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The Impact of the Introduction of the Euro on Firms' Expectations
An Empirical Assessment of the German Business-related Services Sector

Firms’ expectations regarding their ability to enter new markets and to develop new products, and concerning the foreign competition they will face in future, are strongly affected by the introduction of the euro. The following article analyzes these expectations using panel data taken from a quarterly business survey in the service sector.

While the bulk of studies focusing on issues related to European Monetary Union (EMU) mainly deal with macroeconomic aspects of European integration, not much is known about the way individual firms are affected by EMU. Researchers have put a lot of effort into investigating trade patterns within the European Union and the effects of the introduction of the euro on export and import flows.\(^1\) This more aggregate view is of course crucial for the discussion on the advantages and disadvantages of EMU. However, to the authors' knowledge no reliable empirical analysis of the risks and opportunities of EMU for individual firms exists. Likewise, not much is known about the euro's impact on firms from the service sector.

Existing firm-level studies are mainly concerned with the degree of firms' preparation for the euro. Examples of these studies are those by the DIHT\(^2\) and by the consultancy firms Cap Gemini,\(^3\) Andersen Consulting\(^4\) and KPMG.\(^5\) A major shortcoming of these studies is that they do not give guidance on whether the introduction of the euro will have a stimulating effect on firms' export behaviour.\(^6\)

Nerb\(^7\) analyzes the effects of the euro on different business departments such as sales, distribution, marketing and finance. Using data from a German business survey of manufacturing industries, construction and retail trade, he finds that firms expect the euro to influence sales and distribution positively. Negative effects are expected for electronic data processing and accounting while with regard to finance and organization indifference prevails.

However, the probably most interesting aspect of the euro is its impact on firms' export behaviour since the main purpose of EMU is to complete the common market and to facilitate intra-European activity. Thus, this paper aims at supplementing the existing literature in that it uncovers the way the euro affects major strategic decisions and preparations by firms from the German services sector. Panel data from a unique business survey are used in the empirical analysis. The data allow a thorough investigation of the direction in which firms expect the introduction of the euro to influence

- firms' export decisions,
- firms' expectations of new foreign competition and
- firms' ability to develop new products such as software which can be used in the entire EMU or which is needed for conversion to the euro.

Of course, it is difficult to differentiate between effects induced by the common market and those induced by the euro itself, especially as the euro is supposed to complete the common market. It is

\(^1\) For a summary of new developments in the field of new real trade theory and existing studies dealing e.g. with the macroeconomic effects of European integration see Fritz Breuss: Außenwirtschaft Band I: Realer Teil, Schwerpunkt Europäische Integration, Springer Verlag, Wien 1997.

\(^2\) DIHT: Europäische Währungunion vor dem Start: Zum Stand der Vorbereitung in den Unternehmen, IHK Euro-Reihe, 1998. The Deutscher Industrie und Handelstag (DIHT) is the German Association of Chambers of Industry and Commerce and thus the central organisation for 83 chambers. All German companies registered in Germany, with the exception of handcraft businesses, the free professions and farms, are required by law to join a chamber.


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Theoretical Considerations

The impacts of the EMU on export behaviour have recently been widely discussed from a theoretical point of view. In its report "One market, one money", the European Commission\(^6\) presents a summary of the expected effects of the introduction of the euro on exports. According to the Commission, the euro will drive down factors impeding export activity such as transaction costs. This static gain will lead to efficiency gains, an optimal allocation of resources and, in the long run, to dynamic gains such as enhanced price stability and an increase in both production and international trade. Thus, a higher level of export and economic growth could be achieved.

Several aspects are said to be responsible for the decrease in transaction costs with the introduction of the euro. In EMU, currencies no longer need to be converted, and exchange costs are thus eliminated. European-wide financial transactions will be processed faster and will in the long run become less expensive for both firms and banks due the expected development of the more cost-efficient international payment system TARGET.\(^7\) Further, exchange-rate risks are eliminated, rendering hedging activities unnecessary. With the conversion of national currencies into the euro, the intra-EMU volatility of exchange rates is reduced to zero, and hence profits from trans-European activities become more predictable even in the long run while the negative impacts of exchange-rate volatility on the real sector, e.g. on exports, are eliminated.\(^8\)

Another reason why the EMU might induce firms to start or to increase their export activity is that the risk of exchange-rate appreciation no longer exists. Although the D-mark depreciated in real terms between 1972 and 1997 by seven per cent,\(^9\) some periods of real appreciation existed even in that time-span, which has led German exporting firms to

\(^6\) \textit{TARGET} is the abbreviation for "Trans-European Automated Real-Time Gross Settlement Express Transfer". To use TARGET currently is quite expensive relative to the use of national clearing systems. In the long run, the costs of TARGET or/and charges might go down. Besides, banks are considering the installation of an alternative clearing system.

\(^7\) For a discussion of the impacts of exchange-rate variability, see Claudia Müller and Herbert S. Buscher: Exchange Rate Volatility Effects on the German Labour Market: A Survey of Recent Results and Extensions, ZEW mimeo, 1999.

\(^8\) This refers to the weighted external value of the German mark against the currencies of 18 industrialized countries in real terms, deflated by the different consumer price indices and published by the German Bundesbank in its monthly exchange-rate statistics. This external value was based to 100 in 1972 and had decreased to 93\% of its 1972 value in 1997.

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Finally, the paper examines whether firms' judgements on whether or not they expect to enter new markets, to be confronted with new foreign competitors or to develop new products due to EMU have changed between 1997 and 1998. This is an indication of whether there has been a reorientation in the firm's long-term strategy. We find significant negative time effects for both the expectation of being able to enter new markets and that of being able to develop new products.

\[^{6}\] Moreover, the studies by Cap Gemini Consulting, KPMG and Andersen Consulting have several weaknesses from the statistical point of view. In addition to the fact that very small samples are considered, the studies are likely to suffer from severe selection biases since both consultancy firms interviewed (a) their own customers and (b) only those with more than 500 (Cap Gemini Consulting), 1,000 (Andersen Consulting) or 5,000 (KPMG) employees.


\[^{8}\] The U-shaped effect means that the probability of expecting to enter new foreign markets first increases and then decreases with firm size.