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Table of Contents

TRANSFORMATIONAL STRATEGIC CHANGE:
EMPIRICAL FINDINGS OF 4 STUDIES 1
Peter H. Antoniou, California State University San Marcos
Dong Joon Park, The Ansoff Institute
Catherine E. Levitt, California State University

A REVIEW OF THE PERIOD 1946-1960
CONCERNING THE INFANT-INDUSTRY
PROTECTION ARGUMENT 3
Robert L. Brittingham, Christian Brothers University
Sarah T. Pitts, Christian Brothers University
Rob H. Kamery, Christian Brothers University

EAST-ASIAN CRISIS AND ITS EFFECTS ON
INVESTMENT OPPORTUNITIES AND BARRIERS
TO INVESTMENTS IN SOUTHEAST ASIA 9
Jennifer Castro, Sam Houston State University
Balasundram Maniam, Sam Houston State University

STRATEGIES FOR SUCCESSFUL REPATRIATION 11
Yvonne Goss, CPA, The Allyn Group
Geraldine E. Hynes, Sam Houston State University

AN ANALYSIS OF HOW THE USE OF OUTSIDE
START-UP CAPITAL HINDERS CREATION OF
MICROENTERPRISES IN MEXICO 13
Heikki Heino, Governors State University

FDI AND THE EFFECTS ON SOCIETY 15
Michelle Herman, Sam Houston State University
Darla Chisholm, Sam Houston State University
Hadley Leavell, Sam Houston State University

HAS THE IMF OUTLIVED ITS USEFULNESS?
A BRIEF ESSAY ON THE ORIGINS AND THE
EFFECTIVENESS OF THE INTERNATIONAL
MONETARY FUND 19
Frank E. Hood, Mississippi College
Sarah T. Pitts, Christian Brothers University
Rob H. Kamery, Christian Brothers University

THE OPIUM TRADE OF THE U.K. AND U.S.
IN CHINA DURING THE 19TH CENTURY 25
Frank E. Hood, Mississippi College
Kristin O. Prien, Christian Brothers University
Sarah T. Pitts, Christian Brothers University
Rob H. Kamery, Christian Brothers University

THE CHANGING NATURE OF RETURN VOLATILITY
IN THE WORLD'S EMERGING STOCK MARKETS 31
Gerald Kohers, Sam Houston State University
Theodor Kohers, Mississippi State University

RELATED PARTY FINANCIAL STATEMENT
DISCLOSURES-
PURPOSES, SUBJECT AND NUMBER FOR
HONG KONG H-SHARES 33
Gary A. Miller, Texas A&M International University

BANKING ON SUCCESS IN THE WAR ON TERROR 41
Leroy Ashorn, Sam Houston State University
Balasundram Maniam, Sam Houston State University
Rachel Entenza, Sam Houston State University

WAL-MART'S LEARNING CURVE IN THE
GERMAN MARKET 43
Don B. Bradley III, University of Central Arkansas
Bettina Urban, University of Central Arkansas

THE POSSIBILITY OF CORPORATE SOCIETAL
STRATEGY IN CHINA 45
Catherine Levitt, California State University Los Angeles
Kern Kwong, California State University Los Angeles
Lillian Fok, Louisiana State University New Orleans

CONSUMERISM: STATISTICAL ESTIMATION
OF NIGERIA MEAT DEMAND 47
Osho Gbolahan Solomon, University of Houston-Downtown
Asghar Nazemzadeh, University of Houston-Downtown

INDUSTRIAL RELATIONS AND U.S. DIRECT
INVESTMENT ABROAD: THE IMPACT OF FOREIGN
LABOR MARKET RESTRICTIONS 57
Michelle W. Trawick, Western Kentucky University
Cathy Carey, Western Kentucky University

THE VIETNAMESE MARKET AND THE UNITED
STATES: A MATRIX AND HISTORICAL ANALYSIS 59
Han X. Vo, Winthrop University

EURO CURRENCY ADOPTION AND ITS EFFECT
ON SMALL BUSINESS 65
Brandon Wyrick, Sam Houston State University
Hadley Leavell, Sam Houston State University

EFFECTS OF EXCHANGE RATE MISALIGNMENT
AND VOLATILITY ON PRICE LEVELS AND
INTERNATIONAL TRADE FLOWS: EVIDENCE
FROM T G-7 COUNTRIES 67
Mehmet Gunal, Bilkent University, Ankara, Turkey
Christopher Ngassam, Virginia State University

Authors' Index 75

TRANSFORMATIONAL STRATEGIC CHANGE: EMPIRICAL FINDINGS OF 4 STUDIES

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The Ansoff Institute
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ABSTRACT

This paper seeks to examine the possibility of strategic imperatives involved in transformational change in the pursuit of success. The paper is a compilation and integration of findings from four studies done over a six year period at the United States International College of Business at Alliant International University in San Diego. All four studies reflect a theoretical direction based on the Strategic Success Paradigm of H. Igor Ansoff and can be seen as complementary in that they examine the process of transformational change from different vantage points with foci that, while different, reinforce the understanding of the transformational process as a whole. Each of these studies presented empirical tests, the results of which had a statistical validation of p=.05 or better.

The first of the studies presented here addresses the issues incumbent in the process of transformational change. The second delves into the framework of transformational change. Leadership behaviors necessary to the process of transformational change are examined in the third study, while the forth study probes the relationship of behaviors and actions to the success of the transformation.

The integration of these four studies leads recognition that the success of transformational change is neither random nor wholly situational. Instead, the suggestion is that there are a number of imperatives that, if present, predict and insure success of the transformation. Conversely, transformation cannot or will not complete if these imperatives are absent.

A REVIEW OF THE PERIOD 1946-1960 CONCERNING THE INFANT-INDUSTRY PROTECTION ARGUMENT

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ABSTRACT

In the years following World War II, there was a renewed interest in problems of development, as older countries devastated by the war sought to rebuild and younger countries sought a profitable place in worldwide economic activity. This paper presents the contributions of seven economists to the infant-industry argument and discusses the renewed interest in infant-industry protection from 1946 to 1960.

INTRODUCTION

One of the first protectionist topics discussed in the literature after World War II was one that had been somewhat taken for granted by earlier economists. Many economists who had felt that there were valid grounds for temporary protection favored subsidies over tariffs as valid means of providing this protection. This preference was questioned by R.L. Threlfell of South Africa. He contends that neither tariffs nor subsidies are in themselves the better policy, that each case must be separately considered as to elasticity of demand for the good, structure of the tax system which would finance subsidies, level of income of the largest consumers of the good, etc. (Threlfell, 1946). Moreover, Threlfell does not agree with those who argued that subsidies were relatively easy to administer and evaluate; on the contrary, he believes that such difficulties are "so great as often to be forbidding" (Threlfell, 1946, pp. 128-131).

G.W.G. BROWNE'S REPLY

What is not made clear is that Threlfell considers systems of permanent and temporary protection as distinct cases. In other words, if we accept the assumption that is implicit here that the firm is operating in an increasing-cost situation, then a tariff will cause the firm to produce a greater-than-optimum output. This is a questionable point if it is external economies that justify temporary protection, for the question is not whether there are added costs to society (in the form of inefficient production), but whether these costs are outweighed by the external benefits.

Browne's next point is perhaps more valid. It is based on the assumption that the cost of a project should be borne by those receiving the benefit of the project. The argument is not entirely sound, for if some of the external benefits occur in the long run they will affect a different generation of people, and there will never be an identity between the paying and the receiving groups, whether tariffs or subsidies are employed.

GOTTFRIED HABERLER--USE OF THE PRODUCTION-POSSIBILITY TOOL

Gottfried Haberler (1950) resumed his study of the infant-industry argument in his article, "Some Problems in the Pure Theory of International Trade." In it he expressed the opinion that the infant-industry is not precisely the same as the argument relating to external economies, but be does not think that the distinction is important.

In his explanation of the infant-industry argument, Haberler employs the tool of a production-possibility curve. He describes the curve under the "assumption of constant (inelastic) supply of factors of production and of perfect competition in the factor and product market" (Haberler, 1950, p. 244).

Concerning the production-possibility curve, Haberler assumes an initial production point of P and a trading point of T on AB, which is the transformation curve perceived by industry. When an import tariff is imposed on product A, the resulting price distortion causes production to shift on the curve to a point such as P1. With a given international price ratio, the trading point would shift to a point inferior to the original trading point T (to T1, for instance). Once there, however, industry acquires new skills in the production of A, and the result is a new transformation curve.

Haberler (1950) obviously accepts the possibility that "deliberate movements on the production-opportunity curve may shift the curve itself" (pp. 239-240), but he makes a unique contribution to the discussion when he suggests that the arguments he advances in favor of infant-industry protection might well be used for just the opposite purpose, to encourage free trade. Haberler (1950) implies that political considerations far outweigh economic principles when actual trade policies have been devised, stating that "it is a little suspicious that the argument is practically always used in one direction, that is to say for the justification of protection rather than of freer trade" (pp. 239-240).

B.N. GANGULI--A QUALITATIVE EXAMINATION

B.N. Ganguli (1952) did not attempt an empirical analysis of the effects of protection, but attempted instead, as the title of his article indicates, an examination of "Principles of Protection in the Context of Underdeveloped Countries." Although he speaks in general of the "principles of protection" he is interested primarily in tariffs, for he states that the purpose of his study is to relate economic analysis "to the special problems of economically underdeveloped countries and to derive from them certain regulative principles which ought to guide tariff policy" (Ganguli, 1952, pp. 21-38).

Ganguli examines protection from three aspects. The first of these is developmental and begins with a discussion of Alexander Hamilton and Friedrich List. According to Ganguli, the effectiveness of protection lies in its ability to create external economies, and as he views them,

external economies include much more than the sum of the internal economies of all individual firms. Ganguli defines external economies as those "resulting from the external economic environment or 'conjuncture'" (Ganguli, 1952, pp. 25-26). The most important element in the economic environment is the size of the market, and any increase in output, insofar as it increases the capacity of the producers to purchase further output, is an external economy to all other firms or industries in the market. The implication is that virtually any industry will expand the market and create an external economy, therefore meriting protection.

In an already developed economy the new firm creates external economies, but it also profits from the external economies created by established firms and so is not deserving of protection for this reason.

According to Ganguli, several policy principles flow from the foregoing theory. First, the major criterion for selecting industries to be protected is not, as others have stated before, the ability of this industry to eventually exist without protection, but rather: "Priority should be given to those industries which create external economies most valuable from the social point of view" (Ganguli, 1952, p. 29). Further, industries selected for protection should "create external economies for one another on the basis of reciprocal demand for one another's products."

TIBOR SCITOVSKY--EXTERNAL ECONOMIES

Tibor Scitovsky contributed many influential papers on a variety of topics in economics. His article "Two Concepts of External Economies" makes no direct mention of infant-industries, but his analysis does shed some light on the discussions of other economists we are examining (Scitovsky, 1954, pp. 143-151).

Scitovsky argues that external economies that affect general equilibrium theory do not include all of the external economies that are applicable in theories of industrialization. The only external economies "that can arise, because of direct interdependence among producers and within the framework of general equilibrium theory" are labeled "technological external economies" (Scitovsky, 1954, p. 145). He follows James Meade's definition when he states that: "...external economies exist whenever the output of a firm depends not only on the factors of production utilized by this firm, but also on the output and factor utilization of another firm or group of firms" (Scitovsky, 1954, p. 145).

In this case, external economies manifest themselves through the firm's production function. Scitovsky (1954) can find only two examples of such external economies in an industrial context: "the case in which a firm benefits from the labor market created by the establishment of other firms, and that in which several firms use a resource which is free but limited in supply" (p. 145).

JAMES MEADE--EMPHASIS ON STRUCTURAL CHANGE

Meade agrees that policies diverging from free trade may be called for in so-called "second-best" situations, but suggests that such a divergence might even be justified under utopian marginal conditions [Meaning "that throughout the world economy there is a policy of 'modified laissez faire' which has successfully removed all divergences between marginal values and costs" (Meade, 1955), p. 254], and when all citizens of the world are given the same distributional weights

by policy-makers. Meade accepts the free-trade contention, stating that, "In these conditions no marginal changes can add to economic welfare either by increasing economic efficiency or by improving the distribution of income," but he suggests that it may nevertheless "…be possible to increase economic efficiency through a large structural change" (Meade, 1955, p. 254).

Such a structural change would be the introduction of a new industry, and Meade presents a simple total-social-value versus total-social-cost criterion for evaluating interference with the market that would set up such an industry, and he discusses infant-industry protection as a particular example of such a situation. While stating that "…infancy as such provides no argument even for temporary State support," he believes what he calls "atmosphere-creating external economies" "…may well justify some temporary State assistance" (Meade, 1955, p. 256). Meade gives two examples of such external economies: first, where a monetary loss incurred by the initial firm "...may result in the discovery of technical know-how about the best methods of producing X in the particular physical or social atmosphere in country A, and this knowledge may then be automatically available to all other firms setting up to produce X in A;" and second, where "...the setting up of the first firm by making one set of workers familiar with mechanical devices may start a general acquaintance with, and interest in, things mechanical which, once it has started, may spread and perpetuate itself" (Meade, 1955, p. 256).

ALBERT HIRSCHMANN--A DIFFERENT APPROACH

Albert Hirschmann also saw the advantages of infant-industry protection in underdeveloped countries, but he suggested advantages that were somewhat different from those previously discussed. He first discusses the situation in which the country is not only deficient in industrial production, but also lacks the requisite social overhead capital that helps to create the environment in which productive investment can occur. The question concerned the proper place to begin development efforts, and Hischmann considers his answer a new type of infant-industry argument: "…in a situation where SOC (social overhead capital) is not plentiful it may be more efficient to protect...investment in DPA (directly productive activities) than to stimulate DPA indirectly through investment in SOC" (Hirschmann, 1958, p. 89). This suggestion appears to be unique to Hirschmann, probably because of the apparent illogic of supporting an industry when an environment is not prepared for it, as well as the practical difficulty of measuring the relative efficiency of the two approaches.

Hirschmann's second suggestion is that in the early stages of development imports play positive roles in development, for they serve as a signal to investors that a potentially profitable investment opportunity exists. Hirschmann reasons as follows: "...if a country does not produce commodities A and B and if it is importing A in more rapidly increasing volume than B, then it is likely to undertake domestic production of A long before that of B and is acting quite rationally in doing so" (Hirschmann, 1958, p. 122-123).

CONCLUSION

During the time period studied, the infant-industry argument became more explicitly and almost exclusively related to the concept of external economies. Increased attention was given to

protection as a means of furthering development. Both renowned and obscure economists' viewpoints were presented, and a common theme became evident: infant-industry protection promotes economic development.

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EAST-ASIAN CRISIS AND ITS EFFECTS ON INVESTMENT OPPORTUNITIES AND BARRIERS TO INVESTMENTS IN SOUTHEAST ASIA

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ABSTRACT

The East-Asian Financial Crisis in 1997 had a devastating affect on countries' economies within the region. As a result of the crisis, many firms invested in this region withdrew their investments. Southeast Asian policy makers have attempted to create incentives to entice foreign investors to once again invest in their region. This paper examines the affects of East-Asian financial crisis on investments, as well as investment opportunities and barriers for those investments in the area of Southeast Asia. Discussion will include the incentives for investments created as a result from the need for foreign capital inflows after the 1997 crisis in Southeast Asia. Other topics discussed are the obstacles faced by investing in a foreign country and the affect of multinational corporations' foreign investing practices resulting from the crisis.

STRATEGIES FOR SUCCESSFUL REPATRIATION

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ABSTRACT

U.S. multinational corporations (MNC) primarily send their best employees on international assignments to grow new markets, maintain existing operations (Windham, 1999), or develop high potential employees who can both contribute to company strategy and craft a global view of the corporation's business (Derr & Oddou, 1991). Over a twenty year period researchers have consistently reported MNC problems with retaining returning employees, especially pertaining to the high costs of international assignments associated with low retention rates of repatriates. The purpose of this examination is to present strategies for addressing the repatriate attrition problem. The two objectives for this paper are (1) to compile and categorize strategies from corporate and employee perspectives, and (2) to summarize researchers' theories and relate them to actual practice. This approach allows MNC human resources and other executives to customize practices to fit corporate strategic objectives and alleviate low repatriate retention rates.

AN ANALYSIS OF HOW THE USE OF OUTSIDE START-UP CAPITAL HINDERS CREATION OF MICROENTERPRISES IN MEXICO

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ABSTRACT

Policymakers have become increasingly interested in understanding the factors associated with the provision of loans to microenterprises in developing countries, primarily because credit access has been recognized as an important tool for small business economic development and overall reduction in powerty. Microenterprises account for roughly 20 percent of Mexico's workforce, the owners of the microenterprises represent an increasing economic significance coupled with the electoral importance of the owners, and the microenterprises contribute to employment creation irrespectively of the business cycle makes it important for policymakers to try to understand the factors which affect the creation of a microenterprise.

Two core issues characterize the competitive system: How to get started in business and how to survive in business. Lack of access to credit services is important impediment for starting up a microenterprise and to sustain growth of a microenterprise. Using the National Survey of Microenterprises (ENAMIN, Encuesta Nacional de Micronegocios) data I test for the presence of liquidity constraints for obtaining start-up capital in Mexico's credit markets (formal and informal). I use the bivariate probit model with partial observability to recognize two important decisions in the credit allocation process: First, whether an owner of a microenterprise wants to "join the queue" for start-up loan and, second, whether financial institutions decide to provide or not to provide the loan. Finally, I compare the results from this model to those of a simple probit model that looks at whether a microenterprise owner gets funding or not (i.e. the probit model implicitly assumes that no liquidity constraints exist).

I find, that whether the owner has access to borrowed funds from the formal or informal (price of money is higher) credit source is dependent on the socioeconomic characteristics of the owner such as, age, gender, marital status, and years of schooling, and microenterprise specific factors such as, owners equity, number of planned employees, sector of operation, and plans to expand business. Likewise, the finance institution's decision who to lend from the queue of owners is based each institutions analysis based on these factors. For example, a likely borrower from the formal credit market differentiates from the likely owner of the microenterprise who borrows from the informal credit sector in the average years of schooling. The typical formal credit market borrower is 66 percent more educated compared to the average informal credit market microenterprise owner.

The findings of this study show that there is substantial heterogeneity in the socioeconomic background of borrowers, as well as in the sources for start-up capital employed by microenterprises in Mexico. Moreover, there is clear evidence of liquidity constraints in the market for start-up capital that could hinder the creation and growth of small enterprises.

Policymakers (public and private) seem to use two basic policy measures toward fueling the creation of microenterprises in less developed countries - use of variation of capital assistance for seed capital, such as, guaranty schemes, financial support from NGOs (Non-Governmental Organization), subsidized loans and policymakers use fiscal policy tools, such as, tax incentives, entrepreneurial training seminars. Applying the findings of the study, policymakers could fundamentally increase the effectiveness in establishing an economic environment that fosters growth.

FDI AND THE EFFECTS ON SOCIETY

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ABSTRACT

The last decade has seen an explosion in Foreign Direct Investment (FDI) especially in developing countries, where the returns on investment can be higher than in developed countries. Both developing and developed countries have liberalized their policies and introduced new policies to attract FDI inflows. This increase in FDI has had major effects on the social welfare of the citizens of developing host-countries. The purpose of this paper is to examine both the positive and negative effects of FDI inflows to developing countries in areas of politics, society, technology, finance, environment and culture, to determine whether or not FDI contributes to the well-being of society.

INTRODUCTION

Foreign Direct Investment (FDI) is the single most important instrument for the globalization of the international economy. Defined, FDI is the investment of real assets in a foreign country; it is acquiring assets such as land and equipment in another, host country, but operating the facility from the home country. FDI is viewed by many as necessary to stimulate the economies of both developed and underdeveloped countries.

It is widely accepted that FDI inflows provide economic benefits such as increased competition, technological spillovers and innovations, and increased employment. Yet the impact of foreign investment extends far beyond economic growth. At times FDI can be a catalyst for change to society as a whole, therefore one must think in terms of economic, political, social, technological, cultural, and environmental factors and examine all the effects of FDI in order to decipher the true long-term impact. As foreign investment and globalization continues to increase, developing countries desperately seeking to attract foreign investment can have undesirable outcomes. In this scenario FDI can have numerous negative effects, such as job loss, human rights abuses, political unrest, financial volatility, environmental degradation, and increased cultural tensions.

EFFECTS OF FDI

Most literature in this area analyzes the relationships between FDI, multinational corporations, and governments, usually analyzing one side or the other; however, in order to more accurately measure the situation, a more balanced assessment that examines both sides of the debate is necessary. Both Kiss (2003) and Hippert (2002), examining FDI from a social standpoint, provide a negative perspective on the impact of FDI in developing countries. Kiss (2003) analyzes the situation in Hungary when the Hungarian government introduced elements of a parliamentary democracy and market economy that eventually led to the social and political exclusion of Hungarian women. The author argues that governments must address gender issues as well as implement official measures and institutional changes to facilitate women's inclusion into production and social systems. Hippert (2002), examines the effect of FDI on women's health. The author asserts that FDI and Multinational Corporations (MNCs) hamper the economic integrity and sovereignty of the developing world and states that it is women who bear the brunt of human rights abuses because of their social positions in developing countries, especially in parts of Mexico and Asia. The author also discusses solutions to these problems that have failed because they have been primarily "top-down approaches," and proposes that the only plausible solutions are to hold corporations accountable for their employees.

Jones and McNally (1998) provide insight into the environmental degradation that is caused by FDI. The authors consider both sides of the debate on the existence of "pollution havens" and provide reasons why MNCs do not contribute to environmental pollution. The authors also state that in industries that are involved in resource extraction, some evidence suggests that MNCs will relocate to countries where environmental regulations are lax or non-existent. Again in 1998 McNalley, along with Mabey, authored a report on FDI and the environment for the World Wildlife Foundation. The report provides instances of environmental degradation that occurred mostly in extractive industries, along with proposals for reforms to current environmental standards.

In contrast to the negative view of FDI, Rondinelli (2002) explores the public role and economic power of MNCs and the positive ways in which MNCs can influence governments and provide for the social welfare of host-country citizens. By focusing on their roles as philanthropists and political activists, MNCs provide foreign aid to developing countries, expand international trade and investment, and influence public policy. The author provides several instances in which an MNC stepped in and provided foreign aid to developing countries in order to fill the gap that was created when Official Development Assistance was decreased.

Spar (1999), takes a neutral stance when discussing the complexity of the relationship between foreign direct investment and human rights and the ways in which FDI impacts society both negatively and positively. The author concludes that it is the interaction of governments and MNCs that will lead to economic growth and social prosperity through FDI.

CONCLUSIONS

A majority of research highlights the negative effects of FDI yet provides researchers with minimal amounts of data concerning FDI's positive contributions to the global economy. Most research has been precautionary at best and generally is necessary to alert governments and business

leaders to refrain from accepting any and all flows of FDI, which could potentially beget trouble for future development prospects. When all factors are considered though, it is commonly accepted by researchers and economists that the benefits of FDI far exceed the costs. With the exception of the impact on the environments of developing countries and on financial markets, much of the evidence concerning the effects on workers, the political environment, and cultural relationships is hypothetical and anecdotal at best with only a few instances to validate arguments. Moreover, many of the negative effects are short-term and the standard of living for many developing countries would be worse off without FDI flows. In the age of information technology, it would be a logical assumption and it has even been proven that exploitation of workers and the environment can result in losses of credibility and consumer confidence. For example, companies such as Nike, Toys "R" Us, Avon, and Royal Dutch-Shell have increased their compliance with codes of conduct and have even begun developing preemptive policies (Spar, 1999).

With regard to environmental effects, there is sufficient evidence to conclude that FDI does contribute to environmental degradation. However, environmental degradation is a trend that began with the earliest forms of industrialization and is not partial to developing countries. Pollution will result regardless of location. Many developed countries experience pollution to a degree that has not even reached developing countries. The reasons environmental protectionists have focused their attentions on the impact of FDI on the environments of developing countries is because these countries currently lack the same policies and regulations seen in more developed countries which might protect the environment. Ultimately these regulations are meant to slow the effects of continual resource use and to provide the citizens of host-countries with the same rights afforded more developed countries.

An examination of the current trends in FDI shows that the developing countries receive a disproportionate share of inflows when compared to outflows. The recurring theme throughout this paper concerning the negative effects of FDI is the lack of laws, regulations and policies in developing countries that if in place would otherwise allow countries to channel the spillover effects of FDI in to positive outcomes. In some developing countries that have not reached a certain level of education and infrastructure development and where the markets are also underdeveloped and imperfect, they will be unable to benefit from a foreign presence and the effects of FDI on economic growth will be less benign, yet even in these instances an increase in FDI flows is more beneficial than none at all (cuts.org). The experience of countries in East-Asia shows that developing countries that use FDI purposefully by formulating and implementing national and technological development policies, will be successful in their efforts. MNCs alone cannot solve the problems of poverty, political instability and underdevelopment; these problems stretch far beyond the limited capacity of corporations. Because of this, even a strong combination of FDI and public pressure cannot achieve dramatic results in the reduction of human rights abuses, environmental degradation, political unrest, cultural tensions, and financial volatility. The challenge for governments, business leaders, and advocates is to manage the complex relationships between themselves and to forge an agenda that does not focus only on battling exploitation or limiting the scope of FDI. In the end it remains the responsibility of MNCs and governments of more developed countries, specifically, members of OECD, to assist developing countries in building the infrastructure necessary to reap the benefits of FDI, to continually provide financial assistance in the form of long-term productive capital, and to reinvest profits inward rather than repatriate them.

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HAS THE IMF OUTLIVED ITS USEFULNESS? A BRIEF ESSAY ON THE ORIGINS AND THE EFFECTIVENESS OF THE INTERNATIONAL MONETARY FUND

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ABSTRACT

The International Monetary Fund (IMF) is arguably one of the most powerful financial institutions in the world. Yet, almost universally, undergraduate students have little or no idea of the purpose and the controversies surrounding the IMF. By simply developing a logical train of thought from its inception to the present goals and objectives of the IMF, students can develop a concept of the relevance of the IMF in today's global market.

INTRODUCTION

Students should appreciate both the power and the controversy surrounding such an important organization as the International Monetary Fund (IMF). Instructors can achieve this by developing the history of the IMF from its founding to its present agenda (IMF, 2004). Criticism of the institution is part and parcel of today's world. Does it help or hinder economic development?

As the world rushes toward globalization, there can only be one of two outcomes. Either the world will be truly globalized in all markets, or fragmentation and nationalism will prevail. The status quo does not seem to be an option in the determination of financial understanding of markets and prices.

Students who can only reason in a unipolar world are likely to be denied that luxury in the 21st century. A good place to start the learning curve for global financial practices is the IMF. The IMF is one of the most important financial institutions in the world (Focused role for the IMF, 1999). Only the Federal Reserve System and the Bundesbank of Germany are probably more influential in international financial matters. Leading students to explore the role of the IMF should not be too difficult once they understand the pivotal role that the IMF plays in the geo-politics of the world. The IMF is steadily assuming more and more of a directional role in guiding, for better or worse, the affairs of many of the developing nations in the world (IMF wants reform laws, 1999).

THE BEGINNING

The IMF and the World Bank were literally created out of the wreckage of Europe and Asia during World War II. By 1944 it was clear the Allies were winning, but no one knew exactly when the end would come. The Germans were being expelled from France, the Russians were moving steadily west, and the Japanese were being forced back toward Japan in the Pacific. One fact was absolutely clear to the Allied Nations--once the war was over, the system of international payments would be in shambles. Lessons learned in 1918 and 1919 indicated that if no system of payments was in place, a repeat of the economic stagnation in Germany in the 1920s and the failed economic policies of the victors in the 1930s would lead to a dangerous situation that might culminate in another war within 20 or so years.

Germany had been devastated by the Treaty of Versailles, making the rise of Hitler that much easier. To prevent the recurrence of such a world-shaking problem, 44 nations, calling themselves The Allied and United Nations, met in Bretton Woods, New Hampshire on July 1, 1944 for a 27 day conference in order to establish a new economic world order and to provide for a sound system of international payments. The conference had very lofty goals that are still touted today as exemplary. The conference was dominated by the U.S. and the U.K. U.S. Treasury Secretary Henry Morgenthau and the U.K.'s John Maynard Keynes provided the guidance to set an early agenda. Secretary Morgenthau had access to the money and Lord Keynes provided brilliant insight into where the conference should go. Probably the other 42 nations had some input, but it is doubtful that they had either the stature or the resources to insist on any particular point that would have opposed either the U.S. or the U.K. position on significant matters.

The French complained because they felt slighted and insignificant, with no more influence than the delegation from Liberia. However, France in 1944 was almost destitute, and the power of the conference came from the Anglo-American financial strength. The Russians were upset because they wanted credit where none existed. They were accused of having a secret cache of gold that they should contribute to the goals of the conference. The Russians denied this, but they said that if they did have a secret cache of gold, it would be needed for rebuilding Russia.

The result of this early political and economic wrangling was that a nation's vote would be determined by its contribution to the financial integrity of the stabilization funds, as yet unnamed. Therefore, the U.S. had and still has the lion's share of the power in decision-making. Every other industrial nation in the world, Axis or Allied, was strapped financially. The U.S. stood alone as financially untouched by the destruction of the war.

After 27 days of tough negotiations, the Allied and United Nations had achieved a complex system of international payments called the Gold Exchange Standard. This system remained in effect until 1971. Also, two significant institutions were established that are still powerful today: The World Bank and The International Monetary Fund (IMF). The delegates left Bretton Woods at the end of July to present the treaties to their respective parliamentary bodies for ratification. This process of approving the IMF took a year. The system of international payments went more smoothly since it was based on a fixed exchange rate involving the dollar, the pound, and most importantly, gold.

The World Bank is chartered to lend for long-term capital development, while the IMF is chartered to lend short-term (Driscoll, 1995). However, since the frequency of short-term borrowing

is greater than long-term, the IMF has forged ahead of the World Bank in the current realities of power, with the World Bank often finding itself in a supporting role to IMF financial interventions. The IMF began operations in early 1947 and, arguably, did a competent job in both rebuilding a war-torn world and protecting the delicate system of foreign exchange so that trade could resume with the cessation of hostilities. By 1965, it was obvious that the original tasks of the IMF were accomplished. Either the organization would be disbanded or a new direction would have to be found. By the mid-1960s, the IMF had become very powerful in world financial markets, and power of that magnitude is not easy to give up. International prestige and well-paying positions were at stake. Thus, a new direction of activity was in order.

STABILIZATION OF THE GOLD RESERVE STANDARD: 1965-1971

In 1965, the IMF began trying to stabilize the gold reserve standard. The standard was based on a system of key currencies that would eventually be tied to gold redemption. The U.S. dollar and the U.K. pound were the key currencies. Other nations with no gold reserves could tie their currencies to either the dollar or the pound. For example, Ireland tied its pound to the British pound. As a nation collected an accumulation of dollars, these dollars could be exchanged with the U.S. Treasury at a pegged rate of $35 to one ounce of gold. Also, in 1967 the IMF created a system of credits for developing nations, which otherwise would have worthless currency, by creating an international system of credits called Special Drawing Rights (SDRs). A developing nation could accumulate a quantity of these through loans and later convert them into hard currencies. The problem was that developing nations had to meet stringent IMF requirements to qualify for these SDRs. Therefore, the supply would be limited to avoid being inflationary and detrimental to international currency markets.

This system remained in place until the U.S. ended convertibility in 1971. The dollar was so overvalued that the very core of the system was causing instability. It was time for a new direction for the IMF (Scaling back the IMF, 1999). The pegged exchange rates were gone and the currency markets were free to set currency values through the market.

A NEW DIRECTION--AGAIN

When President Nixon ended convertibility of the dollar in 1971, the foreign exchange markets began to float. The market--not Bretton Woods-- now established foreign exchange rates. The IMF found itself in a position of reduced activity and thereby reduced influence (Scaling back the IMF, 1999). Fortunately for the IMF, the oil crisis of 1973 opened the door of opportunity for an expanded role in international economic relations. First, the oil price increases caused severe hardship on emerging nations that had no way to pay for the oil that would be essential for continued economic growth. Secondly, these nations were encouraged to borrow in order to finance economic growth. Part of the lending was done by the IMF through the use of SDRs. However, even larger amounts were provided by commercial banks in the U.S. and Europe. As a result of the oil price hikes, cash had flowed into the banks in very large amounts. This cash had to be lent, and excellent rates of return could be achieved by lending to developing countries in order to aid in growth. The idea was that the money could be used for capital development that would lead to greater export

earnings that would lead to more growth, thus enabling the countries to pay off the debt. The result was far different. Export earnings increased in almost all cases, but the interest on the debt increased at a faster rate. Therefore, the banks found themselves in the position of lending just so they would be repaid, which increased the debt even more. By the late 1970s, it became obvious that the debt could not be repaid because of its sheer magnitude. In the early 1980s, the international debt approached one trillion dollars, with Brazil alone owing $125 billion. The international banks were distressed to the point that outside help was needed to handle the debt in order to prevent a major default.

The IMF now provides assistance in loaning to developing nations as a lender of last resort. One of the conditions that the IMF insists on is a way to manage the debt. This is agreed to before the loan is made. The IMF has achieved greater international exposure and influence once again by maintaining that it stands between the international banking system and default. The banks are willing to accept this because it offers the possibility of eventual repayment. The IMF has a standard package of conditions that are, with some exceptions, forced upon the borrowing nation. They are as follows:

1. *Establish rate concerns*--Usually in the form of devaluation to make the currency more acceptable to industrial nations.
2. *Stabilize prices*--Debtor nations usually are plagued by inflation caused by the excess printing of currency to finance public works. There is usually little or no tax base.
3. *Cut subsidies*--Many of the industries in developing nations are subsidies as a means of retaining political power.
4. *Privatize nationalized corporations*--In most of the developing world, the government is the major employer. This has not resulted in very efficient allocation of resources.
5. *Establish a social safety net*--Privatization will result in unemployment of resources as economic efficiency replaces governmental indulgence (Focused role of the IMF, 1999).

IS THE IMF EFFECTIVE?

Many critics believe that IMF lending has become long-term rather than its original mandate for short-term. As countries borrow more and more and achieve less and less, they become long-term borrowers with slim or no hope of improvement. For example, between 1965 and 1995, 137 countries received loans from the IMF. For many of these countries, the level of borrowing increased over 50 percent from 1981 to 1995. This is compared to the number of times that the same countries borrowed during the 1965 to 1980 period.

The IMF fails to uniformly achieve economic growth in debtor countries. For example, the set policies previously mentioned have usually resulted in the developing nations not enjoying economic prosperity. The very policies demanded as a condition for a loan serve to further impoverish the borrowing nation. Economic austerity often causes further hardship when the client has no viable economic base. These policies almost never result in lower budget deficits or reduced international debt. Bolivia is a case in point. From 1975 to 1983, the budget deficit grew approximately 8,000 percent, and the international debt rose from $470 million to $4 billion by

1993. This happened despite the fact that during this period the IMF loaned funds to Bolivia seven times.
Critics charge that the IMF fails to enforce the requirements--that is, the IMF fails in demanding uniformity. Russia is a good example. Russia has repeatedly received IMF help over the last several years, but each time the nation failed to implement some or all of the conditions imposed by the IMF. Further, the Russians claimed that the IMF is being manipulated by the U.S. The Russians claimed that the U.S. is causing the IMF to delay its latest loan because of western opposition to the war in Chechnya (Russia says IMF withholds funds over West's stance in Chechnya, 1999).

The IMF often fails to help less developed countries improve economically. For example, 48 of the 89 less developed countries that received IMF aid prior to 1995 are worse off today that they were before 1965. The conclusion reached by many IMF critics is that the IMF has not helped countries in their progress toward economic growth, but rather that the IMF has been a dismal failure causing more human suffering than prosperity.

Critics of the IMF point out that there is no evidence that IMF policies have benefited most of the countries that have been the recipients of IMF loans. The improvement in those countries that have shown progress has resulted from private capital inflows that have strengthened exchange rates. The forces of the free market have proven more beneficial than IMF conditions.

CONCLUSION

The IMF has become so politicized that it may have outlived its usefulness. With the emergence of the European Union, the role of the IMF as a power broker may be lessened. For most of the 1990s, the IMF was used as a tool by the U.S. to reward those nations that moved toward a free market approach in resource allocation. However, with the Asian financial crisis of the late 1990s, the idea of controlling financial crises appears to be shifting toward preventing problems before they become crises. Asian nations are disappointed that they seem to be left out, but they do not have much leverage (Business--China, 1999).

All in all, the IMF is a current topic for discussion concerning international finance. Although it is very complex, it should be fairly simple to interest students in the discussion. Either through its origins or some of the many restructures that have happened since Bretton Woods, the topic should provide for lively discussion. The debate over whether the IMF is an instrument for change or a political device should stimulate student interest.

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THE OPIUM TRADE OF THE U.K. AND U.S. IN CHINA DURING THE 19TH CENTURY

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ABSTRACT

China poses many economic and political scenarios for the 21st century. By any standard, China will be a force in international economics for some time to come. Undergraduate students need to appreciate that some of China's peculiarities were the result of past economic and political actions of other nations. Of all of the contributions to the present political and economic values of modern day China, possibly one of the most defining was the drug trade fostered by the western nations of the 19th century.

INTRODUCTION

The problem in explaining China and its geo-political and geo-economic importance to American undergraduates is often complicated by the students' lack of foreign travel. Differing cultures are complex enough without having extraneous factors such as the drug trade defining how one nation behaves vis á vis another. Some of these extraneous factors are beneficial and others detrimental relative to world stability. Although there were several European nations involved in the drug trade in China, England was by far the most notorious.

The U.S. is included in this paper for two reasons: 1) American students will respond to the problem more actively if they can appreciate their country's involvement, and 2) the U.S. enjoys a unique position in world affairs.

In the early part of the 19th century, the U.S. was just beginning to establish its presence as a trading nation in the Pacific (Hobson, 1902). The war of 1812 was recently over; therefore, resources could be directed toward building an empire. Being a young maritime nation, the U.S. was able to travel along with the U.K. and the protection of its gunboat type of diplomacy (Hooker, 1996). It should be noted that although the U.S. government did not officially participate in the opium trade, as did the U.K., the leading families of Boston and New England were heavily involved, and many of the fortunes that built the U.S. were obtained in a dubious manner (Delano, 1946 & 1955).

CHINA

For a thousand years before the birth of Christ, the Chinese had been developing a civilization that was one of the most advanced in the world. The Silk Road ran along its northern borders, and trade flourished in spices and exotic goods that would become the driving force of a worldwide trade. After a series of wars and invasions, the Chinese developed by the 18th century what they considered to be heaven on earth--the Celestial Kingdom, or Middle Kingdom (Wakeman, 1978).

Based on a Confucian hierarchy of class, all things Chinese were absolute perfection. Society was based on classes with the intellectual Manchus at the top, followed by the peasants, and on the bottom were merchants who were engaged in base activities. Under such a system, relations with the outside were not cultivated. There was simply no need for anything outside of China. It was a self-contained society based on agriculture. The dependence on agriculture is why Confucius placed the peasants next to the intellectuals. Because of the experiences under the Mongol rulers in the 15th century, trade was considered unnecessary. The Mongols were traders, but their ruthlessness made subsequent dynasties discourage trade as a refuge for barbarians. All religions other than Confucianism were considered cults and not worthy of support. By the beginning of the 19th century, China had become wealthy. Silks, tea, and porcelain--so perfect that it was simply called china--were just a few of the goods demanded by Europeans.

CLOSED TRADE

After the Manchus consolidated China, the culture began to turn in on itself. Foreigners were distrusted per se (Hooker, 1996). The Manchus, embracing the Confucian way, found that China was the center of civilization and with its diverse production was in no need of anything from anywhere else. The only foreigners in Chinese territory were missionaries left over from previous centuries. The western situation was quite the opposite. Trade had become increasingly important to all maritime nations. The U.K., being the wealthiest, made the largest impact on the Pacific nations. The U.K. and the U.S. not only wanted freer trade, but also whaling stations for their respective Pacific fleets. This same need would lead to the U.S. opening Japan in 1854. The East India Company had a monopoly granted by Parliament for all U.K. trade in the Pacific (Thomas, 1997). The U.S. was governed by the philosophy of manifest destiny, which was just emerging in the 19th century and would provide the dynamism to fuel growth until the early 20th century. Thus, the U.S. and the U.K. wanted Chinese trade to be opened.

China utilized a system of closely guarded trade routes to the interior. First, only the port of Canton would be opened to foreigners (Hooker, 1996). China regarded itself as the master civilization and all others as vassal states. Foreigners would be subject to Chinese custom and law. The British traders found this to be especially objectionable, since Chinese law sometimes involved torture. Here was a conflict of culture that could not be negotiated (Wong, 1998). The West viewed the Chinese as uncultured barbarians, while the Chinese viewed themselves as the embodiment of perfection and westerners as godless heathens. Second, the Manchus limited trade within the interior to a factory system consisting of several buildings in the foreign quarter of Canton. Merchants could only stay six months a year, and women were always forbidden. E.W. Delano

(1946 & 1955), of the Boston firm of Russell, Sturgis and Co., wrote in his diaries of a violent riot in Canton caused by a British merchant bringing his wife ashore.

In 1793, the U.K. sent Lord Macartney to Peking in an unsuccessful attempt to relax the system (Hooker, 1996). The Chinese were simply not interested in what the outsiders had to offer. However, the emperor would allow the U.K. to trade, provided the traders observed Chinese custom and culture. Here was a coexistence doomed to failure: the Chinese, needing nothing (or so they thought), and the westerners, wanting to make money. At first, the West could sell furs and ginseng; however, this market was soon saturated and cash became the only thing that the West could offer. This resulted in a terrible imbalance of payments for the West. Silver flowed into China to purchase silk, china, and tea. Trade could only be conducted through 12 merchants, namely the Hong merchants. One of these, Hao Qua, was reputed to be the richest man in the world by 1830.

To complicate matters further, the Chinese were forbidden to speak English and westerners were forbidden to speak Chinese. The result was pidgin English where words like booty and loot were coined. The word pidgin literally means a language in trade.

At the beginning of the 19th century, the West began to penetrate Chinese markets in spite of the restrictions imposed by the Canton system (Wong, 1998). Purchases of silk, porcelain, and tea stimulated the Chinese merchants, who were less idealistic than the Manchus, to funnel goods from the interior into the foreign quarter of Canton. With this increased activity came corruption and crime. Revolutionary movements ranging from liberalism to the triads sprang up, much to the concern of Peking.

THE U.K.-U.S. CONNECTION

E.W. Delano (1946 & 1955) is reputed to have remarked that, "I make no ethical or moral observation concerning the trade, but that it is a good sound business." He was referring to the selling of opium in Canton (Chesneaux, Bastid & Bergere, 1996). The one thing that was discovered to be very much in demand in China was opium (Wong, 1998). The East India Company, through its political and economic control of India, was able to secure a cheap and large supply of opium in Bengal. As the opium trade increased, U.S. merchants, in order to compete, found a supply in Turkey that was cheap and easily secured.

Opium production was illegal in China and possession was allowed only for medicinal use (Thomas, 1997). However, the smuggling of the drug was widely accepted by the Hong merchants and certainly reversed the balance of payments problem experienced by Western countries. The U.K. and U.S. dominated the trade, with little evidence of other European nations participating in the trade. There is no mention of why this was so; therefore, moral or ethical arguments are not possible. It may be that the supplies were secured by the two trading nations at the expense of others.

There is evidence in the diaries of E.W. Delano (1946 & 1955) that the harmful effects of opium were easily observable; therefore, it was not a case of simple ignorance. The drug rapidly became a vice. Use spread from the young men of rich families to the working poor, who used opium in order to avoid the pain and suffering of intolerable labor. It spread to shopkeepers and public servants. It especially affected the service sector where too many men were hired to do too little work and had too much free time. By 1835, senior officials and generals assumed that many

of their staffs were opium smokers. Because of opium, business slowed down, the standard of living fell, and public services no longer worked smoothly.

Because of the previously mentioned stimulation of Chinese production for export, a mechanism was in place in order to ensure the rapid distribution of opium to the interior. Opium smuggling by the U.K. and U.S., together with other activities of the foreign firms in Canton, created a problem for the authorities that challenged the ability of the state to rule (Wong, 1998). Corruption became endemic, as wealth flowed to the select few. Many Chinese Mandarins and merchants were eager to grow rich through foreign trade, even if it meant breaking imperial law.

OFFICIAL CHINESE REACTION TO THE TRADE

The isolationist policy of the Manchus now revealed its weakness. Rather than being the center of the universe, China was declining into a thin veneer of civilization. Everything appeared stable in Peking, but the country was rife with problems. Poverty was rising, and growth potential was declining. Merchants had few goods to sell to a population who increasingly could not afford to buy those goods.

The emperor appointed a strict Confucian, Lin Ze-xu, as commissioner with vast powers to solve the drug problem. Lin thus became the first drug czar (Wong, 1998). Commissioner Lin first determined that the Chinese war material was inadequate for a military solution. War material was simply obsolete since China had been enjoying centuries of peace; there was little need for constant military preparedness. Lin assessed the trading community. He had his barge rowed around the harbor of Canton in order to observe the foreigners. Lin concluded that foreigners were an uncultured lot of barbarians willing to take advantage of the foolish. Lin wrote a now-famous letter to Queen Victoria, who he perceived to be the one civilized person in Europe.

The letter informed her that there was a class of people that were corrupt in their business and personal manner. Lin appealed to Queen Victoria to aid the Chinese people in stopping this scourge. The letter was never delivered--it was stopped by powerful interests within the British government. Commissioner Lin had few options--his mission was paramount. He seized all of the opium on shore. He did not want to burn the opium because of the smoke that could be inhaled by the population, and so after reciting a prayer to ask forgiveness for the fish and creatures of the sea, he dissolved it in the canals that flowed to the sea. The merchants immediately went to Parliament to demand that either the British government pay for the confiscated opium or force the Chinese to pay for it. Parliament spent weeks debating the issue. William Gladstone, a future prime minister, rose to the floor of The House of Commons to decry: "[The authorities] gave you notice and had the right to drive you out. Justice is with them. While the pagans have it on their side, we the enlightened and civilized Christians do not, and we are pursuing policies that are at odds with justice" (Wakeman, 1978).

Lin destroyed 20,000 crates of opium, but the U.K. launched a punitive expedition in 1839 (Wong, 1998). The first Opium War had begun. The Chinese were totally unprepared for any type of military defense. New developments such as the steam engine allowed the U.K. to travel up the waterways of China, thus opening the interior. The war lasted from 1839 to 1842. A second Opium War was fought to redefine the treaties of the first war from late 1842 to 1844.

The U.S., evidently, sat on the sidelines and allowed the U.K. to do all of the fighting. Therefore, the U.K. would define the peace. First, the Chinese paid for all of the opium. Second, the cost of the war was paid to the Crown, and third, China was to open up for trade with the Canton system being abolished. France, Germany, Spain, and the U.S. all gained trading locations within China. These concessions were privileged zones that became foreign enclaves, independent from Chinese law and custom. Foreigners could now reside in their enclaves and be governed by the laws of their native countries. The U.K. gained the jewel of the Crown--Hong Kong was granted in perpetuity by the treaty of Nanking that ended the first Opium War. This treaty was later renegotiated in 1898 and gave the U.K. Hong Kong for 99 years, reverting it back to China in 1997. Drugs now became a problem in China until the Communist took over in 1949.

CONCLUSION

The after effects of the opium trade are still felt today. China has a deep distrust for any Western nation. The opium trade was not the only reason for such distrust, but it is part of a fabric of culture developed over 200 years of dealing with the West. It is a long fall from being the center of the universe to becoming an economic colony. Probably the only reason that the U.K. did not occupy China, as they did India, is China's sheer size. It would have required an enormous amount of resources to establish a colony.

The problem of drug abuse in 19th century China mirrors the current problem in the world today. The Manchu rulers, while debating how to best deal with the problem, were divided. Some wanted to punish the sellers, some wanted to punish the users and sellers, and some wanted to legalize opium. Even by contemporary standards of ethics and morality, it was a sad exercise to be undertaken by enlightened nations.

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THE CHANGING NATURE OF RETURN VOLATILITY IN THE WORLD'S EMERGING STOCK MARKETS

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ABSTRACT

While prior research has focused heavily on capturing the volatility of U.S. stocks in particular, comparing the market variances for different countries over time is of interest. In analyzing this issue, this study examines the changes in volatility for the world's emerging stock markets over the period from January 2, 1988 through April 30, 2003. This research relies on the daily national stock indices of the emerging markets, as reported by Morgan Stanley Capital International (MSCI). The company categorizes equity markets by a number of factors such as gross domestic product per capita, local government regulations, perceived investment risk, foreign ownership limits and capital controls. The MSCI Emerging Markets Index measures the equity market performance in the global emerging markets. As of 2003, this index consists of the following 26 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey, and Venezuela. Our findings show common trends in the risk and return characteristics of these emerging markets over time. In particular, from 1988 through 1996, volatility for most country indices remained relatively constant. However, from 1997 through April 2003, market variances have increased noticeably for most of the emerging markets. These results are coupled with the observation that the mean percentage daily returns for nearly all of the emerging market indices were consistently lower during the 1997 through April 2003 time frame.

RELATED PARTY FINANCIAL STATEMENT DISCLOSURES- PURPOSES, SUBJECT AND NUMBER FOR HONG KONG H-SHARES

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INTRODUCTION

International financial markets are rapidly becoming a single global market. For these markets, most large institutional users are not satisfied with the existing levels of disclosures by multinational firms (Taylor, 1995). This study will examine one type, related party disclosures, for H-Shares in Hong Kong. In Hong Kong, different groups are concerned about disclosure issues. Cha, Securities and Futures Commission (SFC) executive director, has stated it was important to adopt international standards as part of the SFC and stock exchange's commitment to maintaining Hong Kong's competitiveness (Ibison, 1995). Also, a committee of the Hong Kong Society of Accountants has announced a proposal that was submitted to the society's council in 1996 that included changes in corporate governance disclosure practices for implementation.

The shares for the first H-share company, Tsingtao Brewery, were sold in 1993. Chinese companies are allowed to sell their shares to foreign investors on the Hong Kong Stock Exchange (HKSE) and these shares are called H-shares. Today over thirty Chinese companies sell their shares in Hong Kong. Two other types (A and B shares) may be owned only by Chinese citizens or foreign investors respectively. These shares are traded on either the Shanghai Securities Exchange or Shenzhen Stock Exchange in China that were opened only in 1990 and 1991 respectively.

Very little detailed information is known about the accounting practices for H-shares. The lack of transparency for the H-shares has been cited as a factor behind the poor performance that saw counters touch new lows in the second half of 1995 (Leung, 1996). China has been criticized for having the worst disclosure regulation. The number of China related companies including both H-shares and so called red chip companies (Chinese mainland companies doing most of their business in the mainland, but headquartered in Hong Kong) listed in Hong Kong has grown from five in 1990 to 97 in 1997. The percentage of China related companies in Hong Kong has, also, increased from 2% in 1990 to 15% in 1997. Funds raised by China-related companies represented 83% of the total funds raised in 1997 (Ward, 1997). In 1996, the head of Coopers & Lybrand's China Audit Technical Group, stated, "It's not a problem of standards - it's a problem of practice" (SCMP, 1996). However, Hong Kong has been rated as having the best shareholder communications regime in Asia (Fung, 1997).

An exposure draft, "Related Party Disclosures" was issued by the Hong Kong Society of Accountants (HKSA) in February 1996. The HKSA finalized the statement, Statement of Standard Accounting Practice No. 20, "Related Party Disclosures", in late 1997 with the standard applying to accounting periods beginning on or after October 1997. The statement is based on International

Accounting Standard No. 24, "Related Party Disclosures" that mandates the disclosure of all material related party transactions, whether or not made at arm's length, and disclosure of related party relationships where control exists. There are some differences, for example, as SSAP No. 20 does not require (required by IAS 24) the disclosure of related party relationships where control exists, irrespective of whether or not there have been transactions between related parties.

According to the Serious Fraud Office in the United Kingdom, one of the main reasons auditors fail to find fraud is the auditor's failure to identify related party transactions (Knox, 1994). Also, the inadequate disclosure of related party transactions is the most frequently used and most successful type of fraud. Related party transactions include conflict of interest and sham transactions. Companies can inflate sales and profits by selling to a company owned by an unrelated co-conspirator. Sham transactions can be used to hide the true nature of a transaction (Kerwin, 1995).

In the next section, the purpose of this study is discussed.

PURPOSE

The purpose of this research study was to investigate existing related party footnote disclosure practices for financial statements for H-shares and determine if the practices are similar for H-shares and other companies traded on the Hong Kong Stock Exchange. In addition, this project attempts to determine if existing related party disclosures for H-share companies can be classified according to the purposes identified in the US study and by a review of Hong Kong annual reports. Part of the objective was descriptive. The study summarized and analyzed the related party footnote disclosures for a sample of Hong Kong H-share companies. In a recent study, Barth and Murphy (1994) developed a framework to analyze the required footnotes for companies in the United States. This study uses a similar approach to examine the situation in Hong Kong for this one type of disclosure. However, there are some significant differences. The Barth and Murphy study is extended to include the review of actual disclosures in financial statements. Descriptive statistics are included in the study. Statistical tests are used to determine if practices for related parties are similar.

METHODOLOGY

Information about the accounting disclosures for related parties for H-shares was gathered from 1996 annual reports. This date was before the implementation date for the new standard so the new rules were not required at that time. Twenty-seven companies were selected for the study (see Table 1 for complete company list).

(Table 1 About Here)

The twenty-seven companies represent all of the H-share companies traded on the Hong Kong Stock Exchange in 1996. Annual reports were not available for the other thirteen companies because the companies were not traded until after 1996. All companies had 31 December 1996 year-ends.

Data had to be hand collected in all cases. This lack of available information makes any analysis more difficult and inefficient. In the future, the development of a more complete database would be useful for research.

RESEARCH QUESTIONS

Several research issues were examined during this study. In the first section, descriptive statistics will be provided. In the second, tests to determine if the disclosure level for related parties for H-shares are different for other Hong Kong companies is conducted. As discussed, the disclosure levels for these H-shares have been criticized. If the accounting practices are similar for H-shares and other shares traded on the HKSE, then the specific disclosures for related parties would be expected to be similar. This study investigates the existing disclosures to determine if the levels are, in fact, similar.

The hypothesis to be tested follows:

H1: The disclosure levels for related parties are the same for H-shares as compared to other companies traded on the HKSE.

A Z-test will be conducted to determine if H1 can be rejected statistically.

RESULTS

I. Number of Companies with Related Parties Disclosures

All twenty-seven H-share companies included a footnote disclosing related party information. Sixty-five related parties (average 2.41 parties per company) were identified in the twenty-seven annual reports.

One company described an agreement in a related party footnote as follows:

RELATED PARTY TRANSACTIONS

Every non-executive directors has confirmed that the above-mentioned transactions have been entered into in the ordinary and usual course of business of the Group and on normal commercial terms or on terms no less favourable than terms available to/from independent third parties and are fair and reasonable so far as the shareholders of the Company are concerned.

(a) By an agreement dated 14 July 1993, BGC agreed to be the sole sales agent for the Company's products in the PRC at a fee equal to three percent of the domestic sales in the PRC of the Company's products.

By an agreement dated 14 July 1993, Beijing Yan Long Import & Export Company, a subsidiary of BGC, agreed to provide to the Company export sales, marketing and after sales

services for the Company's products at a fee equal to three percent of the annual export turnover of products marketed by Beijing Yan Long Import & Export Company.

(b) By an agreement dated 18 June 1994, BGC agreed to grant to the Company the right to use the factory area, roads and relevant facilities for a term of 50 years at a fee of Rmb2,000,000 per annum with the term calculated from 1 January 1993. BGC also agreed to deduct this fee from the sole agent fee as note (21) (a) mentioned. If the annual sole agent fee receivable by BGC is less than Rmb2,000,000, BGC agreed to refund the amount equals to the excess of Rmb2,000,000 over the sole agent fee to the Company.

7. By an agreement dated 14 July 1993, BGC agreed to grant to the Company the right to use the "Beiren" trademark for its products at a fee payable quarterly of Rmb15,000 or at the rate of one percent of the sale proceeds from products using the "Beiren" trademark during that relevant period, whichever is the higher. (Beijing Datang Power Generation Co., 1996)

Another company disclosed the following footnote:

RELATED PARTY TRANSACTIONS

Business transactions between the Company and the SHS Group, the Company's fellow subsidiaries and related companies for the year ended 31 December 1996 are as set out below.

(1) Pursuant to a Services Agreement dated 4 July 1994, between the Company and the SHS Group, the SHS Group undertook to provide various services to the Company, relating to, amongst other things, the provision of bunker oil, fuel and material supplies, the supply of fresh water, the installation and maintenance of telecommunication and navigational devices, ship repairs and maintenance, the provision of medical supplies, accommodation for employees and educational training for navigation officers, engineers, technicians, marine officers and electricians. In the same agreement, the Company undertook to provide general control office services relating to the administration and management of vessels. The Services Agreement was effective from 3 May 1994 for a term of ten years, unless terminated earlier by either party upon the giving of sixty days notice. (Shanghai Hai Xing Shipping Co., 1996)

A third company included the following;

RELATED PARTY TRANSACTIONS

A significant portion of the transactions undertaken by the Group during the year has been effected with other PRC State-owned enterprises and on terms determined by the Group and the relevant PRC authorities.

The following is a summary of the significant transactions carried out in the normal course of business between the Group and its related companies during the year:

	1996	1995
	RMB'000	RMB'000
Fellow subsidiaries Sales of finished goods and raw materials	66,287	30,235
Associated companies Sales of finished goods and raw materials	5,923	5,980
Purchases of raw materials	7,484	9,004
Related company Sales of finished goods and raw materials	-	1,432

In the opinion of the directors, the transactions stated above were carried out in the ordinary course of business on normal commercial terms and on terms no less favourable than terms available to third parties. (Chengdu Telecommunication Cable Co., 1996)

An additional firm disclosed the following:

RELATED PARTY TRANSACTIONS

Material related party transactions for the period from 15th August 1996 to 31st December, 1996, other than disclosed in Notes 13 and 16, are summarized as follows:

(a) Toll revenue collections for the period from 15th August, 1996 to 31st December, 1996 were deposited into bank accounts of AEHC which held the funds in trust for the Company. This arrangement resulted in an amount due from AEHC of approximately RMB69 million as of 31st December, 1996. This balance earns interest at 9.18% per annum and has been repaid by AEHC subsequent to 31st December, 1996.

Subsequent to 31st December, 1996, revenue collections have been deposited into the Company's own bank accounts.

(b) The Company entered into an agreement with AEHC to lease certain premises for use as its head office. The property was rented to the Company for a term of three years, from 23rd August, 1996 to 22nd August, 1999. The annual rental is RMB99,360 for the first two years. The rent is subject to a 5% increase from the third year onwards. During the period from 15th August, 1996 to 31st December, 1996, the rental payable to AEHC amounted to RMB33,750. (Anhui Expressway Co., 1996)

In the next section, the results for statistical tests are presented.

I. Results for Hypothesis Testing

Twenty-seven H-share companies had at least one related party disclosed in their 1996 annual reports. In a recent study (Miller, 1997), only six percent (6/ 100) of the selected Hong Kong companies had at least one related party disclosed in their respective 1996 annual reports. The data from this study and the 1997 study were used to conduct a test of proportions to determine if the null hypothesis can be rejected. The null is that p1 equals p2. The hypothesis stated in a different form is repeated as follows:

H1: The level of disclosures for H-shares for related parties is the same as the level of disclosures for other Hong Kong shares.

The alternative hypothesis can be stated as p1 > P2. P1 is defined as the proportion, number of h-share companies with a related party for 1996 divided by the total number of h-share companies (27/ 27). P2 is the number of other HK companies with related parties for 1996 from the 1997 Miller study divided by the total number of other HK companies (6/ 100). The companies selected for the two studies are considered stratified independent samples for all companies traded on the HKSE in 1996. The test of proportions yields a z-value of -20.81. At a 5% confidence level, the critical z is -1.645. The null hypothesis can be rejected.

These results provide evidence that the disclosure levels for related parties for H-shares are significantly higher than the levels for the other HK shares. Because of the small sample sizes, any conclusions need to be carefully considered. Further research needs to be conducted to confirm the possible reasons for the disclosure level differences. Most H-share companies have a relationship with the PRC government that must be disclosed as a related party. This is the probable reason that all H-share companies had, at least, one related party disclosure in this study.

In the next section, the results are summarised and discussed.

SUMMARY AND DISCUSSION

Additional accounting guidance for related party transactions may not need to be provided by the HKSA for H-shares in Hong Kong. All companies provided related party disclosures in 1996. The level of detail does vary greatly for these companies. Many firms included extensive details about activities with related parties.

The actual disclosures in this study appear to meet several purposes. Barth and Murphy determined that related party disclosures met the following general purposes, 1) describe recognised items and provide relevant measures of those items other than the measure in the financial statements, and 2) provide information to help investors and creditors assess risks and potentials of both recognised and unrecognised. The Hong Kong H-share footnotes do appear to meet these same general objectives. However, the level of detail varies greatly. Probably more importantly, the major difficulty is the lack of consistency. Related party disclosures do appear to be adequate.

China has addressed the related party issues. A new standard, "Accounting Standard for Business Enterprises: Disclosure of Related Party Relationships and Transactions" has been issued that is effective for listed Chinese companies from 1 January 1997. This standard is, also, based on IAS No. 24, but there are significant differences. For example, transactions between state-controlled enterprises are disclosable when the transacting enterprises are regarded as related parties. Also, the standard provides a specific definition that an individual investor who controls, directly or indirectly, 10% or more of the voting capital of an enterprise is a related party. IAS No. 24 does not give a specific percentage, but states if there is significant influence then there is a related party transaction.

The Hong Kong Society of Accountants may need to evaluate the accounting disclosures in the related party area. The H-shares and other Hong Kong may be applying a somewhat different standard. At this time, comparisons among Hong Kong companies may be difficult. Different disclosure methods are, apparently, being used by companies. The new standard should increase the comparability among H-shares and other companies traded on the HKSE by standardising the required disclosures. Research in the future should be conducted to confirm that the level of disclosures becomes similar for both groups. Consistent disclosure practices may be critical in the future. It is hoped that this study has provided some useful information about the status of corporate financial reporting for related party transactions.

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Table 1: Companies of H - shares

No	Industry Sector Code	Stock Code	Company Name
1	I	995	Anhui Expressway Co Ltd
2	U	991	Beijing Datang Power Generation Co Ltd
3	I	187	Beiren Printing Machinery Holdings Ltd
4	I	1202	Chengdu Telecommunication Cable Co Ltd
5	C	670	China Eastern Airlines Corporation Ltd
6	I	1072	Dongfang Electrical Machinery Co Ltd
7	I	921	Guangdong Kelon Electrical Holdings Co Ltd
8	U	525	Guangshen Railway Co Ltd
9	I	317	Guangzhou Shipyard International Co Ltd
10	I	1133	Harbin Power Equipment Co Ltd
11	I	368	Jilin Chemical Industrial Co Ltd
12	I	350	Jingwei Textile Machinery Co Ltd
13	I	300	Kunming Machine Tool Co Ltd
14	I	1108	Luoyang Glass co Ltd
15	I	323	Maanshan Iron and Steel Co Ltd
16	I	553	Nanjing Panda Electronics Co Ltd
17	M	1138	Shanghai Hai Xing Shipping Co Ltd
18	I	338	Shanghai Petrochemical Co Ltd
19	I	1065	Tianjin Bohai Chemical Industry (Group) Co Ltd
20	I	168	Tsingtao Brewery Co Ltd
21	I	1033	Yizheng Chemical Fibre Co Ltd
22	I	576	Zhejiang Expressway Co Ltd
23	I	1128	Zhenhai Refining and Chemical Co Ltd
24	I	1122	Qingling Motors Co Ltd
25	I	42	Northeast Electrical Transmission and Transformation Machinery Manufacturing Co Ltd
26	I	719	Shandong Xinhua Pharmaceutical Co Ltd
27	I	548	Shenzhen Expressway Co Ltd

BANKING ON SUCCESS IN THE WAR ON TERROR

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ABSTRACT

Money laundering is any activity used to disguise the origin of money that has been gained through illegal activities or events. Before the events of September 11th, many people associated money laundering operations with drug trafficking and illegal gambling outfits. Since the terrorist attack however, the concern over money laundering has turned from tax evaders to terrorist funding. This has prompted strong and immediate action by the United States and a resurgence of support for legislation aimed at finding the sources of "dirty money." However, anti-money laundering initiatives are not local events, as much of the activity involves shuffling funds overseas and offshore. Many countries are actively trying to reduce the risk associated with money laundering. Multilateral efforts are key to reducing the amount of illicit funds passing through the nations' financial sectors. The Financial Action Task Force on money laundering & IMF are only a few of the international organizations working for the cooperative efforts of reducing this illegal activity and therefore disabling the underlying crimes.

Unfortunately, since there are no formal measures to determine the amount of underground transactions, it is difficult to gauge the effectiveness of current anti-laundering practices. Reports are broadcast describing asset freezes on parties believed to be involved in terrorist or other illegal activities. But just how accurate is the financial trail used to asses the guilt of the account holders? The effectiveness of current practices is often questioned. This paper will examine U.S. anti-money laundering practices and also touch on foreign endeavors in this financial war. Special attention will be paid to recent legislation spawned under the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot) Act of 2001. Despite concerted efforts in the "war on terror," it may be found that while we can prosecute those who surface in the public eye, it is unlikely that financial initiatives will deter future crimes or debilitate the parties and activities involved.

The world is constantly evolving into a global economy with the help of open financial markets and technology. In synch with this movement, the sophistication of financial crimes is increasing as well. Financial crimes such as money laundering are only a symptom of a more serious underlying criminal activity. Detection of these activities remains difficult and effectiveness of current efforts is difficult to determine at best. This paper examines current anti-money laundering practices.

WAL-MART'S LEARNING CURVE IN THE GERMAN MARKET

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ABSTRACT

Entering the German market would present Wal-Mart with many obstacles to overcome. When Wal-Mart decided to do business in Germany the company had to adhere to the many rules and regulations surrounding German businesses. According to German law, selling merchandise below cost is illegal. The sixth amendment of the Act against Restrictions of Competition (ARC) is a ban on undertakings with superior market power offering goods or services below their cost price without justification. This action limited the effectiveness of Wal-Mart's low cost leader strategy. Another German restriction requires stores to limit their amount of operational hours. German shopping hours are strictly regulated under Paragraph 3 of the BGBI (B9 – 74/00, Seite 875). No German stores are allowed to be open 24 hours a day, nor are they allowed to be open on Sundays and must close by 4 P.M. on Saturdays. In response, Wal-Mart began to open its stores earlier to avoid violating any regulations. The response from consumers was positive resulting in increased business. Another barrier to Wal-Mart was the limitation placed on the number of sales it could have in a single year. According to German law, sales are only permitted during a uniform two-week period twice a year. Wal-Mart is looking forward to changing the laws in the German lower house to allow them to offer the two for one deal popular in the United States. The final barrier to Wal-Mart is the law concerning the German workforce. Article 2 of Convention 87 states that German workers have the right to organize. About 25 percent of Wal-Mart's 18,000 workers in Germany are organized in the union called the Uni Commerce affiliate ver.di (Vereinte Dienstleistungsgesellschaft). Wal-Mart traditionally rejects trade unions so they could keep wages and labor costs down. If however the company signs the collective agreement, stating that Wal-Mart workers can unionized, it will show the company cares about the improvement of the relationship with their workforce, equal opportunity, and non-discrimination.

Retailing is, by its nature, a dynamic industry. There have been an almost overwhelming number of changes during the past 50 years. Today's consumer will demand more for less from the shopping experience: more quality, choice, consistency, convenience, and service, for less money, time, effort, and risk. Another major factor in the changing consumer atmosphere is the changing German demographic. Due to the shrinking younger population, older consumers dominate the market. This will drastically affect Wal-Mart's marketing approach to the German people. Today the German people are looking for more convenience and comfort. As life styles are becoming busier, the time devoted to household shopping and meal preparation is shrinking. Wal-Mart will have to adapt to these changes and offer a variety of healthy, prepared meals evidenced by the

organic market increase 20 % from 2000 to 2001. Most importantly, however, consumers in the German market want to indulge themselves with small pleasures and personal rewards. Wal-Mart will have to continue to find new ways to keep the German consumer excited and interested in Wal-Mart's products.

THE POSSIBILITY OF CORPORATE SOCIETAL STRATEGY IN CHINA

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ABSTRACT

In the transition from a command economy based on a strong, socio-political ideology to a free market economy, the entrepreneur or corporate executive finds himself in an environment in which the values fundamental to business are questioned and questionable. Entrepreneurial opportunities to profit in the near term tend to obscure the tong term need for a corporate societal strategy in order to sustain and maximize future profit potential. Many of the issues facing joint ventures and enterprises in China stem from this situation. An examination of business performance in China spotlights the need for developing strategies to bind profit maximization to societal value. Recent studies in ethical decision making indicate that a convergence of societal values is in process in China. This paper presents both the theoretical framework and the results of on-going empirical study.

CONSUMERISM: STATISTICAL ESTIMATION OF NIGERIA MEAT DEMAND

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ABSTRACT

This study estimates the responsiveness of demand for meat to variations in prices and incomes on the basis of food demand data for the time period between 1980 to 2002 using an Almost Ideal Demand System (AIDS) model. These findings are reasonable given the position that beef holds as the dominant and traditional meat in Nigeria. These elasticities also imply that beef and chicken are luxury goods, while other fish and demersal fish are normal goods for Nigeria households consistent with the findings of previous studies. With the exception of some cross-price elasticities, the majority of the price elasticities exhibit the expected signs and magnitudes. This indicates that demand for beef and other meat in Nigeria is very price elastic. In general, the results suggest that own-prices as well as incomes are the predominant factors determining consumer choice and meat consumption patterns in Nigeria rather than relative prices.

INTRODUCTION

Before the 1970's oil boom, agricultural exports were the backbone of the Nigerian economy with livestock products accounting for a significant share of exports. During this period, the country had a well-developed domestic agricultural market. However, despite this sound potential for growth in the domestic market, Nigeria is currently witnessing a drastic decline in agricultural production, especially in livestock and meat sectors of the industry. This decline in agricultural production coincides with the nation's oil boom.

Furthermore, Nigeria has enjoyed yearly economic growth (GDP) of 10.8 percent in real terms between 1980 and 1987 as a result of export earnings from petroleum. Real per capita income rose at 60 percent per year during this period. However, the decline in the world oil prices experienced in 1987, combined with the reduction in world market prices of agricultural products in 1995 brought an end to country's economics growth and real per capita income. Between 1989 and 1997 real per capita income dropped at a rate of 7.8 percent per year.

During this period, the federal government of Nigeria maintained a trade policy dominated by quantitative restrictions and price controls on food items. In January 1990, a tax was imposed on meat imports, ostensibly to raise government revenues and stimulate domestic meat production. The abrupt drop in meat imports, coupled with inadequate domestic supply pushed up price of meat and thus depressed domestic demand. For example, per capita meat consumption that had risen from 12.05 kg in 1981 to 13.8 kg in 1986 dropped to 11.6 kg in 1992. Also meat prices rose by 70 percent from 1987 to 1999, resulting in a decline in Nigerian per capita meat consumption from 10.5

kilograms of meat per year in 1987 to 9.4 kilograms per year in 1999 (*FGS*, 1999).. Although the federal government of Nigeria has designed various programs to help stabilize meat prices and consumption, the country is still experiencing meat shortage and price fluctuations.

The purpose of this study is to understand the source of the change and fluctuation in meat consumption in Nigeria. In order to determine the cost or likely success of the various government programs, this research paper will examine the responsiveness of demand for meat to variations in prices and incomes on the basis of food demand data for the time period between 1980 to 1999. Additionally, it will also assist in formulating recommendations for policies with the potential to create more stable meat consumption and prices for the nation. In order to understand the source of the decline and instability in consumption and to determine whether the shock is from changing incomes or from changing prices, this paper will determine whether demand for meat is price-elastic on the basis of food demand data during the time period studied from 1980-2001.

World demand for meat has risen sharply during the last few decades. The key reasons for these increases in meat demand are increasing population, improving technology and increasing incomes. However, despite this overall improvement in technologies and incomes, per capita consumption of meat has lagged especially in the less-developed countries of the world because protein is the most costly food item.

The early empirical studies of demand were characterized by the extensive use of single equation methods centered on the measurement of elasticities since they are easily understood and conveniently dimensionless. Hence, demand could be directly measured as the parameters of a regression equation linear in the logarithms of purchase, outlay and prices.

Agricultural economists have long been interested in the proper measurement and interpretation of elasticities and flexibilities among endogenous variables in systems of simultaneous equations. Elasticities are vital parameters in developing models for policy analysis, have been used in applied models frequently based on subjective judgment, but not supported by quantitative and empirical evidence (Mdafri and Brorsen, 1993). Adegeye (1988) estimated price elasticities of demand for beef, poultry, and fish products, such as freshwater fish. Unfortunately, he adopted provincial elasticities and failed to aggregate based on the most recent policy analysis. It is well known that partial measures, commonly used in a single-equation context are not valid for obtaining elasticities among endogenous variables in a system framework because indirect effects are not accounted for by standard partial measures. This applies to elasticities with respect to exogenous variables but does not apply to structural elasticities.

THE ALMOST IDEAL DEMAND SYSTEM

Following the important paper by Diewert (1971), several demand system estimation models, known as "flexible functional form", have been developed. The basic method is to approximate the direct utility function, indirect utility function or the cost function by some specific functional form. One of these approaches is Christensen et al's (1975) indirect translog model

$$(1) \qquad U = \alpha_0 + \sum \alpha_k \log(P_k / X) + \tfrac{1}{2} \sum_k \sum_j \beta_{kj} \log(P_k / X) \log(P_j / X),$$

where k, j are goods. The demand function from equation (1) is complicated and clumsy to estimate while the direct translog model is usually estimated under the practically nonsensical assumption that, for all goods, prices are determined by quantities rather than the other way round.

Deaton and Muellbauer (1980) started not from an arbitrary preference ordering, but from a specific class of preferences, by which the theorems of Muellbauer (1975, 1976) permit exact aggregation over consumers: the representation of market demands as if they were the outcome of decisions by a rational representative consumer. They proposed that the cost or expenditure function, which defines the minimum expenditure necessary to attain a specific utility level, can be used to represent consumer preferences, known as the price-generalized logarithmic (PIGLOG) class,

II. $$\log c(u,P) = (1-u)\log\{a(p)\} + \log\{b(P)\}.$$

With some exceptions, u lies between 0 (subsistence) and 1 (bliss) so that the positive linearly homogeneous function $a(P)$ and $b(P)$ can be regarded as the costs of subsistence and bliss, respectively. Next they take specific functional forms for log $a(P)$ and log $b(P)$

(3) $$\log a(P) = \alpha_0 + \sum \alpha_k \log P_k + \tfrac{1}{2}\sum_k \sum_j \gamma^*_{kj} \log P_k \log P_j,$$

(4) $$\log b(P) = \log a(P) + \beta_0 \prod_k P_k^{\beta_k}.$$

After the selection of a specific functional form, the cost function in the AIDS model can be written as

(5) $$\log c(u,P) = \alpha_0 + \sum \alpha_k \log P_k + \tfrac{1}{2}\sum_k \sum_j \gamma^*_{kj} \log P_k \log P_j + \beta_0 \prod_k P_k^{\beta_k}.$$

The demand functions can be derived directly from equation (2). It is a fundamental property of the cost function that its price derivatives are the quantities demanded $\partial c(u,P)/\partial P_i = q_i$: Multiplying both sides by $P_i/c(u,P)$ we find:

(6) $$\frac{\partial \log c(u,P)}{\partial \log P_i} = \frac{p_i q_i}{c(u,P)} = w_i,$$

where w_i is the budget share of good i. Hence, logarithmic differentiation of equation (5) gives the budget shares as a function of prices and utility,

(7) $$w_i = \alpha_0 + \sum_j \gamma_{ij} \log P_j + \beta_i u \beta_0 \prod_k P_k^{\beta_k},$$

where

(8) $$\gamma_{ij} = \tfrac{1}{2}\left(\gamma^*_{ij} + \gamma^*_{ji}\right),$$

for a utility-maximizing consumer, total expenditure X is equal to $c(u,P)$ and this equality can be inverted to give u as a function of P and X, the indirect utility function. Solving equation (5) and (7) and eliminating u, we obtain the budget shares as a function of P and X. These are AIDS demand functions in budget share form:

$$(9) \qquad w_i = \alpha_i + \sum_j \gamma_{ij} \log P_j + \beta_i \log\{X/P\},$$

where w_i is the expenditure share of commodity i, P_j is the commodity price, X is the total expenditure of the selected goods, and P is overall price index, which is defined by

$$(10) \qquad \log P = \alpha_0 + \sum_k \alpha_k \log P_k + \tfrac{1}{2}\sum_k \sum_j \gamma_{kj} \log P_k \log P_j,$$

By taking three sets of restrictions on the parameters of the AIDS equation (7),

$$(11) \qquad \sum_{i=1}^{n} \alpha_i = 1, \; \sum_{i=1}^{n} \gamma_{ij} = 0, \; \sum_{i=1}^{n} \beta_i = 0, \; \sum \gamma_{ij} = 0, \quad \gamma_{ij} = \gamma_{ji}.$$

Provided equation (11) holds, equation (9) represents a system of demand functions which add up to total expenditure $\sum w_i = 1$ are homogenous of degree zero in prices and total expenditure taken together, which satisfy Slutsky symmetry. When there is no change in relative price and X/P the budget shares are constants. Changes in relative prices take effect through γ_{ij}. Changes in expenditure operate through the β_i coefficients, which are summed to zero and are positive for luxuries and negative for necessities (Deaton and Muellbauer, 1980).

An important feature of the AIDS model is that the expenditure levels are allowed to impact the distribution of shares. It is of flexible functional form, allowing testing of theoretical restrictions on demand equations. The AIDS model in share form for a group of n commodities can be written as

$$(12) \qquad w_i = \alpha_i + \sum_j \gamma_{ij} \ln P_j + \beta_i \ln(X/P), \qquad i = 1, 2, \ldots, n$$

where w_i is market share, X is total expenditure, $i = j$, is the number of products in the demand system, and P_j is the price of product j in the system. α_i, γ_{ij}, and β_i are parameters. $\ln P$ is defined as:

$$(13) \qquad \log P = \alpha_0 + \sum_k \alpha_k \ln P_k + \tfrac{1}{2}\sum_k \sum_j \gamma_{kj} \ln P_k \ln P_j.$$

In practice, equation (12) is difficult to estimate because of its nonlinearity. A common alternative is to estimate a linear approximation version of the AIDS model. That is, instead of estimating the complete AIDS model in equation (12), its linear approximation is employed by replacing $\ln P$ with $\ln P^*$, where $\ln P^*$ is the Stone's Index defined as:

(14) $$\ln P = \sum_i w_i \ln P_i, \qquad i = 1, 2, \ldots, n.$$

therefore, (13) becomes:

(15) $$w_i = \alpha_i + \sum_j \gamma_{ij} \ln P_j + \beta_i \ln\{X/P\}.$$

Marshallian and Hicksian measures of elasticities may be computed from the estimated coefficients of the AIDS model as follows:

(16) $$\varepsilon_{ii} = -1 + \gamma_{ij}/w_i - \beta_i,$$

(17) $$\varepsilon_{ij} = \gamma_{ij}/w_i - \beta_i(w_j/w_i),$$

(18) $$s_{ii} = -1 + \gamma_{ii}/w_i + w_i,$$

(19) $$s_{ij} = \gamma_{ij}/w_i + w_j,$$

where ε and s denote Marshallian and Hicksian elasticities respectively. The expenditure elasticities can be obtained from the estimated coefficients as well:

(32) $$\eta_i = 1 + \beta_i/w_i.$$

In the case of Nigeria, the meat demand system to be estimated includes beef, pork, chicken, and fish. Furthermore, time trends in a more appropriate manner would be incorporated into the model more appropriately by interacting each variable in the model with time period variable (Pollak and Wales, 1981).

DATA ESTIMATION AND PROCEDURE

Very few demand meat estimates have been obtained for Nigeria, the earliest dating back to 1965. One reason is the absence of adequate data in terms of both quality and duration of the time period covered. The official source of data on meat and fish in Nigeria is the Statistics Division of the Ministry of Livestock, Fisheries and Animal Industrial, which publishes information on herd inventories and livestock slaughtered numbers. Divisional data are aggregated first into provincial and then national data, and later reported by Nigeria Federal office of Statistics, Economic and Social Statistics in Lagos. Data were obtained from the Nigeria Federal Office of Statistics, Economic and Social Statistics (Lagos: FOS, various years) and the Central Bank of Nigeria. The data are Nigerian time series data on meats and fish categories from 1980 to 2002. The price data are in index form and are constructed so that 1990 = 100 (Base year).

All prices are the retail level and all quantities are per capita and based on retail cuts. Disposable income per capita will be used in the estimation to determine the income effect on meat consumption. Time series data were obtained for meat consumption of meats (demand for all meats), the price level (price index), disposable income per capita, and expenditures on meat products.

RESULTS AND ANALYSIS OF THE ALMOST IDEAL DEMAND SYSTEM FOR NIGERIA MEAT DEMAND SYSTEMS

Parameter estimates for Nigeria meat demand system were obtained using the Deaton-Muellbauer iterative procedure. Most of the parameter estimates were significant at the 10 and 15 percent level of significance (Table 1.1). The principal goal of the study, however, was to estimate Nigerian demand elasticities for beef, chicken, demersal fish, and freshwater fish and analyze the effects of expenditures on household meat consumption behavior in Nigerian. Thus, the Marshallian and Hicksian elasticities are reported in Table 1.2 and Table 1.3 respectively with all expenditure elasticities having positive signs as expected. However, the magnitudes of these elasticities are different for the six commodities. The expenditure elasticities for chicken, freshwater fish, and demersal fish are greater than one, implying that they are luxury goods. However, demersal fish has the greatest expenditure elasticity of 2.389 compared with other meat products. This suggests that demand for demersal fish would increase greatly when per capita expenditure rises. The magnitudes of expenditure elasticities for beef and other meat are similar, although they are relatively lower compared to those of demersal fish and freshwater fish. These findings are reasonable given the position that beef holds as the dominant and traditional meat in the diet for most Nigerians. These elasticities also imply that beef and chicken are luxury goods, while other fish and demersal fish are normal goods for Nigeria households consistent with the findings of previous studies.

With the exception of some cross-price elasticities, the majority of the price elasticities exhibit the expected signs and magnitudes. Uncompensated own-price elasticities presented in Table 1.2 have negative signs in accordance with economic theory. However, the magnitudes of own-price elasticities of demand vary for different types of meat. Own-price elasticities for beef are much higher than those for other meats and less than one. This indicates that demand for beef and other meat Nigeria is very price elastic.

The magnitudes of own-price elasticities for beef and chicken meat consumption are between -0.224 and -0.118 respectively for the Marshallian elasticities illustrated in Table 1.2 and –1.632 and –0.411 for Hicksian elasticities illustrated in Table 1.3. Furthermore, some of the cross-price elasticities have negative signs, but the magnitudes are very small. In general, the results suggest that own-prices as well as incomes are the predominant factors determining consumer choice and meat consumption patterns in Nigeria rather than relative prices.

The results of this estimation broadly coincide within the range of income elasticities (0.57 - 1.0) and price elasticities (0.34 - 1.04) in South Korea and Japan from previous studies such as Hayes et al., (1990) and Hayes et al. (1991). The Hayes et al. studies were based on 1961-1987 and 1947-1978 average data in South Korea and Japan respectively and also employed an LA/AIDS model. Therefore, it appears that meat demand and consumption in Nigeria in the past decade may, in part, be comparable to that in South Korea and Japan during 1960s and 1970s.

CONCLUSION

Nigeria is not only one of the largest meat producing countries in Africa but also one of the largest meat consumers in this region of the world. The empirical results of this study suggest several points of interest for researchers, policy makers, planners and traders with involvement in

Nigerian food production and marketing. First, expenditure elasticities for demersal fish and freshwater fish are highly elastic suggesting that Nigeria households will consume more demersal fish and freshwater fish as incomes increase. In terms of beef, the expenditure elasticity is also highly elastic, implying that Nigeria consumers with low incomes will increase their consumption of beef as their incomes rise. Second, own-price elasticities of all meat items are fairly elastic. This suggests that any changes in meat prices could bring about a significant shift in meat consumption patterns. Third, given the emergence of large unemployment in Nigeria, a major challenge confronting the government is how to design appropriate policies for the relative enhancement of low-income groups. Identifying elasticities for different income groups would enable Nigerian decision-makers to gauge more precisely the impact of their policies on various income groups, and more effectively design policies targeted at low-income groups.

The strength of this study relative to previous meat demand studies in Nigeria and other West African countries is the use of observations pertaining to expenditure share rather than average income estimates for the population as a whole. Further partitioning of income groups with time series data of greater duration and incorporating socio-demographic variables would enhance the accuracy of results. Caution should be taken, however, when interpreting those empirical results because the statistical information on consumption data in Nigeria is rather scarce, incomplete and controversial. The described data problems limit strong interpretation of empirical findings. Nevertheless, this study opens up discussion on the important issue of consumption patterns for different meat and fish products in Nigeria. Further studies will enhance the potency of these preliminary findings.

Table 1. 0: Comparison of Price and Income Elasticities for Beef in Nigeria, by Various Authors

Author	Product	Type of Model	Price	Income
Adegeye (1988)	Beef	Linear Log-linear	-2.367 -2.675	0.470 0.457
Tambi (1991)	Beef	3SLS[a]	-0.411	0.596
Present Study	Beef	Double-log	-0.118	0.327[b]

[a] Three-stage least squares. [b] Expenditure elasticity.

Table 1. 1: Parameter Estimates For Nigeria Meat and Fish Demand System
Using an Almost Ideal Demand System Model, 1980-2002

Dependent Variables
(The budget share of per capita wheat import of:)

Independent Variables	Beef	Chicken	Other Meat	Demersal Fish	Freshwater Fish	Other Fish	Expenditure	R^2
Beef	-0.118 (0.525)	-1.185 (0.296)	0.741 (0.760)	0.315 (0.371)	-0.576 (0.711)	0.388 (0.229)		0.327 (0.751)
Beef	0.163** (0.048)	-0.1704** (0.031)	0.062** (0.001)	-0.050** (0.001)	-0.057* (0.014)	0.080** (0.010)	0.143* (0.041)	0.91
Chicken	-0.111* (0.023)	0.133* (0.022)	0.084* (0.050)	0.133* (0.022)	-0.042* (0.031)	-0.079* (0.004)	0.025* (0.009)	0.842
Other Meat	0.007** (0.001)	-0.112* (0.010)	0.081* (0.009)	-0.023** (0.001)	-0.024** (0.001)	0.029 (0.003)	0.021* (0.005)	0.851
Demersal Fish	0.007* (0.001)	-0.005** (0.011)	-0.062* (0.019)	0.050* (0.015)	-0.057* (0.007)	0.077** (0.004)	0.262** (0.018)	0.956
Freshwater Fish	0.163* (0.018)	-0.171* (0.032)	0.012** (0.008)	-0.036* (0.001)	-0.422* (0.012)	0.072* (0.005)	0.143** (0.019)	0.947
Other Fish	0.007* (0.001)	-0.480* (0.029)	0.062** (0.011)	-0.006* (0.001)	-0.011* (0.002)	0.047* (0.009)	0.016** (0.007)	0.957

Note: The numbers in parenthesis are standard errors.
Single (*) and double asterisks (**) denote significance at the 15% and 10% level, respectively.

Table 1. 2: Marshallian Elasticities for Meat and Fish in Nigeria Using an Almost Ideal Demand System, 1980-2002

Commodity	Beef	Chicken	Other Meat	Demersal Fish	Freshwater Fish	Other Fish	Expenditure
Beef	-0.224** (0.061)	-0.093** (0.051)	-0.112** (0.006)	0.213** (0.021)	-0.911** (0.083)	0.388** (0.019)	1.255** (0.079)
Chicken	-0.189* (0.089)	-0.118* (0.081)	-0.103** (0.041)	-0.342* (0.037)	-0.623** (0.117)	0.102* (0.021)	0.407* (0.014)
Other Meat	-0.111** (0.008)	-0.814* (0.102)	-0.069* (0.013)	-0.012** (0.001)	-0.581** (0.011)	0.671** (0.087)	0.793** (0.084)
Demersal Fish	-0.295** (0.016)	0.413* (0.052)	-0.151* (0.032)	-0.438* (0.046)	0.924* (0.163)	-0.734* (0.053)	1.569* (0.051)
Freshwater Fish	0.126* (0.071)	-0.452 (0.097)	-0.173* (0.011)	-0.011* (0.045)	-0.163** (0.105)	0.181* (0.075)	0.235* (0.011)
Other Fish	-0.071** (0.003)	-0.032* (0.001)	0.525** (0.086)	-0.219** (0.015)	-0.201** (0.041)	-0.419* (0.021)	0.141* (0.091)

Note: The numbers in parenthesis are standard errors.
Single (*) and double asterisks (**) denote significance at the 15% and 10% level, respectively.

Table 1. 3: Hicksian Elasticities for Meat and Fish in Nigeria Using an Almost Ideal Demand System, 1980-2002

Commodity	Beef	Chicken	Other Meat	Demersal Fish	Freshwater Fish	Other Fish
Beef	-1.632** (0.012)	-0.233* (0.011)	0.151** (0.023)	0.421** (0.062)	-0.891** (0.025)	0.087* (0.001)
Chicken	-0.221* (0.062)	-0.411** (0.047)	0.201* (0.019)	-0.178* (0.015)	-0.941* (0.054)	-0.911* (0.013)
Other Meat	0.241* (0.010)	-0.341** (0.107)	-0.012** (0.005)	-0.116* (0.011)	-0.321* (0.017)	-0.221** (0.042)
Demersal Fish	-0.192** (0.022)	0.821** (0.016)	-0.215** (0.021)	-0.321* (0.061)	0.054 (0.001)	-0.307* (0.001)
Freshwater Fish	0.121* (0.011)	-0.106* (0.021)	-0.271* (0.001)	-0.117* (0.064)	-0.551* (0.003)	0.052** (0.001)
Other Fish	-0.090* (0.001)	-0.161* (0.011)	0.511** (0.026)	-0.371* (0.001)	-0.851** (0.073)	-0.101** (0.091)

Note: The numbers in parenthesis are standard errors.
Single (*) and double asterisks (**) denote significance at the 15% and 10% level, respectively.

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INDUSTRIAL RELATIONS AND U.S. DIRECT INVESTMENT ABROAD: THE IMPACT OF FOREIGN LABOR MARKET RESTRICTIONS

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ABSTRACT

Using a new measure of labor market freedom from the Economic Freedom of the World Report, 2001, the authors estimate the impact of labor market regulations in 16 OECD and 11 non-OECD countries on U.S. direct investment abroad. Previous research relating labor market regulation to foreign direct investment has used subjective measures of the intensity of the regulatory environment. In addition, prior research combines OECD and non-OECD countries in the estimation procedure. The authors find that the new more objective measure of labor market regulation results in a highly significant and robust coefficient for OECD countries, but is not significant for non-OECD countries. U.S. firms are less likely to invest in OECD countries where job security provisions are high. Furthermore, we find that OECD and non-OECD countries respond differently to the determinants of foreign direct investment and therefore those sets of countries should be estimated separately.

THE VIETNAMESE MARKET AND THE UNITED STATES: A MATRIX AND HISTORICAL ANALYSIS

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ABSTRACT

Although some commercial relationship existed before the United States and Viet Nam established normal relations in 1995, serious U.S. trade and investment activities in Viet Nam effectively started with the after 1995. This paper analyzes business relations between the two nations. In addition to the historical analysis, this paper develops a model— an investment potential assessment framework to analyze U.S. investment in Viet Nam. This paper will argue that U.S.-VN commercial relationship is shaped by both history and normal cost-benefit considerations.

It also argue that while trade relationships can be based on comparative advantage, investment relationships are influenced by a risk-averse approach. Therefore, given that approach and the Chinese alternative, one cannot expect U.S. investment to take a sharp upturn.

INTRODUCTION

This papers examines the nature and prospects for the United States'commercial relations with its former enemy and explore the reasons for America's slow return to the Vietnamese market. The scope of bilateral economic relations, including short-term of service and commodity exchange and long term commitment to a particular markets, i.e., foreign direct investment—FDI, depends importantly on physical factors such as the size of the market and non-physical dimensions such as social capital and the regulatory environment.

This paper seeks to shed more light on U.S.– bilateral business relationship in terms of the "motivation cum environment" matrix mentioned above. But although this matrix is appropriate to analyze U.S.–VN bilateral relationship, to gain a deeper understanding, we need to look more carefully at the special historical circumstance underlying relationship. This circumstantial specificity would account for the fact that, despite the close encounter between the United States and Viet Nam in contemporary history, there were considerable delays in peaceful economic dialog between the two nations. One of the theses advanced in the paper is that these delays have their root cause in both politics and economics. By examining the latter, it is possible to gain further insights into a specific bilateral exchange process such as that analyzed here, and to offer clues to future developments of that process. Additionally, the experience of U.S.–VN commercial relations can conceivably offer some lessons on bilateral commercial relationships on a global scale. The part of this paper looks at the record of U.S.–VN bilateral relationship and the second part analyzes the tangible and intangible determinants of that relationship.

THE RECORD

Until the U.S. trade embargo against Viet Nam was lifted in February 1994, regular trade relations with Viet Nam was virtually non-existent (Table 1). The said landmarks in U.S.–VN relations took place against the backdrop of a burgeoning economy and impressive growth in foreign trade and investment in that country. At that time, Viet Nam had emerged as one of the most promising markets in Southeast Asia. In fact, according to a 1995 annual survey of investor intentions by *Corporate Location*, Viet Nam was ranked 8th in the top thirty investment sites (from 23rd) (Corporate Location, 1995). This high ranking put Viet Nam below China but above Korea, the ASEAN countries, the United States, and Japan. (Although the government mandated the use of national currency, the VN *đng*, and restricted the use of the U.S. dollar, the latter remained a favorite medium in the Vietnamese market (FEER, 1995). While U.S. total trade, i.e., exports and imports, with ASEAN reached $83.85 billion in 1994, that with Viet Nam was a meager $223.4 billion.

Because of the trade embargo, in value, U.S. trade with Viet Nam was quite negligible up until after 1993. Compared with the pre-1993 period, there was a substantial increase in that volume during 1993-94. With the lifting of the trade embargo in 1994, however, U.S.-VN trade began to increase significantly, and in 1996, U.S. trade with Viet Nam rose to nearly one billion dollars. The Asian financial crisis of 1997 had a depressing effect on that trade, which did not fully recover until 1999 and after. From 2000 to 2003, while the volume of total trade with Viet Nam began to surpass the one-billion dollar mark, the U.S. market has absorbed much more Vietnamese commodities than vice versa. For example, between 2000 and 2001, U.S. imports from Viet Nam increased from $821.3 million to $1,053.2 million, but U.S. exports to Viet Nam only rose from $367.5 million to $460.4 million. Last year marked a high point in U.S.–VN trade relations, again with the United States providing a lucrative market worth $4.55 billion for Vietnamese commodities. Compared to the previous year, the 2003 value show an increase of over 90 percent. Viet Nam also offered the United States a larger consumer market worth $1.32 billion for American exports. In short, in sheer volume and compared with the early 90s, bilateral trade between the two nations has shown a healthy and steady growth pattern. In recent years, the United States has continued to provide Viet Nam with an increasingly larger market. In fact, in 2002, this country alone absorbed nearly 13 percent of the value of all merchandise that Viet Nam sold to the rest of the world. On the other hand, the Vietnamese market has also been broadened to take in American goods over time as shown by the recent rise in the value of U.S. exports to Viet Nam, but the share of American merchandise in Viet Nam's total imports has remained around only three percent (Table 1).

What has Viet Nam bought from and sold to the United States? To what extent does U.S.–VN trade follows and deviates from the Vietnamese global trade pattern? On the U.S. import side, unlike the pattern of VN global trade analyzed above, the commodity group that United States has bought the most of from Viet Nam was food and live animal (according to SITC classification). For example, last year, the United States bought almost one billion dollar's worth of merchandise from Viet Nam in this group, accounting for about one-fifth of total U.S. merchandise imports from Viet Nam. The dominant item in this group in 2003 was marine products: the United States imported nearly half a billion dollars worth of shrimps and prawns. The 2003 imports in this category represents an increase of about 30 percent over the preceding year.

The second largest U.S. import group from Viet Nam last year garments, the bulk of which was sweater, pullover and similar articles, and other knitted products. This import had a value of $429.43 million and accounted for 9.4 percent of total U.S. imports from Viet Nam.
The third most import item from Viet Nam was crude minerals (SITC 3), which consisted of petroleum oil and oil from bituminous minerals (U.S.–VN Trade Council, 2004). Another lucrative U.S. market for Vietnamese exports in 2003 was machinery and transport equipment (SITC 7). Most of the Vietnamese exports in this category was associated with U.S. investment in Viet Nam.

Table 1

U.S. Trade with Viet Nam, 1992-2003

(in millions of dollars)

Year	Exports to U.S.	Imports from U.S.	Balance	Total Exports	Total Imports		
	1	2	3	4	5	(1/5)	(2/4)
1992	4.6	0	4.6	n.a.	n.a.	n.a.	n.a.
1993	7	0	7	n.a.	n.a.	n.a.	n.a.
1994	172.9	50.5	122.4	n.a.	n.a.	n.a.	n.a.
1995	252.3	199	53.3	n.a.	n.a.	n.a.	n.a.
1996	616.6	331.8	284.8	7,256	11,144	0.085	0.030
1997	286.7	388.4	-101.7	9,185	11,592	0.031	0.034
1998	273.9	554.1	-280.2	9,361	11,500	0.029	0.048
1999	291.5	608.4	-316.9	11,540	11,742	0.025	0.052
2000	367.5	821.3	-453.8	14,449	15,638	0.025	0.053
2001	460.4	1,053.20	-592.8	15,100	15,999	0.030	0.066
2002	580	2,394.80	-1,814.80	16,530	19,000	0.035	0.126
2003	1,324.40	4,554.90	-3,230.50	n.a.	n.a.	n.a.	n.a.

Sources: Exports and Imports with U.S. Data: Department of Commerce, U.S. Census Bureau, Foreign Trade Statistics Total Export and Total Import Data: IMF

As far as the consumer marker for U.S. products is concerned, Viet Nam represents a negligible outlet for the United States. Of the total U.S.–VN trade value of $5,879.3 million, U.S. exports to Viet Nam was only $1,324.44 million, or 22.5 percent of the total. In other word, the Vietnamese market contributed about $3.2 to the total U.S. merchandise trade deficit. Here, last year the Vietnamese market absorbed $921.54 million worth of U.S. sales in machinery and transport equipment, representing nearly 70 percent of U.S. exports to Viet Nam (Table 2). The bulk of this U.S. exports to Viet Nam was civilian aircraft ($707,710 million). The other items in this group were materials handling equipment, industrial machines, and measuring/testing/control equipment ($42.5 million).

Next in order of importance in 2003 was chemicals and related products (SITC 5), which valued at $108.73 and accounted for 8.2 percent of U.S. exports to Viet Nam in 2003. The third largest Vietnamese purchase of American goods fell in the broad group of crude and inedible materials except fuels (SITC 2). Viet Nam bought about $91 millions worth of products in this group, with a share of nearly 7 percent of total Vietnamese purchases from the United States in 2003.

CONCLUDING THOUGHTS

Given the dominant position of the United States in the global economy, chances are that bilateral U.S.–VN commercial will in the long run have the effect of changing the institutions and the modal of operation of the smaller country, Viet Nam. Until such a substantial change occurs, perhaps it is fair to predict that while trade relations will continue to expand, the Vietnamese market will not be a major focus of American foreign investment. Based upon the investment potential assessment model developed here, China will continue to be a more attractive alternative for U.S. multinational enterprises. From the Vietnamese perspective, the colossal economy to the North, namely China, will represent the main rival for Viet Nam in attracting U.S. capital and know-how.

On the other hand, like China, Viet Nam's future membership in the WTO will mean that that nation has to open its economy even more for foreign business. Hence, with that membership development, which probably will not take much longer to happen, the business environment in Viet Nam will become more conducive to American ventures. At that point, the Vietnamese market, because of its untapped resources, will have a chance of become an attractive alternative vis-à-vis the Chinese market.

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EURO CURRENCY ADOPTION AND ITS EFFECT ON SMALL BUSINESS

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ABSTRACT

The official christening of the new Euro came and went much like the Y2K phenomenon. A great deal of anxiety and fear of the unknown and untested proved to be unnecessary. While there were a few mishaps, overall, introduction of the now second most common currency in the world went off quite smoothly. This can be attributed to the well designed and implemented logistical operation that permitted Europe the opportunity to join under peaceful conditions.
The currency exchange directly impacted over 300 million people in the European community of adopting nations of Germany, France, Italy, Ireland, Greece, Austria, Belgium, Luxemburg, Netherlands, Spain, Portugal and Finland. This European Union (EU) of countries accounts for approximately 4.3 trillion dollars in gross domestic product. The printing and coining operation produced over 14.5 billion notes and 56 billion coins to distribute. The magnitude of the operation seems almost impossible considering the depth and breadth of areas affected by cash transactions. 3.5 million vending machines had to be converted to accept the coins and over 200,000 automated teller machines were fitted to dispense the new notes. Even the obvious challenges of transportation and security of the $315 billion dollars worth of Euros created an ancillary welcome boon to armored car and security services.

This paper will focus on the introduction of the Euro and its effects on small to medium enterprises (SME) within the Euro zone. In 1993, SMEs accounted for 99.9% of the 17 million businesses in the EC with 93.3% of businesses classified as micro- less than 10 employees. SMEs employ some 68 million people, or 72% of the private sector workforce (Mulhern, 1995). Clearly any impact on SMEs is a significant impact on the economy.

The European Union's conversion to the Single European Market (SEM) and the adoption of the euro as the single currency has significantly impacted people and companies worldwide. This paper discusses the background of the SEM and the macroeconomic issues resulting from implementation of common currency, the euro. This paper will focus specifically on the effect of this conversion to the Eurozone on small business. The strategic advantages and fiscal disadvantages of the single currency on small businesses in the Eurozone will be discussed.

EFFECTS OF EXCHANGE RATE MISALIGNMENT AND VOLATILITY ON PRICE LEVELS AND INTERNATIONAL TRADE FLOWS: EVIDENCE FROM T G-7 COUNTRIES

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ABSTRACT

This study examines the effects of misalignment and volatility of exchange rates on prices, exports and imports of the G-7 countries by using co-integration and causality tests. No long-run relationship was found between exchange rates and the variables examined --except between the exchange rates and exports of Germany. However, results of causality tests showed causal relationships between exchange rates and prices in six countries, between exchange rates and exports in six countries, and between exchange rates and imports in four countries. Lack of support by the tests for long-run relationships can be attributed to hedging mechanisms and to the adaptability of multinational corporations to changes, while unexpected exchange rate changes during the period under examination account for the short-run effects.

INTRODUCTION

Since the breakdown of the Bretton Woods System, the theory of exchange rates has evolved quite rapidly. The evolution of the international monetary system into a regime of generalized floating exchange rates has led to new developments in the theory and empirical analysis of exchange rates. In particular, the continuous appreciation of the U.S. dollar against major currencies in the 1980s generated more research and discussions on the causes and effects of this appreciation. Most economists agreed that exchange rates were more volatile than anticipated.

Although many studies attempted to explain exchange rate volatility see for example, Goldstein (1980), Frenkel and Mussa (1980), Bergstrand (1983), Crockett (1984), Branson (1985), and Frenkel and Goldstein (1988)], very little effort has been devoted to explain its effects.

In the 1970s, most of the theoretical and empirical studies of exchange rates compared the effects of fixed and generalized floating exchange rate systems. The studies comparing the fixed and floating exchange rate periods have found that effects of exchange rate changes on trade prices and volumes were more obvious in the latter period in which exchange rates were more volatile [see Wilson and Tacaks (1979), Artus and Young (1979), Warner Kreinin (1983), and Di Liberto (1985)]. However, in the 1980s, with the influence of the substantial U.S. trade deficit and continuous appreciation of the dollar, economists tended to focus on the causes of this trade deficit and on whether exchange rates affect the prices of trade goods and consequently trade flows. In general, most studies have found evidence that exchange rate changes, more or less, affect the prices

and volume of trade [see, for example, Hooper and Kohlhagen (1978), Cushman (1983), Feinberg (1989), Mann (1989), and Deyak et al. (1990)].

Exchange rate volatility is important to policy-makers since it affects international trade prices and flows. Moreover, in order to deal with the negative effects of exchange rate volatility, policymakers of industrial countries often meet to seek solutions, underscoring the importance of exchange rate volatility in macroeconomic policy coordination.

Thus, the objective of this paper is to examine the effects of exchange rate misalignment and volatility on prices and international trade flows rather than the causes. As geographical boundaries among countries begin to disappear, many regional economic cooperatives are being established. Europe, for example, is becoming a single market. Moreover, exchange rate volatility is becoming more important than ever, as measures to provide stability of exchange rates such as currency and trade zones are discussed and proposed [Frenkel and Goldstein, (1986)].

In light of these developments, this study uses data from the G-7 countries, namely, the U.S., the U.K., Germany, Japan, France, Canada, and Italy. These countries control a considerable share of world trade volume. Since many prior studies have examined the detection of misalignment and volatility, this paper will not focus on these matters [see, for example, Branson (1988), Bean (1988), Loopesko and Johnson (1988), Crockett (1984), Frenkel and Goldstein (1981)].

The remaining part of the paper is organized as follows. Section II describes the methodology and data. Empirical results are contained in section III. In the last section the paper is concluded.

METHODOLOGY AND DATA

Much more research has been conducted on exchange rate volatility, in addition to the studies mentioned above. Most of these studies, however, have used either simple regression models or autoregressive correction models. The models using autoregressive correction are commonly used in literature. However, even though we get favorable results from our regression estimates, we can not rely on these results, since most time series are stationary in levels or levels of logarithms.

The methodology to be used in this paper differs from previous studies on the effects of exchange rates on prices and trade flows. The analysis will proceed in three steps. First, coefficients are estimated using the AR (1) model to account for first-order serial correlation of residuals. After the identification process of the series, the AR (1) process is appropriate since autocorrelation functions of most of the series die off smoothly at a geometric rate, and the partial autocorrelations are zero after one lag. Second, co-integration tests are used to investigate the long-run effects of exchange rate changes. The last procedure involves using the Granger causality tests to examine the short-run effects of exchange rate changes.

Regression Model

Changes in price level for country A are estimated as follows:

$$\log CPI_A = \alpha\alpha\alpha + \beta \log FX_A \qquad (1)$$

WHERE CPI_A is Consumer Price Index for country A, and FX_A us U.S. dollar per country A currency.

Changes in exports and imports for country A are estimated as follows:

$$\log EXP_A = \alpha + \beta \log FX_A \quad (2)$$
$$\log IMP_A = \alpha + \beta \log FX_A \quad (3)$$

where EXP_A is export of country A in U.S. dollar, and IMP_A is import of country A in U.S. dollar.

Co-integration Test

Data are first tested to determine the degree of differencing required to obtain stationarity. In the case of non-stationarity, variables have infinite variances, and statistical inference techniques are inapplicable. However, some of these series may be stationary after differencing or detrending. The unit root test which was developed by Dickey and Fuller (1981) is used to test for stationarity. The following co-integrating regression was run:

$$X_t = \alpha + \beta Y_t + \varepsilon_t \quad (4)$$

After obtaining the co-integrating vector from this regression, residuals are tested for stationarity by using the augmented Dickey-Fuller test. For this test, the following regression was run:

$$\Delta\mu_t = \phi_0\mu_{t-1} + \Sigma \ \phi_1\Delta\mu_{t-j} \ \varepsilon_t \quad (5)$$

where μ_t denotes the residuals from equation (4) and $\Delta\mu_t$ their first differences.

Granger-Causality Test

Existence and direction of causality was tested by performing the Granger causality test.

Data

Data used in this paper are quarterly figures for the G-7 countries, including foreign exchange rates, consumer price indices, exports, and imports. The sample period goes from 1984.1 to 2002.4. Data are obtained from International Financial Statistics of IMF; however, the dollar values of exports and imports for six countries have been calculated by multiplying exchange rates of countries with the domestic currency value of their exports and imports. For CPIs of all the countries, the base year is 1990. Exchange rates for six countries -except the U.S. are defined as U.S. dollar per unit of domestic currency, for the dollar exchange rate, however, the weighted average exchange value of the U.S. dollar taken from Citibase were used.

EMPIRICAL RESULTS

(All Tables referred to herein are available from the authors)

Empirical results are presented in three steps as in the methodology section.

Regression Results

Initially, coefficients are estimated by first-order autoregressive regression. The results are reported in Table 1.

In interpreting these results, it must first be noted that foreign exchange rates -except that of the U.S. - are defined as U.S. dollar per domestic currency. This definition is used partly because

of data availability, and partly to provide homogeneity for the variables. The results must be interpreted accordingly; that is, the signs of the coefficients are the opposites of theoretically accepted ones. Thus, changes in exchange rates affect prices in all the countries positively, but the coefficients are less than 0.10. Exchange rate changes affect exports and imports negatively by unity (more or less) in all countries studies except Japan, with coefficients of -0.64 and -0.58 for export and import, consecutively, and the U.S., with -0.23 and 0.04 (indicating a positive effect) for exports and imports, consecutively. It can thus be concluded that Japanese and U.S. trade are least affected by exchange rate changes and that the effect is positive for U.S. imports, --unlike in the other countries. However, one has to keep in mind that t-statistics for U.S. exports and imports are not significant.

Co-integration Test Results

Although the regression results are favorable, they may not be reliable since time series usually includes unit root; that is, they are non-stationary. The Engle-Granger co-integration test was employed in order to see relationships between exchange rates and prices, exports, and imports of all the countries. First of all, the Augmented Dickey-Fuller (ADF) test was employed. According to the test results, all of the series have a unit root at the 5% level (Table 2a).

However, after taking first differences, all the series became stationary; that is, they were integrated of order 1 (Table 2b).

ADF tests for prices of four out of seven countries were significant at the 5% level, while other ADF tests were significant at the 1% level.

Co-integration test results are reported in Table 3.
As this table shows, only changes in exchange rate and in exports for Germany are co-integrated. It follows that there is no long-run relationship between changes in exchange rates and prices, exports, and imports for the G-7 countries, except German exports.

Granger Causality Test Results

Prior to applying a Granger causality test, the appropriate lag order should be determined. For this purpose, some parameterization schemes such as "Hannan-Quin", "Akaike Information Criterion", and "Schwartz Criterion" can be used. However, these criteria may give us biased or inefficient estimates as well. For a discussion on biasedness and inefficiency of different criteria, see Thornton and Batten (1985). They show that different criterion gives different appropriate lag lengths.

In this study, 1,2,3,4,8, and 12 lags have been used instead of one of the above-mentioned parameterization schemes in order to see the different effects of different lags and not to restrict ourselves with a single lag length chosen by one of the criteria. The results of causality tests are reported in Table 4.

In the six countries, except Canada, a causal relationship from changes in exchange rates to prices has been found. However, lag structure differed from country to country. While France, Germany, Italy, and Japan have significant lags from 2 to 12 (that is three years), the U.K. (with 1 lag) and the U.S. (with 1 through 4 lags) have shorter lagged effects. Causality becomes bi-

directional for France and Germany after 12 lags (that is, three years). For Canada, no evidence has been found to support causality in any direction.

For causal relationship from changes in exchange rates to exports, significant results for six countries (Canada with 4; France with 2,3,4, and 8; Germany with 3,8, and 12; Japan with 8; U.K. 2,3,4, and 8, and U.S. with 1,2,3,4,8, and 12 lags) have been recorded. The striking thing here is that, in the U.S., exchange rate changes affect exports in every lagged period, while other countries have a shorter-term effect. Causality from export to exchange rates is recorded for Germany and Italy only after 12 lagged periods (that is, three years) and for the U.K. after 8 and 12 lagged periods (that is, two and three years). For Italy, causality was only from exports to exchange rates only after 12 lags (that is, three years).

Causality from exchange rates to imports has been found for Canada with 4, France with 3,4, and 8, Japan with 1,2,3,4,8, and 12, and U.K. with 8 and 12 lags. Causality was from imports to exchange rates, as it was in exports, for Italy. Suprisingly, there was no causal relationship between imports and exchange rates at all for Germany and the U.S.

The most striking result of causality tests is that exports of the U.S. and imports of Japan were most affected (from one quarter to a period of three years) by exchange rates, and that prices in the U.K. were affected only by one-quarter-lagged exchange rates.

CONCLUSION

In this paper, effects of misalignment and volatility of exchange rates on prices, exports, and imports have been examined by using co-integration and causality tests. According to the test results, no long-run relationship is found (except between the exports and the exchange rates of Germany). However, in the short run, it is noticed that exchange rate changes affect prices in France, Germany, Italy, Japan, the U.K., and the U.S.; that they affect exports in Canada, France, Germany, Japan, the U.K., and the U.S.; and that they affect imports in Canada, France, Japan, and the U.K.. Finding no evidence that supports long-run relationships between the variables are attributable to two major factors: availability and utilization of hedging mechanisms against exchange rate risk and adaptability of multinational corporations to changes. On the other hand short-run exchange rate effects on these variables are due to unexpected exchange rate changes during the period under examination [Frenkel and Goldstein (1988)].

Another striking result is that U.S. exports and Japanese imports are found to be the most sensitive ones to exchange rate changes. However, while interpreting the results, one must keep in mind that, the existence of misalignment and volatility are not tested in this paper; rather, their effects on prices and trade flows were the primary focus of the investigation, while holding other variables such as real income and relative trade prices constant.

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Authors' Index

Antoniou, P.H 1
Ashorn, L 41
Bradley, D.B 43
Brittingham, R.L 3
Carey, C 57
Castro, J 9
Chisholm, D 15
Entenza, R 41
Fok, L 45
Goss, Y 11
Gunal, M 67
Heino, H 13
Herman, M 15
Hood, F.E 19, 25
Hynes, G.E 11
Kamery, R.H 3, 19, 25
Kohers, G 31
Kohers, T 31
Kwong, K 45
Leavell, H 15, 65
Levitt, C 45
Levitt, C.E 1
Maniam, B 9, 41
Miller, G.A 33
Nazemzadeh, A 47
Ngassam, C 67
Park, D.J 1
Pitts, S.T 3, 19, 25
Prien, K.O 25
Solomon, O.G 47
Trawick, M.W 57
Urban, B 43
Vo, H.X 59
Wyrick, B 65