The euro and trade: New evidence

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The euro has increased trade within the currency union. This column summarises research exploring how firms' exporting behaviours have been shaped by the euro.

The euro was introduced nearly ten years ago. That innovation, in which a group of European countries voluntarily abandoned their national currencies for a newly created one, has been heavily watched by both policymakers and economists for various reasons. For one thing, it was a novel move –for most of the post-war period, countries have shown a strong preference to have their own national currency.[1] Second, before the European Economic and Monetary Union (EMU), countries adopting another's currency appeared to be radically different from non-union members. They were often (extremely) small in size and politically or economically highly dependent. Finally, the European experience has raised considerable interest not only within the European Union, but also outside. Around a dozen of EU members have still to decide whether and when to join the euro-zone. In addition, the euro serves as a benchmark experiment for country groups, particularly in Asia and the Gulf region, considering their own regional monetary unions.[2]

The euro was introduced mainly to achieve a higher level of economic integration within the European Single Market and thereby promote both economic growth and stability. Its anticipated trade effects were small. While the euro might promote international trade within the euro-area by eliminating some exchange rate uncertainties and currency transaction costs, the exchange rate fluctuations between countries that adopted the euro were already low, sometimes even zero, before the formation of the EMU.

Our understanding of the impact of currency unions on trade radically changed with the publication of Andrew Rose's influential *Economic Policy* article in 2000. He found that currency union membership is typically associated with disproportionately large bilateral trade flows.

Subsequently (and rather predictably), a number of studies have specifically focused on the euro. Interestingly, most of these studies find that trade between euro-zone countries has increased after the adoption of the euro (relative to trade that involves non-members). Estimates mostly range from 5 to 20 percent. Still, there are qualifications to be made. For instance, results seem to depend on the countries chosen as the comparison group. Also, Berger and Nitsch (2008) show that the increase in trade within the euro-area is simply a continuation of a long-run trend, probably linked to the broader set of EU's economic integration policies.

How did the euro increase trade?

More recently, research on the effect of currency unions (and the euro, in particular) on trade has shifted its focus from *how much* to *how*. In a recent study for the European Commission, Baldwin, DiNino, Fontagné, De Santis, and Taglioni (2008) argue that the increase in trade due to the euro is likely to have been generated by a rise in the number of exporters and products traded across borders. By reducing the fixed and/or variable costs of exports, the euro has enabled previously non-exporting firms to start exporting and already exporting companies to expand the range of products they sell abroad. They provide stylised evidence consistent with this explanation using firm-level data from Belgium, France, Hungary and Sweden. Along similar lines, Berthou and Fontagné (2008) and Flam and Nordstrom (2006) find some support for this hypothesis. However, their results become weaker when they restrict the control group to those EU countries that did not join the euro.

In recent work (Nitsch and Pisu, 2008), we take a more disaggregated approach to examine channels through which the euro may have impacted trade. Building on the latest literature in empirical international trade, we ask the following questions: Has there been a change in the number of traded goods after the introduction of the euro? Has there been a change in the number of exporters? Has there been a change in the (average) price of traded products? Was the reaction of small and less productive firms different from large and highly productive firms?

With regard to aggregate trade, we confirm earlier findings that trade among member countries of EMU has moderately increased after the introduction of the euro. Our results suggest that this effect is mostly due to an increase in trade in long established trade relationships; the number of traded varieties (at the 4-digit level of product classification) remains largely unaffected by the adoption of a common currency.

In addition to sectoral trade data, we have analysed trade data at the firm level.[3] Examining the trading activities of Belgian firms, we find that the euro has raised the propensity of firms to export to countries in the euro area. Moreover, the euro has increased the number of products that exporters ship to the euro-area. Also, the newly exported products appear to be characterised by lower unit values than those firms already export. All these effects are stronger for smaller and less productive firms.

Overall, these firm-level results suggest that the euro has lowered the fixed and/or variable costs of exports. Some smaller and less productive firms now find exports to the euro-area profitable. The newly exported goods are of lower unit values than those previously exported because the euro has made exporting them profitable, particularly for small exporters.

References

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Footnotes

[1] Glick and Rose (2002) illustrate that political separation (e.g., from a former coloniser) was often accompanied by monetary separation.

[2] A number of countries inside the Gulf Cooperation Council have stated their intention to achieve monetary union by 2010.

[3] For a description of this data set, see Muûls and Pisu (2007).

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