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FOCUS

Measuring the Different Impacts of Outsourcing

The steady decline in the share of industry in total employment currently seems to have been accelerated by the forces of globalisation, and translates into factories being dismantled and eventually relocated abroad. Indeed, the rapid development of the international division of labour, as fostered by the emergence of competitors with a very broad spectrum of comparative advantages in industrial activities (e.g. China), and sometimes in services too (e.g. India), has revived a *leitmotiv* in public debate in Europe, Japan and the United States: the “hoovering-up” of jobs by competition from low-wage economies.

The BACI database developed by the CEPII makes it possible to calculate the respective contributions of the “South” and the “North” to the growth in volume of world trade. The striking change observed when comparing the mid- and the late 1990s is the surge in the contribution of the South. In the first period, two thirds of the growth in world exports were attributable to developed economies’ exports, while more than half is attributable to the South in the second period: the South is now the main engine of growth in world trade.

The recent controversy over the welfare impact of outsourcing between Samuelson and Bhagwati *et al.* should not hide the fact that the perception of globalisation by a large majority of economists is less alarming than that held by the general public. De-industrialisation is primarily a natural outcome associated with the development of modern societies; it results from demand, supply and relative price effects. However, regarding the latter, it is not possible to neglect the evidence that the new competitors, combining low labour costs with satisfactory productivity levels, depress international prices for manufactured products.

In order to properly address these issues, Boulhol & Fontagné define offshore outsourcing in a broader sense, which is generally adopted in the public debate, namely trade in goods with countries where offshoring takes place. They replicate and extend Rowthorn & Ramaswami’s work

using a different econometric methodology (GMM, data for 1970-2002). Basically, the idea is to determine the responsibility of outsourcing in observed de-industrialisation. The contribution of trade with low-wage economies explains 20% (on average) of the observed decline in the share of manufacturing employment within the OECD.

Based on these estimations, it may be asked what would the share of manufacturing employment have been in 2002, if the OECD countries had maintained their trade ratios with developing countries, at the 1970 level. For the USA, Japan and France, trade with developing countries has led respectively to the displacement of around 3.3 million, 1.4 million and 350 000 manufacturing jobs, compensated by jobs created in the service sector.

Relying on microeconomic evidence complements the previous analysis based on sectoral data. What are the effects at home when a domestically-owned, multinational firm decides to launch a business abroad, in particular when a location in a low-wage country is chosen? Data for French manufacturing firms over the period 1988-1998 has been used (Hijzen, Jean & Mayer, 2006, forthcoming CEPII Working Paper) to complement the existing literature (e.g. Hanson, Slaughter & Mataloni, 2005 or Arnold & Smarzynska, 2005). The evaluation of the causal effect of establishing an affiliate abroad on a range of observable outcomes (employment, skills intensity, productivity) is clear-cut: relocation only represents a small fraction of FDI, and its effects on employment at home are likely to be temporary, thanks to the overall gains in efficiency of the firm.

Indeed, the bulk of FDI is North-North and mainly motivated by the proximity to consumers and agglomeration rent-seeking (Fontagné & Mayer, 2005). Higher labour costs are often found to increase inward FDI, in advanced economies. However, within these countries, corporate taxation is found to matter, although it must be balanced against the provision of public goods (Bénassy-Quéré, Fontagné & Lahrière-Révil, 2005; Bénassy-Quéré, Gopalraja & Trannoy, 2006, see research summary in this *Newsletter*). Turning to the new EU member states, there is little evidence that (falling) corporate taxation is central to attracting FDI, although in the future these countries are likely to resemble the EU15 countries more (Lahrière-Révil, 2006).

Overall, competition from the South (via specialisation or offshore outsourcing) is responsible for only a limited part of the concerns referred to above, even if adjustment costs can indeed be large and painful in certain regions, or for certain categories of workers.

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ON THE RESEARCH AGENDA

Tax and Public Input Competition

From 1996 to 2005, average corporate, statutory tax rates declined by 9 percentage points in the EU15, and by 11 percentage points in the ten new member states. Despite some broadening of tax bases, effective tax rates have also been declining. It is tempting to see this trend as a result of tax competition among member states to attract foreign investments and to predict the hollowing out of corporate taxation through a 'race to the bottom'. Still, this view ignores the fact that corporate taxes can be used to create productive public goods, such as infrastructure or education.

In order to provide a theoretical background for such two-tier competition – on taxes and on the provision of public goods – we revisit the popular model of fiscal competition introduced by Mieszkowski & Zodrow (1986). Within a unified theoretical setting, we show that tax/input competition can lead to an expenditure shift from household-specific public goods (like income redistribution, housing or recreation), to productive public goods, and that this expenditure shift is stronger for a more efficient public sector.

The empirical relevance of such twofold competition, on tax rates and on the provision of public inputs, is then tested by using a dataset of foreign direct investment flows, from the United States to 18 EU countries and to 11 sectors over the period 1994-2002. We find that both corporate tax rates and public capital stocks are significant in explaining inward FDI, using controls such as economic size, agglomeration effects or unit labour costs. By contrast, household-oriented public goods, like health and social security spending tend to repel foreign investors.

Still, both our theoretical setting and econometric results show that financing a rise in public capital through a corporate-tax increase reduces the attractiveness of a country. This means that either such investment must be covered at least partially by other taxes, or public capital is bound to decline. High-tax countries, that have already made the choice of a high level of provision of public goods, could find a way to draw large amounts of capital from abroad, despite high taxation through providing appropriate public infrastructure and high quality services. However such a choice is costly both in terms of public resources and in terms of the lower provision of household-specific public goods, such as health care or inter-personal income redistribution.

Agnès Bénassy-Quéré, Nicolas Gobalraja & Alain Trannoy

Zodrow, G. & Mieszkowski, P. , "Pigou, Tiebout, Property Taxation and the Underprovision of Local Public Goods", *Journal of Urban Economics*, Volume 19, N°3: 356-370, May 1986.

Economic Integration In Asia

Institutional regionalisation has come late to East Asia compared to Europe, but its pace has accelerated since the mid-1990s. Many agreements, including bilateral ones such as those signed between Singapore and Japan, and plurilateral ones such as those among the ASEAN countries (e.g. the ASEAN Free Trade Agreement (AFTA)) cover an ever-increasing portion of the East Asian region, including China.

This research begins by analysing the characteristics of regional economic integration in East Asia, questioning the notion of open regionalism, and subsequently explores the possible consequences of different kinds of agreements. The work uses the CEPPII'S CGE model (MIRAGE), adapted to the specificity of Asia's economic integration.

As regards the geometry of the agreement(s), two sets of scenarios are considered, based on a hub-and-spoke *versus* a full FTA assumption:

- In Scenario 1, we envisage a hub-and-spoke scheme: ASEAN-10 removes its tariffs *vis-à-vis* China, India, Japan and Korea. There are no sensitive products and hence no exclusion. Tariffs against third countries remain unchanged. Scenario 3 differs from Scenario 1 only by the exclusion of extra-ASEAN, sensitive products from the liberalisation.

- In Scenario 2, we envisage a full FTA in which China, India, Japan and Korea not only remove their tariffs on imports from ASEAN-10 members, but also remove their bilateral tariffs (e.g. China-Japan). Scenario 4 differs from Scenario 2 only by the exclusion of extra-ASEAN, sensitive products from the liberalisation.

Among the main results, we find that Asian countries do have diverging interests. While ASEAN maximises its benefits in the bilateral scenario including agricultural liberalisation (scenario 1), Japan and Korea benefit most from the regional scenario (scenario 2).

For the EU-25, it appears that an increase in competition within the Asia region has a negative impact on its goods exports, but a positive impact on its service exports. The main losers are the economically-close countries and primary goods producers such as Taiwan, South Asia (excluding naturally India), North Africa and South America.

Mohamed Hedi Bchir & Michel Fouquin

Disparities in Financing Pensions in Europe: Some Preliminary Results

In a previous *Newsletter*, we presented the framework of a general equilibrium model with overlapping generations, focusing on the case of the three main European countries: Germany, France and the UK. The purpose of this was to analyse the macroeconomic effects (in particular the capital flows induced by differential ageing processes across countries), of various pension reforms undertaken to insure the sustainability of the main European countries' pension systems.

This study demonstrates that the macroeconomic equilibrium of the model depends strongly on the functioning of capital markets. The financial consequences of ageing are then markedly different according to the financial environment. In a world of closed economies, differential ageing will generate differences in saving rates and rates of return, that are likely to be accentuated by the reforms implemented. In reality, we do not have closed economies but a global capital market. Population ageing and pension reforms will therefore involve capital flows between countries, inducing significant fluctuations and discrepancies in economic variables.

Whatever the starting level, this study insists on the long-term, financial unsustainability of large, pay-as-you-go pension schemes that exist in France and Germany. For example, the share of public pension payments is forecast to reach 17.8% of GDP in France by around 2050, and 18% in Germany, whereas this value is only around 4.4 in the UK. The low level of generosity of the UK public scheme, combined with a less-marked ageing process and the weight of occupational pension schemes explain this result. Thus, in the long run, resorting to debt financing is impossible. A planned fall of the replacement rates presents some advantages in respect to growth, but implies a large disequilibrium in the standard of living of retirees with respect to active people. Lastly, a progressive rise in the social contribution rates would permit this to be avoided, but at the cost of lower growth.

Xavier Chojnicki

Trade in Cultural Goods

The trade in artistic and cultural goods, as well as trade in economic goods, is rising rapidly, within the context of globalisation. Such trade is also changing, first because geographically new countries are appearing on the international scene (India, China etc.) and then because of the rising importance of services *vis-à-vis* goods, following on from trade in immaterial products, in intellectual property rights and also trade within multinational companies. This study starts with a critical assessment of all available data sources. It then aims to identify, wholly or in part, the trade in cultural goods and services, and especially cultural producer-industries, in order to analyse the place of France in the international market for goods and services. The study takes an empirical approach: developing measurement tools, using descriptive statistics, case studies and econometrics. In so doing, it seeks to set out precisely France's trade in cultural goods and

services, in comparison to the countries of the European Union (EU), and to the main exporters of such products outside the EU. This research also requires the formulation of original theoretical tools, especially in the field of economic modelling, beyond the use of tools which are well-tested for the economy as a whole or for particular sectors. The results of the study will be presented in a final report setting out the strengths and weaknesses of France's cultural goods and services sector, as well as its capacity to tackle globalisation. The study will outline France's future position in the trade of cultural products, and its ability to adapt to change and meet competition both from the United States and from emerging countries, such as China and India, which should play a greater role in the decades ahead.

Thierry Mayer

DATABASES

A Major Improvement in the Description of Trade Policy: MacMap-HS6 version 2

The MAcMap database was created by the CEPII in 2002¹, in collaboration with the International Trade Center (ITC Geneva). It has experienced considerable success thanks to its unmatched product detail and coverage of preferential trade agreements. In particular, its analytical version, MAcMap-HS6 v.1 (5,113 products at the HS6 level), has been widely used in many exercises aimed at assessing trade liberalisation scenarios, on a regional and a multilateral basis. The ongoing WTO negotiations of the Doha Round have reinforced the relevance of an exhaustive and accurate measure of tariff reductions, at the finest level and on a worldwide scale. Many institutions (OECD, US-ITC, European Commission, World Bank, UN-ECA) have relied on MAcMap-HS6 v1 and on the bound tariff database of the CEPII, to assess the possible outcome of the Round. Moreover, as the MAcMap database has become the source of data on protection for the GTAP v6 database, it has now been used by hundreds of researchers across the world.

However, recent trade policy changes have called for a new version of the database. Firstly, a complete update of the protection level has been conducted, based on 2004 applied protection figures, for 168 reporting countries *vis-à-vis* 235 partners. At the multilateral level, the last commitments of the Uruguay Round, which were scheduled to run until 2004, have been applied. Concerning preferential tariffs, new regional trade agreements are permanently incorporated (e.g. the US-Chile FTA, etc.), while pluri-lateral preferential initiatives have been fully applied in recent years (the EBA European Initiative, US AGOA). EU enlargement has also brought numerous changes which are fully taken into account in this new version. Lastly, changes come from the normal evolution of applied trade policies by government.

Second, trade flows have evolved, requiring the updating of the weighting scheme provided in the database (Reference Group or Bilateral Trade) and the unit values used for converting specific tariffs into *Ad Valorem* Equivalent (AVE). On this point, the new database provides several AVEs, computed with alternative unit values (Reference Group, World median and WTO unit values), in order to allow researchers to use figures that match their requirements exactly.

Finally, a new dataset on Tariff Rate Quotas (TRQs) has been developed, increasing in particular coverage of non-WTO TRQs. As previously, the bound tariff database is used to perform consistency

checks on MAcMapHS6. To this end, the new accessions to the WTO since 2001 are taken into account.

Average protection applied by country and categories of Partners in 2004
Differences with MacMap HS6 v.1

	World		LDCs		Developing Countries		Developed Countries	
	Change	New Level	Change	New Level	Change	New Level	Change	New Level
Bangladesh	0.1%	17.0%	-2.5%	14.2%	-0.5%	19.8%	0.5%	15.4%
Brazil	-0.7%	11.1%	-0.7%	1.7%	-1.1%	8.1%	-0.5%	12.3%
Canada	0.0%	3.4%	-5.8%	0.0%	-0.2%	2.7%	0.1%	3.7%
China	-6.4%	7.7%	-2.3%	1.4%	-6.0%	6.6%	-6.5%	8.2%
EU25	-0.3%	3.2%	-0.4%	0.8%	-0.3%	2.9%	0.0%	3.8%
India	-0.4%	33.1%	-1.6%	26.7%	-0.8%	34.6%	-0.1%	32.4%
Japan	-0.2%	3.7%	-0.4%	1.4%	-0.8%	3.4%	0.0%	3.9%
Row	0.0%	7.8%	0.3%	8.2%	0.0%	8.9%	0.0%	7.4%
USA	0.0%	2.3%	0.0%	5.1%	-0.2%	2.3%	0.1%	2.3%
World	-0.9%	4.8%	-1.5%	3.5%	-1.4%	4.1%	-0.6%	5.2%

The MacMap-HS6 v.2 will be used as the new protection dataset for the GTAP v7 database (to be released in 2007) and will be available with the WITS interface at the end of 2006. The MAcMap's webpage of the CEPII will provide complete information, as well as updated figures on protection, for several levels of aggregation (GTAP, HS2, CHELEM).

David Laborde

1 - See The CEPII Newsletter N°17, Summer 2002.

2 - See The CEPII Newsletter N°26, Fall 2005.

3 - See BOUET, A., DECREUX, Y., FONTAGNE, L., JEAN, S. & LABORDE, D., Tariff Data, GTAP Resource V6 Documentation - Chapter 16.D.

EVENTS

The Chinese Economy from a Historical Perspective

23 March 2006

Two leading French Sinologists presented China's recent development in a historical context, with reference to the early 20th century and with respect to the Maoist legacy. Marie-Claire Bergère (INALCO) examined "the State and trade and industrial associations before the revolution, as well as since the reforms". She began by analysing the main merchant corporations and chambers of commerce under the Empire (before 1911) and under the republican regime (1911-1949). Next, she looked at the ambiguous relations which these vassal institutions had with the State, though preserving a degree of representativeness and autonomy. Lastly, Marie-Claire Bergère addressed the following questions: To what extent have today's industrial and trade federations followed in the footsteps of their predecessors? How do they combine their status as Communist Party organisations with their role of defending the interests of producers? Does their existence prevent new, more spontaneous types of associations from emerging, or does it actually favour them? Thereafter, Lucien Bianco (EHESS) put forward an analysis of "Maoism (1953-1978) and subsequent economic development". He began by presenting the imbalances and human cost of the

Maoist development strategy and the Maoist inheritance. He looked at the positive legacy of the Maoist regime, in terms of creating the basis for future industrialisation, and at its negative legacy. This made it possible to draw some lessons from the past and to shed light on China's persistent handicaps.

Exchange Rates: a Global Perspective

28 February 2006

The link between the euro/dollar exchange rate and the transatlantic interest-rate differential has proved to be quite robust in the past. Although growing current account deficits in the United States still nourish the view that the dollar should depreciate in the medium run, such depreciation stopped in 2005, in part due to the strong monetary policy reversal by the Fed. Asian central-bank interventions as well as OPEC countries' portfolio choices in relationship to the sharp rise in the oil price may also have played a role. How is the situation going to evolve in 2006? If the dollar does not depreciate, then how can global imbalances be solved without a major world slowdown? Is China going to genuinely implement its announced regime change, and what will be the impact on the euro/dollar and yen/dollar exchange rates, and on intra-Asian exchange rates? When and on what grounds could official interventions and international cooperation be justified? These were the main questions tackled during the meeting by Stephen Jen (Morgan Stanley), Agnès Bénassy-Quéré (CEPII & Paris X), Jean-Luc Schneider and Philippe Bouyoux (DGTPE).

New Regionalism: Progress, Setbacks and Challenges

9-10 February 2006

The third CEPII-IDB Conference took place at the Inter-American Development Bank headquarters in Washington, D.C. The Conference was organised by the CEPII and the IDB's Integration and Regional Programs Department (through the Institute for the Integration of Latin America and the Caribbean in Buenos Aires) and the Bank's Special Office in Europe. The objective of the conference was to take stock of the progress in the South's regional integration, as well as between the North and the South in different parts of the world, since the 1990s. The conference also sought to examine the achievements as well as challenges that the various integration groupings face today (on a comparative basis). The two-day conference covered a broad range of technical and policy issues, with regard to the design and functioning of regional integration initiatives. See the papers.

WORKING PAPERS

Base de données CHELEM-BAL du CEPII (in French)

No 2006-08, March

This text is a technical document for users of the CHELEM-BAL database, which contains balance of payments statistics for 184 countries, over a period of thirty years, and which was fully overhauled in 2005. The text sets out the main characteristics of this overhaul and presents the database's contents, at heading level. Special place is given to trade in services, which is detailed at the most precise level, set out in the 5th Balance of Payments Manual. While describing the wealth of the database, the document also describes the statistical problems which are inherent in such recordings of international trade.

Houssein Boumellassa & Deniz Unal-Kesenci

De-industrialisation and the Fear of Relocations in Industry

No 2006-07, March

The steady decline in the share of industry in total employment currently seems to be accelerated by competition from low wage countries, which depresses international prices for manufactured products and is being translated into offshore outsourcing and defensive innovation. In order to fully address these issues, we define offshore outsourcing in a broader sense, the one which is generally adopted in the public debate, namely trade in goods with countries where offshoring takes place. Our estimation strategy leads to the conclusion that net trade with low wage countries is

associated with a non-negligible average decrease (2%) in the share of manufacturing in employment since 1970. However, it represents only a fifth of the de-industrialisation over the period.

Hervé Boulhol & Lionel Fontagné

A Dynamic Perspective for the Reform of the Stability and Growth Pact

No 2006-06, March

The causes and the principal axes of this reform are analysed, as well as the main arguments for defending or criticising it. As to the Pact's prior functioning, for almost all small and medium-sized Euro area states, this is a success story and the reform appears apt to facilitate the Pact's future implementation. For the larger Member States, the Pact's experience has been a history of non-observance which the Pact's reform appears only to condone. This contradictory experience leads to a negative judgement on the functioning of the SGP as a whole. Concerning the reform, it does not appear to correct the most evident drawbacks of the Pact and of its application. But a more positive assessment appears possible, if reform is viewed in a more dynamic perspective.

Christian Deubner

China's Emergence and the Reorganisation of Trade Flows in Asia

No 2006-05, March

The emergence of China has intensified the international segmentation of production processes within Asia, but has not created an autonomous engine for the region's trade, as Asia still depends on outside markets for its final goods exports. The reorganisation of production has weakened the position of the advanced economies (Japan and the US) in Asia's trade, but up to now has not severely affected the position of the emerging Asian economies (Malaysia, Philippines, Thailand). However, the surge of China's exports and the decline of its export price, suggest the risk of a downward spiral of cost-competition, while the deterioration of China's terms of trade raises the question of the sustainability of its recent growth strategy.

Guillaume Gaulier, Françoise Lemoine & Deniz Ünal-Kesenci

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RECENT PUBLICATIONS

ECONOMIE INTERNATIONALE, QUARTERLY

No 104, 4th Quarter 2005

Migration du travail qualifié et formation de capital humain dans les pays en développement : un modèle stylisé et une revue de la littérature récente

Frédéric Docquier & Hillel Rapoport

Transition et ouverture économique au Vietnam : une différenciation sectorielle

Xuan Dung Cao & Thi Anh-Dao Tran

A Bird's Eye View of International Outsourcing: Data, Measurement and Labour Demand Effects

Alexander Hijzen

Les banques comme vecteurs et amplificateurs des chocs financiers : le canal du capital bancaire

Grégory Levieuge

Régime de change et croissance économique : une investigation empirique

Chaker Aloui & Haïthem Sassi

Modélisation multifractale du taux de change dollar/euro

Jérôme Fillol

Economie Internationale publishes papers dealing with a wide range of issues in applied international economics. Papers cover topics like macroeconomics, money and finance, trade, transition, European integration and regional studies. *Economie Internationale* especially encourages the submission of articles which are empirical in nature and emphasises the rigour of empirical analyses and data processing. With articles being submitted from economists in universities, central banks and private financial institutions worldwide, the journal achieves a considerable diversity and provides many viewpoints on international economic and financial questions. Papers can be submitted, following certain rules.

BOOKS

The Central and Eastern European Countries and the European Union

Edited by Michael Artis, Anindya Banerjee and Massimiliano Marcellino
Cambridge University Press, 2006

The accession of ten new members to the European Union on 1 May 2004 is among the most significant developments in the history of European integration. Based upon studies conducted by the European Forecasting Network (of which the CEPII is a member), this book analyses key aspects of the impact of this recent enlargement with reference to eight of the ten new Member States, namely the Central and Eastern European countries (CEECs). It demonstrates that the enlargement could have profound consequences on both the new Member States and on the pre-accession members of the Union, given the unparalleled magnitude of the enlargement, the fact that the CEECs have levels of prosperity and economic development well below the Union average, and their history of participation in centrally planned regimes. The contributions examine regional policy, the debate about accession to the EMU, the macroeconomic trajectories of the Central and Eastern European economies to date, and their likely future development.

NEWS IN BRIEF

Thierry Mayer, Professor of Economics at the University Paris-Sud and Scientific Advisor to the CEPII, received Best Young Economist Prize, awarded by *Le Monde Economie* and *Le Cercle des Economistes*, in May 2006. He was awarded for his work on the importance of geography in economics, and in particular on the links between international trade and armed conflict: "the further away a country's trade partners are, the greater the chances of conflict with a country close by. Conversely, the greater the trade links with a nearby partner, the lower the probability of conflict". He shares the prize with Etienne Wasmer.

Xavier Chojnicki, Lecturer in Applied Economics at the University of Lille 2, joined the CEPII as a Research Associate in economic demography, in April 2006. His PhD thesis was titled "Immigration, Public Finances and the Welfare of Host Countries: A Franco-American Comparison".

FORTHCOMING

La mondialisation détruit-elle des emplois?

LE GROUPE
D'ANALYSES DE LA
MONDIALISATION

Organised by the *Groupe d'analyses de la mondialisation*
27 June 2006

Fourth Annual Conference of the Euro-Latin Study Network on Integration and Trade (ELSNIT)

Organised by the IDB and the CEPII
20-21 October 2006

Ouverture et innovation sur les marchés financiers émergents

Call for Papers

Conference organised by the CEFI, the CEP II, the CNCE, Ixis-Cib, MACROFI, the French Embassy in Beijing, *Revue économique* and TX Investment Consulting Co., 27 & 28 March 2007

1st November 2006

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