Feasibility Study of a Single Currency for Pacific Islands: 
a Principal Components Approach

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Abstract
In August 2003, an Australian Senate Committee recommended adoption of a single regional currency, preferably the Australian dollar as a possible remedy to meet the deteriorating economic situations in the Pacific Island Countries, arising from poor fiscal discipline and failure to effectively use external aid inflows. A suggestion to adopt the Australian dollar as a common currency amongst Pacific Island Countries was initiated by Australia during the Annual Meeting of the Pacific Islands Forum Leaders in Auckland, in August 2003. Although the subject was not discussed, the idea of a single currency for the region became a widely discussed topic in other forums in the later months. This paper examines the feasibility of the formation of a currency union by Pacific Island Countries with Australia in light of the principal components approach. This determines any synchronization in the movements of various key economic variables over the last two decades so that common exchange rate and monetary policies can be followed by a currency union amongst Pacific Island Countries and the two major metropolitan countries in the region.

Key words: Common currency area, Economic synchronization, Pacific Island Countries, Principal Components

Introduction

Various evaluation studies on aid utilization including the better publicized one by Professor HUGHES (2003) noted that implementation reform measures, such as improvements in aid delivery, discontinuance of annual budgetary support and institutional strengthening, have been slow and that aid has proved to be ineffective. These concerns prompted an Australian Senate Committee (2003) to examine the need for promoting regional stability in the context of deteriorating fiscal situations and failure of law and order in some of the Pacific Island Countries (PICs) and to come up with