The CEPII NEWSLETTER

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CENTRE D'ÉTUDES PROSPECTIVES
ET D'INFORMATIONS INTERNATIONALES

Focus

The Bursting Financial Bubble and Balance Sheet Restructuring of the Corporate Sector in the United States and Europe

The financial crisis from March 2000 onwards is related to the dynamics of asset prices and broad credit, in a context of low inflation. Since the stock market bubble burst, some balance sheet restructuring of the corporate sector has been necessary to reduce indebtedness and the value of the "goodwill" that appeared during the wave of mergers and acquisitions in the late 1990s. This is a prerequisite for investment to recover.

During periods of innovation, expectations of high profits tend to be accompanied by huge investments and growing external financing (banking credit and bond issues). The increasing value of equities in innovative industries spreads to all stocks. Thus, the ratio of debt to the market capitalisation of the corporate sector tends to fall. The risks of default perceived by creditors decrease, so that the lower costs of external financing favour investment. The higher market value of firms during booms amplifies the business cycle and bolsters growth. This so-called financial accelerator may lead to an over-accumulation of capital and excessive indebtedness, which may constrain future investment after the collapse of the stock market.

When the stock market falls, the reverse occurs. Firms' ratings are downgraded and creditors are thus less inclined to lend insofar as the collateral value for new loans has decreased. The worsening of financial conditions can even lead to credit rationing. To avoid being squeezed out of external financing sources, firms try to engage in debt reduction. This necessitates either the sale of assets or the generation of high profits. But selling assets under pressure in bearish markets is not profitable. The restructuring of balance sheets by restoring profits thus requires a reduction of expenses: in wage bills, in investments, in inventories. It takes more time to restore better financial conditions and self-financing capacity but this is a prerequisite for investment to recover.

When the crash occurred, the market value of American non-financial, non-farm companies was almost twice its book value.

Since the bubble burst in 2000, firms have tried to reduce their rate of indebtedness, but they have also been forced to restructure their balance sheets due to the wave of mergers and acquisitions in the United States and in Europe over the period 1997-2000. Such transactions, which occurred during a period of equity euphoria, led to an impressive overvaluation of firms' assets. Expecting huge profits, takeover bids valued target firms at prices markedly superior to their book values. When the crash occurred, the market value of American non-financial, non-farm companies was almost twice its book value (the difference between total assets and debts). The gap between the market value and the book value, so-called "goodwill", represented 68% of shareholders' equity for America's 100

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largest firms in 2001, and 100% for French companies listed on the CAC 40.

The re-appraisal of profit prospects that led to the stock market crashes threw some doubt on the initial value of the goodwill. As this is registered in balance sheets as intangible assets, the total assets of firms abruptly appeared overvalued. Given the impressive amount of the goodwill to be depreciated, the restructuring of balance sheets, which started in 2001 in the United States, is likely to last for several years. This will affect investment, as the depreciation of goodwill induces falls in value that reduce profits and so firms' self-financing and repayment capacity. In the United States, net profits after taxes and dividends were negative from the third quarter 2000 to the end of 2002.

The depreciation of "goodwill" has significantly worsened corporate balance sheets.

But investment has also been affected by the impact of the depreciation of goodwill in balance sheet liabilities. As shown in the Table, if goodwill equals 80 units at the time of a takeover bid, and subsequently is depreciated to 40, then a loss provision of 40 has to be registered in the balance sheet liabilities, decreasing shareholders' equity. This blackens the assessment of the firm's financial health.

Table: Changes in the Value of Goodwill

Assets and liabilities at time of takeover

Assets		Liabilities	
Intangible Assets	100	Equity	150
Goodwill	80	Shareholders' funds	150
Tangible Assets	100	Provisions	0
Financial Assets	100	Debt	150
Total	300	**Total**	300

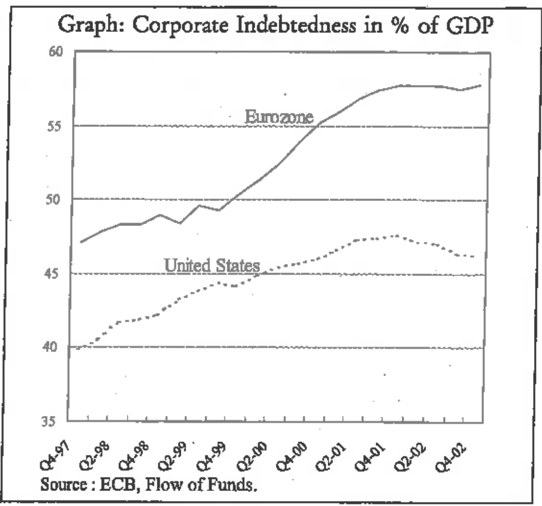
Assets and liabilities after stock market falls

Assets		Liabilities	
Intangible Assets	60	Equity	110
Goodwill	40	Shareholders' funds	150
Tangible Assets	100	Provisions	– 40
Financial Assets	100	Debt	150
Total	260	**Total**	260

Source : author.

In sum, alongside the decline in the market value of the firms, the goodwill depreciation deteriorates the quality of the balance sheet liabilities, increases the perceived default risk and thus the risk premium leading to a rise in the external financing cost.

Despite the huge decrease in US and eurozone interest rates, corporate spreads, which reveal risk premiums, have never been so high since the Great Depression. Banking credit spreads have also reached very high levels. Firms have tried to decrease their indebtedness. But the debt reduction process is still in its early stages. In fact, the debt to GDP ratio of America's corporate sector only began its decline at the end 2001 and has been quite limited: the ratio fell from 47.6% of GDP at its peak level to 46.3%, in the last quarter of 2002. Companies in the eurozone are much more indebted and consolidation efforts have merely allowed a stabilisation of the debt to GDP ratio, at slightly less than 58% (see Graph).



Unable to generate sufficient profits to reimburse their debt, American and European firms have *de facto* rescheduled it. In the United States, the corporate sector has substituted long-term debt for short-run debt. The long term debt to total debt ratio rose from 60.3% in 2000 to 68.2% at the end of 2002. Bond financing has massively replaced bank loans. In contrast, firms in the eurozone are much more dependent on the banking sector as a source of financing and have more restrained access to bond financing. Hence, they have extended the maturity of their banking credits since the third quarter of 2001. The annual growth rate of firm indebtedness has been around 4-5% in 2002 and 2003 in the eurozone, so that no credit rationing can really be diagnosed.

To reschedule their debt, US firms have massively substituted bond financing for bank credits, whereas eurozone firms have extended loan maturities.

Given the efforts engaged by the American corporate sector to reduce its indebtedness, the investment and thus growth prospects are much better than those prevailing in the eurozone. Presently, European firms remain much more indebted than US ones, and the process of debt reduction is less advanced.

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FOR FURTHER INFORMATION SEE:

• 'ECONOMIE MONDIALE 2004',
B. RZEPKOWSKI,
CHAPTER 5, WITH M. AGLIETTA
PARIS, LA DÉCOUVERTE, 2003.

RESEARCH SUMMARY

Does Trade Lead to Economic Convergence? Revisiting Ben-David

Former WTO Director-General, Mike Moore, stated repeatedly that openness to trade helps developing countries catch up with rich ones, thus reiterating Dan Ben-David's findings in his research for the WTO. A recent study by the CEPII aimed at revisiting Ben-David's work and it shows that trade is not generally linked to a reduction in the dispersion of per capita GDP across countries. The existence of a weak form of convergence within trade-based groups, however, is due to a bias in selecting large countries in these groups. In total, even if trading with large countries is beneficial for developing economies, the evidence for trade as a channel for convergence remains limited.

Proponents of liberalisation depict international trade as a strong factor favouring growth and thus economic catching-up by developing countries. Theoretical and empirical research is said to give strong support to the trade and convergence thesis. The essentiel potential benefit for lagging countries stems from technology transfers involved in trade with advanced countries. They could thus be the main beneficiaries of economic integration. However, as pointed out in the theoretical literature, countries lacking a minimum industrial base could suffer from economic integration and still be caught in poverty traps.

Work by the CEPII on this question first replicated the methodology used by Dan Ben-David to evaluate the robustness of his results[1].

In 1996, Dan Ben-David observed that trade-based groups of countries (groups comprising major trade partners) are more likely to exhibit convergence of per capita GDP than groups of randomly selected countries.

First, it was shown that Ben-David's finding of absolute convergence within trade-based groups (so-called beta-convergence, whereby poorer countries have faster growth rates) does not imply a significant reduction of differences in living standards (sigma-convergence, or a reduction in the cross-section dispersion of per capita GDP). More importantly, it was shown that trade intensity *per se* does not bring about convergence. The finding of convergence within trade-based groups is due to a bias towards selecting large countries in those groups. A group of large traders (generally big countries) tends to be a convergence group (a so-called convergence club), but this is not true for a group of smaller countries trading intensively.

Convergence may still be favoured by access to technologies developed in rich countries, especially in countries which benefit from various externalities. However, there is no robust evidence showing that the trade channel is the main channel of technology diffusion.

Ben-David's trade groups were composed of one source country and its major trade partners. Trade source countries were selected according to their per capita income level in 1960: Ben-David excluded countries that did not reach 25% of the US per capita income level then. Countries that are primarily oil producers or were formerly planned economies were also excluded. There were two lists of source countries: major exporters and major importers. For each source country, those partners contributing to more than 4% in trade flows (exports or imports) were included in a trade group. The groups resulting from the 4% threshold ranged in size from a minimum of three countries per group to a maximum of nine. There were 50 groups: 25 export and 25 import groups.

The CEPII's research found no robust evidence showing that trade is the main channel for convergence.

Ben-David investigated whether convergence properties in trade groups are indicative of trade-related convergence, or if a random grouping of these same countries might produce similar results. To test this, he grouped the source countries into different possible sub-groups, estimated their convergence coefficients, and obtained adequate distributions of coefficients with which it is possible to test for the specificity in terms of convergence properties, of any trade-based group. Indeed, the key point was to find evidence not of absolute convergence in trade-based groups but of hypothetical, faster rates.

The database used in the CEPII study is more extensive than Ben-David's: few developing coun-

(1) Ben-David D. (1996), "Trade and Convergence Among Countries", *Journal of International Economics*, Vol. 40(3-4), p. 279-298.

tries are excluded and bilateral trade flows between 48 countries are examined from 1967 to 1997 (1960 to 1985 in Ben-David), using the CEPII's CHELEM database.

Columns (1) and (2) in the Table give median results (across the 48 groups) for the tests of beta and sigma convergence when replicating Ben-David's methodology (trade groups are constructed according to exports plus imports, so no distinction is made between export and import trade groups).

The study compares the results for trade-based groups to randomly selected groups. It also checks whether or not groups converge due to geographical proximity or similarity of specialisation: *i.e.* that the correlation between trade and convergence does not result from a third variable.

Table: Convergence in Trade Groups

Groups formed with:	"More convergence than random grouping" (as in Ben-David 1996) Beta convergence (1)	"More convergence than random grouping" (as in Ben-David 1996) Sigma convergence (2)	"More convergence than size-representative random grouping" Beta convergence (3)	"More convergence than size-representative random grouping" Sigma convergence (4)
Trade in 1997	Yes	Insignificant	Insignificant	Insignificant
Trade in 1967	Yes	Insignificant	Insignificant	Insignificant
Geographical proximity	Insignificant	No (divergence)		
Specialisation similarity	Insignificant	No		
Additive Trade Intensity	Insignificant	No		
Multiplicative Trade Intensity	Insignificant	No		
Relative Trade Intensity	Insignificant	No		

Source: Author's calculations using the CHELEM database (48 countries, 1967-1997).

Trade groups exhibit convergence in the sense that there is a long run tendency for deviations from the mean to vanish (beta convergence) but there is no evidence of a significant decrease in standard of living dispersions in those groups (there is no sigma convergence).

Ben-David results are thus confirmed with this larger dataset. But, the consequences regarding convergence are not far-reaching.

Given the disproportional frequency of the USA, Germany or Japan in the trading groups, two alternative modifications of the Ben-David's methodology are put forward. The aim is to eliminate a possible size effect in order to focus on the intensity of trade relationships as a factor of convergence.

When controlling for country size in trade-based groups, evidence of convergence cannot be found any more.

Indeed, the way countries are classified into trade-based groups by Ben-David is problematic. For example, Greece's group includes the United States (which is in all groups except Portugal's and Tunisia's). But if the two countries' size is controlled for by taking the bilateral trade intensity into account, it appears that the observed Greece-USA trade link is approximately 70% below its theoretical level. This is the level which would prevail if trade flows were distributed according to the relative importance of the two countries in overall world trade. Putting these two countries into a trade group is therefore questionable. Conversely, Macedonia does not reach the **4%** share of Greece's trade threshold and cannot enter the Greece's group even though the two countries trade intensively on a relative basis (given their capacities to trade). It was therefore decided to group countries according to trade intensity rather than trade level. The Table shows convergence results for three alternative measures of trade intensity. Such groups are neither beta- nor sigma-convergent groups.

The second method to tackle the size-bias is to introduce, in the random selection, the same bias as when countries are selected in trade-based groups according to Ben-David's methodology. A uniform random draw is replaced by a size-proportional draw. In the former, the *ex post* probability of drawing a country was 1/48 (for 48 countries in the sample). In the latter, this ratio is replaced with the share of countries in world GDP. This provides a new benchmark to evaluate the significance of convergence coefficients of trade groups assembled using Ben-David's method.

With this new benchmark (the last two columns in the Table) there is no evidence of convergence in trade-based groups.

This means that a group consisting of one source country and its major trade partners (as in Ben-David) has no more chance of experiencing convergence than a group of randomly selected countries, representative of all countries in the world.

What then remains of Ben-David's conclusion? The fact that trading intensively with big countries is correlated to convergence is not rejected by these results. However, convergence is limited to beta-convergence, which is the weakest form of convergence. Also, it is still too early to examine to what extent a (lagging) country can use trade as a lever of growth (via agreements with big countries). Indeed, the benefit could be very limited for countries that do not have large economies as natural trade partners, due especially to their location.

This sceptical view about trade and convergence does not, however, provide support for closing frontiers. Instead, it suggests policy-makers should hold more cautious expectations and that economists should deepen research in this field.

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FOR FURTHER INFORMATION SEE:

- 'TRADE AND CONVERGENCE: REVISITING BEN DAVID', G. GAULIER (2003), *CEPII WORKING PAPER, NO 2003-06.*

Available at www.cepii.fr

CONFERENCE SUMMARIES

RUSSIA'S EUROPEAN FUTURE

This conference was organised by the CEPII in partnership with *Les Echos*, INALCO and Rothschild Conseil International, at the French Senate on 28 April 2003.

Michel Camdessus (IMF, CEPII) opened the conference by indicating his confidence in Russia's economic outlook, subject to further reform of the banking system, social security and public admi-nis-tration. Thereafter the first session dealt with the rapprochement between Russia and Europe. Alain Blum (INED) presented long term demographic trends that are making Russia more European. Pierre Morel (Ambassadeur de France) stressed the strategic implications of the depopulation of Russian Asia, and the importance of present, stable relations with Russia's Asian neighbours. Céline Bayou (Documentation française) examined the relations between Russia and the EU. Michel Fouquin (CEPII) then presented the Centre's research on Russia's trade, which is already strongly oriented towards Europe, and would benefit from liberalisation, especially if this boosts foreign direct investment. The session ended with a discussion between Jacques Delors and Boris Nemtsov (former vice-Prime Minister and leader of the Parliamentary SPS group). Mr Delors emphasised that enlargement has now taken the lead over deepening in the process of European construction, and the present priority must be to "digest" this. Mr Nemtsov drew attention to Russia's current weaknesses and the importance of relations with the United States.

The second session examined Russian-European convergence. Given the problems of diversifying its energy-reliant economy, Professor Evguéni Yassine (Moscow University) stated that Russia would likely experience "neither miracle nor crisis". José Achache (European Space Agency) assessed the weaknesses and strengths of Russian technology. As for politics, Boris Nemtsov was quite critical of the Putin regime, noting that personal freedoms, private property and an efficient State are not yet guaranteed. Jean-Bernard Raimond (former French Minister for Foreign Affairs) stressed that the international code conduct which could be applied to a liberal Russia has been modified by the West's interference in foreign countries and the Iraq crisis.

In a final roundtable discussion, Alain Lamassoure, (former minister and MEP) called on Russia to look towards Europe. Jean-Claude Casanova (*Commentaire*) claimed that the lack of a clear European project will complicate the possibilities of Russia acceding to the Union. Jean-Michel Charpin (INSEE) asked how economic partnership with Russia could be strengthened, and whether or not Russia could adopt the "European Model". Jean-Pierre Saltiel (Rothschild Conseil International) regretted the lack of internationalism in Russian business. In conclusion, Georges Sokoloff (INALCO, CEPII) lauded the struggle by Russia's reforming intelligentsia to open up the country to the world.

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THE ECONOMIC CONSEQUENCES OF EUROPEAN ENLARGEMENT

This workshop was organised by CEPII, CDC-IXIS and WIIW (Vienna), 14 March 2003, and addressed the macroeconomic aspects of enlargement, FDI and labour markets in the accessing countries, as well as the financial aspects of enlargement.

Michael Kejak (CERGE, Prague) examined the convergence rules and their adequacy for accessing countries. Catching up is not a systematic outcome of accession, and will very much depend on a cautious policy mix.

Accessing economies have however already largely adjusted their economic structures, thanks to trade integration and inward foreign direct investment (FDI). The associated productivity growth has outpaced rates recorded in the EU, leading to catching up. Peter Havlik (WIIW) pointed out that CEECs have strongly upgraded product quality. Accession will therefore not imply further dramatic changes in specialisation.

Massive FDI flows may have had a large impact on local labour markets. As a result of agglomeration forces, such as increasing returns to scale, and a complete freedom of location of new plants, there may still be a significant relocation of labour in a limited number of places. Karoly Fazekas addressed this issue for the case of Hungary, by comparing the spatial distribution of labour between foreign-owned and domestic firms. Labour market outcomes are also deeply affected by institutions, which vary across countries. Milan Vodopivec and John Haltiwanger (World Bank) first stressed that variations in labour market performance during the transition period were related to differences in policies and institution settings. It appears that legislation protecting employment has affected this reallocation, by restraining flexibility and adjustment. Less intuitively, the existence of a minimum wage and of unemployment benefits increases the pace of job relocation, by granting a minimal safety net to movers.

Convergence is not only a real phenomenon. It also leads to massive adjustments in relative prices, and so to movements in real exchange rates. This issue was addressed by Thomas Holub (Czech National Bank): the real appreciation of the Czech koruna could reach 1.5 to 2 percent a year, a figure that could be inflated by terms-of-trade changes and price deregulation. For Adam Czyzewski, the market exchange rate fluctuates close to its long run equilibrium (FEER) level, and the central parity should not be set far from this level in the perspective of ERM II. Patrick Artus assessed the feasibility of joining euro for accessing countries through a comparison with North American. Mexico and Canada managed to implement reasonably expansionary policies and avoided financial imbalances and inflation. The wish by the the CEECs to join the euro quickly raises fears for their macroeconomic stability, as growth may fail to benefit from real depreciation.

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Recent Publications

ECONOMIE INTERNATIONALE, QUARTERLY

NO 92, 4ND QUARTER 2002.

Dossier : La Chine dans l'économie mondiale

• *'Présentation'*, F. Lemoine

• *'Chine : spécialisation internationale et rattrapage technologique'*
F. Lemoine, D. Ünal-Kesenci

• *'Compétitivité-prix et hétérogénéité des échanges extérieurs chinois'*
S. Dées

• *'China's WTO Accession and Implications for its Regional Economies'*
L. Shantong, Z. Fan

• *'China's Manufacturing Industry in an International Perspective: A China-Germany Comparison'*
R. Ruoen, B. Manying

• *'Croissance de la productivité dans l'industrie manufacturière chinoise : le rôle de l'investissement direct étranger'*
S. Démurger, Y. Chen

Economic Policy Forum: Monetary Policy in a World of Uncertainty

• *'Monetary Policy in a World of Uncertainty'*
O. Issing

• *'Comments'*
J. A. Scheinkman

• *'Comments'*
E. Chaney

NO 91, 3TH QUARTER 2002.

• *'Quel cadre d'implication du secteur privé proposer pour gérer les crises de liquidité dans les économies de marché émergentes ?'*
C. Cornand

• *'Les pays du sud de l'Europe doivent-ils craindre l'élargissement de l'UEM aux PECO'*
F. Darrigues, J.-M. Montaud

• *'Les conséquences agricoles d'un élargissement sélectif de l'Union européenne'*
M.-L. Duboz

• *'Découplage des aides à l'agriculture et localisation des activités'*
K. Daniel, M. Kilkenny

Economic Policy Forum: British Business and the Euro

• *'Le Royaume-Uni devrait-il rejoindre l'Union économique et monétaire'*
M. Artis

• *'Coûts et avantages de l'UEM pour le Royaume-Uni, le « cinquième test »'*
P. Minford

• *'Entrée du Royaume-Uni dans la zone euro. A quelle parité ? Quels effets sur la politique monétaire ? Quels dangers pour le Royaume-Uni ?'*
P. Artus

• *'Commentaires'*
R. Barrell

• *Synthèse du séminaire 'British Business and the Euro'*
L. Boone

Publisher: la Documentation française.
Price: € 18.50 per issue, € 65.50 annual subscription in Europe, and € 68.50 outside Europe.

LA LETTRE DU CEPII, MONTHLY

• *'The Stability Pact: Two Objectives, Two Rules'*,
A. Bénassy-Quéré
NO 224, JUNE 2003

• *'Sovereign Debt Crises and Multilateral Action Following the Rejection of the Krueger Proposal'*,
J. Sgard
NO 223, MAY 2003

• *'Everyone Will Gain from Enlargement, Won't They?'*,
M.-H. Bchir, L. Fontagné, P. Zanghieri
NO 222, APRIL 2003

• *'India Bets on Technology Niches'*,
S. Chauvin, F. Lemoine
NO 221, MARCH 2003

• *'ICT and Productivity: The Situation in France'*,
J. Melka, L. Nayman
NO 220, FEBRUARY 2003

• *'Europe's Demographic Evolution Through to the Year 2050'*,
R. Sleiman
NO 219, JANUARY 2003

LA LETTRE DU CEPII is published in French.

Publisher: la Documentation française.

Price: € 48.40 outside France.

The English version of this French publication is available on the CEPII's web-site, one month after publication at: www.cepii.fr

CEPII WORKING PAPERS

• *'Imitation Amongst Exchange-Rate Forecasters: Evidence from Survey Data'*
M. Beine, A. Bénassy-Quéré, H. Colas
NO 2003-08, JULY.

• *'Le Currency Board à travers l'expérience de l'Argentine'*
S. Chauvin, P. Villa
NO 2003-07, JULY.

• *'Trade and Convergence: Revisiting Ben-David'*
G. Gaulier
NO 2003-06, JUNE.

• *'Estimating the Fundamental Equilibrium Exchange Rate of Central & Eastern European Countries. The EMU Enlargement Perspective'*
B. Egert, A. Lahrèche-Révil
NO 2003-05, JUNE.

• *'Skills, Technology and Growth Is ICT the Key to Success? An Analysis of ICT Impact on French Growth'*
J. Melka, N. Mulder, L. Nayman
S. Zignago
NO 2003-04, MAY.

• *'L'investissement en TIC aux Etats-Unis et dans quelques pays européens'*
G. Cette, P.-A. Noual
NO 2003-03, MARCH.

• *'Can Business and Social Networks Explain the Border Effect Puzzle?'*
P.-P. Combes, M. Lafourcade,
T. Mayer
NO 2003-02, JANUARY.

• *'Hyperinflation and the Reconstruction of a National Money: Argentina and Brazil, 1990-2002'*
J. Sgard
NO 2003-01, JANUARY.

Working Papers available at: www.cepii.fr

Events

SEMINARS AND MEETINGS

• **The Consequences of Demographic Ageing: Financial Markets and International Capital Movements**
M. Aglietta (Univ. Paris X/CEPII), P. Artus (CDC), L. MacKellar (IIASA).
8 July 2003

• **Financial Services and International Trade Negotiations**
P. Sauvé (FNSP), V. Grimaud (EU Com.), J. Teyssier d'Orfeuil (DREE).
25 June 2003

• **European Integration and the Future of Public Services**
F. Ailleret (EDF/CES), D. Roux (ART), A. Perrot (LEI).
11 June 2003

• **The Enlargement of the Eurozone: The Advantages and Drawbacks for Members and Non-Members**
A. Hallet (Univ. Cardiff), J. Pisani-Ferry (French Ministry of Finance), A. Bénassy-Quéré (CEPII).
10 June 2003

• **The Consequences of Demographic Ageing: Health and Dependency Insurance**
O. Schaal (AGF-Allianz), B. Ennuyer (Ass. "Les Amis"), R. Mahieu (CNAF).
3 June 2003

• **An Economic Assessment of the Doha Round**
H. Testard (DREE), J. Francois (Univ. Erasmus, Rotterdam).
30 April 2003

• **The Consequences of Demographic Ageing on Pension Systems**
A. Jousten (Univ. Liège), S. Hamayon (Quantix), J.-C. Willard (AGIRC-ARRCO).
22 April 2003

• **Explaining and Predicting Exchange Rate Movements by Order Flows**
J.-C. Trichet (Banque de France), A. Kirman (Univ. Aix-Marseilles), R. Lyons (Univ. Berkeley/NBER), A. Persaud (State Street Global Markets), P. Fisher (Bank of England).
2 April 2003

• **Electronic Money: Private Initiatives, New Risks and the Responses of Monetary Authorities**
B. Cohen (Univ. Calif. Santa Barbara), M. Aglietta (CEPII).
26 March 2003

• **Demographics: Certainties or Uncertainties?**
D. Blanchet (INSEE), R. Sleiman (CEPII), J. le Cacheux (OFCE).
18 March 2003

• **The Economic Policy Challenges Facing the New Chinese Leadership**
W. Woo (Univ. Calif. Davis/Columbia), F. Lemoine (CEPII).
26 February 2003

• **Is the Synchronisation of the Business Cycles Across the World's Three Major Zones Sustainable?**
P. Mills (EU Com.), B. Mojon (ECB), P. Zanghieri (CEPII).
18 February 2003

• **The Economic Outlook and Financial Markets**
R. Lescure (CDC IXIS Asset Management).
8 January 2003

CONFERENCES

• **EMPLOYMENT, PRODUCTIVITY AND SKILLS IN THE KNOWLEDGE ECONOMY**
Paris, 16 May
This one-day conference examined a wide range of issues related to the impact of information and communications technologies (ICT) on labour market skills, productivity, investment and growth.

• **RUSSIA'S EUROPEAN FUTURE**
Paris, 28 April
See page 5 of this Newsletter.

• **ASIA 2003: THE OUTLOOK OF JAPAN'S ROLE IN ASIA**
Paris, 3 April
This conference examined the various aspects of Japan's economic relations and position in Asia. It covered the prospects of the Asian economy, the domestic difficulties of Japan's economy, the challenge of globalisation for Japan, as well as Japan's role in regional integration.

For further information about these conferences, see www.cepii.fr

NEWS IN BRIEF

• As in previous years, the CEPII participated as a "knowledge partner" in the OECD Forum 2003, entitled "Grow, Develop and Prosper". Presentations and workshops addressed a wide variety of issues, including: the return to world growth after the Iraq war, the Doha Development Agenda, the prospects for developing country economic catch-up, the social implications of international trade and investment, as well as corporate and public governance. The Forum took place in Paris on 28-29 April.

• As a member institute of the European Forecasting Network (EFN), the CEPII participated in drafting EFN Economic Outlook Spring Report 2003 which examines the growth prospects of the eurozone as well as the macroeconomic implications of EU enlargement. The report was presented the 23 April (see www.cepii.fr).

• Anne-Marie Boudard retired from her post as Secretary General of the CEPII at the end of June 2003. She has worked for the CEPII since its creation in 1978, and became Secretary General in 1991, having been head of the Centre's IT staff.

• Frédérique Abiven was nominated to succeed Ms. Boudard, as Secretary General, as of 1 July 2003.
Ms. Abiven will also continue to head the CEPII's documentation centre and library.

• Chantal Bartholin returned to the CEPII's Business Club in June, to take on the responsibilities as Secretary General. She previously held this post from 1987 until 1997.

• François David resigned as Chairman of the Business Club in June. The General Meeting and Board of the Club have confirmed the nomination of Bruno Durieux, a former trade Minister, as the new Chairman of the Club.

• Jean-Louis Guérin left the CEPII in April 2003. He will be replaced by Catherine Bac, on 1 August 2003, who will begin working in the CEPII's "factor markets and growth" research programme.

• Claire Hitier left the Centre's IT team in June.

FORTHCOMING

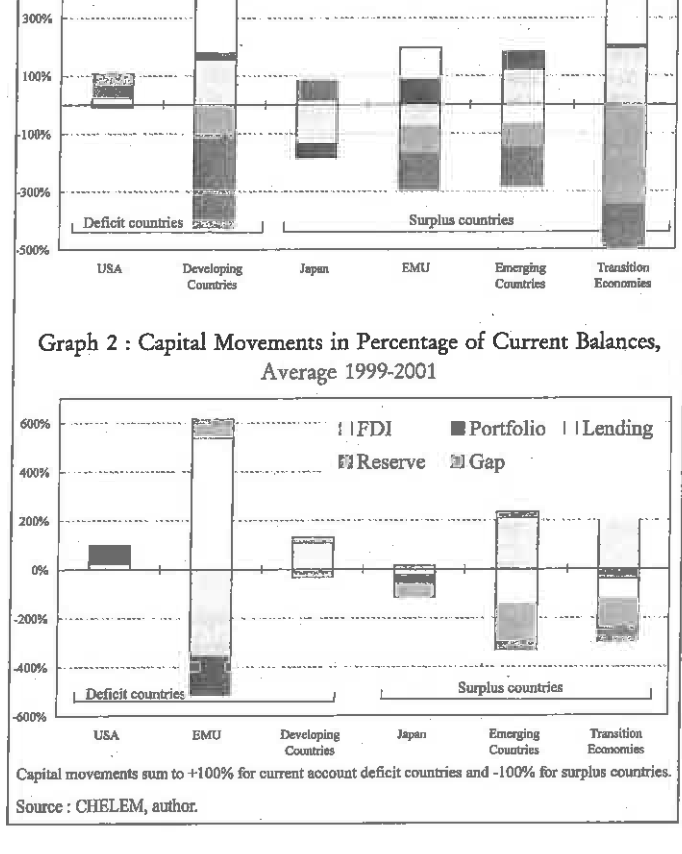
• A major conference on the *Economic Implications of the Doha Development Agenda for Latin America and the Caribbean* is being organised with the Inter-American Development Bank in Washington, 6-7 October 2003. Speakers will include academics, politicians, government officials and business representatives from North and South America, as well as Europe. For further information please contact: Mr. Michel Fouquin at the CEPII: fouquin@cepii.fr

THE CEPII'S MODELS AND DATABASES

Current Account Imbalances: Short-Term or Long-Term Financing

The growing current deficits of the United States, the persistence of a current surplus in Japan and the liberalisation of financial markets increased international capital movements during the 1990s.

Graphs 1 and 2 retrace the way major zones finance (use) their current account deficits (surpluses). The data is taken from the CEPII's CHELEM database, and the Graphs show net capital movements (for example, in 1999-2001 the eurozone was a major net recipient of bank loans and a large net exporter of FDI). The United States exhibits specific characteristics relative to other developed economies, but is also different from the emerging countries. US net borrowing, due to its investment and consumption boom, was mainly financed by net portfolio inflows, mostly from the EU and Japan, surplus regions in search of higher returns. Meanwhile, emerging, transition and developing countries kept on benefiting from net FDI inflows. Nonetheless, though FDI flows towards less developed countries increased rapidly in absolute terms, the share of these nations in world FDI flows has slowed. This mirrors the reduced privatisation programmes in host countries and the mergers & acquisitions boom in the developed countries, in the late 1990s. Important international sources of financing were thus withdrawn, in relative terms, from emerging countries to finance US external deficits, as the eurozone acquired US firms and Japanese investors built up reserve assets at the end of the decade. FDI inflows to the US then fell in 2001 and collapsed in 2002, due to macroeconomic uncertainties and the fall of equity prices, especially in the ICT sector. In contrast, FDI inflows to transition economies and emerging countries, notably in Latin America grew in 2002, according to the OECD[1], while decreasing by more than 20% within the OECD itself. This change-around suggests that international investors remain risk-friendly, depending on factors such as access to markets.



Capital movements sum to +100% for current account deficit countries and -100% for surplus countries.

Source : CHELEM, author.

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(1) OECD (2003), *Trends and Recent Developments in Foreign Direct Investment*, Directorate for Financial, Fiscal and Enterprise Affaires, June.

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