C O N T E N T S:

FOCUS

China: the Long Way to a Balanced Economy

Up to now, China has successfully overcome the shock of the global crisis which erupted in 2007. Its economic growth has remained strong thanks to the expansionary economic policy initiated in late 2008, and the country has further enhanced its position in the world economy and international trade. Since 2007, China has overtaken Germany as the world leading exporter and Japan as the second largest GDP in the world. China's recent economic performance and its long term prospects have been comprehensively analyzed, especially by N. L. Lardy (2012) and in a 2012 joint report by the World Bank and the Development Research Center of the State Council of the People's Republic of China (DRC): "China 2030".

The CEPII has contributed to the understanding of China's economy with research work focusing on foreign trade and future growth strategy. The following conclusions have been put forwards.

Foreign trade performance

There is a huge literature explaining China's stellar export performance. Research conducted at CEPII suggests that the density of links between products gives rise to export-enhancing spillovers and plays a significant role. These results are however mainly limited to ordinary trade activities and to domestic firms. This is consistent with the fact that firms (mostly foreign) engaged in processing trade activity are less embedded in the local environment, and consequently that the export performance relates less to the consistency of their products with the local productive structure. Researchers at CEPII have also put forward that exposure to foreign exporters helps to reduce the fixed cost of creating new trade linkages, and suggested that the increasing presence of foreign exporting firms in China might contribute to the diversification of Chinese domestic firms' exports towards more difficult and previously inaccessible destinations.

External rebalancing

China was a major player in the rise of global imbalances in the mid 2000s. Since 2007, China has rebalanced its foreign trade but the bilateral trade imbalances have remained large. China's trade surpluses with Europe and the U.S. have not diminished. Its deficits have deepened with countries in Asia and in the Middle East and Africa. The rising prices of energy and raw materials have contributed to reduce China's trade surplus. China has stimulated the Asian country growth through its demand of manufactured goods and the growth in African and Latin American countries through its demand of primary products. Consequently, the weakening of China's growth in 2012 will have negative effects on these partners.

China's economy has shifted from export-led to domestic demand-led growth. The rise of consumption goods in China's imports already reflects the strong demand of the most affluent Chinese households, and European high-end products have proved successful in this new market. However, the imbalance in favor of investment at the expense of private consumption has worsened, although the National Account statistics may exaggerate the distortion. China is still a long way to a consumption driven economy, and has to move in that direction to make its growth sustainable in the next decades.

Long term prospects: toward a new growth strategy

Simulations of an original DGE model of the US, Chinese and Euro area economies with financial frictions and various monetary regimes, show that the contribution of China in global rebalancing should primarily rely on structural policies aiming at reducing aggregate savings in China and opening up the financial account. The role of the exchange-rate regime would be minor under standard monetary policies.

According to CEPII's macroeconomic projections for the world economy at the 2050 horizon, China could account for 33% of the world economy in 2050 (thanks to its economic growth and the appreciation of the yuan), which would be much more than the United States (9%), India (8%), the European Union (12%) and Japan (5%). China would overtake the United States around 2020 (2040 at constant relative prices). However, in terms of standards of living, measured through GDP per capita in purchasing power parity, China would still lag 10 percent behind the United States at the 2050 horizon.

China's catching up will occur in a finite world of limited natural resources and climate change, where the consumption pattern epitomized by the US way of life is no more sustainable and must not be replicated. The purpose of China's reform is an harmonious society, a balance of forces that contributes to strengthening the sovereignty of the nation. It will need to leapfrog Western economic achievements, not to imitate them. The 12th five-year plan provides a roadmap for gradually overhauling the reform process to firmly reach sustainable growth by 2030.

In an oncoming book by the CEPII, the main drivers in the new stage of reform are elicited.

Environment-friendly urbanization involving about 400 million rural migrants will be the main axis of structural change. The success of this process is vital since it will mix upward social mobility and ecological balance. To meet this challenge, strategic planning must coordinate public good provision and private initiatives to maximize the gains of agglomeration in transportation, housing and the production of high-end services. They will be the linchpins of post-modern modes of consumption that embody frugal, carbon-light technology.

Since the growth regime shaped by those drivers will be human capital and R&D intensity, sweeping changes in economic incentives are warranted by way of the price system. The former stage of reform was a great achievement in liberalizing industrial good prices. The next stage of reform will deeply improve the regulation in factor prices: labor, credit, rural land, resources and carbon.

In creating new rights and obligations and in opening a host of new markets, the reform will alter the interdependencies between the political sovereign and the civil society. Labor interests will be better accounted for in corporate governance, a renewed fiscal reform will better align the interests of bureaucrats with overall policy objectives and sui generis social welfare, combining universal access to basic cares and activation of Confucian solidary networks may arise.

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*O*N THE RESEARCH AGENDA

The Effect of Non Tariff Measures on Trade

Non-Tariff Measures (NTMs) have risen in prominence and have become a source of concern. Streamlining cost-raising NTMs is now recognized, in many countries, as a key component of national competitiveness agendas. It is therefore important to measure the effects of these NTMs in order to identify which are the most harmful. The objective of this study is to assess the effect of NTMs on trade (their severity), and to infer their *ad-valorem* equivalents (AVEs), *i.e.* the rate at which tariffs would have the same effect as NTMs on trade flows.

An important strand of the literature has focused on the variation in trade flows induced by NTMs. Kee *et al*. (2009) rely on an import equation at the product level (HS6 digit) aggregated

over all origins. One problem with this approach is that the regression equations are run product by product on small cross-sections of countries. Another strand has sought to estimate AVEs by comparing directly home (NTM-ridden) product prices with the prices of similar products on markets where those products are free of distortions, in order to obtain an estimated "price gap". Andriamanjara *et al.* (2004) regress prices collected by the Economist Intelligence Unit at the city level on suitably coded NTMs. But this price database contains too few products.

   We estimate AVEs of NTMs by combining NTM data recently collected (at HS6 digit level, for 5000 products) with the bilateral Trade Unit Value database from CEPII (at the HS6 digit level) and inferring how NTMs affect the unit value of the imported product. Therefore one could obtain a database covering a significant number of countries and presenting series of those AVEs for different sort of NTMs (SPS, TBT, Licenses…) at the country level and product level.

<div align="right">Julien Gourdon & Olivier Cadot</div>

Kee, H. L., Nicita, A. & Olarreaga, M., **Estimating Trade Restrictiveness Indices**, *Economic Journal* vol. 119, Issue 534, January 2009, pp.172-199

Andriamananjara, S., Dean, J., Feinberg, R., Ferrantino, M., Ludema, R. & Tsigas, M., **The Effects of Non-Tariff Measures on Prices, Trade, and Welfare: CGE Implementation of Policy-Based Price Comparisons**, *USITC Office of Economics Working Paper* 2004-04-A.

Product Standards and Margins of Trade: Firm Level Evidence

   Using a detailed dataset of French firms exports for the period 1995-2005 and a new database on specific trade concerns raised in the TBT and SPS committees at the WTO, we analyse the trade effect of restrictive product standards on the extensive and the intensive margins of trade.

   The advantage of using specific trade concerns as an index of the degree of restrictiveness of product standards is that it focuses only on those product standards that are perceived to represent a barrier to trade, thus overcoming a limitation of existing measures of non-tariff barriers.

   We analyse the effects of product standards on three trade-related aspects:

> (i) probability to export (firm-product extensive margin),
> (ii) value exported (firm-product intensive margin) and
> (iii) pricing strategy (upgrading versus pricing-to-market).

   Furthermore we look at how firms' market shares, orientation of French exports, and comparative advantage modify the effect of SPS. We find that SPS concern discourages the presence of French firms in SPS-imposing foreign markets. However, the intensive margin is not significantly affected.

<div align="right">Lionel Fontagné, Gianluca Orefice, Roberta Piermartini & Nadia Rocha</div>

Product Relatedness and Firm Exports in China

   Recent empirical work has put structural transformation back at the forefront of the understanding of economic growth (Hausmann and Hidalgo, 2011). Differences in countries' ability to diversify away from agriculture and the production of traditional goods into manufacturing and other modern activities appear to explain why they take off or remain poor. The New Structural Economics theory argues that the key explanation for a successful upgrading process is the

consistency of the new industries with the country's latent (and evolving) comparative advantages (Lin, 2012).

We empirically test this proposition based on Chinese data. Specifically, we use Chinese firm-level data between 2000 and 2006 to investigate whether export growth is higher for products that are characterized by denser connections with the local productive structure. We follow the literature and investigate the possible heterogeneity of results depending on the trade type (ordinary or processing) and firm ownership (foreign or domestic) as it may be the case that firms (mostly foreign) engaged in processing trade activity are less embedded in their local environment, and consequently that their export performance relates less to the consistency of their products with the local productive structure.

<div align="right">Sandra Poncet & Felipe Starosta de Waldemar</div>

Hausmann, R. & C. Hidalgo, (2011), **The Network Structure of Economic Output**, *Journal of Economic Growth*, vol. 16, Issue 4, pp.309-342.

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Border Carbon Adjustment and Potential Trade Retaliation: an Evaluation with MIRAGE-e

Recently, carbon leakage risks have been examined in depth in the framework of the European Emission Trading Scheme (EU ETS). Since 2005, this system has capped emissions of highly emissive European companies. But some of these companies are significantly exposed to international competition. Several Member States, in particular France, have proposed to impose a Border Carbon Adjustment (BCA) to imports of the products covered by the EU ETS. However, as a trade measure, a BCA may be contested by a World Trade Organization member under its dispute settlement mechanism and may lead to trade retaliation from some trade partners. While the economic impacts of border carbon adjustment measures have been addressed in several papers, we are not aware of any study that assesses the implications of trade retaliation if the BCA is deemed illegal. The aim of this research is to analyze the efficiency, in terms of carbon leakage limitation, of a BCA in complement to the EU ETS, and also to evaluate the cost of possible trade retaliation due to the implementation of this trade measure.

The analysis is based on the model MIRAGE-e, the energy-oriented version of CEPII's global CGE model, MIRAGE.

A first scenario attempts to represent the commitments taken in the world concerning the greenhouse gas (GHG) emissions climate policies. This scenario models an increasing constraint on GHG emissions of the highly emissive industrial sectors in the EU up to 2025 based on the decision taken by European Parliament and Council in 2009, including the integration of the aviation sector from 2012. The emission reductions applied in the non-ETS sectors and in the rest of the world are consistent with the pledges taken in the Copenhagen and Durban Agreements.

A second scenario encompasses the implementation of a BCA to imports of the products covered by the EU ETS. Like EU producers, foreign producers must surrender allowances equal to the emissions linked to the production of the imported products.

A last scenario assumes that EU's main trade partners bring a WTO challenge against the BCA and apply some trade retaliation, modeled as an increase in custom duties, compatible with the WTO framework.

<div align="right">Jean Fouré, Houssein Guimbard & Stéphanie Monjon</div>

Assessing the Price-Raising Effect of Non-Tariff Measures in Africa

In spite of widespread tariff reductions, intra-African borders remain "thick", with many hurdles standing in the way of regional trade. Inadequate transportation infrastructure is not the only obstacle. Ample anecdotal evidence summarized in, *inter alia*, Gillson (2011) and Charalamides and Gillson (2011) suggests that non-tariff measures (NTMs), whether deliberately protectionist or not, raise trade costs and inhibit regional trade in Africa.

We follow the price-based strand of the literature and estimate the price-raising effect of NTMs by combining the World Bank's International Comparison Project (ICP) price database with the new NTM database.

Consistent both with earlier estimates and with the anecdotal evidence, we find that, on average, sanitary and phytosanitary (SPS) measures raise the domestic prices of foodstuffs by about 13% in sub-Saharan Africa (SSA). SSA is no outlier in this, with similar price-raising effects observed in other regions, but interaction terms with income suggest that the effect is heavier in low-income countries, possibly reflecting poor or restrictive administration of the regulations.

We then use Kenya's household survey and show that, looking only at the effect of NTMs on prices (i.e. ignoring their non-trade objectives), SPS measures act like a regressive tax, a reflection of the large share of food in poor households' budgets.

Julien Gourdon

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DATABASES

Product-Level Relatedness

The role of structural transformation as a major engine for economic growth and development has regained attention in the last few years. Whether countries take off or remain poor appears to relate to their ability to diversify away from agriculture and the production of traditional goods into manufacturing and other modern activities (McMillan and Rodrik, 2011) . Since countries can only diversify by building on what they already have, successful upgrading process requires a very efficient capacity to capitalize on existing productive knowledge and to exploit the links between products. Recent studies focusing on the Product Space suggest that initial product specialization is key in this respect (Hidalgo *et al.*, 2007). As developed by Hausmann and Klinger (2007a) and Hidalgo *et al.* (2007), the Product Space is a network that formalizes the idea of relatedness between products traded in the global economy. The main contention from this work is that all products do not have the same degree of relatedness (and hence the same position in the product space) and, as a result, have different potential, notably as a platform for jumping on to new economic activities. The relationship between production structure and economic performance has been confirmed by several macro-level studies. Countries specialized in products with dense connections with other goods are found to grow faster (Hidalgo *et al.*, 2007). This finding suggests that density of links between products gives rise to spillovers such as knowledge externalities and economies of scale and scope.

In order to quantify the relatedness between products traded in the global economy and to investigate its role in the reshaping of the structure of production in the specific case of China , CEPII's researchers have computed bilateral relatedness between products and linked it to productive structure in Chinese cities to investigate whether denser connections with the local productive structure provide export growth gains. They use the Hidalgo *et al.* (2007)'s indicator of proximity based on co-exporting probabilities in the world. The fact that a product is co-exported with another product by many countries is held as an outcome-based measure of relatedness. This builds on the idea that co-export reflects similar requirements in terms of institutions, infrastructure, resources, technology, or some combination thereof. Producing and exporting computers is for example expected to require competencies, technology, inputs and production factors rather similar to those that allow to produce televisions. Hence, most of the countries should export computers and televisions in tandem, resulting in a high level of proximity between the two products. Alternatively, since the necessary requirements for the production and export of a product like cheese or natural gas are likely to be very different from those behind computers, the proximity value between these two products and computers should be rather low.

Bilateral proximities (for each pair of products i and j) is the minimum of the pair-wise conditional probabilities of countries exporting a good given that they exports another.

$$Proximity_{ij} = min[Pr(i|j); Pr(j|i)]$$

with Pr(i|j) being the average conditional probability that good i is exported when good j is exported and Pr(j|i) the average conditional probability that good j is exported when good i is exported.

These probabilities are computed as the average of bilateral co-exporting probabilities in the world. In order to exclude marginal exports, a country is said to export a product, when it exhibits a Revealed Comparative Advantage as indicated by a Balassa index greater than 1.

We compute the bilateral relatedness proximity$_{ij}$ between products i and j for 5016 HS6 products, using data for 239 countries in 2000 from the BACI world trade dataset_.

Table 1 provides summary statistics of the 25,155,240 (5015*5016) pairs of products.

Table 1 : **Average proximity ij**
in 2000

	Mean	Median	Bottom 5%	Top decile
All sample	0.14	0.13	0	0.32
nimal and vegetable products (obs: 2592755	0.11	0.10	0	0.22
Textile (obs: 653672)	0.24	0.23	0.06	0.46
Machinery / Electrical (obs: 247506)	0.22	0.21	0.6	0.41

Table 2 reports proximity measures for specific product pairs. It illustrates examples of how products are related to each other. Digital computers have a proximity value of 0.02 with oil, reflecting the fact that in the whole sample of countries exporting computers or oil, only 2% export the other product at the same time. This clearly indicates that the requirements needed to export both products are distinct. Conversely, computers have a strong proximity (0.4) with automobile. This value shows that the requirements for exporting computers and cars are quite similar.

Table 2 : **Proximity ij measures by specific products pairs**
in 2000

	Rice	T-shirt cotton	Colour TV	Digital computer	Automobiles, spark ignition engine <1000 cc
Oil	0.15	0.08	0.07	0.02	0.02
Rice		0.09	0.04	0	0.09
T-shirt cotton			0.12	0.06	0.08
Colour TV				0.03	0.4
Digital Computer					0.32

Several studies have built on this indicator of proximity to measure the average relatedness between products for specific locations and link it with their economic performance. Empirical results based on cross-country data (Kali *et al.*, 2010; Hidalgo *et al.,* 2007) suggest that the intensity of links within the local productive structure is associated with higher GDP growth. This finding is confirmed when applying this approach to analyze the export performance of Chinese firms: export growth is higher for products that are characterized by denser connections with the local productive structure. Interestingly the gains in export growth are mainly limited to ordinary trade activities and to domestic firms. This suggests that firms (mostly foreign) engaged in processing trade activity are less embedded in their local environment, and consequently that their export performance relates less to the consistency of their products with the local productive structure.

BACI is downloadable from http://www.cepii.fr/anglaisgraph/bdd/baci.htm

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Poncet S. & Starosta de Waldemar F., **Product relatedness and firm exports in China**, mimeo.

Sandra Poncet

Revisiting the theory of optimum currency areas: Is the CFA franc zone sustainable?
N°2012-13 June 2012

   This paper aims at explaining why the CFA countries have successfully maintained a currency union for several decades, despite failing to meet many of optimum currency area criteria. We suggest that the CFA zone, while not optimal, has been at least sustainable. We test this sustainability hypothesis by relying on the Behavioral Equilibrium Exchange Rate (BEER) approach. In particular, we assess and compare the convergence process of real exchange rates towards equilibrium for the CFA zone countries and a sample of other sub-Saharan African (SSA) countries. Our findings evidence that internal and external balances have been fostered and adjustments facilitated in the CFA zone as a whole?compared to other SSA countries?as well as in each of its ember countries.

Cécile Couharde, Issiaka Coulibaly, David Guerreiro, Valérie Mignon

Macroeconomic transmission of eurozone shocks to emerging economies
N°2012-12 June 2012

   This paper analyzes the robustness of emerging economies growth performance to a number of external demand shocks using a Bayesian vector autoregressive (BVAR) model with informative priors on the steady state. Using quarterly data from 1993 to 2011 for global financial conditions and external demand variables, it examines the magnitude of the shocks from a deepening Eurozone recession on China, emerging Asia, and emerging Latin America, and the factors that influence the transmission of these shocks. It finds that more than fifty percent of the variation in real GDP growth of Latin American emerging economies is explained by external factors, while it is slightly less than fifty percent for emerging Asia and China. Conditional forecasts of different scenarios indicate that a deepening of the Eurozone recession would create a severe and persistent contraction for emerging economies, depending on the response of the U.S. growth to this shock. Finally, forecasts suggest that a sharp slowdown in China's growth would have a significant negative impact on emerging economies' growth, and that the Latin American countries would be more severely hit than the Asian ones.

Bilge Erten

The fiscal impact of immigration in France: a generational accounting approach
N°2012-11 June 2012

   The objective of this study is to use both static and dynamic frameworks to compare the benefits that immigrants draw from the public system with their contributions through the taxes that they pay. The main conclusion of this article is that the impact of immigration on welfare systems is weak. Thus, if we compare, on a given date, immigrants' global contribution to the public administration budget with the volume of transfers they receive, immigrants appear to be relatively favored by the redistribution system. At the same time, even if immigrants seem to pay less taxes and receive more transfers than natives, the difference in distribution between the two populations, with a higher concentration of immigrants in the active age groups and a sparser concentration among the net beneficiaries of the social transfer system, leads to a slightly positive long-term impact of immigration on public finances. However, the impact of immigration remains very slight compared to the global effort that would have to be undertaken to reduce budgetary imbalances.

Xavier Chojnicki

MAcMap-HS6 2007, an exhaustive and consistent measure of applied protection in 2007
N°2012-10 May 2012

The third version of the MAcMap-HS6 database, built as a result of a joint effort of CEPII (Centre d'Études Prospectives et d'Informations Internationales, Paris) and ITC (International Trade Centre, Geneva), based on ITC's MAcMap raw data, proposes an exhaustive and consistent measure of applied, preferential tariff protection in 2007. The methodology, similar to the one used for previous versions, relies on reference groups of countries to limit the endogeneity bias faced when computing ad valorem equivalents of tariff protection, and when computing averages at aggregate levels. The world average applied protection level in 2007 is estimated to be 4.4%. Compared to 2004, this is a decline by nearly 0.7 percentage point, mainly due to unilateral liberalizations and to new preferential trade agreements. The decline in the ad valorem equivalent of specific tariffs of some agricultural products, linked to the surge in world prices, lowers the average protection. In the opposite way, the increasing share of developing countries, where protection is higher, tend to raise the world average.

<div align="right">Houssein Guimbard, Sébastien Jean, Mondher Mimouni, Xavier Pichot</div>

Regional Integration and Natural Resources: who benefits? Evidence from MENA
N°2012-09 May 2012

This paper is built on Venables (2011) theoretical predictions which show that gains from regional integration are unevenly distributed between resource rich and poor countries. We explore the effects of different integration schemes in Middle East and North Africa. Results suggest that within Pan Arab Free Trade Agreement (PAFTA), there is significant trade creation for resource poor countries associated with regional integration, and no evidence of trade diversion. In resource rich countries, however, there is evidence of pure trade diversion in both resource-rich/labor-abundant countries and resource-rich/labor-importing countries. This underscores the idea that regional integration can help to spread benefits of unevenly distributed resource wealth among the region's economies.

<div align="right">Céline Carrère, Julien Gourdon, Marcelo Olarreaga</div>

A Foreign Direct Investment database for global CGE models
N°2012-08 April 2012

We describe the methodology used to construct a global database of foreign direct investments in three dimensions (investor country, host country and sector) for 2004. Based on Eurostat data, we estimate theoretical investments for all countries. Then we constrain our estimates subject to existing data with lower dimensions (1 or 2) during the balancing of the matrix, using a quadratic optimization. This database is intended for use for CGE modeling studies.

<div align="right">Christophe Gouel, Houssein Guimbard, David Laborde</div>

On currency misalignments within the euro area
N°2012-07 April 2012

Although nominal parities have been completely pegged within the euro area since the launch of the single currency, real effective exchange rates have continued to vary under the effect of inflation disparities, exhibiting a strong appreciation in the peripheral countries. In this paper, we assess real exchange rate misalignments for euro area countries by using a Behavioral Equilibrium Exchange Rate (BEER) approach on the period 1980-2010. The results show that the peripheral member countries have been suffering from increasingly overvalued exchange rates since the mid-2000s, as their real appreciation has not stemmed from improving fundamentals in terms of productivity or external position. In addition, currency misalignments have been increased on average for all euro area countries since the monetary union, while becoming more persistent.

More worryingly, our findings highlight different patterns across members, as misalignments have been larger and more persistent in peripheral countries than in core countries.

<div align="right">Virginie Coudert, Cécile Couharde, Valérie Mignon</div>

How frequently firms export? Evidence from France
N°2012-06 April 2012

This paper proposes studying export frequency as an additional margin of international trade. While extensive margins of products and destination define the scope of firm's export, export shipment frequency is determined by sale method choice and cost structure of the trade technology. We define export shipment frequency as the per annum number of shipments of a given product, by a firm to a given destination. In order to more deeply understand the trade cost structure and sale methods, we estimate gravity models on export frequency and other margins of trade using monthly firm-product-destination level export data from France. We show that in key predictions of the model are validated. During the recent trade collapse, we also find a great deal of stability in shipment frequency with a modest adjustment to declining GDP.

<div align="right">Gábor Békés, Lionel Fontagné, Balázs Muraközy, Vincent Vicard</div>

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