Since mid-1995 the Chinese government has been pegging its currency, the renminbi, to the U.S. dollar at the exchange rate of approximately 8.28 renminbi to the dollar. In Chinese, renminbi means “People’s Currency”, and the base unit of the renminbi is the yuan. So China’s currency is frequently quoted as the yuan in the foreign exchange market and the current exchange rate therefore as 8.28 yuan to the dollar.

Why has the government adopted the policy of pegging its currency to the dollar, and what are its consequences? What alternative policies should the government consider?

These questions are at the heart of a major ongoing debate among academic economists, and the Chinese government’s exchange rate policy has been the subject of intense political and economic discussions at the highest international levels.

Before attempting even a brief discussion of some of the issues, a short profile of China will serve as a useful introduction. China is the world’s most populous country with a population of 1.3 billion people, fully one-fifth of mankind. Measured by Gross Domestic Product using current market prices and exchange rates, China’s economy is about 12% of the size of the U.S. economy. Its per capita GDP has been estimated at approximately $5000 calculated on a purchasing power parity (PPP) basis, about 11% of U.S. per capita GDP. Thus, China remains a very poor country. Its main exports are light manufactured goods including apparel and electronics, and it is the world’s second largest oil consumer after the United States.

After stagnating for two decades under Communist rule, market reforms were gradually introduced beginning in 1978. In the early 1980’s collective farming was dismantled, and private enterprise was allowed again. China has now emerged in recent years as the world’s fourth largest exporting country, and it has attracted large amounts of foreign investment. Its leading markets as of 2002 were the United States (21.5%), Hong Kong (18.0%), Japan (14.9%), and the European Union (14.8%). Its economy has been continually liberalizing and expanding, and it joined the World Trade Organization in 2001. The economy’s recent high growth rate – 9.1% in 2003 according to official data – has produced fears of overheating and has led the government to discourage bank lending.

The fact that the Chinese authorities have kept its currency unchanged against the dollar has had several consequences. The current exchange rate of 8.28 yuan to the dollar, China has been experiencing a current account surplus (essentially an excess of exports of goods and services over imports of goods and services). This current account surplus, along with the large amount of foreign investment in China, has created an imbalance in the foreign exchange market and has forced the central bank to sell yuan and buy dollars in this market in order to maintain...
PUBLICATIONS


Goodman, Allen C. The Economics of Health and Health Care, (Folland, Goodman and Stano) has just appeared in Chinese and in Korean translations.

RESEARCH AWARDS


ALUMNI UPDATE

Mehmet Balcilar (PhD 1996) is now Associate Professor at Kazakhstan Institute of Management, Economics, and Strategic Research (KIMEP) in Kazakhstan.

Swarna Dutt (PhD 1993) was promoted to Professor of Economics at West Georgia State University as of Fall 2003.

Markus Krygier (PhD 1998) was appointed Managing Director and Chief Debt Strategist at Dresdner Kleinwort Wasserstein (DrKW), the investment bank of Dresdner Bank AG. In this role, Markus will focus on providing a consistent approach across all debt asset classes including credit, emerging markets, FX and liquid markets. Markus, who will be based in London, joins DrKW from the International Monetary Fund (IMF) in Washington where he was an economist in the International Capital Markets Department. Prior to joining the IMF in March 2003, Markus was head of Strategy at Credit Agricole Asset Management in London and Paris.

DISSERTATION DEFENSE


AWARDS

Alexander Barfield. 2004 Mendelson Award. $1,500

Konstantinos Ioannou. Economics Scholarship for Majors, Winter 2004. $500

Ronald Mariutto. Economics Scholarship for Majors, Winter 2004. $500

Maia Platt. “Mental Health Parity: Can Michigan Afford It?” Student Award, Blue Cross Blue Shield of Michigan Foundation, August 2004. $27,821

Jason Whateley. Economics Scholarship for Majors, Winter 2004. $500

Jing Zhou. 2004 Samuel M. Levin Economics Award. $1,000
2004 Nobel Prize in Economics

By Jay H. Levin

The winners of the Nobel Prize in Economics were announced on October 11 by the Royal Swedish Academy of Sciences. Finn Kydland, a Norwegian who teaches at Carnegie Mellon University and is a visiting professor at the University of California at Santa Barbara, and Edward Prescott, an American who teaches at Arizona State University and was a senior monetary advisor to the Federal Reserve Bank of Minneapolis, were cited “for their contributions to dynamic macroeconomics: the time consistency of economic policy and the driving forces behind business cycles.” The Academy said that the pair “made fundamental contributions to these areas of great significance, not only for macroeconomic analysis, but also for the practice of monetary and fiscal policy in many countries.” Kydland and Prescott will share a $1.37 million prize for their work.

In a paper published in 1977 Kydland and Prescott were able to show how the effects of expectations about future monetary policy can give rise to a time consistency problem. If monetary policymakers lack the ability to commit in advance to a specific decision rule, they will often make inconsistent policy decisions at different points in time. For example, policy makers may abandon longer term inflation aims to milk a shorter term reduction in unemployment. Consequently, governments will have difficulty stabilizing their economies when they cannot credibly persuade the public that they will stick to a particular policy. Instead of making a longer term commitment to a set course of action, they will often not implement the most desirable policy later on. Countries then can become trapped in high inflation even though price stability is the stated objective of monetary policy. In summary, the argument is that policymakers who have discretion will be tempted to take short term actions that are inconsistent with the economy’s best long term interests.

In 1982 Kydland and Prescott published another paper showing that supply-side shocks, such as technological innovations, are a driving force behind the business cycle rather than variations in demand alone. The Academy noted that “whereas earlier research had emphasized macroeconomic shocks on the demand side of the economy, Kydland and Prescott demonstrated that shocks on the supply side may have far-reaching effects.

Kydland was born in Norway in 1943, and although he has worked and taught in the United States since the 1970’s he remains a Norwegian citizen. He received a bachelor’s degree in economics in 1968 from the Norwegian School of Economics and Business Administration in Bergen before earning his Ph.D. from the Carnegie Mellon University in 1973.

Prescott was born in Glen Falls, New York in 1940. He received his bachelor’s degree in mathematics from Swarthmore College in 1962, his master’s degree in operations research from Case Western University in 1963, and his PhD from Carnegie Mellon University in 1967.

Kydland was lecturing at the Norwegian School of Economics and Business Administration when he was interrupted to take a phone call. “I was a little perturbed when they interrupted my lecture until I got to the secretary’s office and found out what the phone call was about,” he said. “It is wonderful to get this recognition.” Prescott was sleeping at his home in Arizona when a phone call awakened him at 4 a.m. with the news that he had won the Nobel Prize.

A New Course in Economics
ECO 6500: Public/Urban Economics

This winter 2004 semester the Department of Economics will introduce a new course titled Public/Urban Economics (ECO 6500). This is a graduate level course offered for 4 credits.

Topics will include theory of public goods; externalities’ taxation from the standpoint of efficiency and income distribution; effects of taxation on labor supply and saving; local public finance; tax competition; transportation economics; and housing economics. The course will be taught by Professor Ralph Braid on Monday evenings, 5:30 p.m. – 9:10 p.m.

Leading Expert on Chinese Economy to speak at Levin Lecture

Professor Gregory Chow (Princeton University), world famous economist and a leading expert on Chinese economy will be the guest speaker at the next Samuel M. Levin Economics Award Lecture scheduled for Friday, April 1, 2005.

The Levin Award Fund was created by donations to the university to honor the distinguished educational leadership and scholarly contributions of the late Professor Emeritus Samuel M. Levin.

In a brief ceremony preceding the lecture, a representative from the Levin family will present the 34th annual Levin Award to the graduate student who submits the best essay in economics.

Invitations to this event will go out at a later date. For more information, please call (313) 577-3347.

Birth Announcements

Congratulations to Jay Levin (Chair) on the birth of his first grandchild. Jonah Liam Zimmermann was born on June 14. He weighed in at 8 lbs. 10 oz.

Also, congratulations to Tomomi Kumagai (Asst. Prof.) and her husband, Chris on the birth of their son, Caeden Couch. Caeden was born on June 25 at 1:07 a.m. weighing 8 lbs. 1 oz.
Tax Deductions

Wayne State University is classified as a 501 (c)3 organization by the IRS and, as such, is eligible to receive charitable contributions. You will receive a receipt to this effect.

Double Your Dollar

Many companies will double or even triple their employee’s contributions to WSU. If you or spouse work for a matching gift company, ask for a matching gift form at your personnel office.

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This foreign exchange intervention has had two effects. First, China has continued to build up its foreign exchange reserves as the central bank purchases dollars in the foreign exchange market. Second, however, and of greater significance, is the fact that the central bank’s sale of yuan on the foreign exchange market means that China’s money supply will automatically expand. Indeed, China’s money supply has increased rapidly, and this monetary expansion is potentially inflationary for the Chinese economy.

Furthermore, because of the imbalance in the foreign exchange market at the current exchange rate, China’s currency is undervalued in comparison with an exchange rate below 8.28 yuan to the dollar that would eliminate the imbalance. Indeed, some recent estimates indicate that the yuan is currently undervalued on the order of 15 to 25 percent. A lower exchange rate against the dollar, which is equivalent to an appreciation of the yuan (i.e., higher dollar price of the yuan), would make Chinese goods more expensive in the United States and thereby reduce China’s exports to the U.S. and other countries as well as increase imports coming into China. Thus, China’s current account surplus would be reduced by such an exchange rate adjustment. Consequently, there has been intense international pressure coming from the United States and other industrialized countries to have the Chinese government sever the link between the yuan and the dollar and let the exchange rate on the yuan be determined by market forces. The yuan would then appreciate on the foreign exchange market against the dollar, China’s exports to the United States and other countries would decline, and the undervaluation of the yuan would disappear.

Since an appreciation of the yuan would hurt Chinese exports and the workers in the factories that depend on exports, the Chinese government has been reluctant to consider this course of action and has given every indication that they will maintain the current level of the exchange rate against the dollar. However, some observers believe that an appreciation of the yuan would create an environment in which some depreciation could occur smoothly and non-traumatically by the end of the transition period in 2007 when China is required to undertake significant trade liberalization as part of its accession agreement with the World Trade Organization. Others believe that the government’s refusal to let the yuan appreciate has caused the economy’s overheating since the foreign exchange intervention has led to rapid monetary expansion. If one accepts either argument, this might be an ideal time for the Chinese government to reconsider its position.

It is clear that China’s exchange rate policy has important ramifications both within China and for its trading partners. On April 1, 2005 Professor Gregory C. Chow of Princeton University, one of the world’s leading specialists on the Chinese economy, will be presenting the Annual Samuel M. Levin Lecture sponsored by the Department of Economics. We will all be looking forward with great interest to hear Professor Chow’s views on this and other matters involving the Chinese economy. The Lecture will be free and open to the public.

Jay H. Levin

Reference

The Donor Report

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<td>Mr. James Mallett, Ms. Della Lee Sullivan, Mr. Richard D. Ventura</td>
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New 2004-2005 Graduate Students

**GRADUATE TEACHING ASSISTANTS**

- Susanne Buesseleman, Univ. of Augsburg, Germany
- Deena Fahmy, American Univ. of Cairo, Egypt
- Michael Faulkiner, Univ. of Detroit/Mercy
- Li Li, Huazhong Univ. of Science and Technology, China

**DAAD (GERMAN MA PROGRAM)**

- Wanda Mimra, Univ. of Nuremberg
- Verena Rathgeber, Univ. of Nuremberg
- Marius Richter, Univ. of Nuremberg
- Stefan Walter, Univ. of Nuremberg
- Stefan Weih, Univ. of Nuremberg

**RUMBLE FELLOWS**

- Christopher Brunt, Eastern Michigan Univ.
- Anna Ejakova, Krasnoyarsk State Academy, Russia

**FYI...**

Effective this fall 2004 semester, the College of Liberal Arts and the College of Science merged and is now called the College of Liberal Arts and Sciences with Professor Robert L. Thomas as dean.
ALUMNI UPDATE

We would love to hear from you. Drop us a few lines and tell what you are doing now.

Name:

Address:

Type of Degree/Date Earned:

Present Position:

Comments: