Focus

Russia's Economic and Political Crises

The years following the liberalisation of the Russian economy have been very turbulent, and there seem to be few signs of rapid recovery at present. The articles below analyse Russia's problems from three points of view, reflecting the CEPII's multi-disciplinary approach to the transition in this country.

The Financial Crisis in Russia

Russia's default on its domestic public debt and the moratorium on the foreign obligations of its private banks in August 1998, constitute a watershed in the story of failed transition. These two huge financial pyramids were created out of what looked, say in 1996, as a reasonable, medium-term financial strategy, whereby domestic and foreign resources would have been mobilised to restructure the economy.

With hindsight, the short term story of this eventual collapse was both dramatic and very banal. Though external shocks (the Asian crisis and the fall of energy prices) played a role, the main causes were internal. With increasing financial instability, real interest rates reached levels above 30% by spring 1998. Hence, interest payments on large stocks of short term, public debts increased by the week, while the State's tax resources were still falling.

At the same time, its capacity to issue new debt declined steadily: from May 1998 onward, new issues of T-bills fell below redemptions, so that financial pressure rapidly became unsustainable.

After a last attempt at stabilisation, with a large IMF programme, announced on July 21, the inevitable outcome became ever clearer to all, and by mid-August, only two options remained open: either the monetisation of the public debt by the Central Bank, that is inflation, or an outright default. Since the default, the crisis has imposed dramatic consequences on the economy as well as on the policy-making framework. Being unable to raise new international resources, whether on a private or multilateral basis, or to issue domestic bonds and credits, the State sector is de facto run on a pure-cash basis. Meanwhile, after a new large inflation tax on bank deposits, the willingness of the population to hold cash or deposits is now very limited. The major risk is that any supply of money exceeding such limited private needs will immediately trigger inflation and/or depreciation.

Under these circumstances, monetary policy should arguably be run along the lines of a quasi-Currency Board, even if not officially admitted.

The other key financial issue concerns the future of the banking sector, which was decimated in 1998. One aim should be to limit the re-emergence of the opaque relationships between the major banks and the policy-makers, which weighed so heavily in the collapse. A reasonable proposition is then to give priority to constructing a strong set of regulatory and prudential institutions, before the kick-starting a new generation of banks, which otherwise risk being as dangerous and unreliable as their forerunners.

Jérôme Sgard
E-mail: sgard@cepii.fr

For further information see:

• Enterprise Adjustment and the Role of Bank Credit in Russia: Evidence from a 420 Firm Qualitative Survey,
Russia's Search for Political Stability

The development of a democratic and effective regime in Russia is clearly of prime importance both domestically and internationally. Economically, political stability is vital to the confidence needed to stem capital flight, the erosion of foreign reserves, devaluation and inflation, as well as to restore Russia's international credit position. Not surprisingly, the markets reacted very badly to the sacking of the Primakov administration, in May this year. The Kremlin's justification that a new government is needed to re-launch the reform process cut little ice with market opinion, which saw the sacking more as a partisan ploy. Nevertheless, the episode merits deeper analysis.

Institutionally, the demonstration of presidential power—against a government that had been imposed on the Presidency by parliamentary opposition after the August 1998 crash—was quite logical. In effect, it restores the spirit of the constitution adopted the 12 December 1993, the President and the Government are to form a homogenous, strong executive jointly. As for the Duma, elected by universal sufferage, its role is to express the electorate's views concerning executive policy. The weaknesses of this arrangement—notably the blocking of essential laws such as a new tax code—have been demonstrated on several occasions. But the solution President Yeltsin was constrained to accept on the 11 September 1998, namely the alliance between the Parliament and the Government against the Presidency, was without doubt even less viable.

Russia's current instability, also stems from the personalities involved, as borne out by the five impeachment charges levelled against Boris Yeltsin. Indeed, the Parliament has frequently shown itself to be lacking in rigour and political maturity. As for the President, he has shown surprisingly little capacity to adapt his behaviour to much-changed circumstances. The relaunching of reforms after their temporary withdrawal, his irradiation at the Prime Minister's popularity, his anti-communism, his fear of the agricultural lobby and the military-industrial complex are all constant aspects of his behaviour. The impact of the crisis is still very fresh and as elections are not far off, this is surely not a moment to return to unpopular structural reforms, as the free-marketeers themselves admit.

It is the electorate which holds the keys to political stability: next December they have the opportunity of returning politically responsible deputies to the Duma, and a candidate more open to their aspirations to Presidency next summer.

Georges Sokoloff
E-mail: bartolozz@cepii.fr

For further information see:

The Strategic Issues of Russia's Economic Transformation

According to some experts, Russia's drive to liberalisation, initiated in 1992 and largely guided by the West, was a mistake. Prior to freeing prices and the currency, political and market institutions should have been constructed first, and a more pedagogical approach to society should have been adopted. Thus, it is now necessary to go back somewhat and re-administrate the economy. Others put down the "failure" of the transition to weak convictions by the authorities, and insufficient firmness by the IMF. This line of argument calls for more radical reform via a tougher macro-economic policy.

Neither position is completely wrong, nor completely right. The former forgets that the drive to the free-market was imposed on Russia in 1991, as the country was in near-chaos: unable to control events, the authorities had at least to pretend to guide them. The latter stresses rightly that the transition in Russia was not imposed sufficiently, nor conducted thoroughly. But, as in other countries, Russia's transition had to be a compromise with free-market forces because of the social and political risks involved.

In reality, the current "debate" follows from the difficulty of managing the various speeds at which the components of the new system for allocating resources are put into place, including the tools (the price mechanism, the currency etc.) the institutions sharing power (central government, the regions, companies, banks etc.), and social values (the perception of security, inequality etc.) which are particularly long to change. This disharmony of time-lags leads to constant adjustments in the progress of the various areas of reform. Crises reveal disequilibria, but they also constitute an opportunity to reduce them.

Some say that the necessary institutions should have been put into place, and that Russian society ought to have been educated beforehand, so as to reduce such time lags. But, it is clear that the institutions and culture of the market cannot be introduced ex ante, by reproduction or invention, as they must be adapted to the societies experiencing change. The transformation can only be an inductive process, with economic and political liberalisation guiding institutional change and modifying social values and behaviour. Such a "learning process" is presently underway in Russia, though it is clearly more difficult, and longer than in other countries.

Gérard Wild
E-mail: wild@cepii.fr

For further information see:
- "La crise économique russe", in Crise mondiale et marchés financiers, Cahiers français, La Documentation Française, Paris, No 289, Janvier 1999.
I n the real economy, the degree of asymmetry within the Union is revealed notably in the analysis of the nature of trade. Indeed, if Member States are strongly specialised in the reciprocal trade, then a sectoral shock to the EMU bloc may have varying effects from country to country.

Previous research by the CEPII has indicated that only 40% for intra-European trade fits into the traditional patterns of specialisation between industries. This relative diversification of Member States’ activities reduces the degree of asymmetry due to sectoral shocks. However, beyond such a “static” observation, the study of asymmetries across European countries may be usefully deepened by introducing technological aspects. In fact, the degree of technological content within branches, in which countries are asymmetrically implicated, could have permanent consequences for growth. In short, the type of products in which a country specialises is important. Under these circumstances, the assumption that European countries are little specialised does not make it possible to conclude that shocks will be symmetrical. A limited share of European trade which is focused on high-technology products is likely to have dynamic effects that are disproportionate to their current quantitative value.

<table>
<thead>
<tr>
<th>Country</th>
<th>Partners</th>
<th>World</th>
<th>EU 15</th>
<th>Third-countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sweden</td>
<td>12.3</td>
<td>-5.0</td>
<td>17.4</td>
<td></td>
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<tr>
<td>France</td>
<td>9.8</td>
<td>-3.6</td>
<td>13.4</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>8.8</td>
<td>9.9</td>
<td>-1.1</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>2.4</td>
<td>3.2</td>
<td>-0.8</td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>-1.7</td>
<td>-10.2</td>
<td>8.5</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>-9.3</td>
<td>-9.8</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>-0.4</td>
<td>8.9</td>
<td>-9.4</td>
<td></td>
</tr>
<tr>
<td>Belgium-Luxembourg</td>
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<td>0.6</td>
<td>-1.5</td>
<td></td>
</tr>
<tr>
<td>Ireland</td>
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<td>5.3</td>
<td>-10.0</td>
<td></td>
</tr>
<tr>
<td>Denmark</td>
<td>-2.8</td>
<td>-1.6</td>
<td>-1.2</td>
<td></td>
</tr>
<tr>
<td>Austria</td>
<td>-8.2</td>
<td>-7.9</td>
<td>-0.3</td>
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<tr>
<td>Greece</td>
<td>-13.6</td>
<td>-11.5</td>
<td>-2.1</td>
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<tr>
<td>Spain</td>
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<tr>
<td>Portugal</td>
<td>-16.4</td>
<td>-14.6</td>
<td>-1.9</td>
<td></td>
</tr>
</tbody>
</table>

Source: Eurostat-Comext, authors’ calculations. Note: The specialisation is measured here by the contribution of products to the trade balance. The indicator is expressed in per thousandths of each country's total trade.

Table 1: Technological Specialisation in the EU-15, 1996

More striking differences are to be found when an analysis of the quality of technological products in the EU could have dynamic effects which risk aggravating asymmetric shocks.

To permit an examination of the degree of technological specialisation in Member States, the CEPII has used a "list of technological products" constructed by the OECD and Eurostat. By using input-output tables for Member States, the OECD has identified 8 branches whose products incorporate high levels of R&D spending, either directly or indirectly (intermediate or investment goods). Subsequently, experts from both organisations have used foreign trade data to identify just the high-technology products in the major branches. The list used by the CEPII includes 252, high-technology products, which accounted for 10% of the European Union's trade in 1996. These mainly involve aerospace products, emission and transmission equipment, pharmaceutical products as well as electronic component parts.

The United States is the EU's primary supplier, providing Europe with nearly 20% of its high-technology purchases. Germany, France, the United Kingdom and the Netherlands are next in this competition, each with lower market shares (ranging from 13 to 6%). The size of these respective economies of course explains a part of this variation. Yet, taking out this size effect shows up notably the presence of certain Asian countries. Thus, technology products constitute between 14 and 28% of sales to the EU by the four Asian Dragons, along with Malaysia and the Philippines.

Overall, the Union appears to have a slight comparative advantage in high-technology products (exceeding 1.7% of its total trade in 1996 - see the Table 1 for explanation of this indicator), which in turn translates a specialisation in products and a commitment of resources in innovative activities. However, this European position masks strong, national contrasts, which lead to clear sectoral asymmetries (Table 1).

Table 1: Technological Specialisation in the EU-15, 1996

Differing technology specialisations in the EU could have dynamic effects which risk aggravating asymmetric shocks.
products is taken into account, which is a main factor in innovation efforts, along with product variety. To this end, a quality scale was introduced on the basis of unit values of traded products, calculated at the most detailed level of the classification.

If all technological products are taken into account, the Union's overall advantage (1.7%) hides a deficit of -2.7 in down-market products (theoretically old and obsolete), which is offset by a 3.1 surplus in up-market products (new products, at the top of the range), and by a 1.2 surplus for mid-market goods. Hence, the EU's exports are more up-market than its imports, indicating a comparative advantage in the most innovative products.

Table 2 crosses these two classification criteria, by looking at the position of contributions running above 3‰ in the total trade of each Member State. The countries are ranked according to their increasing, positive contributions. The first box highlights three countries which have an up-market advantage in high-technology goods: the United Kingdom, Sweden and France. In contrast, Germany has a very marked advantage in up-market, non-hi-tech products.

From the point of view of the modern analysis of economic growth and international trade mechanisms, the most unfavourable configuration, with permanent effects on growth, is to be found on the periphery of the Union, in Greece, Italy, Portugal and Spain. Thus, while the macro-financial performance and degree of industrial diversification of these latter three countries have converged with the rest of Europe, their specialisations constitute a source of asymmetry which is all too often neglected, and which may be potentially destabilising in the long term.

Europe's southern periphery would appear to have the most unfavourable trade specialisation.

Apart from important differences in the sectoral positioning of technological products, a second source of asymmetry results from the exposure of such activities to different external shocks. This is demonstrated by the geographic breakdown of the contributions of technological products to Member States' trade balances (the last columns in Table 1). Sweden, France, Finland and Italy record strong surpluses with non-European countries. The high-technology sectors of these countries are thus especially exposed to fluctuations in growth in Europe. Conversely and symmetrically, the United Kingdom, Germany, the Benelux and Ireland have a comparative advantage in intra-European trade and a deficit with third countries. These three, country-blocs are thus most exposed to business-cycle shocks within Europe.

Table 2: Comparative Advantages by Market Positioning and Technology, 1996

<table>
<thead>
<tr>
<th>Market positioning according to quality</th>
<th>High-Technology</th>
<th>Other Products</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up-market</td>
<td>United Kingdom</td>
<td>Germany</td>
</tr>
<tr>
<td></td>
<td>Sweden</td>
<td>Ireland</td>
</tr>
<tr>
<td></td>
<td>France</td>
<td>Denmark</td>
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<td></td>
<td>Finland</td>
<td>France</td>
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<td></td>
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<tr>
<td></td>
<td>United Kingdom</td>
<td>Sweden</td>
</tr>
<tr>
<td></td>
<td>Italy</td>
<td>Other Products</td>
</tr>
<tr>
<td>Middle-market</td>
<td>France</td>
<td>Finland</td>
</tr>
<tr>
<td></td>
<td>Sweden</td>
<td>Germany</td>
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<td></td>
<td>Finland</td>
<td>Portugal</td>
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<tr>
<td></td>
<td>United Kingdom</td>
<td>Austria</td>
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<tr>
<td></td>
<td>Spain</td>
<td>Belgium-Lux.</td>
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<tr>
<td></td>
<td></td>
<td>Netherlands</td>
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<tr>
<td>Down-market</td>
<td>Greece</td>
<td>Spain</td>
</tr>
<tr>
<td></td>
<td>Italy</td>
<td>Portugal</td>
</tr>
</tbody>
</table>

Source: Eurostat - Comext, authors' calculations.
Note: The comparative advantages correspond to the positive contributions that products make to the trade balance. Only positive contributions above 3 thousandths of each country's trade are included here. The indicator is expressed in thousandths of each country's trade.

Such asymmetries are at the heart of different degrees of exposure to macroeconomic shocks.

From a static point of view, the effects on the trade balances of Member States risk being contrasted, though limited, due to the low share of such goods in European trade. From a dynamic point of view, however, the consequences of such shocks risk being disproportionately large. In these activities, where market size is important, products evolve rapidly and generate rents: heterogeneity across European countries may thus be the source of cumulative asymmetries.

Lionel Fontagné and Deniz Ünal-Kesenci
E-mail: fontagne@cepii.fr
and d.unal.kesenci@cepii.fr

For further information see:


(3) Quality scales have a different meaning here than they usually do. In as much as they relate to intermediate or equipment goods, and not to consumer goods, quality effects may be assimilated to brand effects.
ON THE RESEARCH AGENDA

THE DIVERSITY OF LABOUR MARKETS: IN EUROPE: THE IMPLICATIONS FOR EMU?

The aim of this research project is to study the consequences for EMU of the diversity of national labour markets. First, it sets out a detailed analysis of the main characteristics of the European labour markets (Part I). Then it shows that such markets are highly heterogeneous, with respect to wage bargaining, employment protection, etc. Subsequently, the project proceeds with a comparison of wage and employment reactions during the 1990s, and uses these estimations to simulate the response of the different countries to symmetric and asymmetric shocks (Part II). Labour markets in Europe behave differently, but the hypothesis according to which a deregulated labour market exhibits high, real wage flexibility is not supported by the estimations. In addition, the macroeconomic simulations show that even in the countries where wage and employment flexibility are most significant, the labour market is unable to make up for the loss of national economic policy instruments. Another conclusion is that these differences are not large enough to have asymmetric consequences for EMU countries. These results underline the need for common macroeconomic policies, in the case of symmetric shocks, and for well-differentiated policies in the case of country-specific shocks.

Loïc Cadiou and Stéphanie Guichard
E-mail: cadiou@cepii.fr and guichard@cepii.fr

THE CEPII’S NEW MULTINATIONAL MODEL

The CEPII is constructing a new multinational model called MARMOTTE, which focuses on the medium term (2-7 years). It is based on two principles of contemporary macroeconomics: the optimising behaviour of agents and rational expectations. During the construction of the model, special care is being given to the cross-country analysis. To this end, the model is being estimated using panel data techniques. This model is designed to carry out three tasks: i) quantifying the consequences of various economic shocks to the world economy; ii) evaluating economic policy rules, as well as international institutional frameworks, by using stochastic simulations; iii) analysing medium term scenarios. The first version of the model, which is limited to OECD countries, should be available at the end of 2000, while the completed version is scheduled to be available at the end of 2001.

Modelisation team
E-mail: guichard@cepii.fr

INTERNATIONAL PRODUCTIVITY COMPARISONS

This spring, the International Economics Unit of the CEPII has initiated three projects on productivity comparisons. The first is an update and extension of a CEPII study done in 1994, and compares productivity levels between France, Germany and the United States in manufacturing and several service activities, in 1997. One of the aims is to examine the general impact of the German reunification. The apparent comparative advantages of these countries in terms of trade performance are confronted with their real advantages as expressed by productivity levels and unit labour costs. The second project, which is linked to the first one, aims to study the economic growth and innovation performance of France over the past thirty years from an international perspective, using a new (Jorgenson) approach. This research is embedded in a large European-North American project including eight countries. The third project, funded by the European Commission, aims to reinforce the FEMISE network, and analyses the productivity and competitive performance of the manufacturing sectors in seven Mediterranean countries. For this purpose, the CEPII is collaborating with institutes of each participating country.

Nanno Mulder and Deniz Ünal-Kesenci
E-mail: mulder@cepii.fr and d.unal kesenci@cepii.fr

MILLENIUM ROUND TRADE NEGOTIATIONS

In the context of a new round of trade negotiations that will be launched in November 1999, the CEPII is undertaking a major research project on trade policies. One of the main issues concerns the measurement of tariff and non-tariff trade barriers, which is a difficult task due to the large number and complexity of the existing measures. A first approximation of these barriers will be made by taking the difference between the actual and theoretical trade flows. The latter represent the flows that would prevail in the absence of trade obstacles and is estimated by the relative sectoral trade intensity indicator. Subsequently, the effects of trade liberalisation among Europe, the USA and Japan will be evaluated. These depend largely on prevailing market structures. For example, in sectors characterised by scale economies, trade liberalisation will produce mixed effects for countries. The aim is thus to arrive at a typology of the effects of trade liberalisation.

Michel Fouquin
E-mail: fouquin@cepii.fr

THE COMPETITIVENESS OF CHINA

The research project proposes different approaches to evaluate the competitiveness of China in the late 1990s. Firstly, levels of output and productivity of Chinese manufacturing are compared with those in France and Germany using a standardised methodology developed by the University of Groningen’s Growth and Development Centre. Secondly, China’s performance in world trade is studied, partly by using constant market share analysis. The research also focuses on the decisive role of firms involved in the international segmentation of production processes, which is driving China’s trade and development. Considering the very different levels of productivity, labour costs and unit labour costs of firms and the closed nature of the Chinese economy, the opening up of the domestic market will have far-reaching implications. Thirdly, the study will assess the degree of competition which presently exists in the domestic market, and will evaluate the effect of increased competition due to import liberalisation, in view of China’s future WTO membership. Finally the project will examine the regional dimensions of industrial and trade performance. In particular, it focuses on the consequences of trade liberalisation on regional disparities, and the necessary conditions for the least developed areas to catch up with the richer parts of China.

Françoise Lemoine
E-mail: f.lemoine@cepii.fr
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- Each research unit of the CEPII welcomes a new member: Sophie Chauvin (Emerging Countries Unit) who will work on patterns of industrial recovery and growth prospects in Asia, Guillaume Gaulier (International Trade Unit) who will analyse the impact of non-tariff trade barriers and the link between financial globalisation and emerging markets, and the world economic situation in general.

- Jean-Louis Guérin (International Macroeconomics Unit) who will study the harmonisation, co-ordination and impact of budgetary policies in Europe.

- Olivier Cortes definitively left the CEPII in January to study at the Ecole Nationale d'Administration. Philippe Cour left the CEPII in February to work for the Fiscal Policies Division at the European Central Bank in Frankfurt. The staff of the CEPII wish their parting colleagues all the best for the future.

Forthcoming

- This Summer 1999 the CEPII will publish a special edition of its journal dedicated to the past hundred years of the architecture of international finance (Economie Internationale, N°78).

- This Autumn the new edition of Economie mondiales, edited by Isabelle Bensidoun and Agnes Chevallier, will be published by La Découverte. The book will be presented and debated on the 16 September, at the French Centre for International Trade (CFCE). The discussions will address the link between financial globalisation and emerging markets, and the world economic situation in general.

- The CEPII together with the German Friedrich Ebert Stiftung, the French Institute for South-Africa and the Foundation for Global Dialogue are organising a workshop on "Regionalism and a Post-Lomé Trade Regime: Implications for Southern Africa", in Johannesburg on 14-15 October 1999.

- The CEPII's business club (the CIREM) together with the Franco-Americas Association is organising a seminar entitled "The US Economy: A New American Dream?" on 8 December 1999. Three questions will be discussed: Does Macroeconomic Policy Reduce the Magnitude of Recessions? Do New Technologies Explain High Economic Growth? and Is the High Level of Wall-Street Justified?
Changes in Geographical Specialisation Patterns, 1967-1997

The new version of the CHELEM CD-ROM will be available late August and will operate for the first time in a WINDOWS environment. The database will also be accessible via the internet. The new CD-ROM will offer international trade and balance of payments data up to 1997 and GDP data up to 1998.

The new CHELEM-Balance of Payments database has undergone major revisions. It has been adapted to the classification of the IMF’s fifth ‘Balance of Payments Manual’ (1993), and presents 131 items, 49 aggregates and 26 specific balances. The new classification provides greater detail for trade in services. Moreover, it separates capital from current transfers, as is done in the standard national accounts. The CHELEM-BOP database has several advantages over the IMF Balance of Payments data. Firstly, it offers long run time series from 1967 to 1997 whereas the IMF series often start at a later date. Secondly, the World Current Account estimated by CEPII includes (contrary to the IMF), International Organisations and several non-IMF member countries. Thirdly, aggregates have been made consistent with the sum of their components. Finally, missing data have been estimated.

The CEPII often uses the three databases in combination, for example to show the large changes that have occurred in the specialisation of the different geographical zones. This is illustrated by the comparative advantage indicator, which compares the observed balance of a component to a theoretical balance (see Table). The latter equals the share of that component in the world current account multiplied by the total surplus or deficit of the zone. Traditionally, the comparative advantages of developed nations were the opposite to those of developing countries: the first group specialised in primary products and capital manufactures and capital revenues, while the second group specialised in manufactures led to a fall in the specialisation of developing countries in primary products. Europe, Japan and the USA de-specialised in manufactures, to the benefit of emerging countries. The pattern of capital transfers remained stable whereas the picture changed significantly for the remaining two current accounts components: capital revenues and services. In the former category, a decline of the USA and a rise of Japan may be observed, whereas in the latter case the position of the USA improved at the expense of the European Union.

Colette Herzog and Isabelle Rabaud

For further information on the CHELEM database, please contact Colette Herzog at the CEPII, tel: (33) 1 53 68 55 27, fax: (33) 1 53 68 55 03, or E-mail: herzog@cepii.fr

For copies of all CEPII publications contact: Sylvie Hurion, tel: (33) 1 53 68 55 14, E-mail: hurion@cepii.fr

CEPII - 9, rue Georges Pitard, 75740 Paris Cedex 15, France tel: (33) 1 53 68 55 00 fax: (33) 1 53 68 55 03 HTTP://WWW.CEPII.FR

THE RENEWED CHELEM DATABASE

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Sources: Databases CHELEM-CIN, CHELEM-BOP and CHELEM-GDP.
(a) The sum of the contributions equals zero for each zone (horizontal addition). as well as for each item (after including international organisations and the statistical adjustments) equals zero.

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