Economics: Trans-Tasman Currency - Would the Kiwi-Kangaroo combination work?

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Would this kiwi-kangaroo combination work?

An idea of a Trans-Tasman currency, one common between New Zealand and Australia, is not something new. The Productivity Commission of both countries came out with a report in April 2012, highlighting that a shared currency may result in lesser costs, but also pointed to the euro crisis as an example of the risks. While there are valid and justified arguments on both sides, generally Australian lawmakers show considerably more interest in the prospect than the New Zealand central bankers and politicians who often cite concerns about mismatched business cycles, the loss of independent monetary policy, and fears that Australia will call the shots. However, there are positives for New Zealand in going ahead, in the form of business cost reductions and exchange rate smoothing. Yet, the difference between the Australian and New Zealand dollar is increasing, courtesy of the mining boom in Australia, so there are doubts over whether now is an appropriate time to move to a monetary union.

Massive trade imbalances is a factor worth consideration; Australia is the biggest trading partner of New Zealand, but New Zealand is only Australia’s 5th largest partner. Their economic cycles are different, owing to the fact that New Zealand is an agrarian economy, and Australia’s is based on mining. The recent eurozone crisis proved that countries whose economies are not matched or compatible will face an uphill struggle to balance and equate their economies after adopting a common currency.

Is adopting the Australian Dollar the best bet?

The success of a currency union depends on the synchronization of business cycles, as this reduces the need for independent monetary policy and as a result the cost of sharing the same currency is less. In a currency union there would be a common central reserve bank, with a common rate of interest and inflation. So, if one country is in a recession, it would be very difficult to change the inflation or rate of interest for that specific country, and the necessary stimulus couldn’t be achieved. This is what we observed in the current European economic crisis, between countries like Germany and Greece.

As recently as 2009, the Governor of the Reserve Bank of New Zealand dismissed the idea of a currency union as “unlikely” – noting that the euro was “under quite a bit of stress”. But even before that, in 2000, Donald Brash (the then Governor of the Reserve Bank) wrote about the idea of a currency union: “any decision to abandon our own currency is fundamentally a political issue. Currency unions are generally formed as part of a larger strategic push to integrate the countries entering the currency union, often in combination with free trade agreements, harmonisation of legal standards, and liberalised migration laws”.

Since the Australian economy is so heavily dependent on mining, a demand shock isolated to this market would cause the Australian and New Zealand economies to diverge and put pressure on the currency union and the restrictions it imposes on both countries. In the case of a metal price increase, Australia would want to move to control inflation with higher interest rates, but that would be counterproductive for New Zealand’s agrarian economy. Australia would also be the larger party in a currency union, and as mentioned they would rather prefer the adoption of the Australian dollar than moving on a common Trans-Tasman currency. With this option, control of central bank, inflation rates, tariff rates, would be decided in Australia.

However much discussion or research has been done in regards to convergence of Australian and New Zealand economy, only in its realisation will we be able to assess its true merits. From the opinions gathered, and the statistics reviewed under the backdrop of the volatile Euro situation, it seems it is still not the time to go for a monetary union or dollarisation.

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