Focus

Mimetic Contagion in the Euro/Dollar Market

This research project has aimed at constructing a model of exchange rate dynamics that explicitly includes mimetic contagion of opinions among traders. The model highlights the key role of heterogeneous expectations in portfolio decisions and ultimately in the determination of the euro/dollar exchange rate. Market participants are aware that they are imperfectly informed and that their knowledge of the underlying model of the economy is incomplete. Hence, agents are all the more likely to mimic the behaviour of their competitors, the less confident they are in their forecast of the future exchange rate. An increasing uncertainty associated with a given forecast raises the incentive to discard it and to rely on that of the other investors, expecting to gain some possible additional information. Furthermore, this mimetic contagion may be enhanced if the other agents obtain superior ex post returns on their investments. Herd behaviour arises because successful strategies will tend to be imitated by a growing number of investors.

To describe the heterogeneity of agents, the market is divided into two groups of investors. Their respective proportions fluctuate over time due to migrations induced by mimetic contagion. The migrants’ wealth reallocations between euro and dollar denominated assets determine the model-based forecasts of the future exchange rate.

In order to achieve a good description of the euro/dollar dynamics, one has also to determine the best assumption characterising the way the two classes of agents may differ in this market. Two alternative sources of heterogeneity are successively considered. The first distinction rests on pessimistic versus optimistic agents concerning the future value of the euro, whereas the second relies on confident versus unconfident traders about their exchange rate forecast.

At the launch of the euro, the pessimists about its future value against the dollar were more confident in their forecasts than the optimists.

Unlike most agent-based simulation models with heterogeneous expectations and mimetic contagion, the present specification makes it possible to test the relevance of both the model and the heterogeneity assumptions. The reason lies in the fact that information from the currency options market is used to infer the exchange rate expectations: the respective proportion of the two classes of investors, their average expectations, and the standard deviations of their expectations. The price of a call option reflects the perceived probability of the
future exchange rate lying above a given level at maturity, because only in this case is its payoff positive. Combining all option prices, that is all the current bets of market participants about the future value of the euro, allows the risk-neutral probability density function (PDF) of the expected exchange rate to be estimated.

The methodology consists first in estimating the risk-neutral probability density function of the future euro/dollar exchange rate on the assumption that the PDF results from a weighted mixture of two lognormal distributions.

Figure 1 presents the PDF of the euro/dollar expected at a one-month maturity, the 26th July 1999, (in bold) as well as its two lognormal components (in grey). These two lognormal densities are supposed to characterise the beliefs of the two groups of agents and their respective weight to reflect the proportion of each category of investors. Hence, the narrow density with a weight of around 70% represents the limited dispersion of expectations held by confident investors, whereas the flat distribution (30%) takes into account the large range of exchange rates expected by unconfident agents.

At this date, confident agents were pessimistic about the future value of the euro (1.063) relative to the market average expectation (the forward exchange rate, 1.067), whereas the unconfident agents were optimistic (1.077). But this correspondence changes over time depending on the relative location of the two lognormal densities. For example, on the 8th September 2000, the flat density (with a weight of 33.5%) is located to the left of the narrow distribution, so that unconfident agents were pessimistic about the euro (Figure 2). Actually the proportion of each class of agents is far from being constant. This result stresses the weakness of specifications relying on fixed proportions of traders, that is neglecting mimetic contagion of opinions to describe short-term dynamics of market prices. Agents do indeed interact inside a decentralized network of traders, and not directly through market prices.

Figure 1 – Risk-Neutral Probability Density Function of the Euro/Dollar

Shifts in the euro’s exchange rate may be explained by the relative confidence traders have in their rate forecasts.

Model-based forecasts of the exchange rate can be based either on the optimistic versus pessimistic distinction or on the confident versus unconfident agents one. It turns out that the short-term dynamics of the euro/dollar market is better described by the model composed of confident and unconfident investors, as opposed to the pessimists’ versus optimists’ assumptions.

The period under consideration is characterised by a high degree of uncertainty linked to the launch of a new currency. This is a context propitious to mimetic contagion phenomena among traders. The short-term dynamics of the euro/dollar could then well be explained by the volatile changes in the opinions of market participants. This uncertainty is likely to lessen, as the lifetime of the euro increases.

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For further information see:
Future demographic trends and disparities between pension schemes will lead to strongly diverging tendencies in the supply and demand for capital across the various regions of the world, in the 21st century. With financial globalisation, capital transfers, which a priori are mutually beneficial, should help correct these imbalances. However, simulations carried out with the INGENUE model indicate that the scale of such transfers may put Europe in a delicate external financial position.

The reform of pension schemes is much debated in Europe, often being backed up by detailed studies. But paradoxically these analyses assume economically and demographically closed countries. This ignores a major aspect of macroeconomic problems, namely that "demographic ageing" is a world-wide process, although it occurs at different rhythms across the globe. This opens the possibility for inter-temporal and international trades to take place, which are mutually beneficial. Taking this global context into account leads to results which are significantly different from those relating to a closed economy. INGENUE, a world general equilibrium model embodying overlapping generations, has been constructed to study such problems.

The long term trend of demographic ageing across the world increases the proportion of retired people relative to working population throughout the 21st century. However regions strongly differ in the composition of their populations, as well as the speed of ageing. The dependency ratio and the level of economic development are the two criteria used to divide the world into six regions within the model. The rise of this ratio is at the heart of all discussions concerning reforms of Pay-As-You-Go (PAYG) pension schemes in OECD countries. Nevertheless, the effect of demographic shifts is far from being limited to this perspective.

The transfer of savings should allow labour in the younger, developing countries to benefit from higher rates of capital investment.

The life cycle hypothesis stresses that people in the age-group of 40 to 65 save the most as they are economically active and have the highest incomes. Demographic projections indicate that these age-groups will become more important at different points in time across the world. This suggests that there will be important discrepancies in national savings rates. Between 1995 and 2015, the share of the population with the highest savings will peak in the three developed regions of the world (Japan, North America and Western Europe). After 2015 this share will fall, whereas it will rise in the three developing regions.

Demographic trends will also shift the demand for capital. A region with a growing labour force has to "equip" its new workers with capital. These "dynamic" regions are also those which currently have the lowest levels of capital per worker (developing countries). In the OECD countries, capital intensity is already high and new capital equipment needs are relatively low. This explains the direction of capital transfers, facilitated by financial globalisation. Everybody benefits from these transfers. Savers in rich and older countries will earn higher returns than they would under autarky. As for the younger, developing countries, they will be able to satisfy their greater capital needs, at a lower cost and real wages will rise more quickly. In time, when these countries achieve high savings rates, they will be able to pay off their foreign debts and even finance OECD countries that will run down their savings massively. However, while such capital transfers may a priori be mutually advantageous, they could also lead to critical financial situations.

With financial liberalisation, intergenerational and inter-temporal trade in capital follows from the demand and supply of capital in each region. These market forces depend on demographic movements, but they are also conditioned by the institutional nature of retirement regimes. The baseline scenario calculated here by the INGENUE model assumes on average demographic projections made by the United Nations, and that the retirement regimes currently in place (in the different regions of the world) will not change. Given that the supply of capital in the developed regions remains abundant, the world interest rate is forecast to fall in the first decades of the 21st century. Subsequently, it will stabilise at about 3.5%, when the capital equipment needs of the developing countries are pulled by stronger productivity growth and when the fall of savings in the OECD is offset by a rise in the developing countries.

With no change in its pension schemes, Europe is likely to become a significant, net debtor.

The contrast in demographic trends and the institutional disparities in retirement regimes work together to bring about marked differences in accumulated wealth, which in turn show up in the
financial equilibria of the different regions, with respect to the rest of the world. These financial situations are summarised by the rates of ownership: i.e. the relationship between residents' wealth and productive capital available within a region. A region is a net creditor when its rate is above 100%.

In the baseline scenario, a spectacular fall is to be observed in Europe's ownership rate, as of 2030 (see Graph 1). For several decades to come, the strong diminution of European household savings rates will be the predominant trend, and will entail cumulative deficits and push the continent from being a net creditor to being a net debtor. Such financial dependence by Europe on the rest of the world may be controversial, politically speaking. Under these circumstances, the issue of pension scheme reform becomes unavoidable.

Europe has the most generous public pension systems in the world: the retirement ages are lower than elsewhere and the income replacement rates guarantee higher pension benefits, relative to wages. If the situation remains unchanged, then the external financial position of Europe will deteriorate.

Two different scenarios of reform have been simulated. The first type consists of holding the contribution rate at its 1999 level. This implies programming a progressive fall in the purchasing power of pensions. To compensate for the loss of future pensions, households are then encouraged to save more. This reform leads to an increase in the scale of funded pensions relative to the PAYG system. The second reform consists of maintaining pensions at their current relative level, but raising the age of retirement progressively from 60 to 65 years, between 2000 and 2020.

The funded pension scenario strongly raises savings in Europe, and lowers the world rate of interest. De facto, Europeans will export a major share of their additional savings, by buying property rights on new capital in demographically dynamic regions. Europe will then remain a net creditor throughout the century i.e. the ownership rate at the end of the century will be at 130%.

In contrast, the scenario based on raising the retirement age will increase the working population, and will then raise Europe's productive capacity. Savings will increase with the rapid rise in the wage bill. But these extra savings will be partly invested in Europe, in order to equip the additional working population. The result of this set of circumstances will be to raise slightly the interest rate above the rate associated with the "no reform" scenario, though the trend in the ownership rate will follow the same pattern.

Raising the contribution period of Europe's PAYG pension schemes will raise investment and consumption more than extending funded schemes.

However, the soundness of such reforms cannot be gauged only with respect to financial equilibria. More important to the population will be the impact of reform on consumption. Using this criteria, the contrast between the two reforms is staggering (see Graph 2). A per average per capita consumption is always weaker in the funded-scheme case than if the retirement age is raised with benefits remaining unchanged. Funding is even costly, compared to the "no reform" scenario, as it leads to a relative fall in consumption throughout the first half of the century! In contrast, increasing the age of legal retirement will always lead to higher consumption. This result is sufficiently robust with respect to uncertainties concerning world growth to allow this option to be judged as preferable, if Europeans do indeed want to maintain their standard of living rather than opt for a shorter working life.

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For further information see:
• “An Applied International, Overlapping-Generation Model”,
  The INGENUE Research Team,
(Available at www.cepii.fr)

(1) The INGENUE Team is composed of M. Aglietta and J. Chateau (CEPII), M. Juillard (C EPREMAP), J. Fayolle, J. Le Cacheux and V. Touzé (DFCE).
ON THE RESEARCH AGENDA

THE RENEWAL OF JAPANESE CAPITALISM

Many analysts have emphasised the weakness of Japan’s financial system to explain the economic crisis of the 1990s. But, the extreme difficulty of getting growth to recover is better explained by complex factors, linked to the destabilisation of so-called Japanese capitalism. Obviously, an approach spanning economics, sociology and politics is the most appealing.

This project has tried to identify what was at the core of Japan’s traditional model and of its current change. Three fundamental themes emerged: the problem of inequality in the economic field; the problem of "groupism versus individualism" in the social field; and the problem of "centralism" in politics.

The Challenge to Equality
(Evelyne Dourille-Feer, CEPII)

The opening up of Japan’s economy and its drive to maturity have overturned the conventional roles of the State, private enterprise and households. With the strengthening of market forces, the maintenance of social equality has become increasingly difficult, both in terms of income and wealth, as well as in terms of the labour market. But the present ructions are also redistributing economic power. They may lead to a new “hedonist” socio-economic model, whose foundation will not be “productivity at any price” but rather the search for a better quality of life. It will, however, be less likely to generate as much growth as American consumerism.

The Emergence of Individualism
(Kazuyoshi Yatabe, University of Paris VI)

During the years of rapid industrial growth and the expansion of trade, from 1960 to 1985, a strong middle class emerged in Japan, which had a clear cultural identity. Thereafter, however, the negative side effects of a strongly integrating society began to emerge. The middle class has progressively been revealed as mythical, as the reproduction of elites in education and working-life has become more evident. Individualism seems to have emerged among the young generation, during the present crisis. Still, there is a strong differentiation among men and women, with young women emerging as the most dynamic component of society.

The Transformation of the Political System
(Jean-Marie Bouissou, CERI)

The overall transformation process has reached the country’s political system and all its institutions. It has led to the decay of the comfortable “555 System”. This system ensured the survival of all existing parties, and its erosion has led to a weakening of the “neo-corporatist” system. Market forces are provoking new balances of power between the government and the administration, between Tokyo and local authorities. They are also pushing for greater transparency in the decision-making process and the emergence of more charismatic Prime Ministers. Lastly, the desire by citizens to be involved more actively in politics has led to a process remodelling institutional power.

This research project is set to lead to a joint publication, released through La Documentation Française, towards the end of 2001.

THE ADJUSTMENT AND FINANCING OF HUNGARIAN ENTERPRISES,
1989 - 1998

Since 1990, the Hungarian transition has been consistently rated as among the most promising. This common judgement has been vindicated by the early opening of negotiations with the European Union, at a time of sustained recovery in growth and productivity, low inflation, fiscal stability and sound external balances. This research project - undertaken as part of the ACE programme - aims at analysing how enterprises adjusted during this transition period, and then embarked on a sustained growth path. It relies upon a panel data set of some 4500 firms, which includes all standard accounting figures. The aim is to establish a detailed account of the adjustment and growth trajectories observed within the corporate sector. Three main research directions will receive the most attention.

First, the functioning of the relationship between productivity gains, gross savings and investments will be examined. The experience of transition economies suggests that industrial recovery is based upon the productivity gains, which require competitive product markets, capital injections and a strong governance of firms, especially by private shareholders. In these areas, Hungary is a highly successful case: the fall in labour costs since 1995 has produced a very large economic surplus, privatisation has proceeded at a sustained pace and foreign direct investments have reached record levels at the same time.

Second, while foreign-owned firms tend to dominate the growing, profitable, export sector of Hungary’s private economy, a critical issue for the future is the recovery and growth potential of domestically-owned, more inward-looking firms. The development of this part of the economy, however, may be associated with risks regarding a wide range of public interest issues: revenue growth prospects, regional imbalances, social inequality, or unemployment levels.

Lastly, the credit relationship between enterprises and banks was severely affected by the 1992 banking crisis and the ensuing credit crunch. A key issue has therefore been the very process of consolidation, depending on sectors or types of enterprises involved etc. Another important matter stems from the link between access to external finance, the distribution of dividends and the level of domestic investment by firms.

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FOR FURTHER INFORMATION SEE:
• ‘DIRECT FOREIGN INVESTMENTS AND PRODUCTIVITY GROWTH IN HUNGARIAN FIRMS, 1992-1999’, J. Sgard, CEPII WORKING PAPER, FORTHCOMING.

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Recent Publications

**ECONOMIE INTERNATIONALE, QUARTERLY**

No 85, 1st Quarter 2001.
- "Libéralisation financière, spéculation et crises bancaires" J. Pihlou, L. Miotti
- "Multinationales émergentes: un modèle coréen ?" L. Miotti, S. Perrin, F. Sachwald
- "Le renforcement international des droits de propriété intellectuelle" E. Combe, E. Pfister
- "Intégration économique et convergence des revenus" J. Glachant, C. Veilutini
- "Taux de change réel et effet Balassa-Samuelson" R. Duval
- "Consommation, contraintes de liquidité et canal du crédit en Europe" S. Lecarpentier-Moyal, N. Payelle, P. Renou-Maissant
- "Taux de change réel et effet de discrimination" R. Avisse, M. Fouquin
- "Pouvoir prédictif de la volatilité implicite dans le prix des options de change" O. Allais, L. Cadiou, S. Dées
- "Pouvoir prédictif de la volatilité implicite dans le prix des options de change" O. Allais, L. Cadiou, S. Dées
- "MacSim: un logiciel de simulation macroéconomique" P. Augier, J.-L. Brillet, G. Cette, R. Gambini

Price: FF 118 per issue, FF 440 annual subscription in Europe, and FF 465 outside Europe. Publisher: la Documentation française.

**LA LETTRE DU CEPII, MONTHLY**

- "China: the Iron Rice Bowl is Broken", F. Lemoine
  No 202, June 2001
- "Has Bismarck Been Sunk?", F. Legros
  No 201, May 2001
- "Our Future Pensions and Globalisation: an Exploration of the Issue Using the INGENUE Model", Equipe INGENUE
  No 200, April 2001
- "Does Food Security Justify Support for Agriculture?", A. Bouët
  No 199, March 2001
- "Textile and Clothing: the End of Discriminatory Protection?", R. Avisse, M. Fouquin
  No 198, February 2001
- "Failure at the Hague: Climate Protection is Put-Off Once More?", N. Kousnetzoff
  No 197, January 2001

LA LETTRE DU CEPII is published in French.
Price: FF 312 (47.50 euros) outside France. Publisher: la Documentation française.
The English version of this French publication is available on the CEPII’s web-site, one month after publication:
www.cepii.fr

**BOOKS BY CEPII RESEARCHERS AND THE CEPII’S ANNUAL REPORT**

- "L’Économie Mondiale 2002" edited by I. Bensidoun & A. Chevallier, 125 p., FF 52, Collection Repères, la Découvertes, 9 bis rue Abel Hovelacque, 75013 Paris. Tél : 01 44 08 84 00 Fax : 01 44 08 84 19


**CEPII WORKING PAPERS**

- "The Impact of Eastern Enlargement on EU-Labour Markets and Pension Reforms Between Economic and Political Problems" 8th meeting, Berlin, 16 January 2000, Franco-German Economic Forum, CEPII-ZEI-Bonn University No 01-03, JULY.
- "Discrimination commerciale: une mesure à partir des flux bilatéraux" G. Gaulier
  No 01-04, MARCEIL
- "Heterogeneous Expectations, Currency Options and the Euro/Dollar Exchange Rate" B. Rzepkowski
  No 01-03, MARCEIL
- "Defining Consumption Behavior in a Multi-Country Model" O. Lafaye (Thomson Multimedia).

Q. Allais, L. Cadiou, S. Dées
No 01-02, FEBRUARY,
- "Pouvoir prédictif de la volatilité implicite dans le prix des options de change?" B. Rzepkowski
No 01-01, JANUARY.

The full text of Working Papers is available on the CEPII’s web-site:
www.cepii.fr

**CONFERENCES**

The CEPII was one of the several "knowledge-partners" to contribute to the organisation of this conference, which brought together a wide range of policymakers in government, economics institutions and business.
M. Camdessus (Chair of the CEPII) gave a keynote address on "Openness and the Challenge of Poverty Reduction in the 21st Century". L. Fontagné (Director of the CEPII) was moderator for the "Sustainable Development in the New Economy" workshop.
See: www.oecd.org/Forum2001/

- **ASIA 2001 - NEW RISKS AND REGIONAL PROGRESS**
This conference was jointly organised with CFCE and BNP Paribas, Paris, April 3 2001
Opening Speech: J.-D. Gardère (Director, CFCE)
**Roundtable I: A Return to Monetary and Financial Stability?**
B. Coeuré (French Treasury), T. Ito (Ministry of Finance, Japan), D. J. Amc (DREE), S. J. en (Morgan Stanley Dean Witter), G. Longueville (BNP Paribas).
Presentation by F. Huwart (France’s Minister for Foreign Trade)

Roundtable II: Regional Integration Strategies
F. Croiugnié (Les Echos), D. Herren (DREE), D. Camroux (IEP, Paris), F. Gauliet (IFRI-INALCO), O. Lafaye (Thomson Multimedia).

Roundtable III: Asia and Globalisation
F. Croiugnié (Les Echos), M. Fouquin (CEPII), K. Fukasaku (OECD), P. Mersserlin (IEP, Paris), H. Testard (DREE), P. Verkhovsky (Clifford Chance), P. Jacquet (IFRI).
Events

SEMINARS AND MEETINGS

- American Priorities for Multilateral Trade Negotiations
  D. Blandford (Pennsylvania State University)
  28 June

- Franco-German Economic Forum
  Guest speaker: J. Mistral (Economic Advisor to France's Minister of Finance)
  'The Political Economy of the Nice Treaty: ReBalancing the EU Council',
  F. Bobay (DIGITIP), D. Laskar (CEPREMAP), S. Collignon (European University Institute)
  'The Future of European Agricultural Policies', W. von Urf (Technische Universität, Munich), J.-J. Becker (Forecasting Directorate, French Ministry of Finance)
  24-25 June, Paris

- The CEPII Business Club Series – ‘Three Perceptions of the World Economy’
  Brazil’s Economic Outlook and the Consequences for Mercosur
  M. Camdessus (CEPII), F. David (CEPII-COFACE), P. Joubert (Alstom Transmission
  21 June

- Environmental Policy
  S. Gaskódi (Ministry of the Environment), O. Godard (LEEP), J. Sgard (CEPII), L. Tubiana (CAE)
  14 June

- The New Economy and its Consequences for Financial Stability
  (in collaboration with the European Office of the IMF), F. Larsen (IMF), O. Davanne
  6 June

- European Competition Policy and the Single Market: The Case of Telecommunications
  P. Buigues (DG Competition), J. Jenny (ESSEC), E. Cohen (CNRS-CAE)
  26 April

- The Outlook for Japan
  T. Ito (Ministry of Finance, Japan)
  4 April

- Are Current Account Surpluses Sustainable?
  M. Aglietta (CEPII), J. Chateau (CEPII), A. Brander (CPR)
  8 March

- B-to-B Commerce and its Implications
  J.-M. Boucher (La Redoute), E. de Cazotte (DSA)
  8 February

- Can France Return to Full Employment?
  J. Boissonnat (Expansion), J. Pisani-Ferry (CAE), P. Artus (CERC)
  24 January

  H. Bräcker (DIW), J. Sgard (CEPII), M. Burda (Humboldt University)
  ‘Pension Reforms in the European Union Countries’, F. Legros (CEPII),
  C. Hoffmann (German Ministry of Labour), J. Le Cacheux (OFCE)
  16 January, Berlin

- Will the Growth Differential Between Europe and United States Persist?
  O. Garnier (Société Générale Asset Management), J.-C. Chouraqui (OECD),
  N. Sobczak (Goldman Sachs)
  11 January

NEWS IN BRIEF

- The CEPII has established a Scientific Committee of outside experts
  who will advise the Centre on the nature and quality of its research,
  though responsibility for setting the CEPII’s research programme remains
  with the Centres Board. Members of the Scientific Committee include:
  F. Bourguignon (Chair), P. Artus, R. Barrell, R. Fini, S. Guillarmont,
  The work of the committee, which meets twice a year, will begin in the autumn of 2001.

- The CEPII is a founder member of the European Forecasting Network (EFN),
  which was launched in July 2001 on behalf of the European Commission
  in order to provide a better understanding of future economic developments in Europe and especially the euro-zone. Other partners in the network include: University of Bocconi-IGIER, Milan; Halle Institute for Economic Research, Halle (Germany); European University Institute, San Domenico di Fiesole, (Italy); Econometric Institute - Erasmus University, Rotterdam; Grup de Recerca “Analisi Quantitativa Regional”, University of Barcelona; Instituto Floris de Lernau, University Carlos III, Madrid; Department of Applied Economics, Cambridge.

- The CEPII hosted a workshop on ‘The Competitiveness of China’s Economy’, on the 3-5 April. Outside participants included L. Shantong (Department of Applied Economics, Cambridge), R. Ruoen (Beijing University) and S. Démurger (CERDI).

- Stéphane Désé, macroeconomist with the MARMOTTE modelling team, left the CEPII at the end of July to join the ECB.

- Jean Chateau joined the CEPII in January, to work on the INGENUE project (see Research Summary, p 3 of this letter).

- Johanna Melka joined the CEPII in June, to work on the role of the New Economy in Europe.

- Thierry Mayer, lecturer at the University of Paris I, has become a Research Fellow with the CEPII, specialising in economic geography.

- Richard Avissle left the Centres IT staff in March. He has been succeeded by Eric Leydier.

FORTHCOMING

- The CEPII is co-organising a major conference with the IDB on ‘Impacts of Trade Liberalization Agreements on Latin America and the Caribbean’, in Washington, the 5-6 November. The objective of the conference is two-fold. First, to give Computable General Equilibrium (CGE) modelisers the opportunity to present publicly, policy-related applications focused on Latin America and the Caribbean’s international relations within the Americas, with the European Union, and the world. Second, to promote technical discussion on the models’ advantages and shortcomings, as well as data and methodological aspects, all with a view to stimulating further advances in the construction and use of CGE models.

- Call for papers
  The CEPII is co-organising a conference entitled “Towards Regional Currency Areas” in Santiago, Chile on the 26-27 March 2002. Co-organisers include the CDC, CEPII, ECLAC, Foundation of the Banque de France, and Revue Économique. Proposals for presenting a paper at the conference can be sent in electronic form, before 1 November 2001, to R. Artus, A. Cartapanis & L. Fontagné to ceci@univ-aix.fr.
For the last fifteen years, the inter-industry, intra-regional specialisation in textiles and clothing between developed countries and their less-developed neighbours (developing or transition countries) has been a trend of world trade. The former have somewhat improved their comparative advantage (European Union) or reduced their disadvantage (USA) in textiles. At the same time, less-developed countries have seen their clothing industries progress rapidly, while these sectors have retrenched massively in the developed countries. These phenomena are shown to be linked here.

The trends are visible in Europe, between the EU and the CEECs on the one hand, and between the EU and the Mediterranean countries on the other hand. Taking the CEECs as an example, since the fall of the Berlin Wall, the EU has largely increased quotas for CEEC products, within the framework of Outward Processing Trade (OPT), prior to complete elimination. The OPT quotas, which are accorded to finished goods made from European textiles, have favoured the Union’s neighbouring countries, with European importers being encouraged to chose producers in nearby countries, in order to reduce transport costs. This regional division of labour has helped sustain European activity throughout the sector. Thus in 1996, for every $100 of clothes imported by the EU from Mediterranean and central European countries, the EU exported $55 in yarns and textiles. In contrast, exports to Asia stood at only $9 for the equivalent amount of clothing imports. Similar trends have emerged with the development of specific agreements with Mediterranean countries, and in America with the Caribbean Basin Initiative and the NAFTA.

These trends are also based on new forms of internationally organised networks. Distribution channels in the developed countries stand at the centre of this organisation: retail conditions are closely examined, with distributors ordering extra supplies from nearby developing countries when necessary. In turn, clothes producers then order additional yarns and textiles from manufacturers in the developed countries, the whole process being facilitated by new Information Technologies. But, with the end of the MFA on the 1st January 2005, these discriminatory regional arrangements will disappear, and so may the regional specialisation.

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