Referee Report

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The Single Currency's Effects on Eurozone Sectoral Trade: Winners and Losers?

Summary

The paper looks at the effects of the adoption of the euro on the patterns of trade between countries that have joined the single currency, and a number of other OECD economies with independent monetary regimes. The analysis uses a standard methodology to extend the existing literature aiming to measure the impact of changes in the monetary regime on the manufacturing sector. The authors argue that existing studies explore the issue at the aggregate level with respect to both trade flows and country aggregates. Building a richer disaggregate picture of the relationship between monetary institutions and trade flows is well motivated and deserves attention. The subject under consideration is important and interesting, especially for EU members who have not joined the monetary union yet. In particular, the idea that the effects of the EMU are industry and country specific is an important one to explore, and inform this significant area of policy debate.

If we accept the basic assumptions of the gravity model, and the addition/subtraction of new variables in the specific context of this analysis, the paper adds some useful observations to the existing literature. The authors claim that their model shows:

1) The effect of the EMU is not uniform across the 25 manufacturing sectors they study.

2) The positive effect of the EMU is concentrated in sectors that exhibit scale economies, as well as those with a capacity to produce differentiated goods.

In my opinion, there are several issues that require clarification and some caution in the interpretation of the results:

1) On p. 8 the authors state that the bilateral export data are in dollar terms and "deflated by value added implicit deflators". It would be helpful to explain what this exactly means and how exchange rate movements impact this (dependent) variable, and hence the analysis.
2) According to the authors, the main contribution of the paper to earlier sectoral studies is that the estimated magnitude of the effect is "lower and less widespread across industries." Since other studies on the subject typically employ static models, and hence report the cumulative impact of the euro effect, the results are not directly comparable to the short-term effect measured by the methodology employed in this paper. This issue should be delineated clearly in the paper.
3) The paper seems to adopt a somewhat limited view of trade integration since it measures the success of the euro adoption in terms of trade volumes only and does not analyze the potentially pro-competitive impact on prices and increased consumer welfare. This limitation of the analysis should be clearly outlined in the scope of the paper.

4) The analysis is confined to the manufacturing sector and excludes services. This is potentially an important omission and should be at least acknowledged in the paper.
5) Giving up monetary policy independence and irrevocably fixing the exchange rate entails one major risk: Since the exchange rate now cannot adjust to restore international intra-EMU competitiveness, wages should be flexible downward to compensate for this. If the characteristics of labour market institutions are such that they allow little downward flexibility in wages, some countries within the EMU might be less likely to benefit from the reduction in transaction costs and the adoption of the euro for improving export performance. Accounting for differences in labour market institutions (through an aggregate qualitative index or sector-specific union density as a proxy) might potentially explain the country-specific findings in the paper with respect to more negative effects in France, Finland and Italy.

In general, the motivation and methodology of the analysis are interesting. The limitations of the methodology and the scope of the paper should be nevertheless more carefully delineated. Similarly the interpretation of the results warrants more caution. With some revisions, the paper can make a useful contribution to the ongoing policy debates.