Is there a case for a single currency for the South Pacific islands?

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This article examines the case for the Pacific island countries to adopt a single currency by establishing a currency union on the basis of optimal currency area conditions, pre-union trade patterns, asymmetric economic shocks, labour mobility and fiscal transfers. It indicates that the Pacific island countries which have recently decided to form a free trade area would prefer to await the full effects of trade liberalisation before forging higher forms of integration.

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Regional integration has sparked interest in the formation of a currency union, or single currency unit, among the Pacific island countries. Two agreements, the Pacific Agreement on Closer Economic Relations (PACER) and the Pacific Island Countries Trade Agreement (PICTA), were signed by all members in August 2001 under the auspices of the Pacific Islands Forum (hereafter 'Forum'). The Forum comprises 16 member countries, which include 14 developing island economies (Forum island countries)—Cook Islands, Federated States of Micronesia, Fiji, Kiribati, Nauru, Niue, Papua New Guinea, Republic of Palau, Republic of Marshall Islands, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu as well as Australia and New Zealand.

Although the potential economic gains from PICTA are estimated to be small (Scollay 1998; Centre for International Economics 1998), Forum island countries have taken this intial step before opening their markets and expanding the arrangements to Australia, New Zealand and the European Union. Thus, PICTA is seen as a small component in their overall strategy of gradually liberalising their trade, as well as a way to promote greater integration among Forum island countries.

The birth of the euro in 1999 as a single currency for 12 member countries in the European Union's Economic and Monetary Union, began with similar efforts in 1958. First, these countries made a move towards free trade among themselves, later they established a customs union with common tariffs against imports from third countries, and then they moved gradually towards a common market with full factor mobility in

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labour and capital. In the developing world, there have also been some notable integration efforts involving monetary arrangements.[1]

The exchange rate arrangements of Forum island countries vary, spanning the continuum from the exclusive use of a foreign currency as domestic currency to a free-floating domestic currency (see Table 1). Eight Forum island countries which do not have an independent domestic currency have adopted the national currencies of Australia, New Zealand or the United States: Kiribati, Nauru and Tuvalu (using the Australian dollar); the Cook Islands and Niue (the New Zealand dollar); and Federated States of Micronesia, Republic of Marshall Islands, and Palau (the United States dollar). Five Forum island countries (Fiji, Samoa, Solomon Islands, Tonga and Vanuatu) have their own currencies which have been pegged to baskets of currencies whose composition and weights are generally kept confidential. Only one Forum island country, Papua New Guinea, has a freely floating exchange rate regime.

Criteria for monetary integration

Monetary integration can take various forms, with the degree of rigour ranging from highly restrictive to flexible arrangements (Masson and Pattillo 2001a). It could take the form of a currency union, in which a single currency, either through creation of a new currency or adoption of an existing currency, replaces all the domestic currencies. Alternatively, it could take the form of a monetary union with national currencies co-existing alongside a common external exchange rate, or it could take the form of 'pseudo-exchange rate arrangements' of monetary integration (Corden 1972). However, the basic requirement of all these options is the setting up of a supra-national monetary authority with a single external exchange rate policy. The national authorities have to relinquish their individual control over international reserves by vesting them in the common central authority.

Restrictive conditions

The monetary union arrangement is a looser concept than a currency union, as the former allows the circulation of individual national currencies without the need for a common currency. However, there are restrictive conditions: a single external exchange rate; full convertibility and a single monetary policy (Allen 1976). In a pseudo-exchange rate union, a permanently fixed relationship between national currencies, and an absence of exchange controls on current and capital transactions within the area of its jurisdiction, might be adopted. There is, however, 'no explicit integration of economic policy, no common pool of foreign exchange reserves and no single central bank' (Corden 1972:3). Because of the absence of these mechanisms for maintaining exchange rate rigidity, there is the possibility of a member country deliberately depreciating or appreciating its currency against those of others. Such monetary unions are not credible and lack the rigour of formal unions (Cobham and Robson 1994).

In a currency union, all national currencies are replaced by a single common currency and there is no coexistence of domestic currencies. Aside from a single monetary policy and permanency in the fixation of exchange rates, the purists underscore the absence of central banks and pooling of international reserves as the fundamental requirements. A monetary union permits the possibility of exit should a member country wish to return to its previous regime, as it can easily fall back upon its own currency. Exit from a currency union is far more difficult, since the exiting country has to face the substantial costs involved in restoring its discontinued

Table 1 **A comparative picture of Forum island countries economic performance, 1995–99** (average)

Category	Average GDP growth rate (per cent)	Overall fiscal balance excluding grants (per cent of GDP)	Overall fiscal balance including grants (per cent of GDP)	Inflation (per cent)	External current account (per cent of GDP)	Growth in M2 (per cent)	Foreign reserves in terms of import cover (in months)
Countries with no separate legal tender							
Cook Islands	–1.2	–38.4	–4.2	0.1	–2.6	n.a.	n.a.
Kiribati	4.3	–37.6	–3.4	2.0	17.1	n.a.	n.a.
Marshall Islands	–5.1	–31.8	11.8	4.9	–0.7	n.a.	n.a.
Micronesia	–0.5	–46.4	–0.9	5.6	7.9	n.a.	n.a.
Nauru	..	..	–41.8	8.9	..	n.a.	n.a.
Niue	..	..	..	..	..	n.a.	n.a.
Palau	4.7	–30.8	17.5	3.5	22.2	n.a.	n.a.
Tuvalu	5.3	–15.2	4.1	2.8	5.8	n.a.	n.a.
Countries with currencies pegged to a basket							
Fiji	2.1	–3.7	–3.5	3.2	0.9	–0.1	6.1
Samoa	4.7	–10.7	1.1	2.2	6.3	12.3	7.4
Solomon Islands	2.3	–16.2	–3.4	9.8	2.4	8.7	2.2
Tonga	2.3	–2.4	–1.2	3.3	–5.0	11.3	5.1
Vanuatu	1.7	–5.6	4.7	2.5	2.1	5.0	5.8
Country with a flexible exchange rate							
Papua New Guinea	0.2	–6.6	–2.1	12.9	3.9	11.9	3.2

Source: Rosales, J.R., 2001. 'Macroeconomic policy and financial sector stability in Pacific island countries', paper presented at the Conference on Financial Sector Stability and Development, Apia, 2–21 February; Asian Development Bank 2001. *Key Indicators of Asian and Pacific Developing Countries 2001*, Asian Development Bank, Manila.

national currency and reviving the central bank and related arrangements.

Institutional safeguards

Masson and Pattillo (2001a) and Cohen (1998) emphasise the need for a strong bond of solidarity among the participating member countries in a currency union. A long period of close cooperation, as well as continued existence of institutions, would contribute to the strengthening of such a bond, as witnessed in the case of the euro zone. It would assure some degree of permanency under certain circumstances. There should be at least one member exercising hegemonic power such as Germany, as it was in Europe, with a good record of price stability and sound financial and monetary institutions. The prospective members would then feel assured of gains arising out of union arrangements with the leadership role assumed automatically by the dominant member (Cohen 1998).

External convertibility is not an essential requirement for either a currency union or a monetary union. In the initial phase of monetary integration efforts, developing countries may prefer to retain exchange controls. For the successful operation of integration arrangements, the common central bank in a currency union should enjoy full autonomy in establishing and implementing appropriate monetary policy to maintain price stability and the value of the currency. As a corollary to this rule, no individual member government should be permitted any fiscal expansion unsupported by domestic resources. The common central bank is expected not to bow to pressures to accommodate such deficits. A common central bank is expected to act as an 'agency of restraint' (Collier 1991:342).

Optimal currency area conditions

The idea of monetary union generally gathers support after a period of sustained free trade, as witnessed in Europe with the creation of the euro. It requires a gradual build up of certain factors, which are accentuated because of more intimate trade relations. Falling under the description of optimal currency area conditions (Mundell 1961; McKinnon 1963; Kenen 1969), these factors relate to similarities in pre-union trade patterns and adjustment policies as well as similarity in economic structures but with sufficient diversity to sustain trade. Once a free-trade area is created, giving rise to flourishing intra-country trade, the next logical step for consideration is formation of a customs union and a common market with full factor mobility. Although the European Union is cited as an example for emulation, it need not be an inevitable step for other parts of the world. However, growing appreciation of the benefits of freer trade does lead to consideration of forging a monetary union, as witnessed in the Eastern Caribbean states (Blackman 1998).

Preconditions

McKinnon (1963) argued that in open economies with large tradable sectors, exchange rate changes were less effective than domestic policy changes in correcting external imbalances, because of wages and prices being sticky in the shortrun (Mundell 1961). In the case of a negative external shock arising out of a decline in demand for its exports, the country has to shift production away from non-tradable goods to the tradable sector in order to maintain its external balance. In the absence of downward flexibility of domestic prices of non-tradable goods, devaluation of currency is necessary. However, devaluation produces upward pressure on the domestic price level, diminishing the benefits of devaluation. The larger the tradable sector, the less effective is devaluation. So, domestic policies are more important under such circumstances and the loss of the use of the nominal exchange rate is not of serious concern to open economies (Ng 2002).

If the volume of intra-area trade among the members of a free trade area is substantial, a monetary union with a fixed internal exchange rate relationship and full convertibility between them would bring benefits. This is because of the reduction in transaction costs and exchange rate fluctuations. In a currency union, adoption of a common currency totally eliminates transaction costs and hence raises the static efficiency of the regional economy (Soltwedel, Dohse and Krieger-Boden 2000). In a world of risk-averse individuals, a common currency generates welfare gains by reducing uncertainties about exchange rate changes (de Grauwe 1994). Furthermore, elimination of exchange rate risks and costs of currency exchange and hedging would result in the saving of real resources, which can be shifted to other productive uses (Kenen 1997), and greater transparency would increase the intensity of competition, raising the dynamic efficiency of the economy (Soltwedel, Dohse and Krieger-Boden 2000).

In addition to the prerequisite of a substantial volume of trade between the prospective member countries of a monetary union, symmetry in external shocks facing the countries is considered an important factor (Mundell 1961). Countries experiencing common external shocks would be better suited to a currency union because it permits the use of union-wide policies to correct any imbalances, including the adjustment of the common currency. Since the currency union would have a single monetary policy, the more asymmetric the external shocks, the greater the risk to the stability of the union. Countries are less likely to face large asymmetric terms of trade shocks if they have similar structures. For example, a country exporting mineral resources and importing manufactures is likely to face different movements in its terms of trade than a country exporting coffee and importing oil (Masson and Pattillo 2001a, 2001b).

Most of the adverse effects of asymmetric shocks, including increases in unemployment and declines in income, would be reduced if there is downward flexibility in prices and wages (Soltwedel, Dohse and Krieger-Boden 2000). In the absence of such downward flexibility, the presence of considerable mobility of labour between member countries would be a great help. Additionally, if the monetary union builds in some provision for a mechanism of fiscal transfer to redistribute income or compensate for differences in unemployment between member countries, the asymmetry of shocks will be less of a problem (Masson and Pattillo 2001a, 2001b; de Brouwer 2000; McKinnon 1963; Kenen 1969).

The case for a currency union among Forum island countries

Inflation levels in Forum island countries are relatively low, except for Nauru, Solomon Islands and Papua New Guinea. These three countries have been going through crises of various kinds. While non-economic factors, including ethnic rivalries and inter-island animosities in Solomon Islands have caused major political problems, poor economic management has afflicted all three Forum island countries. Further, governance issues including central bank independence have come to the fore in Papua New Guinea and Solomon Islands. Until the late 1980s, the external current account deficits of Forum island countries were sustainable. Some of them even ran surpluses thanks to generous official transfers and remittances from overseas residents.

In recent years, however, the external account situation has considerably deteriorated in Papua New Guinea and Solomon Islands. In the past, timely assistance from external agencies and in particular from the bilateral donors who were ready to come to the rescue of Forum island countries in crisis, mainly because of their geopolitical interests, the danger signals were quickly reversed. Thus there was no felt concern relating to monetary and currency instability in the Pacific region, meriting an agency of restraint solution, similar to the one suggested in the African context by Collier (1991). In these circumstances, it was believed that an appreciation of long-term gains and costs would alone determine the case for monetary union or currency union. Such an appreciation requires an evaluation in the light of optimum currency area conditions.

Intra-regional trade

The Forum island countries are open economies—in several cases this is not because they have low trade barriers but because they are small and therefore have large import flows. Their trade volumes in commodities (exports and imports) expressed as percentages of gross domestic product are fairly high. In 2000, they ranged from 120 per cent in Kiribati to 68 per cent in Republic of Marshall Islands. Their exports of goods are limited. While Papua New Guinea's main exports are gold, petroleum, copper, timber and coffee, Fiji's main exports

Table 2 **Main merchandise exports and tourism earnings of Forum island countries, 1996–99** (average)

	Main merchandise exports (per cent of total merchandise exports)		Tourism earnings (per cent of exports of goods and services)
Fiji	Sugar	27.1	25.1
	Garments	23.1	
Kiribati	Copra	52.1	14.2
	Seaweed	7.8	
Marshall Islands	Fish	66.1	8.3
	Coconut oil	12.1	
Micronesia	Fish	88.1	7.6
	Garments	6.2	
Papua New Guinea	Gold	30.1	.
	Copper	19.4	
	Crude oil	18.0	
Samoa	Coconut oil	28.1	51.3
	Copra	15.9	
Solomon Islands	Timber	51.1	.
	Palm oil	11.1	
Tonga	Squash	44.4	29.1
	Fish	19.6	
Vanuatu	Copra	40.2	41.7
	Beef	12.1	

Source: World Bank, 2000. *Pacific Regional Strategy*, World Bank, Washington, DC.

are sugar, garments and gold. For smaller island countries, which have negligible manfacturing capacity, reliance on primary exports is much greater. For Samoa, the main exports are fish, copra and related products; for Tonga they are squash, fish and root crops; and for Vanuatu, beef, copra and cocoa (Table 2). Thus, the economies of Forum island countries are more competitive than complementary.

Intra-country trade has been small among Forum island countries (Table 3). The major intra-regional trading partners are Fiji and Papua New Guinea because of their significant manufacturing base. Fiji has been exporting processed consumer goods, such as wheat flour, cooking oil and biscuits, in fairly large volumes to other Forum island countries. Fiji's imports from other Forum island countries are confined to a very small volume of agricultural commodities. Papua New Guinesa exports coffee and other manufactured goods. Thus, of the Forum island countries only Papua New Guinea and Fiji are substantially diversified, while other Forum island countries lack product diversity.

In terms of percentages of GDP in 2000, intra-regional trade volume in 2000 varied from 59 per cent in Tuvalu which imports substantial consumer goods from Fiji, to 0.01 per cent in Federated States of Micronesia, which imports most of its consumer goods from the United States. In terms of percentages of total trade, they ranged from 56 per cent in Tuvalu to 0.02 per cent in Federted States of Micronesia. Only under exceptional circumstances, such as cyclones or poor agricultural seasons, does one Forum island countries import staples such as root crops from another. For instance, in the early 1990s, when coconut palms in Tonga were uprooted by cyclones, coconuts were imported from Samoa. Likewise, in the mid 1990s when the taro leaf blight severely damaged root crops in Samoa, resulting in poor yields for three years, large volumes of taro were imported from Tonga and other Forum island countries to meet domestic requirements. Thus, any commodity trade between Forum island countries in similar and competitive crops has been exceptional.

Since 1993 the preferential trading arrangements under the Melanesian Spearhead Group (MSG) Agreement covering Fiji, Papua New Guinea, Solomon Islands and Vanuatu have encouraged intra-regional trade in specified commodities such as coffee, kava and beef. However, because of a large increase in imports from the other two MSG countries relative to their exports, both Solomon Islands and Vanuatu have accumulated sizeable trade deficits with Fiji and Papua New Guinea. As a result, they have sought temporary withdrawal from MSG trade arrangements.

Impact of shocks

Successful currency union efforts depend on whether the countries experience similar external shocks so that similar measures can be taken to counter their ill-effects. A rigorous estimation procedure for identifying supply and demand shocks and looking at the correlation of supply shocks between countries in the region is being pursued separately, employing the methodology adopted by Eichengreen and Bayoumi (1999) and Bayoumi, Eichengreen and Mauro (2000).

A simpler approach to evaluate whether the Forum island countries are experiencing similar shocks is to study past movements in their real effective exchange rates. The latter are endogenous prices, the outcome of the structure of the economy as well as of domestic and external shocks. If countries are similarly placed in terms of economic structure and external and domestic shocks, their real effective exchange rate movements would have common trends. In his study on real effective exchange rate movements in all Forum island countries, de Brouwer (2000) has shown that there has been substantial divergence, indicating that Forum island countries are not prone to similar shocks. As a result of divergence in external shocks,

Table 3 **Intra-regional exports and imports of Forum island countries, 1994–2000**

Countries	Intra-regional exports (per cent of total exports)	Intra-regional imports (per cent of total imports)	Intra-regional trade (per cent of total trade)	Intra-regional trade (per cent of GDP)	Total trade (per cent of GDP)
Cook Islands					
Average 1994–97	.	10.26	9.52	4.90	51.43
1998	.	11.76	10.83	5.60	52.45
1999	.	10.44	9.82	5.20	54.85
2000	.	18.49	15.68	12.03	76.73
Fiji					
Average 1994–97	0.31	0.07	0.38	0.51	76.87
1998	1.75	0.12	1.87	0.73	86.84
1999	1.56	0.10	1.57	0.64	90.62
2000	2.10	0.14	2.24	0.94	89.62
Kiribati					
Average 1994–97	.	7.80	5.15	11.67	88.78
1998	.	10.01	8.70	17.06	102.74
1999	.	14.00	11.37	16.31	98.02
2000	.	14.21	10.70	22.26	119.98
Republic of Marshall Islands					
Average 1994–97	.	0.97	0.71	0.46	83.40
1998	.	0.78	0.70	0.35	67.90
1999	.	1.16	1.02	0.50	68.90
2000	.	1.25	1.05	0.54	68.30
Federated States of Micronesia					
Average 1994–97	0.01	.	0.01	0.01	65.60
1998	0.19	.	0.02	0.01	64.70
1999	0.20	.	0.02	0.01	64.39
2000	..	..	..	..	73.07
Papua New Guinea					
Average 1994–97	0.03	0.03	0.06	0.11	88.89
1998	0.21	0.24	0.45	0.21	94.70
1999	0.18	0.30	0.44	0.23	114.12
2000	0.21	0.36	0.57	0.29	116.45
Samoa					
Average 1994–97	.	10.49	7.70	6.50	47.89
1998	.	18.08	11.90	11.60	51.74
1999	.	16.67	12.27	11.52	57.34
2000	.	11.50	9.48	13.02	38.69
Solomon Islands					
Average 1994–97	0.38	0.66	1.04	1.92	94.27
1998	1.07	4.30	5.10	2.66	108.46
1999	1.29	3.70	4.36	2.81	110.78
2000	2.10	6.10	8.20	3.70	85.89

Tonga					
Average 1994–97	3.08	7.65	6.97	3.76	51.67
1998	6.12	7.41	7.26	4.04	46.54
1999	2.00	9.96	8.79	4.98	47.14
2000	1.65	12.2	9.73	6.65	52.84
Tuvalu					
Average 1994–97	1.04	30.49	45.50	29.23	81.63
1998	1.61	59.81	58.39	41.24	70.06
1999	5.14	63.84	57.18	45.67	79.87
2000	11.39	58.58	56.01	58.77	104.93
Vanuatu					
Average 1994–97	0.01	0.93	0.94	2.67	85.58
1998	1.41	5.67	7.08	3.92	92.30
1999	1.19	4.12	5.31	3.98	122.87
2000	4.84	8.55	13.39	5.75	79.20

Source: Asian Development Bank, 2001. *Key Indicators of Asian and Pacific Developing Countries 2001*, Asian Development Bank, Manila.

growth rates of Forum island economies are not highly correlated (Table 4). In these circumstances, it is clear that these countries at their present stages of development cannot afford to have identical policies to meet the challenges of domestic growth, as they may have potential conflicts with common objectives in the short term.

Factor mobility

In the absence of downward flexibility in prices and wages, which is compounded by the presence of relatively strong trade unionism in the formal sectors in Forum island countries, unhindered labour mobility between them can be relied upon to reduce the adverse impact of asymmetric shocks. However, this is not the case in Forum island countries. There are legal hurdles to free labour mobility. Past trends in migration indicate a much lower rate of labour mobility among Melanesian countries (Fiji, Papua New Guinea, Solomon Islands and Vanuatu) in comparison to the high mobility rate among Polynesian countries (Cook Islands, Samoa and Tonga). Despite some positive trends in migration from the Polynesian and Micronesian countries to metropolitan countries, there are no concerted efforts undertaken by the countries concerned to evolve an agreed set of long-term regional migration policies.

Summary and conclusions

A preliminary study of a case for a single currency for the 14 Forum island countries shows that traditional optimal currency area conditions for such a currency union do not hold. Intra-country trade is small and is unlikely to increase much under free trade arrangements. Although Forum island countries' principal exports are mostly primary commodities and their prices tend to fluctuate together due to fluctuations in global demand, one cannot ignore the ongoing efforts in Fiji and Papua New Guinea to diversify exports and wean away from dependency on sugar and other primary products.

Presently there are impediments to factor mobility. Aside from barriers to capital and

Table 4 **Correlation of coefficients of real GDP growth for Forum island countries**

Countries	Cook Islands	Fiji	Kiribati	RMI	FSM	PNG	Samoa	Solomon Islands	Tonga	Tuvalu	Vanuatu
Cook Islands	1										
Fiji	0.426	1									
Kiribati	0.045	0.142	1								
RMI	0.248	0.102	0.070	1							
FSM	0.389	0.118	0.197	0.572	1						
PNG	0.441	0.095	0.145	0.051	0.589	1					
Samoa	0.751	0.180	0.179	0.329	0.071	0.097	1				
Solomon Islands	0.092	0.435	0.221	0.224	0.121	0.259	0.179	1			
Tonga	0.211	0.168	0.433	0.294	0.208	0.217	0.135	0.143	1		
Tuvalu	0.283	0.840	0.227	0.177	0.330	0.100	0.443	0.193	0.235	1	
Vanuatu	0.389	0.419	0.461	0.048	0.390	0.600	0.402	0.065	0.637	0.027	1

Source: Author's calculations.

labour mobility, there is no practice of fiscal transfers between Forum island countries. The conclusion, therefore is that there is no case for forming a currency union among Forum island countries at this stage, as there will be no significant gains in terms of savings in transaction costs as well as reduction in uncertainties associated with fluctuations in exchange rates.

Forming a currency union with Australia with whom Forum island countries trade a lot more would on the other hand, produce substantial gains. They will arise from savings in transaction costs as well as reduction in inflation rate and in interest rate fluctuations/risk premiums. These gains have to be weighed against loss of seignorage revenue arising out of discontinuation of national currencies, which will be replaced by the Australian dollar as legal tender. However, Forum island countries cannot afford to take for granted that there would be some automatic sharing of seignorage revenue by Australia or that the Reserve Bank of Australia would also be willing to act as 'a lender of last resort' when domestic banks in Forum island countries are in crisis.

The literature on optimal currency area conditions—relating to similarity in economic structures and adjustment policies adopted, fiscal and debt position, and inflation—was all written in the context of European monetary integration. It is increasingly argued that these optimal currency area conditions do not have much predictive power when applied to actual exchange rate regimes. Masson and Pattillo (2001a) refer to a recent study by Frankel and Rose (1998). Their findings are that optimal currency area criteria are to some extent endogenous and that monetary union might help make the shocks hitting member countries more symmetric and may also expand intra-union trade. These findings echo the view expressed by Scitovsky (1958), around the time when the European common market was born, that the common currency arrangements would by themselves tend to make countries more similar.

The discussion on the applicability of optimum currency area conditions to Forum island countries would be incomplete without a reference to the long running debate between two schools of thought—'the economists' and 'the monetarists'—on economic and monetary union. The economists saw the need for prior convergence on economic policy and performance before proceeding to fixed exchange rate parities. The monetarists, on the other hand, stressed early action on locking exchange rate parities into place so as to impose monetary discipline upon member states and herd them towards convergence of their economic policies (Blackman 1998). Temporarily, the debate seemed to have been settled in favour of the economists when after four decades, the euro, the common currency for the 12-nation euro zone in the European Union, was finally born on 1 January 2001.[2]

The role of politics

Blackman acknowledged that a mere optimistic 'economist approach alone would not be sufficient' (1998:152). In his writings and speeches, he recognised the role of politics as the most critical factor by quoting from William Demas, a former Governor of the Central Bank of Trinidad and Tobago, who later became the Secretary General of CARICOM. Demas declared that

> [a] single independent currency entails a single set of economic, monetary, financial and fiscal policies designed to influence the balance of payments. Such a single set of policies is possible only with a high degree of economic union tantamount to a political union (Demas 1974:54).

The Asian situation has been described as particularly difficult. Eichengreen and Sussman (2000) referred to special circumstances in Asia of trade and financial flows being regionally diversified, with neither the American dollar nor the Japanese yen an attractive anchor currency for most of the smaller countries of the region. They observed that currency board or monetary union arrangements would be elusive; and that the required degree of political comity did not exist.

Political commitment among the Pacific island countries has been lacking until very recently. The signing of the agreements on PACER and PICTA in 2001, therefore, assumes great significance. There is an increasing realisation that regional integration would be beneficial. However, the signs are not particularly encouraging. Two major Forum island countries, Solomon Islands and Vanuatu have already withdrawn, although temporarily, from the MSG Trade Agreement. Further, they have also not ratified PICTA. For PICTA to come into force, heralding the birth of a free trade area, the minimum number of required ratifications is six. At this stage, only four Forum island countries have ratified PICTA: Cook Islands, Fiji, Samoa and Tonga.

Obviously, there seems to be some hesitation. Such hesitation was not there in the case of PACER. With Niue ratifying PACER in early September 2002, the required seven ratifications have been obtained from the two developed Forum member countries (Australia and New Zealand) and five Forum island countries (Cook Islands, Fiji, Niue, Samoa and Tonga). It is significant to note that Solomon Islands and Vanuatu have not yet ratified PACER either. Unless there is a build-up of high degree of political solidarity, currency union appears to be only a distant possibility.

Notes

1 These include Communauté financière africaine (CFA), consisting of two zones, West African Monetary Union, and Central African Economic and Monetary Union in Africa (International Monetary Fund 1998; Cobham and Robson 1994; Collier 1991); the rand zone; the Eastern Caribbean Currency Union (ECCU) within the Organisation of Eastern Caribbean States (OECS); and the Caribbean Community and Common Market (CARICOM) in the Caribbean region (Samuel 2001; Hilaire 2000, 2001; Van Beek 2000; Blackman 1998; Demas 1974), with which Forum island countries share many commonalities (Fairbairn and Worrell 1996).

2 This extended period included 40 years of common market operations since 1958. It includes a gradual transition period from 1979, when the European Monetary System was installed by eight member countries (Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg and the Netherlands). They were later joined by Spain in 1989, the United Kingdom in 1990 and Portugal in 1992, under which they agreed to fix their exchange rates *vis-à-vis* one another and float jointly against the American dollar. A further seven years of transition elapsed from the signing of the Maastricht Treaty in February 1992, imposing stringent convergence criteria.

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