FOCUS

Emerging Economies and the Global Crisis: From Decoupling to Contagion

Since the beginning of this century, the momentum of world economic growth has been undisputedly located outside the rich country club. The rise of demographic giants, China and India, has given an unprecedented scale to the impact of late comers’ integration into the world economy.

Today’s advanced economies are a still dominant but shrinking part of the world economy and, taking stock of this trend, prospective studies indicate that by 2050, the largest economies in the world (by GDP) may not be the richest (in terms of income per capita). According to the CEPII analysis, China and India taken together could match the size of the US in current dollars (with about 27% of the world GDP).

In rich countries, the rise of emerging economies is often perceived as a threat. Competition from low cost countries is seen as destroying jobs in industrialized economies, but economic research has tended to show that innovation weighs more in that process. Indeed the two factors are related. The CEPII estimates that outsourcing to low wage countries accounted for one fifth of the decrease in manufacturing employment in OECD countries from 1970 to 2002. Besides, rich and emerging countries do not compete head-on. First, new specialization patterns emerge from the international
splitting up of the value added chain, in which the former still control the upstream stages of production, intensive in capital and R&D. Second, rich countries have kept their comparative advantages in high price/quality segments. CEPII studies have shown that emerging economies have enlarged their market shares at the price of a decrease in the unit value of their exports. China, for instance, has remained heavily specialized in low-price/quality segments (70% of its exports) and has experienced a severe deterioration of its terms of trade since the end of the 1990s.

In the 2000s, the idea of “decoupling” came to the fore, according to which emerging economies could be “de-linking” from the dominant economies and namely from the US. This implied that emerging economies would be able to eschew the impact of an economic down-turn in the developed world and to become the engine of world growth. This hypothesis was comforted by two factors: first, economic growth picked up in China and India, which seemed to provide a new frontier for the world economy. Second, trade among the new players intensified, suggesting strong complementarity between them and especially between exporters of manufactured goods and “rentiers” (exporters of primary goods).

During the year 2008, as the global crisis unfold, there was evidence that financial and commercial interdependency between emerging economies and the rest of the world was stronger than ever. Even in emerging countries where the financial systems had no direct exposure to the sub-prime assets (such as India) the financial crisis had knock-on indirect effects, as large capital outflows were triggered by international investors. Enterprises faced tightening of liquidity in their domestic market as well as constraints in their access to external financing. Trade was the other contagion channel. The drop of US and European demand put an end to export-led growth in Asian emerging economies (mainly China) and led to a disruption in intra-Asian trade, still highly dependent on extra-regional markets. The external crisis has hit both China and India at the peak of their economic cycle. Their economic growth would have slowed down even without the global crisis which has turned the cyclical downturn into a hard landing. Clearly, these large emerging economies are not (yet) able to pull growth in the rest of the world, but they are likely to remain the fastest growing economies in 2009.

References:
Fontagné L. & Paillacar R., China is Shipping more Products to the United States than Germany, La Lettre du CEPII, N° 270, September 2007.

ON THE RESEARCH AGENDA

Institutions and Trade

Insecurity on foreign markets creates frictions that reduce international trade. A large body of empirical work documents the role of insecurity and institutional quality on international trade. Anderson (2000), Anderson & Marcoullier (2002), Dollar & Kraay (2002) and Levchenko (2007), for instance, show that countries with better institutions trade more, or that differences in institutional quality deters bilateral trade. Moreover, Blomberg and Hess (2006) estimate that the impact of terrorism and wars is equivalent to a 30% tariff.
Hence, countries with bad institutions trade less and thus incur welfare losses. We aim to investigate further this issue. We emphasize another channel through which insecurity and institutional quality affects countries’ gains from trade. Indeed, we claim that institutions and risk on aggregate trade not only affect total trade, but also the prices of imported goods. On a risky market, less foreign firms export and they are more likely to charge higher prices. We use French firm-level export data to test the influence of institutions on firms’ export prices.

Matthieu Crozet, Sébastien Jean & Sandra Poncet

Wholesalers in International Trade

Many recent empirical studies emphasize that only a small share of manufacturing firms engage in international trade. Even in the main trading countries, such as the United States, France or Germany, the proportion of exporting firms barely exceeds 20%. This very robust stylized fact has deeply renewed our views of globalization. It reveals the importance of trade barriers impeding small firms to develop arm’s length transactions. From a policy point of view, it suggests that export promotion policies may improve national performance on foreign markets, increasing of the number of exporting firms.

We argue however that computing the share of firms declaring directly their export flows to Customs largely underestimates the importance of firms' participation to foreign trade. Indeed, a closer look to custom data reveals that a very large share of exports is channeled by wholesalers. These firms distribute goods produced by firms that prefer not to operate themselves abroad. The role they play in international trade thus suggests that the share of firms actually succeeding in selling their products on foreign markets is likely to be much larger than the share of firms officially declaring exports.

Our study develops a simple model of international trade where firms may decide whether to export directly or to deal with a wholesaler. It shows that the share of exports channeled by wholesalers should be larger on small and distant markets. We use French firm-level data to test this prediction and, more generally, to show how the presence of wholesalers influences French export performances and the structure of its foreign trade.

Matthieu Crozet, Hélène Erkel-Rousse & Guy Lalanne

Remittances, Capital Flows and Financial Development during the Mass Migration Period, 1870-1913

This research addresses the question whether the substantial financial flows received by emigration countries in the four decades running up to World War I contributed to local financial development. We quantify a sizable and significant relation between remittances and measures of development of the financial sector that is both larger than the contribution of other international capital flows and than the best estimates of the same relation in our days. Given that financial development is regularly included among the conditions for economic growth and catch up of developing nations, this work adds to our understanding of the multiple impacts of the mass migration phenomenon in the economies of emigration nations.

Rui Esteves & David Khoudour-Castéras

The Trade-Growth Nexus in the Developing Countries: a Quantile Regression Approach

Policy recommendations based on export-led growth and trade liberalization have been at the heart of poverty reduction strategies for many years, and developing countries were encouraged to reduce trade barriers in order to allow for comparative advantage to develop. Theoretical
foundations of the positive links between trade openness, growth and poverty reduction come at least from two sources. On the one hand, the neoclassical approach explains the gains from trade liberalization by comparative advantages, be they with the form of resource endowment (as in the Hecksher-Ohlin model) or differences in technology (as shown by the Ricardian model). On the other hand, the endogenous growth literature asserts that trade openness positively affects per capita income and growth, through economies of scale and technological diffusion across countries.

The empirical investigation of these theoretical foundations points to a large variations in the benefits from trade openness to growth or to economic development. Asian and some Latin American countries that managed to develop export-based strategies have been rewarded with high economic growth, while African countries have remained trailing behind despite efforts to emulate the export-led growth model. To explain this, one strand of the literature emphasizes the conditional aspect of the trade-growth link: trade openness may not be conducive to growth without the appropriate economic, social and political environment. Others state that the expansion of growth augments a country’s income once the rise in inputs (capital, labor, education, and infrastructure) is taken into account, suggesting the possibility of various trade-growth relationships under different economic and social environments.

Our aim is to test the conjecture that differences in the trade-growth nexus originate from fulfilled or unfulfilled internal preconditions, most of which related to the domestic factors of economic growth (productive infrastructure, human capital, efficient investment, and factor productivity). In particular, we examine the relationship between openness and growth for 75 developing countries over the period of 1980-2006. In order to address the issue of parameter heterogeneity, we use a quantile regression analysis which allows the investigation of the openness-growth nexus at various points on the conditional growth distribution.

Gilles Dufrénot, Valérie Mignon & Charalambos Tsangarides

DATABASES

World Economic Overview

Using CHELEM database, the CEPII produces every year a World Economic Overview. Tables and graphs provide a synthetic long-term view of major changes in the world economy: population, production, exchanges of goods and services etc...

This World Economic Overview highlights the main changes in the world economy in the long run and how nations took part in it. Trends are featured: from 1960 to 2007 for GDP, and from 1967 to 2006 for international trade in goods and services.

i) Population and levels of development

The first part of the overview is dedicated to changes in the world ranking of economic and population weights, and of development levels. The second part describes trade flows. It sets out the growing share of trade in goods and services in the world production along with trade balances and imbalances across nations. Trade in goods and services, reflecting and explaining global and national transformations, is observed in detail. On one side through the product structure evolution, on the other side through the changes in geographical breakdowns. In the third part, specialization indicators –in terms of comparative advantages– are presented for about twenty major countries.

For example Table 1 shows that the share of Europe from East to West in world population has declined by 41% (EU-27), i.e. from 12.8% of world population in 1960 to 7.5% in 2007. Japan followed the same trend (-39%) and the share of United States of America declined slightly less, by 23%.
Table 1  

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Source: CEPII, CHELEM-GDP database.

* South and Central America and the Caribbean is referred to as South America.

** Former East Germany included since 1991.

More surprisingly China’s share in world population also declined, by 6%. The decline is quite fast since it only started after 1980.

On the other hand, South Asia, India and especially all the Middle East and sub-Saharan African countries saw their shares in world population increase. The formers’ share grew by 19% while Africa’s share as well as Middle East’s share grew by 56% each.

ii) World Trade

A look at the evolution of world trade shows that developed countries continue to dominate the world exchange of goods in general. But here again, major changes appeared in the last forty years.

The almost continuous decline of the USA, from 14% of world trade in 1967 to 8% in 2006, with a ten year relief (1985-1995) due to the dollar weakness.

The "Rise and Fall" of Japan: the rise is impressive from 1967 to 1985 until the "endaka" (i.e. the
dramatic appreciation of the Yen) is followed by a severe decline from a 10% share of world exports to 5% (close to the value in 1967). Over the same period, Japanese firms decided to go global and to massively invest in North America, in particular.

The rise of China from the very beginning of the “socialist market economy” in 1978 seems irresistible. The pace accelerates all along the way and China overtakes Japan in 2003 and the USA in 2005.

Germany managed to maintain a high level in the world economy. After a decline from 12% in 1973 to 9% in 1983, Germany regained and kept a 10% share. This performance is almost unique among developed nations as can be seen from Graph 1.

France’s share declined from 6% in 1973 to 4% in 2006 and similar evolutions can be observed in the other large European exporters.

Graph 1

Ten Leading Merchandises' Exporters (1967-2006)
(percent of world merchandise trade)

Source: CEPII, CHELEM International Trade Database.

Michel Fouquin & Colette Herzog

The World Economic Overview is available here.

WORKING PAPERS

Do Terms of Trade Drive Real Exchange Rates? Comparing Oil and Commodity Currencies
N° 2008-32, December 2008
This paper investigates whether terms of trade have an impact on real exchange rates for commodity exporters and oil exporters. To this end, we estimate a long term relationship between the real effective exchange rate and economic fundamentals, including the commodity terms of trade. The estimation relies on panel cointegration techniques and covers annual data from 1980 to 2007. Our results show that real exchange rates co-move with commodity prices in the long run and respond to oil price somewhat less than to commodity prices. We also find that some pegged currencies have been driven away from their equilibria by wild fluctuations in the key currencies, on which they are anchored.

Virginie Coudert, Cécile Couharde & Valérie Mignon

Vietnam’s Accession to the WTO: Ex-Post Evaluation in a Dynamic Perspective

Vietnam’s accession to the World Trade Organisation (WTO) on January 11, 2007 has represented the outcome of decades of efforts to modernise its economy. In this paper, we propose a new general equilibrium assessment of Vietnam’s accession to WTO using a dynamic approach and benefiting from the ex-post perspective offered one year after the membership acceptance. We rely on a dynamic global model incorporating duty-drawbacks and taking into account tariff changes at the HS6 level. A particular attention is paid on the sensitivity to dynamics assumptions and labour market closure. Our results show that gains for Vietnam linked to WTO accession are positive for trade in merchandises, but highly dependent on the evolution of textile and apparel sectors, whose exports were boosted by the commitments.

Houssein Boumellassa & Hugo Valin

Structural Gravity Equations with Intensive and Extensive Margins

Recent trade models with heterogenous firms have considerable consequences on the interpretation of gravity equations. Chaney (2008) shows that the effect of distance on trade margins incorporates three parameters: the elasticity of substitution between goods, the elasticity of trade costs with respect to distance, and the degree of firm heterogeneity. We structurally estimate the parameters of trade flows in Chaney’s model using French firm-level export data for 1986-1992, and controlling for the fixed costs of exporting. Our estimated parameters are consistent, for 27 out of 34 industries, with the theoretical model. They also allow us to evaluate the effects of transport cost separately from the effects of tariffs, without having to resort to detailed data on trade frictions.

Matthieu Crozet & Pamina Koenig

Trade Prices and the Euro

This paper describes the impact of the Euro on i) the level, ii) the evolution and iii) the dispersion of trade prices. This empirical analysis relies on firm level data about French exports over the period 1995-2005.

We find that the elimination of exchange rate fluctuations reduces the pricing-to-market behavior of French exporters. At the beginning of the EMU, we also observe an increase in aggregate prices for sales in the Euro zone. This price increase does not compensate for the aggregate price gap between cheaper EMU markets and more expensive non-EMU countries. Last we find that the Euro has affected firms’ pricing strategies leading to a reduction of the price dispersion inside the Euro zone.
Consumers are gradually going to have to pay, within the framework of international agreements on climate change mitigation, for the environmental cost of CO2 emissions caused by international transportation. The resulting increase in transportation costs will magnify the impact of the upward trend in oil prices. In such a context, this paper reviews past trends in international freight transportation and their impact on the growth of world trade; then it provides estimates of the impact of carbon taxes on transportation. The first section lists the difficulties arising in measuring transportation costs and their impact on international trade. The second section describes the growth of international freight transportation over the last 40 years. The third section provides estimates of the impact of carbon taxes on transportation obtained by using the MIRAGE general equilibrium model. We consider two taxation cases and two levels of taxes ($25 and $50 per ton of CO2). In both cases, by 2020, the result shows that a carbon tax on transportation will have a stronger negative effect on world trade than on GDP growth. Nonetheless these impacts remain small with these rates of taxation.

The majority of independent nations today were part of empires in 1945. Using bilateral trade data from 1948 to 2006, we examine the effect of independence on post-colonial trade. On average, there is little short run effect of trade with the colonizer (metropole). However, after three decades trade declines more than 60%. We also find that trade between former colonies of the same empire erodes as much as trade with the metropole, whereas trade with third countries exhibits small and unsystematic changes after independence. Hostile separations lead to larger and more immediate reductions. Trade deterioration over extended time periods suggests the depreciation of some form of trading capital such as business networks or institutions.

This article examines the performances of French exporting firms. Using a highly detailed database, we confirm that exporting firms are much bigger, more productive and more profitable than domestic ones. We show that this difference is particularly strong for firms that export to non-EU markets. However, this difference is mainly due to a selection effect: one to two years before starting to export, firms experience a relatively strong productivity growth, but this advantage tends to disappear rapidly.

Most European countries have recently introduced pension system reforms to face the financial problem related to population ageing. Italy is not an exception. The reforms introduced during the...
nineties (Amato Reform in 1992 and Dini Reform in 1995), even if they will produce a strong reduction in pension benefits, are generally thought not sufficient to adequately face the population ageing problem. For this reason, in 2004, the Berlusconi government introduced a new reform that increases the retirement age to 60 years from January 2008 onwards, to 61 years from 2010 and to 62 from 2014. In 2007, the left-wing government replaced this reform with a softer one that fixes the minimum retirement age at 58 from 2008. Using an applied overlapping-generations general equilibrium model, we analyze the impact of the new reforms on the macroeconomic system and in particular on the long-run sustainability of the pension system. We show that the increase in the retirement age would permit to reduce pension deficits in the short and medium run, while in the long run these reforms would become ineffective.
LA LETTRE DU CEPII, QUARTERLY

Oil Prices, Transport Costs and Globalisation
N° 282, October 2008

Detailed data enables to examine how the costs of transporting goods imported into the United States have changed over the last thirty years or so. Clear trends emerge, yet the link with the price of oil – a significant component of these costs – is not always obvious. It is only by conducting an econometric analysis that the real impact of the price of oil on the choice of mode of transport, imported product prices and the division of the market between supplier countries can be determined. The results obtained appear to indicate that, due to their impact on transport costs, rising oil prices actually undermine global integration by favouring countries located close to the world's major markets over those that are further away.

Nina Kousnetzoff, Daniel Mirza & Habib Zitouna

The Price of Virtue: 25 Years of the Currency Board in Hong Kong
N° 280, July-August 2008

Adopted in October 1983, the currency board has allowed Hong Kong to face the economic storms and to maintain the markets' confidence in one of the world's main financial centres. However, exchange rate stability has not been achieved without hitches. The adjustment costs related to this system are high, like they were during the Asian crisis of 1997, and the economic performance of Hong Kong tends to be lower than that of its neighbours. In a context of international financial instability and growing integration to an increasingly more open Chinese economy, what is the assessment of the 25 years of operation of this regime and what are the prospects?

David Khoudour-Castéras

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