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THE INTRODUCTION OF THE EURO AND ECONOMIC GROWTH: SOME PANEL DATA EVIDENCE

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We use a difference in difference estimation framework to analyse the effects of the adoption of the euro on the level of per capita GDP for a sample of seventeen European countries (the EU15 plus Norway and Iceland) over the period 1990–2010. We find that the adoption of the euro may have raised the level of per capita GDP (and labour productivity) by about 4 percent. There is also some evidence that the impact of the euro has been smaller in the case of countries with a high debt-to-GDP ratio in 1999 when the euro was introduced. Results are robust to controlling for country fixed effects, time trends and to estimation strategies that control for cross-country parameter heterogeneity.

JEL classification codes: 043, 052

Key words: euro, economic growth, difference-in-difference

I. Introduction

The economic troubles that have been characterizing the euro area since the burst of the sovereign debt crisis are well known and currently at the centre of the European economic policy debate. Many authors have discussed at length the major shortcomings of the euro project, such as the limited powers of the European Central Bank, the absence of a fiscal and financial union and the widening trade imbalances and gaps in productivity across countries (Shambaugh 2012). For some opinion makers the current institutional and economic arrangements of the European Monetary Union are so flawed and difficult to change that in some

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countries political pressures to leave the euro might soon enter into the mainstream political debate.

Notwithstanding the recent problems, the academic literature has been highlighting several possible channels through which the euro could positively affect income and productivity, namely lower exchange rates volatility and risk, increased trade, higher price transparency and stronger integration of financial markets and a full exploitation of the European Single Market, among others.

Surprisingly, in the academic literature the evidence on the macroeconomic effects of the euro on growth and productivity are scant at best, a notable exception being a recent paper by Bugamelli et al. (2010) which convincingly shows that the euro has led to stronger labour productivity growth in sectors that used to compete mostly in prices and in countries that tended to rely more on competitive devaluations.[1]

In this paper we aim to contribute to the debate on the economic effects of the euro by estimating the effect of the euro adoption on per capita GDP with yearly data for a set of seventeen European countries over the period 1990–2010 using a simple differences-in-differences framework. We find that, after controlling for country fixed effects and time trends, the euro had a positive impact on per capita GDP and labour productivity. In most regression specifications and estimation strategies we find that the euro had a positive effect, in the 3–4% range. These results are confirmed if we estimate the model using methodologies that take into account non-stationarity and panel cointegration issues; moreover, if we allow some dynamics into the model, the euro effect on per capita GDP could have been even slightly larger, although estimation strategies that deal with parameter heterogeneity suggest more conservative estimates of about 4%. Interestingly, we also find evidence of some heterogeneity across countries associated to macroeconomic imbalances that existed when the euro was introduced: in fact, some empirical estimates suggest that the effect of the euro falls with the level of the debt-to-GDP ratio in 1999. Although our approach could be considered a "crude" way to assess the impact of the euro on per capita GDP, nevertheless we believe it might provide a useful starting point for future research.

[1] In turn, there is a large literature on the positive effects of euro on trade (Bun and Klaassen 2007 and the references therein) and some empirical evidence on the effects of euro on disposable income inequality (Bertola 2010) and financial integration (Kalemni-Ozcan et al. 2009).

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