

The CEPII NEWSLETTER ^{n°14 -} Winter 2000/2001

CENTRE D'ÉTUDES PROSPECTIVES
ET D'INFORMATIONS INTERNATIONALES

FOCUS

■ Tax Harmonisation in the EU

Tax harmonisation is an on-going issue in the European debate, but negotiations are made difficult by the reluctance of EU countries to abolish the so-called "harmful" measures¹, designed to attract tax bases. For corporate taxes, harmonisation should however be of great concern: tax incentives do influence the location of multinational firms, which encourages tax competition.

The recent upswing in European growth alleviates the pressure on fiscal deficits that had marked the 1990s, and allows European governments to engage in large-scale tax reforms. Such reforms, as the ones recently launched in Germany and France, mainly aim at simplifying the tax system and improving the neutrality of taxation.

But these reforms are also occurring in a context of increasing capital mobility, stemming both from the global liberalisation of capital flows, and, in the European case, from the launching of the Euro. This ends exchange rate risk in the Euro area, and thereby increases capital mobility inside the EMU.

Under these circumstances, uncoordinated tax cuts might end up in tax competition, since multinational firms can evade taxation through locating in low-tax countries. This could be a favourable outcome if, as a consequence of tax cuts, public goods and services are produced more efficiently. But tax revenues would shrink. And if taxes are shifted to less mobile taxable incomes, the fairness of tax systems could be questioned. This seems to be the case in the European area. Since the 1980s, taxes on mobile bases (i.e. employer social security

contributions and corporate tax) have been decreasing slightly in proportion to the GDP, while taxes on the immobile bases (personal income tax, employee social security contributions and VAT) have kept growing. This could be, at least partially, the consequence of tax competition.

Uncoordinated tax cuts might lead to tax competition.

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To avoid tax competition, the European Union has long been advocating tax harmonisation, mostly in the fields of capital and profit taxation. The ambition is to avoid both double taxation, and "harmful tax competition" between EU states. However, the process of harmonisation is long and difficult.

In order to assess the costs and benefits of tax harmonisation versus competition, the CEPII has measured the sensitiveness of capital movements to corporate tax differentials. This subsequently allows the impact of various tax scenarios in Europe to be simulated, and hence the consequences of a coordinated, versus uncoordinated, tax policy in Europe to be measured. The exercise is done for foreign investment (FDI) inflows in a set of OECD countries, including European countries and the US, as well as Japan. Both effective and statutory tax rates are used.

One difficulty of such an assessment is the fact that the responsiveness of capital outflows to tax differentials should differ between European countries, due to the different tax schemes in operation. Most European countries operate exemption schemes, whereby the repatriated profits of affiliates are taxed only in the country of affiliate, and exempted from taxation in the home country. Such a system maxi-

(1) Measures leading to unfair tax competition identified in the Primarolo Report which was submitted to the Ecofin Council in November 1999.

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mises the impact of tax differentials on the location strategies of multinationals, since any favourable tax discrepancy can be exploited. But two European countries (namely, the UK and Ireland) operate credit schemes for their multinationals: the latter are granted a tax credit for the taxes paid on profits made abroad, and pay the home state tax level. Hence, UK and Irish multinationals have no incentive to evade domestic taxation, and FDI originating from these countries should not be driven by tax considerations, with the qualification that high taxes abroad are an incentive not to invest, as multinationals only partially recover these taxes.

Once the features of national tax schemes are taken into account, the study shows that FDI inflows do react to tax differentials: a corporate tax cut in the host country increases inward FDI in this country. Consequently, there might be scope for a tax competition policy, at least at the individual country level, since such a strategy should increase FDI inflows to the competing country. The question is then to measure the benefits (in terms of increased inward FDI) and the costs (in terms of tax revenues and the shift of the tax burden to the non-mobile tax bases) of European tax policies, according to various scenarios. This would lead to a reformulation of the question of tax harmonisation in Europe.

Most countries in the EU operate tax exemption schemes for foreign affiliates.

Three scenarios illustrate the future of tax policies in Europe. First, some countries may individually engage in tax cuts, hoping they will be small enough to capture all the gains without triggering reprisals from their European partners. Simulating such a situation shows that the "tax dumping" country indeed records an increase in inward FDI, at the expense of its European partners, and of the US and Japan.

But such a non-cooperative strategy can hardly be sustained in the long term, as other European partners would likely adopt the same behaviour. The game would probably end in generalised competition, and eventually in generalised dumping, defined respectively by all European partners cutting their taxes to the lowest European level or to zero. The empirical model does not allow the intra-European impact of such policies² to be compared, but conclusions can be drawn for third countries: the US and Japan would be strongly hit, as European firms cut their overseas investments.

But, such policy is little realistic, as the strong cuts in tax revenues would have to be compensated by an increase of taxes on mobile bases³.

Given the constraints on fiscal deficits under the Amsterdam Stability Pact, this loss in tax revenues might be impracticable for some European countries. For example, Italy would incur a loss of tax revenues as high as 2.6% of GDP in the case of tax competition on statutory rates. Moreover, if Italy wanted to retain its fiscal revenues, it would have to increase the tax burden on immobile tax bases by almost 20%.

Harmonisation might lead to a more fruitful outcome if the issue of tax credit schemes were considered first.

The third scenario simulates tax harmonisation, defined as the convergence of European tax rates to the (non-weighted) European average⁴. As far as third countries are concerned, tax harmonisation has no negative externality. Moreover, there is almost no loss in terms of fiscal revenues. However, gains and losses are unevenly distributed (which is also the case in the competition scenario). This could be a political impediment to a negotiated move to harmonised tax rates, since European countries might not accept to lose out in the negotiation process.

For this reason, tax harmonisation might lead to a more fruitful outcome if the issue of tax schemes were considered first. In particular, generalising credit schemes at the European level might improve the efficiency of tax harmonisation negotiations. Indeed, the CEPPII study shows that the generalisation of credit schemes in Europe would reduce the flow of inward FDI, because opportunities for tax evasion would be cancelled. But simultaneously, the race to the bottom by European countries would become useless. Hence, negotiations on tax harmonisation would be easier, since converging on a common range of tax rates (nominal as well as effective) would be less painful: some countries could keep higher rates without fearing the competition from lower tax countries.

Amina Lahrèche-Révil
E-mail: LAHRECHE@CEPII.FR

FOR FURTHER INFORMATION SEE:

- 'FOREIGN DIRECT INVESTMENT AND THE PROSPECTS FOR TAX CO-ORDINATION IN EUROPE',
A. BÉNASSY-QUÉRÉ,
L. FONTAGNÉ AND A. LAHRÈCHE-RÉVIL
CEPII WORKING PAPER, N°00-06, APRIL 2000
(Available at www.cepii.fr)

(2) Because the model estimates the impact of tax differentials, which are by definition zero as soon as uniform tax rates are implemented in the EU, whether these rates are rather high (harmonisation) or very low (competition/dumping).

(3) The exercise does not take into account the impact of tax cuts on tax revenues.

(4) Note that harmonisation does not imply standardising tax rates, since location rents or disadvantages can justify the maintenance of tax differentials between countries within an integrated area.

RESEARCH SUMMARY

■ A Fortress Europe?

On the eve of new, multilateral trade negotiations, countries are trying to estimate their own levels of protectionism and those of their partners. In terms of customs duties, the major industrialised countries have appeared to be very open to trade, even if certain sectors still benefit from significant protection. But doubts remain in the area of Non-Tariff Barriers, anti-dumping duties and over methods for measuring trade protection.

Though the launching of new multilateral trade negotiations continues to be a delicate subject, they should begin some time in early 2001. Preparation for a new round thus requires an overview of the present situation, in order to identify the level of protectionism in the European Union (EU) and its partners. It is generally assumed that trade barriers in the major industrialised countries are very low. According to the OECD, the average rate of "applied" and weighted customs duties for national imports stood at 3.7% for the United States, at 6.6% for the EU and at 3.5% for Japan, in 1996. But these figures do not include Non-Tariff Barriers (NTBs), which are still high for textiles and clothing, and anti-dumping duties that have proliferated across the industrialised countries in recent years. It must thus be asked whether taking such protectionist instruments into account does not alter the outlook for the new negotiations, by re-establishing the reduction of trade barriers as a priority with respect to other, more qualitative issues (the precaution principle, social norms etc.).

Evaluating protectionism requires an adequate indicator of the intensity of each barrier to trade. When trade policy uses *ad valorem* tariffs, difficulties arise in calculating an average and in the weighting system. If tariffs are not weighted, then every heading is given the same importance. Weighting for imports, however, leads to endogenous bias: a tariff heading with a very low or zero tariff will have a high level of imports and will be over-weighted.

In contrast, a prohibitive tariff will have no weight. Protection is thus underestimated.

Table 1 indicates the average level of tariffs (non-weighted average) for 5 countries belonging to the WTO. Protectionism is indeed weak among the rich countries, especially the United States and in the European Union. By comparison, it is high for certain developing countries, such as Venezuela and India. In all countries, the food & agriculture sector, along with textiles and clothing always manifest a very significant level of protection.

Different ways for measuring NTBs can lead to markedly different conclusions about levels of protectionism in the industrialised countries.

3

Numerous tools allow national producers to be protected, such as import quotas, import licences, price controls etc. Measuring these Non-Tariff-Barriers is particularly problematic. Their restrictive nature is mainly gauged using a frequency index (the percentage of tariff headings subject to NTBs) and coverage index (the share of imports affected by NTBs). The impact of Non-Tariff Barriers can therefore be measured using the price difference method, *i.e.* by comparing domestic and world prices. This method has its limits. It

requires selecting a particular quality, an exchange rate to compare different prices, and lastly, it assumes that discriminatory practices do not exist - when the estimation is based on the exporting country's price.

An assessment of both tariff and non-tariff barriers has been made by Messerlin¹, who summed customs duties, NTB *ad valorem* equivalents (evaluated using the price dif-

MFN	Japan	United States	European Union	India	Venezuela
Total	7.3	4.5	4.7	29.8	12.4
<i>of which</i>					
Processed foods	18.6	15.3	13.9	61.1	18.7
Leather & animal skins	20.9	3.5	2.6	15.6	13.3
Textiles & textile items	9.2	10.2	9.0	37.6	18.7
Foot- & headware	28.5	8.9	7.9	40.0	19.0

Sources: TRAINS database and authors' calculations.

(1) P. Messerlin, 'Measuring the Cost of Protection in Europe', Institute for International Economics, Washington DC, forthcoming.

ference method especially) and anti-dumping duties. This approach has the great merit of putting forward a global measure of protectionism, which was estimated to run at 14.3% for Europe, in 1998. But, it rests on two importance choices. First, Messerlin used consolidated duties and not applied duties.

The former are maximum taxable levels and not the taxes actually levied on imports from WTO member states, which is the case for the latter. This difference can be very important. Second, he applied fully anti-dumping duties to the products concerned, while such taxes are in reality only levied on some of the suppliers of the countries in question. This share is generally very small: for the 21 *ad valorem* anti-dumping tariffs in Europe only 6.7% of all imports were affected, in 1998. When these two reservations are taken into account, then the average level of protection in the European Union (NTBs and anti-dumping duties included) is about 8.5%. Lastly, a major part of extra-European trade occurs under more liberalised conditions: the Generalised System of Preferences, the agreements with North African countries etc.

These methods may be criticised at a more fundamental level. They seek to measure the average level of protectionism in an economy, without taking into account the distortions generated in terms of welfare. It is from this point of view that Anderson, Bannister and Neary have put forward a new indicator².

An initial version of these indicators has been called the "Trade Restrictiveness Index" (TRI). Its aim is to evaluate the uniform customs duty - applied to the prices of all goods subject to any distortion - which is equivalent to the existing customs structure in terms of welfare. This really is therefore a matter of evaluating the degree of distortion due to protectionism. This approach has the advantage of basing measures of protectionism on theoretical foundations. At the same time, it makes it possible to aggregate different instruments of trade policy in a coherent manner: output subsidies, production taxation, quotas etc.

The next trade round needs to look at traditional quantitative trade issues, as well as new, qualitative considerations.

As an illustration, an extremely simple general equilibrium model has been constructed to evaluate the TRI of the European Union and the United States, in 1995. It places an open economy within a competitive framework. The products are grouped into 9 sectors. The distortions taken into account include *ad valorem* tariffs provided by the GTAP

database (which sums customs duties and the *ad valorem* NTB equivalents). Table 2 indicates the tariff equivalents for TRI. While this method has the advantage of taking the resulting distortions into account, it is nevertheless burdensome in terms of the information and calculations required.

The comparison of TRI suggests that American protectionism is more "costly" than European protectionism. This fact could be explained by the importance of American tariffs peaks.

Table 2: Tariff Equivalents for Trade Restrictiveness Index (TRI)

	TRI Tariff equivalent	Average unweighted customs duties	Average weighted customs duties
European Union	1.41	17.2	2.2
United States	4.72	10.4	3.5

Sources: GTAP, authors' calculations.

Indeed, a simple average of customs duties minimises the impact of these peaks though they are the source of important distortions, as economic theory demonstrates that the cost of protectionism is proportional to the square of the tariff and not the tariff itself. Taking the degree of distortion generated by trade barriers into account may modify the assessment of simple, average tariffs, though this model is only used for illustration.

Nevertheless, it seems clear that the low level of average protectionism cannot be used as an argument for focussing the next round of trade negotiations only on qualitative issues. Instead, negotiations should also address the issue of persisting tariff peaks in the major industrialised countries.

Antoine Bouët

E-mail: BOUET@CEPII.FR

Estelle Dhont-Peltrault

E-mail: ESTELLE.DHONT@UNIV-PAU.FR

FOR FURTHER INFORMATION SEE:

- 'HOW SHOULD TRADE PROTECTION BE MEASURED?'

LA LETTRE DU CEPII,
N°195, NOVEMBRE 2000.

- 'LA MESURE DES PROTECTIONS COMMERCIALES NATIONALES'

CEPII WORKING PAPER,
N°00-15, NOVEMBRE 2000.

(Available at www.cepii.fr)

(2) J.E. Anderson, G.J. Bannister, J.P. Neary, 1995, 'Domestic Distortions and International Trade', *International Economic Review*, vol. 36, No 1, Feb., pp. 139-157.

ON THE RESEARCH AGENDA

INTERNATIONAL TRADE AND FIRMS' HETEROGENEITY UNDER MONOPOLISTIC COMPETITION

The core theories of international trade are based on the hypothesis that firms are homogeneous. This is a natural simplifying assumption, but it is highly questionable, and may be misleading. For instance, in studying the impact of trade liberalisation, the gains associated with increasing internal returns to scale have probably been largely exaggerated, while the effects of reshuffling the output shares among firms have been underestimated. Heterogeneity among firms may also be important in order to understand the link between international trade and labour skills, as increases in employment at exporting plants may have played an important role in the increase in the relative demand for skilled labour in manufacturing.

Several robust results emerge from the recent literature, which hold for various countries:

i. Only a fraction of firms export anything, and exporters are generally larger and more productive than non-exporters.

ii. This specificity of exporters does not seem to be the result of any learning-by-exporting. The causality is the other way round: good firms become exporters, and this has a positive influence on their output, but not on their productivity.

iii. International trade can induce major changes in output-shares among firms, within an industry.

iv. Previous export experience is important in establishing the export-status of firms, suggesting the presence of fixed costs.

Despite such striking results, international trade theory provides little understanding of the interaction between heterogeneity across companies and foreign trade. The aim of this research project has been to put forward a tractable model, to examine this issue. The model describes two economies producing and trading two goods, one homogeneous, the other differentiated, within a general equilibrium framework. In the differentiated-good sector, firms are heterogeneous in their marginal cost, within a context of monopolistic competition of free-entry and exit. They face fixed production costs, and also fixed costs if they choose to export. The analysis pays special attention to the way firms' heterogeneity influences the nature of trade and, reciprocally, to the impact of trade on the population of firms, and to its consequences in terms of industry-wide efficiency. In particular, the study shows that trade in differentiated goods increases industry-wide efficiency, by two logical processes. The first is defensive, import-driven, with less efficient firms being eliminated due to competition from importers. The second is offensive, export-driven, as the prospect of extra profits attracts new producers whose entry into the market stokes up competition. As soon as international differences in productivity are sufficiently small and trade costs are low enough, this second process dominates in shaping the impact of international trade.

Sébastien Jean

E-mail: SEBASTIEN.JEAN@OECD.ORG

THE CAPITAL STOCK AND PRODUCTIVITY OF FRENCH TRANSPORT IN AN INTERNATIONAL PERSPECTIVE

Since the early 1990s, France and its neighbouring countries have started to deregulate transport services by the (partial) privatisation of public transport firms and by opening up borders to foreign competition. To assess the impact of these measures several indicators can be used of which total factor productivity (TFP) is one of the most comprehensive. This analysis could hitherto not be carried out for transport activities, as no detailed measures on capital inputs were available in France. This project aims to estimate capital stocks and TFP by sector of transport, and to compare the performance of France, Germany and the UK, with the United States, where transport was deregulated in the late 1970s.

In most sectors, the capital stock was measured by the perpetual inventory method (PIM) which sums several years of capital formation and deducts assets that reached the end of their service life. Detailed series were compiled for the acquisitions and sales of capital assets in eight different parts of the transport sector, providing a breakdown into infrastructure, transport equipment, and other machinery and equipment. In air and maritime transport, equipment is to a large extent leased or rented. In air transport, for example, more than 80 per cent of the new aircraft were leased, in 1998. As the PIM fails to include these non-owned assets, another method was used (i.e. administrative records) to evaluate the stock of aircraft and ships.

The second part of the study presents the results for labour, capital and total factor productivity estimated on the basis of the Törnqvist discrete approximation to the Divisia index. Between 1970 and 1997, TFP grew fastest in air and maritime transport. In contrast, road haulage, urban and inter-urban passenger transport, and transport services performed poorly. The good performance in air transport was accompanied by an increase in capital inputs and employment. In maritime transport, by comparison, labour and capital inputs fell sharply.

The other three countries also showed large variations in TFP performance across sectors. Overall TFP gains in the Germany and the United Kingdom were similar to those in France. The three European countries showed some catch-up relative to the USA, as their TFP performance was superior. In the three European countries, the TFP growth rates were highest in sectors which were most opened to competition, i.e. air transport, and lowest in railways which continued to be protected until recently. France outperformed other countries in railways and airlines.

Bernard Chane Kune and Nanno Mulder
E-mail: MULDER@CEPII.FR

FOR FURTHER INFORMATION SEE:

- 'INTERNATIONAL TRADE AND FIRMS' HETEROGENEITY UNDER MONOPOLISTIC COMPETITION',
S. JEAN,
CEPII WORKING PAPER, N°2000-13, SEPTEMBER 2000.
- 'CAPITAL STOCK AND PRODUCTIVITY IN FRENCH TRANSPORT: AN INTERNATIONAL COMPARISON',
B. CHANE KUNE AND N. MULDER,
CEPII WORKING PAPER, N°2000-18, DECEMBER 2000.

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P. Geoffron

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BOOKS BY CEPII RESEARCHERS

• *Le FMI : DE L'ORDRE MONÉTAIRE AUX DÉSORDRES FINANCIERS*

M. Aglietta & S. Moatti, 255 p.,
Collection CPR-Economica,
May 2000, FF 98.

• *L'ÉCONOMIE MONDIALE 2001*

edited by I. Bensidoun &
A. Chevallier, 125 p., Collection
Repères, La Découverte, FF 49.

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S. Jean
No 00-12, JULY.

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Events

SEMINARS AND MEETINGS

- **Global Economic Prospects 2001**
U. Dadush (World Bank), D. Van Der Mensbrugge (World Bank), L. Fontagné (CEPII), A. Bouët (CEPII), G. Gaulier (CEPII), J.-L. Guérin (CEPII)
4 December
- **Should Europe's Industrial Policies Be Given a New Boost?**
E. Cohen (CNRS), J.-L. Lorenzi (University Paris IX, CAE), L. Fontagné (CEPII)
4 December
- **A Trade System for the 21 Century**
S. Laird (WTO)
7 November
- **Structural Asymmetries in Europe**
L. Cadiou (CEPII), B. Mojon (ECB)
20 October

- **Controlling the Green-House Effect in International Public Policy**
A. Bernard (Ponts & Chaussées), O. Blanchard (University of Grenoble), J.-M. Burniaux (OCDE), P. Criqui (IEPE), E. Fortin (CIRED), O. Godard (CNRS), J.-C. Hourcade (CIRED), J. Oliveira-Martins (OCDE), M. Vielle (University of Tours), P. Villa (CEPII)
18 October
- **EMU and Asymmetries in Labour Market**
L. Fontagné (CEPII), J.-P. Laffargue (CEPII), D. Mayes (Bank of Finland), E. Pentecost (Loughborough University), P. Morin (INSEE), K. Dury (NIESR), A. Borghijs (Antwerp University), W. Scheremet (DIW Berlin), S. Tanguy

- (Rennes University), D. Gros (CEPS), K. Alho E. (ETLA), R. de Mooij (CPB), R. Nahuis (CPB), N. Viegi (Strathclyde University)
29-30 September
- **Growth Forecasts to 2010**
N. Kousnetzoff (CEPII), A. Adler (Courier International)
28 September
- **Wither the Euro? The Costs of Learning**
L. Fontagné (CEPII), D. Gros (CEPS), O. Davanne (CAE), V. Koen (OCDE), J. Pisani-Ferry (CAE)
5 July

BUSINESS CLUB CONFERENCE

- **New Business Club Conference**
Series: "THREE PERCEPTIONS OF THE WORLD ECONOMY"

The CEPII's Business Club has launched a new conference series aimed at providing executives with business-specific information on major countries in the world economy. M. Camdessus, Chairman of the CEPII and former Managing Director of the IMF will generally provide the

macroeconomic analysis at each meeting, and F. David, CEO of the COFACE (France's main export insurance agency), the country risks analysis. A business personality then gives a more "hands-on" presentation of the business prospects in the country or country-group. The first conference in the series took place the 23 November 2000; its theme was: **Russia, One Year after the Elections**. M. Camdessus and F. David

were joined by P. Blayau (CEO of Moulinex).

The second conference will take place in March 2000, and will examine the prospects of Argentina and Brazil. For further information, please contact Astrid du Lau d'Allemans, Secretary General of the CEPII Business Club: tél : 33 (1) 53 68 55 26 or email: allemans@cepii.fr.

CONFERENCES

- **ECONOMIC AND SOCIAL DIMENSIONS OF EU ENLARGEMENT**
Joint EU Presidency - ENEPRI Conference,
Brussels, November 16, 2000
- Keynote speech during the dinner of November 15: J. Linn (World Bank)
- **Session 1: The Labour Markets in Accession Countries**
T. Boeri (Bocconi University), J. Hausner (University of Krakow), M. Gora (Warsaw School of Economics), J. ten Geuzendam (EU).

• **Session 2: Potential Spillovers Between the Labour Markets of EU and of Accession Countries**
C. Wallace (University of Derby), M. Belka (Advisor to the President of Poland), S. Feld (University of Liège), J. Decaillon (CGT).

• **Session 3: Social Security Reform: Is It a Different Issue for Accession Countries?**
M. Rutkowski (World Bank), A. Simonovits (Institute of Economics,

Budapest), Z. Ferge (University of Budapest), J. Mortensen (CEPS).

Panel Discussion chaired by L. Fontagné (CEPII) & D. Gros (CEPS).
P. Beres (European Parliament), R. Hornung-Draus (Confederation of German Employers), M. Lado (National Labour Centre, Budapest), W. Orłowski (NOBE), M. Vodopivec (World Bank).

NEWS IN BRIEF

- Florence Legros joined the CEPII as Deputy Director, as of November 2000. She will be responsible for leading research programmes relating to factor markets and growth, as well as economic policy and the European economy. She succeeds Agnès Bénassy-Quéré, who remains a scientific advisor to the Centre and is responsible for the CEPII's research programme on the international monetary and financial system, while pursuing her academic work as a Professor of Economics at the

University of Paris X (Nanterre).

- Loïc Cadiou, who has worked on the construction of the CEPII's new macroeconomic model (MARMOTTE), left the CEPII in December, to join CPR Asset Management.
- Yvan Decreux joined the CEPII in November, and will be working on the CHELEM database and the Centre's Computable General Equilibrium Model.
- Sébastien Jean has been seconded from the CEPII to the OECD for one

year, as of September 2000. He is temporarily replaced by Hedi Bchir, who is working on the General Equilibrium Model.

- Julien Talbot's secondment with the CEPII ended in August 2000. He returns to the INSEE, and is succeeded by Ana-Maria Vespa, who is responsible for electronic documentation and data management.
- Philippe Dufaut has left the CEPII's IT staff. He is succeeded by Richard Avisse, as of January 2001.

FORTHCOMING

- On 6-7 February the CEPII and France's National Institute for Agronomy (INRA) are organising a major conference on "Agriculture

and International Trade", in Paris. The conference will discuss a wide range of issues related to trade negotiations in this field.

For further information please contact Prof. Antoine Bouët at: bouet@cepii.fr.

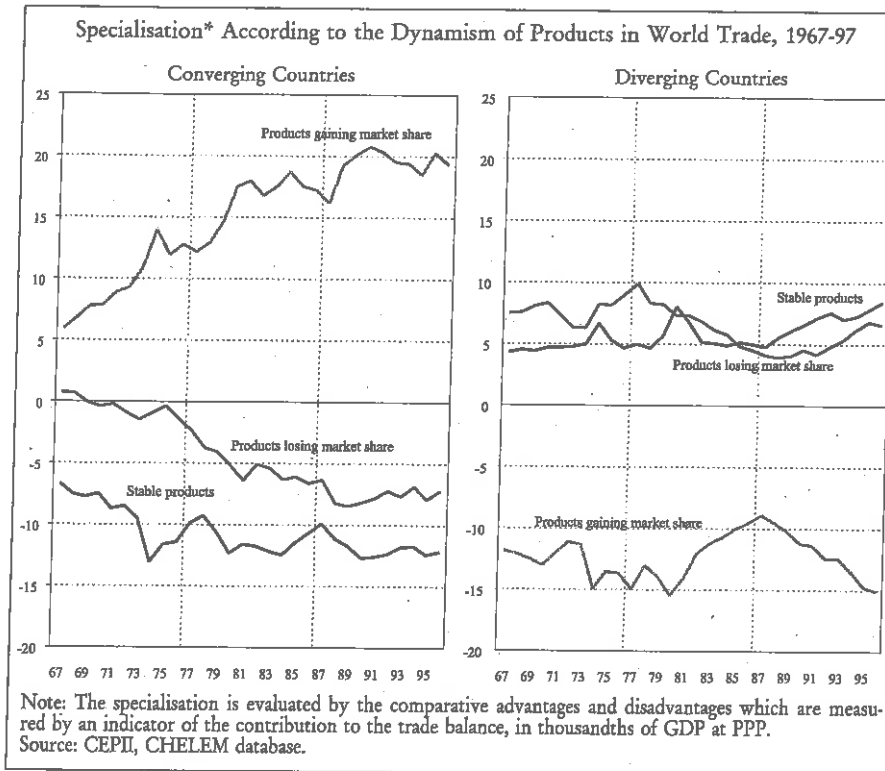
THE CHELEM DATABASE

■ Specialisation and Growth

The fact that poor countries are not able to catch up systematically with rich countries has given rise to a large body of research analysing the factors which impede the catch-up process. Few studies, however, have taken into account the influence of international specialisation on growth. In 1998, the CEPII published a report on competitiveness which clearly showed up the marked diffe-

is characterised by inertia. By maintaining comparative advantages in goods whose share in world trade has been stable at best, or falling at worst, (eg: food & agriculture, energy), these countries have suffered from the cumulative effects of an unadapted international trade specialisation.

The link between the nature of specialisation and growth suggested by simple observation remains when



other factors influencing growth are taken into account. Indeed, the introduction of an indicator measuring the degree to which a country is specialised in "dynamic" products into a standard equation of conditional convergence confirms the positive impact of this variable on growth of developing countries*. The success of liberalisation strategies thus depends on a country's specialisation patterns. The effects of trade liberalisation are not automatic, but subject to the environment in which they occur. Apart from the institutional or macro-economic environ-

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rences in the specialisation structures between countries that have managed to reduce the relative gap in living standards with the rich countries and those that have not (see Graph). The former have "betted" on dynamic products, i.e. goods whose share in international trade has increased (eg: electronics, textiles). In contrast, the latter group of countries have an international specialisation which

ment, the way a country is integrated into international trade conditions the success of liberalisation strategies.

Isabelle Bensedoun, Deniz Ünal-Kesenci,
Guillaume Gaulier
E-mail: BENSIDOUN@CEPII.FR

* 'The Nature of Specialisation Matters for Growth: an Empirical Investigation', *CEPII Working Paper*, forthcoming.

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

Opinions expressed in *The CEPII Newsletter* are those of the authors.