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The Middle East and Northern Africa
as Part of the "Euro Time Zone"

MICHAEL STURM

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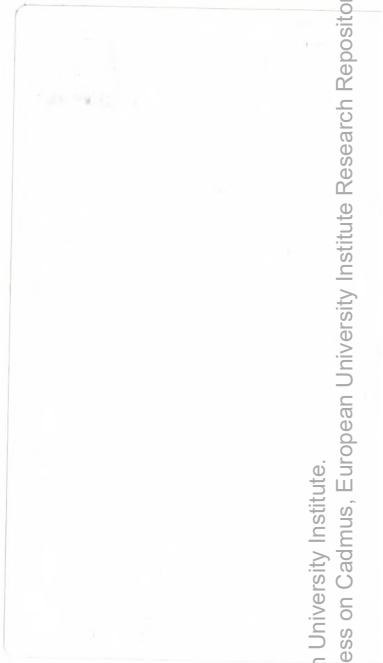
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**ROBERT SCHUMAN CENTRE
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**The Middle East and Northern Africa
as Part of the "Euro Time Zone"**

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EUI Working Paper **RSC** No. 2001/40

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Introduction*

The purpose of this paper is to describe the role of the Middle East and Northern Africa within the "Euro Time Zone" (ETZ). The highly stylised concept of the ETZ takes account of the deep-rooted change in the international monetary system, which was caused by the introduction of the euro on 1 January 1999. As a result only three major international currencies exist today, the US-Dollar, the euro and the Japanese Yen. Each of the three major currencies has already developed, or has the potential to develop, a "gravitation zone", i.e. an area comprising those countries, in which the major currency plays a special role and which are characterised by particularly close relations with the economic area issuing this currency.

This phenomenon is most reflected concerning the US-Dollar so far. Latin-America could be considered as a "Dollar Time Zone", as the US currency is widely used in all functions of an international currency.¹ Even outright "dollarisation", i.e. the introduction of the US-Dollar as a legal tender, seems to be an attractive option for a growing number of countries.² In Asia, the picture is less clear so far, as the US-Dollar plays a crucial role alongside the Yen, and for both economic and political reasons it is an open question whether the Yen could grow into the role the US-Dollar plays for Latin America. Nevertheless, in the aftermath of the Asian crisis there are signs of a growing disassociation from the US-Dollar and moves to further regional monetary integration, e.g. the Chiang Mai agreement.³

Concerning the euro, it is obvious that the new currency has not yet been able to exploit its full potential as an international currency given its short history. Nevertheless, a number of regions can be identified, whose common denominator is - in spite of their diversity - closeness to the euro area in various respects, and which therefore can be considered as part of the Euro Time Zone. Roughly speaking, the ETZ comprises the area that is more strongly influenced by the EU and its policies than by the policies of other major economies,

* This paper was presented at the Second Mediterranean Social and Political Research Meeting, Florence, March 21-25, 2001, Mediterranean Programme, Robert Schuman Centre for Advanced Studies, European University Institute.

¹ These functions are: investment/financing currency, payment/vehicle currency, pricing/quotation currency (private use), and reserve currency, intervention currency, pegging currency (official use); (ECB 1999, 32).

² Panama, Ecuador and El Salvador are dollarised, while in several other countries there is a debate about this option.

³ The Chiang Mai agreement concluded in May 2000 between the ASEAN countries and China, Japan and the Republic of Korea foresees the establishment of a network of bilateral swap arrangements and repurchase agreements among the participating countries, the closer monitoring of capital flows and development of a regional surveillance mechanism.

especially the US and Japan. It could also be called the “European Hemisphere” and comprises roughly 100 countries. The ETZ is primarily determined in geographic terms, as geography also matters regarding economic, financial and political relations. The following regions outside the EU are considered here as a part of the ETZ: The 13 EU accession countries, other European countries (Iceland, Norway, Switzerland and the European micro-states), the Balkans, the European CIS including Russia, the Middle East and Northern Africa and Sub-Saharan Africa. The focus in this paper is only on the latter four regions and particularly the Middle East and Northern Africa, as the issues arising with them from a euro area perspective are in many respects very different from those with the former group of countries.⁴ The ETZ could be defined as *the zone, which – considering a set of economic, financial, institutional, geographical and historical criteria – gravitates around the euro area, and for which the euro already is or will in all likelihood become the most relevant international currency.*

The paper is organised as follows:

Section 1 highlights the reasons why from a euro area perspective particular attention should be paid to the countries belonging to the ETZ. Section 2 presents a number of indicators, which point at multidimensional factors of closeness to the euro area, thereby underpinning the concept of the ETZ. Section 3 briefly describes the ETZ in a global context. Section 4 focuses on the Middle East and Northern Africa as a part of the ETZ by describing key characteristics of the region and the major links to the euro area, particularly in the economic and financial field. Section 5 discusses selected economic issues, which are of mutual interest for both the euro area and ETZ countries.

1. Motives for a special focus on the Euro Time Zone (ETZ) from a euro area perspective

The following stylised facts underline the special link between the euro area and the ETZ:

- Euro area banks are the most exposed to countries in the ETZ. Russia is a striking example with EU banks accounting for more than 80% of total exposures of BIS reporting banks to Russia.

⁴ This is due to the fact that with a few exceptions, e.g. the Balkans, countries from these four regions do not have a perspective for EU accession and thus accession specific issues do not play a role in relations with the EU. Secondly they distinguish themselves from the former group of ETZ countries by their level of economic development.

- Together with the EU, euro area States are the main official creditors of (most) ETZ countries (e.g. the EU is the biggest donor of non-military aid in the Middle East peace process).
- Some ETZ countries are the most important producers of oil, gas and other raw materials, on which the euro area depends. More than 75% of proven world oil reserves are located in the ETZ, the bulk of it in the Middle East.

Thus, given the possible spill-over effects of developments in the ETZ on the euro area, it is crucial for policy makers to deepen their knowledge on ETZ countries and their economies. On the other hand, the euro area is by far the most important region in the world for ETZ countries, e.g. as trading partner and source of financing. For instance, the euro area accounts for far more than 50% of the Maghreb countries' external trade. ETZ countries have thus a vital interest in developments in the euro area and in a better knowledge of the euro.

As regards the single currency, there is a specific reason why a special focus on the ETZ is required: The ETZ is likely the area where the international role of the euro will grow most rapidly and most extensively. Already today, the euro plays a major role, e.g. in exchange rate regimes and foreign reserves of many ETZ countries. Given the close links to the euro area, the greatest potential for an increasing international use of the euro, including full euroisation in some cases, lies in the ETZ. Furthermore, it is necessary to deepen the knowledge of ETZ countries on European institutions and the euro. There is clear evidence of a significant information gap concerning EMU and the euro, which, inter alia, may hinder the building up of confidence in the new currency and thereby the use of the euro.

Finally, from a euro area perspective, it must be kept in mind that the regions neighbouring Europe tend to be politically fragile and less dynamic in economic terms than other parts of the world. Exporting stability in a broader political sense, but also in a narrower economic sense, including price stability, is in the vital interest of Europe. On the one hand, Europe will be more affected by political and economic crises in Russia or the Middle East than, for instance, the US. On the other hand, Europe will be the main beneficiary of political stability and prudent macroeconomic management that will boost economic growth in those regions. It goes without saying that greater stability and higher growth are not only in the interest of the euro area, but primarily in the interest of the regions constituting the ETZ itself.

2. The concept of the ETZ: multidimensional factors of closeness to the euro area

A. *Economic and financial indicators*

Economic, monetary and financial variables are of primary importance to indicate the closeness of a given country to the euro area. The role of the euro in third countries' exchange rate regimes is of particular interest from a monetary policy point of view and can take various forms, from the unilateral adoption of the euro or euroisation (e.g. in Montenegro⁵), to a float with the euro taken informally as a reference currency (see section 5.1. for the issues arising in this context). The choice of the euro as an anchor for exchange rate arrangements is often justified by the fact that the relevant third countries' trade share with the euro area is significant.

Furthermore, the origin of financial flows to third countries, and in particular foreign direct investments (FDI), is an indicator that contributes to shape the concept of ETZ. The higher the share of third countries' companies owned by euro area companies, the tighter is the integration with the euro area. Finally, with respect to the public sector, the share of euro area countries and the EU as creditors of third countries' external debt reflects a direct linkage between the euro area and the financial conditions in third countries.

However, if only economic and financial indicators were taken into account, there would be the phenomenon of "ETZ countries outside the ETZ". E.g. Argentina would be part of the ETZ since the euro area represents 17% of its exports (against 10% of the US); euro area banks account for 60% of international bank claims (against 20% of the US), while the euro area and the US are each at the origin of almost half of FDI flows to Argentina. Thus, the concept of the ETZ is not exclusively based on economic and financial indicators, but also looks at other dimensions of closeness to the euro area.

B. *Geographic approach*

This approach is contained in the word Euro Time Zone itself. It takes account of the fact that geography also matters for economic, financial and political relations. From Russia to South Africa, the countries located in the time zones close to that of the euro area belong to the ETZ. While the Northern, Southern and Western borders of the ETZ are well-cut, uncertainties appear with respect to the Eastern border of the ETZ. The Eastern frontier could be set so as to include Iran as part of the Middle East, Kazakhstan, Russia and all neighbouring

⁵ Montenegro belongs to the Federal Republic of Yugoslavia and is thus not a sovereign country in a legal sense, but exercises independence regarding its monetary regime.

countries to the Black Sea and all those which are west of the Caspian Sea. Given that 80% of Russia's population lives west of the Ural Mountains, this country clearly is part of the ETZ.⁶

C. Institutional and political co-operation

Since the important "wave of independence" of former colonies in the 1960s, the EU has developed a comprehensive policy of co-operation agreements with various regions of the world. Examples are the Barcelona-Process with Mediterranean countries and the Lomé/Cotonou agreements with African, Caribbean and Pacific (ACP) countries. The degree of institutional and political co-operation depends largely on the ties the ETZ countries concerned traditionally had with individual member states now forming the EU. This co-operation includes financial contributions and loans, the level of which tends to reflect the importance of countries for the EU. In addition to institutional co-operation directly related to the EU framework, the countries' membership of regional organisations and fora, such as the OSCE or the Council of Europe, also highlights the political links to the EU.

D. Historical ties

Finally, the special relationship between euro area countries and ETZ countries is often based on ties rooted in history. E.g. the close monetary link between 14 countries in Central and Western Africa forming the CFA franc zone, which have a fixed parity to the euro, is basically explained by these countries' colonial past and the special relationship they preserved with France after their independence.

3. The ETZ in a global context

The Euro Time Zone in a comprehensive sense, including the EU, comprises 29.2% of the world population and more than one third of world GDP (36.4%, Table 1). The contribution of the different regions of the European hemisphere to these overall shares of population and GDP however, are rather unbalanced. The euro area alone accounts for 21.3% of world GDP and thus for almost 60% of the European hemisphere's GDP. This clearly points to the fact that from an economic perspective, the ETZ gravitates around the euro area. The four regions Balkans, European CIS, Middle East and Northern Africa and Sub-Saharan

⁶ In any event, this definition is somewhat arbitrary, since for instance Turkmenistan has not been included, whereas Kazakhstan is considered as part of the ETZ here, while both countries border the Caspian Sea. The inclusion of Kazakhstan into the ETZ is justified primarily by its close links to Russia, since one-third of its population is Russian and Russia uses the platform of Baikonour for its space activities.

Africa make up only 5.4% of world GDP; their combined share is even smaller than that of the EMU “Pre-ins”.⁷ But those regions account for 20.1% of the world’s and more than two-third of the European hemisphere’s population. This imbalance of GDP and population shares reflects the sharp contrast in the level of economic development between the euro area and some wealthy European countries surrounding it on the one hand, and the other ETZ regions on the other hand.

Table 1: Euro Time Zone - Population and GDP 1999*

ETZ-region	Population Mill.	In % of world population	GDP Bill. US\$	In % of world GDP
Balkans**	24.4	0.4	31.0	0.1
Russia	146.5	2.4	375.3	1.3
Other European CIS	97.1	1.6	95.4	0.3
MENA***	301.4	5.0	770.3	2.6
Sub-Saharan Africa	642.9	10.7	333.2	1.1
Sum	1,212.3	20.1	1,605.2	5.4
Accession countries	170.0	2.8	568.0	1.9
Other European countries	11.9	0.02	414.2	1.4
Sum ETZ	1,394.2	22.9	2,587.4	8.7
<i>Memorandum:</i>				
<i>Euro area</i>	293.3	4.9	6,396.9	21.3
<i>Pre-ins</i>	83.8	1.4	1,924.7	6.4
<i>ETZ incl. EU</i>	1,771.3	29.2	10,909.0	36.4
<i>World</i>	6,000.0	-	30,000.2	-

* For countries, whose 1999 GDP data were not available, data for previous year up to 1996 have been used.

** GDP data for Balkans without Yugoslavia

*** GDP data for Middle East and North Africa (MENA) without Iraq

Source: World Bank

4. The Middle East and Northern Africa

The following countries are covered in this paper as Middle Eastern and North African: Algeria, Bahrain, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, the Palestinian Territories (West Bank and Gaza), Qatar, Saudi Arabia, Syria, Tunisia, United Arab Emirates (U.A.E.), Yemen.

⁷ In 1999, Denmark, Greece, Sweden and the UK have been “Pre-ins”, i.e. EU members that have not adopted the euro yet. On 1 January 2001, Greece joined the euro area.

4.1. Some key characteristics of the region

The Middle East and Northern Africa (MENA) is a very heterogeneous region in terms of population and wealth (Table 2), but also with regard to political structure. With more than 60 million inhabitants, the most populated countries are Iran and Egypt, contrasted by eight countries with a population of less than five million. GNP per capita ranges from 350 US\$ in Yemen to 19,020 US\$ in Kuwait. Oil resources are the major determinant for wealth in the region and are distributed unevenly across countries. As a general pattern, the less populated countries are those, which produce oil, and are better off than countries with a large population. This constellation creates migration pressure both within MENA and from several MENA countries to Europe. With the exception of some small oil producing countries, Israel is the only high income country with a development level similar to Europe (Table 3), reaching approximately three quarters of the euro area average GNP per capita and thereby a higher level than some euro area member states. Looking at the overall GDP, Saudi Arabia, Iran, Israel and Egypt are by far the largest economies in the region. In contrast to other ETZ regions, e.g. Sub-Saharan Africa, MENA is not characterised by high debt levels (Table 4). Growth performance in the region is very diverse, but generally less dynamic than in other key emerging markets (Table 5), and regional integration is low.

Table 2: Population, GDP and GNP per capita in MENA

Country	Population 1999		GDP 1999		GNP per capita 1999, US\$	
	Mill.	(rank)	Bill. US\$	(rank)	1999, US\$	(rank)
Algeria	30.0	(3)	47.0	(6)	1,550	(14)
Bahrain	0.7	(18)	5.3*	(16)	7,640*	(5)
Egypt	62.4	(2)	92.4	(4)	1,400	(16)
Iran	63.0	(1)	101.1	(2)	1,760	(11)
Iraq	22.8	(5)	n.a.	-	1,750+	(12)
Israel	6.1	(10)	99.1	(3)	17,450	(3)
Jordan	4.7	(12)	7.6	(14)	1,500	(15)
Kuwait	1.9	(16)	19.6	(9)	19,020***	(1)
Lebanon	4.3	(13)	17.2*	(11)	3,700	(9)
Libya	5.5	(11)	n.a.	-	5,500+	(7)
Morocco	28.2	(4)	35.2	(7)	1,200	(17)
Oman	2.3	(15)	15.0*	(12)	4,940****	(8)
Palestinian Terr.	2.8	(14)	3.6	(17)	1,610	(13)
Qatar	0.8	(17)	9.2**	(13)	12,000****	(4)
Saudi Arabia	21.4	(6)	128.9*	(1)	6,910*	(6)
Syria	15.7	(8)	19.4	(10)	970	(18)
Tunisia	9.5	(9)	21.2	(8)	2,100	(10)
U.A.E.	2.8	(14)	47.2*	(5)	17,870*	(2)
Yemen	17.0	(7)	6.8	(15)	350	(19)

* 1998 ** 1997 *** 1996 **** 1995

Source: World Bank, † Deutsche Bank

According to the World Bank definition of country income groups, the bulk of MENA countries falls into the lower middle income category (Table 3), having reached higher income levels than Sub-Saharan Africa, which is pre-dominantly low income, and levels comparable to most Balkans and European CIS countries.⁸

Table 3: Income classification of MENA countries*

Low income Countries	Lower middle income Countries	Upper middle income Countries	High income Countries
Yemen	Algeria, Egypt, Iran, Iraq, Jordan, Morocco, Palest. Territories, Syria, Tunisia	Bahrain, Lebanon, Libya, Oman, Saudi Arabia	Israel, Kuwait, Qatar, U.A.E.

* Low income: (GNP per capita < 755 US\$)
 Lower middle income: (GNP per capita 756-2995 US\$)
 Upper middle income: (GNP per capita 2996-9265 US\$)
 High income: (GNP per capita > 9266 US\$)

Source: World Bank

With regard to indebtedness, MENA countries are classified by the World Bank as follows:

Table 4: Indebtedness of MENA countries*

Severely indebted Countries	Moderately indebted Countries	Less indebted Countries	Not classified by indebtedness
Iraq, Jordan, Syria	Algeria, Lebanon, Morocco, Tunisia, Yemen	Bahrain, Egypt, Iran, Libya, Oman, Saudi Arabia	Israel, Kuwait, Palestinian Territories, Qatar, U.A.E.

* Standard World Bank definition, which combines a range of indicators like present value of debt service to GNP and to exports.

Source: World Bank

Indebtedness is thus not a prevailing problem in MENA as a whole, as only three countries are classified as severely indebted.

⁸ In this context it is worth noting however, that several European CIS countries meanwhile have declined to low income levels, e.g. Ukraine with a GNP per capita of 750 US\$ (World Bank estimate for 1999) has a level below all MENA countries except for Yemen.

Table 5: Growth rates in MENA countries

Country/Region	Average growth 1982-91 Annual rates in per cent	Average growth 1992-99 Annual rates in percent
Algeria	2.2	2.0
Bahrain	3.5	4.8
Egypt	5.4	3.7
Iran	3.4	3.2
Iraq	n.a.	n.a.
Israel	3.6	4.6
Jordan	2.0	5.0
Kuwait	-5.7	15.5
Lebanon	-2.8	4.5
Libya	0.6	-1.4
Morocco	4.8	1.9
Oman	7.5	4.7
Palestinian Terr.	n.a.	n.a.
Qatar	-1.5	7.9
Saudi Arabia	1.2	1.0
Syria	1.9	5.2
Tunisia	3.4	4.9
U.A.E.	-0.1	6.2
Yemen	n.a.	4.1
<i>Memorandum:</i>		
<i>Africa</i>	2.3	2.3
<i>Asia</i>	6.9	7.8
<i>Latin America</i>	1.8	3.2
<i>USA</i>	3.0	4.1
<i>Euro area</i>	2.7	1.6

Source: IMF WEO October 2000

The data on growth performance exhibit a wide dispersion and volatility of growth rates within MENA (Table 5), which is partially explained by political events, wars and civil wars (e.g. Kuwait, Lebanon) and also reflects the dependence of many countries on primary commodity and agricultural exports. The growth rate of the largest economy of the region, Saudi Arabia, is remarkably low. Although growth in several countries has been considerable in the past 18 years, they have not reached the dynamics of other emerging markets, particularly in Asia. It should also be noted that population growth is high in many countries of the region. Thus GNP per capita has stagnated or even decreased in a number of countries (Most remarkably in Syria, from 1,210 US\$ in 1995 to 970 US\$ in 1999).

MENA is characterised by a low degree of regional integration so far (Table 9, section 4.2.1.). The only exception is the flow of labour, mainly from poor and populous Arab countries, e.g. Egypt, to oil producing countries. This

flow is facilitated by a common language, culture and religion. There are several reasons explaining the low degree of regional integration (de Vasconcelos 2000 7ff., El-Arian, Fischer 1996 8f., Giovanetti 1999, 12f.): Political conflicts and rivalries, a high dependence of government revenues from tariffs, due to a weak fiscal basis⁹, as well as similar factor endowment and production structures, which limit the scope for intra-regional trade. Given the low basis, the potential for regional integration is nevertheless great.

A framework for political and economic integration in the region is the Arab League, which comprises 22 Arab states. Within the Arab League the Arab Monetary Fund fosters monetary cooperation. However, the Arab framework does not include Israel and Iran, two major players in the region, and suffers from a lack of political coherence. For instance, plans launched by the Arab League in 1997 to establish an all Arab Free Trade Agreement (AFTA) by 2008 have not led to substantial results so far regarding the agreed tariff cuts (Calleya 2000 26 f.). Other frameworks for regional integration are the Arab Maghreb Union (AMU: Algeria, Libya, Mauritania, Morocco, Tunisia) which has not achieved much progress due to political conflicts either, and the Gulf Cooperation Council (GCC: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates). The GCC, so far the most successful framework for regional integration, intends to establish a customs union in 2005, and the GCC economic agreement includes a reference to an “endeavour to establish a unified currency”. At the GCC summit in Bahrain on 1 January 2001 Gulf leaders launched an initiative to live up to this objective. The Monetary Agencies and Central Banks Governors’ Committee and the Financial and Economic Committee of the GCC were asked to work out a plan and a timetable for a monetary union to be presented to the next GCC summit in December 2001.

4.2. Major links to the euro area

MENA constitutes an important part of the Euro Time Zone for several reasons:

- Geographic proximity: MENA countries are the immediate neighbours of the euro area in the South and South East. Proximity generates a number of links and issues, which are of mutual interest for both the euro area and the countries of the region. Migration is such an issue. Income in many MENA countries is relatively low, and many countries exhibit high population growth. E.g. the populations of the most populous countries in North Africa, Egypt, Algeria and Morocco, are expected to grow until 2025 by 44%, 70% and 39%, respectively (Eurostat 2000a, 20). This results in migration pressure to neighbouring Europe, which can particularly be felt in Southern

⁹ For an overview of fiscal developments in MENA countries see Jalali-Naini 2000.

European countries that have become countries of immigration. A high number of people, whose nationality or ethnic origin is Middle Eastern/North African, is already living in the EU, also reflecting historical ties (e.g. Algerians in France). Instability is another issue. Due to the unresolved Israeli-Palestinian conflict, but also to conflicts and rivalries among Arab states, MENA as a region is characterised by an inherent political instability, which repeatedly resulted in armed conflicts. Europe has an overwhelming interest to contribute to stability in this neighbouring region, which is mirrored in the fact that the EU is the biggest donor of non-military aid to the Middle East peace process. Instability in the region has, inter alia, an impact on oil prices, as the oil crises in the 1970s and even developments in the second half of 2000 have demonstrated.

- Oil supply: MENA includes some of the most important oil producing countries like Saudi-Arabia and Iran, and almost 70% of proven oil reserves are concentrated in the region. This highlights the importance of MENA for Europe (see section 5.2.).
- Historical ties: European history has been intertwined with the region for more than two millennia. The Middle East is the birthplace of the three monotheistic religions that have strongly influenced European culture; the Roman Empire included almost the whole region and most countries have been European colonies. In the long common history, periods of fruitful exchange on the one hand and of tensions or even armed conflict on the other hand followed each other. Although traditional ties to Europe are strong, US influence in the region is prominent in several areas, particularly in political and security matters (e.g. the US role in the Middle East peace process and in military protection for Gulf countries).
- Special relationship with the EU: In 1995 the EU and 12 Mediterranean countries launched the Barcelona-Process¹⁰, which is aimed at creating a new framework for Euro-Mediterranean partnership. It comprises the EU and the following 12 Mediterranean partners: Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Palestinian Territories, Syria, Tunisia, Turkey. The three main topics of the Barcelona Process are: (i) Political and Security Partnership, (ii) Economic and Financial Partnership, (iii) Partnership in social, cultural and human affairs. One of the objectives of the Barcelona-Process is to create a Euro-Mediterranean Free-Trade Area (target date: 2010). Furthermore, it aims at promoting “South-South”-trade, given the low level of regional integration. The EU has a special programme, MEDA, to finance projects in the Mediterranean countries; to which 3,4 bill. euro were

¹⁰ For an overview of the Barcelona-Process see European Commission (2000a).

allocated 1995-1999 and 5,35 bill. euro for 2000-2006. Furthermore, loans from the European Investment Bank (EIB) are an important source of financial assistance to Mediterranean countries (EUR 7.4 billion available for 2000-2006). According to most analysts, the Barcelona-Process has not fulfilled expectations so far, which is e.g. reflected by the low rate of disbursements from the MEDA programme (26% of the amount committed 1995-1999), the slow progress in setting in force Association Agreements and the difficulties encountered in drafting a regional Charter for Stability and Security. The heterogeneity of the 12 partners involved in the process both in political and economic terms is a major problem. Moreover, the unresolved Middle East conflict is an impediment for the Euro-Mediterranean dialogue. The Barcelona-Process is, however, the only framework so far, where Israeli, Syrian and Lebanese officials meet at ministerial level. Currently the EU plans to revitalise the Euro-Mediterranean partnership (European Commission 2000b 2ff), which has been one of the objectives of the Fourth Euro-Mediterranean Conference of Foreign Ministers held in Marseille in November 2000.

- Economic links: Economic ties between the euro area and MENA as a whole and with most of its countries are intense. Looking at the institutional side, EU-Association agreements have entered into force with 4 Mediterranean countries (Tunisia, Israel, Morocco, Palestinian Territories), agreements with 2 countries (Egypt, Jordan) have been concluded, but not ratified yet, and negotiations on Association agreements have been launched with another 3 countries (Algeria, Lebanon, Syria). Furthermore, the EU has a cooperation agreement with the Gulf Cooperation Council since 1989.

Given the focus of this paper, the economic and financial ties between the euro area and MENA are investigated in more detail here, focusing on trade, bank claims and FDI. The following stylised facts emerge:

- The euro area-MENA relationship is characterised by an asymmetry: While the euro area is the major partner for MENA as a whole and for most of its countries, MENA's importance for the euro area is limited. This asymmetry, which can also be observed for the other ETZ regions, reflects the different economic weight of the two areas, underpinning the concept of the ETZ as the region gravitating around the euro area.
- The relatively largest relevance of MENA for the euro area lies in its role as a trade partner; nevertheless with 6.9% its overall share in euro area foreign trade only slightly exceeds that of Switzerland, and is lower than the share of EU accession countries. Bank exposure and FDI flows are not significant from a euro area perspective.

- Economic links to the euro area are much stronger than ties with the US for MENA as a whole and for most countries.
- A distinction can be made within MENA between the Mediterranean countries and the Arab Peninsula. Mediterranean countries are in many respects closer to the euro area than countries on the Arab Peninsula. For the latter ties to the US and to Asia are important as well, besides those to the euro area.

Key countries in the region are Egypt, Israel, Saudi Arabia, the Maghreb countries Algeria, Morocco and Tunisia, and Iran. Egypt is the largest Arab country and traditionally a leader in the Arab world. Israel is by far the economically most advanced country and the euro area's most important trade partner in the region. Saudi Arabia is the world's biggest oil producer and the only country of the region in the G 20. The Maghreb countries have particularly close economic ties to the euro area. With 63 million people, Iran has the largest population in the region besides Egypt, is an important oil producer and a country with traditionally close ties to Europe.

4.2.1. Trade

Looking at individual MENA countries' trade with the euro area and comparing these data with those for the US and with intra-regional trade, the importance of the euro area as a trade partner, while generally high and exceeding that of the US, varies considerably among individual countries (Table 6).

The ranking in Table 7 allows to identify 3 groups of countries, which exhibit a clear geographical pattern:

- Countries with an overwhelming orientation to the euro area. (> 50). These are the North African countries (Algeria, Libya, Morocco, Tunisia), whose trade links with the euro area are even closer than those of some member countries with the euro area itself (e.g. 44% of German exports go to and 43% of imports come from the euro area). Within the ETZ, only accession countries and some Balkan countries have similarly close trade relations with the euro area.
- Countries for whom the euro area is clearly the dominant trading partner (30-50). This group includes the countries in the Eastern Mediterranean (Egypt, Lebanon, Israel, Syria) and Iran and Iraq.
- Countries with less intensive trade links (< 30), namely the countries on the Arab Peninsula and Jordan.

Reversing the perspective by ranking MENA countries with regard to their importance as trade partners for the euro area also shows interesting results (Table 8).

The euro area's importance to MENA countries as a trade partner is reflected by the euro area's trade share (Table 7).

Table 6: MENA countries' trade with the euro area, MENA and the US

Country	Exports to euro area	Imports from euro area	Exports to MENA	Imports from MENA	Exports to USA	Imports from USA
Algeria	59	59	1	2	15	5
Bahrain	2.5	34	8	13	3	14
Egypt	32	30	18	6	12	14
Iran	28	33	5	8	0	0
Iraq	36.5	40	n.a.	7	n.a.	1.5
Israel	23	37	0.5	0.2	35.5	20
Jordan	9	30	36	13	2	9
Kuwait	12	24	1	15	14	12
Lebanon	16	46	41	11	6	7
Libya	81	53	4	12.5	0	0
Morocco	58	57	3.5	5	5	5
Oman	0.5	16	18	34.5	1	6
Qatar	3	24	4	13	4	10.5
S. Arabia	14	23	11	7.5	17	19
Syria	53	32	25	6	2.5	3.5
Tunisia	80	71	6	5	0.5	3.5
U.A.E.	4	25	11	8	2	9
Yemen	1	22	4	23	1	7

Exports and imports in percent of a country's overall exports/imports 1999.

Without Palestinian Territories, euro area includes Greece here and in the following tables on trade.

Source: IMF DOTS, own calculations

Table 7: Importance of euro area as trade partner to MENA countries
(Euro area trade share 1999*)

Country	Euro area trade share
Tunisia	75.5
Libya	67
Algeria	59
Morocco	57.5
Syria	42.5
Iraq	38
Egypt	31
Lebanon	31
Iran	30.5
Israel	30
Jordan	19.5
Saudi Arabia	18.5
Bahrain	18
Kuwait	18
U.A.E.	14.5
Qatar	13.5
Yemen	11.5
Oman	8

* Trade share: Export share + import share (sum of columns 2 and 3 in table 6), divided by two. Without Palestinian Territories

Source: IMF DOTS, own calculations

Table 8: Importance of individual MENA countries as trade partner to euro area
(Exports and imports in million US\$ 1999)

Country	Euro area exports to ...	Euro area imports from ...	Exports+Imports
Israel	11,574	6,048	17,622
Tunisia	7,194	5,801	12,995
Algeria	5,726	7,215	12,941
Saudi Arabia	6,507	6,421	12,928
Morocco	6,731	4,711	11,442
U.A.E.	8,235	1,070	9,305
Libya	2,278	6,391	8,669
Iran	3,900	4,236	8,136
Egypt	4,762	1,139	5,901
Iraq	610	3,194	3,804
Syria	1,695	1,923	3,618
Kuwait	1,796	1,228	3,024
Lebanon	2,642	128	2,770
Jordan	1,128	114	1,242
Bahrain	947	175	1,122
Qatar	904	165	1,069
Oman	734	40	774
Yemen	573	19	592

Without Palestinian Territories

Source: IMF DOTS, own calculations

The five most important trading partners are Israel, Tunisia, Algeria, Saudi Arabia and Morocco. Israel's leading position is remarkable and reflects the country's high GDP per capita compared to the region, in combination with its EU Association. Israel has a particularly outstanding position as the euro area's most important export market in the region, making up 17% of all euro area exports to MENA. Its share in euro area overall exports is, nevertheless, small with roughly 1%. This points to the fact that, from an euro area perspective, MENA as a whole plays only a limited role as a trading partner (Box 1).

Box 1: MENA share in euro area overall trade

MENA share in euro area exports: 7,7%
MENA share in euro area imports: 6,1%

The low level of regional integration in MENA is clearly mirrored in the region's intra-regional trade figures, if they are compared to trade with the euro area and the US (Table 9). Only 7% of MENA exports and imports go to or come from the region. This is a significantly lower value compared to other regions, e.g. Asia or Latin America (El-Arian, Fischer 1996, 8). For only three MENA countries (Jordan, Lebanon, Oman), the share of intra-regional trade exceeds 20%, for another four countries (Bahrain, Egypt, Syria, Yemen) this share is between 10% and 20%. Israel is the country with least intra-regional trade.¹¹ It is also obvious that the euro area is a far more important trading partner to the region than the US, particularly on the import side.

Table 9: MENA trade with the euro area and the US compared to intra-regional trade
(Exports/imports in percent of overall MENA exports/imports 1999)

	Euro area	US	MENA
MENA exports to ...*	25	12	7
MENA imports from ...**	35	11	7

*Without Iraq and Palestinian Territories

**Without Palestinian Territories

Source: IMF DOTS, own calculations

The relative importance of the euro area grows, if the Arab Peninsula is excluded from MENA (Table 10). Mainly oil is exported from the Arab Peninsula, and the major market for Gulf oil is Asia. Thus, for those countries trade links with Asia are considerably more intense than for the rest of MENA.

¹¹ Derived from data in table 6. As IMF DOTS data are used here for the purpose of comparability, the Palestinian Territories are not included. As, according to Palestinian sources, more than 80% of West Bank and Gaza trade is with Israel, the Palestinian Territories would have the economy most integrated into the region, due to the specific political circumstances. Israel's intra-regional trade would also be slightly higher, although it would not alter the overall picture for this country.

Table 10: MENA without Arab Peninsula: trade with the euro area and the US compared to intra-regional trade
(Exports/imports in percent of overall MENA without Arab Peninsula exports/imports 1999)

	Euro area	US	MENA
MENA exports to ...*	43	14	5
MENA imports from ...**	43	10	5

*Without Iraq and Palestinian Territories

**Without Palestinian Territories

Source: IMF DOTS, own calculations

For this MENA sub-region, the euro area's role as the major trading partner is by far more significant than for the region as a whole. The euro area's share of ex- and imports outpaces that of the US about three-times and four-times, respectively. Intra-regional trade is even somewhat more limited in this sub-region. This is due to the low intra-regional trade share of Israel and the Maghreb countries and the more advanced integration in the framework of the GCC. Saudi Arabian exports make up almost one quarter of MENA overall exports, and 15% of imports. Given Saudi Arabia's relatively low share of exports to the euro area, its exclusion explains the particular dramatic increase in the euro area's share in exports, if MENA without Arab Peninsula is compared to MENA as a whole.

4.2.2. International bank claims

Another crucial link between MENA and the euro area are bank claims. To illustrate this link from a euro area perspective the claims of euro area banks to MENA and individual countries in the region are exhibited and compared with claims of US banks (Table 11). From a MENA perspective it is useful to look at the total bank liabilities of individual countries and the respective shares of euro area and US banks (Table 12).

It is evident that euro area banks are the dominant source of international bank financing for MENA countries, far ahead of US banks, which only play a minor role. This is in line with data for the other regions forming the ETZ. The role of euro area banks is particularly dominant (> 70%) in Syria, Algeria, Tunisia, Morocco and Iran. Two countries, Saudi Arabia and Israel, make up more than half of all US claims. Euro area claims are more evenly distributed in the region, the most important countries being Iran, Saudi Arabia, Morocco, Algeria, Egypt and Israel. From a euro area perspective, with a share of 2.1% of all international bank claims, MENA plays only a minor role. This reflects again the asymmetry in the financial links between the two regions, given the importance of euro area banks as financing source in most countries. For US banks, MENA is almost negligible.

Table 11: Claims of euro area and US banks to MENA

Q1 2000

Claims to ...	Euro area banks		US banks	
	Mill. US\$	% of total claims	Mill. US\$	% of total claims
Algeria	4,715	0.21	228	0.03
Egypt	4,683	0.21	495	0.07
Iran	6,926	0.31	6	0
Iraq	913	0.04	41	0.01
Israel	4,109	0.18	1,580	0.23
Jordan	719	0.03	103	0.02
Kuwait	2,274	0.1	546	0.08
Libya	120	0.01	n.a.	n.a.
Morocco	5,989	0.27	261	0.04
Oman	1,943	0.09	144	0.02
Palestinian Territories	2	0	n.a.	n.a.
Qatar	3,606	0.16	228	0.03
Saudi Arabia	6,467	0.29	3,273	0.48
Syria	498	0.02	0	0
Tunisia	2,486	0.11	115	0.02
U.A.E.	1,839	0.08	266	0.04
Yemen	374	0.02	0	0
Sum: MENA	47,663	2.1	7,286	1.1

No data for Bahrain, Lebanon. Source: BIS, Consolidated International Banking Statistics

Table 12: International bank liabilities of MENA

Q1 2000

Country	Total liabilities, Mill. US\$	To euro area banks, in percent of total	To US banks, in percent of total
Algeria	5,499	85.7	4.1
Egypt	7,315	64.1	6.8
Iran	9,250	74.9	0.06
Iraq	1,382	66.1	3.0
Israel	8,234	49.9	19.2
Jordan	1,247	57.7	8.3
Kuwait	6,174	36.8	8.8
Libya	287	41.8	n.a.
Morocco	7,079	84.6	3.7
Oman	3,455	56.2	4.2
Palestinian Terr.	58	3.5	n.a.
Qatar	6,166	58.5	3.7
Saudi Arabia	17,667	36.6	18.5
Syria	573	86.9	0
Tunisia	2,907	85.5	4.0
U.A.E.	5,758	31.9	4.6
Yemen	739	50.6	0
Sum: MENA	83,790	56.9	8.7

No data for Bahrain, Lebanon. Source: BIS, Consolidated International Banking Statistics

4.2.3. Foreign Direct Investment

Concerning FDI flows to MENA, the respective roles of the euro area and the US are reversed (Table 13).

Table 13: FDI flows to MENA 1995-1999

Mill. ECU

Sub-Region	From euro area	From US	Total inflow
Gulf*	1,155	1,982	8,483
Iran	494	0	193
Israel	750	1,556	2,444
Maghreb**	1,059	1,777	3,622
Mashreq***	120	678	1,217
Sum:	3,578	6,002	15,959

As data availability for individual countries is limited, sub-regions are displayed here.

* Bahrain, Iraq, Kuwait, Oman, Qatar, Saudi-Arabia, U.A.E., Yemen

** Algeria, Morocco, Tunisia

*** Egypt, Jordan, Libya, Syria

Without Lebanon and Palestinian Territories

Source: Eurostat, own calculations

US FDI flows to the region in the observed period exceeded those originating in the euro area. However, with regard to geographic origin of FDI, it should be noted that 5,346 Mill. ECU were invested in the Gulf region from “Pre-in”-EU countries. This explains the comparatively large gap between US plus euro area FDI on the one hand and overall FDI flows to MENA in general and that for the Gulf countries in particular. Looking at the overall sums invested in the region, it becomes evident that MENA so far has not succeeded in attracting significant FDI. E.g. in 1999, South Africa alone has attracted FDI which were almost three times as high as flows to MENA as a whole. It is also worth noting that more than half of all FDI flows to MENA went to the Gulf region. Israel attracted about 15% of FDI. This underlines in particular the weakness of the rest of MENA, including the most populated countries, with regard to FDI.¹²

5. Selected ETZ issues related to the euro

A range of issues concerning the ETZ is of interest from a monetary and financial point of view. Most concern the international role of the euro. For instance, while Europe is MENA’s most important trading partner, this has so far not been reflected by the use of European currencies in trade invoicing. Instead the US-Dollar has been the most widely used currency in bilateral trade (Chauffour, Stemitsiotis 1998, 15ff). Thus there is a great potential for the euro to be increasingly used as invoicing currency in bilateral trade between the euro area and MENA. Another topic of interest is whether the euro will gain ground

¹² For an extensive overview of FDI in MENA see Alessandrini 2000.

as an invoicing currency in intra-regional MENA trade and MENA trade with third countries outside the region. So far, there is no reliable and comprehensive data available on the use of the euro as an invoicing currency since its introduction two years ago. Furthermore, the use of the euro as an investment and financing currency is an important issue. Although the euro area is the major source of financing for e.g. MENA, almost 40% of the region's long term debt (1998) is denominated in US-Dollar. The D-Mark and French franc together make up only 15%, the other national currencies of euro area countries are negligible in this context (World Bank 2000b, 197)¹³.

Other issues of interest are bank exposure and financial stability (of relevance with regard to e.g. Russia, of less relevance with MENA) as well as migration and its economic impact on both the emigrant and immigrant countries. Two issues are discussed in the following in more detail: Monetary and exchange rate policies as they are the core function of central banks, and energy supply and invoicing on commodity markets, as MENA plays a particularly important role in this respect within the ETZ.

5.1. Monetary and exchange rate policies

Given the close economic and financial ties to the euro area, the euro's role in ETZ countries' exchange rate regimes is likely to increase. This role is already evident today. On the whole, 31 out of 81 ETZ countries in the Balkans, the European CIS, MENA and Sub-Saharan Africa manage exchange rate arrangements at present including a reference to the euro.¹⁴ A reference to the euro does not necessarily imply a strong and effective euro orientation in the exchange rate policy of a country; for instance the euro may represent only a small percentage in a currency basket dominated by the US-Dollar (e.g. Israel), or a currency may be formally pegged to the SDR, but de facto follow the US-Dollar (e.g. Saudi Arabia). But also a stronger and effective euro orientation can be observed in many ETZ countries, ranging from euroisation over currency boards based on euro and conventional pegs to managed floats, with the euro as the main reference currency. However, a number of countries, for which the euro area is a more important economic partner than the US, pursue a US-Dollar oriented exchange rate policy (Table 14). This holds particularly true for

¹³ The World Bank's definition of MENA in this statistics is different from that used in this paper; Israel, Kuwait, Qatar and U.A.E. are excluded, while Malta and Djibouti are included by the World Bank. This does not change however, the overall picture.

¹⁴ "These arrangements are mainly a legacy of past links to the former national currencies of the euro area countries. In the future, the euro can be expected to gain further importance as a reference or anchor currency for the more than 80 countries located in what could be called the "European Hemisphere", i.e. the European, Mediterranean and African regions." (Padoa-Schioppa 2000, 24). If the ETZ in a comprehensive sense is observed, the number of regimes with a reference to the euro is 49 out of 103 countries.

MENA, where external anchors are widely spread, with the US-Dollar as the pre-dominant choice (Table 15). Egypt for instance maintains a US-Dollar peg, although trade with the euro area is twice as high as trade with the US.

Pegs to currencies, which only represent a small share of foreign trade, may prove to be problematic. Developments in Argentina in late 2000/early 2001 can serve as an example. However, other determinants than the direction of trade have to be taken into account as well, when choosing an exchange rate anchor: e.g. the invoicing currency of trade and the level as well as the denomination of foreign debt.

Table 14: Exchange rate regimes in selected ETZ countries

Exchange rate regime	Against euro	Against US-Dollar
Currency board	Estonia, Bulgaria	Lithuania
Conventional fixed peg	CFA franc zone,* Macedonia, Morocco (b)	Egypt, Iran, Saudi-Arabia
Crawling pegs	Tunisia (b)	
Crawling bands		Israel (b)
Managed float	Croatia	Algeria, Belarus, Nigeria, Ukraine
Free float	Albania, Armenia, Moldova, Russia, South Africa	

* Special arrangement, see footnote 16.

(b): peg to currency basket, where euro or US-Dollar plays dominant role.

Source: IMF

A possible re-orientation of exchange rate policies in ETZ countries with a growing role of the euro as an anchor currency is an issue of mutual interest for the countries concerned and the euro area. For countries that have pegged their currency to the euro or to a basket with a dominant weight of the euro, the ECB's monetary policy is of immediate interest given its impact on domestic monetary and economic conditions. For the ECB, a growing role of the euro as an anchor currency might e.g. impact the exchange rate channel of monetary transmission (ECB 1999 41 ff.). Furthermore, it might trigger an increasing demand for the euro as a reserve currency.

Two peculiar monetary and exchange rate regimes, which exist in the ETZ, and only in the ETZ, have to be monitored with particular attention:

- euroisation
- special monetary arrangements with euro area authorities (CFA franc zone)

Euroisation as the unilateral introduction of the euro as legal tender, as recently realised in Montenegro and Kosovo, may develop into an option chosen by countries in the ETZ under certain conditions: Given the close ties to the euro area, the euro is the “natural candidate” as a legal tender, if a country in the ETZ comes to the conclusion that introducing a foreign currency is the only option to gain monetary credibility. This option is underpinned by the circulation of banknotes of euro predecessor currencies in several countries, particularly in the Balkans. The prospect of euroisation is enhanced by the fact that many ETZ countries are small, and several of them are politically fragile and in the past have from time to time been confronted with hyper-inflation due to political crises, wars or civil wars. In such an environment, in which it is hardly possible to gain market reputation for a national currency, the introduction of a stable foreign currency as a legal tender might seem to be a viable option to stabilise the domestic economy. Experiences with dollarisation in the Western Hemisphere (Ecuador, El Salvador, Panama) are likely to influence whether euroisation will become more widely spread in the ETZ.¹⁵

Special monetary arrangements with the euro area like the CFA franc zone also deserve particular attention.¹⁶ Given a relatively successful economic performance of the current 14 CFA members, it cannot be ruled out that there will be requests to enlarge this zone to other African countries or to establish similar arrangements elsewhere in the ETZ.

¹⁵ For an overview of the economic implications of dollarization see Berg, Borensztein 2000 3 ff.

¹⁶ This zone comprises 14 members: 8 West African countries –Benin, Burkina Faso, Cote d’Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo-, which form the “Communauté financière de l’Afrique” (CFA), and 6 Central African States –Cameroon, Central African Republic, Chad, the Republic of Congo (Brazzaville), Equatorial Guinea and Gabon, members of the “Coopération financière africaine” (CFA). Two regional central banks issue the currencies, which have the same parity against the French franc (at present 100 CFA franc = 1 French franc). The two African monetary areas are governed by inter-State agreements built on two principles: (i) free capital flows between France and the two CFA franc regions are ensured and exchange control regulations are harmonised; (ii) the French treasury guarantees the convertibility of the CFA franc into French francs through the availability of (in principle) unlimited liquidity in French francs, when required. The guarantee of the French treasury implies that this commitment is of budgetary nature.

Besides exchange rate arrangements, the evolution of monetary policy and monetary policy frameworks in ETZ countries is an interesting issue. Although there is evidence that the trend to greater price stability has also struck roots in most of the ETZ, many countries still exhibit comparatively high inflation rates. In this context, central bank independence is a crucial issue. Central bank independence is a spreading feature of monetary frameworks in industrialised and democratic countries. As many countries in the ETZ are neither industrialised nor fully fledged democracies, the political and institutional environment for central bank independence still has to be developed. (Fry, Julius, Mahadeva, Roger, Sterne 2000, 99f.). It remains to be seen whether the model of the ECB as an independent central bank with a clear mandate for price stability is conducive to sharpening the awareness for the benefits of price stability and central bank independence in the ETZ regions gravitating around the euro area.

Table 15: Exchange rate regimes in MENA

Country	Exchange rate regime
Algeria	Managed float with US-Dollar as main reference currency
Bahrain	Officially peg to SDR with fluctuation band of +/-7.25%, de facto peg to US-Dollar
Egypt	Peg to US-Dollar
Iran	Dual exchange rate, official rate pegged to US-Dollar
Iraq	Peg to US-Dollar
Israel	Crawling fluctuation band (asymmetric band of currently 44%) against currency basket (Units of each currency in basket: USD 0.6698, EUR 0.2493, GBP 0.0453, JPY 7.2411)
Jordan	Officially peg to SDR, de facto peg to US-Dollar
Kuwait	Officially peg to adjustable basket, de facto peg to US-Dollar, fluctuation band of +/-1.5%
Lebanon	Tightly managed float against US-Dollar
Libya	Peg to SDR with wide fluctuation band, de facto managed float with US-Dollar as reference currency
Morocco	Peg to currency basket, composition is not disclosed, euro has likely replaced US-Dollar as most important currency in basket in 1999
Oman	Peg to US-Dollar
Qatar	Officially peg to SDR with fluctuation band of +/-7.25%, de facto peg to US-Dollar
Saudi Arabia	Officially peg to SDR, de facto peg to US-Dollar
Syria	Multiple exchange rate, official rates pegged to US-Dollar
Tunisia	Crawling peg to currency basket, composition is not disclosed, euro likely the most important currency in basket, real exchange rate objective
U.A.E.	Officially peg to SDR with fluctuation band of +/-7.25%, de facto peg to US-Dollar
Yemen	Free float

Source: IMF, Deutsche Bank

As regards monetary policy and its framework, ETZ countries could, to some extent, draw on the experiences of EU accession countries. Some ETZ countries (European CIS, Balkans) are also transition economies, and some of them could at some point in time be granted the status of accession country. But even for those non-European ETZ countries, for whom EU membership is not an option, there seem to be similarities with accession countries regarding the challenges for monetary and exchange rate policy, central bank independence and disinflation (e.g. monetary policy strategy and conduct in the absence of a developed financial market infrastructure, weak banking systems, the choice of external or internal anchors, establishing central bank independence in a difficult institutional environment, gaining central bank credibility without track record).¹⁷

Table 16: Inflation in MENA

Country	Average inflation 1982-1991	Average inflation 1992-1995	Average inflation 1996-1999
Algeria	10.7	27.8	8.0
Bahrain	0.7	1.5	0.7
Egypt	18.4	12.7	5.4
Iran	18.0	33.0	20.2
Iraq	n.a.	n.a.	n.a.
Israel	108.5	11.3	7.7
Jordan	5.4	3.3	3.3
Kuwait	4.0	1.3	1.7
Lebanon	80.2	35.8	5.3
Libya	7.7	16.6	8.5
Morocco	6.8	5.5	1.9
Oman	1.6	0.8	0.0
Palestinian Terr.	n.a.	n.a.	n.a.
Qatar	3.3	1.6	3.7
Saudi Arabia	n.a.	1.5	-0.2
Syria	21.8	9.6	2.1
Tunisia	8.3	5.2	3.3
U.A.E.	4.0	5.1	2.2
Yemen	n.a.	61.8	16.1
<i>Memorandum:</i>			
<i>Africa</i>	<i>19.5</i>	<i>44.0</i>	<i>16.2</i>
<i>Asia</i>	<i>9.7</i>	<i>12.2</i>	<i>5.7</i>
<i>Latin America</i>	<i>163.0</i>	<i>145.3</i>	<i>13.6</i>
<i>USA</i>	<i>4.1</i>	<i>2.9</i>	<i>2.3</i>
<i>Euro area</i>	<i>5.4</i>	<i>3.5</i>	<i>1.6</i>

Consumer prices.

Source: IMF WEO October 2000

¹⁷ Similarities between Israel and several accession countries regarding the challenges for monetary and exchange rate policies in a process of disinflation are particularly striking (Bufman, Leiderman 1999, 215ff)

When looking at price stability in MENA, it becomes evident that countries have made considerable progress in reducing inflation rates (Table 16). In most countries, average inflation in the past four years is below the rates in previous periods, particularly compared to the 1980s. Two countries, which experienced hyperinflation in the past, Israel and Lebanon, have achieved a remarkable stabilisation. Also Egypt and Syria were successful in bringing down comparatively high inflation rates. The Gulf countries have managed to maintain more or less stable prices over the whole period considered here. In contrast, Iran is a country with a persistently high inflation rate. Also Yemen, Libya and Algeria exhibited relatively high price increases still in the past four years.

5.2. Energy supply and invoicing

The ETZ is crucial with regard to world energy supply (Table 17). Currently, 50% of oil and almost 40% of natural gas production come from three ETZ-regions, MENA, European CIS and Sub-Saharan Africa. Their importance will even increase in future, as more than 75% of proven oil and gas reserves are concentrated in those regions. In contrast, reserves in the major oil and gas consuming regions, North America and Europe, are significantly below their present share of production. For the euro area, it is worth noting that the UK and Norway only command small reserves. These are currently two significant oil and gas suppliers, which are geographically close and politically stable. In the medium term their share in Europe's energy supply will likely decrease and have to be replaced by other sources.

According to EU Commission estimates, the EU's dependence on oil imports, which is already high at 75% of its oil supplies in 2000, is likely to increase further and exceed 85% in 2020.¹⁸ In 2020 40% of the world's oil production will come from the Persian Gulf alone (at present roughly 30%). The bulk of reserves, particularly of oil, is located in the Middle East, with Saudi Arabia alone accounting for 25% of proven reserves. Looking at natural gas, also Russia plays a major role. These data highlight the importance of the ETZ for Europe with regard to energy supply. Political and economic developments in those ETZ regions commanding large reserves of oil and gas will thus increasingly have a crucial impact on world energy prices going beyond the influence they have already today. Therefore they deserve particular attention, as price developments in the euro area are influenced considerably by oil price movements, although to a lesser extent than in the 1970s (ECB 2000, 21ff).

¹⁸ For a detailed analysis of medium- and long-term oil market developments and a proposed strategy of the EU see European Commission 2000c.

Table 17: The role of the ETZ in oil and gas supply

Region	Oil		Natural Gas	
	Production In percent of world total	Reserves In per cent of world total	Production In per cent of world total	Reserves In per cent of world total
MENA	35.4	69.5	12.4	38.5
Russia + European CIS	10.1	6.2	25.0	35.5
Africa (Sub- Sahara)	5.3	3.1	0.5	3.0
ETZ	50.8	78.8	37.9	77.0
<i>Memorandum:</i>				
<i>Europe</i>	<i>9.6</i>	<i>2.0</i>	<i>12.1</i>	<i>3.5</i>
<i>North America*</i>	<i>18.6</i>	<i>6.2</i>	<i>31.8</i>	<i>5.0</i>
<i>South/Central America</i>	<i>9.9</i>	<i>8.6</i>	<i>4.1</i>	<i>4.3</i>
<i>Asia/Pacific</i>	<i>11.1</i>	<i>4.4</i>	<i>14.1</i>	<i>10.2</i>

* including Mexico

Data for end 1999, Reserves: Proved reserves

Source: BP AMOCO, own calculations

The importance of the ETZ with regard to world energy supply is mirrored by the oil export dependency of many ETZ countries (Table 18).

Table 18: Oil export dependency of ETZ countries

Net oil exports in percent of total exports*	Countries
> 90	Nigeria, Libya, Oman
80-89	Angola, Yemen, Kuwait, Rep. of Congo, Saudi Arabia
70-79	Iran, Gabon, Equatorial Guinea,
60-69	Syria, Algeria, Qatar
40-49	United Arab Emirates
30-39	Cameroon
20-29	Bahrain, Russia

* averaged over 1995-97

Source: IMF WEO October 2000

The high, in some cases even extreme, oil export dependency in several ETZ countries however, does not only point to their crucial role as oil supplier. It also exhibits the lack of diversification of their economies, which makes them dependent on oil price movements.

The oil price increase during 1999 and 2000 and its implications for the euro area economy have led to political initiatives at the EU level to intensify

contacts with major energy supplying countries. The European Commission has suggested to set up an ongoing dialogue with OPEC and its principal member states on oil market developments with the goal to achieve stable prices. Most of the important OPEC members are in the ETZ. In addition, energy related issues will likely play an increasing role in EU relations with Russia. At the EU-Russia summit in October 2000, the two sides agreed to develop a “EU-Russia energy partnership”.

A particularly interesting issue that has emerged with the introduction of the single European currency is the invoicing of oil in euro instead of US-Dollar.¹⁹ Recently Iraq decided to replace the US-Dollar by the euro as invoicing currency for its oil exports. This move, although entirely driven by political considerations, has drawn attention to this issue. Two crucial questions arise in this context:

- Under which conditions would major oil producers, particularly Gulf countries, consider a move to invoicing their oil exports in euro?
- What would be the consequences of such a move for the euro area?

As regards the conditions, the network externalities of using only one currency in invoicing oil trade favour the status quo and impede a (partial or complete) switch to the euro. Given these network externalities, a “critical mass” is likely to be required to make such a switch conceivable.

As regards the consequences, oil trade in euro could be potentially advantageous for the euro area, as it could insulate the euro area from the effects of currency fluctuations in the dollar denominated oil price. As experienced in 2000, these effects can exacerbate the effects of rising oil prices. Nevertheless it should be noted that in times of an appreciating euro versus the US-Dollar, the effect of rising oil prices on import prices in the euro area could be dampened. The general effect would depend on the correlation between the dollar-euro exchange rate and the oil price. An analysis of this question is beyond the scope of this paper and could be a topic for future research.

It would be particularly interesting to investigate whether there is a natural “built-in-stabiliser” for the import price movements of a country, whose currency is used as an invoicing currency on oil markets. The reasoning is as follows: Rising oil prices imply a higher demand for the invoicing currency, currently the US-Dollar, as oil importing countries have to pay their increasing bill for oil in that currency, which c.p. tends to appreciate. The effect of such an appreciation tends to compensate partially for the higher import prices resulting from the initial oil price hike. Thus the inflationary impulse would be cushioned

¹⁹ For an overview of this issue see Noreng 1999.

in the country, in whose currency oil trade is invoiced. In this context, it is also suggested that oil proceeds primarily are invested in US-Dollar denominated assets, as investors from oil producing countries, whose currencies are pegged to the US-Dollar, would thereby avoid a currency risk. In times of rising oil prices/revenues this recycling of “petro-dollars” might thus c.p. further strengthen the US currency and add to the “built-in-stabiliser”-effect on import prices. These effects are difficult to quantify however, and may overlap with various other factors determining the exchange rate (IMF 2000e, 31).

A move to invoicing oil, and possibly other commodities, in euro, might also have an impact on the exchange rate regimes of the exporting countries. Currently, the US-Dollar orientation of e.g. the Gulf countries is well explained by the fact that oil revenues, which constitute their main income flow from exports, are invoiced in US-Dollar. An increasing role of the euro as invoicing currency on commodity markets could thus also foster a re-orientation of exchange rate policies particularly in ETZ countries (see section 5.1.).

6. Concluding remarks

This paper highlighted the concept of the ETZ as the zone, which gravitates around the euro area, and for which the euro already is or will likely become the most relevant international currency. Moreover, it described the role of MENA within the ETZ. As the euro area is the world’s leading trade partner and second largest economic area, its single currency is likely to develop a gravitation zone similar to that of the US-Dollar, and traces of such a zone can already be detected. The concept of the ETZ particularly acknowledges that the implications of the euro might be stronger for regions neighbouring Europe like MENA than for the rest of the world. This seems to be the result of a complex interaction of economics, politics, geography and history, which certainly deserves future research. The relevance of the ETZ for the euro area and vice versa should be reflected in a particular attention of policy makers from both sides for developments in the respective regions. The euro could serve as a pole of stability in the economic gravitation centre of the ETZ. Furthermore, access to a large and integrated euro area financial market in their vicinity could be conducive to economic development in ETZ countries. It would then be up to each country to decide - according to its individual economic circumstances - how to make the best use of a stable euro in the different functions of an international currency.

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