

Submission to
Australian and New Zealand Productivity Commissions' Joint Study:
Strengthening economic relations between Australia and New Zealand

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A key issue on which the Commissions have been asked to provide analysis is:

“potential areas of further economic reform and integration, including identification of the areas of reform where benefits are likely to be most significant, with particular focus on critical areas for business like investment and productivity.” (Joint Study, Issues Paper, p 1)

In this context, my brief submission is substantially high-level nature, and draws primarily on the applied work I have been involved in on macroeconomic costs and benefits of any potential currency union between Australia and New Zealand. Two of the key papers summarising this applied work, recent international literature and the advantages and disadvantages of currency unions are Hall (2005) and Hall and McDermott (2011).

Issues paper Question 14: What is the appropriate ‘end-point’ to trans-Tasman integration?

Recent events involving countries in the European Union and those also belonging to the euro zone have highlighted the potential net disadvantages of a common currency when (optimal) conditions for entry have not been clearly set down and adhered to over the medium term. Under such conditions, actual and potential microeconomic benefits can be swamped by ongoing costs associated with macroeconomic factors.

Also of particular relevance for Australia and New Zealand is that New Zealand has no single dominant trading partner and that much more of New Zealand’s trade and financial capital flows have been conducted in US dollars than in Australian dollars.

In the context of the Joint Study’s Figure 5 entitled “Five levels of economic integration”, I see it as **essential** that Australia and New Zealand continue to pursue further economic integration as far as possible through (Rodrigue, 2012) levels 1 to 3 of Free Trade, Customs Union and Common Market. Wherever feasible, this way forward should have the additional benefit of seeking to strengthen “joint capability to influence international policy design” (Joint Study Issues Paper, p 6). I also see **considerable potential benefit** for business investment and productivity, from continuing to pursue the “harmonised tax rates element” of level 4 Economic Union. In particular, consistent with findings in the Henry Review, and despite the well-known counter-arguments of “fiscal and initial distribution implications, particularly for Australia” (Joint Study, p 30), I see it as **desirable** to continue pursuing mutual recognition of imputation credits. Finally on this question 14, I see **no material net benefits** for the short through to medium terms of pursuing any of the other level 4 elements of Common Currency, Common Monetary Policy or Common Fiscal Policy.

Issues paper Question 16: What would be the advantages and disadvantages of implementing a currency union between Australia and New Zealand?

The papers by Hall (2005, especially ss. 1, 2 and 4) and by Hall and McDermott (2011, especially ss. 1, 4.4 and 5) have presented findings of a macroeconomic nature for Australia and New Zealand, along with summary reference to key international and Australasian literature, presentation of some advantages and disadvantages of currency unions, and some implications for policy.

My current summary view, set now against the background of the late 2000s Global Financial Crisis and subsequent ongoing sovereign debt crises, remains broadly consistent with that expressed in Hall (2005, s. 4.2), i.e.

“... for the foreseeable future, the policy path forward for New Zealand [and Australia] should be based on [New Zealand’s] retaining its independent monetary policy and currency; ongoing fiscal prudence; ongoing attention to alleviating labour market and physical capital market constraints to real GDP growth; continued focus on reducing trade barriers, via multi-lateral processes, CER [agenda] enhancement, and bi-lateral trade agreements; and a ‘world-best’ approach to Single Economic Market (SEM) harmonisation ... “

Hence, only once the (Rodrigue, 2012) Free Trade, Customs Union and Common Market goals have been essentially achieved, and the Harmonised Tax Rates possibilities have been pursued to their limits, would I see any merit in focussing significant attention on any one or more of a Common Currency, Common Monetary Policy or Common Fiscal Policy.

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References

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