, cost benefit analysis and consultation with relevant stakeholders. This work will require a multi-disciplinary technical assistance package of support. It may be provided by one or multiple consultancies. The €500,000 technical assistance will be used to complete some of these activities. The work may take up to eighteen months to complete. A specific task to be completed in the PPTA phase is the development of an On-site Effluent Treatment Plan for Rarotonga and Aitutaki. Once this plan is completed, it will be possible to resume with a revised SUP programme if this is delivers an acceptable impact on achieving the long term goal of the protection of public health and the environment.

Calibre recommended that work on the institutional/organisational work stream be completed in parallel but separate to the technical work stream. This work was considered equally important to ensure that there is a viable and sustainable institutional framework in place beyond the life of the project (technical work stream).

The clear delineation of the work streams allows specific focus onto each one. The technical work can be continued under the guidance of an expanded TMV PSG/PMU, while the essential institutional/organisational work is driven independently by the Cook Islands Government.

On the 8 November 2016, Cabinet endorsed a proposal to establish a more effective approach to water and waste water (sanitation) planning and management. The existing project

management unit (PMU) for Te Mato Vai will incorporate the management of the Wastewater Project (currently the Sanitation Upgrade Programme). This new approach will bring together key government agencies under one steering group enabling consistent government policy development and direction, more effective and broader community and industry consultation and access to finance for technical expertise not available within government agencies. The lessons learnt during the design and delivery of Te Mato Vai Project will strengthen this new approach. This approach is expected to provide a high degree of certainty and confidence to our communities and industry.

The environmental impacts of the growth in domestic housing and tourism development in Rarotonga and Aitutaki in our foreshore area are major concern and need to be addressed urgently. The existing water quality data and bathymetry studies will need to be enhanced to support effective decisions making as well as the consultative process with the communities and general public.

As an immediate step, a full assessment of options to determine the most cost-effective and technically viable long-term solutions for the collection, treatment and disposal of wastewater on Rarotonga and Aitutaki is required. This preparatory work will commence immediately and is expected to take up to 18 months before construction commences.

Government recognises that in the interim period before effective systems are in place that address the treatment of our waste water, decisions need to be made to mitigate the environmental impacts of substandard systems. With special reference to Muri lagoon, government will work within the law, and work with communities to develop interim solutions that minimise the environmental impacts on our lagoons.

The direction of the current onsite domestic system upgrade will be outlined in a detailed work plan under development to determine where the on-site treatment can be installed with maximum effect. A temporary pause to the on-site wastewater treatment upgrade on Rarotonga is required while this plan is being completed.

Developing an effective solution to managing our waste water and its impacts on our environment, our communities and our economy is a complex process and government looks forward to undertaking this process in a participative and consultative manner based upon sound science in the best interest of all.

With regard to ODA spending for the quarter July-September 2016, no funds have been spent. All expenses came from Government shared costs budgets for this project.

#### **8.9.4 Te Mato Vai (TMV)**

The TMV project is the largest single infrastructure project in the Cook Islands since the construction of the international airport in Rarotonga in 1974. The project is broadly divided into two stages – Stage 1, the replacement of the ring main; and Stage 2, refurbishment of intakes and provision of storage, filtration and trunk mains. Stage 1 was delivered by the China Civil Engineering Construction Corporation (CCECC) and is practically near complete.

Implementation of the TMV project is being managed by the Project Management Unit (TMV PMU) now led by GHD Ltd. The TMV PMU reports on the following activities:

##### *Stage 1*

The ring main pipeline construction works, carried out by the China Civil Engineering Construction Corporation (CCECC) is completed. At this stage CCECC are carrying out outstanding works that were identified by the Project Management Unit (PMU) before the final Check and Acceptance inspections are carried out. Outstanding works include fire hydrant and valve chamber reinstatement and road reinstatement works. Once the inspection is carried out and approved, the Check and Acceptance certificate will be signed off and the maintenance period of 12 months will commence. During the maintenance period, if there are any defects in the construction works, CCECC will remedy the defects found.

Another component of the stage 1 project is to commission the new ring-main, which carries the water distributed from all of the intakes around the island. There are existing cross connections located around the island on the main and back roads at 1km intervals, these cross connections distribute water from the existing ring-main pipe line to the sub-main pipeline where everyone is connected on.

This commissioning project involves connecting the existing cross connections to the new ring-main, this project will involve disruptions to the existing water supply around the island. It is planned to commission the ring-main in one kilometre sections to minimise disruption to the existing system. It is expected the physical works will start in February 2017, but prior to the work starting in a particular section of Rarotonga, the public will be advised that disruptions will take place within that section.

##### *Stage 2*

Meetings were conducted with landowners of all 10 intakes that are to be upgraded for the Te Mato Vai project, the meetings were conducted from August to December 2016. The purpose of the landowner meetings was to seek agreements from the landowners to allow contractor's early site access to carry out survey works to complete the final designs. The consent form was originally drafted by lawyer Tim Arnold and Manavaroa Philip Nicholas for Avana intake but was adopted for the other 9 intakes. The consent describes obtaining landowner consent for the design contractor early site access to prepare detailed plans which will give the landowners full details of exactly what areas of land will be directly affected by

that upgrade. That information will let owners of those areas, for themselves, make a full, informed, decision whether to allow that work to proceed without objection; and whether to seek compensation for loss or damage suffered.

The consent also allows landowners to be present on site when the design and survey works are being carried out. Landowners will be advised to meet and discuss construction works, once the detailed designs and surveys are complete.

To date consents for early site access have been obtained from Avana, Avatiu, Matavera, Ngatoe, Papua, Taipara, Takuvaine, Totokoitu, Tupapa and Turangi.

Any further delays to the implementation to the constructions will incur additional costs to the TMV project.

The Cook Island and New Zealand Governments would like to thank all landowners that attended the landowner meetings and for allowing their consent to allow contractor's early site access to carry out survey works

#### *Special TMV Select Committee*

The Te Mato Vai Project Special Select Committee was established by Parliament in June 2016 to consider the grievances and concerns of the petitioners of the Te Mato Vai project in light of the existing status and progress of the project and to report the findings and conclusions of the Committee to Parliament by December 2016.

Committee meetings were held at Parliament Chamber on 24 & 27 October, 03, 10 & 23 November to discuss the petition and to hear presentations from the petitioners, landowner representatives, staff from CIIC, MFEM, NES and the TMV Project Management Unit.

The staff from the different agencies dedicated their time to attend the committee meetings over the period but welcomed the opportunity to work with the Special Select Committee

To date, no funds have been spent. All expenses came from Government budgets.

#### **8.9.5 Aid Effectiveness**

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

An increased budget of 160,000 was allocated for the 2015/2016, and also to the 2016/2017 and 2017/2018 financial years. The Development Partners roundtable has been approved by cabinet shifting to biennially and is currently planned to fall within the 2016/2017 financial year, around late 2016.

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

## 8.10 NEW PROGRAMMES APPROVED FOR IMPLEMENTATION

In August 2016, it was brought to the attention of the Development Coordination Division of the Ministry of Finance and Economic Management that several government agencies received funding from Donor partners to execute programmes in the financial year 2016/17. These new programmes were not included in the appropriation schedule for FY2016-17 due to non-inclusion in the annual budget process. Given that these omissions are less than 5% of the total appropriation for ODA, legal advice allowed for the implementing agencies to expend funds to ensure timely implementation of programmes and transparency in reporting of programmes already implemented but not captured in the ODA appropriation. The table below outlines ten new programmes and projects to be implemented. The programmes will formally be appropriated in Parliament during the supplementary budget process scheduled for the end of 2016 as the Appropriation Amendment Bill 2016/17.

Govt Agency	Project Name	Development Partner	Start Date	End Date	FY2016-17 Budget NZD <sup>13</sup>
MOCD	National Auditorium Indoor and Outdoor Sound Equipment	China	Jul-16	Dec-16	586,180
NES	HCFC Phase-out Management Plan for PIC Countries through Regional Approach Stage 1 Second tranche	MLF/UNEP	Jul-16	Jun-21	35,308
NES	Review and Update the National Implementation Plan for the Stockholm Convention on Persistent Organic Pollutants (POPs) in the Cook Islands	UN Environment Programme (UNEP)	2016	2018	76,831
NES	Pacific POPs Release Project	GEF/UNEP/SPREP	Jul-16	Jun-18	25,173
NES	Development of Minamata Convention Mercury Initial Assessment in Pacific	GEF/UNEP/SPREP	2016	2018	39,296
NES	Survey of ODS Alternatives at the National level in the Cook Islands	GEF/UNEP/SPREP	2016	2018	35,714
MFEM	RSA Cemetery NZ PDCT Project	New Zealand	2016	2017	50,000
MFEM	The Project for the Upgrade of Avana Harbour	Japan	2016	2017	110,071
MFEM	The Project for the Improvement of the Fire Station in Teimurimotia	Japan	2016	2017	93,653
MFEM	The Project for the Improvement of	Japan	2016	2017	113,000

<sup>13</sup> Exchange rate is based on rates provided by BSP dated 18.08.2016. USD conversion rate is 0.7647



<b>Govt Agency</b>	<b>Project Name</b>	<b>Development Partner</b>	<b>Start Date</b>	<b>End Date</b>	<b>FY2016-17 Budget NZD<sup>13</sup></b>
	the Te Kainga Mental Health Respite Centre				
MFEM	Non Project Grant Aid	Japan	2016	2017	1,335,113
MFEM	Project for Reinforcing Meteorological Training Function of FMS	JICA (Japan)	2016	2017	1,095
MFEM	JICA Training Program for Young Leaders/Local Governance Course	JICA (Japan)	2016	2017	33,151
MFEM	JICA Training Program for Basic Education science, maths, local governance and law and order	JICA (Japan)	2016	2017	90,748
MFEM	Germany Small Grants - Fire Station in Teimurimotia	Germany	2016	2017	14,400
<b>Total</b>					<b>2,639,733</b>

## 9 STATEMENTS OF FISCAL RESPONSIBILITY

### 9.1 Statement of Fiscal Responsibility (Operating)

#### Operating Statement (\$'000)

	2016/17 Budget	2016/17 HYEFU	2017/18 Projection	2018/19 Projection	2019/20 Projection
<b>Operating Revenue</b>					
Taxation Revenue	109,634	117,503	119,336	121,363	122,965
Other Crown Revenue	15,031	14,830	14,983	15,033	15,033
Trading Revenue	6,161	6,161	6,149	6,149	6,149
Interest on Loans to Subsidiaries	702	702	676	676	676
Dividends	1,787	1,787	1,947	2,153	2,153
Interest on Balances	1,885	1,885	1,885	1,885	1,885
Performance Based Budget Support - Core Funding	7,577	8,577	8,577	0	0
<b>Total Operating Revenue (excluding Bonus)</b>	<b>142,777</b>	<b>151,445</b>	<b>153,552</b>	<b>147,259</b>	<b>148,861</b>
Performance Based Budget Support - Bonus Payment	1,000	0	0	0	0
<b>Total Operating Revenue (including Bonus)</b>	<b>143,777</b>	<b>151,445</b>	<b>153,552</b>	<b>147,259</b>	<b>148,861</b>
<b>Operating Expenditure</b>					
Ministry Outputs	101,409	102,012	104,631	97,164	96,869
<i>Personnel</i>	48,578	48,621	48,652	47,443	47,434
<i>Operating</i>	19,637	19,750	19,299	16,443	16,457
<i>Administered Payments</i>	29,173	29,621	32,641	29,241	28,942
<i>Depreciation</i>	4,020	4,020	4,039	4,036	4,036
POBOC	23,648	23,978	23,057	22,468	22,631
Airport Authority subsidy	0	0	0	0	0
Airport Authority Capital	0	0	0	0	0
Bank of the Cook Islands - social assistance subsidy	0	0	0	0	0
Concession Loan Fund - Top Ups	0	0	0	0	0
Cook Islands Primary Schools 50 year Saver	0	0	0	0	0
Public Sector Strengthening	0	0	0	0	0
Ports Authority - subsidy	0	0	0	0	0
Te Aponga Uira - social assistance subsidy	0	0	0	0	0
Debt Interest Contribution to LRF	1,710	1,710	1,696	1,688	1,688
Asset Management (CIIC)	0	0	0	0	0
Crown Infrastructure Depreciation	3,682	3,682	3,682	3,682	3,682
Transfer to Emergency Response Trust Fund	604	604	50	50	50
Depreciation Contingency Fund	2,362	2,362	3,957	4,066	4,066
<i>Chinese Equipment</i>	663	663	663	663	663
<i>Rarotonga Water Network</i>	299	299	694	803	803
<i>Northern Pa Enuā Renewable Energy System</i>	400	400	400	400	400
<i>Southern Pa Enuā Renewable Energy System (excl. Aitutaki)</i>	0	0	1,200	1,200	1,200
<i>Other Assets</i>	1,000	1,000	1,000	1,000	1,000
Contingency Funds - Operating	100	200	100	100	100
Contributions to CISWF	0	0	0	0	0
<b>Total Operating Expenses</b>	<b>133,515</b>	<b>134,548</b>	<b>137,173</b>	<b>129,217</b>	<b>129,086</b>
<b>Operating Surplus/(Shortfall) (excluding Bonus)</b>	<b>9,262</b>	<b>16,896</b>	<b>16,379</b>	<b>18,042</b>	<b>19,774</b>
<b>Operating Surplus/(Shortfall) (including Bonus)</b>	<b>10,262</b>	<b>16,896</b>	<b>16,379</b>	<b>18,042</b>	<b>19,774</b>

## 9.2 Statement of Fiscal Responsibility (Non-Operating)

### Financing and Applications Statement (\$'000)

	2016/17 Budget	2016/17 HYEFU	2017/18 Projection	2018/19 Projection	2019/20 Projection
<b>Reductions in Net Borrowings</b>					
Loan Disbursements	11,984	12,337	0	0	0
Contribution to Loan Reserve Fund	8,603	9,378	9,447	9,506	9,024
	<b>-3,381</b>	<b>-2,959</b>	<b>9,447</b>	<b>9,506</b>	<b>9,024</b>
<b>Capital Expenditures</b>					
Ministries and Outer Islands (Including CIIC Capital)	36,663	36,673	34,433	8,450	5,918
Infrastructure Capital Investment in SOEs	0	0	0	0	0
Airport Authority	0	0	0	0	0
Te Aponga Uira	0	0	0	0	0
Contingency Funds - Capital Expenditure	50	0	0	0	0
	<b>36,663</b>	<b>36,673</b>	<b>34,433</b>	<b>8,450</b>	<b>5,918</b>
<b>Foreign Aid</b>					
Receipts	-60,661	-64,543	-32,813	-16,293	-4,687
Expenditure	60,661	64,543	32,813	16,293	4,687
	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Other Committed Considerations</b>					
Transfer to Reserve Trust Fund	548	588	597	607	615
ADB Share Capital	0	0	0	0	0
Disaster Response Fund	604	604	50	50	50
	<b>1,152</b>	<b>1,191</b>	<b>647</b>	<b>657</b>	<b>665</b>
<b>Total Non-Operating balance</b>	<b>-34,434</b>	<b>-34,906</b>	<b>-44,527</b>	<b>-18,613</b>	<b>-15,607</b>
<b>To be Funded by</b>					
Operating Surplus	9,262	16,896	16,379	18,042	19,774
Depreciation	10,065	10,065	11,679	11,784	11,784
<i>of which: R.E. Capital Replacement</i>	<i>400</i>	<i>400</i>	<i>1,600</i>	<i>1,600</i>	<i>1,600</i>
Unencumbered Cash Reserves	5,695	-2,243	6,972	-20,769	-25,025
Contribution to Loan Reserve Fund	8,603	9,378	9,447	9,506	9,024
Economic Recovery Support Program	206	206	0	0	0
Transfer to Emergency Response Trust Fund	604	604	50	50	50
<b>Total Funding Items</b>	<b>34,434</b>	<b>34,906</b>	<b>44,527</b>	<b>18,613</b>	<b>15,607</b>
<b>Net Surplus/Shortfall</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>

## **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 2016

	Actual 2015-16	Budget 2016-17	HYEFU 2016-17	Projected 2017-18	Projected 2018-19	Projected 2019-20
	('000)	('000)	('000)	('000)	('000)	('000)
<b>Revenue</b>						
Taxation revenues	116,270	109,634	117,503	119,336	121,363	122,965
<u>Other revenue</u>						
Revenue on behalf of the Crown	24,492	22,608	23,407	23,559	15,032	15,032
Sale of goods and services	5,721	6,161	6,161	6,149	6,149	6,149
Interest	1,627	2,587	2,587	2,561	2,561	2,561
Dividends	818	1,787	1,787	1,947	2,154	2,153
<b>Total Revenue</b>	<b>148,928</b>	<b>142,777</b>	<b>151,445</b>	<b>153,551</b>	<b>147,259</b>	<b>148,860</b>
<b>Expenditure</b>						
Appropriations to agencies	92,951	101,409	102,012	104,630	97,163	96,868
Payments on behalf of Crown	23,116	23,648	23,978	23,057	22,468	22,631
Debt-servicing interest	2,571	1,710	1,710	1,696	1,688	1,688
Building maintenance	1,798	0	0	0	0	0
Infrastructure depreciation	2,920	3,682	3,682	3,682	3,682	3,682
Other expenditure	0	400	400	1,600	1,600	1,600
<b>Total Expenditure</b>	<b>127,442</b>	<b>133,516</b>	<b>134,548</b>	<b>137,173</b>	<b>129,217</b>	<b>129,085</b>
<b>NET OPERATING SURPLUS / (DEFICIT) *</b>	<b>21,487</b>	<b>9,262</b>	<b>16,897</b>	<b>16,379</b>	<b>18,042</b>	<b>19,774</b>

\* 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

	Actual 2015-16	Budget 2016-17	HYEFU 2016-17	Projected 2017-18	Projected 2018-19	Projected 2019-20
	('000)	('000)	('000)	('000)	('000)	('000)
<b>Assets</b>						
Cash and equivalents	45,448	33,539	38,992	22,819	34,337	50,551
Loan reserves	17,788	17,464	18,593	17,713	14,927	9,398
Trust accounts	0	400	400	2,000	3,600	5,200
Inventory	7,327	8,455	8,519	9,166	9,822	10,487
Tax receivables	4,395	4,395	4,395	4,395	4,395	4,395
Debtors and other receivables	16,714	16,713	16,713	16,713	16,713	16,713
Advances to SOEs	10,699	10,699	10,699	10,699	10,699	10,699
Investment in SOEs	26,206	26,206	26,206	26,206	26,206	26,206
Plant, property, and equipment	146,733	146,733	146,733	146,733	146,733	146,733
<b>Total Assets</b>	<b>299,990</b>	<b>392,136</b>	<b>391,142</b>	<b>446,709</b>	<b>459,670</b>	<b>458,491</b>
<b>Liabilities</b>						
Creditors and other payables	30,954	26,283	26,284	21,937	20,831	20,781
Trust liabilities	7,653	8,251	8,252	9,028	13,058	19,601
Borrowings	97,918	101,611	98,783	89,424	80,548	73,387
<b>Total Liabilities</b>	<b>136,525</b>	<b>136,145</b>	<b>133,319</b>	<b>120,389</b>	<b>114,437</b>	<b>113,769</b>
<b>Net Crown Balance</b>	<b>438,775</b>	<b>520,595</b>	<b>529,073</b>	<b>582,764</b>	<b>612,665</b>	<b>625,104</b>

**Statement of Cashflows**  
For the year ending 31 December 2015

	Actual 2015-16	Budget 2016-17	HYEFU 2016-17	Projected 2017-18	Projected 2018-19	Projected 2019-20
	('000)	('000)	('000)	('000)	('000)	('000)
<b>Cashflows from Operating Activities</b>						
<u>Cash provided from:</u>						
Taxation and levies	116,270	109,634	117,503	119,336	121,363	122,965
Collection of tax arrears	0	0	0	0	0	0
Sale of goods and services	5,721	6,161	6,161	6,149	6,149	6,149
Interest	1,627	2,587	2,587	2,561	2,561	2,561
Dividends	818	1,787	1,787	1,947	2,154	2,153
Other income	24,492	22,608	23,407	23,559	15,032	15,032
	<u>148,928</u>	<u>142,777</u>	<u>151,445</u>	<u>153,551</u>	<u>147,259</u>	<u>148,860</u>
<u>Cash applied to:</u>						
Appropriations to agencies (less depn)	89,440	97,388	97,992	100,592	93,127	92,833
Payments on behalf of Crown	23,116	23,648	23,978	23,057	22,468	22,631
Debt-servicing interest	2,571	1,710	1,710	1,696	1,688	1,688
Building maintenance	1,798	0	0	0	0	0
Other expenditure	1,595	704	804	150	150	150
	<u>118,520</u>	<u>123,451</u>	<u>124,484</u>	<u>125,494</u>	<u>117,433</u>	<u>117,302</u>
<b>Net Operating Activity Cashflows</b>	<b>30,408</b>	<b>19,327</b>	<b>26,961</b>	<b>28,057</b>	<b>29,826</b>	<b>31,557</b>
<b>Cashflows from Investing Activities</b>						
<u>Cash provided from:</u>						
Subsidiary loan repayments	0	0	0	0	0	0
	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
<u>Cash applied to:</u>						
Capital expenditure	13,142	36,663	36,673	34,433	8,450	5,918
Advances to Subsidiaries	0	0	0	0	0	0
	<u>13,142</u>	<u>36,663</u>	<u>36,673</u>	<u>34,433</u>	<u>8,450</u>	<u>5,918</u>
<b>Net Investing Activity Cashflows</b>	<b>-13,142</b>	<b>-36,663</b>	<b>-36,673</b>	<b>-34,433</b>	<b>-8,450</b>	<b>-5,918</b>
<b>Cashflows from Financing Activities</b>						
<u>Cash provided from:</u>						
Loans drawn down	643	11,984	12,337	0	0	0
Other	0	0	0	0	0	0
	<u>643</u>	<u>11,984</u>	<u>12,337</u>	<u>0</u>	<u>0</u>	<u>0</u>
<u>Cash applied to:</u>						
Loan repayments	5,424	5,303	7,490	7,551	7,601	7,161
Loan reserves	0	0	0	0	0	0
Other reserves	942	1,552	1,592	2,247	2,257	2,265
	<u>6,366</u>	<u>6,855</u>	<u>9,082</u>	<u>9,797</u>	<u>9,858</u>	<u>9,426</u>
<b>Net Financing Activity Cashflows</b>	<b>-5,723</b>	<b>5,129</b>	<b>3,255</b>	<b>-9,797</b>	<b>-9,858</b>	<b>-9,426</b>
Net cash movements	11,543	-12,208	-6,457	-16,174	11,518	16,213
Add: Opening Cash and Equivalents	33,888	45,746	45,448	38,992	22,819	34,337
<b>Closing Cash and Equivalents</b>	<b>45,431</b>	<b>33,539</b>	<b>38,992</b>	<b>22,818</b>	<b>34,337</b>	<b>50,550</b>

**Statement of Borrowings**  
For the year ending 31 December 2015

	Actual 2015-16 ('000)	Budget 2016-17 ('000)	HYEFU 2016-17 ('000)	Projected 2017-18 ('000)	Projected 2018-19 ('000)	Projected 2019-20 ('000)
<b>Total Gross Borrowings</b>	<b>97,918</b>	<b>101,611</b>	<b>98,783</b>	<b>89,424</b>	<b>80,548</b>	<b>73,387</b>
<b>Assets Held Against Borrowings:</b>						
Advances to subsidiaries	26,206	26,206	26,206	26,206	26,206	26,206
Loan reserves	17,788	17,464	18,593	17,713	14,927	9,398
<b>Total Assets Held Against Borrowings</b>	<b>43,994</b>	<b>43,670</b>	<b>44,799</b>	<b>43,919</b>	<b>41,133</b>	<b>35,604</b>
<b>Net Borrowings of the Government</b>	<b>53,924</b>	<b>57,941</b>	<b>53,984</b>	<b>45,505</b>	<b>39,414</b>	<b>37,783</b>



### Revenue Levied on Behalf of the Crown

	Actual 2015-16	Budget 2016-17	HYEFU 2016-17	Projected 2017-18	Projected 2018-19	Projected 2019-20
	('000)	('000)	('000)	('000)	('000)	('000)
<b>Taxation</b>						
Income tax	24,711	22,942	22,449	23,084	23,536	23,920
Company tax	13,391	10,091	13,216	13,581	14,073	14,283
Import levies	12,313	11,366	14,270	14,003	13,838	13,459
Departure tax	8,441	9,653	9,675	9,796	10,106	10,466
VAT	54,486	55,582	57,441	58,871	59,811	60,836
Withholding tax	2,928	0	452	0	0	0
<b>Total Taxation</b>	<b>116,270</b>	<b>109,634</b>	<b>117,503</b>	<b>119,336</b>	<b>121,363</b>	<b>122,965</b>
<b>Other Crown Revenue</b>						
Financial Services Levy	340	293	253	293	293	293
FSC Return of Excess	225	160	0	160	160	160
FSC Vested Assets	317	0	0	0	0	0
Immigration Fees	715	587	587	587	587	587
IMO Subscription - Maritime Cook Islands	0	66	66	66	66	66
Court Services	49	50	50	50	50	50
Instant Fines	23	20	20	20	20	20
Fishing Licences	7,714	9,000	9,000	9,000	9,000	9,000
Fisheries Catch Revenue	-1,700	0	0	0	0	0
Fisheries - US Treaties (purse seining)	5,819	1,200	1,200	1,200	1,200	1,200
Fishing Fines	0	0	0	0	0	0
Research Fee	1	1	1	1	1	1
Permits	5	24	24	24	24	24
Dividends	818	1,787	1,787	1,947	2,153	2,153
<i>Banana Court - dividend</i>	0	10	10	10	10	10
<i>Bank of the Cook Islands - dividend</i>	0	248	248	408	614	614
<i>Ports Authority - dividend</i>	0	0	0	0	0	0
<i>Punganga Nui Market - dividend</i>	0	0	0	0	0	0
<i>Te Aponga Uira - dividend</i>	0	319	319	319	319	319
<i>Extraordinary SOE Dividend</i>	18	60	60	60	60	60
<i>Telecom Cook Islands (Bluesky) - dividend</i>	800	1,150	1,150	1,150	1,150	1,150
Numismatics	150	350	350	350	400	400
Border Management Fees	0	120	120	120	120	120
Drivers Licences	-24	80	80	80	80	80
Motor Vehicle Registration	631	875	875	875	875	875
Interest on balances	1,627	1,885	1,885	1,885	1,885	1,885
Interest on loans to subsidiaries	0	702	702	676	676	676
Foreign Investment Fees	38	26	26	26	26	26
Upper Air Management Agreement	580	746	746	746	746	746
Shipping Registration	208	268	268	268	268	268
International Shipping Licence	20	15	15	15	15	15
Liquor Licencing	30	30	30	30	30	30
Tattslotto Grants	201	120	120	120	120	120
Censorship Fees	-8	10	10	10	10	10
Circulating Currency - Coins	-3,065	100	100	100	100	100
Sale of NZ coins	961	0	0	0	0	0
Sale of Circulating Currency Cook Islands Coins	3,142	809	809	762	762	762
Smelting of Old Coins	135	0	0	0	0	0
Employer Liabilities	-44	75	75	75	75	75
Motor Vehicle Dealers	454	5	5	5	5	5
Justice Unclaimed Rental Monies	0	0	0	0	0	0
Performance Based Budget Support - Core Funding	7,577	7,577	8,577	8,577	0	0
<b>Total Other</b>	<b>26,937</b>	<b>26,982</b>	<b>27,781</b>	<b>28,068</b>	<b>19,747</b>	<b>19,747</b>
<b>Total Revenue Levied on Behalf of Crown</b>	<b>143,207</b>	<b>136,616</b>	<b>145,284</b>	<b>147,403</b>	<b>141,110</b>	<b>142,712</b>
<i>Performance Based Budget Support - Bonus Payment</i>	1,000	1,000	-	-	-	-
<b>Total Revenue Levied on Behalf of Crown - including Bonus</b>	<b>144,207</b>	<b>137,616</b>	<b>145,284</b>	<b>147,403</b>	<b>141,110</b>	<b>142,712</b>

## Statement of Fiscal Risks

As at 30 June 2017

<b>Quantifiable Contingent Liabilities</b>	<b>('000)</b>
Guarantees and indemnities	500
Uncalled capital	1,789
Legal proceedings and disputes	4,356
<b>Total Quantifiable Contingent Liabilities</b>	<b>6,645</b>

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

### Guarantees and indemnities relate to the following:

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

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

### Uncalled Capital

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

### Legal Proceedings and Disputes

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

### Financial liabilities relating to Island Governments

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

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

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

## 11 Statement of Accounting Policies

There have been no changes since the Half Year Economic and Fiscal Update 2014/15. 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:

<u>STANDARDS</u>	<u>EFFECTIVE DATE</u>
IPSAS 28 Financial Instruments: Recognition and Measurement	1/01/2013

IPSAS 29 Financial Instruments: Presentation

1/01/2011

IPSAS 30 Financial Instruments: Disclosure

1/01/2013

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

### **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.

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

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

#### **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 or for nominal consideration, the cost is the current replacement cost at the date of acquisition.

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

#### *Investments*

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

#### *Banking portfolio investments*

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

#### *Provision for doubtful debts*

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

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

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

### *Aid Assets*

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

## **11.2.7 Liabilities**

### *Borrowings*

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

### *Pension Liabilities*

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

### *Employee Entitlements*

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

### *Other Liabilities*

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

### *Aid Liabilities*

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

## **11.2.8 Cash Flow**

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

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

#### **11.2.9 Leases**

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

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

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

#### **11.2.10 Commitments**

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

#### **11.2.11 Contingent Liabilities**

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