A Single Currency for Pacific Island Countries: a Revisit

T.K. Jayaraman  
*The University of the South Pacific, Fiji Islands*

Chee-Keong Choong  
*Universiti Tunku Abdul Rahman, Malaysia*

**Abstract**

This paper re-visits the subject of a common currency for the Pacific region, comprising 14 Pacific island countries (PICs) and the region’s two advanced countries, Australia and New Zealand. The PICs are highly dependent on Australia and New Zealand for trade in goods and services and aid inflows. Earlier studies on regional common currency, which dealt with certain aspects of the optimum currency area conditions, took into consideration three kinds of shocks, namely shocks in world output, domestic output and price levels. Since PICs’ growth is influenced by regional developments to a larger degree than by world developments, this paper takes into consideration regional shocks, in addition to shocks in global and national outputs. Using variance decomposition analysis in this paper we investigate whether PICs and the region’s two advanced countries could be suitable candidates for a currency union.

- **JEL Classification**: A15, C32, F36, F42
- **Key Words**: optimum currency area, shocks, pacific island countries, Australia and New Zealand

*Corresponding address: T. K. Jayaraman: School of Economics, Faculty of Business and Economics, The University of the South Pacific, Laucala Campus, Laucala Bay Road, Suva, Fiji Islands, Tel: +679-323-2178/2547, Fax: +679-323-2522/1506, e-mail: Jayaraman_tk@usp.ac.fj, Chee-Keong Choong: Department of Economics, Faculty of Business and Finance, Universiti Tunku Abdul Rahman (Perak Campus), Jalan Universiti, Bandar Barat, 31900 Kampar, Perak Darul Ridzuan, Malaysia, Tel: +603-4662323, Fax: +603-4661313, e-mail: choonck@utar.edu.my.

©2009-Center for International Economics, Sejong Institution, Sejong University, All Rights Reserved.
I. Introduction

Regional integration of Pacific island countries (PICs) has been the objective ever since their leaders joined hands with the two advanced countries in the region, Australia and New Zealand to establish in 1971 a regional organization known as South Pacific Islands Forum. This Forum underwent a name change in October 2000 to Pacific Islands Forum, and is now known as the Forum (Jayaraman 2001).

The Forum\(^1\) comprises 16 members: Australia and New Zealand, and 14 independent PICs, which are: Cook Islands, Fiji, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Niue, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu. Recent initiatives towards promoting deeper integration derived inspiration from the birth of the new currency, the euro in 1999, heralding the arrival of the new Millennium. These initiatives included the signing of two agreements in 2002, one known as the Pacific Island Countries Trade Agreement (PICTA), aimed at ushering in free trade amongst all PICs by 2010, and the other as Pacific Agreement on Closer Economic Cooperation (PACER) for promoting by 2015, intensive economic cooperation between PICs and Australia and New Zealand (Jayaraman 2005).

The idea of a common, regional currency was floated during the annual Forum Leaders’ meeting in Auckland in August 2003, which was attended by the heads of member governments. As the subject did not officially figure in the agenda of the meeting, it was not formally discussed. However, it was apparent that Australia was keen to adopt a common currency, as a step towards bringing about greater fiscal and monetary discipline. The timing of the proposal for a common currency was triggered by certain global and regional developments. They included the perceived terror threat to the region and failure of some PICs in maintaining peace and order. Furthermore, the deteriorating economic conditions in some of island states due to weak economic policies and poor governance were causing concerns to donors in regard to aid effectiveness (Hughes 2003), which prompted an Australian Senate Committee (2003) to come up with a strong plea for a Pacific Economic and Political Community. One of the recommendations made by the Australian Senate Committee for promoting regional stability was adopting a common currency, preferably the Australian dollar, replacing the existing national currencies.

\(^{1}\)Australia, as the largest and richest member of the Forum, bears a major proportion of its administrative costs. Further, it plays a lead role as a significant provider of foreign aid to PICs.