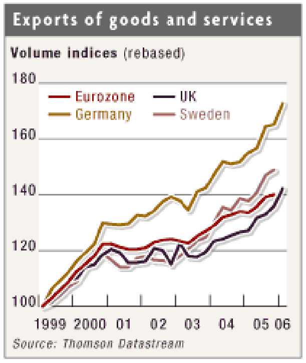
Euro's trade impact

Published: July 2 2006 19:36 | Last updated: July 3 2006 12:30



Source: Thomson Datastream

Has Britain been the clever one, staying out of the euro? Recent research suggests it has had all the benefits of better market access and improved trade enjoyed by the eurozone countries, without sacrificing an independent monetary policy.

Six years ago, Berkeley's Andrew Rose suggested that a common currency zone boosted bilateral trade by 200 per cent. In 2003 the UK Treasury said the pro-trade effect on Britain of using the euro would be over 40 per cent. Richard Baldwin, in a report for the Centre for Economic Policy Research, argues that such conclusions are analytically flawed. He suggests that the euro has had a surprisingly modest impact on trade between its members, increasing it by an estimated 9 per cent. Most surprisingly, he argues that adoption of the euro has boosted imports from non-euro area nations almost as much as imports from eurozone countries. Britain, Sweden and Denmark, he says, have not lost any trade into the euro area since 1999, but have seen their exports grow 7 per cent.

Professor Baldwin's explanation is that joining the euro acted like a unilateral trade liberalisation by the "ins", which boosted their imports from the "outs" almost as much as their imports from fellow euro-users. Trade was not diverted from outside the currency union to within it. Instead, there was both external and internal trade creation. This extra trade resulted less from reduced transaction costs than from the export of new goods to eurozone countries, possibly driven by a reduction in the fixed costs of introducing such goods into these markets. For policy-makers, the implication is that adopting the euro would have only a small effect on the joiner's exports, but that imports should rise substantially more than exports.

On such an analysis, the costs of not joining the euro are also minimal. This may be one occasion when being a party-pooper has not stopped the UK enjoying the goodie bag.