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FOCUS

How is European Industry Coping with the New Patterns of the International Division of Labour?

Given the combination of substantial cuts in transport and communications costs, the opening-up of large economies with abundant cheap labour, as well as the scope for overseas subsidiaries of multinational corporations to employ this labour by using advanced technologies developed in the North, what is the future for European industry?

It is questionable whether the idea of comparative advantage and international specialisation as a "win-win" game remains valid under such new circumstances. The emergence of competitors with a very broad spectrum of comparative advantages in industrial activities, as exemplified by China, and sometimes in services too, as is the case of India, has therefore revived the issue of the future of manufacturing industry in industrialised countries, in the face of competition from low-wage economies.

Has Europe the means to hold on to its manufacturing sector? Or will it have to abandon its industrial base and instead become a major market for imported products and a producer of services?

For all the decline of manufacturing in total employment ("deindustrialisation"), industry continues to play a key role in Europe's economy, when the statistics are adjusted to take into account the development of temporary work, the outsourcing of certain activities by manufacturers and the increasingly-blurred boundaries between services and manufacturing in many sectors. Moreover, the bulk of the relative decline of industry in terms of value added and jobs is attributable to price movements, reflecting industry's faster productivity gains and greater exposure to competition.(1)

Accelerating globalisation may, however, contribute to the decline of industry in a number of ways: specialisation according to comparative advantage, downward pressure on prices exerted by new competitors, the global reorganisation of firms, shifts in markets and therefore in the factories supplying them, etc. The scale of the emergence of international production processes, both as they now stand and as they are forecast to develop over the next fifteen years changes the situation completely. Until the mid-1990s, European integration saw intra-Community trade accounting for a growing share of world trade, peaking at 30%. That share has since fallen considerably, and will soon be down to only 20%. This trend contrasts with that observed for NAFTA. Meanwhile, new big players are appearing on the world scene, such as Brazil, India and China. These trends contribute to profound changes in trade patterns: while the European dynamics of integration was of an intra-industry type(2), a return to inter-industry trade and associated adjustment costs has been recently recorded.(3) The world economy is therefore facing a new phenomenon: big open economies, whose average standards of living will remain lower than in the old industrialised countries, for a long period of time, are playing an increasingly important role in the world economy.

Overall, the Southern countries are now major participants in the recent development of international trade. Whereas the North continued to drive world trade from 1995 to 1998, accounting for two thirds of the growth in world exports and over four fifths of the growth in world imports, the situation has since been reversed. The South now accounts for more than half of the growth in world exports and already more than 40% of the growth in world imports.(4) Owing to significant internal inequalities and the fluid movement of capital and technology at international level, these countries also enjoy comparative advantages in a wide range of goods.

There is a tradition at the CEPII of compiling trade data at the world level, using harmonised and stable trade classifications going back to the 1970s. As a result, the CEPII's CHELEM trade database is informative regarding the big shifts of countries' specialisation and the emergence of new competitors.(5) The period covered (1967-2003) allows the current changes to be placed in a medium term perspective, helpful for the analysis. Complementing this effort, the new database developed by the CEPII on the basis of COMTRADE data, BACI (6), makes it possible to break down world trade flows at the HS6 level (about 5,000 products) by quality level, transformation stage and by the technological content of the traded products. Last but not least, the development of a Computable General Equilibrium Model, named MIRAGE(7), which uses a detailed database of tariffs (MAcMap)(8) constructed in collaboration with the ITC (UNCTAD-WTO, Geneva), makes it possible to investigate further the effects of new competition in certain sensitive sectors.

The emergence of a global factory, exploiting cost differences throughout the value-added chain, across various locations, is beginning to have a very appreciable impact. It is based on the modularity of the products, on the fragmentation of the production process, and the specialisation of sites. Countries such as China are building their competitive advantage on such division of labour (9), which is reflected in the growing share of parts and components in world trade, as recorded by BACI. Besides, we are seeing a radical redistribution of comparative advantages between countries: whole sectors of industry are destined to leave the North. The traditional view of the North as specialising in recent industries and the South in traditional industries is in fact totally misconceived. With the global factory, the Southern countries are increasingly specialising their industrial apparatus in both areas of activity. Only a few industries - those involving processes which are intensive in capital or skilled-labour, cumulative technology or which face transport difficulties - are able to buck these underlying trends, e.g. aeronautics, electronic components and the automobile sector.(10)

The problem of Europe's performance is essentially a problem of sectoral adaptation: EU products are out of step with trends in world demand. A detailed analysis shows that Europe has missed the technological boat of the 21st century: Europe’s second fastest growing export is pork and poultry fat; another fast growing export is ships... for scrap. We are therefore a very long way from exporting products that would make Europe a player in world technological competition and the information society. That said, Europe retains an advantage for high-end products for which the competition is the lowest, thanks to the vertical differentiation of products, as shown by BACI.(11) The low dollar is nevertheless a challenge for European industries. Europe’s exposure to dollar competition occurs *vis-à-vis* the whole dollar zone on the export side as well as on import side, and in third country markets. An estimate for the manufacturing sector suggests an average exposure of 12.4 %, varying from 2 % for printing products, to 33 % for TIC.

Apart from exposure, industries' sensitivity to exchange rate movements fluctuates. Combined effects show that the mechanical industries are the most affected by any fall in the dollar.(12)

Depending on both the sectoral and geographical distribution of their external trade, European countries have reacted differently to the fall in the dollar. Generally, speaking Northern countries (including Ireland) are more affected than Southern countries (including Austria and France), Germany and Italy being in a median position.

How the current multilateral trade negotiations are expected to impact on European industry depends crucially on the reduction of tariff peaks at the world level, but all in all, the overall impact on European industry will remain limited when compared to agriculture.(13) Certain industries are however potentially sensitive: the textile and clothing sector given the remaining tariff peaks; and the automobile sector, where firms have spread production capacities over the world, very often to circumvent significant border protection.

For these two industries, specific studies have been conducted. Regarding textiles and clothing, a study published in 2002 pointed to the concentration of the gains by China and India, while the small developing countries were losing out.(14) More originally, it may be asked what conditions the regional division of labour among the EU and its Mediterranean and small Eastern neighbours would be able to survive such new competition. Wage costs are only one component of the value added chain, since design, distribution and transport costs (including time for delivery) also play an important role.

The differentiation of products and the pace of innovation are key elements in explaining world competition in the automotive industry. European countries are divided into three groups: net importers (such as the UK and Belgium), net exporters of high value cars (such as Germany and to a lesser extent France) and net exporters of lower value cars (Italy and Spain). Competition from emerging countries will come from the low value segment of the market and from accessibility to these markets. As shown by recent simulations with MIRAGE, full liberalisation will bring major impetus to Japanese and South Korean industries, while a scenario of regionalisation benefits the Latin American countries most, given their preferential access to the US market. In all cases, the European car industry misses out on the bulk of the gains of liberalisation as regards its European locations, and profits will have to be made in the fast-growing emerging markets in Asia, by the means of a local presence.

All in all, what is the future for European industry? The answer of course very much depends on the policies adopted in Europe. Protectionism to isolate the European market from new competitors would, in the long run, be detrimental to efficiency and welfare, while entering into head-to-head price competition would be hopeless. Innovation – both in terms of creativity and high technology - and positioning of the top end products would, on the contrary, reinforce the traditional advantages of Europe, in addition to allowing it to benefit fully from the potential of a regional division of labour. Last but not least, the situation of the losers out to globalisation must be addressed internally, by providing simultaneously a macroeconomic and institutional environment favourable to job creation and a satisfactory safety net.

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ON THE RESEARCH AGENDA

Tax Competition

The CEPII's research on tax competition has intensified since the launch of the TAXBEN consortium, in December 2004. The starting point is past research carried out at the CEPII, which aimed at estimating the impact of corporate taxation on Foreign Direct Investment (FDI) within a gravity framework for a set of OECD countries, over the period 1984-2000. Based on bilateral FDI data, this research shows that tax differentials between source and host countries do impact on FDI, albeit in a non-linear way.

The research underway builds on this first set of results along three lines. First, a similar econometric analysis is being carried out on a completely different dataset that covers the EU25 for a more recent period. The new set of estimations aims at addressing the specific question of tax interactions within the European Union and provides an assessment of possible plans for cooperation. The preliminary results tend to confirm previous results, but they also provide evidence of some heterogeneity between new member states and old ones, as far as FDI attraction is concerned.

The second line of research consists in studying the possibility of competition both on tax rates and on the provision of public factors of production. A unified theoretical framework is proposed to analyse tax competition when a corporate tax is levied in order to finance a public good which can raise household utility and/or firms' productivity. It is shown that tax competition may lead to an expenditure-shifting effect and/or to a rise in public sector efficiency. Then, the determinants of US FDI to EU25 countries are estimated econometrically. The preliminary results show that both taxation and the provision of public factors matter for attracting US investments, which means that one outcome of tax competition could be a vertical differentiation of countries, some of them being able to tax more, provided they offer a higher level of public factors in an efficient way.

The last field of research investigates the issue of equilibrium tax differentials within an integrating Europe. Building on a new economic geography framework, this work in progress shows that centripetal forces could justify persistent tax differentials in Europe, even though real integration increases the potential for firms to locate to where taxation is lower. As a consequence, "central" countries seem to be able to sustain higher levels of taxation, while peripheral ones should normally display lower levels of corporate taxation.

Agnès Bénassy-Quéré

The Oil Price and the Dollar

The real oil price has been increasing since early 2002, notably due to tensions in supply and the increase in demand which have led to the almost complete utilisation of the production capacities.

At the same time, the dollar has been depreciating since mid-2001. Since the American currency plays a key role in the oil sector, it is useful to study the links between these two variables. Various authors (Krugman, 1980 and 1983 ; Golub, 1983 ; Rogoff, 1991 ; Amano and van Norden, 1995, among others) have studied the impact of oil prices on exchange rate movements. Generally, their studies exhibit a positive relationship between the two series, meaning that an increase in oil prices is linked to a dollar appreciation. Accordingly, the current period, which is characterised by a dollar depreciation and simultaneous oil price increases, is atypical, compared to the relationships found in previous papers.

In this study, we propose an empirical analysis of the links between oil prices and the real effective exchange rate of the dollar, between 1974 and 2004. In particular, we try to find a stable long-term relationship between these two variables and to identify the direction of the causality. To this end, after a description of the main relationships and interactions that may exist between oil prices and the dollar exchange rate, we proceed with a cointegration and causality study between the two variables.

Our results indicate that a long-term equilibrium relationship (i.e. a cointegration relationship) exists between real oil prices and the real effective exchange rate of the dollar. Moreover, the causality runs from oil prices to the exchange rate. The estimation of a vector error correction model reports a very slow adjustment speed of the dollar exchange rate to the long-term target, with a half-life of about six and a half years. Moreover, relying on the Behavioral Equilibrium Exchange Rate (BEER) approach *à la* Clark and MacDonald, our results show that the relationship between the two series seems to be transmitted by the United States' net foreign asset position and not by the terms of trade.

Valérie Mignon & Alexis Penot

The Stock Market and the Business Cycle

This project aims at exploring how the business cycle affects the stock market, the focus being placed on the euro area. We are interested in analysing this issue along three different lines: by testing if cyclical fluctuations (European or possibly US ones) have had any effects on rate of return levels (percentage changes in stock prices), on return volatility (time series variance) or on return dispersion (cross-sectional variance), within the euro area stock market.

Some relevant macro-finance theories, in fact, predict that such relationships are relevant: on the one hand, the Consumption Capital Asset Pricing theory (CCAPM) suggests that levels of stock returns should evolve in relation to the growth path of consumption, returns being higher the stronger the growth rate of consumption. On the other hand, returns should be more volatile during economic expansions, along the lines set out by the "Operating Leverage Theory" (Schwert, 1989, Gourio, 2005). Finally, the "Sectoral Shift Hypothesis" (Lilien, 1982, Davis, 1987) suggests that returns should be more dispersed during phases of economic slowdown.

Some (non-consensual) empirical evidence about these theories exists for the US stock market, but there is none for the (aggregate) euro area market. This work tries to fill the gap, by relying on a dynamic factor-model, econometric technique.

First, we will explore whether it makes sense modelling euro area stock markets as an aggregate entity, before and after the introduction of the single currency. To this end, we will provide some estimates on the co-movement of stock prices (and returns) across member countries' stock markets. Secondly, after suggesting some definitions for a common euro area business cycle, we will test whether this cycle might be important in explaining the dynamics of stock prices, in terms of the three lines of research proposed above.

Jacopo Cimadomo

Preferential Access: A Gateway to Growth for Africa?

For historical reasons, the African countries benefit from important preferential access to the EU market. In recent years, granting preferences to least developed and/or Sub-Saharan countries has spread, thanks to generic programmes such as the "Everything But Arms" (EBA), or specific ones like the US AGOA signed in 2000. Nevertheless, preferential regimes are passing through a phase of turbulence. For example, the trade part of the "Lomé Agreement" between ACP countries and EU does not comply with WTO's rules and will be replaced by the Economic Partnership Agreements. At the same time, the Doha Round aims to improve economic development across the world, but will have negative side-effects: the reduction of multilateral tariffs will bring down preferential margins. In this context, the impact and the future of preferences appear to be a burning issue for policy makers and trade negotiators.

If trade preferences have often been criticized, either for their lack of effectiveness or their negative effects, several recent studies suggest that these preferences have had significant positive effects on growth or at least on exports and have often been underestimated due to the lack of data. The CEPII has recently conducted research on trade preferences that stresses three important elements. First, preferential schemes such as the EU-ACP Cotonou Agreement are of particular importance for beneficiary countries. Second, notwithstanding their limitations, EU preferences have actually a high average rate of take up, especially in agricultural products. Third, the erosion of existing preferential access and the negative impact of higher food prices caused by the multilateral liberalisation would likely hurt the poorest countries.

Using computable general equilibrium assessments and highly detailed information on tariff structures, this project defines how preferences could be part of a development-oriented policy targeted to African Countries. What kind of preferential schemes will compensate them from their losses due to the multilateral negotiations? How can preferences be defined that will lead to a true diversification of production, and limit artificial specialisation?

David Laborde

DATABASES

Measuring World Intra-industry with BACI

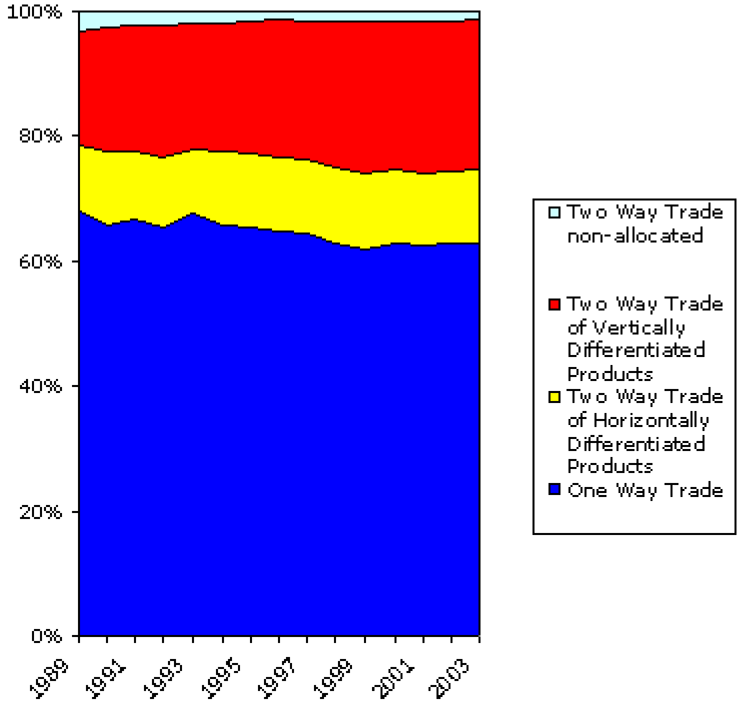
By using BACI, a dataset that is being developed at the CEPII, we are able to provide a systematic decomposition of world trade at the most detailed level (bilateral flows for some 5,000 products), into three trade types: inter-industry, and intra-industry in both horizontally and vertically differentiated products, over the period 1989-2003. Fontagné, Freudenberg & Gaulier[(1)] extend previous work limited to European countries[(2)] to a systematic appraisal of intra-industry trade at the world level, therefore contemplating globalisation rather than regional integration.

The decomposition method, first described in detail in Fontagné & Freudenberg[(3)], is based on a simple algorithm:

- first, reciprocal trade flows are tested for their intra-industry nature (imports represent at least 10 % of exports or reciprocally);
- second, if the answer is positive, it is necessary to test whether unit values of elementary trade flows are similar or not (a difference in unit values of up to a 25 % is allowed, this threshold is preferred to the 15% threshold as in Fontagné & Freudenberg [(3)] in order to take into account the larger differences in “prices” in a panel of developed and developing economies). This second test disentangles the horizontal and vertical components of intra-industry trade.

One important item of information obtained is that inter-industry trade still dominates world trade, even if its share has been reduced over time (Figure). This has been associated exclusively with an increase of IIT in vertically differentiated products. Accordingly, the phenomenon observed within the EU has been transposed to the world level. Interestingly however, a recent levelling-off of intra-industry or a come-back of inter-industry trade is to be noted in the 2000s, in line with the increasing role of emerging countries in international trade flows.

Evolution of the 3 trade types,1989-2003
(% of world trade)



Source: CEPII-BACI, 2005
Note: non-allocated TWT (because of a lack of quantitative data) are not plotted, they account for less than 2% of world trade. The sample of products excludes those with less reliable statistics (cf. Fontagné, Freudenberg, Gaulier, 2005).

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Guillaume Gaullier

EVENTS

Can Germany Sustain Locational Competition?

Can Germany sustain locational competition? This question was addressed at the annual conference of the German institutes of economics (Arbeitsgemeinschaft Deutscher Wirtschaftwissenschaftlicher Forschunginstitute), co-organised by the DIW and the CEPII in Berlin on 14th April, 2005.

In the opening lecture, Lionel Fontagné presented a joint contribution with Thierry Mayer, highlighting the prominent role of market access in the determinants of firms' location. The growing concern over the attractiveness of European locations for mobile firms, resulting from "a race to the bottom" taking the form of tax competition, social dumping or environmental competition, is hardly justified on the grounds of the actual geographical structure of the foreign presence of German, French or Swedish firms. On the contrary, firms from these countries are massively present in high income, high labour cost locations, suggesting a foreign presence mainly driven by the access to large and rich markets.

Cost differentials do, however, also matter, as Lionel Fontagné stressed. Wage differentials have been proved to impact somewhat on the location of German firms. With trade integration continuing and ensuring that peripheral, low-cost countries are less and less undesirable locations in terms of market access, core countries with differentially high corporate tax rates will hardly be able to resist convergence towards lower rates offered by neighbouring countries. Labour market regulations impact on foreign direct investment (FDI), as environmental policies also impact on the location of firms, when sectoral characteristics are properly taken into account in the estimations. This was illustrated, regarding environmental policies, in the paper presented by Peter Egger (IFO, Munich), and regarding the labour market by Sascha Becker (CES, Munich). The problem with such effects is their magnitude: the impact of wage differentials on the decision of locating jobs in Germany rather than in the CEECs has been proved to be limited. Henning Klodt (Kiel) stressed the fact that the accuracy of the cost-saving argument for FDI was strongly dependent on the set of assumptions considered: the new trade theory provides numerous arguments suggesting that the determinants of FDI are much more complex than generally assumed. More fundamentally, job losses associated with relocation in the East are felt much more directly than positive countervailing effects which are spread throughout the whole economy. In the light of the high unemployment in Germany, such pressure might be hardly socially acceptable. But, since the option to prevent these trends is limited, it is necessary, according to Rolf Jungnickel (HWWA, Hamburg) to facilitate adjustment by reconsidering institutional arrangements hindering job creation.

Accordingly, the sensitivity of public opinion to these issues is typically the result of a sluggish macroeconomic environment, in which low growth, low employment and deflationary pressures make it more difficult to cope with necessary adjustments. If a competition for location exists, providing an appealing macroeconomic environment to firms is certainly the best policy, if combined with a reinforcement of European market positions in high-end products.

Finally, the capacity of a country to adjust to a changing international environment depends crucially on its level of flexibility. Tobias Seidel (CES, Munich) showed that if, assuming flexible goods and factor markets, globalisation exhibits welfare gains for all countries, this is hardly the case when such assumptions are relaxed. Under these circumstances, capital mobility could lead to a welfare loss for the capital for exporting economy.

Lionel Fontagné

Competitiveness and Economic Growth – Policy Proposals on Current Economic Policy Issues in Europe

The 6th Meeting of the German-French Council of Economic Advisers was held on the 14th April 2005.

Background

The German-French Council of Economic Advisers was set up in March 2003, with the support of the French Prime Minister’s Office and the German Chancellery. The objectives of the Council are to exchange views on current economic policy issues, to develop policy recommendations, and thus to support the harmonisation of German and French economic policies. The Council is presided by Professor Christian Stoffäes (Université Paris IX-Dauphine and Chairman of the board of the CEPII) and Professor Klaus F. Zimmermann (President of DIW Berlin and Director of IZA, Bonn). It consists of 14 members from both countries; in addition, the Council relies on background research carried out by research institutions in France and in Germany.

Acting on the recommendation of the German and French Economics Ministers, Wolfgang Clement and Nicolas Sarkozy, at the last German-French Council of Ministers, 26 October 2004 in Berlin, the Council of Economic Advisers will continue its work in the form of bi-annual policy workshops. For the 6th meeting, which took place on the eve of the French-German Council of Ministers in Paris, the CEPII had been asked to present his works to the Council.

The meeting dealt with oil prices and economic growth, competitiveness, and innovation policies in France, Germany, and in Europe as a whole. On the first two topics, the Council heard and discussed introductory statements by Professor Ulrich Fritsche from the DIW

Berlin, and by Professor Lionel Fontagné, Director of the CEPII. In order to address the issue of innovation, the Council organised a joint session with the President of the French-German Group of Industrialists, Jean-Louis Beffa. The following paragraphs sum up the results of the meeting, concerning these three topics.

1- Oil prices and Macroeconomic Developments: The Need to Follow Events Closely

Rising oil prices to record levels of over $50/barrel are confronting governments and central banks with crucial decisions about whether to tighten monetary policies to prevent inflation, or to instead relax them to support growth. Current estimates indicate that a sustained $10 per barrel increase in oil prices would result in the OECD-countries loosing 0.4% of GDP; a $25/barrel increase, as observed recently, would thus lead to almost a full 1% reduction of GDP. Contrary to the two large oil shocks of 1973-74 and 1979-80, the current situation is not only an oil price “shock” of the same magnitude in real terms; but the oil prices seem to have moved away above the former OPEC target range ($22-28/barrel) for a prolonged period of time. However, according to first estimates, the short-term effects on macroeconomic activity promises to be less dramatic this time. This is due to the lower oil intensity of growth in the industrialised countries, negligible second-round effects (i.e. no rising wages thus far), and a smoother recycling of petrodollars. Although the oil price increase observed currently seems to be connected with less painful macroeconomic consequences than in the 1970s, there is clear need for increased attention, notably:

- a better understanding of oil price determinants by economic policy-makers is necessary. European governments also need to take a closer look at potential oil supply sources, without interfering directly in the market. This also includes a reduction of direct or indirect subsidies to oil consumers in emerging countries;

- given the importance of energy policy for macroeconomics, this topic should be treated more in-depth by policy analysis. One of the next meetings of the Council of Economic Advisers could devote a session to this topic;

- with current output gaps and the costs of economic restructuring under way, oil price increases should not - lead to premature monetary tightening in the euro area. In any event, monetary and fiscal policies have to be prepared to counteract an economic recession;

- rather than wait for technical innovations reducing fossil-fuel dependency and energy-intensiveness, governments might consider a more pro-active innovation policy in the energy sector. The European experience over the past three decades has shown that indirect taxation can go quite a long way in shaping consumers’ and producers’ behavior with regard to energy use.

2 - De-industrialization, Outsourcing, and Competitiveness: Favoring the Race to the Top

The Council is concerned by the apparent problems of the Lisbon Agenda at its midterm. The objective of creating the most competitive region in the world cannot be attained by the methods used up to now. The situation of Europe and its manufacturing industry must be considered in a wider context and in an appropriate framework of economic analysis. Developed countries like France and Germany have to adapt and develop their position as manufacturers in their area of strength in the international division of labour. It is to European firms' advantage to practice outsourcing towards emerging countries in the South and/or in the East. The reasons for this outsourcing are complex; one of the main drivers of the locational choice of firms is the wish to be close to promising markets. It is more or less a coincidence that today these markets are the countries with very large quantities of very low labour costs, like Eastern Europe, China and India. Given the high (labour) cost differential with such countries, Europe will not be able to reconquer its former place in global manufacturing. Cost differentials also matter compared to other developed countries, so structural reforms in Europe must be completed. In particular, countries like France and Germany have traditionally been strong as producers of high-technology and high-quality products, and should focus on the high-end segments:

- public policies in France and in Germany should aim at increasing each country’s attractiveness and market potential; in particular, the existing potential in high-technology and high-quality industries must be enhanced;

- restricting trade between the South and the North, or the East and the West, does not seem to be an appropriate response to increasing competition. In particular, the experience with the EU Agricultural Policy is a discouraging example, from which policy conclusions can be drawn;

- there is a role for public policy, especially within the EU Lisbon Agenda, by providing support for R&D and by improving the institutional environment in which citizens and firms are acting, in particular with respect to higher education and the labor market;

- with regard to firms' location and FDI in Europe, the attractiveness of the European countries needs be increased, albeit not by resorting to a "race to the bottom" (with respect to taxes, social and environmental regulation). This also includes facilitating agglomeration, but without direct subsidies.

3 - Innovation and Industrial Policy: Towards a More Harmonised French-German Approach

Innovation is an important engine of economic growth, and the innovation systems of France and Germany are in danger of falling behind other countries. For a long time, the philosophy of innovation policies has differed between the French, "Colbertist" and German, "market-oriented" approach. However, some convergence can be observed recently, i.e. in the European debate on "new industrial and innovation policy", as well as attempts to organise public-private synergies in R&D and innovation. The Council discussed concrete measures put forward by the 'Beffa Report', proposing a more targeted innovation policy. In institutional terms, there are marked differences between the two countries. The Beffa-Report suggests a specific Innovation Agency for France, because the existing policy framework is too complex to take quick decisions efficiently; the German institutional framework seems better adapted to this challenge, even though it, too, has potential to improve cooperation between public and private finance. There was a general consensus that:

- a more pro-active approach in innovation is compatible with market principles, if it does not target sectors, company sizes, or other criteria at will. There is clearly market failure at play, and this should be overcome by pubic policy, as far as possible;

- state support should essentially target measures to improve the overall environment in which firms are making their innovation choices;

- public support to fundamental and applied research should increase, albeit not by substituting private firms' R&D;

- the French and German governments should coordinate and harmonise their national approaches to support innovation and policymaking. This is best done at the European level. However, there may be cases where activities need to be launched bilaterally.

Outlook

Building on these results, the Group will continue its work. The next plenary session will take place on the occasion of the German-French Council of Ministers in October 2005 (Berlin/Genshagen). It should focus on similarly urgent macroeconomic and structural problems, with a particular emphasis on German-French, but also European issues. The cooperation with the German-French Group of Industrialists, which was successfully started at the 6th meeting, will be intensified, in particular with respect to issues of industrial and structural policy.

Christian Deubner

The New Frontiers of the European Union

On 16th and 17th March, a conference was held in Marrakech (Morocco) on "The New

Frontiers of the European Union”. It was co-organised by the CEPII and a number of partners: the CDC Institute for Economic Research, the *Caisse de Dépôt et de Gestion*, the CEFI and the *Revue Economique*. This conference brought together people from both academic and institutional research (universities, central banks, research centres, international institutions like the World Bank), and offered an opportunity to investigate the impact of the recent EU enlargement on both the internal and external frontiers of Europe.

Within Europe, the recent enlargement raises the issue of the euro area perimeter, and of the best strategy as regards the EMU enlargement. The heterogeneity of national situations gave rise to discussions about the optimal path for the adoption of the euro. Institutional issues were also evoked, as the gap is deepening between the logic of a "nation-states Europe" and the relative sizes of the member states.

After the enlargement, three categories of neighbours now border the EU. The new candidates, the potential next candidates, and those countries that are not meant to enter the EU, and come under the new neighbourhood policy. For these countries (mostly the MENA countries) the asymmetric integration scheme of the past is no longer relevant, because of the multilateral liberalisation process. This leaves open the question of how to integrate these countries without further enlarging the EU.

The conference addressed all these issues, also showing that the competition from other emerging countries will be a very significant issue for the Southern Mediterranean neighbours of the EU, as globalisation is weakening the regionalisation logic that underpinned the euro-Mediterranean partnership of the Barcelona agreements.

The conference also offered the opportunity of a better understanding of Morocco, and of the country’s relations with the EU. A guest speaker was Mr. El Merghadi, Advisor of the Morrocan Minister of Finance and Privatisation, who provided an overview of the Moroccan situation and the country’s strategy towards the EU. During a roundtable, Mr. Abouyoub, former Moroccan Ambassador to France, and Mrs. Lahrichi, Counsellor of the Moroccan Prime Minister, offered a rich discussion on the attractiveness of Morocco for both domestic and foreign investors, and on the growth prospects of the country in a globalising world.

Amina Lahrèche-Révil

The CEPII Business Club's Meetings

Series of meetings on China:

China's Growth: Is the Agricultural Sector Being Left Behind ?

10 March 2005

It is a ritual of the Chinese New Year for the highest authorities to visit very poor peasant households. Similarly, the No 1 Document of the Central Committee of the Chinese Communist Party, which sets out the priorities of the government at the start of the year, is dedicated to agricultural problems, as it was last year. Is this marked attention by the government for rural China, which still makes up 60% of the population, a sign of a real policy favouring the country’s peasant class? Or does it indicate that the problems of Chinese peasant farmers have not yet been resolved? Is China’s sustained growth carrying this rural world with it? Or is it precisely the self-development of the rural economy which feeds China’s export industries that are its growth engine? Is this mode of growth sustainable over the long term? Is the State capable of redressing rising inequalities? Or is equitable growth still Utopian? All these questions were discussed following a presentation by Claude Aubert. Thereafter, Andrezj Kwiecinski gave his point of view on the subject and provided additional information concerning foreign trade in agricultural products.

China’s Demographic Challenges

24 May 2005

Despite uncertainties and contradictions in Chinese statistics, demographers consider 1.3 billion to be a good approximation of China's population. China is quite advanced in its demographic transition and in the next 50 years it will be confronted by two successive challenges. In the present decade, the labour market will have to absorb about 100 million people of working age. Secondly, China will have to face the varied consequences of rapid population ageing after 2020. Michel Cartier (EHESS) analysed these recent demographic trends and their impact on the internal development of China. Subsequently, Isabelle Attané (INED) placed these recent trends, and especially the rising deficit in girls, within the broader context of the falling number of children and the traditional preference for boys. She concluded by outlining their causes and the consequences for Chinese society.

Argentina's Restructuring and Sovereign Debt

13 April 2005

The recent offer to swap Argentine debt has ended, though perhaps only provisionally, the open crisis brought on by Argentina's unilateral default in December 2001. However, the process of reconstruction has been slow and controversial, given the volume of debt concerned (more than $100 billion), the complexity of the interests at stake and the fact that relations between the Argentine authorities, private investors and the IMF have often not been very cooperative. This experience has, *de facto*, raised once more the question of a "good regime" for negotiating sovereign debt and the role of the IMF within such a framework. After an introduction by Jérôme Sgard (CEPII), Eric Lalo (Lazard Frères SAS) presented an outline of Argentine restructuring and the major obstacles it has run into. Next, Jean-Pierre Jouyet (Club de Paris) drew some more general lessons of this experience concerning the evolution of the international financial architecture.

The Car Industry and the Impact of Emerging Countries

20 April 2005

A major phenomenon of the last ten years has been the emergence of very large, newly industrialised countries as producers, exporters and importers of industrial products. The international trade negotiations, their failures as well as their successes are ever more clearly marked by a clash of interests between the developed countries, the emerging countries (G20), and the least advanced countries (G90). The car sector is at the heart of this process. The study presented by Michel Fouquin (CEPII) sets out an outline of existing trade and protectionism in the car industry, and simulations of various scenarios for change in North-South relations, centred on the car industry. These scenarios are simulated using a general equilibrium model developed by the CEPII (the MIRAGE model). A roundtable debate followed, which included Hugues Chevalier (Renault), Jean-Philippe Lacroix (GEFCO) and Laurence Massenet (CCFA). The meeting was chaired by Henri Martre, Honorary President of Aerospatiale and Honorary President of the CEPII Business Club.

WORKING PAPERS

Migration, Trade and Wages

No 2005-06 May

This study adopts a GNP function approach in order to examine the impact of migrant labour on domestic factors of production in the United Kingdom, during the period 1975-1996. It also examines the relationship between imports and migrants, which are two different facets of globalisation. We find that an increase in the number of unskilled migrants reduces the wages of unskilled domestic workers. However the quantitative impact of this increase is small. No discernible impact of migration is found for skilled, native workers. The results also suggest that unskilled migrant workers and imports are substitutes in production, whilst skilled migrant workers and imports are complements.

Alexander Hijzen & Peter Wright

Institutional Determinants of Foreign Direct Investment

No 2005- 05 April

In this paper, we contribute to the literature on the determinants of FDI in developing countries, and re-evaluate the role of the quality of institutions on FDI. We use a newly available database, with unprecedented detail on the institutions of a set of 52 countries, and compare the results with matched variables from more familiar datasets. The paper controls for the correlation between institutions and the GDP per capita of the host country, and also accounts for potential endogeneity of institutions. Finally, we evaluate whether proximity of institutions between the host and the origin country raises bilateral FDI.

Agnès Bénassy-Quéré, Maylis Coupet & Thierry Mayer

The CEPII's Working Papers are available free, on-line, in PDF format; hard copies are also available on request.

RECENT PUBLICATIONS

ECONOMIE INTERNATIONALE, QUARTERLY

No 101, 1st Quarter 2005

The phasing out of EU agricultural export subsidies: Impacts of two management schemes
Alexandre Gohin & Patrice Gautier

Tax incentives and house price volatility in the euro area: Theory and evidence
Paul van den Noord

Normes de travail fondamentales et échanges sud-nord
Clotilde Granger

Déterminants de la localisation des activités en Chine : avantages comparatifs, forces géographiques et interventionnisme politique
Cécile Batisse, Sandra Poncet

Vers une régionalisation des échanges commerciaux en Europe centrale et orientale
Julien Lefilleur

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Publisher: La Documentation Française, price: €18.50 per issue, €65.50 annual subscription in Europe and €68.50 outside Europe.
Some selected articles are available in pdf format.
Issues published more than 2 years ago are available in full text on the web site.

LA LETTRE DU CEPII, MONTHLY

Africa Puts Forward its Eco

N° 243 March 2005

European monetary union has contributed to projects for monetary union being relaunched in other parts of the world. The most advanced is without any doubt that of the “second” west African monetary union, which binds together the five non-members countries of the West African Economic and Monetary Union (WAEMU), though the second union is ultimately set to merge with the WAEMU. In 2002, the project for the second union led to the creation of a West African Monetary Zone (WAMZ), and the monetary unification of these five countries is scheduled for 1st July 2005. However, the process of convergence is far from being completed and the union might well be postponed. These problems raise questions about the feasibility of the project and the monetary borders of the region. For each country the costs and benefits are analysed with respect to criteria defined by the theory of optimal currency areas. A summary analysis classifying the countries according to their economic proximity is put forward. This suggests that the WAEMU is a relatively homogenous group, which is not the case for the countries of the WAMZ, whose members thus do not have much interest in rapid monetary unification.

Agnès Bénassy-Quéré

Global Inequalities: Weights and Measures
N° 242 February 2005

Indicators of inequality across the world show trends which are apparently contradictory, but they are actually based on different concepts. The types of information they provide are therefore complementary. The fact that inequalities in the average income of more than 150 countries are rising, does indeed not prevent the majority of the world's population from belonging to countries whose average incomes are tending to converge. It is, however, necessary to look beyond national averages and take into account domestic inequalities to obtain a more complete image of global inequalities. From this point of view, estimates no longer differ due to concepts, but due to the data and statistical methods used. Nevertheless, in more recent times, estimates do suggest that world inequalities are falling from previous, very high levels, because to their international component. In contrast, domestic inequalities are increasing, on average, at the world level.

Isabelle Bensidoun & Agnès Chevallier

Argentina's Debt and the Decline of the IMF
N° 241 January 2005

More than three years after defaulting on its debt, the Argentine Government has proposed a bond exchange which would see its investors losing about 70% of their initial investments. Whatever the exact outcome of the operation, it already illustrates the weaknesses of the contractual approach to handling sovereign defaults. Given the coordination problems faced by private investors, the Argentine authorities were able to refuse any constructive and sincere negotiation. However, the scope for resisting such an non-cooperative strategy is in fact limited: the threat of court action was over-estimated and no arbiter or institutional monitor has emerged able of replacing the IMF. The absence of a binding link between private renegotiation and multilateral instruments for policy monitoring considerably reduces the leverage of the Fund on the overall process. This confirms the relative decline of the IMF in the new "international financial architecture". Furthermore, if the contractual approach may attain its objectives for "small" defaults, then several accidents as occurred in Argentina could well lead to a dead-end, requiring more institutional and political responses.

Jérôme Sgard

La Lettre du CEPII (monthly) is published in French. Publisher: La Documentation Française, price: €48.40 outside France (on subscription only). The English version of this publication is available on the CEPII's web:

http://www.cepii.fr/anglaisgraph/news/accueilengl.htm

BOOKS

Economie internationale
Jean-Louis Mucchielli & Thierry Mayer
Dalloz

The global interaction of economies is a source of economic gains but also leads to worries linked especially to the effects of the opening up labour markets. *Economie internationale* provides a set of thorough, analytical tools to place these phenomena in a proper perspective. This textbook offers a complete picture of founding theories of international economics and recent developments. The theoretical aspects are organised around fundamental institutions and graph-based reasoning. Stress is placed on measuring concretely relevant phenomena, as well as providing empirical support for theory. Each chapter provides a course and pedagogical material (summaries, keywords, skills acquisition tests, exercises and a bibliography) to help prepare classes and exams. Internet resources are used, along with on-line data for certain applications. The book is aimed mainly at undergraduates and students embarking on a Master's degree in economics, management, economic and social administration or business studies.

Les Russes de Gorbachev à Poutine
Alain Blum, Martine Mespoulet, Marie-Pierre Rey, Anne de Tinguy & Gérard Wild
Armand Colin

The coming to power of Mikhail Gorbachev in 1985 was soon followed by the upheaval of the established Soviet regime. While at first little concerned about reforming the country to stem its economic decline, the Secretary General of the CPSU progressively set about launching a political, social and very much cultural revolution. Glasnost and Perestroika were on the agenda: the authorities started to undertake an overhaul of the socialist functioning of the economy, before turning to abolishing the leading role of the Communist Party, as well as providing civil society with much-desired, previously non-existent liberties. But the results were not up to initial expectations. Within a few short years, the Soviet regime, faced with growing difficulties, collapsed, giving way to a Russian Federation. The latter's political, geographical and even mental borders remain fragile, so that it has not escaped a profound identity crisis. What is the situation today, twenty years after the beginnings of Perestroika? What assessment may be made of the two previous decades? To what extent is today's Russia, modelled by the successive presidencies of Boris Yeltsin and Wladimir Putin, different from the Soviet Union in 1985, from a political, institutional and economic perspective? Has Russian society really changed? What are today's Russians' behaviours, aspirations and values? This book sets out to answer these complex questions, as a whole.

NEWS IN BRIEF

A graduate of the European University of Viadrina (Germany), Olena Havrylchyk joined the CEPII in May to work on issues related to the economics of finance and banking. Her PhD was on "Banking Efficiency, Consolidation and Foreign Ownership: Essays on the Polish Banking Market". At the CEPII, she is participating in the project "The determinants of bank profitability in Eastern Europe". Olena Havrylchyk was previously a consultant with the European Investment Bank.

Eric Leydier left the CEPII in April, having worked several years within the IT unit.

FORTHCOMING

L'Economie mondiale 2006
Presentation of the CEPII's yearly publication
14 September 2005

Third Annual Conference of the Euro-Latin Study Network on Integration and Trade (ELSNIT)
Conference organized by the IDB, the IFW, the CREI, the RSCAS and the CEPII
21-22October 2005

Tenth Annual Meeting of the Latin American and Caribbean Economic Association (LACEA)
With the scientific support of the CEPII

27-29 October 2005

New Regionalism: Progress, Setbacks and Challenges Call for Papers
Conference organized by the IDB and the CEPII
9-10 February 2006

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Webmaster: DOMINIQUE PIANELLI

Subscription manager: SYLVIE HURION
Address: CEPII - 9, rue Georges Pitard - 75015 Paris - France
Tel. (33) 1 53 68 55 00 - Fax: (33) 1 53 68 55 03
http://www.cepii.fr/anglaisgraph/news/accueilengl.htm

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