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THE FRENCH CENTRE FOR RESEARCH
AND STUDIES ON THE WORLD ECONOMY

CONTENTS:

FOCUS

The World Economy in 2050: a Tentative Picture

There is considerable interest for long term growth issues in the business and policymaking communities, in particular when it comes to addressing the future place of emerging countries and their ranking. One headline of the Economist in October 2010 teasing on "How India's growth will outpace China's" is a good example of this interest. The mechanisms leading to their rankings range from simple arithmetic to the actual engines of growth – an issue extensively studied in economics.

Arithmetic is of limited help, even if it illustrates how little growth differentials can re-shape the world economy in few decades. A growth differential of a single percentage point per year, cumulated over 40 years, for example, results in a 49% income gap, while a differential of two percentage points results in a gap of 121% and three percentage points a gap of 226%. Based on the same arithmetic and simple assumptions about productivity and demographic trends, Fogel (2007) predicts that the three largest economies in the world in 2040 will be China (40%), ahead of the United States (14%) and India (12%).

However, the growth process is far from being mechanical and tackling the engines of growth is a challenging issue. Accumulation of physical and human capital, growth in total factor productivity (TFP) and energy constraints may vary over time. For instance, with a constant annual growth rate of 8%, China's economy will grow 21-fold in the next 40 years, while a linear convergence of China's annual growth rate from 8% to 3% over 40 years would result in 'only' 8-fold growth. These two scenarios would have entirely different implications for the world in terms of commodity markets, multinationals' strategies, carbon emissions, geopolitics, etc.

Although a very risky exercise, projecting the long run world economy is useful, beyond the guidance of business. Importantly, it also provides an indispensable baseline for global economic policy models, since the results of these simulations are often heavily dependent on the baseline path of the world economy. As thinking in global terms is increasingly relevant – think of environmental or trade policies – there is a growing need of theoretically founded projections.

Against this background, the CEPII published in 2006 a first consistent scenario at the 2050 horizon for 103 countries based on a neo-classical growth model with two production factors (capital and labor), plus TFP growth dependent on human capital. Relative valuation effects were introduced, based on a simple Balassa-Samuelson effect: theresults suggested that China would represent 22% of world GDP in 2050. Between 2005 and 2050, China and India would experience a 13-fold and a 10-fold increase in GDP, respectively. Over the same period, GDP for advanced economies would "only" double (Germany, France, Japan) or, for some, triple (the United States). However, the United States would keep the first rank in the world GDP hierarchy: only a swap between Japan and China was expected to take place for the second rank, while India would jump from the 13th to the fifth position.

The global economic crisis has provided powerful incentives to reconsider these long-term projections, for two reasons:

(i) advanced economies have suffered much more than emerging ones during and after the crisis, while developing countries have proved quite resilient;
(ii) global imbalances may be much more long-lived than initially thought, so the convenient assumption of a closed economy to model capital accumulation (used in the 2006 paper) may be inadequate. Furthermore, existing projections generally do not account for the energy constraint that will undoubtedly be binding at the 2050 horizon.

Consistently, in December 2010 the CEPII issued an updated set of long-term projections for 128 countries, introducing two new elements:
1. the energy constraint (through adding energy as a production factor)
2. a non-unitary relationship between savings and investment, which departs from assumptions of either a closed economy or full capital mobility.

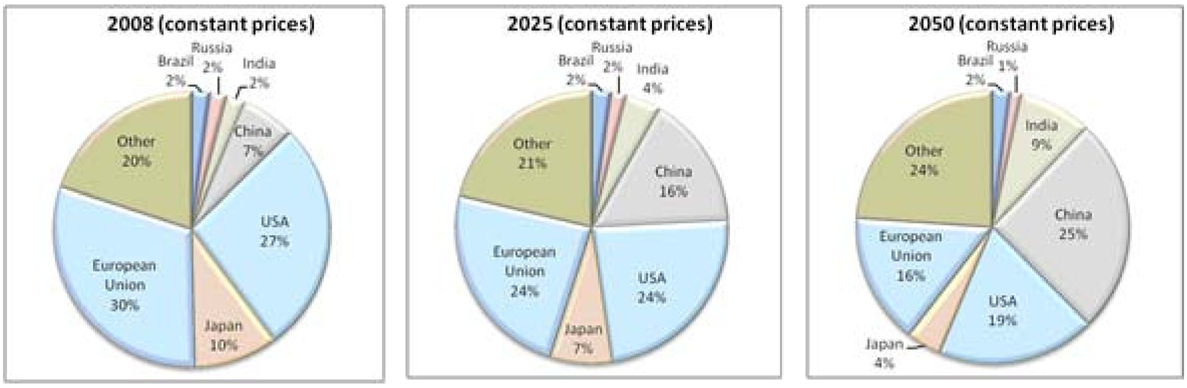
The projection is initialized in 2013, hence when the output gap can be assumed to be closed in most countries (IMF projections are used for the 2008-2012 period). Finally, the Balassa-Samuelson effect for relative prices is calibrated so as to be fully consistent with the three-factor growth model.

Accounting for relative price variations, the results suggest that China's and India's GDPs could grow 16-fold and 21-fold, respectively, between 2008 and 2050. Meanwhile, the US economy would only double and the European Union would grow by a mere 40%. In approximately 2025 China would overtake the United States, and India would overtake Japan. In 2050, China would represent 28% of the world economy, outdoing the United States (14%), India (12%), the European Union (9%) and Japan (3%) (see Figure below However, in terms of living standards, measured as GDP per capita in purchasing power parity, only China would be close to achieving convergence to US levels, and only at the end of the simulation period.

Hence these new projections tend to give credit to an acceleration of the move of the world's economy gravity centre towards emerging countries and more specifically China and India. It should however be kept in mind that any exercise of this type is heroic and should be used with great caution. To put this exercise in perspective, we must think of looking at the post 2008 crisis world economy through our pre-first oil shock glasses.

Figure: Shares of the world economy, 2008, 2025 and 2050

(in % of world GDP, including valuation effects)



Source: Fouré, Bénassy-Quéré and Fontagné (2010).

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ON THE RESEARCH AGENDA

Financial Development and Trade Performance in China

The attention has long been drawn on the apparent inefficiency of China's financial system, and on the surprising fact that the Chinese economy has achieved high growth rates despite this handicap. The paradox is especially apparent when looking at the export sector, which has been growing at even higher rates over the past 25 years. This seems to contradict results from the recent literature on the link between finance and trade, which has shown theoretically, and empirically in cross-country studies, that a well-functionning financial intermediation system was crucial for export activity, due to the presence of specific fixed costs for accessing foreign markets.

In this research we aim at answering this puzzle, using export data with information on the province of origin; we exploit variation in financial system development across provinces, coupled with variation in finance intensivity at the sector level, to test if the level of inefficiency in financial intermediation has a distortive impact on the structure of Chinese exports. In addition, we also exploit information on the ownership type of exporting firms, distinguishing between foreign-owned, domestic private-owned and state-owned firms, and joint ventures. When fully controlling for province-level variables, we find contrasted results depending on how financial development is measured. The liquidity ratio, a standard measure in empirical studies, has a clear positive impact on export growth. By contrast, measures of the structure of financial markets, such as the share of state-owned banks in the banking sector, or of the openness of the banking sector to foreign entry, have an influence through a redistribution of export activity across firm types, but with no net impact on aggregate exports. We also find evidence that the ownership type determines the degree of access to credit, and that firms adapt by sorting themselves into sectors with high or low needs in finance. Putting these results together suggests that the high level of liquidity in China on one hand, and the sorting of firm types according to varying degrees of credit constraint on the other, help explaining the outlying position of China in the finance-export relationship.

Joachim Jarreau & Sandra Poncet

The Consequences of Banking Crises for Public Debt

In the context of the aftermath of the recent financial crisis this study considers past historical episodes to examine what has happened to public debt over the medium and long term, The research provides estimates of the dynamic impact that banking crises episodes have typically had on the gross debt-to-GDP ratio, and of the role that structural and policy variables have had in shaping this response. The analysis complements previous work analysing the fiscal costs associated with banking crises in several respects by:

- Focusing on gross public debt as a dependent variable.

- Focusing on the debt-to-GDP ratio rather than the percentage change in debt levels. First, the debt-to-GDP ratio is a better measure to assess fiscal sustainability. Second, analysing the percentage increase of debt levels in the aftermath of banking crises could lead to possible misinterpretations since the *percentage* increase crucially depends on the initial level of the debt before the occurrence of the crisis.

- Presenting *inferential* empirical evidence on the increase of the debt-to-GDP ratio in the aftermath of banking crises.

- Estimating the effect of banking crises on the debt-to-GDP ratio both in the short and in the long run, in particular to assess whether fiscal costs associated with the crises have been permanent or if they have tended to dissipate in the long term.

- Analysing the heterogeneity of responses among different countries and episodes.

Using an unbalanced panel of 154 countries from 1970 to 2006, and estimating impulse response functions of public debt to banking crises we find that banking crises have produced a significant and long-lasting increase in the government debt-to-GDP ratio, with the effect being a function of the severity of the crisis. In particular, for severe crises, comparable to the current one in terms of output losses, the government debt-to-GDP ratio is found to increase by up to 50 percentage points at the peak, and by 37 percentage points in the medium term (eight years after the crises onset). The effect is considerably lower for moderate crises.

The increase in public debt in the aftermath of banking crises depends not only on the severity of the crises but also on country-specific characteristics. In particular, analysing a set of structural and policy variables larger increases in debt are found to occur in countries with higher initial debt-to-GDP ratios and with a larger share of foreign debt.

Davide Furceri & Aleksandra Zdzienicka

On the Link Between Credit Procyclicality and Bank Competition

The link between bank competition and banking system stability has recently drawn a renewed interest. Two approaches have emerged in the literature: the “competition-fragility” view according to which a rise in bank competition may destabilize the banking system, and the “competition-stability” for which more competition between banks has positive effects on the banking system stability.

From an empirical viewpoint, results are somewhat mixed regarding the superiority of one approach over the other. This absence of clear-cut findings may be due to various factors, such as the lack of a unique measure of bank competition, or the fact that the link between bank competition and banking system stability may be polluted by endogeneity problems—the degree of bank competition being potentially dependent on the stability of the banking system. In addition to these factors, we think that the measure retained for the stability of the banking system may also play a crucial role. While the previous literature mainly focuses on risk exposure indicators or on probability of bank failures, we suggest to add a new dimension to the analysis by measuring the banking system stability through the credit procyclicality.

Within this framework, our aim is to investigate the link between banking system stability —apprehended through the credit dynamics—and banks' market power. More specifically, we aim at studying whether credit procyclicality—*i.e.* the response of the credit market to a shock on GDP—is more important when the degree of banking competition is higher. We consider a sample of 17 OECD countries over the 1986-2009 period, and rely on the panel VAR (PVAR) modeling by accounting for the heterogeneity of countries in terms of their degree of bank competition.

Vincent Bouvatier, Antonia López & Valérie Mignon

FDI from the South: "*La raison d'être*" and consequences for the North

The share of developing and transition countries in the global foreign direct investment (FDI) outflows has doubled in the last 20 years, reaching 16% of the total FDI outflow stock. This process has not been only driven by an active role of China, whose share amounts to 6 percent of total FDI stemming from developing countries. Other important investors are Brazil, Hong Kong, India, Malaysia, Mexico, Russia, South Africa, South Korea, Singapore and the UAE, who together accounted for 72 percent of the total South FDI outflows in 2008. Most of the investment flows from developing countries go to other developing and transition economies, giving rise to the term "South-South FDI" and amounting to one-third of the total foreign investment in emerging economies.

The goal of this study is to understand the determinants of these investment flows, and their differences vis-à-vis more traditional FDI from developed countries ("the North"), as well as their implications for receiving countries and for investors form developed economies. Relying on a novel dataset of bilateral FDI flows over the past decade, and working within gravity model framework, we demonstrate that FDI from the South has a more regional focus than investment stemming from the North. In contrast with North investors, institutional distance between countries does not seem to deter investors from the South, and it even serves as a source of comparative advantage for emerging economies. We also find that investment flows from the North and South exhibit a complementary, or crowding-in, rather than substitute relationship, which we attribute to different investment behaviors of these investors. The latter finding is good news for both Northern investors and for South receiving countries, who see different investment opportunities grasped by different investors, rather than southern corporations competing head-to-head with their northern counterparts to earn market share.

Olena Havrylchyk

WORKING PAPERS

The World Economy in 2050: a Tentative Picture

N° 2010-27, December 2010

We present growth scenarios for 128 countries to 2050, based on a three-factor production function that includes capital, labour and energy. We improve on the literature by accounting for the energy constraint through dynamic modelling of energy productivity, and departing from the assumptions of either a closed economy or full capital mobility by applying a Feldstein-Horioka-type relationship between savings and investment rates. Our results suggest that, accounting for relative price variations, China could account for 28% of the world economy in 2050, which would be much more than the United States (14%), India (12%), the European Union

(11%) and Japan (3%). They suggest also that China would overtake the United States around 2025 (2035 at constant relative prices). However, in terms of standards of living, measured through GDP per capita in purchasing power parity, only China would be close to achieving convergence to the US level, and only at the end of the simulation period.

Jean Fouré, Agnès Bénassy-Quéré & Lionel Fontagné

Determinants and Pervasiveness of the Evasion of Customs Duties

N° 2010-26, November 2010

Evasion of customs duties is a serious concern in developing countries, where tariff receipts are often important, but their collection is often problematic. We study theoretically and empirically the determinants of evasion across countries and products, based on a systematic analysis of discrepancies in trade declarations - when available - for both partners. We conclude that evasion of customs duties is greater in poorer countries, especially where the rule of law is limited. The consequences are likely to be the most serious in the poorest countries, where we find a one percentage point higher tariff to be associated on average with an understatement of imports of 1% or more. We assess some policy remedies and conclude that automated customs data treatment may be particularly useful.

Sébastien Jean & Cristina Mitaritonna

On the Link Between Credit Procyclicality and Bank Competition

N° 2010-25, November 2010

This paper investigates the relationship between bank competition and credit procyclicality for 17 OECD countries on the 1986-2009 period. We account for heterogeneity among countries in terms of bank competition through the use of a hierarchical clustering methodology. We then estimate panel VAR models for the identified sub-groups of economies to investigate whether credit procyclicality is more important when the degree of bank competition is high. Our findings show that while credit significantly responds to shocks to GDP, the degree of bank competition is not essential in assessing the procyclicality of credit for OECD countries.

Vincent Bouvatier, Antonia López-Villavicencio & Valérie Mignon

Are Derivatives Dangerous? a Literature Survey

N° 2010-24, November 2010

Since the 1970s, the financial system has undergone deep structural changes. Innovation has been a key driver of these changes and most economists acknowledge that the impact has been positive overall. However, each time a financial crisis arises, the debate is on. Derivatives especially, which are among the major innovations of the past thirty years, cause deep concerns. In this paper, we propose a survey of the academic literature that has addressed the threats posed by derivatives. An initial issue is the impact of derivatives on the volatility of the underlying assets, but empirical findings do not suggest any significant effect. The recent literature on the dangers of derivatives is more concerned by systemic risks. Several studies suggest that the sophistication of the products and the concentration of risks are potential sources of instability because of the increasing uncertainty, the repeated occurrence of extreme losses, and finally the greater possibility of global crisis. Among the solutions that have been proposed to mitigate risk, beyond strengthening internal control, putting clearinghouses into general use and limiting naked-transactions seem to be the most promising avenues.

Gunther Capelle-Blancard

BACI: International Trade Database at the Product-Level. The 1994-2007 Version

N° 2010-23, October 2010

This paper documents the construction of BACI, our international trade database, which covers more than 200 countries and 5,000 products, between 1994 and 2007. New approaches have been developed to reconcile data reported by almost 150 countries to the United Nations Statistics Division, collated via COMTRADE. When both exporting and importing countries report to Comtrade, we have two different figures for the same flow, so it is useful to reconcile these into a single figure. To do this, firstly, as import values are reported CIF (cost, insurance and freight) while exports are reported FOB (free on board), transport and insurance rates have to be estimated and removed from import values. We regress the observed CIF/FOB ratios for a given flow on gravity variables and a product-specific world median unit value. In a second step we evaluate the reliability of countries reporting. We decompose the absolute value of the ratios of mirror flows using a (weighted) variance analysis. These measures of the reliability of reported data are used as weights in the reconciliation of each bilateral trade flow which is reported twice. Taking advantage of this bilateral information on each flow, we end up with a large coverage of countries and more reliable data, especially in terms of unit-values. BACI is freely available online to users of COMTRADE database, in different product classifications.

Guillaume Gaulier & Soledad Zignago

Indirect Exporters

N° 2010-22, October 2010

An Indirect Exporter is defined as a firm that sells its product to a trade intermediary in its own country, who then goes on to export the good. Despite the numerous appearances of these firms in recent theoretical models, there has been no empirical work comparing these firms to Domestic firms and “Direct Exporters". Using a firm-level data set for Eastern Europe, I show that these firms do, as predicted in the theoretical literature, lie between Domestic firms and Direct Exporters for a range of measures of firm performance. The advantage enjoyed by Direct Exporters is the most robust finding, while the ambiguity surrounding the productivity gap between Indirect Exporters and Domestic firms indicates that these two categories of firm may be close to identical.

Fergal McCann

Réforme des retraites en France : évaluation de la mise en place d'un système par comptes notionnels

N° 2010-21, October 2010

L’objectif est d’évaluer les effets d’une transformation du système actuel de retraite français en un système par comptes notionnels. L’analyse est effectuée à l’aide d’un modèle d’équilibre général à générations imbriquées qui permet de prendre en compte les effets de bouclage macroéconomique sous différentes hypothèses d’ouverture économique. Nous simulons les effets de la mise en place progressive, entre 2015 et 2030, d’un système unique par comptes notionnels se substituant, à terme, entièrement à tous les régimes actuels, de base et complémentaires. Par rapport à notre scénario de référence, les simulations montrent que l’introduction progressive d’un système par comptes notionnels permettrait d’obtenir une réduction des besoins de financement de l’ordre de 0,6 point de PIB à l’horizon 2050. Ensuite, nous évaluons la stabilité du système par comptes notionnels. Si le système par comptes notionnels réagit mieux que le système actuel dans les cas d’une augmentation de l’espérance de vie, d’un ralentissement de la productivité et d’une baisse des taux d’activité, il réagit de façon très similaire dans le cas d’une baisse de la fécondité et d’une hausse du taux de chômage. Par contre, une hausse des cotisations a un effet négatif sur les besoins de financement dans un système par comptes notionnels du fait d’un accroissement parallèle de la valeur des pensions.

Xavier Chojnicki & Riccardo Magnani

The Art of Exceptions: Sensitive Products in the Doha Negotiations

N° 2010-20, October 2010

It is necessary for multilateral trade negotiations to include exceptions to accommodate politically sensitive sectors. However, given the highly concentrated distribution of agricultural protection, too many exceptions put at risk the objectives of World Trade Organization. This paper assesses the delicate balance required, based on the case of agricultural trade protection in Europe and Japan, two countries where tariff dismantling in the agricultural sector is a particularly sensitive issue. Since agricultural border protection is heterogeneous, we avoid aggregation bias by extending a multi-country computable general equilibrium model to the product level. This allows us to combine the assets from general equilibrium and partial equilibrium modeling, and to take explicit account of interdependencies and trade policies. The results suggest that consideration of sensitive products strongly limits the potential gains from a possible agriculture agreement at Doha. Moreover, there is no aggregate trade-off between decreasing tariffs and increasing/opening quotas. To achieve "substantial" market access improvements in the agricultural sector, the objective should be most favored nation tariff reduction.

Christophe Gouel, Cristina Mitaritonna & Maria Priscila Ramos

Measuring Intangible Capital Investment: an Application to the "French Data"
N° 2010-19, September 2010

Following Corrado, Hulten and Sichel (2005) this paper investigates French spending in intangible capital. In this work, we tackle two issues. First, working on national accounting data we sharply investigate the data sources, using detailed supply & use tables taken from the French national accounts. Second, referring to different fields in the economic literature, we deepen the analysis and the measurement methods that have been used recently in the empirical literature. We are then able to assess more accurately the items of interest. We estimate that French intangible GFCF could be valued for the whole economy between 8% and 9% of GDP in 2004 and between 6% and 7% for the business sector.

Vincent Delbecque & Laurence Nayman

Clustering the Winners: the French Policy of Competitiveness Clusters
N° 2010-18, September 2010

In 2005 the French government launched a policy of competitiveness clusters, giving subsidies for innovative projects managed locally and collectively by firms, research centers and universities. This paper proposes an ex-ante analysis of the outcome of the selection process that took place before the implementation of the subsidies program, in order to assess whether the policy ended up in choosing winners or losers. We first ask how the clusters have been selected, and then focus on the selection of firms within the clusters, using export and productivity as a measure of performance. Our main conclusion is that public authorities have chosen the winners during the two-step selection procedure. Export premium, beyond what individual characteristics would predict, is however most visible within the category of clusters having no international ambition, where heterogeneity among firms is the largest.

Lionel Fontagné, Pamina Koenig, Florian Mayneris & Sandra Poncet

The Credit Default Swap Market and the Settlement of Large Defaults
N° 2010-17, August 2010

The huge positions on the credit default swaps (CDS) have raised concerns about the ability of the market to settle major entities' defaults. The near-failure of AIG and the bankruptcy of Lehman Brothers in 2008 have revealed the exposure of CDS's buyers to counterparty risk and hence highlighted the necessity of organizing the market, which triggered a large reform process. First we analyse the vulnerabilities of the market at the bursting of this crisis. Second, to understand its resilience to major credit events, we unravel the auction process implemented to settle defaults, the strategies of buyers and sellers and the links with the bond market. We then study the way it worked for key defaults, such as Lehman Brothers, Washington Mutual, CIT and Thomson, as well as, for the Government Sponsored Enterprises. Third, we discuss the ongoing reforms aimed at strengthening the market resilience.

Virginie Coudert & Mathieu Gex

The Impact of the 2007-2010 Crisis on the Geography of Finance

N° 2010-16, August 2010

The location of financial activities is traditionally characterized by a great deal of inertia. However, the 2007-10 crisis may considerably modify the geography of finance and cause an upheaval in world hierarchy. The crisis hit the Western countries directly and the main financial centers have been massively losing jobs, especially London and New York. Moreover, in Western countries, the financial industry is on the way to lose the support implicitly provided by governments until the crisis. Indeed, while finance was considered as a first-class position in the international division of labor, the crisis has clearly shown the threats associated with an excessive growth of the financial industry (vulnerability to external shocks, rising of inequalities, etc.). Hence, even within the traditional bastions of finance it is claimed that the financial industry needs to get smaller. At the same time, stock markets in Shanghai, Hong-Kong and Bombay are upstaging them as major players.

Gunther Capelle-Blancard & Yamina Tadjeddine

Socially Responsible Investing: it Takes More than Words

N° 2010-15, August 2010

Socially Responsible Investing (SRI) enjoys a large consensus and is frequently presented as a solution to conciliate finance and sustainable development. As proof of its success, most of its proponents point to the growth of the SRI market. The aim of this paper is to put this growth into perspective. To begin with, we propose an appraisal of the SRI market growth. Then, we use online search engines and archive collections to examine the popularity of SRI in the public debate. We also rely on a content analysis of articles that deal with SRI. It enables us to identify the most favored topics and consequently to find out journalists and scholars' mainstream opinions and attitudes vis-à-vis SRI. Our main results can be summarized as follows. Actually, the SRI market share remains low (slightly more than 10%), not to say very low if we consider only "Core SRI" (very few percent). Its growth is relatively high in Europe, but its market share is stagnating in the US. In this regard, the contrast is striking with the growing number of articles related to SRI on the web and in books, newspapers and academic journals worldwide. The fact that these papers focus on the performance of the SRI funds, to the detriment of conceptual issues regarding ethic or altruism, may explain this dissonance.

Gunther Capelle-Blancard & Stéphanie Monjon

A Case for Intermediate Exchange-Rate Regimes

N° 2010-14, August 2010

Despite increasing capital mobility and the subsequent difficulty in controlling exchange rates, intermediate exchange-rate regimes have remained widespread, especially in emerging and developing economies. This piece of evidence hardly fits the "impossible Trinity" theory arguing that it becomes difficult to control the exchange rate without a "hard" device when capital flows are freed. Calvo and Reinhart (2000) have suggested several explanations for such "fear of floating": exchange rate pass-through, liability dollarization, dollar invoicing of domestic and external transactions, and an underdeveloped market for currency hedging make it more desirable to stabilize the nominal exchange rate.

However, the New-Keynesian model, which has become the main workhorse for studying exchange-rate regime choice since the 1990s, typically opposes fixed nominal pegs to free-floating regime, without considering intermediate regimes. We intend to fill this gap here by comparing the performance of "extreme" regimes to that of an intermediate regime where monetary authorities care both about inflation and about nominal exchange-rate deviations from the steady state, when a small economy is hit by several types of shocks. Without nominal wage rigidities, our results are in line with the New-Keynesian literature arguing in favor of inflation-targeting regimes. However, when nominal wage rigidities are taken into account, we find the intermediate regime to be appropriate for an economy that is mainly hit by productivity and foreign-interest shocks, which is often the case in emerging and developing economies. The free-floating regime (with inflation targeting) seems more adequate if the economy experiences mostly demand shocks and foreign prices shock. Finally, the fixed peg regime is always dominated by either the free-floating or the intermediate regime. A fully-fledged analysis of intermediate regimes should of course account for the fear-of-floating-type advantages of such regimes, as well as for their shortcomings in terms of costly reserve-accumulation and/or recurrent crises. Our results however suggest that, by concentrating on two extreme regimes (fixed nominal pegs and free floats), by neglecting wage rigidities and/or by assuming that floating countries can engineer an "optimal" interest-rate feedback rule, the existing New-Keynesian literature may have exaggerated the merits of free-floating regimes to the detriment of "soft" pegs.

Véronique Salins & Agnès Bénassy-Quéré

Gold and Financial Assets: Are There Any Safe Havens in Bear Markets?
N° 2010-13, July 2010

This paper looks into the role of gold as a safe haven against stocks during recessions and bear markets. Following Baur and McDermott (2010) and Baur and Lucey (2010), we characterize safe havens by their negative correlations with stocks during crises. We extend their results in three ways. First, we identify crisis periods by exogeneous means using, successively, recession periods provided by the NBER and periods of bear US stock markets. Second, we estimate a model allowing for time varying conditional covariances between gold and stocks returns. Third, we test if long run relationships exist between gold and stocks and explore whether they can be used to construct portfolios immune to crises. The regressions are run on monthly data for gold and several stock market indices (France, Germany, UK, US, G7) over the period 1978:2-2009:1. In the short run, we find that the correlation between gold and stocks is close to zero during recessions, which qualifies gold for being a “weak safe haven”. This is also the case during bear markets against the stock indices of most considered countries, although gold appears as a strong hedge versus the US stock index. A closer look at the data shows that these results only hold on average and not for every crisis episode or every country. In the longer run a negative relationships exists between gold and some stock markets (France, UK, US). However, it does not allow the construction of a hedged portfolio immune to all crises. Overall, despite its interest for the diversification of portfolios, gold stays a risky investment, even during crises.

Virginie Coudert & Hélène Raymond

European Export Performance
N° 2010-12, July 2010

Countries no longer specialise in products or sectors, but in varieties of the same product (sold at different prices). To study the way in which the European Union copes with the emergence of new big world exporters in this context, we analyse the redistribution of world market shares at the level of product variety. We distinguish for each product three price ranges. We decompose the growth of exports into structural effects (geographic and sectoral) and into a pure performance effect. From 1994 to 2007 the EU25 withstood the competition of emerging countries better than the U.S. and Japan. European market share losses arise during the 1994-2000 period, and are mainly explained by poor export performance of old member states. More precisely, the EU gains market shares in the upper segment of the market, by cumulating good performance and favourable structure effects, contrary to the U.S. and Japan which withdraw extensively from this segment of the market. Finally, all developed countries lose market shares in high-technology products to developing countries, with the EU losing less than other countries.

Angela Cheptea, Lionel Fontagné & Soledad Zignago

The Effects of the Subprime Crisis on the Latin American Financial Markets: an Empirical Assessment
N° 2010-11, July 2010

The aim of this article is to answer the following question: can the considerable rise in the volatility of the LAC stock markets in the aftermath of the 2007/2008 crisis be explained by the worsening financial environment in the US markets? To this end, we rely on a timevarying transition probability Markov-switching model, in which "crisis" and "non-crisis" periods are identified endogenously. Using daily data from January 2004 to April 2009, our findings do not validate the "financial decoupling" hypothesis since we show that the financial stress in the US markets is transmitted to the LAC's stock market volatility, especially in Mexico.

Gilles Dufrénot, Valérie Mignon & Anne Péguin-Feissolle

RECENT PUBLICATIONS

LA LETTRE DU CEPII, MONTHLY

Can the Democratic Party of Japan Implement a New Economic Policy?
N° 301, 14 September 2010

In August 2009, for the first time since 1955, an opposition party, the Democratic Party of Japan, won a clear mandate to form a new government, ousting the incumbent Liberal Democratic Party. Its initial economic reform programme of refocusing growth on domestic demand using large social transfers has come under severe political pressure, including within the current majority, with the supporters of Naoto Kan in favour of reining in budget spending and those of Ichiro Ozawa partisans of a vigorous economic stimulation policy. Naoto Kan's election as President of the Democratic Party keeps him in the post of Prime Minister and seems to confirm the shift in the DPJ's economic policy towards one of tighter control of public finances.

Evelyne Dourille-Feer

Eurozone Crisis: Debts, Institutions and Growth
N° 300, 28 June 2010

The Eurozone crisis is much more than a sovereign debt crisis. It calls into question the whole architecture of economic policy, from monetary policy to macroeconomic surveillance and sanctions. Beyond the short-run urgencies, EU members need to come out with a clear view of what kind of coordination device they want to invent. There are several routes forward, but failing to select one could contribute to marginalizing the Eurozone in the global economy.

Agnès Bénassy-Quéré & Laurence Boone

The G20 in the Aftermath of the Crisis: a Euro-Asian View
N° 299, 25 June 2010

This Letter du CEPII draws on the meeting of the fifth Asia-Europe Economic Forum held in Tokyo on 25 March 2010. The forum brought together a broad range of participants including policymakers, academic experts and private sector specialists. This year, the agenda focused on reforms, national budgets, G20 hopes from both Asian and European perspectives. After focusing in the midst of the crisis on the international financial regulation reform, the G20 has launched at the Pittsburgh summit in September 2009 the Framework for Strong, Sustainable, and Balanced Growth. The rebalancing of global growth requires exit strategies differentiated across countries, structural reforms and a better fiscal coordination in Europe. Moreover, a question remains: the G20 has reacted promptly at the height of the crisis, but it has to prove its legitimacy and its ability to achieve reforms although the appetite for coordination decreases.

Agnès Bénassy-Quéré, Fan He, Masahiro Kawai, Yung Chul Park & Jean Pisani-Ferry

China: the End of the Outward-Oriented Growth Model
N° 298, 21 April 2010

China, which since the 1980s has developed a dynamic export sector in order to drive its economic development, was hit hard by the collapse in global demand in late 2008. This episode revealed the fragility of the Chinese growth model, which is currently at a crossroads, not only as a result of the global context but also owing to the internal tensions it has caused. The results of thirty years of economic openness, as evidenced by CEPII studies, show that China's outstanding successes on international markets also have adverse effects and cannot be deemed to constitute a long-term development strategy. CEPII analyses are now assessing the changes that may occur in Chinese supply and the need to refocus growth on internal demand.

Guillaume Gaulier, Joaquim Jarreau, Françoise Lemoine, Sandra Poncet & Deniz Ünal

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NEWS

Baseline

BASELINE is the database developed by the CEPII in 2010 to picture THE WORLD ECONOMY IN 2050.

FORTHCOMING

Environmental Policy: Lessons from Economic Theory
Organized by the CEPII, the French Ministry for Ecology, the *International Economics* Journal, the Université Catholique de Louvain and the University of Lille I
Paris, January 12, 2011

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