A New World Economic Order

Second Biennial Conference
Hong Kong Economic Association

Date: December 16-17, 2002

**Venue: Hong Kong Baptist University
Kowloon Tong, Kowloon, Hong Kong**

"A New World Economic Order"

Second Biennial Conference
Hong Kong Economic Association

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A New World Economic Order

Second Biennial Conference
Hong Kong Economic Association

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Lingnan University (LU)
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Date: 16-17 December 2002
Venue: Hong Kong Baptist University
Kowloon Tong, Kowloon, Hong Kong

Programme

16 December 2002

Morning

8:30   **Registration Desk Opens**
(Main Entrance to Lam Woo International Conference Centre)

9:00-11:10   (Lecture Theatre: WLB203)
Welcome Address: Professor NG Ching-fai
(President and Vice-Chancellor, HKBU)

Presidential Address: HO Lok Sang (LU)

Opening Plenary Session: (Lecture Theatre: WLB 203)
Money and Monetary Policy in the 21st Century (sponsored by Hong Kong Institute for Monetary Research)

Keynote Speeches:

1. "Improving the Performance of Money in an Electronic Age", Robert SHILLER (Yale University)

2. "Monetary Policy Analysis for Economies with Little or No Money", Bennett T. McCALLUM (Carnegie Mellon University)

11:10-11:30   **Tea break** (Outside Conference Reception Area)

11:30-1:00   **Parallel Sessions:**

Session A: (Lecture Theatre: WLB 310)
The Chinese Economy One Year After the WTO Accession (中國「入世」一周年的回顧與前瞻) (Session in Chinese, sponsored by the EPSON Foundation)

Chaired by Priscilla LAU (PolyU)
主席：劉佩瓊 (香港理工大學)

1．"入世後中國經濟形勢的變化"，李曉西教授（北京師範大學經濟與資源研究所所長）

2．"入世後跨國資本進入中國遇到的問題分析"，文宗瑜博士（中國國務院財政部科研所）

3．"入世後中國外商投資區位變化及中西部吸引外資前景"，魏后凱博士（中國社會科學院西部發展研究中心主任兼工業經濟研究所區域室主任）

4. "入世後技術性貿易壁壘對中國出口的挑戰及其發展趨勢", 夏友富教授 (對外經濟貿易大學技術性措施研究中心理事長)

5. "FDI 在中國經濟中的作用", 汪同三教授 (中國社會科學院數量經濟與技術經濟研究所所長)

評論員: 馬躍 (香港嶺南大學)

Session B: (Lecture Theatre: WLB 308)

Chaired by Changqi WU (HKUST)

1. "Social Restratification and Corruption in Economic Transition", DU, Julan (CUHK)

2. "Ownership Structure and the Effect of IPO in China", Tim-tian ZHU (HKUST)

3. "Protectionism and Regional Specialization: Evidence from China's Industries," Chongen BAI, Yingjuan DU, Zhigang TAO, and Sarah TONG (HKU)

4. "Asset Specificity and Performance of International Joint Ventures in China", Changqi WU (HKUST and Peking University)

Session C: (Lecture Theatre: NAB 311)
Economic Development in the Asia Pacific Region (co-organized by the Research Centre for International Economics & APEC Study Centre of CityU)

Chaired by Francis LUI (HKUST)

1. "Some Unorthodox Thoughts on China's Unorthodox Financial Sector", Wing Thye WOO (UC-Davis)

Discussant: Erh-Cheng HWA (Hsin Hsin University)

2. "The Marketization of Voting Rights as A Mean of Corporate Governance Reform in China's Publicly Listed Companies", On-Kit TAM (Monash University) & Mu LING (Tsinghua University)

Discussant: Lixin HUANG (CityU)

3. "Deflation and its Challenge to Monetary Policy in East Asia", Ben FUNG, Guonan MA & Bob McCAULEY (Bank of International Settlement, Hong Kong)

Discussant: Kit-ming Isabel YAN (CityU)

4. "Productivities and Competitiveness of Hong Kong Industries in 1980-2000", LI Kui-wai (CityU)

Discussant: Francis LUI (HKUST)

Afternoon

1:00-2:00   **Lunch** (University Restaurant)

2:00-3:30   **Parallel Sessions:**

Session D: (Lecture Theatre: NAB 311)
Industrial Organization, Regulation and Consumer Protection (organized by Centre for Applied Economics, University of South Australia & Australia Economic Papers)

Chaired by David ROUND (University of South Australia)

1. "Consumer Protection in an Open Economy", Rhonda SMITH (University of Melbourne) & David ROUND (University of South Australia)

2. "Competition, Public Finance and Utility Industry Restructuring", Jean-Francois WEN and Lasheng YUAN (University of Calgary)
.
3. "Hierarchy Design with Flattened Resource Allocations", Eric Siu-wen CHOU (CUHK)

Session E: (Lecture Theatre: WLB 310)
International Trade (co-organized by the Research Centre for International Economics & APEC Study Centre of CityU)

Chaired by Eden YU (CityU)

1. "The Causes and Cures of Japan's Recession", Charles Yuji HORIOKA (Osaka University)

Discussant: Wing-Thye WOO (UC-Davis)

2. "International Protection of Intellectual Property Rights", Gene GROSSMAN (Princeton University) & Edwin LAI (CityU)

Discussant: Koon Lam SHEA (HKU)

3. "China: On the Strategic Role of Services", Erh-Cheng HWA (Hsin Hsin University)

Discussant: SUNG Yun-wing (CUHK)

4. "The Gain and Loss in Export Advantage Among World Regions", LI Kui-wai (CityU)

Discussant: Larry QIU (HKUST)

Session F: (Lecture Theatre: WLB 308)
Labour/Family Economics I (organized by LU)

Chaired by WEI Xiangdong (LU)

1. "Free Agent and Talent Allocation", LIU Haoming (National University of Singapore)

2. "Addition through Depletion: The Brain Drain as a Catalyst of Human Capital Formation and Economic Betterment", Simon FAN (LU)

3. "The Implicit Market for Family-Friendly Work Practices", WEI Xiangdong (LU)

3:30-4:00   Break

4:00-5:30   Parallel Sessions:

Session G: (Lecture Theatre: WLB 310)
Financial Crises, Policy Responses and Reforms (organized by HKBU)

Chaired by TSANG Shu-ki (HKBU)

1. "Indonesia's Protracted Crisis and the Muddling Through Recovery", Soedradjad DJIWANDONO (Nanyang Technology University and University of Indonesia)

2. "Why Is Currency Attack/Peg Prolonged", CHAN Chi-Shing (JCTW Consultancy), SIN Chor-yiu (HKBU) & CHENG Yuk-shing (HKBU)

3. "Sluggish Adjustment and Vulnerability to Changes in Confidence: A Mesoeconomic Perspective on the Effects of a Financial Crisis", NG Yew-Kwang (Monash University and National University of Singapore) & WU Ying (Salisbury University)

4. "How a Currency Board Fixes the Exchange Rate in a Crisis", MA Yue (LU) & TSANG Shu-ki (HKBU)

Session H: (Lecture Theatre: NAB 311)
Outstanding Issues in Economic Analysis (organized by CEANA)

Chaired by LI Kui-wai (CityU)

1. "Do the Economies of Specialization Justify the Work Ethics? An Examination of Buchanan's Hypothesis", NG Siang & NG Yew-kwang (Monash University & National University of Singapore)

2. "APEC Economic Openness and Growth Before and After the Asian Financial Crisis", WU Yanrui (University of Western Australia)

3. "Incentives and Efficiency under Uncertainty", Harrison CHENG (University of Southern California)

4. "The Effects of China's Exchange Rate on Exchange Rates in the Rest of Asia: 1984-2000", Jonathan E. Leightner (Augusta State University)

Session I: (Lecture Theatre: WLB 308)
Industrial Organization (organized by LU)

Chaired by LIN Ping (LU)

1. "Vertical Integration, Exclusive Contracts, and ex post Cartelization", Yongmin CHEN (University of Colorado at Boulder) and Michael RIORDAN (Columbia Unviersity)

Discussant: Yuk-fai FONG (HKUST)

2. "Product Differentiation, Asymmetric Information and International Mergers", Larry Dongxiao QIU and Wen ZHOU (HKUST)

Discussant: Stephen CHIU (HKU)

3. "Third-degree Price Discrimination, Heterogeneous Markets and Exclusion", Yong HE (Universite Pierre-Mendes and ENSGI) and Guang-Zhen SUN (Monash University)

Discussant: Ching-yi TSE (HKU)

4. "Strategic Spin-offs of Input Divisions", LIN Ping (LU)

Discussant: Zhigang TAO (HKU)

6:30-9:15   Conference Dinner
(Venue: Lippo Chiu Chow Restaurant, Lippo Centre, Queensway, Central, HK. Tel: 28454151) (Cash bar: 6:30-7:00 p.m.)

Guest speaker: The Honorable Antony LEUNG, Financial Secretary
                            Hong Kong Special Administrative Region Government

17 December

Morning

9:00-10:00 **CUHK/HKEA Sponsored Plenary Session** (Lecture Theatre: WLB 203)

Keynote Speech

"Education, Poverty and Terrorism: Is there a Causal Connection?" Alan KRUEGER (Princeton University)

Commentator: William JOHNSON (University of Virginia)

Moderator: Junsen ZHANG (CUHK)

10:00-11:10 **HKEA Plenary Session** (Lecture Theatre: WLB 203)
The Past, Present and Future of the HK Economy

Chaired by Larry CHAU (Macau Millennium College and Vice-President, HKEA)

1. "Industrial Policy and Economic Restructuring", Leonard CHENG (HKUST)

2. "Evolving Hong Kong and China Economic Relations", SUNG Yun-wing (CUHK)

3. "Fiscal Policy", TANG Shu-hung (HKBU)

4. "Housing Problems, Deflation, and What Needs To Be Done", HO Lok-sang (LU)

11:10-11:30 **Tea break** (Outside Conference Reception Area)

11:30-1:00 **Parallel Sessions:**

Session J: (Lecture Theatre: WLB 310)
Economics of Banking and Banking Reform in China (organized by HKUST)

Chaired by David LI (HKUST)

1. "Bank Operation, Bank Failure, and Bank Risk Premium", Zhixiong ZENG (CUHK)

2. "A Theory of Banking Regulation Based on the Soft Budget Constraint", Julan DU (CUHK) and David D. LI (HKUST)

3. "China Asset Management Corporations", Guonan MA (Bank for International Settlements) and Ben S. C. FUNG (Bank for International Settlements)

Discussants: Yan YU (HKUST)
                       Changqi WU (HKUST)

Session K: (Lecture Theatre: WLB 306)
Information Economics I (organized by HKU)

Chaired by Keith WONG (HKU)

1. "The Optimal Hedge Ratio and the Elasticity of Risk Aversion", Udo BROLL (University of Saarland)

2. "The Nontradability Premium of Forward Contracts", Rafael ELDOR (IDC)

3. "Financial Constraints, Investment and Capital Structure: Implications from a Multi-Period Model", Sudipto DASGUPTA (HKUST)

Session L: (Lecture Theatre: NAB 311)
Money (organized by HKU)

Chaired by YUEN Chi-wa (HKU)

1. "Private Money, Bank operations, and Government Regulation", LI Yiting (National Taiwan University)

Discussant: Brett Norwood (HKU)

2. "A Theory of Money with Market Places", Akihiko MATSUI and Takashi SHIMIZE (University of Tokyo)

Discussant: LI Yiting (National Taiwan University)

3. "Liability Dollarization and the Bank Channel", CHOI Woon Gyu (IMF) & David COOK (HKUST)

Discussant: YUEN Chi-wa (HKU)

Session M: (Lecture Theatre: WLB 308)
Labour/Family Economics II (organized by CUHK)

Chaired by ZHANG Junsen (CUHK)

1. "Strikes, Scabs and Tire Separations: Labor Strife and the Production of Defective Bridgestone/Firestone Tires", Alan KRUEGER (Princeton Univ.)

2. "Grade Inflation", Wing SUEN (HKU)

3. "Are Public Subsidies to Higher Education Regressive", William R. Johnson (Univ. of Virginia)

4. "Testing the External Effect of Household Behavior: The Case of the Demand for Children", Junsen ZHANG (CUHK)

Afternoon

1:00-2:00   **Lunch** (University Restaurant)

2:00-3:30   **Parallel Sessions:**

Session N: (Lecture Theatre: WLB 306)
Financial Reform in China (organized by HKU)

Chaired by Frank SONG (HKU)

1. "Economic Analysis of China Securities Regulatory System", by HU Ruyin (Shanghai Stock Exchange)

Discussant: Geng XIAO (SFE)

2. "Some Theoretical Issues in China's Security Market", by MA Junlu, (Nankai University)

Discussant: Geng XIAO (SFE)

3. "Financial Liberalization in China's Banking Sector", by HAN Jinglun, (Nankai University)

Discussant: Jack ZHANG (HKU)

4. "Income Inequality between China's Unbran and Rural Residents", by HUANG Zuhui (Zheijing University)

Discussant: Jack ZHANG (HKU)

Session O: (Lecture Theatre: WLB 310)
Information Economics II (organized by HKEA)

Chaired by: WONG Wing-keung (National University of Singapore)

1. "Production Flexibility and Hedging", Keith WONG (HKU)

2. "Information Revealed by Prices in Competitive Stock Market", Wa-ka CHEUNG (Zhongshan University)

3. "On Two-Moment Decision Models and Expected Utility Maximization", WONG Wing-keung (National University of Singapore)

4. "Cross-listing and Firm Value: What Can Explain the Cross-listing Premium? Evidence from Japan", Ting YANG (Nanyang Technological University, Singapore)

Session P: (Lecture Theatre: WLB 308)
Exchange Rates and Banking in China (organized by LU)

Chaired by MA Yue

1. "China's Foreign Exchange Policies since 1979: A Review of Developments and An Assessment", LIN Gui-Jun (University of International Business and Economics, Beijing)

Discussant: MA Guonan (BIS)

2. "Rising Foreign Currency Liquidity of Banks in China", MA Guonan (BIS)

Discussant: LIN Gui-Jun (University of International Business and Economics, Beijing)

3. "The Impact of External Balance on Money Supply and Inflation in China", Yue MA (LU), Y. Y. KUEH (LU), Shu Ki TSANG (HKBU)

Session Q: (Lecture Theatre: NAB 311)
Economic Growth (organized by LU)

Chaired by Simon FAN (LU)

1. "Taxes and Economic Growth", Herakles POLEMARCHAKIS (Brown University)

2. "Intergenerational Mobility with Constraints", Eric HANUSHEK (Stanford University), Charles LEUNG (CUHK) and Kuzey YILMAZ (Koc University)

3. "Allocation of Tax Revenue and Growth Effects of Taxation", Jinli ZENG (National University of Singapore)

4. "Government Consumption and Economic Growth: An Integration Analysis", Pak Hung MO (HKBU)

3:30-4:00   Break

9

4:00-5:30   **Parallel Sessions:**

Session R: (Lecture Theatre: NAB 311)
Issues of Globalization (organized by HKEA)

Chaired by HO Lok-sang (President, HKEA)

1. "Basel Accord and Macroeconomic Activity", CHEN John-ren (University of Innsbruck, SOWI)

2. "A WCU-based Currency Board System", Lok-sang Ho (LU)

3. "WTO's Prudential Carve-out and China's Finance Opening and Supervision", LI Shenglan (Zhongshan University)

Session S: (Lecture Theatre: WLB 306)
Issues facing Asian Developing Countries (sponsored by ADB)

Chaired by Jeffery Liang , ADB (to be confirmed.)

1. Syed Zahid ALI (Lahore University of Management Sciences, Pakistan)

2. Eatzaz AHMAD (Quaid-I-Azam University, Pakistan)

3. "Sustainability of SME for Sustainable Development", Somchai HARNHIRUN (Office of Industrial Economics, Ministry of Industry, Thailand)

4. Michael LEIGH (Universiti Maylais Sarawak, Malaysia)

Session T: (Lecture Theatre: WLB 308)
Exchange Rate Systems (organized by LU)

Chaired by Jimmy RAN (LU)

1. "The Effects of China's Exchange Rate on Exchange Rates in the Rest of Asia: 1984-2000", Jonathan E. LEIGHTNER (Augusta State University, US)

2. "Shocks to Real Exchange Rate Under Floating Exchange Rate Regime in Thailand: Estimation From VAR Approach, Komain Jiranyakul", (National Institute of Development Administration, Bangkok) and Tantatape BRAHMASRENE (Purdue University-North Central, US)

3. "The Exchange Rate Determination in China: 1984-2001", Mustafa Mohamed ABDALLA (Peoples' University of China, Beijing)

4. "Exchange Rate Effects on the Transmitted Unemployment", Jimmy RAN (LU) and Cindy CHEN (University of Iowa)

Session U: (Lecture Theatre: WLB 310)
Macroeconomics of Labor and Capital Markets (organized by HKU & CUHK)

Chaired by Charles LEUNG (CUHK)

1. "Public Enterprises and Labor Market Performance", Rachel NGAI (LSE), Johannes HORNER (Northwestern University) and Claudia OLIVERTII (Boston University)

Discussant: Chung Yi TSE (HKU)

2. "Asset Pricing in an Environment with a Credit Constraint Sector", Claudian KWOK (CityU)

Discussant: Zhixiong ZENG (CUHK)

3. "Public Capital, Asymmetric Information and Economic Growth", Patrick Wai-hong HO (University of Macau) and Yong WANG (CUHK)

Discussant: Charles LEUNG

4. "Land Price Cycles", Charles LEUNG (CUHK)

Discussant: Rachel NGAI

A New World Economic Order

Second Biennial Conference
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Paper Abstracts

Abstracts

16 December 2002

Morning

11:30-1:00

Session A: The Chinese Economy One Year After the WTO Accession (中國「入世」一周年的回顧與前瞻) (Session in Chinese, sponsored by the Epson Foundation)

1．"入世後中國經濟形勢的變化"，李曉西教授（北京師範大學經濟與資源研究所所長）

2．"入世後跨國資本進入中國遇到的問題分析"，文宗瑜博士（中國國務院財政部科研所）

3．"入世後中國外商投資區位變化及中西部吸引外資前景"，魏后凱博士（中國社會科學院西部發展研究中心主任兼工業經濟研究所區域室主任）

4．"入世後技術性貿易壁壘對中國出口的挑戰及其發展趨勢"，夏友富教授（對外經濟貿易大學技術性措施研究中心理事長）

5．"FDI 在中國經濟中的作用"，汪同三教授 (中國社會科學院數量經濟與技術經濟研究所所長)

Session B:

1.   "Social Restratification and Corruption in Economic Transition", DU Julan (CUHK)

2.   "Ownership Structure and the Effect of IPO in China", Tim-tian ZHU (HKUST)

3.   "Protectionism and Regional Specialization: Evidence from China's Industries", Chongen BAI, Yingjuan DU, Zhigang TAO, and Sarah TONG (HKU)

4   "Asset Specificity and Performance of International Joint Ventures in China", Changqi WU (HKUST and Peking University)

Session C: Economic Development in the Asia Pacific Region (co-organized by the Research Centre for International Economics & APEC Study Centre of CityU)

1.   "Some Unorthodox Thoughts on China's Unorthodox Financial Sector", Wing Thye WOO (UC-Davis)

2.   "The Marketization of Voting Rights as A Mean of Corporate Governance Reform in China's Publicly Listed Companies", On-Kit TAM (Monash University) & Mu LING (Tsinghua University)

3. "Deflation and its Challenge to Monetary Policy in East Asia", Ben FUNG, Guonan MA & Bob McCauley (Bank of International Settlement, Hong Kong)

4. "Productivities and Competitiveness of Hong Kong Industries in 1980-2000", LI Kui-wai (CityU)

Afternoon

2:00-3:30

Session D: Industrial Organization, Regulation and Consumer Protection (organized by Centre for Applied Economics, University of South Australia & Australia Economic Papers)

1. "Consumer Protection in an Open Economy", Rhonda SMITH (University of Melbourne) & David ROUND (University of South Australia)

   The consequences of market failure in the form of information asymmetries create a heavy burden for consumers. The principle of 'caveat emptor' will in the absence of consumer protection legislation lead to significant consumer detriment, especially in developing economies. Many countries in East Asia have now recognised the need to introduce a systematic program of consumer protection, but just as they are beginning to get comfortable with such a regulatory regime, a major new consumer protection problem has arisen – the twin phenomena of emerging global markets and electronic commerce. National policies are not likely to cope successfully with these issues, which will usually arise offshore. New approaches to these problems need to be found. Questions of jurisdiction arise. Regional and international co-ordination and co-operation will be needed, in areas where little such interaction has previously occurred. Incentive structures, codes and quality assurance programs, and effective penalty mechanisms that cannot be subverted need to be developed. Consumer education programs are essential. Capacity building and convergence on these issues deserves the highest possible policy attention.

2. "Competition, Public Finance and Utility Industry Restructuring", Jean-Francois WEN and Lasheng YUAN (University of Calgary)

   This article examines the timing, objectives and impacts of privatization and deregulation of the electricity industry. We argue that the increase in dead weight loss of public fund motivates the restructuring of electricity industry in many Western countries such as UK, US and Canada. Even though the objective of governments might be the social surplus maximization, the governments can explore the nature of the vertical structure of power generation, transmission and distribution in the electricity industry and make of the post-restructuring industry appear to be competitive. The scheme requires the optimal design of divestiture of power generation and distribution and continued regulation of transmission. After restructuring, the industry appears competitive; the government receives substantial proceed to pay down public debt; however, the electricity price goes up.

3. "Hierarchy Design with Flattened Resource Allocations", Eric Siu-wen CHOU (CUHK)

This paper compares the efficiency of flat and tall hierarchies from the perspective of flattened resource allocations (henceforth FRA) – a recently documented problem of multi-segment firm where high-profit segments tend to be underinvested and low-profit segment tend to be overinvested. We characterize FRA with the possibility of divisionalization – grouping elementary business segments into a fewer number of divisions and transforming flat hierarchies to tall hierarchies. The inefficiency of FRA is shown to be decreasing in management ownership. Most importantly, FRA will be aggravated by the divisionalization, implying tall hierarchies are necessarily less efficient than flat hierarchies. This result suggests that U-form (undivisionalized) organizations, represented by flat hierarchies, can actually outperform M-form (divisionalized) organizations, represented by tall hierarchies, in resource allocations – a result opposite to Williamson's "M-form hypothesis."

Session E: International Trade (co-organized by the Research Centre for International Economics & APEC Study Centre of CityU)

1. "The Causes and Cures of Japan's Recession", Charles Yuji HORIOKA (Osaka University)

2. "International Protection of Intellectual Property Rights", Gene Grossman (Princeton Univgersity) & Edwin Lai (CityU)

3. "China: On the Strategic Role of Services", Erh-Cheng HWA (Hsin Hsin University)

4. "The Gain and Loss in Export Advantage Among World Regions", LI Kui-wai (CityU)

Session F: Labour/Family Economics I (organized by LU)

1. "Free Agent and Talent Allocation", LIU Haoming (National University of Singapore)

An important implication of the Coase Theorem on the labor market of professional athletics is that the allocation of talent players should not depend on the property right of players' services. The abolishing of the reserve clause in the American Major League Baseball at the end of 1975 has provided an ideal testing background for the Coase Theorem. The existing literature largely focused on changes in either the competitiveness or the mobility of players before and after the introduction of the free agent scheme. Their findings are mixed. Because players can only become free agents after six years of service, and more than half of the players in the MLB have less than six years of experience, the impact of the introduction of free agent on competitiveness or the mobility of all players is likely to be downward biased. In this paper, we propose to examine the allocation of the players directly. Our preliminary results support the implication of the Coase Theorem.

2. "Addition through Depletion: The Brain Drain as a Catalyst of Human Capital Formation and Economic Betterment", Simon FAN (LU)

Enabling educated individuals to work abroad entails a brain drain and results in educated unemployment at home. Because the prospect of migration raises the

expected returns to higher education it also facilitates a "brain gain:" a developing economy ends up with a higher fraction of educated individuals. Due to the positive externality effect of the prevailing, economy-wide endowment of human capital on the formation of human capital, a relaxation of migration policy pursued in both the current period and the preceding period can greatly facilitate the "take-off" of a developing economy in the current period. Thus we identify a new policy tool that could yield an improvement in the well-being of the population of a developing economy: a controlled migration of educated workers.

3. "The Implicit Market for Family-Friendly Work Practices", WEI Xiangdong (LU)

    The observation that a worker has a family friendly job reflects both the worker's decision to search for such a job and employer's decision to provide it to that worker. Previous research estimating the determinants of family friendly work practices has been severely limited by the inability to distinguish between these two decisions. Using linked employer-employee data and partial observability probit models, this paper provides the first empirical identification of the determinants of these two decisions. In addition to confirming the role of many worker and firm characteristics, the results are consistent with a theoretical model in which family friendly work practices are valuable to workers but costly to employers. Specifically, as predicted by a hedonic model of the labour market, firms providing such practices offer lower wages, all else equal.

4:00-5:30

Session G: Financial Crises, Policy Responses and Reforms (organized by HKBU)

1. "Indonesia's Protracted Crisis and the Muddling Through Recovery", Soedradjad DJIWANDONO (Nanyang Technology University and University of Indonesia)

    The Indonesian crisis raises curious question on why an economy that had a legitimate claim of starting with similar or even better macroeconomic fundamentals than other crisis countries in Asia, and initially hailed by many as providing judicious policy responses ends up becoming a basket case? Together with Thailand and Korea, Indonesia resorted to the International Monetary Fund's Stand-by Arrangements in coping with the crisis. The presentation will revisit policies to address the crisis that almost entirely rely on the Fund-supported programs. With a view to the past policies and in light of current environment an outlook for future policies is conjectured.

2. "Why Is Currency Attack/Peg Prolonged", CHAN Chi-Shing (JCTW Consultancy), SIN Chor-yiu (HKBU) & CHENG Yuk-shing (HKBU)

    Existing models of currency attacks focus on how economic fundamentals and speculators' belief determine the onset of currency attacks. In some of these models, once the attack starts, the monetary authority abandons the peg; while in others, due to the speculators' ignorance of the monetary authority's private information, the attack may happen regardless of any change in the fundamentals. However, most if not all models are silent about the duration of currency attack/peg. In this paper, we employ a variant of war of attrition and gauge the time when the speculators stop attacking (if they fail) and the time when the monetary authority de-pegs (if it concedes). Unlike many applications of war of attrition, we considered an asymmetric game, which is

more convincing in our context. We argue that the duration of currency attack/peg depends not only on the economic fundamentals such as high interest rate or costs of borrowing, but also on the two-sided private information of the potential gain on currency devaluation or exchange rate stability. We derive some comparative static results and thus draw conclusions on policy implications. In particular, we show that for a heavily indebted economy, the optimal interest rate policy depends on the level of interest cost as well as the interest sensitivity of the cost of attacking/defending the peg.

3. "Sluggish Adjustment and Vulnerability to Changes in Confidence: A Mesoeconomic Perspective on the Effects of a Financial Crisis", NG Yew-Kwang (Monash University and National University of Singapore) & WU Ying (Salisbury University)

According to simple economic analysis in the textbooks, a financial crisis should have no effect on the real economy. However, in the real world, they may have big real effects. Even optimistic commentators (the first author included) on the likely effects of the September 11 incident have to qualify their predictions with qualifications such as 'in the absence of a big collapse in confidence'. Mesoeconomic analysis (a simplified general equilibrium analysis that takes account of both the micro mechanism of profit maximization and the influence of macro variables) shows that when the assumption of perfect competition is relaxed, the real economies may be susceptible to changes in confidence and may be sluggish in adjusting back to the position of full employment.

4. "How a Currency Board Fixes the Exchange Rate in a Crisis", MA Yue (LU) & TSANG Shu-ki (HKBU)

Standard exchange rate theories that are largely macroeconomic in orientation have been criticized for yielding insufficient explanatory and forecasting power. This paper attempts to provide an alternative model of spot exchange rate determination based directly on the specifics of market activities. It looks at the behavior of two different camps in the foreign exchange market: the arbitrageurs and the speculators. The model is cast in such a framework that it is especially suitable for probing the operations of currency board arrangements (CBAs), which are heavily dependent on arbitrage efficiency in locking the spot exchange rate.

Session H: Outstanding Issues in Economic Analysis (organized by CEANA)

1. "Do the Economies of Specialization Justify the Work Ethics? An Examination of Buchanan's Hypothesis", NG Siang & NG Yew-kwang (Monash University & National University of Singapore)

Buchanan (1991, 1994) proposes an interesting hypothesis explaining the prevalence of an ethic encouraging more work. Economies of specialization mean that more division of labour may increase productivity. If everyone works more, this increases the extent of the market which enables higher degree of division of labour and hence higher productivity. Individual choice between leisure and work thus results in a sub-optimal level of work. One way to counteract this is to maintain a work ethic. This paper examines the validity and significance of this hypothesis in the Yang-Ng framework of inframarginal analysis. Buchanan's thesis probably has more relevance in ancient times when the work ethics originated but is less significant in the current

world of global trade where the billions of individuals involved is sufficient to sustain specialization without artificial encouragement of additional work effort. On the contrary, the competition for relative standing, the materialistic bias caused by our accumulation instinct and advertising, and the environmental disruption of material production and consumption suggest that the discouragement of long working week may be more conducive to welfare.

2. "APEC Economic Openness and Growth Before and After the Asian Financial Crisis", WU Yanrui (University of Western Australia)

   After five years' restructuring and reforms, most Asian economies have recovered from the 1997 financial crisis. How has the crisis affected growth and openness in APEC economies? This question has hardly been addressed in the literature. This paper proposes an econometric approach which is employed to examine the impact of openness on the sources of growth in the APEC economies. Specifically, the proposed technique decomposes economic growth into several components associated with technological progress, efficiency changes, factor inputs and the influences of openness, respectively. The findings in this study may help gain fresh insight into the relationship between openness and growth performance in the APEC economies.

3. "Incentives and Efficiency under Uncertainty", Harrison CHENG (University of Southern California)

   In an important paper by Williams and Radner (1995), it was shown that uncertainty in some strange ways can make the design of efficient incentives easier. They were not able to show general results of this nature, but illustrate with an example. The paper offers new insights into the question of whether uncertainty in production simplify or complicate the incentive designs. We make use of a no surplus condition as a basis of our theory to show that general results in incentive designs are possible under Williams and Radner (1995) framework. Holmstrom's (1983) results on the impossibility of efficient designs in partnerships, which is based mainly on models with out uncertainty, receive anew evaluation in our framework.

4. "The Effects of China's Exchange Rate on Exchange Rates in the Rest of Asia: 1984-2000", Jonathan E. Leightner (Augusta State University)

   This paper builds on Branson and Lovell (2000) and Leightner (2002) to develop a new analytical technique, named "Two-directional Reiterative Truncated Projected Least Squares" (2DRTPLSS), which produces reduced form estimations while greatly reducing the influence of omitted variables that interact with included variables. In the first simulation test of 2DRTPLS, it produced $1/10^{th}$ of the error that OLS produced. WDRTPLS is used to produce reduced form estimates of the relationship between China's exchange rate and exchange rates in the rest of Asia and to show how omitted variables have affected these relationships across countries and over time. During the Asian financial crisis, some experts expressed concern that China might devalue its currency, causing the value of other Asian currencies to free-fall. Given the large number of immeasurable variables (like international expectations) that affect exchange rates, 2DRTPLS is the best way to estimate the relationship between the exchange rates of China and the rest of Asia

Session I: Industrial Organization (organized by LU)

1. "Vertical Integration, Exclusive Contracts, and ex post Cartelization", Yongmin Chen (University of Colorado at Boulder) and Michael Riordan (Columbia Unviersity)

   This paper uncovers an unnoticed connection between exclusive contracts and vertical organization. The combination of vertical integration and exclusive contracts results in the exclusion of an equally (or even more) efficient upstream competitor and the increase of downstream prices. Neither of these practices alone achieves these anticompetitive effects. By raising the marginal costs of downstream rivals under exclusive contracts, the vertically integrated firm raises its own marginal opportunity cost as well. The ex post effect is a cartelization of the downstream industry. The analysis concerning a downstream duopoly extends to a "Spokes" model and a circle model of multiple downstream competitors.

2. "Product Differentiation, Asymmetric Information and International Mergers", Larry Dongxiao QIU and Wen ZHOU (HKUST)

   Information asymmetry creates value and incentives for firms from different countries to merge. To demonstrate this point, we develop a model of international trade under oligopolistic competition and asymmetric information, in which domestic firms are informed of the local market demands, but foreign firms are not. By emphasizing two features of a merger between a domestic firm and a foreign firm, we show that the two firms always want to share information, but output coordination is not always profitable, depending on the extent of product differentiation. We also examine how such a merger affects the non-merging firms' profits, consumer surplus, domestic welfare and global welfare. The results are crucially determined by the extent of product differentiation.

3. "Third-degree Price Discrimination, Heterogeneous Markets and Exclusion", Yong HE (Universite Pierre-Mendes and ENSGI) and Guang-Zhen SUN (Monash University)

   This short paper analyzes the effect of heterogeneity of markets in terms of income on the exclusion of markets under uniform price by considering linear demand curves in all markets. We show that more markets (and consumers) are excluded the higher are the inter-market income differences, and that adding markets, even with lower reservation prices than in existing ones, helps to decrease the price and thus make more markets served. The multiple market case turns out to be not an insignificant extension of the two-market case. We also address the welfare implications of the price discrimination and show that discrimination could be beneficial or inefficient, crucially depending on the inter-market wealth distribution.

4. "Strategic Spin-offs of Input Divisions", LIN Ping (LU)

   When a downstream producer enters backward into the input market, a "helping the rivals effect" exists: Such entry hurts the firm's downstream business as it increases upstream competition and thus reduces the input price for rival downstream firms. This negative externality prevents the newly-created upstream unit from expanding. A spin-off enables the firm to *credibly* expand in the input market, forcing the upstream competitors to behave less aggressively, a task direct entry could not accomplish.

Spin-offs occur in equilibrium if and only if the number of downstream firms exceeds a certain threshold level. If several producers can each spin off their input division, a spin-off by one firm can trigger a spin-off by another firm that would not take place otherwise. Spin-offs lower welfare by worsening the double-marginalization problem.

17 December

Morning

9:00-10:00

CUHK/HKEA Sponsored Plenary Session: Keynote Speech

"Education, Poverty and Terrorism: Is there a Causal Connection?" Alan Krueger (Princeton University)

The paper investigates whether there is a causal link between poverty or low education and participation in terrorist activities. After presenting a discussion of theoretical issues, we review evidence on the determinants of hate crimes, which are closely related to terrorism. This literature tends to find that hate crimes are independent of economic conditions. Next we analyze data on support for terrorism from public opinion polls conducted in the West Bank and Gaza Strip. These polls indicate that support for terrorism does not decrease among those with higher education and higher living standards. The core contribution of the paper is a statistical analysis of the determinants of participation in Hezbollah terrorist activities in Lebanon in the late 1980s and early 1990s. The evidence that we have assembled suggests that having a living standard above the poverty line or a secondary-school (or higher) education is *positively* associated with participation in terrorism. Evidence from cross-national comparisons is also presented. Although our results are tentative and exploratory, they suggest that neither poverty nor education have a direct, causal impact on terrorism. The conclusion speculates on why economic conditions and education are largely unrelated to participation in, and support for, terrorism.

10:00-11:10

HKEA Plenary Session: The Past, Present and Future of the HK Economy

1. "Industrial Policy and Economic Restructuring", Leonard CHENG (HKUST)

2. "Evolving Hong Kong and China Economic Relations", SUNG Yun-wing (CUHK)

3. "Fiscal Policy", TANG Shu-hung (HKBU)

4. "Housing Problems, Deflation, and What Needs To Be Done", HO Lok-sang (LU)

11:30-1:00

Session J: Economics of Banking and Banking Reform in China (organized by HKUST)

1. "Bank Operation, Bank Failure, and Bank Risk Premium", Zhixiong ZENG (CUHK)

   This paper analyzes the role of banks' operating cost in shaping the behavior of bank failure rate and bank risk premium when there is informational asymmetry between banks and depositors. In our model, returns on bank loans are subject to regional shocks which are costly to monitor. In addition, banks incur cost of operation that is

increasing and convex in the size of bank loans. In contrast to the standard result that bank failure rate only depends on the ratio between bank debt and bank asset (i.e., banks' financial leverage), we show that the size of bank loans serves as another determinant of bank failure rate. Given banks' leverage ratio, an increase in the size of bank loan reduces the probability of failure. There are two forces underlying this result. The first is that the increase in the size of loans raises the marginal cost of bank operation, and efficient cost sharing requires depositors to set a lower monitoring threshold. The second is that the increase in marginal cost raises the equilibrium return on bank loans, making bank solvency more likely. We also show that when banks are highly leveraged, the increase in the size of bank loans reduces the risk premium charged on bank deposits. Our results are consistent with the observation that bank risk premium declines during booms and following monetary expansions, at which times the size of bank loans increases.

2. "A Theory of Banking Regulation Based on the Soft Budget Constraint", Julan Du (CUHK) and David D. LI (HKUST)

Existing theories justify banking regulation as means of overcoming market failure resulting from laissez faire banking. This paper views banking regulation as a response to government failure, i.e., the failure of government to commit to no bailing out insolvent banks. Government's soft budget constraint contributes to the private bankers' moral hazard problem. Banking regulation is implemented to overcome this government failure as well as market failure. We argue that government ownership of banks and regulation of private banks are both ways to overcome the moral hazard problem associated with the government soft budget constraint syndrome, but regulation of private banks will preserve better the banking efficiency in many cases.

3. "China Asset Management Corporations", Guonan Ma (Bank for International Settlements) and Ben S. C. Fung (Bank for International Settlements)

To address the banking system's non-performing loan (NPL) problem, the Chinese government set up four asset management corporations (AMCs). They were to buy up bad debts of the big four state-owned commercial banks and dispose of them over 10 years, taking a large step towards NPL resolution. But in their first two years, these AMCs have made only a limited contribution to resolution of the NPL problem. They have taken over less than half of the NPLs at the big four banks. In addition, while AMC financing have been less than transparent, it appears to have burdened The People's Bank of China (PBoC) with greater risks to date than the Ministry of Finance (MoF), although there have not been to date any evident monetary consequences. Under plausible recovery scenarios, the AMC losses would surpass the current financial contributions to the AMCs from both the MoF and the PBoC. Since their cash recoveries have lagged their interest obligations, the AMCs face rising cash flow pressure. In response, the government is pushing for speedier asset recovery, as evident in the milestone of the first international NPL auction.

Session K: Information Economics I (organized by HKU)

1. "The Optimal Hedge Ratio and the Elasticity of Risk Aversion", Udo Broll (University of Saarland)

   In this note the mean-standard deviation approach is used to examine a well-known model of the hedging literature. This is possible because the hedging model satisfies a scale and location condition. The mean-standard deviation technique can provide more intuition for the firm's introducing the concept of elasticity of risk aversion, we describe the interaction of optimum hedge ratio and price risk.

2. "The Nontradability Premium of Forward Contracts", Rafael Eldor (IDC)

3. "Financial Constraints, Investment and Capital Structure: Implications from a Multi-Period Model", Sudipto Dasgupta (HKUST)

Session L: Money (organized by HKU)

1. "Private Money, Bank operations, and Government Regulation", LI Yiting (National Taiwan University)

   This paper studies how the functions and competition of inside money and outside money are affected by financial operations and regulations in an economy with explicit trade frictions. We find that claims on banks circulate when the redemption rate is low, and dominate fiat money in the rate of return. When the quantity of fiat money is limited, coexistence of private money and fiat money dominates in welfare term the equilibria where either one is used as the unique medium of exchange. If the quantity of fiat money is ample, banks may accept it as deposits and keep some vault cash for redeeming financial claims. Under this operation, changes in the quantity of fiat money do not affect real activity and prices. A binding reserve requirement policy eliminates neutrality of money, under which a tightening monetary policy creates a credit-rationing phenomenon. Although restrictions on note issue may harm bank's intermediation function, it may be beneficial to the public.

2. "A Theory of Money with Market Places", Akihiko Matsui and Takashi Shimizu (University of Tokyo)

   This paper considers an infinitely repeated economy in which divisible fiat money is used to trade goods. The economy has many market places. In each period, each agent makes a production decision and chooses a market place. In each market place, agents are randomly matched to form a pair, and they trade their goods when both agree to do so. There exist various classes of stationary equilibria. In some equilibria, all the agents visit the same market place, while in others, market places are specialized, i.e., at most one type of good is traded in each market place. In some equilibria, each good is traded at a single price, while in others, every good is traded at two different prices. Each class itself consists of equilibria with infinitely many price and welfare levels. However, it is shown that only the efficient single price equilibria with specialized market places are evolutionarily stable. An inefficient equilibrium is upset by the mutants who visit inactive market places to establish a more efficient trading pattern than before. An extension to the economy with multiple currencies is also examined.

3. "Liability Dollarization and the Bank Channel", CHOI Woon Gyu (IMF) & David Cook (HKUST)

Session M: Labour/Family Economics II (organized by CUHK)

1. "Strikes, Scabs and Tire Separations: Labor Strife and the Production of Defective Bridgestone/Firestone Tires", Alan Krueger (Princeton Univ.)

   This paper studies the effect of labor relations on product quality. We consider whether a long, contentious strike and the hiring of permanent replacement workers by Bridgestone/Firestone in the mid-1990s contributed to the production of an excess number of defective tires. Using several independent data sources we find that labor strife in the Decatur plant closely coincided with lower product quality. Count data regression models based on two data sets of tire failures by plant, year and age show significantly higher failure rates for tires produced in Decatur during the labor dispute than before or after the dispute, or than at other plants. Also, an analysis of internal Firestone engineering tests indicates that P235 tires from Decatur performed less well if they were manufactured during the labor dispute compared with those produced after the dispute, or compared with those from other, non-striking plants. Monthly data suggest that the production of defective tires was particularly high around the time wage concessions were demanded by Firestone in early 1994 and when large numbers of replacement workers and permanent workers worked side by side in 1996.

2. "Grade Inflation", Wing SUEN (HKU)

   When employers cannot tell whether a school truly has many good students or whether it is just giving easy grades, schools have an incentive to inflate grades to help their mediocre students. However schools also care about preserving the value of good grades for their good students. We construct a signaling model in which grade inflation is the equilibrium outcome. The inability to commit to an honest grading policy in an environment of private information reduces the informativeness of grades and hurts the school. We also show that grade inflation by one school makes it easier for another school to fool the market with grade inflation. Hence easy grades are strategic complements, and this provides a channel to make grade inflation contagious.

3. "Are Public Subsidies to Higher Education Regressive", William R. Johnson (Univ. of Virginia)

   This paper estimates the dollar amount of public higher education subsidies received by U.S. youth and examines the distribution of subsidies across parental and student income levels. I focus on intracohort rather than intercohort redistribution. Although youths from high-income families obtain more benefit from higher education spending, high-income households pay sufficiently more in taxes that the net effect of the spending and associated taxation is distributionally neutral or mildly progressive. Surprisingly, these results are consistent with Hansen and Weisbrod's earlier celebrated findings for California, although not with the conclusions they draw from those findings.

4. "Testing the External Effect of Household Behavior: The Case of the Demand for Children", Junsen ZHANG (CUHK)

This paper tests the external effect of household childbearing behavior by drawing on micro-fertility data from China. The test is executed by regressing one household's fertility on the average fertility of other households in the same community. This exercise is complicated by the endogeneity problem from three sources: simultaneity, omitted community variables and sorting by fertility preference. China's household registration and birth control policies provide a natural experiment for solving all three sources of endogeneity. First, these policies prevent households from moving for fertility reasons, thus endogenous sorting is not a problem. Second, the unique affirmative birth control policy allows us to test the external effect from the *han* Chinese to minority households by 2SLS without worrying that our IVs could be correlated with omitted community variables that in turn affect fertility. Therefore, the 2SLS method with households attributes as IVs can solve both simultaneity and omitted variable bias. We find fertility has a large external effect in general, and in particular among households who have many social interactions.

Afternoon

2:00-3:30

Session N: Financial Reform in China (organized by HKU)

1. "Economic Analysis of China Securities Regulatory System", by HU Ruyin (Shanghai Stock Exchange)

2. "Some Theoretical Issues in China's Security Market", by MA Junlu, (Nankai University)

3. "Finaicial Liberalization in China's Banking Sector", by HAN Jinglun, (Nankai University)

4. "Income Inequality between China's Unbran and Rural Residents", by HUANG Zuhui (Zheijing University)

Session O: Information Economics II (organized by HKEA)

1. "Production Flexibility and Hedging", Keith WONG (HKU)

2. "Information Revealed by Prices in Competitive Stock Market", Wa-ka Cheung (Zhongshan University)

In this paper, we construct a multi-period trading model in competitive stock market and all investors are assumed to have received some public news related to a particular stock at the beginning. With differential estimation on the return of the stock according to personal experience, an investor trades in the stock market based on his/her subjective estimation and the information revealed by the market prices, but generally the stock market may not get equilibrium in each trade. We shall prove that through a finite number of trades, the stock market gets in rational belief equilibrium (RBE) in which as if all investors know other investors' personal estimations about the

return of the stock, though in some cases investors don't know other investors' personal estimations (partial informative).

3. "On Two-Moment Decision Models and Expected Utility Maximization", WONG Wing-keung (National University of Singapore)

    Mean-variance efficient sets have been widely used in both Economics and Finance to analyze how people make their choices among risky investments. However, many authors only used quadratic utility functions and assumed normality for the distributions of the investment in the theory. Meyer (1987) extended the theory to include the comparison among distributions that differ only by location and scale parameters and to include general utility functions with only convexity or concavity restrictions. He also provided several important theorems and properties. In this paper, we make some comments on Meyer's paper and extend the results from Tobin (1958) that the indifference curve is convex upwards for any risk averter, concave downwards for any risk lover, and horizontal for any risk neutral investor to include the general conditions as stated in Meyer (1987). We also provide an alternative proof for the theorem.
    Sinn (1990) found that the sign change of the indifference curve slope depends on the speed of increase in the absolute risk aversion, while we find that the shape of the indifference curve depends only on the sign of the second order derivative of the utility function but not on the speed of increase in the absolute risk aversion.
    Levy (1989) extended Meyer's results to prove that the first- and second-degree stochastic dominance efficient sets are equal to the mean-variance efficient set under certain conditions, and he developed the inequality relationship between the support of the seed random variable and the parameters for the linear functions of the seed random variables. In this paper, we comment on Levy's findings and show that the inequality relationship in Levy's proposition does not hold in certain situations. We further explore the relationship among the first- and second-degree stochastic dominance efficient sets and the mean-variance efficient set.
    In addition, we comment on the convexity property of the utility function as stated in Meyer (1987) and provide an alternative proof for the property.

4. "Cross-listing and Firm Value: What Can Explain the Cross-listing Premium? Evidence from Japan", Ting YANG (Nanyang Technological University, Singapore)

    Using a sample of Japanese firms at the end of 1998, we document the existence of cross-listing premium: the Tobin's Q of firms that are cross-listed exceeds the Q of non-cross-listed firms by a significant 19.65% on average. We argue that this differential valuation is due to the fact that cross-listing firms have higher visibility to investors. The empirical results in this paper clearly support our argument.

Session P: Exchange Rates and Banking in China (organized by LU)

1. "China's Foreign Exchange Policies since 1979: A Review of Developments and An Assessment", LIN Gui-Jun (University of International Business and Economics, Beijing)

2. "Rising Foreign Currency Liquidity of Banks in China", MA Guonan (BIS)

3. "The Impact of External Balance on Money Supply and Inflation in China", Yue MA (LU), Y. Y. KUEH (LU), Shu Ki TSANG (HKBU)

   This paper focuses particularly on the impact of external balance on money supply and inflation in China. The main findings of the paper are that the external factors such as trade balance and exchange rate exert significant impact on the money supply and inflation in China, although there is no J-curve effect in China's current account. Whilst the real exchange rates create sizeable effects on both money supply and inflation in the short run, the external balance generates significant influence on those two same variables in the long run. Especially given the fact that the external balance will take a long time to be effective to influence the domestic macroeconomic activities, the policy makers should bear in mind their lagged effects when they conduct the short run economic policies.

Session Q: Economic Growth (organized by LU)

1. "Taxes and Economic Growth", Herakles Polemarchakis (Brown University)

2. "Intergenerational Mobility with Constraints", Eric HANUSHEK (Stanford University), Charles LEUNG (CUHK) and Kuzey YILMAZ (Koc University)

3. "Allocation of Tax Revenue and Growth Effects of Taxation", Jinli ZENG (National University of Singapore)

4. "Government Consumption and Economic Growth: An Integration Analysis", Pak Hung MO (HKBU)

4:00-5:30

Session R: Issues of Globalization (organized by HKEA)

1. "Basel Accord and Macroeconomic Activity", CHEN John-ren (University of Innsbruck, SOWI)

   Due to externalities as well as imperfect information the banks as financial intermediaries have usually been regulated by national bank supervisory authorities. Minimum reserve ratio for deposits, interest ceiling, loan loss reserves as well as minimum capital requirement, deposit insurance etc. have been broadly used for bank regulation to protect against back runs and an insolvencies of banks. These measures applied both, to nationally and to internationally active banks. Internationally active banks need an international well functioning international payments system which has the character of a "global" public good, more exactly a club good. The debt crisis in the 1980's brought the international financial system to the brink of collapse. The Basle Accord of international convergence of supervisory regulations governing the capital adequacy of international banks (shortly: The Basle Accord) is a result of an effort initiated by the US and the GB to maintain the safety and soundness of the international financial system via international cooperation system as well as to reduce competitive inequalities between internationally active banks without to deteriorating the competitiveness of banks in relation to other financial intermediation.

The Basle Accord explicitly mentions that it is to be applied to internationally active banks. But according to a report of the Committee more than 100 countries world-wide have already adopted the Basle Accord to their bank supervision since 1988.

The Basle Accord was an agreement of the Basle Committee on Banking Supervision, a committee of banking supervisory authorities which was established by the central bank governors of the Group of Ten countries in 1975 after the breakdown of the Bretton Woods system. The committee usually meets at the Bank for International Settlements in Basel (location of its permanent Secretariat).

On July 15, 1988 the committee released the Basle Accord under the title "International Convergence of Capital Measurement and Capital Standards. The Basle Accord 1988 has two main contents as follows:

1. Definition of capital: a two-tier capital framework is used. Tier One capital is confined to shareholder is equity   Tier Two capital includes (a) loan loss reserves, (b) up to 45 percent of the unrealised gain on marketable securities, an (c) hybrid debt-capital instruments.

2. A minimum risk-adjusted capital adequacy standard of 8 percent: half of which (4 percent) had to be in the form of Tier one capital to be attained by the end of each bank's 1992 fiscal year.

About a decade latter the Committee decided to undertake more detailed capital adequacy framework proposals which are called the Basle II and are planned to replace the Basle Accord 1988.

The Basle Accord has demonstrated an interesting example of providing a global public good. "The Story of the Basle Accord may shed light on not just a financial regulation, but more broadly on the politics of rule creation in the international economy." [Kapstein 1994, p.106]

What are the main impacts of the Basle Accord on the international financial system and on the national and international financial market? Is the international financial system more safe and sound since the Basle Accord 1988? A working group of the Bank for International Settlements (BIS) led by Patricia Jackson has reviewed over 130 research papers conducted by academics and research departments in theG-10 central banks and regulatory bodies. In the Section II of this paper a short survey of the main results is presented. The main changes in the new Accord will be summarized in the Section III. Important special characteristics of the Austrian economy are discussed in the Section IV. The impact of the new Accord on macroeconomic activity in Austria will be discussed in the Section V. A short summary is given in Section VI.

2. "A WCU-based Currency Board System", Lok-sang Ho (LU)

This paper argues that avoidance of economic and financial crises requires that the values of national currencies maintain such real values as to be consistent with the underlying economic fundamentals. The nominal values of the currencies should therefore adjust spontaneously in response to changes in nominal values to preserve the underlying needed real values. When the fundamentals require a change in the real exchange rate, a mechanism for adjustment has to be in place. This paper recommends adopting a monetary anchor in terms of stable purchasing power vis-à-vis a comprehensive basket of world output, and to introduce a crawling peg mechanism vis-à-vis this anchor.

3. "WTO's Prudential Carve-out and China's Finance Opening and Supervision", LI Shenglan (Zhongshan University)

China's finance is still in its infanthood but has to face great challenges after China's entry into WTO. Prudential carve-out is one of crucial exceptions which WTO equips its members with from Financial risks and can protect china's finance from being destroyed. In this article, the author analyzes the definite, the standards and the attributes of prudential carve-out, and then provides feasible measures for China to utilize it best.

Session S: Issues facing Asian Developing Countries (sponsored by ADB)

1. Syed Zahid ALI (Lahore University of Management Sciences, Pakistan)

2. Eatzaz AHMAD (Quaid-I-Azam University, Pakistan)

3. "Sustainability of SME for Sustainable Development", Somchai HARNHIRUN (Office of Industrial Economics, Ministry of Industry, Thailand)

4. Michael LEIGH (Universiti Maylais Sarawak, Malaysia)

Session T: Exchange Rate Systems (organized by LU)

1. "The Effects of China's Exchange Rate on Exchange Rates in the Rest of Asia: 1984-2000", Jonathan E. Leightner (Augusta State University, US)

2. "Shocks to Real Exchange Rate Under Floating Exchange Rate Regime in Thailand: Estimation From VAR Approach, Komain Jiranyakul", (National Institute of Development Administration, Bangkok) and Tantatape Brahmasrene (Purdue University-North Central, US)

3. "The exchange rate determination in China: 1984-2001", Mustafa Mohamed Abdalla (Peoples' University of China, Beijing)

Exchange rates are crucial for the global economy. By facilitating international transactions; for China to maintain a stable and strong foreign exchange market is an extremely important target on the basis of world economic globalization. As a result of the adoption of the economic reforms and openness during the last two decades, China has emerged as a major economic power not only in the Southeast Asia region but also at an international level. During the well-known Asian financial crisis of the late 1990s, and in spite of its repercussions that still prevailing up until now, China maintained a strong currency. Quite the opposite of what was expected; the country was able to pass through the crisis without harmful effects. The purpose of the present paper is first; to shed light on the Chinese foreign exchange system, second; to explore and explain the factors that determine the foreign exchange rate in China in order to visualize the reasons behind China's immunity to the Asian crisis, that is by analyzing the theoretical basis of the foreign exchange system, then the paper investigates empirically the main determinants of the exchange rate in china over the period 1984-2000 based on the monetary approach to the exchange rate model.

Chinese currency performance during the period under investigation was found to be stable; the reason was mainly due to the foreign exchange system, which is

characterized by foreign exchange control. However, it is argued that the economic fundamentals namely; the output growth, the fairly acceptable monetary expansion and the marginal changes in the interest rate differentials were found to be the main factors behind the stability of the exchange rate. It is critically important to note that the convertibility of the national currency which contradicts the objective of maintaining a stable secured foreign exchange market as a policy option for China needed to be carefully suited, taking into account the challenges that the Chinese economy might face in its integration in the world economy. Based on the monetary approach to the exchange rate, the study estimated an econometric model; the results obtained confirm the model prediction. It is recommended that China still needs to maintain relatively moderate monetary expansion in accordance with GDP growth rate, in order to keep the exchange rate stable. Higher output growth rates are required to appreciate the exchange rate. Interest rate differential has shown marginal effects, but higher interest rates are needed to eliminate the gap and to attract foreign investments to various sectors (especially for exportables), hence this would appreciate the exchange rate.

4. "Exchange Rate Effects on the Transmitted Unemployment", Jimmy RAN (LU) and Cindy CHEN (University of Iowa)

Session U: Macroeconomics of Labor and Capital Markets (organized by HKU & CUHK)

1. "Public Enterprises and Labor Market Performance", Rachel NGAI (LSE), Johannes HORNER (Northwestern University) and Claudia Olivetti (Boston University)

This paper suggests that the state involvement in the production sector in European countries may contribute to explaining the difference in unemployment rates and dynamics between Europe and the United States. We report evidence about the scope and size of state-owned enterprises across countries, and relate it to their labor market performances. We develop a simple model that helps explain those stylized facts. Our model predicts that more interventionist countries may have higher unemployment rates, especially in the presence of economic turbulences.

2. "Asset Pricing in an Environment with a Credit Constraint Sector", Claudian KWOK (CityU)

This paper considers an environment in which a class of production technologies is susceptible to credit constraints. It studies how the probability of having access to this class of production technologies might affect the portfolio choice of agents between safe and risky assets. It shows that agents could require a risk premium on the risky asset even though they are risk neutral. The risk premium depends negatively on their net worth positions and positively on the probabilities that they have access to the production technologies. These results could shed light on the equity premium puzzle and asset price volatilities.

3. "Public Capital, Asymmetric Information and Economic Growth", Patrick Wai-hong HO (University of Macau) and Yong WANG (CUHK)

We investigate the effect of the provision of tax-financed public capital in an endogenous growth model with asymmetric information. In a credit market where

lenders can identify the risk types of borrowers only by using a costly screening technology, we show that the equilibrium contracts are characterized by self-selection of borrowers. The presence of asymmetric information introduces an additional adverse effect of taxation on growth, as higher taxes lead to greater deadweight losses due to more frequent screening. Consequently, comparing with previous studies, our analysis justifies a more conservative tax policy. Moreover, the optimal tax rate and the growth rate are shown to be negatively related to the severity of asymmetric information.

4. "Land Price Cycles", Charles LEUNG (CUHK)

The cyclically and volatility of property prices are well known. Many explanations have been proposed. This paper builds a simple dynamic general equilibrium model in which these often cited channels are assumed away. Instead, the role of simple intertemporal elasticity of substitution is highlighted. In this model, either unstable dynamics is resulted, or the land price cycles will be observed. Moreover, the land price will always fluctuate more than the aggregate output. The welfare of different cohorts depends crucially on the land price at the period they were born. The implications of these results are discussed.

Full-Text Paper:
To access full-text paper, please visit the website of *Centre for Public Policy Studies*, Lingnan University at **http://www/ln.edu.hkcpps/hkea2002/program.PDF** .

A New World Economic Order

Second Biennial Conference
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Location Maps

Lam Woo International Conference Centre

Level 2

Level 3

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