The Euro and the Future EU- Arab Countries Trade Relations

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ملخص

اليورو ومستقبل العلاقات التجارية بين الدول العربية والاتحاد الأوروبى

تقدم هذه الورقة تحليلاً شاملاً لنتائج تكوين الاتحاد المالى الأوروبى بعد إدخال اليورو على الاقتصادات المتنوعة وغير المتنوعة فى العالم العربى. وتعالج أيضاً الإمكانيات المتوقعة من تعزيز الاتحاد العربى إضافة للاتحاد التجارى الأوروبى العربى. ويثبت هذا البحث أن الأساليب التجارية الأوروبية العربية السائدة سوف تزداد مع إدخال اليورو. كما أن مدى تأثير إدخال اليورو على كل دولة لن يكون متشابها وسيكون نتيجة لمدى العلاقات التجارية مع منطقة اليورو، إضافة إلى السياسات الاقتصادية الكلية والجزئية المتبعة فى كل دولة، وأخيراً، من الملاحظ أن تأثير إدخال اليورو على الدول العربية المنتجة للبترول سوف يتجسد فى القريب العاجل من خلال قناة الواردات. أما التأثير على الاقتصادات العربية الأكثر تنوعاً، منها التى دخلت باتفاقات تجارية مع الاتحاد الأوروبى أو التى تناقش مثل هذه الاتفاقات، فسوف يتجسد من خلال قنوات الصادرات والواردات معاً.

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1- Introduction

This paper highlights the implications of the introduction of the Euro on a sample of selected Arab countries(1). It aims at a discussion of the trade channel of transmission through which economic integration in the European Union (EU) achieved after the introduction of the Euro will affect the Arab region. It is expected that the Euro position as an international currency will be bound to gradually increase, while the dollar's preeminent position in the region might gradually decline. Competition from the Euro will grow sufficiently stiffer, thereby reducing the monopolistic advantage that the United States (US) might have enjoyed as a source of international money. Undoubtedly, the Euro possesses all the potential to become a leading international currency and challenge the role of the Dollar in the world goods markets in general and the Arab region in particular, which started with the Bretton Woods Conference of 1944.

The Arab region is particularly poised to benefit from the European Monetary Union (EMU). This is not only due to geographical proximity but also to extensive cultural and trade relationships. The Arab region is composed of two heterogeneous groups of countries: The first with a concentrated export and production structures (Oil-Producing Arab Countries), while the second enjoys a more diversified structure (Non-Oil Producing Arab Countries). Thus, the implications of the introduction of the Euro will vary across Arab countries depending on each country's trade patterns, and factor endowments.

The EU-Arab trade relations have historically rested on a model of comparative advantage, whereby the EU has mainly supplied the Arab region with capital-intensive goods while the Arab region has specialized in land and labor intensive goods. This paper argues that these current trade arrangements are expected to prevail in the region even after the introduction of the Euro in January 2002, and the Barcelona Declaration of

1995, which envisaged the creation of a Free Trade Area (FTA) of mutual trade, economical and financial cooperation. Moreover, the creation of a single market in Europe is expected to stimulate its GDP growth rate. This will impact positively on the Arab region as the EU begins to consume more imports from the region. It will thus be argued that EU-Arab trade will intensify after the adoption of the Euro.

This paper is divided as follows. The Second Section outlines the EU-Arab current trade agreements and relationships. Section 3 discusses the impact of enhanced Arab trade integration with the EU. The Arab region and the prospects for enhanced trade integration are discussed in Section 4. Section 5 explores the implications of the introduction of the Euro on EU-Arab trade relationships. Section 6 concludes the main findings of the paper and offers some policy recommendations.

2- Overview of EU-Arab Countries Trade Patterns and Agreements

Since the early 1970s the EU has been engaged in financial and trade co-operation agreements with Arab countries. This is not only justified by geographical proximity but also by the long and extensive trade and cultural relationships. These agreements had duration of five years and provided unilateral trade concessions by the EU to mainly non-oil producing Arab countries. This framework of co-operation was substantially altered with the Barcelona Conference in 1995(2). The EU on one hand and Egypt, Lebanon, Syria, Jordan, and the Palestinian Authority on the other signed the Barcelona Declaration in 1995. One main feature of the agreement is to establish an integrated Euro-Arab region of mutual economic co-operation. One of the prominent features of Barcelona is to create a Free Trade Area(3) by the year 2010 that will promote trade flows in the region, as countries will lift obstacles to trade. Already concluded agreements are with Jordan, and the Palestinian Authority, signed in 1997, and with Lebanon signed in 2002. Negotiations are still taking place with Egypt, while preparatory talks have begun with Syria[4].

It should be emphasized that these trade agreements and the establishment of a free trade area have been concluded with non-oil producing Arab countries. Although, EU trade with oil-producing Arab countries, mainly countries of the Gulf Co-operation Council (GCC),[5] has been extensive over the last decade, no trade negotiations or agreements are under way. This is perhaps due to the fact that trade in these countries relies, and to a great extent, on the export of oil, which is not the case in the remaining Arab countries that mainly export primary and agricultural products. The heavy reliance of non-oil producing Arab countries on trade with the EU has prompted these countries to undertake early negotiations with the EU and the Barcelona declaration is one by-product. The establishment of the Free Trade Area, it is hoped, will bring about extensive trade and enhanced growth in these countries which have a weak export structure, and rely heavily on the EU for an extensive range of consumers and industrial products. For oil-producing Arab countries the scenario is quite different. These countries have been providing oil and oil-related raw materials and goods to the EU and US in exchange for finished goods. Although, these countries import about 50 percent of their goods from the EU, the need to enter into trade negotiations with the EU with the objective of creating a free trade area is not urgent. There is, therefore, no pressing need to remove tariffs and trade barriers and enhance integration with the EU in the foreseeable future. In fact, many GCC countries have started to diversify their production structure and are increasingly relying on import substitution policies, whereby, innovations are well under-way since the early 1990s in many industrial sectors. Saudi Arabia, for example, has started to rely less and less on the imports of industrial goods from the West. Saudi products have fared well on the domestic and regional levels but have not yet competed with EU products. Whether they can withstand EU competition is yet to be determined, and this trend is expected to continue and intensify in the future. It is expected that the EU-Arab trade integration will not have the same implications on oil-producing and non-oil producing Arab countries at least in the coming few years. However, increased integration in Europe is expected to lead to an intensification of trade and financial relations with all Arab countries whether oil or non-oil producing countries.

3- The Impact of Enhanced Arab Trade Integration With the EU

The diversified Arab economies will benefit from trade liberalization with the EU in various aspects. The trade literature during the last three decades has focused on the advantages and disadvantages of adopting free trade policies. Edwards (1989) shows that trade liberalization policies have generally been more successful in solving unemployment problems in many Less Developed Countries than interventionist policies. He argues that higher tariffs tend to affect negatively economic performance because of their distortionary effects. Moreover, lower tariffs contribute in reducing domestic inflation and lower interest rates if they are above world rates. Balassa (1978, 1982) argues that trade liberalization, through lower tariffs, has a positive effect on output. Taylor (1993b) stresses the importance of an equal income distribution and wealth in improving economic efficiency. He explores the correlation between the degree of economic openness and growth and finds that the higher the openness of an economy the higher its GDP growth rate. Feder (1983) and Tyler (1981) explore whether an increase in exports leads to higher growth rates in GDP. The results of their estimations indicate a positive and significant relationship between exports and growth. Keesing (1979), Balassa (1980) and Krueger (1981) have argued that countries with trade promotion policies have performed much better in terms of growth, employment and adjustments to external disturbances, than those that have engaged in more inward - looking trade policies. Liberalization was promoted through incentives for exports production and import substitution policies. Also, after trade liberalization the domestic balance of payment may improve, even though the current account deficit widens and external debt deteriorates. The IMF has argued that rapid trade liberalization coupled with currency devaluation, privatization and financial reform is the most reasonable strategy to achieve growth and economic stability[(6)].

However, with the gradual dismantling of tariffs, quotas, and other trade barriers and the phasing out of various forms of protection, both the industrial and agricultural sectors in the Arab region will suffer from increased EU competition and some firms operating in these sectors might be forced to exit the market in the short run. Subsequently, the area could experience increases in the rates of unemployment and lower GDP growth rates. Dornbusch (1992, pp. 81-82) argued: "the elimination of obstacles to trade invariably creates an immediate increase in imports [(7)]. But… the beneficial rise in exports and growth do not happen immediately." Mansoorian and Neaime (2000) have explored the effects of trade liberalization on the current account. It is shown that immediately after a decrease in tariffs a country will experience a sharp increase in expenditures, and a current account deficit. But this deterioration in the current account will be short lived, as there will come a time after which the country will start running a current account surplus. Moreover, there will also be considerable adjustment costs due to the reduction in tariff revenues and slower GDP growth stemming from the liberalization of the current account in the Arab region. In Lebanon, for example, tariff revenues alone amount to 40 percent of total government revenues and any attempt to liberalize the current account will worsen the already critical deficit problems and may lead to macroeconomic imbalances.

These economic costs could well spur and cause disturbances on the social and economical levels. One way to get around these problems would be for Arab countries, which are now heavily dependent on tariff revenues, to start seeking alternative sources of revenues. They should mainly rely more on income taxes and taxes on capital gains, so that these revenues would constitute one alternative to the lost revenues due to liberalization. Moreover, Arab governments and instead of collecting tariff revenues from foreign importers, can shift the tax burden onto domestic residents by lowering tariffs and custom duties and raising domestic taxes on goods and services. One example is the Value-Added Tax (VAT), which is somehow absent in many Arab countries. Its introduction requires, however, a major fiscal reform, which could prove to be unpopular and painful. Lebanon has been very active in reforming its taxation system. The value added tax has been introduced in Lebanon in February of 2002. It will allow the Lebanese government to gradually phase out its tariff policy.

Arab countries hope that the loss in tariff revenues, and the higher costs arising from increased unemployment rates and low GDP growth rates, would all be dampened through European Foreign Direct Investment (FDI) to the region and other types of financial assistance.

4- The Arab Region and the Prospects for Enhanced Trade Integration

The Arab region comprises mainly two heterogeneous groups of countries. The first comprises GCC countries which are oil producing countries and where oil exports and oil production dominate their exports and production structures. These countries have relatively higher Gross Domestic Product (GDP) and GDP per capita than countries in the second group, and their external debt is still relatively low and sometime totally absent. The second group of countries in the Arab region comprises mainly the non-oil producing countries. These countries have relatively more diversified economies. They don't rely on the export of one specific commodity but on a wide spectrum of mainly agricultural products. Relative to GCC countries their GDP and GDP per capita are considered low (see Table 1). In Egypt, Syria and Jordan, the per capita GDP has ranged between USD1000 and USD 1500 between 1995-1999 while in Bahrain, Kuwait and the UAE the range is between USD10,000-20,000. Due to their weak export base, and the nature of their production structure, these countries have relied over the years on the imports of more than 80 percent of goods consumed domestically. This led to the accumulation of a sizable foreign debt, which has exerted tremendous pressures on their domestic economies. In Jordan, for example, total debt amounts to about 120 percent of GDP, and Jordanian exports can only cover a small portion of that debt. Syria is also in a similar situation where debt exceeds its GDP (see Table 2).

Table (1): Arab Region: Selected Economic Indicators, 1995-1999

Country	GDP (Millions of USD)				
	1995	1996	1997	1998	1999
Bahrain	5850	6100	6350	6184	6621
Egypt	60457	67380	75605	82710	88964
Jordan	6506	6645	6976	7306	7465
Kuwait	26560	30242	25234	25323	29676
Lebanon	10968	12822	14293	16168	16491
Oman	13785	15258	15579	14162	15634
Qatar	8137	9059	9193	10255	12197
Saudi Arabia	125690	141329	146494	128377	139206
Syria	18659	21406	22775	16043	16820
UAE	42740	47993	49354	47366	52134
Yemen	3657	5167	5611	5992	6772

Table (1): Continued

Country	Population (in Millions)					GDP/ Capita (USD				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Bahrain	0.56	0.58	0.59	0.642	0.665	10483	10705	10891	9630	9956
Egypt	59.23	60.60	62.01	60.70	62.01	963	1066	1168	1360	1430
Jordan	5.44	5.58	5.75	4.75	4.90	1673	1662	1698	1536	1520
Kuwait	1.69	1.68	1.73	2.27	2.25	15738	18207	17461	11150	13160
Lebanon	3.01	3.08	3.20	3.40	3.52	3645	4159	4548	4750	4670
Oman	2.02	2.21	2.30	2.28	2.32	6397	6842	6846	6190	6720
Qatar	0.55	0.56	0.57	0.53	0.55	14850	16235	16157	19020	21890
Saudi Arabia	18.25	18.83	19.48	20.66	21.33	7002	7506	7521	6210	6520
Syria	14.20	14.60	15.00	15.59	16.11	1314	1469	1524	1028	1040
UAE	2.21	2.26	2.31	2.77	2.93	19370	21236	21393	17060	17740
Yemen	15.02	15.67	16.30	17.07	17.67	246	330	344	350	380

Source: UNCTAD, World Investment Report, 1998; Joint Arab Economic Report, 2000; IMF, International Financial Statistics, 2000.

Table (2): Arab Countries External Debt and Debt Related Indicators

Country	Total Debt/ Total Exports			Total Debt/GDP			Total Debt Service/ Total Exports		
	1996	1997	1998	1996	1997	1998	1996	1997	1998
Egypt	173.5	150.4	167.3	0.46	0.38	0.42	12.7	9.7	9.5
Jordan	151.8	149.3	154.7	1.2	1.16	1.15	19.1	16.6	16.4
Lebanon	84.6	98.7	237.9	0.31	0.35	0.27	6.4	14.4	18.7
Oman	44.8	44.8	--	0.22	0.23	0.26	9.9	5.9	--
Syria	327.3	343.1	421.8	1.47	1.25	0.93	3.9	9.3	6.4
Yemen	175.3	104.0	139.0	0.91	0.67	0.80	2.4	2.6	4.2

Source: The World Bank, Global Development Finance, 2000.

On the other hand, trade agreements and free trade within the Arab region are still very far from being enhanced and promoted. Trade between GCC countries and the remaining Arab countries is still low and in some instances totally absent. Most GCC countries export oil to the North and in exchange import most of their goods and services. These countries have never relied on importing goods from other Arab countries, and to this end they have maintained high tariffs on these goods. As countries like Saudi Arabia and Kuwait started diversifying their production structures and promoting import substitution policies, moving away from trade in oil and oil related products, there was a need to start looking for other Arab markets to market their new semi-industrial products. One area where competition might not be very stiff would of course be in the remaining countries of the Arab region, since competing with the North might not be an easy task.

Furthermore, there is an increased perception on the part of Arab countries to fully liberalize inter-Arab trade and establish an Arab free-trade zone. With the exception of perhaps Lebanon and Egypt, which have started phasing out bilateral tariffs over a period of five years especially on agricultural goods, most barriers to trade and financial flows are still in place in most of the Arab region. This is, however, not the case for GCC countries, which are moving quickly towards increased trade integration. Tariffs have almost been totally abolished and capital is free to flow between those countries. This trend should strengthen and spillover into significant trade flows between GCC countries and the remaining countries of the Arab region. All this when the EU is not doing much to further enhance South-South integration, as a stepping stone for enhanced North-South integration. The partnership agreements have formally endorsed to promote South-South integration but the EU has done nothing to really push it forward. The danger then would be in the FTA, which is emerging in 2010, where instead of having multilateral exchanges only bilateral exchanges will take place and where trade between the North and South will be promoted at the expense of South-South trade. This will then enhance dependency of the South on the North rather than natural and complementary integration. Nonetheless, there is still room for the EU to step in and take a firm stance in fostering and promoting South-South integration if of course its objective from the creation of the FTA in 2010 is cooperation and complementary, and integration between equal partners. And the reason why this has not yet taken place is due to some European concerns that improved South-South integration might endanger the EU's position as the main trading partner.

5- The Implications of the Euro On EU-Arab Trade Relationships

Arab countries rely heavily on trade and have a relatively high degree of trade openness (see Table 3). This is somehow due to the particular factor endowment of the region (rich in oil, poor in water) resulting in considerable oil exports and food imports rather than regular trade. Because of the great reliance of Arab countries on trade whether oil exports or the imports of a wide range of consumer products; the introduction of the Euro will thus have an important impact on the economies of this region.

Table (3): Trade Openness of Arab Countries, 1995-1999

Country	Degree of Openness of Arab Countries: (X+M)/GDP				
	1995	1996	1997	1998	1999
Bahrain	1.35	1.43	1.10	0.90	1.46
Egypt	0.25	0.25	0.23	0.24	0.22
Jordan	0.78	0.87	0.72	0.71	0.68
Kuwait	0.78	0.73	0.90	0.69	0.60
Lebanon	0.67	0.68	0.57	0.48	0.39
Oman	0.74	0.78	0.80	0.71	0.75
Qatar	0.69	0.87	0.92	0.84	0.73
Saudi Arabia	0.62	0.63	0.61	0.54	0.54
Syria	0.47	0.60	0.50	0.42	0.53
UAE	1.05	1.05	1.10	1.35	1.18
Yemen	0.96	0.83	0.76	0.61	0.67

Source: IMF, Direction of Trade Statistics, Yearbook 2000.

The macroeconomic stabilization programs introduced by the Stability and Growth Pact, along with the reduction in government debt and deficits, will all contribute to a higher EU growth rate. In addition, increased integration and enhanced growth within the EU will not only lead to a trade creation effect between the EU and Arab countries, as a result of increased competitiveness within the Euro area, but also to a trade diversion effect. This effect will manifest itself through increased trade between countries of the Euro area, replacing import flows from the rest of the world to the EU. Specifically, industrial goods that used to be imported from the rest of the world for consumption in the EU will now be produced within the Euro area.

Also, in the Arab region, some imports from Japan and the US may well be replaced by imports from the Euro area. As a result of enhanced competition in the EU, Arab imports from the EU will be much cheaper. This trade diversion from goods denominated in yen or US dollars to goods denominated in Euros is expected to further enhance the role of the Euro in international trade between the Arab region and the EU(8). Geographical proximity will also be important in this context. Now Arab countries, will not only have access to low priced high-Tech products, but will also save on transportation costs. Transportation costs are considerably higher from North America and Japan than from the neighboring EU countries. It should be noted that the trade diversion and creation effects would only manifest themselves in the long run. Shifts in trade invoicing might take place, as soon as, 2002 after the establishment of the Euro as the sole currency of the Euro area. Thus, the Arab region will not only experience an increase in its exports to the EU but will be able to import goods from the EU at much lower prices, as a result of improved competition in the EU. Thus, increased EU integration in the goods market is expected to enhance and intensify both Arab imports and exports at the same time.

According to the IMF (1998), in 2010 the impact of an expected 4 percent GDP growth rate in the EU will have a significant impact on growth and trade in Arab Countries. Specifically, Egypt's total exports will increase by four percent while exports in Jordan and Syria will be higher by 2 and 6 percent respectively. In addition, this will be expected to translate into higher GDP growth rates. In Egypt and Jordan, this will contribute to a 0.4 percent increase in the GDP growth rate, and to a 0.8 percent in Syria (see Table 4).

Table (4): Effects of a 1 Percent Higher Output in the Euro Area on Selected Arab Countries

Percent	Exports to the EU (As share of Total Exports, 1996)	Total Exports (As Share of GDP, 1996)	Change in Total Exports Caused by 1 Percent Higher GDP Growth Rate in the EU	Change in Total Output Caused by 1 Percent Higher GDP Growth Rate in the EU
Egypt	39.6	8.1	1.0	0.1
Jordan	7.7	18.0	0.5	0.1
Syria	53.1	21.5	1.5	0.4

Source: IMF, Direction of Trade Statistics and World Economic Outlook, columns 1 and 2 , and T. Heliodoro and R. Feldmann, Selected Transition and Mediterranean Countries: An Institution Primer on EMU and EU Relations, Occasional Paper (IMF, 1998) for columns 3 and 4.

Thus, increased growth and prosperity in Europe will be expected to spillover to Arab countries as Europeans begin to consume more exports, as well as, domestic goods. The Arab region is particularly poised to benefit from this geographic proximity for a number of reasons. Historically, The Arab region has had strong trade and cultural ties with the EU. Existing trade patterns point significantly in this direction, where on average more than 45 percent of Arab trade is with Europe (see Table 5). Egypt, Lebanon and Qatar import about 40 percent of their total imports from the EU, while Saudi Arabia, the UAE, Kuwait, and Jordan import about 35 percent of their total imports from the EU. Also, Syria and Egypt export about 50 percent of their total exports to the EU. The story is quite different when one considers Arab trade with the US.

Table (5): Euro-Arab Countries Trade Patterns

Country	Exports to EU (Millions of USD)					Imports from EU (Millions of USD)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Bahrain	126	74	236	313	248	718	772	833	834	1207
Egypt	1577	1613	1621	1196	1237	4563	4711	5031	5978	5728
Jordan	90	122	179	161	151	1227	1359	1453	1372	1416
Kuwait	26	1804	1504	1254	1427	2962	2676	2584	2590	2322
Lebanon	162	205	163	183	157	3205	3293	3539	3276	3025
Oman	53	93	112	148	124	1186	1158	1282	1660	1134
Qatar	48	46	54	120	202	651	1600	1316	1641	1230
Saudi Arabia	9977	11345	11622	7280	7899	9784	9579	9646	9800	9391
Syria	2262	2442	2101	1455	2050	1620	1726	1269	1269	1911
UAE	921	1117	1448	1601	2073	6894	6829	6992	8065	11168
Yemen	21	154	202	88	24	364	522	423	546	735

Country	Exports to EU %					Imports from EU %				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Bahrain	3.03	1.61	8.49	11.38	3.61	19.32	18.86	19.95	29.46	43.06
Egypt	45.83	45.64	41.48	37.43	34.99	38.87	36.19	38.21	36.28	35.89
Jordan	6.24	8.32	14.79	1.68	12.05	33.52	31.66	38.38	34.21	37.35
Kuwait	0.20	13.22	10.46	14.07	14.07	38.12	31.96	31.46	30.06	30.49
Lebanon	2.30	17.78	2.29	2.56	2.01	48.05	43.56	47.47	46.40	52.79
Oman	0.89	1.29	1.50	2.75	1.75	27.89	25.15	25.53	29.22	19.99
Qatar	1.30	1.03	0.97	2.43	3.29	33.75	47.02	45.82	44.15	44.23
Saudi Arabia	19.95	18.69	19.16	18.80	16.69	35.64	34.50	33.86	32.65	33.50
Syria	56.98	32.41	28.84	50.35	56.32	34.40	32.37	31.50	32.58	35.83
UAE	3.83	4.04	4.63	6.20	7.30	32.85	30.17	30.44	32.61	33.80
Yemen	1.08	6.38	8.15	5.88	1.22	23.07	28.19	23.41	25.20	28.41

Source: IMF, Direction of Trade Statistics, Yearbook 2000.

According to Table 6, the US accounts for only about 12 percent of Arab trade. With the exception of perhaps oil producing Arab countries, trade with the US does not exceed the 10 percent range. It is, however, a little higher for countries like Kuwait, Saudi Arabia, and Bahrain.

This can be explained by the fact that cultural and social ties between GCC countries and the EU are not extensive. On the contrary, these countries are more inclined to do business with the US, and have extensively relied on the US for various industrial goods and military hardware. The wisdom of enhanced trade relations between the US and the GCC countries is expected to be seriously challenged after the creation of the EU integrated goods market. Geographical proximity is not the only factor justifying this, but also increased integration within the EU and improved competition might render EU goods more attractive than US products.

Table (6): US-Arab Countries Trade Patterns

Country	Exports to US (Millions of USD)					Imports from US (Millions of USD)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Bahrain	131	107	115	154	215	303	273	446	293	394
Egypt	522	460	447	390	436	2211	2609	1720	2074	2296
Jordan	21	19	24	16	28	343	416	443	388	333
Kuwait	31	1620	1816	1337	1410	1254	1398	1124	1329	936
Lebanon	21	33	44	47	48	649	825	685	660	418
Oman	195	332	116	87	87	276	345	403	399	300
Qatar	90	148	153	216	264	204	388	319	390	171
Saudi Arabia	8476	10674	9252	6332	7940	5863	6081	6392	6404	5309
Syria	36	15	14	16	87	319	390	261	186	187
UAE	441	489	877	644	670	1763	2494	2590	2493	2948
Yemen	5	3	4	41	18	121	140	134	125	180

Country	Exports to EU (% of total)					Imports from EU (% of total)				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
Bahrain	3.15	2.33	4.14	5.60	3.13	8.15	6.67	10.68	10.35	14.06
Egypt	15.17	13.02	11.44	12.21	12.33	18.83	20.04	13.06	12.59	14.38
Jordan	1.46	1.30	1.98	0.17	2.23	9.37	9.69	11.70	9.67	8.78
Kuwait	0.24	11.87	12.63	15.00	13.90	16.14	16.69	13.68	15.42	12.29
Lebanon	0.30	2.86	0.62	0.66	0.61	9.73	10.91	9.19	9.35	7.29
Oman	3.27	4.60	1.55	1.62	1.23	6.49	7.49	8.03	7.02	5.29
Qatar	2.45	3.31	2.74	4.37	4.31	10.58	11.40	11.11	10.49	6.15
Saudi Arabia	16.95	17.59	15.25	16.35	16.77	21.36	21.90	22.44	21.34	18.94
Syria	0.91	0.20	0.19	0.55	2.39	6.77	7.31	6.48	4.78	3.51
UAE	1.83	1.77	2.81	2.50	2.36	8.40	11.02	11.28	10.08	8.92
Yemen	0.26	0.12	0.16	2.74	0.92	7.67	7.56	7.42	5.77	6.96

Source: IMF, Direction of Trade Statistics, Yearbook 2000.

GCC countries account for 24 percent of the world production of oil and export 40 percent of total oil exports. In 1995, per capita GCC income ranged between USD 4,950 in Oman, and USD 22,110 in Kuwait, compared to USD 5,148, the world average per capita income. These countries export mainly oil and oil related products but import a wide range of commodities. Thus, international trade in GCC countries can be characterized by a high concentration in exports and a very diversified import structure. GCC oil exports are channeled primarily to industrial countries and the scarcity of oil in EU countries has rendered these countries the main destination of these exports. In 1996, for example, total EU oil imports form GCC countries averaged USD 31.8 billion. After the year 2002, GCC countries will have to pay for their EU imports in Euros and in order to minimize the exchange rate risk, GCC countries will have to earn an equivalent Euro amount from their exports to the EU.

Table (7): GCC Countries Direction of Foreign Trade, 1999

GCC	United States	Japan	Europe	Total
Imports (in percent)	16	9	32	57
Exports (in percent)	10	24	11	45
Imports (US$ millions)	13714	7953	27916	49583
Exports (US$ millions)	11361	27459	13159	51979

Source: IMF, Direction of Trade Statistics, 2000.

The impact of the introduction of the Euro on GCC trade will not be homogeneous across GCC imports and exports. Table 7 indicates that in 1999 nearly 57 percent of GCC countries imports are from the three main trading partners: the EU, the US and Japan, and 45 percent of GCC total exports are destined to these countries. In fact, 32 percent of GCC imports are from the EU compared to 9 percent from Japan and 16 percent from the US. It is, thus, expected that the impact of the Euro on GCC countries will mainly manifest itself through the import channel. Moreover, in between the period 1997-1999, GCC countries have accumulated on average a trade surplus with Japan ($12.3billion), a moderate deficit with the US ($0.9 billion) but have accumulated a significant deficit with the EU ($23.1 billion) (see Tables 8, 9 and 10). Thus, although GCC countries will receive Euros in exchange for their EU exports, they will not be able to reduce the exchange rate risk, since their EU exports account for only 47 percent of their total imports from the EU.(9)

Table (8): GCC Countries Trade Balance with the US

Country	Exports to US			Imports to US			Trade Balance		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
Bahrain	115	154	215	446	293	394	-331	-139	-179
Kuwait	1816	1337	1410	1124	1329	936	692	8	474
Oman	116	87	87	403	399	300	-287	-312	-213
Qatar	153	216	264	319	390	171	-166	-174	93
Saudi Arabia	9252	6332	7940	6392	6404	5309	2860	-72	2631
UAE	877	644	670	2590	2493	2948	-1713	-1849	-2278
Total	12343	8786	10673	11535	11494	10245	1055	-2538	528

Source: IMF, Direction of Trade Statistics, 2000.
Note: (-) indicates deficit.

Table (9): GCC Countries Trade Balance with Japan

Country	Exports to Japan			Imports from Japan			Trade Balance		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
Bahrain	12382	225	179	2545.5	208	324	9836.5	17	-145
Kuwait	11961	2135	2783	3087	1171	975	8874	964	1808
Oman	3734	986	1641	655	894	712	2780	92	929
Qatar	3031	2532	3126	381	590	248	2651	1942	2878
Saudi Arabia	1842	5786	7631	743	2581	2578	1100	3205	5053
UAE	33363	7583	8089	7901	2606	2786	25463	4977	5303
Total	12382	19256	23470	2545.5	8205	7795	9836.5	11197	15826

Source: IMF, Direction of Trade Statistics, 2000.
Note: (-) indicates deficit.

Table (10): GCC Countries Trade Balance with the EU

Country	Exports to US			Imports to US			Trade Balance		
	1997	1998	1999	1997	1998	1999	1997	1998	1999
Bahrain	235	313	248	832	834	1207	-599	-521	-959
Kuwait	1496	1254	1427	2755	2590	2322	-1259	-1336	-895
Oman	196	148	124	1631	1660	1134	-1435	-1512	-1010
Qatar	54	120	202	2506	1641	1230	-2452	-1521	-1028
Saudi Arabia	11065	7280	7899	16083	9800	9391	-5018	-2520	-1492
UAE	14471	10716	11973	33377	24590	26452	-18906	-6464	-9095
Total	27517	19831	21873	57184	39474	41736	-29667	-19643	-19863

Source: IMF, Direction of Trade Statistics, 2000.
Note: (-) indicates deficit.

Oil and oil related products dominate GCC's total exports. With the exception of perhaps Saudi Arabia, which started lately to export some industrial products to the EU, most GCC exports are composed of only oil and oil related products. Oil has so far been denominated in Dollars and this has been justified by the fact that the US Dollar minimizes trade transaction costs. Until the year 2005, three years after the Euro becomes legal tender in the Euro area, GCC countries will not be able to undertake any sustainable and strategic move to shift part or most of their oil export denomination to the Euro. In the long run, however, the scenario is quite different. Once the Euro is established as a world prominent currency, GCC countries will have to deal with this important monetary development by seriously considering shifting their oil exports denomination to the Euro. This will be expected to reduce GCC's exchange rate exposure, as these countries will be able to cover half of their EU imports denominated in Euros without having to exchange their respective currencies to the Dollar and then to the Euro. Moreover, GCC countries play an important role in the World Monetary System and the decision to shift the denomination of parts of their oil exports to the Euro is expected to enhance its role as a leading world currency and as a strong competitor to the Dollar. Not to mention of course the fact that it will reduce GCC's exchange and trade transactions costs.

On the other hand, GCC's imports are much more diversified than their exports primarily dominated by oil and oil related products. GCC countries import a wide range of producers and consumers goods, and rely heavily on the West in general, and the EU in particular, for most of their industrial imported products. The EU's share in these imports is significant, and it is expected to become even more significant as a result of the establishment of one integrated goods market. Greater competition resulting from the newly created EU goods and product market will offer GCC countries a much wider range of industrial products at relatively lower prices. It is, thus, expected that GCC-EU trade in Euros will intensify and strengthen over-time.

6- Conclusions and Policy Implications

This paper has shown that the main channel of transmission through which the Euro will affect the Arab region will be the international trade channel. It has argued that existing trade patterns between the Euro area and the Arab region are expected to persist even after the introduction of the Euro, where the Arab region will continue to specialize in labor intensive goods while the EU in industrial products. Yet, even given these present trade patterns, an increase in trade between the two regions is anticipated. This increase in trade flows will be the result of increased growth and prosperity in Europe, which will lead to an increased demand for goods from Arab countries. In addition, the EU-Arab trade integration will not have the same implications on oil-producing and non-oil producing Arab countries at least in the coming few years.

After the introduction of the Euro trade liberalisation of Arab countries with the EU should become a priority. Trade liberalization policies have been more successful in solving unemployment problems in many LDCs than interventionist policies. They have reduced domestic inflation and lowered interest rates, and proved to have a positive impact on output. Also, the higher the openness of an economy the higher its GDP growth rate, and empirically it is shown that there exists a positive and significant relationship between exports and growth, and countries with trade promotion policies have fared much better in terms of growth, employment and adjustments to external disturbances, than those that have engaged in more inward looking trade policies. Thus, increased trade with the EU will widen the Arab countries markets, will enhance their scope of specialization, will remove domestic shortages in capital goods and raw materials, and will enhance the transmission of technological innovations and know-how.

The introduction of the single currency in Europe will not only lead to a trade creation effect between the EU and the Arab region, as a result of increased competitiveness within the Euro area, but will also lead to a trade diversion effect. This effect will manifest itself through increased trade between countries of the Euro area, replacing import flows from the rest of the world to the EU. This trade diversion from goods denominated in Yen or US Dollars to goods denominated in Euros is expected to further nhance the role of the Euro in international trade and trade between the Arab region and the EU. Shifts in trade invoicing might take place as soon as 2002, after the establishment of the Euro as the sole currency of the Euro area. Thus, the Arab region will not only experience an increase in its exports to the EU, but will be able to import goods from the EU at much lower prices as a result of improved competition in the EU. Thus, enhanced

Arab trade agreements and trade relations with Europe may challenge the wisdom of only using the Dollar for international quotes and trade invoicing.

After the year 2002, GCC countries will have to pay for their EU imports in Euros and in order to minimize trade transaction costs, GCC countries will have to earn an equivalent Euro amount from their exports to the EU. In addition, the impact of the introduction of the Euro on GCC trade will not be homogeneous across GCC imports and exports. It will mainly manifest itself through the import channel, particularly since GCC countries have accumulated a significant trade deficit with the EU which is not the case for trade with the US and Japan. These trade deficits are expected to become more significant as a result of the establishment of one EU integrated market. Greater competition resulting from the newly created EU goods and products market will offer GCC countries a wider range of industrial products at relatively lower prices. It is, thus, expected that GCC-EU trade in Euros will intensify and strengthen overtime. Until the year 2005, three years after the Euro becomes legal tender in the Euro area, GCC countries will not be able to undertake any sustainable and strategic move to shift part or most of their oil export denomination to the Euro. In the long run, however, once the Euro is established as a world leading currency alongside the US Dollar, GCC countries will have to deal with this important monetary development by seriously considering shifting their oil exports denomination to the Euro.

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Endnotes

(1) The selected Arab countries which are included in the analysis, are the GCC countries with non-diversified economies: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates, and the Arab countries with more diversified economies: Egypt, Jordan, Lebanon, Syria, and Yemen. The Magherb Arab Countries are not included in the study because of their particular and distinguished trading patterns with the EU from the rest of the Arab world.

(2) The Barcelona Conference is not only limited to creating a free trade area in 2010 but has ambitious plans to expand and strengthen cooperation in social and political fields.

(3) The free trade area restricts free trade only to some products.

(4) Agreements have also been signed with other Arab countries like for example Tunisia in 1995, and Morocco in 1996.

(5) Gulf Cooperation Council Countries are mainly the oil-producing countries: Bahrain, Oman Qatar, Kuwait, Saudi Arabia, and the United Arab Emirates.

(6) See Neaime 2000, for a detailed discussion of trade liberalization and the impact of globalisation and its effects on Third World countries.

(7) This is expected to negatively affect growth in the Arab Region right after liberalization.

(8) The conditions for a currency to play a global role depends on the size of its economy and trade, the absence of exchange controls, its breath, depth, and liquidity, the fundamentals of the economy, and its strength and stability. The size of the Euro area and the depth and liquidity of its financial market makes it a potential rival to the Dollar. It is therefore expected that the Euro will have an increasingly important role in the quotation of raw materials and more specifically oil contracts and oil derivative products. Firms

operating in this region trading with other firms in the Euro area have already been requested to invoice their trading transactions in Euros. In fact, the Euro has presented a structural break in EU-Arab trade invoicing practices.

(9) Despite the fact that the US Dollar still constitutes the main denomination of Arab countries foreign exchange reserves, however, after the introduction of the Euro and the resulting enhanced trade flows between the EU and the Arab region, Arab central banks may find it more attractive to convert major portions of their reserves into Euros. This is expected to reduce trade transaction costs since imports, which are primarily denominated in Euros, are usually covered by revenues from exports and the balance, in case of a deficit, from foreign reserves.