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Revisiting the Euro's Trade Cost and Welfare Effects

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Abstract: When, about twenty years ago, the Euro was created, one objective was to facilitate intra-European trade by reducing transaction costs. Has the Euro delivered? Using sectoral trade data from 1995 to 2014 and applying structural gravity modeling, we conduct an *ex post* evaluation of the European Monetary Union (EMU). In aggregate data, we find a significant average trade effect for goods of almost 8 percent, but a much smaller effect for services trade. Digging deeper, we detect substantial heterogeneity between sectors, as well as between and within country-pairs. Singling out Germany, and embedding the estimation results into a quantitative general equilibrium model of world trade, we find that EMU has increased real incomes in all EMU countries, albeit at different rates. E. g. incomes have increased by 0.3, 0.6, and 2.1 percent in Italy, Germany, and Luxembourg, respectively.

Keywords: Euro, trade, general equilibrium, quantitative trade models, European Union

JEL Classification: F15, F17, N74

1 Introduction

The roots for the project ‘European Monetary Union’ (EMU) can at least be traced back to 1970, when the so-called Werner report recommended the introduction of a common European currency. From these beginnings, the objective was to foster intra-European economic exchange, in particular trade, by eliminating currency related transaction costs such as arising from the simple need of exchanging currencies, the insurance against exchange rate fluctuations, or reduced price transparency.

Both the academic and the political debates of the last years have mostly focused on the monetary aspects of EMU and on the macroeconomic

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