

## **TRADE PRICES AND THE EURO**

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### **NON-TECHNICAL SUMMARY**

Ten years after the creation of the European Monetary Union (EMU), it becomes possible to empirically assess its economic impact. The first real effect that comes immediately to mind is to further integrate markets of the Euro zone. Market integration can manifest itself through trade creation, as discussed in many papers, following Rose (2000). Another manifestation that can be tracked down statistically, but has been less investigated in the empirical literature, is the impact of EMU on trade prices. In this paper, we ask whether and how the introduction of the European common currency has affected pricing strategies of French exporting firms.

There are three channels through which the Euro might impact trade prices. Firstly, the elimination of exchange rate fluctuations and associated risks is expected to reduce transaction costs, which should affect firms pricing strategies. Secondly, market integration is expected to enhance firms and products entry which should impact aggregate prices through composition effects. Lastly, a common currency should ease arbitrage behavior of European consumers and reduce the magnitude of price discrepancies within the Euro zone.

In order to investigate these different channels, our paper describes the effect of the Euro on i) the level, ii) the evolution and iii) the dispersion of trade prices. The empirical investigation relies on firm level data about French exports over the period 1995-2005. The bilateral dimension of the dataset helps comparing the pricing behavior of French firms toward EMU countries and the rest of the OECD. The use of individual data limits the aggregation bias associated with the use of trade unit values as proxy for prices. Besides, firm-level unit values are free on board, directly reflecting pricing strategies of firms selling goods in several export markets. Finally, this data makes it possible to disentangle the effects of the Euro on to types of flows: the flows present during the whole period and the flows which enter and/or exit the sample within the period.

Our results can be summarized as follows. First, we find that, on average, French export prices are lower toward the Euro area. This is true during the whole period, even if prices tend to increase in the Euro area at the beginning of the EMU, this price increase being driven by extensive flows. Then, we show that the Euro reduces pricing to market of French firms exporting toward EMU countries. This tends to lessen the price volatility inside the Euro zone. Finally, the extent of price discrimination is smaller toward Euro countries than toward the rest of the OECD. We use a difference-in-difference approach to investigate the dynamics underlying this stylized fact. We show that, after the introduction of the Euro in 1999, price dispersion has been reduced in the Euro zone in comparison with the rest of the OECD.

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