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CONTENTS:

FOCUS

China's Export-Led Growth Has Reached its Limits

The rise of China has been a major feature of the global economic landscape for the last three decades. Research carried out at the CEPII has amply shown how the integration of China's economy into the world economy has produced dramatic changes in its foreign trade and led to a far-reaching reshuffle of international trade. It has also argued that China's extraordinary export performance could not provide by itself a sound base for its long-term development.

In 2009, China has become the leading world exporter. The expansion of China's exports was made possible by a rapid diversification, from textile to electronics. This has also resulted in China becoming the world top exporter of high-technology products since 2004, ahead of the US since 2003. The degree of sophistication of China's exports is now similar to that of a country with a level of income per capita three times higher. These spectacular achievements originate mainly from foreign firm affiliates located in China carrying international processing activities, i.e. assembling duty-free imported inputs for exports. Foreign affiliates are responsible for half of China's trade and 80% of its high-technology exports. During the past decade, the gap between the export performance of foreign and domestic firms has widened both in terms of sophistication and technological levels. The foreign trade sector has thus remained highly dualistic, which has far reaching implications for China's long-term development. Indeed the analysis at provincial level indicates that the export upgrading of foreign entities has no direct positive impact on economic performance. Only the technological upgrading of ordinary exports (for which the main part of the value-added chain is produced in China) has a significant impact on growth. Still, ordinary trade accounts for a small part of total high-tech exports.

The analysis of China's position in international trade has also revealed that the technological advance of Chinas exports has not been accompanied by their quality/price upgrading. Based on the calculation of the unit value of trade goods (at a very detailed level of commodity classification), the composition of Chinese exports by price/quality range appears to be distorted downward even for the high-technology products. China's exports are concentrated (70%) in low-price/quality goods and this has not changed since the mid-1990. The low unit value of Chinese exports has several explanations. The most plausible is that Chinese exports are mostly composed of mass market, standardized products. The undervaluation of the yuan is part and parcel of this strategy aimed at price competitiveness. In this respect, China's position in world market segment strongly differs from that of India. China's specialization has contributed to cushion the costs of adjustment for its major partners, as has left room for advanced economies in the upper ranges of the market.

Due to a scissor effect between the evolution of export and import prices, China's terms of trade have sharply deteriorated since the mid 1990s. Prices (unit values) of China's exports declined between 1997 and 2002 and they have shown a moderate upward trend since then. By contrast, China's import prices (unit values) increased much faster, due on the one hand to the prices of imported manufactured goods (parts and components) and on the other hand to the prices of primary products. This has reduced the gains China has derived from its integration in international trade.

In the 2000s, China's exports surged and its economic growth became increasingly dependent on external demand. The global economic crisis which broke out at the end of 2008 severely affected China's exports and a strong stimulus package was necessary to support economic growth in 2009. The uncertainty of future external demand is now forcing China to shift to a growth model centered on domestic demand and, more specifically, on household consumption. A substantial appreciation of the yuan would contribute to the rebalancing and would also reverse the decline in the terms of trade.

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ON THE RESEARCH AGENDA

The Case for Intermediate Exchange-Rate Regimes

Despite increasing capital mobility and the subsequent difficulty in controlling exchange rates, intermediate exchange-rate regimes have remained widespread, especially in emerging and developing economies. However, the New-Keynesian model, which has become the main work-horse for studying exchange-rate regime choice since the 1990s, typically opposes fixed nominal pegs to free floats, without considering intermediate regimes. We intend to fill this gap by comparing the performance of "extreme" regimes to that of an intermediate regime where monetary authorities care both about inflation and about nominal exchange-rate deviations from the steady state, when a small economy is hit by several types of shocks. Without nominal wages rigidities, our results are in line with the New-Keynesian literature arguing in favor of inflation-targeting regimes. However, when nominal wage rigidities are taken into account, we find the intermediate regime to be suitable for an economy that is mainly hit by productivity and foreign-interest shocks, which is often the case in emerging and developing economies. The free-floating regime (with inflation targeting) seems more adequate if the economy experiences mostly demand shocks and foreign price shocks. Finally, the fixed peg regime is always dominated by either the free-floating or the intermediate regime.

Agnès Bénassy-Quéré & Véronique Salins

Crises and the Collapse of World Trade: the Shift to Lower Quality

Much attention has been paid to the collapse of world trade during the last quarter of 2008 and the first quarter of 2009. Between July 2008 and January 2009, the volume of world exports decreased by 24%, while trade prices decreased by 14%. Similar disconnection between values and volumes of world trade was also observed during the crisis of 2001.

We show that contraction of income affects more the imports of high quality varieties, which are sold at a higher price, leading to a decrease in import-price indices. Import price indices may indeed go down because (i) the individual price of each variety declines, (ii) the product mix that is imported changes, and (iii) importers change the composition of varieties they import of a single product. In our analysis, a variety is defined as a product category differentiated by its country of origin.

We use detailed product-level data for European Union 15 (EU15) imports provided by Eurostat on a monthly basis, and confirm that the import-price index of the EU15 decreased sharply during the crisis of 2008-2009. 24% of the collapse in the trade price index can be explained by a larger cut in the demand addressed to high-quality varieties that are sold at a higher price on the European market.

The econometric analysis is performed on historical data for about 200 countries in the World and 5000 product categories over the period 1995-2007. Estimation results confirm that imports of high-quality varieties are more sensible to GDP variations. The larger income elasticity for high-quality varieties contributes to explain the sharp reduction in trade price indices during crises.

Antoine Berthou & Charlotte Emlinger

Determinants and Pervasiveness of the Evasion of Custom Duties

Because they are collected in specific places –the place of custom clearance-, tariff receipts are considered to benefit from low collection costs compared to other taxes. This might actually explain why tariffs are frequently used by low-income countries as revenue devices. Still, custom duties can be evaded through a number of ways. This raises questions about the effectiveness of custom duties collection, and about its change with tariff liberalisation. Should tariff revenue losses associated with tariff changes be computed "at face value", i.e. based on statutory protection, or may the relationship be more complex? Would specific reforms be likely to improve custom duty collection?

The discrepancies between mirror declarations of trade flows, by both the importer and the exporter, offer an opportunity to gauge the importance of these unlawful practices. Higher tariffs are statistically associated with a lower declaration by the importing country, in comparison to the mirror declaration by the exporter. The relationship is not negligible (in the case of China a one percentage point increase in the tax rate is associated with a 3 percent increase in evasion - see Fisman & Wei, 2004) , but varies in magnitude across different case studies (e.g. for Mozambique in Arndt and van Dunem, 2005 or India in Mishra *et al.*, 2008 the elasticity is quite lower than in China).

We aim at investigating the effectiveness of policy measures targeted to reduce custom corruption and their interaction with an improved broader legal environment.

The paper addresses these questions, both theoretically and empirically. We develop a simple model, sketching the determinants of customs duties evasion and their interaction with the institutional framework. Then we apply the methodology described above to all countries for which relevant data were available in 2001 and 2004, to see how pervasive the phenomenon is. The results suggest that corruption is effectively common, especially in the poor countries and for differentiated products. Moreover, the main measures of economic policies proposed to fight corruption, such as the simplification of the tariff structure, the automation of data processing of customs or the ratification of the agreement of the WTO on custom valuation, appear to be effective, mainly for the poorest countries.

Other remedies, such as hiring Pre-Shipment Inspection (PSI) companies to inspect the value of goods before shipment to the importing country, seem to be more effective when the country has already relatively well functioning customs services.

Sébastien Jean & Cristina Mitaritonna

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The Distorted Effect of Financial Development on International Trade Flows

This paper investigates the effects of financial development on the intensive and extensive margins of countries exports, at different stages of economic development.

A partial equilibrium model with monopolistic competition is developed. In this model, firms are heterogeneous in terms of productivity and have access to external liquidity, at some cost. The effect of financial development on the intensive and extensive margins of countries exports is predicted to be positive, especially in sectors with a higher reliance on external finance. In countries with poor financial institutions though, only the most productive firms benefit from an increased access to financial resources and start exporting. The effect of financial development on exports is therefore higher the more developed financial institutions.

The empirical analysis confirms that financial development promotes both the intensive and extensive margins of countries' exports. This is more the case in industries with a higher reliance on external finance. Though, more than 60% of the effect of financial development channels through the intensive margin. In industries where the demand for external finance is high, the effect of financial development is the highest in economies characterized by an intermediate development of financial institutions, and the lowest in countries with poor or advanced financial institutions. This contradicts the traditional expectation that financial development benefits more in terms of exports to countries where financial constraints are the most binding.

Antoine Berthou

DATABASES

Trade in Services of French Firms

This project is among the first studies to look at services trade using micro data. Breinlich *et* Criscuolo[1] is the only other micro-based paper we know on this topic. However it focuses on British firm data. Our first concern is to check whether the stylised facts put forward by these authors regarding the characteristics of services traders (size, productivity, nature of products being traded) can be reproduced on French data.

Our work goes a step further though by making a systematic comparison between firms trading services and those trading goods. Besides, we look at the sector (manufacturing or services) to which the exporters and importers of services belong. As a matter of fact, some manufacturing firms may import but also export services (licences, patents, R&D blueprints, Management fees, etc…). Symmetrically, we also look at firms in the service industry that trade goods. As a matter of fact, many services firms might import and export manufacturing goods (e.g. retail sellers and wholesales firms).

We use information from four databases:

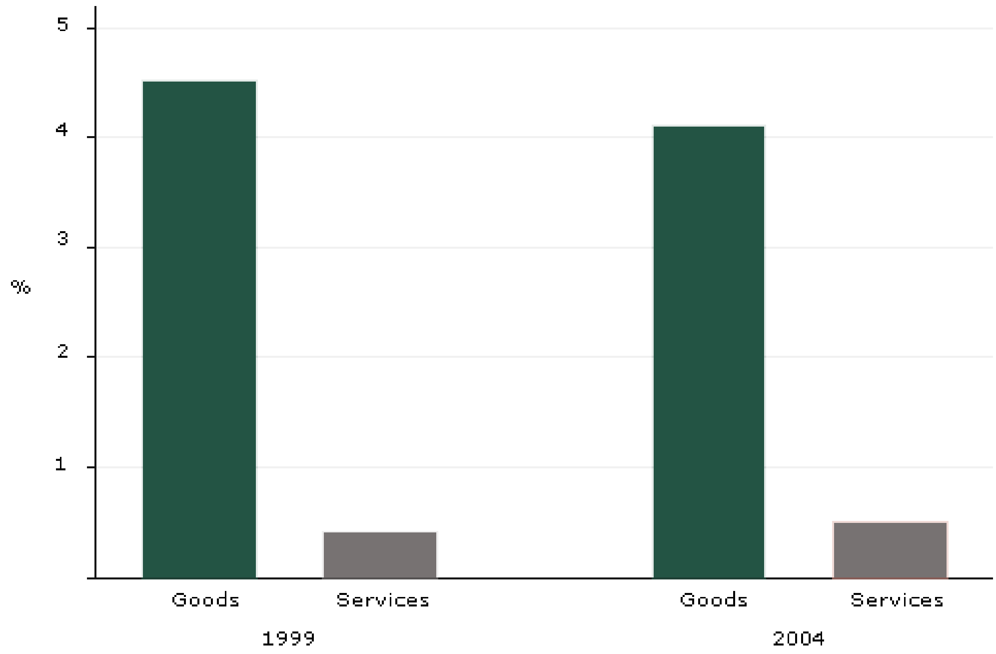
1/ The Banque de France Services Trade dataset (BFST);
2/ In order to compare services trade with trade in goods we first match the Banque de France Services Trade dataset (BFST), with the French Customs' data (DOUANES) which deliver firm level exports and imports in goods;
3/ In order to appreciate the proportion of services and/or goods traders compared to firms that do not participate in trade, we include exhaustive information on the number of active firms in France in each calendar year from the INSEE Stojan (or January Stock of firms) database;
4/ Because we need to look at firm-level characteristics in terms of productivity and size and their relation to trade in goods and services, we merge BFST and DOUANES with the annual survey of French firms activity (Enquête Annuelle d'Entreprises, EAE).

Many stylized facts come out from our study.

- First, Figures 1 and 2 show that the number of traders in goods (importers and exporters) is 10 times that of services traders: with respect to the firms listed in Stojan in manufacturing and business services (around 1,8 million in 1999), around 4% of the firms import and/or export goods, while only 0.4% import and/or export services.

Figure 1: Share of Exporters of Goods and Services

(in % of the total of firms)

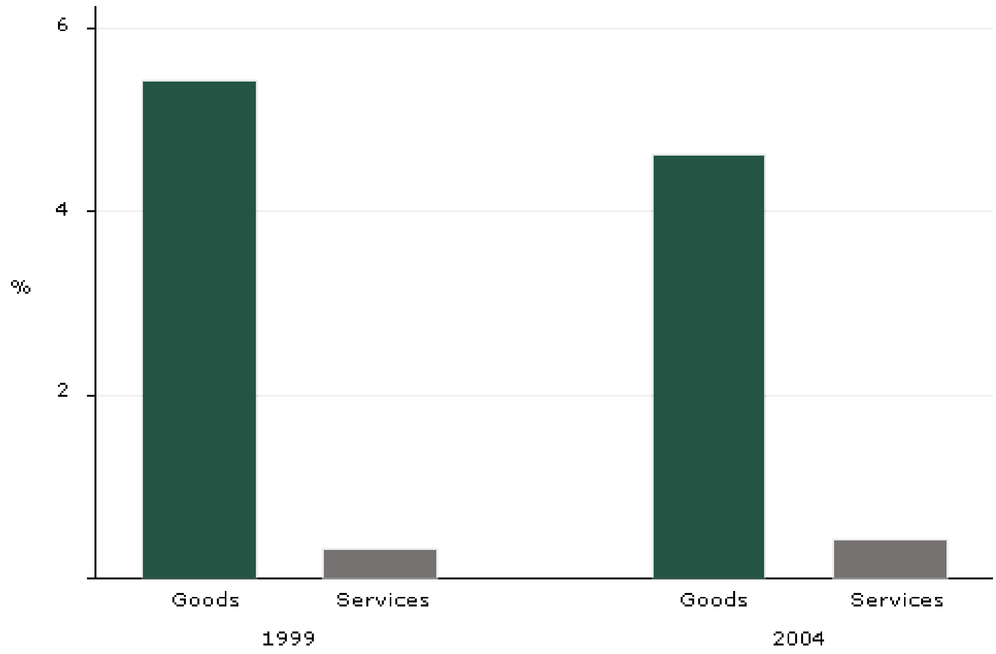


Source: authors' calculations.

- Second, within service traders, the number of firms from the business service industry is 5 times that of firms belonging to manufacturing. This is due to the size of the service industry which counts around 1,6 million firms in services, that is 7 to 8 times that of manufacturing.

Figure 2: Share of Importers of Services and Goods

(in % of the total of firms)

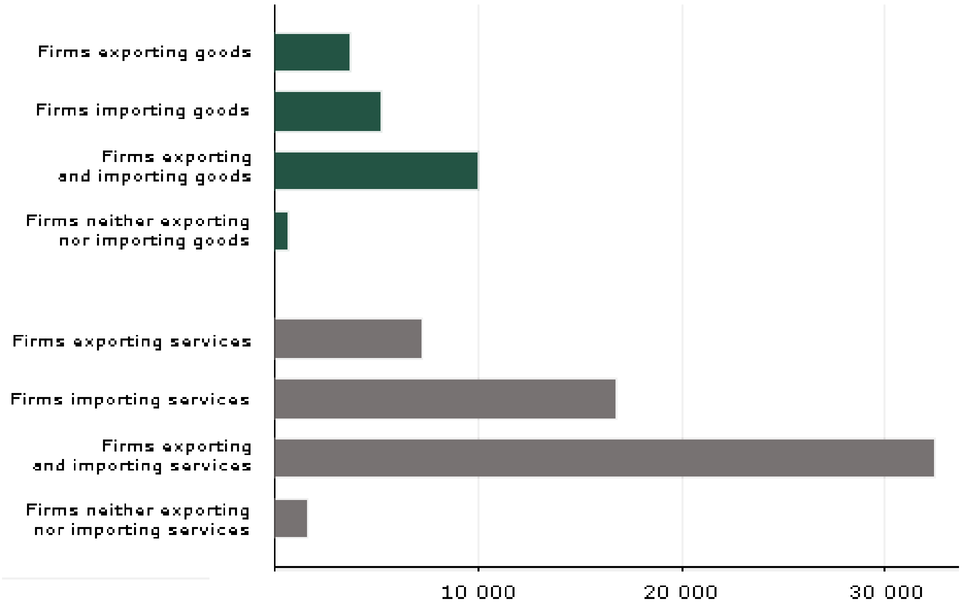


Source: authors' calculations.

- Third, the firms which trade services are in general bigger, more productive and pay higher wages than those trading goods only (see figures 3 to 5). Services traders which belong to the service industry, however, are smaller in size than those from Manufacturing.

Figure 3: Median Turnover of Firms in 2004

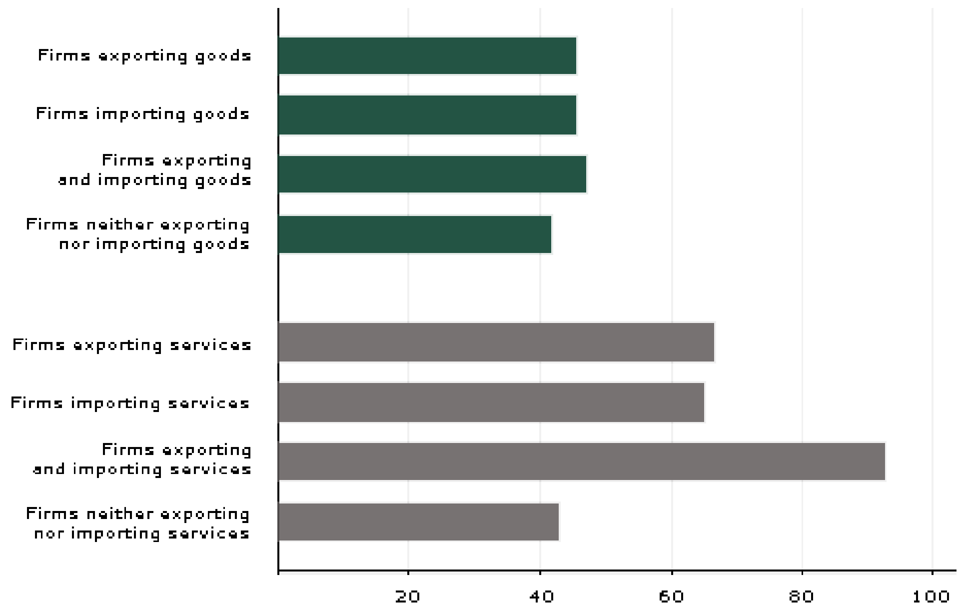
(in thousand of €)



Source: authors' calculations.

Figure 4: Median Labor Productivity in 2004

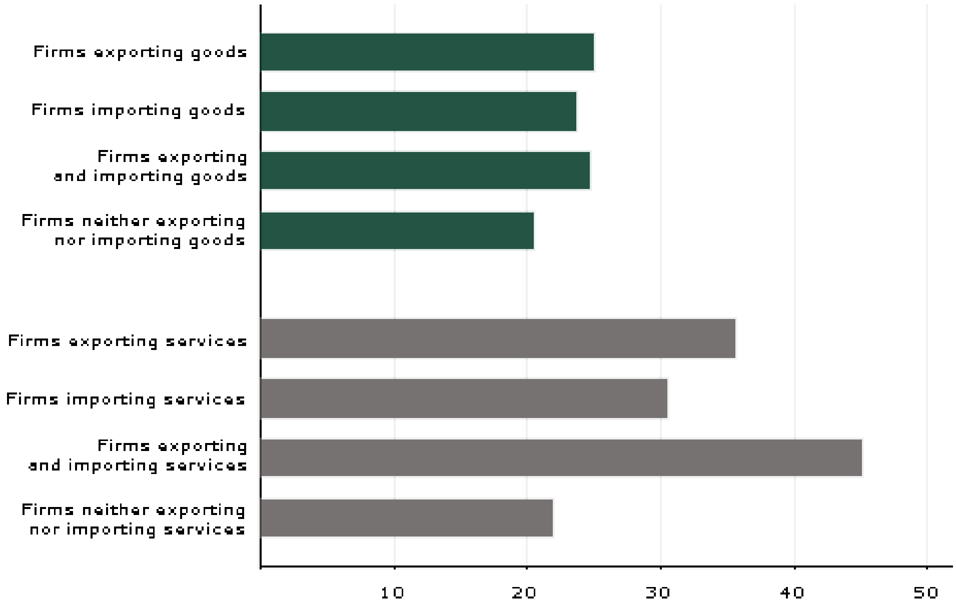
(in thousand of €)



Source: authors' calculations.

Figure 5: Median Wage per Worker in 2004

(in thousand of €)



Source: authors' calculations.

Finally, within exchange of services, one of the most striking differences resides in the nature of the service being traded by firms from Manufacturing and firms from Services: while firms where manufacturing is the major activity of production specialize in business-type services and in particular Report studies, Research and Development and Licenses, firms' exports from the service industry are more evenly distributed across different types of product services (business type services, communication, finance, construction, etc...)

Guillaume Gaulier, Emmanuel Milet & Daniel Mirza

(1) Holger Breinlich, Chiara Criscuolo, (2009): "Service Traders in the UK", *LSE-CEP Working Paper*, N° CEPDP0901, December 2008.

WORKING PAPERS

Fiscal Expectations on the Stability and Growth Pact: Evidence from Survey Data

N° 2010-05, March 2010

The paper uses survey data to analyze whether the Stability and Growth Pact (SGP) has changed financial market's expectations on government budget deficits in France, Germany, Italy, and the UK. Our findings indicate that accuracy of financial experts' deficit forecasts has increased in France during the SGP. The Pact seems to have also promoted a gain in credibility of European Commission's deficit forecasts in France, Italy, and in the UK, particularly after its reform in 2005 and up to December 2007. Nevertheless, the National Fiscal Authorities' forecasts of France, Germany, and Italy seem to have not been credible among market experts during the SGP. These results suggest that additional measures could be taken in order to make the fiscal rules of the Pact more credible among market specialists.

Marcos Poplawski-Ribeiro & Jan-Christoph Rülke

Terrorism Networks and Trade: Does the Neighor Hurt?

N° 2010-04, March 2010

We study the impact of transnational terrorism diffusion on security and trade. We set a simple theoretical model predicting that the closer a country to a source of terrorism, the higher the negative spillovers on its trade. The idea is that security measures, which impede trade, are directed both against the source country of terror and its neighbor countries where terrorism may diffuse. In contrast, we demonstrate that countries located far from terror could benefit from an increase in security by trading more. Taken to the test, we empirically document these predictions. We find (1) a direct negative impact of transnational terrorism on trade; (2) an indirect negative impact emanating from terrorism of neighbor countries; and (3) that trade is increasing with remoteness to terror. These results are robust to various definitions of the neighboring relationships among countries.

José de Sousa, Daniel Mirza & Thierry Verdier

Wage Bargaining and the Boundaries of the Multinational Firm

N° 2010-03, March 2010

Do variations in labor market institutions across countries affect the cross-border organization of the firm? Using firm-level data on multinationals located in France, we show that multinational firms are more likely to import intermediate inputs from external independent suppliers instead of importing from their own subsidiaries when importing from countries with empowered unions. Moreover, this effect is stronger for firms operating in capital-intensive industries. We propose a theoretical mechanism that rationalizes these findings. The fragmentation of the value chain weakens the union’s bargaining position, by limiting the amount of revenues that are subject to union extraction. The outsourcing strategy reduces the share of surplus that is appropriated by the union, which enhances the firm’s incentives to invest. Since investment creates relatively more value in capital-intensive industries, increases in union power are more likely to be conducive to outsourcing in those industries. Overall, our findings suggest that multinational firms use their organizational structure strategically when sourcing intermediate inputs from unionized markets.

Maria Bas & Juan Carluccio

Estimation of Consistent Multi-Country FEERs

N° 2010-02, January 2010

Most studies on equilibrium exchange rates focus on a limited number of G7 countries. But in a situation of world imbalances, emerging countries can no longer be excluded. The study of all equilibrium exchange rates is delicate. First, the trade model has to be balanced at the aggregate level. This paper suggests a method to achieve world balance both in volume and in value. Second, the N-1 bilateral exchange rates cannot ensure that the N areas will reach their macroeconomic equilibrium simultaneously. This paper examines the existing solutions to solve the N-1 problem and proposes an alternative which minimizes the distance to the current-account targets. Finally, in order to compare the relevance of the different methodologies, FEERs are calculated for 19 industrialized and developing countries.

Benjamin Carton & Karine Hervé

The Elusive Impact of Investing Abroad for Japanese Parent Firms: Can Disaggregation According to FDI Motives Help?

N° 2010-01, January 2010

In the present paper, we investigate whether previous findings of limited effects of investing abroad on the firm’s performance can be explained by the aggregation of heterogeneous effects depending on the FDI motives, sectors and locations. Results suggest, in line with previous work, that on average Japanese outward FDI has limited effects (whether positive or negative) on the activity of internationalizing firms. Fears of “Hollowing out” effects seem to be more justified in the case of FDI to low income countries, for which a contraction of employment and investment and exports is observed. By contrast, we observe a significant positive employment effect for FDI in services, presumably reflecting the operational complementarities between the affiliate and the parent. There is also some evidence of positive labour productivity gains deriving essentially from FDI in manufacturing in high GDP countries.

Laura Hering, Tomohiko Inui & Sandra Poncet

The Effects at Home of Initiating Production Abroad: Evidence from Matched French Firms

N° 2009-39, December 2009

Based on matching techniques in combination with a difference-in-difference estimator, this paper estimates the effects at home of initiating production abroad through the establishment of a foreign production affiliate. The analysis covers manufacturing and service firms active in France during the period 1987-1999. We show that the motivation to start producing abroad is an important determinant of its impact at home. Market-seeking FDI in manufacturing is associated with significant scale effects, resulting in job creation. By contrast, factor-seeking FDI in manufacturing has no significant effect on employment. However, there is some evidence that this type of FDI is associated with technology effects, in the form of greater capital-intensity and efficiency, as well as larger exports. Finally, FDI in service sectors is associated with significant positive employment effects, presumably reflecting the importance of the market-seeking motive in these sectors.

Alexander Hijzen, Sébastien Jean & Thierry Mayer

On Equilibrium Exchange Rates: Is Emerging Asia Different?

N° 2009-38, December 2009

The aim of this paper is to provide equilibrium exchange rates values for a large set of currencies and to study the adjustment process of observed exchange rates towards these levels by paying a special attention to emerging Asian countries. Relying on panel smooth transition regression models, we show that the real exchange rate dynamics in the long run is nonlinear for emerging Asian countries, while it is linear for the G7 currencies. More especially, there exists an asymmetric behavior of the real exchange rate when facing an over or undervaluation in Asia: the adjustment speed is more important in case of undervaluation, a result that may be explained by the international pressure to limit undervaluations. However, this adjustment being long-lasting, undervaluations may persist over time, as observed since the beginning of the 1990s.

Antonia López-Villavicencio & Valérie Mignon

Assessing Barriers to Trade in the Distribution and Telecom Sectors in Emerging Countries

N° 2009-37, December 2009

We compute ad valorem equivalents (AVEs) for the regulation in three service sectors (i.e. fixed telecom, mobile telecom, distribution) applied by selected emerging countries. We start with qualitative information on the restrictions applied by each country in each sector on the basis of which we apply a multivariate statistical approach, to transform this qualitative data into a trade restrictiveness synthetic index (STRI). In a second stage we estimate the average impact of STRI on price cost margins, using a method avoiding the usual two-stage estimation. In the third stage, this impact is used to calculate the AVE of the STRI estimated in the first step. It is shown that the STRI has a significant effect on the price-cost margins of the individual firms only when controlled for Regional trade Agreements and exception to the MFN clause in the considered sector. Lastly, we compute tariff equivalents for the STRIs previously calculated using the estimated impact. More than half our AVEs are larger than 50% and one AVE out of six is above 100%.

Lionel Fontagné & Cristina Mitaritonna

Les impacts économiques du changement climatique : enjeux de modélisation

N° 2009-36, December 2009

Des divergences considérables subsistent dans l'évaluation des coûts des dommages du changement climatique et des politiques d'atténuation. Elles sont dues en partie aux hypothèses et aux choix structurels des modèles économiques avec effets environnementaux. Cette étude établit une grille d'analyse pour révéler l'impact des choix de modélisation sur les résultats. Les modèles sont analysés en prenant comme exemples ENV-Linkages, GEMINI-E3, IMACLIM-R et POLES. Les modèles Top-Down prennent insuffisamment en compte les potentiels de progrès technique dans le secteur énergétique, alors que les modèles Bottom-Up reproduisent mal les effets en retour du secteur énergétique sur l'ensemble de l'économie. Les modèles à dynamique récursive représentent insuffisamment les anticipations des agents et ne peuvent produire de scénarios normatifs. A l'opposé, certains modèles hybrides et tous les modèles d'optimisation inter-temporelle ont des mécanismes d'endogénéisation qui rendent difficile l'interprétation des résultats. Nous étudions ensuite sur un exemple – la détermination de la valeur économique du carbone par les modèles GEMINI-E3, IMACLIMR et POLES – comment les divergences théoriques des modèles se traduisent dans la pratique. La revue est complétée par l'analyse du "rapport Stern", replacé dans le cadre plus large de la modélisation des liens entre croissance économique et environnement. Les divergences des résultats avec d'autres modèles « coûts-bénéfices » proviennent de la connaissance incomplète des risques de dommages, du choix des taux d'actualisation et enfin de l'évaluation des dommages hors domaine marchand.

Pierre Besson & Nina Kousnetzoff

Trade, Foreign Inputs and Firms' Decisions: Theory and Evidence

N° 2009-35, December 2009

We investigate the effect of different channels through which input trade liberalization affects firms' export decisions. We develop a trade model with heterogeneous firms and sectors of varying imported input intensity that reproduces different mechanisms through which the access to foreign inputs affects the performance of domestic firms. In industries with lower input tariffs (or more intensive in imported intermediate goods), more firms become exporters and export larger volumes. The effect of firm productivity on export status and export sales is greater for firms producing in these industries. The export selection process is reinforced by the access to foreign inputs. We provide strong empirical evidence in support of these theoretical predictions based on plant-level panel data from Argentina (1992-2001) and Chile (1990-1999). Our findings suggest that the impact of firm productivity on the probability of exporting and on the volume of exports is more pronounced for firms producing in industries that have a greater access to foreign inputs.

Maria Bas

Export Sophistication and Economic Performance: Evidence from Chinese Provinces

N° 2009-34, December 2009

We consider the effect of export sophistication on economic performance using regional variations within a single country (China) over the period 1997-2007. We confirm Hausmann, Hwang and Rodrik (2007)'s prediction that regions that engage in the cost discovery process of developing sophisticated goods grasp greater gains from globalization and grow faster. We find that these gains are limited to to export activities undertaken by domestic entities. Direct gains do not appear to derive from foreign entities typically engaged in processing trade even though they are the main contributors to the global upgrading of China's exports. Our findings globally suggest that the expected gains from exporting higher productivity goods are not unconditional, they are greater for provinces already blessed by high incomes, better market centrality and higher trade performance and Foreign Direct Investment attractiveness. These features consistent with evidence of increasing returns to sophistication are unfortunately likely to contribute further to the current widening of spatial economic disparities across China.

Joachim Jarreau & Sandra Poncet

Assessing the Sustainability of Credit Growth: the Case of Central and Eastern European Countries

N° 2009-33, December 2009

Strong credit growth rates in transition countries may result from a normal catching-up process in a framework of financial development. However, as elsewhere, they can also pertain to a "credit boom", paving the way to future "credit crunches". We try to disentangle these two types of situation for the Central and Eastern European countries (CEECs) by applying a number of methods. First, we consider the gap between current credit and its long-term trend and we find some signs of credit booms, in several CEECs in 2005-2007. Second, we assess the "normal" growth of credit with regard to fundamentals through econometric estimations. Credit growth is also shown to have been excessive in several countries just before the 2008-2009 financial crisis.

Virginie Coudert & Cyril Pouvelle

How do Different Exporters React to Exchange Rate Changes? Theory, Empirics and Aggregate Implications

N° 2009-32, December 2009

This paper analyzes the reaction of exporters to exchange rate changes. We present a model where, in the presence of distribution costs in the export market, high and low productivity firms react differently to a depreciation. Whereas high productivity firms optimally raise their markup rather than the volume they export, low productivity firms choose the opposite strategy. Hence, pricing to market is both endogenous and heterogenous. This heterogeneity has important consequences for the aggregate impact of exchange rate movements. The presence of fixed costs to export means that only high productivity firms can export, firms which precisely react to an exchange rate depreciation by increasing their export price rather than their sales. We show that this selection effect can explain the weak impact of exchange rate movements on aggregate export volumes. We then test the main predictions of the model on a very rich French firm level data set with destination-specific export values and volumes on the period 1995-2005. Our results confirm that high performance firms react to a depreciation by increasing their export price rather than their export volume. The reverse is true for low productivity exporters. Pricing to market by exporters is also more pervasive in sectors and destination countries with higher distribution costs. Consistent with our theoretical framework, we show that the probability of firms to enter the export market following a depreciation increases. The extensive margin response to exchange rate changes is modest at the aggregate level because firms that enter, following a depreciation, are smaller relative to existing firms.

Nicolas Berman, Philippe Martin & Thierry Mayer

Spillovers from Multinationals to Heterogeneous Domestic Firms: Evidence from Hungary

N° 2009-31, December 2009

Technological and informational spillovers from multinational firms can be particularly beneficial to domestic firms especially in less developed economies. The technological superiority and management experience of foreign multinational firms yield various opportunities for learning. Yet, the importance of foreign firm's spillovers might vary with respect to the different intensities of the linkage between the multinational and the domestic firm, the differences in firms' absorptive capacity and their ability to face competition. We show using firm-level Hungarian data that positive spillovers from multinationals depend on the level of productivity and the exporting status of the domestic firm. Larger and more productive firms are more able to reap spillovers from multinationals than smaller and less productive firms. The export status, in contrast, is of minor importance.

Gábor Békés, Jörn Kleinert & Farid Toubal

Ethnic Networks, Information, and International Trade: Revisiting the Evidence

N° 2009-30, December 2009

Influential empirical work by Rauch and Trindade (REStat, 2002) finds that Chinese ethnic networks of the magnitude observed in Southeast Asia increase bilateral trade by at least 60%. We argue that this estimate is upward biased due to omitted variable bias. Moreover, it is partly related to a preference effect rather than to enforcement and/or the availability of information. Applying a theory-based gravity model to ethnicity data for 1980 and 1990, and focusing on pure network effects, we find that the Chinese network leads to a more modest amount of trade creation of about 15%. Using new data on bilateral stocks of migrants from the World Bank for the year of 2000, we extend the analysis to all potential ethnic networks. We find, i.a., evidence for a Polish, a Turkish, a Mexican, or a Pakistani network. While confirming the existence of a Chinese network, its trade creating potential is dwarfed by other ethnic networks. The large heterogeneity in the trade-creating potential of different networks is, among other things, explained by the share of high-skilled immigrants, the degree of ethnic fragmentation, and GDP per capita.

Gabriel J. Felbermayr, Benjamin Jung & Farid Toubal

Financial Constraints in China: Firm-Level Evidence

N° 2009-29, November 2009

This paper uses a unique micro-level data-set over the period 1998-2005 on Chinese firms to test for the existence of a "political-pecking order" in the allocation of credit. Our findings are threefold. Firstly, private Chinese firms are credit constrained while State-owned firms and foreign-owned firms in China are not; Secondly, the geographical and sectoral presence of foreign capital alleviates credit constraints faced by private Chinese firms. Thirdly, geographical and sectoral presence of state firms aggravates financial constraints for private Chinese firms (“crowding out”). Therefore it seems that ongoing restructuring of the state-owned sector and further liberalization of foreign capital inflows in China can help to circumvent financial constraints and can boost the investment of private firms.

Sandra Poncet, Walter Steingress & Hylke Vandenbussche

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The Productivity Gap Between the United States and the Euro Zone Continues to Widen

N° 294, 30 November 2009

From 1950 to 1970, labour productivity levels converged between the United States – considered to be the global technological leader – Western European countries and Japan. But thereafter this process gradually became less marked before disappearing completely since the mid-1990s: while in the United States, labour productivity growth accelerated, it slowed down in the majority of European countries and Japan. Technological progress, associated with the development of information and communication technologies (ICT), goes some way towards explaining the revival of productivity in the USA, before the dotcom bubble burst. However, it does not tally with the decline seen in Europe because, although the level of investment in ICTs in Europe falls some way behind that of the USA, it has nonetheless grown significantly. A fundamental explanation for the divergence relates to a change in intensity of the employment component of growth. While it fell sharply in the United States, there was a significant rise in Europe where, prior to the crisis of 2007-2008, mass unemployment fell as a result. The most recent data for 2009 confirm the existence of diverging productivity trends.

Michel Fouquin

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