

# **Preston University**

## **Abstract of Graduation Thesis for the Degree of Doctor**

### **A Comparative Study about the Impact of RMB Exchange Rate On China - US Economy**

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**Date:** Oct 23, 2004

# « A COMPARATIVE STUDY ABOUT THE IMPACT OF RMB EXCHANGE RATE ON CHINA - US ECONOMY»

## ----Abstract----

From 2003 on, the international community led by the U.S. and Japan launched a tidal wave of demands for the appreciation of the RMB. Statements by European Officials--Romano Prodi and Win Duisenberg--made the case for the RMB Rate rise even hotter.

American public opinion focuses on the argument that the devaluation Chinese currency made for the U.S. manufacturing industry's serious problem of unemployment; "China must change the existing fixed exchange regime under which the RMB is pegged to the U.S. dollar," thereby solving the huge Sino-American trade surplus. Otherwise, China would only face trade retaliations and sanctions.

Is the RMB Rate really a major factor in the American manufacturing industry's job loss dilemma? Is it the root cause in the Sino-American trade surplus? Does the RMB Rate and its system need to be fixed? In particular, how does the RMB Rate affect the Chinese and American economies? This is an issue of major concern facing decision-makers and theorists in China's macroeconomics. With the use of basic economic theories, the modern exchange rate theory in particular, and through a comparative study of the macro-economies of the two countries, this paper answers the above questions and offers a unique view on analyzing the medium-to-long-term trends of the RMB and the choice of its exchange rate mechanisms.

The issue of exchange rates falls into the realm of macro-economic studies. This writer thinks that the Keynesian theoretical framework fits better into the condition of China, such as about the relationship between unemployment and inflation, there is the Phillips curve, for that between the goods market equilibrium and the monetary market equilibrium, there is the IS-LM model. There are also the Mundell-Fleming model and the modern growth theory, all of which forms the basis of this study.

The train of thoughts of the paper evolves on two levels.

Firstly, the paper explores exchange rate development history and exchange rate basic theory, each country's exchange rate and system development history and changes, development of exchange rate system choice, including analysis of exchange rate and system of development and change, relating theory to practice, describing the appropriateness of China's

present exchange rate policy and offering the writer's own innovative viewpoints.

Secondly, the paper studies a lot of data, for example, Chinese and American governmental and international institutions' open and public data, internal and external papers, books, magazines, journals, the statistical and analytical data from experts and scholars, and internet data. Likewise it uses the theory on international capital flow and the international production synthesis theory founded by the English economist John Dunning to describe relationship of RMB Rate and Sino-American trade surplus as unrelated in cause and effect; it utilizes labor market theory and the Colin Clark law and the business cycle theory to prove that heavy job losses in the U.S. manufacturing industry are unrelated to the RMB Rate and RMB Rate System. America made a mistake.

The paper adheres to historical materialism and dialectical materialism. It draws comprehensively on numerous analytical methodologies to make a case. Comparative analysis and study plays an important role in it.

The paper's innovative theory has the following five aspects:

Firstly the case is advanced to be the key point of the choice and decision of the exchange rate is to pursue the maximum national interests and to link macroeconomics with the political-economy.

The second innovative point is advanced to be that the shift from the Fixed Exchange Rate System to Floating Exchange Rate System is called for by the intrinsic laws evolving from the exchange rate regime.

Thirdly, exposing the huge Sino-American imbalance of trade from its mystical veil, the paper states that from a global settlement viewpoint, there is no deficit in trade in US.

The fourth point is advanced to be that the RMB Rate is by no means the root cause of the U.S. manufacturing industry's job losses.

Lastly, for a country that needs to shift from Fixed Exchange rate System to Floating Exchange Rate System, maintaining domestic financial security is a necessary and sufficient condition. At the same time, China is a nation that has a large share in the global GDP and has to complete her urbanization. Moreover, the author provides the condition and timetable according to which the RMB completely floats in response to market changes and a basic mathematical model which the condition and timetable predicts, thereby filling a gap in RMB Rate Study.

The paper consists of four sections, including eight chapters.

Section 1 is mostly an introduction about the arguments, reasoning and main points over the RMB Rate question among the international community, the positions the governments of the two countries adopt about the RMB Rate question, and the views the domestic and international academic communities respectively offer in the debate, the reasons why the author chooses this topic and approach, train of thoughts, and new point of view.

Section 2, from chapter 2 to chapter 4, mostly includes the parts on theoretical study.

Chapter 2 makes a study of the developmental history of the exchange rate and exchange rate regimes, describing in more detail the process of evolution in the international exchange rate and exchange rate regimes, and confirming that the changes and developmental history of the international exchange rate are actually in sync with the law of commodity economics in the human society, that exchange rate regimes are in fact the core of the monetary system and that the type of monetary system determines the type of the exchange rate system.

The Chapter introduces Bimetallism, the Gold Standard, the Bretton Woods and Fixed Exchange Rate Regimes. Since 1967, an international monetary regime under the Jamaica Agreement has been a mixed exchange rate regime which accommodates the rapid global economic development following the collapse of the Bretton Woods system. The author focuses his analysis on the Plaza Accord, explaining the principle of national benefits supremacy of the American government in its exchange rate policy.

Chapter 3 studies exchange rate theory, mainly the modern exchange rate theory's developmental history and especially focuses on an analysis of the M—F model.

Chapter 4 discusses Chinese and American monetary and exchange rate regimes' development history and changes. Through studies in the chapter, the conclusion is drawn that despite their different evolutionary and formation processes, China-American monetary and exchange rate regimes both fall into the category of commodities and are affected not only by the law of commodity, but also by the law of political economy. The interactions between the two laws result in the formation mechanisms and development history of the exchange rates in various countries.

Section 3, spanning from chapter 5 to chapter 7, studies the relationship of RMB Rate to the Chinese and American economies.

Chapter 5 is an analysis of the macroeconomic operations in the two countries, mostly a study and analysis of the 1990s, such as GDP, Unemployment, and Inflation and so on. We find

the two countries developing very fast throughout the 1990s. We especially have to say that American Unemployment Rate and Inflation are very low, at meantime; the RMB had remained in a thin trading band between 8.2 and 8.3. So the conclusion is now RMB Rate and exchange rate running very ok for China-American macroeconomics, but, RMB Rate does not change during the entire 1990s.

Chapter 6 is an analysis of the RMB Rate vs. China-American imbalance of trade, which results from statistical errors in the technology and methodology. Why does the imbalance of trade persist? Because of non-tariff barriers from American government. The American government unfairly prevents China from importing American high technology products. China exports labor-intensive products to America, because China's labor force is very cheap. Even if America does not import products from China, it will still need to import the same type of products from another country. So the two economies are complementary. The conclusion from this is very clear: It is not the RMB Rate and exchange rate regimes that create the imbalance of trade between the two countries.

Chapter 7 has a detailed analysis about RMB Rate in relation to American manufacturing industry's unemployment. First comes an analysis about technological progress productivity growth causing the industry construction change, so, manufacturing industry workers unemployment rising. Second, the paper does an analysis about the business cycle in relation to American Unemployment, American new economy business cycle end causing whole Unemployment changed more higher. Thirdly, another important reason is that the September 11 terrorist act causes great losses to the American economy; the manufacturing industry's unemployment rate also is forced to rise. So, the conclusion is that present RMB Rate and China's RMB Rate System is not causing American manufacturing industry Unemployment Rate to rise.

The final section is Chapter 8, the chapter discusses choices theory of exchange rate system and long-term trends of RMB Rate, in the chapter, not only discusses point of internal and external county learned man to RMB Rate choices, but also the writer advance self-point, more important to be, the writer built a new model of mathematics about calculating RMB Rate System becoming Floating Exchange Rate System's time table.

Economists no have same point in exchange rate regime choice, no have a kind of exchange ate regime to all country is correct in anytime confirmed by international exchange rate regime

choice now. When each country decides choice of exchange rate regime, the first decisive factor “to maximize the benefits for their own country”.

Since the 1997 – 1998 Asian - currency crisis, the RMB policy was switched from Practical Approach to Nominal Anchor Approach – a unitary peg to the US dollar. The history has proved that it is a right policy to China. After the Asia Financial Storm, China’s government keeps RMB Rate unchanged and as a steady policy, which is a very correct policy.

The writer thinks that China’s presently management of exchange rate policy satisfactorily “gets the most benefit for China” and also satisfies “IMF” to each country demanding, there is no reason to change present China RMB Rate policy, keeping the RMB Rate steady is the most important.

Macroeconomic theory tells the U.S. that the RMB is a big country currency, when China’s economy becomes very strong, RMB Rate must freely exchange and sets Floating Exchange Rate, this is law of market economy deciding. So the writer advances a new model of mathematics, the model can use the prediction about what time to set RMB Rate System to become Floating Exchange Rate regime’s time table. The model’s written foundation type, called  $GDP_C = GDP_A$ , when China’s  $GDP_C$  is equal to America’s  $GDP_A$ , the equation becomes “China’s ideal Floating Exchange Rate regime time table”.

China is obliged by WTO membership to freely trade the RMB around the world .The Yuan itself will be finally determined by the market and become a major world currency.

**Key words: China – US Economy? RMB Exchange Rate? Exchange Rate System? History of US-China Currency? Comparative Study.**