

Chapter 2

The Economic Setting

2.1 Economic Growth

The economy achieved 6 consecutive years of growth to 2004 as it maintained a steady recovery from the crisis of the mid-1990s (Box 2.1). Economic reforms adopted, in response to the crisis, catalyzed growth by building the foundation for a robust expansion in the private sector. The economy slowed in 2005 (Figure 2.1), but real gross domestic product (GDP) per head has increased by more than 3.5% per annum (p.a.) on the average since the economic reform program started.

Tourism has led strong growth.

The expanding tourism industry has driven economic growth. Visitor arrivals grew from less than 50,000 people in the mid-1990s to 75,000 in 2001 and 88,000 in 2005. This reflects an average growth of 4.3% p.a. since 2001, or more than 7.4% p.a. since the economic reform. This expansion has substantially intensified the already high dependence of the economy on tourism. In 1995, there were 2.6 visitor arrivals for every resident.³ By 2005, there were more than 5 visitor arrivals for every resident. By comparison, the equivalent figure for the Fiji Islands and New Zealand is 0.6; for Australia, it is 0.3.⁴

The growth in tourism is apparent in the expansion of business in the wholesale and retail trades, restaurants

3 Cook Islands Statistics Office (CISO). *Annual Statistical Bulletin*. Various years.

4 Derived from the Fiji Islands Bureau of Statistics, Statistics New Zealand, and Tourism Australia data.

Pearl farming and fishing have grown

and accommodation, and transport and communication (Figure 2.2). These three industries have accounted for most growth in GDP post-reform. Agriculture and fishing have accounted for much of the remaining growth. Pearl exports, which provide the main source of merchandise exports, more than tripled in 2000 to reach 18 million New Zealand dollars (NZ\$). But disease associated with overstocking and a fall in international prices led to a large drop in the value of pearl exports.⁵ Fish exports commenced in 2002 and were worth NZ\$8 million in 2003. However, rising costs have seen fish exports weaken in recent years.

The economy is now led by the private sector

Economic growth post-reform has been in the private sector. A downsizing in the public service and control of pay rates brought a sharp contraction from 1998 to 2001 in the contribution to GDP from public administration. Public administration has expanded again more recently, but far less than other sectors (Figure 2.2). This contrasts with the last period of economic expansion in the first half of the 1990s. This earlier surge was led by an expansion in the public sector that proved unsustainable and subsequently imposed a very high cost on the community through the required restructuring.

The early years of recovery relied heavily on preexisting capital stock. This is most evident in occupancy rates in the tourism industry. Available room nights increased by only 6% from 1996 to 2000. Meanwhile, room occupancy increased by 40% over the period, pushing the occupancy rate up from 57% in the mid-1990s to a peak of 76% in 2000.

Investment surged from 2000

The initial strengthening of economic activity post-reform appears to have boosted business confidence and the availability of capital, with investment subsequently surging. Notably, available room nights increased by 27% from 2001 to 2005. The increase in capacity brought a fall in the occupancy rate to 63% by 2005.

5 The value of pearl exports is widely seen to be underestimated because of under-declaration motivated by a desire to minimize tax exposure.

Box 2.1: The Mid-1990s Financial Crisis

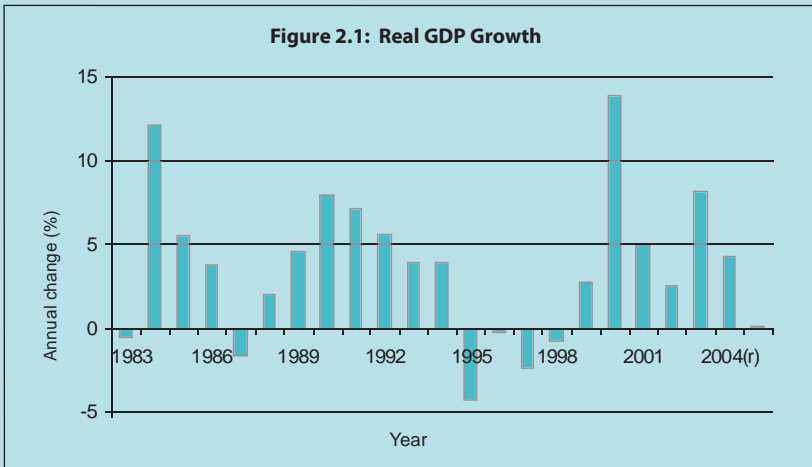
The economy of the Cook Islands grew rapidly over the early 1990s as the tourism industry expanded, major government-supported construction projects commenced, and the Government ran large budget deficits. However, the economy moved into recession in fiscal year (FY) 1995 as difficulties emerged in the monetary system—leading to the adoption of the New Zealand dollar (NZ\$)—and as construction slowed. While the economic slowdown contributed to the Government’s 1996 cash shortage, the problem was a result of more fundamental weaknesses that had built up over a number of years.

Public sector investment had surged in the 1990s, notably on projects such as the Vaimaanga Hotel and the Cultural Center, peaking at a ratio to gross domestic product (GDP) of 70%. External borrowing backed by government guarantees funded much of the investment. The failure to complete the Vaimaanga Hotel and the generally poor commercial performance of other assets created an excessive debt-servicing burden for the Government. By FY1993, the Government’s debt had risen to NZ\$135 million, equivalent to 1 year’s GDP. Debt servicing had grown to more than 15% of internally funded government expenditure by FY1995.

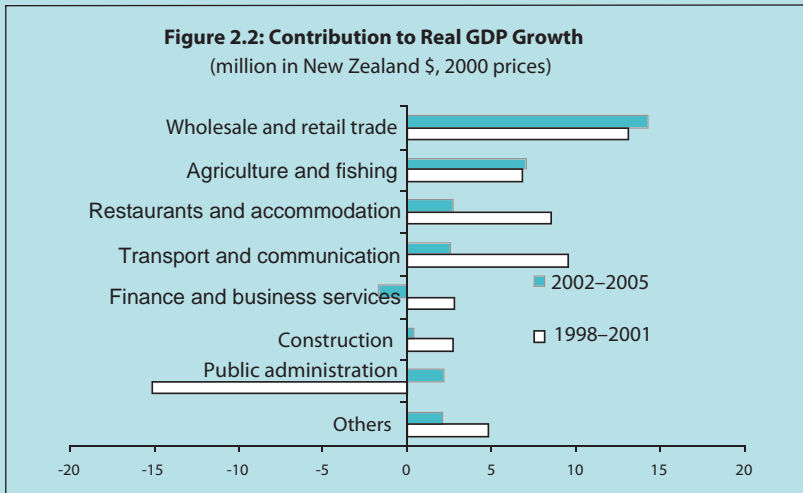
The Government had also allowed a large wage bill to build up and created a substantial welfare system providing old-age pensions, child support, and sickness and destitution allowances. A large share of public service employment was effectively an income supplement, particularly in the outer islands, with many employees reportedly contributing little if any work.

By FY1996, the worsening fiscal position forced cuts in the more readily accessible areas of the Government, notably expenditure for investment and goods and services. Despite the cuts, the combination of a decline in internally raised revenue and rising debt-servicing costs created a cash shortage. As the availability of cash declined, the Government faced the politically difficult options of (i) increasing taxes, (ii) cutting public service employment or pay, or (iii) cutting the welfare system. Large arrears were accumulated, and some loans defaulted. Government salary, wage, and superannuation payments fell behind, and debt to suppliers grew. By the end of February 1996, the projected budget deficit was NZ\$7 million; outstanding arrears had accumulated to NZ\$30 million; and other forms of government debt totaled NZ\$170 million. The arrears included loan repayments, amounts owed to donor-funded projects, subloan funds diverted from sinking funds, and funds informally borrowed by the Government from various entities such as the Cook Islands Saving Bank. This cash shortage of FY 1996 triggered the economic reform.

Sources: ADB. 1995, 2002a; Knapman and Saldanha. 1999.



CISO = Cook Islands Statistics Office, GDP = gross domestic product, (r) = revised, % = percent.
 Source: Authors' estimates derived from CISO. *Annual Statistical Bulletin*, various years.



CISO = Cook Islands Statistics Office, GDP = gross domestic product, \$ = dollar.
 Source: Authors' estimates derived from CISO. *Annual Statistical Bulletin*, various years.

The surge in investment is also apparent in other economic indicators. The average number of new van and pickup registrations annually for the 5 years to 2005 (i.e., 2001–2005) was 33% above the annual average for the previous 5-year period (i.e., 1996–2000). The rate was 140% higher for trucks and buses. The real value of commercial building approvals issued over the 5 years to 2005 was 122% above the real value of approvals for the previous 5-year period. Moreover, in the 5 years to 2005, the real value of imports of basic manufactured goods rose by 49%, and of machinery, vehicles, and other equipment by 35%.

Economic growth is also linked to a rise in household expenditure: commercial bank lending for personal services (mainly housing and personal loans) rose from 15% of GDP in 1996 to 28% by 2005. The real value of residential building approvals issued in the 5 years to 2005 was 71% above the figure for the previous 5-year period, and the number of new motorcycle and car registrations over the 5 years to 2005 was both more than double the levels of the previous 5-year period. Foreign direct investment (FDI) likely provided an injection of cash (e.g., through land leases and the sale of businesses) and this, combined with the general improvement in economic conditions, supported the increase in household spending.

Preliminary estimates point to near-zero economic growth in 2005. This slowdown is partly because of the adverse impact of five damaging cyclones early in the year. Although there are no growth forecasts to draw upon, the economy appears sound and, barring external shocks, can be expected to grow over the short to medium term. Visitor arrivals remain on their upward trend; FDI approvals, albeit slowed, remain positive; banks remain committed to continued lending growth; and household disposable income was boosted in mid-2006 by the removal of most import duties. However, the rate of growth may slow somewhat because of rising interest rates, a tighter labor market, and an apparent slowdown in foreign investment.

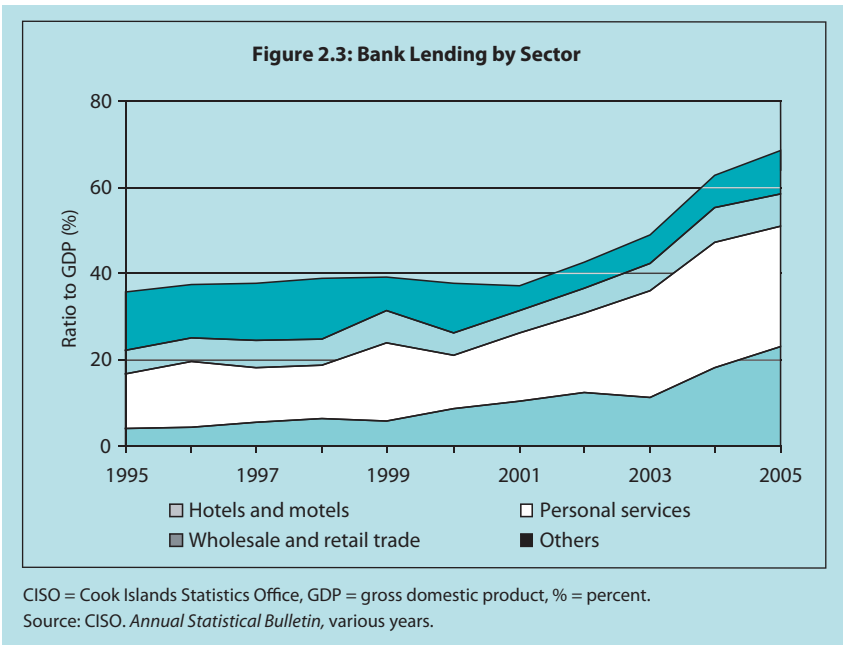
**Household
expenditure
has risen**

**Growth is
likely to
continue**

2.2 Bank Lending and Foreign Investment

Bank lending has grown

Commercial bank lending has provided a key source of funding for the surge in investment. Business lending has been concentrated in hotels and motels (Figure 2.3). Commercial bank lending to hotels and motels as a ratio to GDP was 5% in 1996, rising to 9% by 2000 and 23% in 2005.

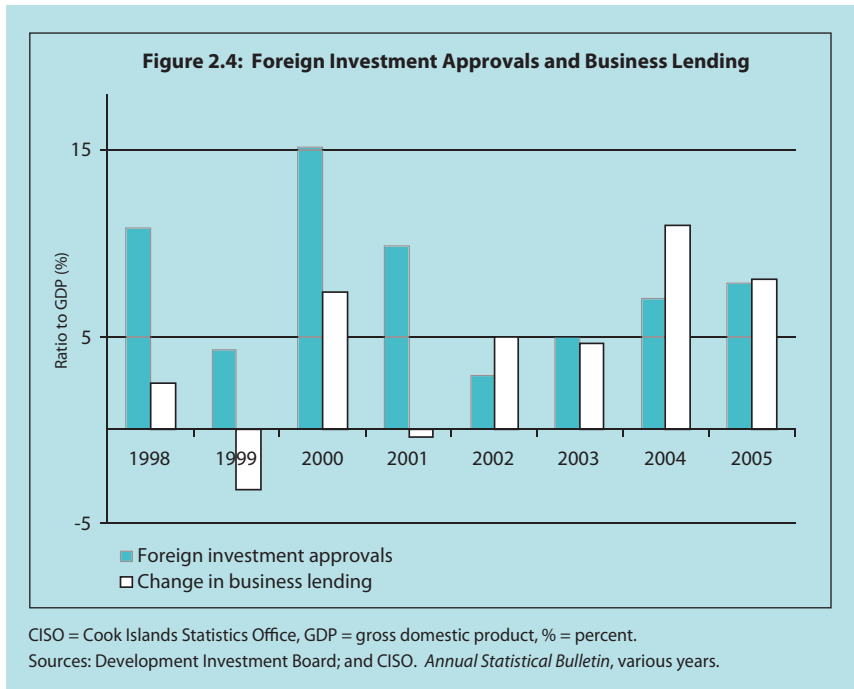


FDI has been vital but peaked in 2000

FDI has also been an important source of investment funding. Estimates of the actual level of FDI are not available, but the value of approvals provides an indication of the magnitude. As a ratio to GDP, FDI approvals were about 40% in 2000 and 2001. Approvals subsequently eased but remained close to the value of new business lending (Figure 2.4).⁶ Remittances from Cook Islanders overseas and the

⁶ Data on foreign investment approvals should be used with care. Time lags are likely to occur between foreign investment approval and actual investment, and some approved proposals will likely fail to go ahead, such that the actual value of investment falls short of the approved value of investment.

savings of returning Cook Islanders are likely to have been significant additional sources of investment funding, though their size cannot be estimated.



From 2001 to June 2006, the Development Investment Board approved FDI totaling NZ\$81.7 million, covering 217 projects.⁷ By value, two thirds had been for tourism, followed by the undefined category of “others” (almost one fifth), marine resources (mainly pearl farming, one tenth), and finance (one thirtieth). The number of registration approvals for foreign-owned enterprises (new and existing businesses) peaked at 77 in 2001 and then fell to only 11 in the first

7 Some 85% of all foreign direct investment (FDI) approvals were for Rarotonga, followed by the pearl farming centers of Atiu and Manihiki. Mainly Cook Islander investors have financed tourism development in Aitutaki.

6 months of 2006.⁸ The value of approvals, however, trended up until 2005. There was a short-lived decline in 2002, and the value of approvals appears likely to decline substantially in 2006.

International competitiveness may have weakened, perhaps contributing to slowing foreign investment

The data suggest that approvals that are more recent have been for higher-value investments, probably in more up-market tourist resorts. The sharp drop in the number of projects approved may simply reflect an easing in FDI following a rush of earlier approvals that are now being implemented. However, the declining trend in the number of approvals, combined with what appears to be a sharp fall in the value of approved FDI in 2006, may be symptomatic of declining foreign interest. Possible explanations for the decline include the supply of tourist and related facilities catching up with demand and concerns regarding the international competitiveness of the Cook Islands.

To maintain robust economic growth, the Cook Islands needs to maintain its attractiveness both to tourists who generate demand in the economy and to foreign investors who are a key source of capital for the economy. Recent developments have reinforced the importance of vigilance in maintaining international competitiveness.

2.3 Inflation and the Exchange Rate

The Cook Islands adopted the New Zealand (NZ) dollars as its currency in 1995 following a period of excessive issuance of its own currency, an associated decline in foreign exchange reserves, a decision by commercial banks to restrict the clearance of checks denominated in Cook Islands dollars, and concern surrounding the issue of government guarantees. As a result, the Cook Islands no longer has the option of effecting an independent monetary policy.

8 Sectors with significant FDI in early 2000, such as fisheries and black pearls, have been in decline.

**Inflation has
been low**

This has the disadvantage of limiting the Government's ability to manage domestic demand largely to the use of fiscal policy. However, the very close economic relationship with New Zealand means that using NZ dollars has the advantage of providing price stability as long as New Zealand maintains price stability. Inflation averaged 3.5% p.a. from 2001 to 2005 but had dropped to 3.1% p.a. as of June 2006.

Although NZ dollars depreciated against the United States (US) and Australian dollars, yen, and euro in the first 11 months of 2006, the trend in recent years has been for it to appreciate against these currencies, with the appreciation substantial against the US dollar and the yen. This trend may have cut into the competitiveness of the Cook Islands as a tourist destination in the American and Japanese markets.

The ability of Cook Islanders to emigrate tends to set a floor on the local wage rate, based on pay rates in New Zealand or Australia. This floor and the use of the NZ dollar place important constraints on economic adjustment within the Cook Islands. Open economies can normally address a loss of international competitiveness by adjusting the nominal exchange rate and/or real wage rate. With no ability to depreciate its currency, and limited ability to vary the real wage, the Cook Islands may find it unusually difficult to recover from any loss of international competitiveness. This economic characteristic, combined with a narrowly based economy and high exposure to natural disasters, makes the Cook Islands vulnerable to macroeconomic instability.

2.4 The Budget Balance and Debt Position

Strong economic growth, combined with improved tax administration, has provided for growth in the real (absolute) value of revenue and, consequently, of expenditure.

Size of the Government is declining as a ratio to GDP

Nonetheless, general government revenue has fallen slightly as a ratio to GDP, and expenditure has been trimmed to fit the more constrained revenue envelope. This trend of a declining ratio of revenue and expenditure to GDP is projected to continue. This means that the general government sector has declined in relative importance as a source of demand and will continue to do so.

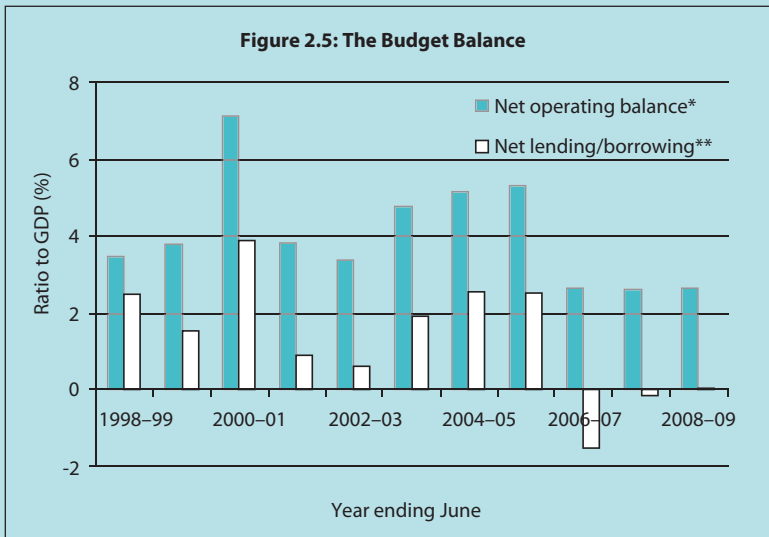
The developments on the revenue side of the budget are led by a downward trend in internal revenue collections. They declined from 29% of GDP to 27% of GDP over the 5 years to FY2006 and are expected to fall to 24% of GDP in FY2007 mainly because of the removal of most customs duties from the FY2007 budget. The total tax revenue in 2007 however improved from the better than expected economic growth. The most recent budget has projected a further fall in internal revenue to 22% by FY2009. Total revenue collections were 40% of GDP in FY2002 and 38% of GDP in FY2006. The fall in internal revenue is projected to reduce total revenue collections to 35% of GDP in FY2007 and to 32% of GDP in FY2009. As a ratio to GDP, foreign aid is relatively high, ranging from 5–7% of GDP.

The public fiscal position is sound, with the budget showing a surplus for some years, and the Government is almost free of debt

The Government has maintained a tight fiscal stance overall since the implementation of economic reform. In most years, operating surpluses have been sizable, equivalent to 3–5% of GDP. This has provided the Government a good financial capacity to either fund investment or run overall budget surpluses. In the event, capital expenditure has been restrained and the overall budget has been in surplus since at least FY1999 (Figure 2.5).

Budget surpluses have brought a steady reduction in government debt, and the general government sector is now almost free of debt (Figure 2.6).⁹ Government debt

⁹ The general government sector is the public sector excluding public enterprises.



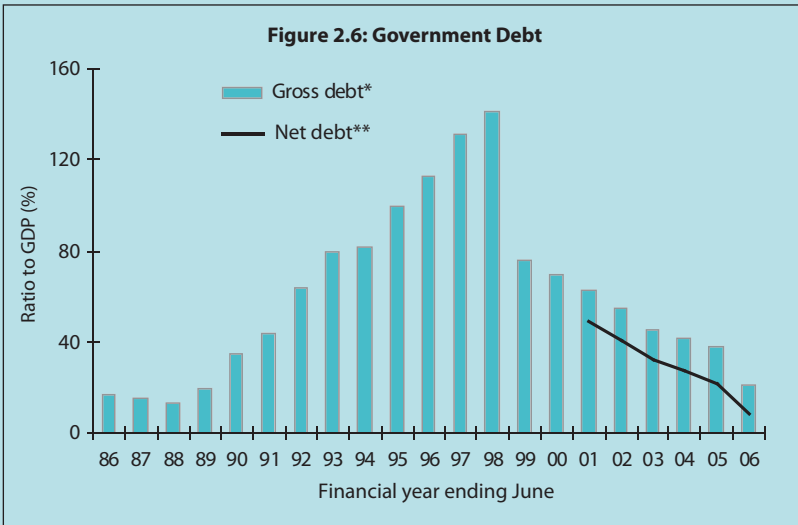
FY = fiscal year, GDP = gross domestic product, MFEM = Ministry of Finance and Economic Management, % = percent.

* The net operating balance is a measure of the sustainability of government operations, showing the surplus of revenue over operating (i.e., non-capital) expenditure.

** Net lending (+)/borrowing (-) is derived as revenue less total expenditure. It is a measure of the extent to which the Government is either putting financial resources at the disposal of other sectors or utilizing the financial resources generated by other sectors.

Source: Authors' estimates based on data supplied by MFEM and MFEM budget estimates, Part I, Appropriation Bill, Appropriations and Commentary, various years.

had reached extraordinarily high levels over the 1990s because of poor management of the government's involvement in commercial activities and high budget deficits. Debt peaked at 140% of GDP before a debt restructuring facilitated by ADB (known as the Manila Agreement) cut debt by around half. The recent budget surpluses, the appreciation of the NZ dollar, and a further write-down in the debt in 2004 (by the French government) and in 2006 (by the Government of Italy) reduced gross general government debt to 21% of GDP by 2006. Once government cash reserves built up to cover future loan obligations are taken into account, the net outstanding debt is only 8% of GDP.



FY = fiscal year, GDP = gross domestic product, MFEM = Ministry of Finance and Economic Management, % = percent.

* The gross debt ratios are based on the book value of debt. Nearly all-current debt is held on concessionary terms with ADB. The net present value of the gross debt, which determines the effective value of the debt, is much lower than shown, notably for the post-1998 period.

** Gross debt at book value less cash holdings.

Source: Authors' estimates based on data supplied by MFEM and MFEM budget estimates, Part I, Appropriation Bill, Appropriations and Commentary, various years.

2.5 The Private Sector

The private sector, fuelled by tourism, is the economy's engine

Business confidence is high in the Cook Islands, and the economy has now reoriented such that the private sector provides the engine of growth. The private sector's contribution to GDP has grown impressively since the economic reform. Inclusive of informal sector activity, the private sector is estimated to have grown from 59% of GDP in 1995 to the plateau of 83% of GDP in 2001. Formal private sector activity is estimated to have grown from 49% of GDP in 1995 to the current level of 74% of GDP.

The private sector engine has been fueled by tourism development. Tourism has stimulated the growth of a broad range of service industries, from retailing and restaurants to

tour operations and car and bike rentals. Development has centered in Rarotonga, but the main outer island, Aitutaki, has also benefited substantially from tourism. Tourism's share of GDP is estimated to have risen from 20% in 1988 to the current share of 50%.¹⁰

As a country that is very small—in terms of both population and arable land—and isolated but blessed with an established tourism potential, the Cook Islands is unlikely to develop sizable manufacturing and agriculture sectors. Future growth in income, exports, and employment will hinge on developments in the services sector fuelled by tourism. Services—including electricity, water supply, and construction—accounted for 84% of GDP in 2005. While this is less than in 1995 (89%), the composition of services rendered has changed substantially in favor of the private sector. The economic reform of the mid-1990s has seen the share of GDP accounted for by public administration contract by half, hitting 13% in 2005. The growth in services has been in areas related to tourism, such as the wholesale and retail trades, which grew by 30% from 1995 to 2005, to account for 25.3% of GDP), and restaurants and accommodation (up by 63% to account for 15.2% of GDP).

The private sector is now very well developed and relatively sophisticated, and it is backed by a commercial and legal environment closely resembling that in New Zealand. Private companies, partnerships, or sole proprietorships carry out most business activity. A number of relatively large companies operate in major industries such as finance, gasoline, light manufacturing, tourism, and the wholesale and retail trades. The private sector also includes many small businesses across a range of activities, most obviously in the accommodation, car and bike rental, restaurant, and retail industries. Small family-run businesses are widespread.

The private sector is diverse, and the many businesses have created good competitive pressures

¹⁰ Cook Islands Tourist Corporation. 2005. p. 9.

As expected in a small population, several key private sector participants have diversified into a range of activities. By this major means, entrepreneurs and businesses can exploit economies of scope,¹¹ which are difficult to realize when concentrating on one activity in a small market like the Cook Islands.

The number of businesses has grown substantially, especially when compared to the small population, providing for effective competition in most industries. Currently, almost 1,300 value-added tax (VAT) registrations are active, which covers any business with an annual turnover exceeding NZ\$30,000. Registration numbers have virtually doubled since 2001. The latest *Yellow Pages* phonebooks are relatively large and diversified, listing some 800 businesses in over 150 categories. A high degree of competition is also evident in the extent of media advertising, especially on television.

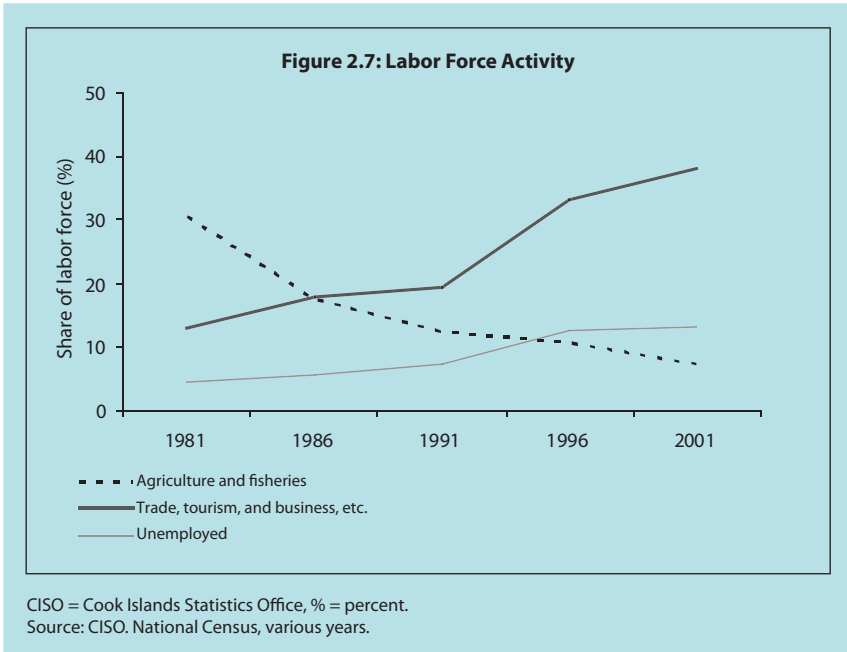
Since the Cook Islands has a very small production base, the private sector relies on imports, with major suppliers frequently doing their own importation. This practice, combined with a good number of importers, provides for vigorous competition in the supply of imported goods.

**Formal
businesses
dominate**

Formal businesses dominate the private sector, and the role of the formal or cash economy now appears to be approaching that of developed countries like New Zealand and Australia. The decline in the relative importance of the informal sector is evident in employment data. Employment in agriculture and fishing—the traditional mainstays of the Cook Islands economy—has been decreasing since the early 1980s, while employment in formal businesses has grown strongly (Figure 2.7). Even before the reforms, formal private sector employment had grown by more than 50% between

11 Economies of scope can be achieved when average costs are lowered by producing, marketing or distributing more than one output.

1991 and 1996. Over the 1990s, it almost doubled. These changes have brought greater monetization of the economy. The trend is also marked by a rising number of unemployed people, some of whom would previously have been involved in semi-subsistence traditional agriculture but now define themselves as being without paid work and wanting it.



The Cook Islands private sector can also be thought of as extending to the export of labor. Because Cook Islanders hold New Zealand passports, they travel freely to New Zealand and Australia and work there. That more than three times as many Cook Islanders now live overseas as in the Cook Islands is an indication of the economic importance of the outward flow of labor.¹²

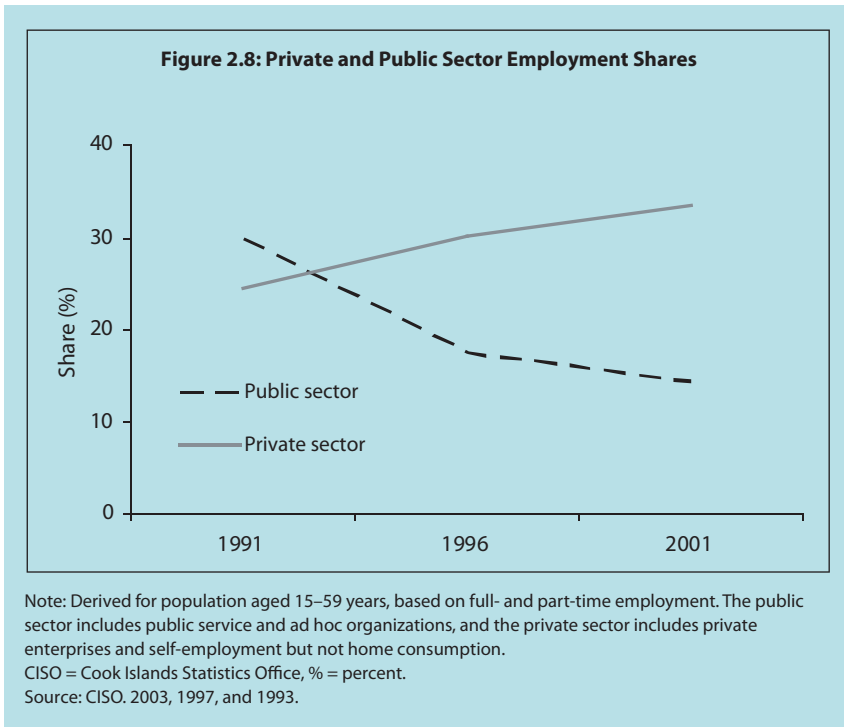
**The export of
labor is a key
activity**

12 No national records of remittances exist, but they are generally understood to be small.

2.6 Employment Trends

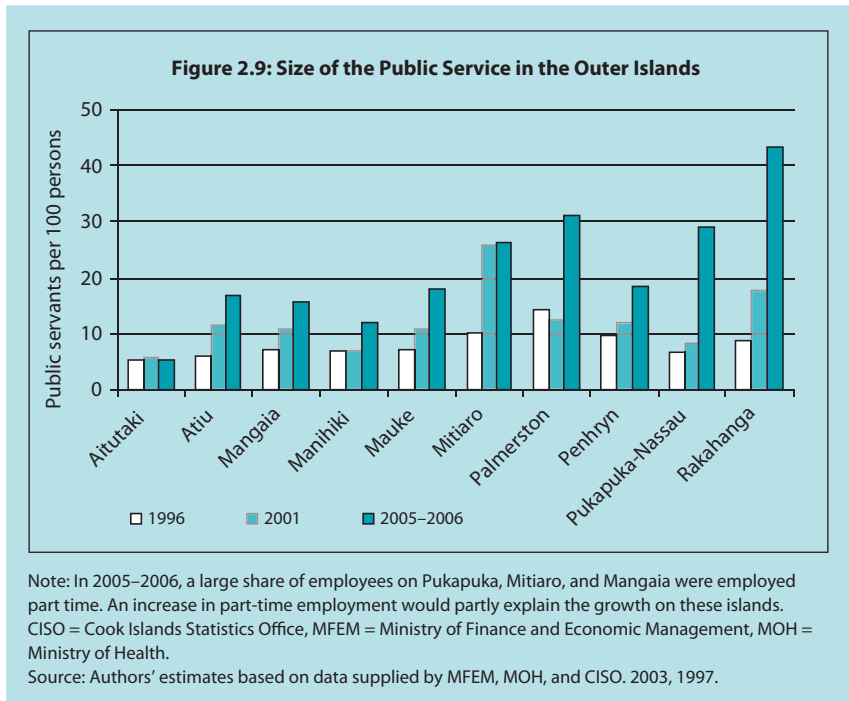
Private sector employment has grown, but almost exclusively on Rarotonga and Aitutaki

The overall expansion in the private sector and contraction in the public sector is evident in the employment data generated by the 5-yearly censuses. Over the 10 years to 2001, the share of the adult population of working age engaged in private sector activity has grown substantially while the share engaged by the public sector has declined substantially (Figure 2.8).



Almost all expansion in private sector employment post reform has occurred in Rarotonga and Aitutaki. In most outer islands, the private sector has remained very small, while the public sector has remained the main source of employment and has shown the fastest growth post reform. In some cases, the public sector is relatively larger

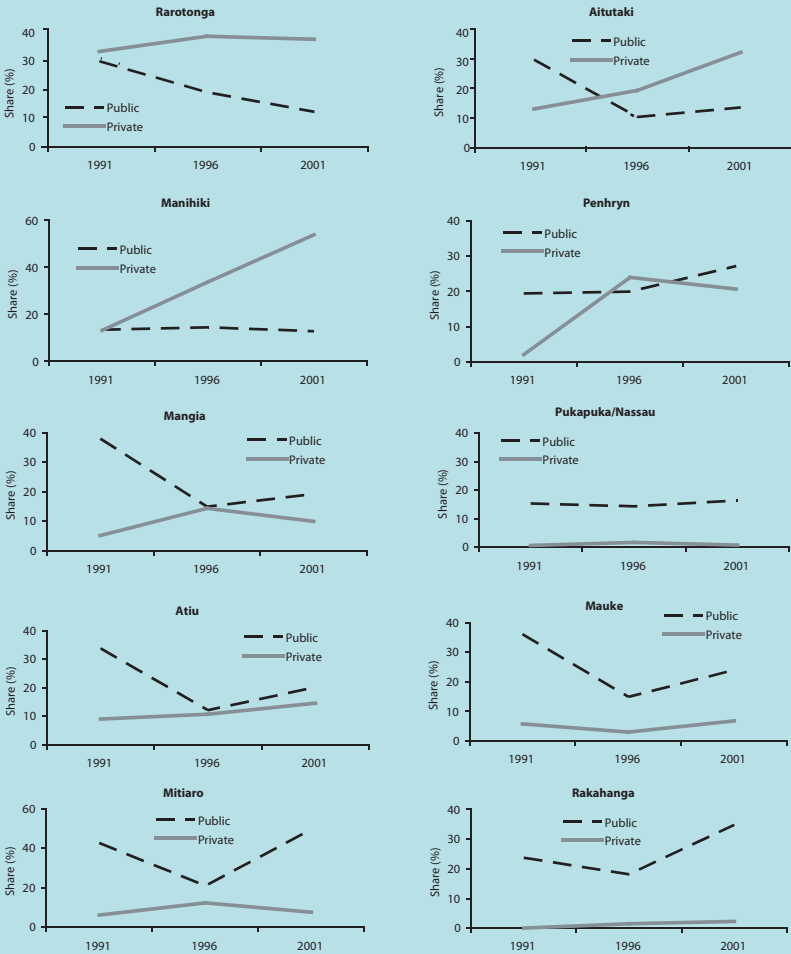
than it was before reform, with the public sector's share of employment in 2001 higher than it was 1996 (Figure 2.9). Manihiki is the only exception among the outer islands because of the growth in pearl farming. However, even this situation may be changing, as much of the economic stimulus in Manihiki has been stymied since 2001 by the adverse effects of disease and low world prices on pearls. Pearl exports peaked at NZ\$18.4 million in 2000, but were projected at only NZ\$2.2 million in 2007.



The available data suggest that the situation in the outer islands has deteriorated even further since 2001. Data from the government payroll show the relative size of the civil service having grown substantially in the last 5 years in most outer islands (Figure 2.10).

Public service has grown on all the outer islands, except Aitutaki

Figure 2.10: Sector Employment Shares by Island



Note: Derived for population aged 15–59 years. Public employment includes public service and ad hoc organizations, and the private sector includes private enterprises and self-employment but not home consumption. On some outer islands, the growth in public sector employment has largely been in part-time employment.

CISO = Cook Islands Statistics Office, % = percent.

Source: CISO, 2003, 1997, and 1993.

This implies that economic reform has succeeded in generating private sector-led growth only in Rarotonga and Aitutaki. Elsewhere, the private sector has not responded

or, perhaps more correctly, has been unable to respond. In general, the main impact of the mid-1990s reform in the outer islands was the exodus of people. There was no offsetting gain in economic sustainability, with the public sector continuing to dominate island economies and crowding out prospects of sustainable private sector activity. This crowding-out effect has grown over time, not eased. The public sector and welfare payments now provide the future source of economic activity in most outer islands.

Most outer islands remain dominated by the public sector

This conclusion is supported by regional differences in participation in key activities. Between 1996 and 2001, the number of people engaged in home duties in Rarotonga and the outer islands fell. In Rarotonga and Aitutaki, employment grew, and it appears that a significant share of those moving out of home duties moved into full-time employment. Most of the remainder appeared to have left the island. The outer islands, excluding Aitutaki, saw almost no employment growth and almost all those who moved out of home duties left the island (Figure 2.11). The economic reform triggered these departures as sources of livelihoods were cut back with no viable replacements emerging.

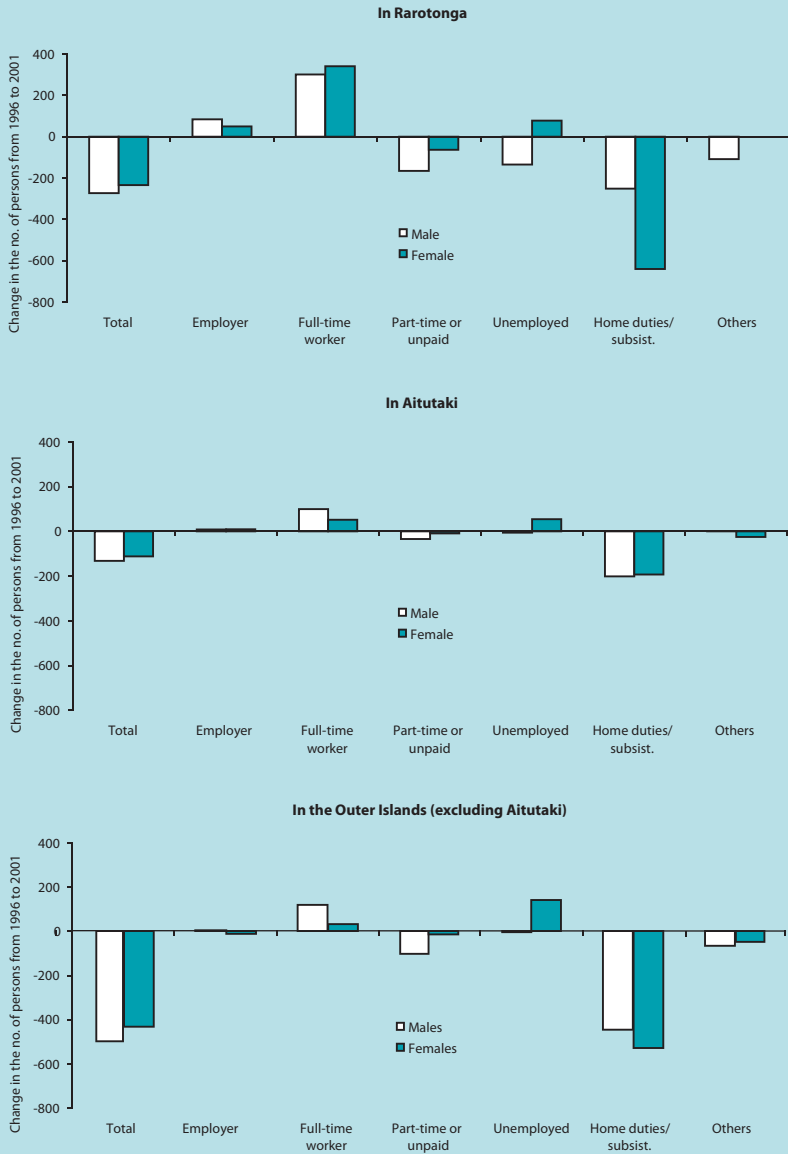
Consequently, economic activity has become even more concentrated. In 1991 and 1996, Rarotonga and Aitutaki accounted for 74% of the adult population of working age and 84% of employment. By 2001, the equivalent figures were 81% and 86%, respectively. Estimates of a continuing decline in population in the outer islands, excluding Aitutaki, since 2001, and the strong growth evident in Rarotonga and Aitutaki suggest that this trend has continued.

Outer islands, excluding Aitutaki, generate less than 15% of employment

A further indication of the concentration of economic activity in Rarotonga and Aitutaki is provided by data on power generation. While all sizable island centers receive power from public electricity systems, 96.9% of all electricity generated through public electricity systems in 2005 was in Rarotonga and Aitutaki.

Figure 2.11: Change in Participation in Key Activities by Region

Change in the number of persons engaged in key activities from 1996–2001



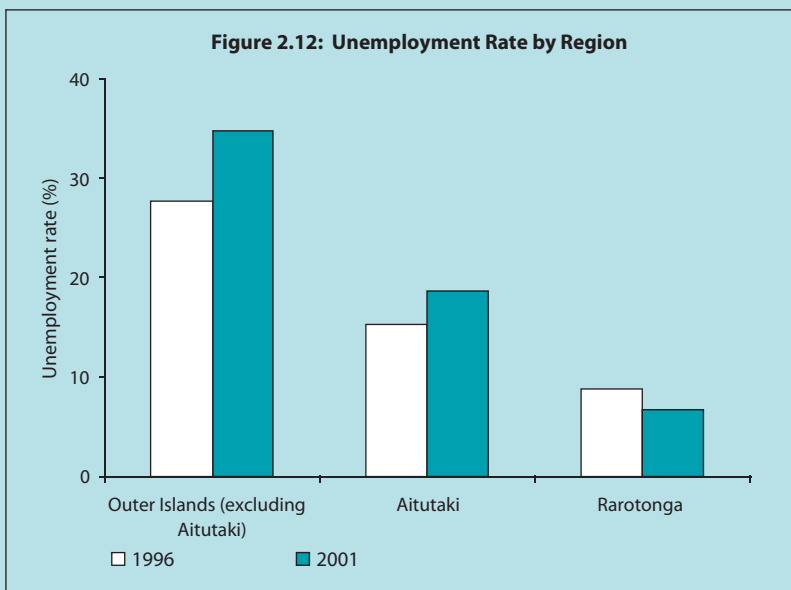
CISO = Cook Islands Statistics Office, no.= number, subsist. = subsistence agriculture or fishery.
 Source: Authors' estimates derived from CISO, 2003 and 1997.

2.7 Unemployment

Unemployment was estimated to have remained unchanged nationally from 1996 to 2001 at 13%. Unemployment rates vary greatly across regions. They were estimated as substantially higher and rising in the outer islands, excluding Aitutaki, and very low and falling in Rarotonga (Figure 2.12). The stronger than expected economic growth in 2006 has produced an almost full employment on Rarotonga. The regional differences appear to be in line with the differences between regions in economic activity (e.g., activity is relatively higher in Rarotonga, so unemployment is relatively lower). Anecdotal evidence of rising wages and a growing need to import labor at all skill levels suggests that the national unemployment rate has fallen over the last 5 years, though rates have probably remained high in the outer islands, excluding Aitutaki.

**Unemployment
was 13% in
2001**

**Unemployment
is low in
Rarotonga**



CISO = Cook Islands Statistics Office, % = percent.

Source: CISO. 2003 and 1997.

2.8 The Population Challenge

The population has been in decline

The population of the Cook Islands has been declining since the opening of the international airport in the early 1970s. As the rate of out-migration has been highest among young people of working age, the domestic population is getting older. The median age and dependency rates are both rising, and older people, especially women, are increasingly left to care for young children.

Until recently, there was a large enough pool of unemployed to ensure that the economy's needs could be met even in the face of this out-migration. But this is no longer the case. To grow the economy, the Government has allowed foreign workers to replace departing Cook Islanders. Gaps in education and training opportunities for locals add to the shortage of skilled workers. In the tourist industry of Rarotonga, foreign workers are increasingly required for all types of skills and, in recent years, even for unskilled jobs.

Remote communities are at risk

While the country benefits from new arrivals, it faces the gradual erosion of established communities. Few signs show this trend slowing, and it is unclear what changes it will bring and how to prepare public policy to meet emerging challenges. Most at risk are the outer islands, which depend increasingly on cash transfers, particularly on the financial support that comes with their role of caring for the young children of absent parents.

The sustainability of current service standards is eroded with every year that brings new departures. In contrast, the rising concentration of people and economic activity in Rarotonga and Aitutaki helps ensure their future prosperities.

Economic conditions have been critical

A number of factors drive these recent changes. A key driver is the New Zealand citizenship held by all Cook Islanders. This provides them with good opportunities and an important safety net, but at the expense of population growth

and now, if poorly managed, potentially of economic growth. A second key driver has been socioeconomic conditions, notably their deterioration in the mid-1990s following cuts in public sector employment and changes in service delivery. Many families who lost jobs during the adjustment left the country, and some outer island populations appear to have fallen so low that their private sector has little, if any, prospect of avoiding economic dependency.

The magnitude of the demographic changes, their causes, and wide-ranging implications makes population a key dimension of public policy. Maintaining the country's culture or identity is linked to the state of the economy and the quality of public services, as these are seen to be key factors behind a person's decision to stay or to leave.