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WHY CHINA WANTS TO PEG IT'S CURRENCY? AN EMPIRICAL INVESTIGATION

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ABSTRACT

Our study develops two propositions for establishing the superiority of a flexible exchange rate system over a fixed one. These propositions require one of the two following conditions: a) either purchasing power parity holds between two countries, or b) the output target of the reference country is adjusted to its long-run value and its real exchange rate is lower than the long-run value. Our analysis on China shows that neither of these conditions is satisfied. Therefore, we conclude that in case of China the conditions for the superiority of flexible exchange rate system are not fulfilled. As such, China's decision to peg its currency with U.S. dollar cannot be considered to be irrational. This paper devotes itself to analyzing the effect of the violation of PPP along with the deviation of output target and real exchange rate from their long-run equilibrium values on government's loss function.

JEL Classification: F1
Key Words: fixed exchange rate, flexible exchange rate, purchasing power parity, welfare

INTRODUCTION

This paper devotes itself to analyzing the effect of the violation of PPP along with the deviation of output target and real exchange rate from their long-run equilibrium values on government's loss function. We will develop a model in section 2 and outline the data and methodology in section 3. In sections 4 and 5, we will present the empirical results and the summary of our findings, respectively.

THE MODEL

We assume a typical government loss function taken from Barrow and Gordon (1983) as following:

$$L = (Y - KY^*)^2 + \beta(\Pi^2) + c(\varepsilon), \quad (1)$$

where, Y is the output level, Y* is the targeted output level, Π is the rate of inflation, c(ε) is the cost of changing the exchange rate, ε is the exchange rate, and K and β are assigned weights. The first squared term in the loss function is the quadratic approximation of the welfare loss of being away from targeted output level. The output deviation enters the government loss function, because it causes unnecessary economizing on real balance, which generates costs of price change and even increases endogenous relative price uncertainty (Benabou, 1988). The second term in the equation is the rate of inflation. An unanticipated inflation is costly, because it increases relative price variability (CuKiermanm, 1984), and costs of information gathering. The redistribution of income and wealth associated with unanticipated inflation can also be regarded as socially undesirable. The third term is the cost of changing exchange rate. Because excessive short-run fluctuations in exchange rates under a flexible exchange rate system may be costly in terms of higher frictional unemployment if they lead to over-frequent attempts at reallocating domestic resources among the various sectors of the economy.

The output function is drawn from the augmented Phillips curve as following:

$$Y_t = \bar{Y} + \alpha(\Pi_t - \Pi_t^e) + u_t, \qquad (2)$$

where, Y_t is the output level, $\bar{Y}$ is the long-run output level, Π_t and Π_t^e are actual and expected inflation rates respectively, and u_t is the output shock. After a series of derivations we obtain the loss functions under flexible and fixed exchange rate systems respectively as following:

$$c^*(\varepsilon) = \frac{\alpha^2}{\alpha^2+\beta}(\bar{Y} - KY^* - \alpha\varepsilon_t^e)^2 + \frac{\beta^2}{\alpha^2+\beta}\lambda^2(\zeta - q_{t-1})^2 + \frac{\alpha^2}{\alpha^2+\beta}\sigma_u^2$$
$$- \frac{2\beta\alpha}{\alpha^2+\beta}\lambda(\zeta - q_{t-1})(\bar{Y} - KY^* - \alpha\varepsilon_t^e) + (\alpha^2 + \beta)\sigma_v^2 \qquad (13)$$

Since c*(ε) is the critical value of c(ε), which equalizes $E(L^{Flex})$ and $E(L^{Fix})$, c*(ε) > 0 implies that $E(L^{Flex}) < E(L^{Fix})$, whereas c*(ε) < 0 implies $E(L^{Flex}) > E(L^{Fix})$. So, dynamic consistency requires that the government change the exchange rate whenever c*(ε) > 0. Thus a fixed exchange rate system is sustainable as long as c*(ε) < 0.

In the above derivation, we have implicitly assumed that the cost of exchange rate change is negligible (i.e. c(ε) = 0). Further, if we assume that purchasing power parity holds, then it implies that qt-1 = 0 and, therefore, ζ = 0. Thus, the negative term on the right hand side of equation (14) drops out. If we also assume that output target is fully adjusted to the long run equilibrium output level i.e. $\bar{Y}$ = KY*, and that the real exchange rate is lower than its long-run equilibrium value i.e. qt-1 < ζ, then, from equation (14), it is clear that E(LFix) > E (LFlex). This means the expected loss under a fixed exchange rate system outweighs the expected loss under a flexible exchange rate system. These results lead us to the following propositions.

Proposition-1: Under purchasing power parity, a flexible exchange rate system is always better.

Proposition-2: Under purchasing power disparity, a flexible exchange rate system is better only if output target is adjusted to its long-run value and the real exchange rate is lower than its long-run value. If these conditions do not hold under purchasing power disparity, then the superiority of a flexible exchange rate system cannot be claimed.

CONCLUSION

Studies, so far, on various exchange rate systems, do not clearly establish the superiority of one exchange rate regime over the other. Most of these studies, either in the support or against of a flexible exchange rate are based on the assumption that purchasing power parity holds between two countries. Our study develops two propositions in this regard. The first proposition states that under purchasing power parity, a flexible exchange rate system is always better. The second proposition states that under purchasing power disparity, a flexible exchange rate system is better only if output target is adjusted to its long-run value and the real exchange rate is lower than its long-run value. If these conditions do not hold under purchasing power disparity, then the superiority of a flexible exchange rate system cannot be claimed. To test these propositions and to see if pegging its currency with U.S. dollar is a rational decision on the part of China, we employ our tests on the data over the period of 1982-2005. Our result shows that purchasing power parity does not hold between China and the U.S. Therefore, we test the second proposition to see if a flexible exchange rate system is better for China. For a flexible exchange rate system to be better for China, the second proposition requires that China's output be adjusted to its long-run value and that its real exchange rate with the U.S. dollar be lower than its long-run value. Our results again show that both of these requirements are not fulfilled. Therefore, a flexible exchange rate system cannot be claimed to be better than a fixed exchange rate system for China. As such, China's choice to peg its currency in terms of U.S. dollar cannot be claimed to be irrational.

THE IMPACT OF CORPORATE GOVERNANCE ON FIRM PERFORMANCE ON STOCK PRICE AMONG PUBLICLY LISTED COMPANIES IN THE PHILIPPINES 2009 TO 2011

Habib Mohammadoor, Delasalle University

ABSTRACT

This study examined the impact of corporate governance on firm performance and stock price among publicly listed companies in the Philippines during 2009 to 2011. This study utilized multiple regression analysis to test the hypothesis in a sample of 53 firms to come up with set of independent variables that were significant to ROE, ROA and Stock Price.

Firm size directly related to ROE and Stock Price while inversely related on ROA. Interaction of Firm Size and Silver directly related to ROE and Stock Price while inversely related on ROA. The Interaction of Firm Size and Gold directly related to ROA while inversely related on ROE. Interaction of Firm Size and Platinum inversely related to Stock Price. Interaction of Firm Age and Silver directly related to ROA while inversely related on ROE. The Interaction of Firm Age and Gold directly related to ROE while inversely related on ROA and Stock Price. Interaction of Firm age and Platinum and Interaction of Firm age and Platinum Plus directly related to Stock Price. The variables are transformed to make it comparable and were able to meet assumptions such as Linearity, Multicollinearity, Normality and Heteroscedasticity.

INNOVATION MOTIVATION: REDUCING ENVIRONMENTAL IMPACT

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ABSTRACT

"Green" product and process innovations that seek to protect the environment by reducing environmental impact are vital to the health of society. They can also make good business sense as they create competitive advantages. Cost savings from reduced energy use can be substantial for large businesses with high production levels. For small and medium-sized businesses, the costs of green materials and the necessarily investments may outweigh other savings. From a philosophical point of view, ecopreneurs, who are more typically found among SMEs, view environmental friendliness as more important than pure profit. Therefore, businesses of all sizes have reason to pursue green innovation. This study examines environmental innovation motives among small, medium-sized and large businesses that are involved in product and/or process innovation. Overall, the results show that large businesses are more likely than SMEs to say that reducing environmental impact is a highly important objective for innovation.

INTRODUCTION

The interaction of innovation and sustainability has become a "strategic priority for theory and practice" (Dangelico & Pujari, 2010, p. 471). This is especially seen in Scandinavia, where great value is placed on protecting the environment. Investments by small and large companies alike can pay off if customers view environmentally friendly products as more desirable and suppliers can thus differentiate themselves from the competition (Isaak, 2002; Morsing & Perrini, 2009; Schick, Marxen & Freimann, 2001; von Weltzien Høivik & Shankar, 2010). These rewards do not, however, come without risk. Innovation activities require an investment of resources without the guarantee of return on that investment. This proposition can seem even riskier for small businesses with limited resources and less to gain from economies of scale (Millard, 2011). At the same time, SMEs may be more flexible and better able to take advantage of green innovation opportunities (Jenkins, 2009; von Høivik & Shankar, 2010). Business founders, especially ecopreneurs, are also more likely to be able to show their own

concern for the environment through their firms, even when it means putting profits in a secondary position (Beveridge & Guy, 2005; Tilley & Young, 2009; von Weltzien Høivik & Shankar, 2010). Zee, Fok & Harman (2011) found that small businesses showed greater belief in the importance of going green.

This study examines environmental protection as a motive for innovation. Specifically, it examines the proportion of innovative firms that pursue reduction of environmental impact as a highly important objective. Data from the Eurostat Community Innovation Survey for Norway and Sweden are compared to determine if there is a relationship between business size and the tendency to engage in this type of innovation. The next section presents a brief background on green innovation, followed by the methodology, results and analysis of the data for this study.

ENVIRONMENTAL INNOVATION

According to Walley and Taylor (2002, p. 36) the 'greening' of business means "moving towards environmental or ecological sustainability." This can include firms that actively seek to reduce environmental impact and those that simply pursue improved operations, such as reduced energy costs. More profitable business operations, as well as compliance with regulations and philosophical concern for the environment, are common reasons for environmental innovation.

Environmental innovation can make business sense all along the value chain, contributing to a successful overall business strategy (Braun, 2010; Dangelico & Pujari, 2010; Gibbs, 2009; Isaak, 2002; Martin, McNeill & Warren-Smith, 2013; Millard, 2011; Revell & Blackburn, 2007; Schick et al., 2002; Tilley, 1999; von Weltzien Høivik, & Shankar, 2010). In production, more efficient use of materials and energy reduce costs (Dangelico & Pujari, 2010; Johnson, 2009; Lober, 1998; Millard, 2011; Kolk, 2000; Seiler-Hausmann, Liedtke & von Weizsacher, 2004; von Weltzien Høivik & Shankar, 2010). Decreased pollution is linked to increased efficiency, which also leads to savings (Chang & Chen, 2012; Chen, 2008; Day & Schoemaker, 2011; Isaak, 2002; Lober, 1998). Green products are also increasingly popular with consumers around the world who report that they expect to purchase more environmentally friendly products in the coming years (Cohn & Wolfe, 2011). Green products and processes are also useful for promoting a positive image (Yarahmadi & Higgins, 2012).

In contrast to these factors that "pull" companies into green innovation, regulations also "push" firms to comply with stricter environmental policies (Gibbs, 2009; Linnanen, 2002; Martin et al., 2013; Pastakia, 2002; Taylor & Pandza, 2003; von Weltzie Høivik & Shankar, 2010; Walley & Taylor, 2002). Examples of regulations include the Kyoto Protocol, Montreal Convention, Restriction of the Use of Certain Hazardous Substances in EEE (RoHS) and Waste Electronics and Electrical Equipment Directive (WEEE) (Chang & Chen, 2012; Chen, 2007; Environment Agency, 2011; Haden, Oyler & Humphreys, 2009; Pastakia, 2002; Schick, Marxen & Freimann, 2002).

Ecopreneurs who start their own businesses in order to follow their passion for the environment while at the same time making a profit are more likely to truly support green initiatives than are companies that are founded primarily for profit (Schick et al., 2001). At the same time, larger businesses have been shown to be more likely than SMEs to engage in environmental innovation (Robinson & Stubberud, 2013, Zee et al., 2011). While small businesses may be better at creating particular markets for green products, they have relatively less to gain from cost reductions due to their smaller size (Anderson, 1998; Bansal & Roth, 2000; Cohen & Winn, 2007; Dean & McMullen, 2007; Isaak, 2002; Kirkwood & Walton, 2010; Millard, 2011; Morsing & Perrini, 2009; Schaper, 2002; Schaltegger, 2002; Schick et al., 2001; von Weltzien Høivik & Shankar, 2010).

SMEs' small size and limited resources present numerous challenges. Larger companies are more likely than SMEs to control the resources necessary for innovation, including human and financial capital (Eurostat, 2009). Previous research (Robinson & Stubberud, 2012) has also shown large businesses to be more likely to start innovative projects, but not necessarily to see them through to completion. The following section describes the results of this study comparing the proportion of innovative small, medium-sized and large businesses in Norway and Sweden that consider environmental innovation a highly important objective.

METHODOLOGY AND RESULTS

This study used data from the 2010 Community Innovation Survey conducted by Eurostat (Eurostat, 2014). Norway and Sweden are neighboring countries with similar, yet different, cultures, and were therefore studied together to provide comparison and contrast. One question in this study pertained to whether reducing environmental impact was a highly important objective for innovation. Only companies that were engaged in product or process innovation are included in this study. These results therefore present the proportion of innovative firms, not the proportion of total firms that viewed reducing environmental impact as highly important. Some firms may have viewed reducing environmental impact as a secondary goal or an unintended consequence of innovation. Such firms would be counted among those who did not state that reducing environmental impact was a highly important objective.

Table 1 presents the results of Chi-square analysis.

Table 1
PROPORTION OF INNOVATIVE COMPANIES WITH REDUCING ENVIRONMENTAL IMPACT AS A HIGHLY IMPORTANT OBJECTIVE

Country	Total	10-49 employees	50-249 employees	250+ employees	Chi-sq	P<
Norway	38.2%	40.4%	29.5%	47.1%	33	.001
Sweden	18.2	16.6	20.4	29.7	59	.001

Norwegian large businesses were significantly more likely to state that reducing environmental impact was a highly important objective for innovation, with almost half (47.1%) of large companies saying yes to item. Over 40% of small businesses also indicated this. Medium-sized businesses were the least likely to say this was a highly important objective, with just under 30% proclaiming this motive.

In Sweden, this pattern was changed as small businesses were the least likely (16.6), but large businesses were gain the most likely (29.7%). The proportions were lower for each category. Whereas the lowest percentage among Norwegian businesses was 29.5% for medium-sized businesses, the top percentage in Sweden was 29.7% for large businesses. This suggests that the Norwegian businesses in this study were more likely to view reducing environmental impact as important and/or that they were more likely to actively pursue this goal. In both countries, large businesses took the lead and were more likely than SMEs to engage in environmental innovation, or at least to state it was a highly important objective.

CONCLUSIONS

The results of this study are encouraging in that more than 18% of Swedish businesses (overall) and 38% of Norwegian businesses were engaged in innovation seeking to reduce environmental impact. Although this represents a minority of innovative businesses and an even small subset of all businesses, there is a considerable proportion of businesses that view reducing environmental impact as a highly important objective.

The motives behind this goal were beyond the scope of this study and should be investigated in future research. Large companies may be enticed by cost savings, such as reduced energy costs, or compelled by regulations to become more environmentally friendly. SMEs may find green products and processes provide a competitive advantage. Ecopreneurs may be operating their businesses with a goal or protecting and preserving the environment.

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DISCOURSE ANALYSIS OF APPLE-FOXXCON CASE OF EMPLOYEES' SUICIDE IN CHINA

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ABSTRACT

In the international business settings, multinational corporations commonly face challenges and allegations of treating local labor unfairly. Through discourse analysis, this paper illustrates the case of Foxxcon Technology Group, which is the largest producer of Apple products with its factories located in Guanlan, Longhua, and Chengdu. An audit of Foxxcon Technology Group revealed serious and pressing violations of Chinese labor laws. These Employees worked an average of 60 hours per week, while earning only $360- $450 per month. Employees were given the ultimatium to either obey the rules, work grueling hours, or to leave their employment positions. In 2010, at least 10 employees committed suicide, setting the tone of the miserable conditions that employees had to withstand. In response to the criticism following the Foxxcon suicide, Apple became the first technology company to join the Washington-based Fair Labor Association (FLA). Based on the analysis of discourses constructed by stakeholders in this case, the paper highlights the negotiation of stakes among various parties and the strategic management of Foxxcon in handling with stakeholders' pressures in this international business context.

INSTABILITY IN INTERNATIONAL JOINT VENTURE: INTER-ORGANIZATIONAL TENSION PERSPECTIVE

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ABSTRACT

This article examines how inter-organization factors affect alliance instability in forms of ownership change in international joint ventures. For that purpose, we employ the perspective of inter-organizational tension between cooperation and conflicts between alliance partners. We find that initial unequal ownership promotes ownership change due to power asymmetry. We also find that partner credibility, IJV satisfaction, and longer duration stabilize IJV relationship and thus reduce the possibility of ownership change. These findings show dynamic relational changes associated with internal tension among alliance partners. This study contributes to the existing literature by fine-graining the impacts of diverse inter-organizational factors rather than external environmental factors.

THE IMPACT OF ISO 9000 ON THE FINANCIAL PERFORMANCE OF DELL COMPUTERS

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ABSTRACT

The utilization of Total Quality Management practices such as ISO 9000 has garnered the attention of both researchers and practitioners. Therefore many fortune 500 firms have adopted the various versions of ISO 9000 (ISO 9002; ISO 9000:1994; ISO 9001:2000; ISO 9000:2008) as an integral part of their strategic plan for improving quality and reducing costs (Adanur & Allen, 1995; Albuquerque et al. 2007; Beattie & Sohal, 1999; Corbet et al., 2005; Marquardt, 1992; Singels et al. 2001). This study compares the change in revenue and operating income results over a six year period (1999-2005) for Dell Computers as they implement operational practices that will have a significant impact on the financial assets of the company. The study utilizes longitudinal data to examine the research problem. First, the study shows that the change in revenue is not statistically significant. Second, it shows that there is a change in operating income that is also not statistically significant. The implementation of the new ISO 9001:2000 certification standards are the focal point for determining the ultimate impact on the company's revenue and operating income.

Key Words: ISO 90002, ISO 9001:2000, Operating Income, Revenue