

**INITIAL IMPLICATIONS OF THE INTRODUCTION OF THE  
EUROPEAN COMMON CURRENCY “THE EURO” FOR THE  
ECONOMIES OF THE OIC COUNTRIES**

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The introduction of the Euro, arguably the most important financial event of the decade, is expected to have numerous impacts, which will shape the new financial order in the EU and the world. In view of the EU's weight and proximity to the OIC world, the introduction of the Euro has and will continue to have a notable impact upon the OIC member economies. Of these, the countries with historical and special economic ties with the EU area are the ones that will be influenced the most. This paper examines the implications of the introduction of the Euro on the OIC member countries. It uses a tentative cost-benefit analysis of the means through which the European Monetary Union (EMU) affects OIC countries, in an attempt to envision the overall course and size of the expected impact on them. Most of the anticipated impact will pass through two main—direct and indirect—routes. The direct route relates to the fresh potentials and the new dimensions the Euro's introduction is likely to open to the EU markets. Indirectly, the Euro's impacts on the EU's economy will spillover to affect the world economy at large. The international implications of the EMU will depend mainly on:

1. The extent and direction of the Euro's impact on the economy of the EU.
2. The extent of spillover effects.
3. The characteristics and behaviour of the Euro and the consequences of these on the demand for the Euro as an international currency.

The Euro's impact on non-EU countries depends on individual countries' initial circumstances. This will vary from one country to another, depending on factors such as: the depth of each country's trade and financial links with the Euro area; the degree of its integration in the international capital markets; and the fitness of the financial and economic policies adopted by each country, particularly with regard to debts, interest rates and inflation.

**1. INTRODUCTION**

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This paper looks into the impact of the introduction of the Euro<sup>1</sup> on the OIC member countries' economies. The method used is to identify the economic costs and benefits of the introduction of the Euro to the EU and the OIC countries during the transitional period 1999-2002, and following the circulation of Euro notes and coins, the last step of stage three of the EMU, in 2002. The paper predicts that the introduction of the Euro will have direct (primary) and indirect (secondary) impacts on the OIC economies. The primary impact relates to the services that the Euro is likely to render to these countries. A case in point is the use of the Euro as an alternative international currency for transaction and investment purposes. The indirect impact will occur as virtuous spillovers to the world economy, with the fulfilment of the likely benefits of the Euro on the EU. The EU's external trade and financial market are the main transmission channels through which the bulk of the impact of the introduction of the Euro on the OIC and other countries would be taking place.

The introduction of the Euro will have a significant economic impact on most members of the OIC, as it will on the rest of the world. The extent of these effects will differ among individual countries depending on existing relations of each country with Euro-land. Effects on OIC members that have enjoyed historical links with certain EU countries will follow those countries' stands vis-à-vis the Euro. For example, Euro effects on OIC countries with traditional links with France will differ from those on OIC countries that are linked with the UK. Given the potential for divergence, the bulk of the effects are more likely to follow regional lines. The effect of the Euro on the CFA and the Euro-Mediterranean regions is a typical example of this regional bias.

Thus, the paper will examine the likely effects of the introduction of the Euro on the EU and the rest of the world, by examining the economic and financial impacts of the Euro within the Euro area, the EU and worldwide. This would help delineate the likely impacts of the EMU on the OIC world.

## 2. HISTORY AND CHRONOLOGY OF THE EMU EVENTS

The treaty of Rome<sup>2</sup> (1957), which founded the EEC, included no explicit reference to monetary union among the original six<sup>3</sup>. However, its founders

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<sup>1</sup> The chosen name for the European single currency. It replaces the ECU on a one-to-one basis. At this stage, the Euro is only a bank currency as no Euro notes and coins will be issued until January 2002. Meanwhile, national currencies will coexist with the Euro until they are phased out by June 30, 2002.

<sup>2</sup> Treaty of Rome relates only to the formation of a Customs Union (CU) and provides the basis for a common market in terms of factor mobility.

saw it as a first phase in a process towards full economic and political integration in Europe. Monetary union was envisaged as the final ‘positive integration’ step in that process. Five years after the treaty of Rome, the Commission of the European Community drew up a plan for monetary union. However, the plan was aborted with the collapse of the Bretton Woods fixed exchange rate system of adjustable parities. The idea was revived in the European Monetary System (EMS 1979) which established the ‘exchange-rate mechanism’ (ERM)<sup>4</sup>. The aim of the EMS was to secure monetary stability in Europe.

By the mid 1980s, the EC launched the Single European Act (SEA 1987)<sup>5</sup> with the EU’s single market—*often the internal market*— as its central objective. The *internal market*’s primary aim was to enhance the functioning of the EC’s increasingly integrated markets. Implicit within the SEA, the objective of establishing a single currency recurred as a culmination of the plan. Accordingly, in June 1988, the European Council reaffirmed the EU’s commitment to establish a monetary union in the EU area. The Delors Committee (1989) devised a process in three stages<sup>6</sup> leading to the EMU which was laid down in the Treaty of Maastricht (1991).

The first stage, which started in July 1990, prepared the ground for the EMU. The important developments during this stage were the liberalisation of capital movement and the founding of the internal market amongst EU member states. The questions of fiscal and monetary convergence were also addressed during this stage. The second stage, which began on January 1, 1994, witnessed the setting up of the basic organs and the structure of the EMU institutions. It was also during the second stage that the agreed convergence criteria came into effect. The third stage was initiated on January 1, 1999 with the issuing of the single currency, which marked the beginning of the final stage of the EMU. With that, the exchange rates of the participating members were irrevocably fixed against the Euro and, thus, against one another. In due

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<sup>3</sup> The founding six countries of the EC are Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands, hence the name.

<sup>4</sup> The most important provision of the EMS relates to the so-called parity grid of bilateral exchange rates. Under the ERM, member countries undertake to maintain their exchange rates with each other within  $\pm 2\frac{1}{4}$  per cent of a central exchange rate. The central parities, expressed in the European composite currency (ECU), were set and revised only by the collective decision of the participating members.

<sup>5</sup> The SEA, which came into effect on July 1, 1987, has widened the responsibilities of the EEC role and institutions to include social, environmental, and foreign policies in addition to political and economic co-operation.

<sup>6</sup> The leaders of the EU12 agreed to establish an EMU in three stages, the first of which commenced on July 1, 1990.

time, the EMU institutions became fully operational and assumed the monetary policy of the EMU. At the same time, EMU member states relinquished their right to act independently on monetary policy issues.

On January 1, 1999, the Euro was launched as a single currency in 11 of the 15 EU member states<sup>7</sup>. Thus, the first 11 have unified their monetary and exchange rate policies that have been entrusted to the EU institutions, namely the European System of Central Banks (ESCB)<sup>8</sup> and the European Central Bank (ECB)<sup>9</sup>. On January 1, 1999, the ESCB took on the responsibility of the stability of the new currency<sup>10</sup>. In January 2002, Euro notes and coins will be circulated. The date July 1, 2002 has been set to mark the end of the transition to the Euro, by which time the Euro will have fully replaced the national currencies of the EMU member states.

### 3. THE UNIVERSAL IMPLICATIONS OF THE EMU

The effects of the EMU on the world economy at large, and on the developing world in particular, will depend on two main factors:

The **first** factor is composed of two sub-factors, namely:

- a. The EMU’s effects on the economic performance within the EU and
- b. The extent of spillover effects onto the rest of the world.

In this regard, the monetary and exchange rate policies of the EMU will have a substantial global influence. Besides its general effects, the EMU will bring about more specific effects on the regions and countries with close economic and financial links with the Euro area. This is notably true for most countries in Central and Eastern Europe and the Mediterranean region, and for many countries in Africa.

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<sup>7</sup> Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Britain, Denmark and Sweden have met the EMU joining criterion but chose not to join from the start, while Greece failed to meet the criterion.

<sup>8</sup> The ESCB, which was set up on June 1, 1998, is composed of the ECB and the national central banks of the EMU members, and its primary aim is to maintain price stability in the common monetary area. The Executive Board is responsible for implementing the decisions of the ECB Governing Council and for carrying out the ongoing business operations of the ECB.

<sup>9</sup> The ECB Governing Council, which comprises the members of the Executive Board of the ECB and the governors of the central banks of the Euro-zone, will issue the guidelines and take the decisions needed to perform the tasks of the ESCB, and, in particular, will formulate the single monetary policy. The national central banks, being an integral part of the ESCB, execute the monetary policy of the latter in their respective member states.

<sup>10</sup> Besides the ECB Governing Council, there is also a General Council, as a third decision-making body, in which the central banks of the EU member states, which are not yet participating in the EMU, are also represented.

The **second** factor is the demand for the Euro and the extent to which it will be used as an international currency. EMU domestic policies will have an important bearing on the relative strength of the Euro, but more so on the financial world at large. "The prospective Euro area rivals the United States in terms of output and trade, and the role of the Euro in financial transactions may eventually challenge that of the U.S. dollar." (IMF 1998:123)<sup>11</sup>. In the remaining part of this section, we look into these factors in some detail.

### **3.1. The implications of the Euro within the EMU area and their spillover effects world-wide**

The economic performance in the Euro area will have its largest external effects on neighbouring economies in western Europe, and on developing and transition economies which have important trade and financial links to Europe, including countries linking their currencies to the Euro. The bulk of the effects on non-EU countries would be channelled through the Euro's impact on international trade and capital markets.

The introduction of the Euro is expected to give rise to negative as well as positive effects on the EU economy. The negative effects, as projected, will dominate the short run—i.e. before and for some time after the start of EMU—while payoffs, which will more than make up for the adverse effects, will come at a later stage. The year 2000 is predicted to be the breaking point in this pattern.

#### **3.1.1. The negative effects (The costs of the EMU)**

The costs of the EMU started to accrue for the EU long before the introduction of the Euro in 1999. Some of these are associated with the preparations for the Euro while others relate to the uncertainties created by the project itself.

##### *A. The costs associated with fiscal policy*

The EU's output and employment have been adversely affected by the fiscal tightening applied to meet the targets set in the EMU treaties. In the run-up period to the EMU, the EU's output growth had been rather slow which might not have been the case without the EMU plans. To meet the joining-up

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<sup>11</sup> On April 9, 1999, the ECB took the financial world by surprise by cutting EMU interest rates by 0.5 %. The reduction boosted share prices and economic expectations, not only in the EU, but also in Asian and American markets.

criterion, as drawn by the treaty of Maastricht<sup>12</sup>, EU member countries had to adjust and rectify their budget balances through tight fiscal policy. Further, to address the concern that EMU member countries will not abandon their pre-joining fiscal discipline, the European Council passed, in 1997 in Amsterdam, the ‘Stability and Growth Pact’ (SGP). The SGP adopted the joining-up criteria as continuous targets to ensure the continuity of fiscal discipline in the EMU area after the project has been completed.

### *B. Risk premiums*

Higher risk premiums and thus higher short- and long-term interest rates resulted from the uncertainties associated with the EMU. The lingering uncertainties as regards the performance of the EMU in general and the Euro in particular, even at this later stage, continue to caution the market and dampen expectations. Accordingly, nominal short- and long-term interest rates in the EU are thought to be higher than their psychological growth path. As a result, this might have driven higher the risk premiums on EU interest rates. However, this might also have induced some positive effects by enhancing EU exports and domestic investment spending.

### *C. Investment spending*

The EMU entails extra investment spending on the part of the EU governments and businesses to prepare for the Euro. Governments and businesses are expected to bear the additional investment spending associated with the introduction of the Euro<sup>13</sup>.

Some of these costs have already materialised in the run-up to the EMU while others are continuing. Estimates expect some of the negative effects of the EMU to linger on long after the Euro’s introduction in 1999.

#### ***3.1.2. The positive effects (Expected benefits of the EMU)***

As mentioned earlier, some benefits may have accrued to some EU economies in the run-up period to the EMU. Some national currencies had been weaker

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<sup>12</sup> The criterion provides reference values for general government deficit of 3 percent of GDP, and for general government gross debt of 60 percent of GDP, to be used in judging whether there is sufficient fiscal discipline.

<sup>13</sup> For governments, administrative and operational costs of the EMU’s new institutions, such as the ECB and ESCB and the costs associated with issuing the new Euro. Businesses have to invest to adjust their systems to the Euro.

due to the higher risk premium of the EMU. This may have had a boosting effect on the EU's exports, at least in the short run.

Apart from this, and a few other secondary effects, no substantial gains have accrued to the EU during the earlier stages of the EMU. The main gains of the EMU are expected to occur after the project is fully completed. Hereunder, we give a brief account of the EMU's likely gains.

*A. The EU potential savings*

The EU is expected to realise substantial savings from the elimination of the currency conversion costs and from the reduction of the higher risks associated with the exchange of funds. In the medium term, savings will be made by EU states as a result of the removal of currency conversion costs. That will reduce the risk premiums built in interest rates which are associated with that system. Various studies estimated the transaction costs related with the existence of national currencies in the EU to range between 0.5 to 1.0 of GDP. Such a decline in risk premia could induce a 5 to 10 per cent increase in the EU GDP in the long run (Bekx 1998:4).

*B. The Euro and production and output*

Factor productivity within the EU will increase due to enhanced micro and macro efficiency gains. The former stems from the elimination of exchange rate uncertainty and transaction costs within the EU, thereby stimulating EU trade, and so too its output and income. The latter, macroeconomic stability, is to arise in response to the exchange rate effect as well as the greater fiscal and monetary discipline within the EU. This will help lower the risk premia built into interest rates and thus lead to higher investment.

Over the medium term, supply conditions within the EU will be expected to improve. Triggered by the Euro, production conditions will improve, since EU governments can no longer run large budget deficits (footnote 12). Lower government deficits within the EMU area will minimise the crowding out effect of investment funds, which will help keep interest rates down. Sustaining lower and stable interest rates will boost investment and therefore production and supply. It will also reduce the uncertainty regarding governments' actions and thus further suppress real interest rates. This, in turn, will help improve the business environment and may thus induce a new virtuous cycle of reactions. For these and other reasons, the general view with respect to the response of the output growth to the Euro's introduction is predicted to be positive. Due to these reasons, the general view is that "the



introduction of the Euro will give a substantial growth impetus to the countries of the EU, as real income and output move to a higher level of steady-state” (Bekx 1998:4).

#### *C. The Euro and EU trade*

The introduction of the Euro will have trade creation as well as trade diversion effects. The reduction of transaction costs and the elimination of exchange rate risk within the Euro area, and the other elements linked with the creation of the EMU, will increase competitiveness and thus output and income in the Euro area. The output and income effects of the Euro will boost the import demand of the EU, which will now face increased access to the EU market. In the words of the EC (1996), the creation of the single market amounts to external liberalisation towards non-EU countries, which effect, will now be reinforced and facilitated by the Euro’s introduction.

#### *D. The Euro and capital markets*

The introduction of the Euro will bring about structural improvements in the European capital markets. The European market will become much deeper, more liquid, and more diverse in terms of the range of instruments at hand. The size of the Euro-based capital market is expected to become the second largest in the world in a fairly short time. This will increase the market’s independence margin from the US market, particularly in the determination of interest rates. To cope with the expected rise in activity levels and to contest other markets, the financial infrastructures of the EU market have been modernised. Accordingly, the costs of capital transactions should be expected to fall in the EU market while competition grows intense. This ought to make the EU market more productive. “The Eurobond and Euro shares markets will be revitalised along with the U.S. market reducing capital costs and increasing efficiency in investments.” (Euro-Latin SP/DRE/Di No.26, June 1998).

#### *E. The EMU and factor mobility*

Introduction of the Euro will make price, wage and share comparisons much clearer across EU member states. This will enhance factor mobility and suppress non-economic price differentials. Essentially, these will mean lower inflationary and wage pressures that could be translated in lower production

costs and thus better international competitiveness. It will also facilitate cross-area comparisons between EU companies and share prices.

### 3.2. Demand for the Euro and its implications

Demand for money relates to the services money provides and needs it satisfies. It is sometimes decomposed according to its uses for transactions, investment and speculative demands. Conventional monetary theory delineates three functions for money, namely,

- a medium of exchange,
- a unit of account, and
- a store of value.

The purposes are essentially the same in domestic and international usage but their transmission mechanisms may differ. Internationally, however, a distinction is sometimes made between the public and private uses of money. In line with these conventional functions, an international currency is expected to serve part or all of the functions categorised in Table 1.

<b>Table 1</b>		
<b>The Functions of an International Currency</b>		
<b>Function</b>	<b>Private Sector</b>	<b>Public Sector</b>
<b>Unit of account</b>	Invoicing of foreign trade; international financial transactions; quotation of prices on international markets	Determination of exchange rate relationships
<b>Medium of exchange</b>	Settling of international trade and financial obligation; vehicle currency; substitution currency	Interventions in foreign exchange markets; official flows
<b>Store of value</b>	Denomination of financial instruments	Denomination of official international reserves

Source: Peter Bekx, *Euro Paper*, No.26, July 1998.

To the extent the Euro fulfils all or some of the functions above, it may have an external effect on the non-EU countries by offering them an alternative to the predominant international currency, the dollar. (Bekx 1998:3). Thus, the demand for the Euro too will depend on its ability to fulfil these functions within the EU and abroad.

Accordingly, the fitness of the Euro as a universal currency depends mainly on the following factors:

**First**, the global importance of the EU15, and particularly that of the EMU members;

**Second**, the characteristics of the Euro;

**Third**, the question of policy, which relates to the extent to which EMU institutions and member states are apt to pick and co-ordinate appropriate policies at the different levels within the EU (between area-wide and national institutions). In the following section, we discuss these factors in some detail.

### 3.2.1. *The global importance of the EU*

In 1996, the relative economic weight of the EU matched that of the US and outstripped that of Japan in terms of output and trade (Table 2). The EU is the world's largest economic bloc. In 1997, the EU share in world trade, including intra EU trade, amounted to 33.6 per cent, with the latter taking 20.4 per cent. Thus, the EU's external share in world trade is 13.2 per cent, which is slightly lower than the US's share of 14.3 per cent but far higher than the share of Japan, 6.8 per cent (Table 3)<sup>14</sup>. The EMU is expected to enhance the EU's economic import to feasibly become the first in the world.

	<b>US</b>	<b>EU15</b>	<b>Japan</b>
Relative economic size			
Shares of world GDP, 1996	20.7	20.4	8.0
Shares of world export (ex-intra-EU), 1996	15.2	14.7	6.1
Relative use of currencies <sup>1</sup>			
World trade, 1992	48.0	31.0	5.0
World debt securities, September 1996	37.2	34.5	17.0
Developing country debt, end 1996	50.2	15.8	18.1
Global foreign exchange reserves, end 1995	56.4	25.8	7.1
Foreign exchange transactions, April 1995 <sup>2</sup>	41.5	35.0	12.0

<sup>1</sup> Shares denominated in currency (or currencies) of country (or EU).

<sup>2</sup> Shares adjusted for double counting that arises from the fact that each transaction involves two currencies.

Source: IMF, *World Economic Outlook*, October 1997, p. 71.

The EU is the largest trade partner with the developing world. Table 4 details the distribution of the EU trade worldwide. Around 76.4 per cent of EU trade is with the industrial world, the bulk of which is intra-EU trade (55.7 per cent), while 8.0 and 2.8 per cent are with the US and Japan respectively. The EU's trade with DCs was the second largest after the EU-intra trade with a 22.4 per cent share distributed unevenly between the various regions. In descending order, the shares of the various regions are: Asia 7.6, Europe 7.2,

<sup>14</sup> These shares are simple averages of exports plus imports shares.

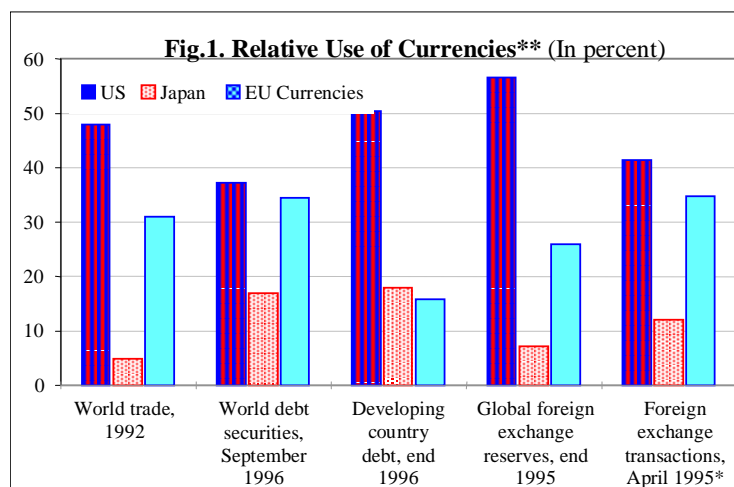
the Western Hemisphere and Africa 2.4 for each, then the Middle East with 2.3 per cent.

Table 3 Directions of International Trade (DOT) in the World in 1997 Shares of the EU, the US, and Japan Compared								
A: In Billions of US dollars								
	World		Industrial World		EU		DCs	
	Exp.'s	Imp's	Exp.'s	Imp's	Exp.'s	Imp's	Exp.'s	Imp's
EU	1873.34	1854.37	1486.23	1413.81	1179.7	1084.7	386.52	439.18
US	687.581	898.66	381.43	477.812	158.7	165.8	305.8	420.85
Japan	421.067	338.65	203.2	152.705	40.6	73.6	217.68	185.53
All three	2981.99	3091.68	2070.84	2044.33	1379	1324.1	910.1	1045.56
Totals <sup>1</sup>	5512.2	5597.6	3618.3	3616.1	2094.1	1517.9	1891.2	1977.2
B: In Percentage terms								
EU of which <sup>2</sup>	34.0	33.1	41.1	39.1	56.3	71.5	20.4	22.2
Intra-EU trade	21.4	19.4	32.6	30.0	56.3	71.5	--	--
exc. Intra-EU	12.6	13.8	8.5	9.1	0.0	0.0	--	--
US	12.5	16.1	10.5	13.2	7.6	10.9	16.2	21.3
Japan	7.6	6.0	5.6	4.2	1.9	4.8	11.5	9.4
All three	54.1	55.2	57.2	56.5	65.9	87.2	48.1	52.9
% of World	100	100	65.6	64.6	38.0	27.1	34.3	35.3

Study calculations, percentages of corresponding categories.

-- Not applicable; DOT: Direction of Trade; Totals: Respective categories totals.

Data Source: IMF, *Direction of Trade Statistics Quarterly*, December 1998.



\* Shares adjusted for double-counting that arises from the fact that each transaction involves two currencies.

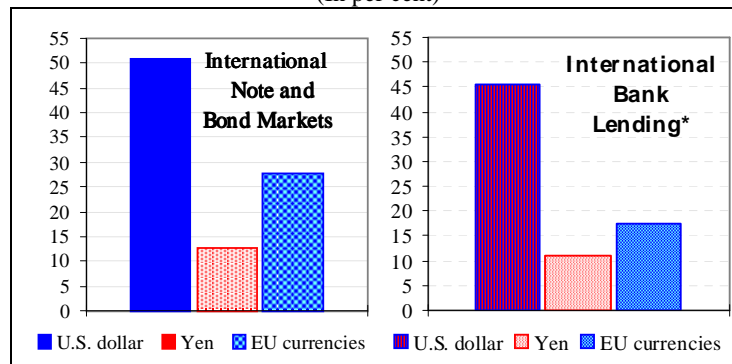
\*\* Shares denominated in currency (or currencies) of country (or EU).

Data Source: IMF, *World Economic Outlook*, October 1997.

With the above weight of the EU in mind, its currencies are under-represented in international transactions. The relative use of the EU existing currencies is disproportionate to its economic importance, especially when compared with the US dollar (figures 1 and 2).

**Fig.2. Currency Composition of International Lending, 1997**

(In per cent)



\* Cross-border claims and local claims in foreign currency of banks located in industrial reporting countries. European Union currencies comprise the Deutsche mark and French franc only.

Data source: IMF, *World Economic Outlook*, October 1998.

	Billions of US dollars			In per cent <sup>1</sup>	
	Exports	Imports	T. Balance	Exports	Imports
DOT world total	2094.1	1968.2	139.1	100.0	100.0
Industrial countries	1585.7	1517.9	67.8	75.7	77.1
US	158.7	165.8	-7.1	7.6	8.4
Japan	40.6	73.6	-33.0	1.9	3.7
Developing countries	476.5	432.2	44.3	22.8	22.0
Africa	46.4	51.8	-5.4	2.2	2.6
Asia	140.9	168.0	-27.1	6.7	8.5
Europe	168.0	123.4	44.6	8.0	6.3
Middle East	67.1	45.8	21.3	3.2	2.3
Western Hemisphere	54.1	43.2	10.9	2.6	2.2
<b>Memorandum items</b>					
EU (Intra-EU)	1179.7	1084.7	95.0	56.3	55.1
Oil exporting countries	58.3	58.7	-0.4	2.8	3.0
Non-oil Developing Cs	418.3	373.5	44.8	20.0	19.0
<b>OIC Countries<sup>2</sup></b>	<b>130.2</b>	<b>111.9</b>	<b>18.3</b>	<b>6.2</b>	<b>5.7</b>

Source: IMF, *Direction of Trade Statistics Quarterly*, December 1998.

<sup>1</sup> Percentages calculated on the basis of the total of each category.

<sup>2</sup> Study calculations.

### 3.2.2. *Characteristics of the Euro*

The relative strength and stability of the Euro will be significant factors in defining an international role for the Euro. A relatively soft and stable Euro has been seen as desirable by the market as it is perceived to be more advantageous for the EU than a strong, rigid and/or volatile Euro. Over the medium to longer term, many other factors point towards a broader role and thus greater demand for the Euro than for current EU currencies. A greater international acceptability for the Euro, and a wider, deeper and more liquid foreign exchange and financial markets represent the factors.

In line with an IMF comment, it is indeed not possible to predict the Euro's behaviour, especially in the short term. However, over a longer time frame, forecasts of the general direction of the Euro's trend are feasible. According to IMF *and others'* predictions, the Euro will tend to appreciate against the US dollar and pound sterling, and to depreciate against the yen over the next few years (IMF 1998:142, 144-145)<sup>15</sup>.

Accordingly, the awaited influence of the Euro as a worldwide currency will, in due time, contest that of the dollar. Compared with the EU's world economic weight, EU currencies are underrepresented in the world financial markets (see figure 1). The Euro—as it takes over as the EU's single currency—will rapidly assume a larger role in international finance, at first, for trade invoicing and investment purposes, and may, at a later stage, be used for reserve purposes.

EMU member countries and institutions are well aware of the prerequisite that, for the Euro to be successful and to contribute to monetary stability in the EU, it must first win confidence at home and abroad. There is consensus and resolve among EMU circles to work towards that end. To secure that, they have settled that members strictly adhere to the following conditions:

1. No interference on the part of EU governments in monetary policy.
2. Full compliance with the provisions of the treaty of Maastricht and the guidelines on fiscal policy laid down in the Stability and Growth Pact.
3. EU countries must resolutely undertake structural reforms, particularly regarding labour markets and problems of unemployment. According to IMF and OECD sources, 80 per cent of the EU unemployment is structural. The Euro will help structural reforms by easing the flow of goods, services and capital within the Euro-zone.

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<sup>15</sup> See also IMF, *Finance and Development*, December 1998, p. 9.



4. Economic policy leaders must be clear-sighted on the crucial question of competitiveness, and co-ordinate fiscal and economic policy.

### ***3.2.3. Questions regarding choice and co-ordination of policy***

The EMU agreements divided economic policy in the EU11 between area-wide institutions, entrusted with monetary and interest rate policies, and national institutions which will keep fiscal and structural policies. As if this arrangement is not complicated enough to co-ordinate, EU members out of the EMU—by option or non-qualifying—are offered the choice to peg their currencies to the Euro by participating in the ERM2<sup>16</sup>. Accordingly, concerns and issues about the choice and the co-ordination of consistent policies across this trilateral system will remain, and may only be addressed through practice. This pragmatic arrangement, as indeed it is, will inevitably inject an element of uncertainty about policy in the EU area. This will, in turn, have a negative effect on the Euro, at least until confidence is established, and that will take some time, perhaps the full length of the transitional term.

### **3.3. Potential uses of the Euro as an international currency**

In line with the predictions of market observers and analysts, the Euro is likely to play a key role in international trade and finance.

#### ***3.3.1. The Euro and international trade: An invoicing currency role***

The US dollar is the dominant trade invoicing currency. Nearly all external trade that is not invoiced in one of each trading partner’s currency is invoiced in US dollars. The internationalisation ratio of the US dollar, defined as the ratio of world exports denominated in dollars to the share of the US in world exports, is more than triple the combined ratio of the top five EU currencies (Bekx 1998). Since the EMU, intra-EU trade has become domestic trade which is to be deducted from the EU external trade and world trade figures. Accordingly, estimates put the Euro’s current share in world trade invoicing around 20 per cent. In EU trade with developing countries, this Euro role will be much higher.

#### ***3.3.2. The Euro and financial markets***

In financial markets, the Euro will be expected to play the following roles:

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<sup>16</sup> ERM2 is a negotiable financial arrangement, similar to the original ERM. However, in ERM2 only EU members out of the EMU may negotiate central parities for their national currencies vis-à-vis the Euro within maximum floatation bands of 15 per cent.

*A. The Euro as a vehicle currency on foreign exchange markets*

Until the early 1980s, the US dollar was the sole vehicle currency. With the establishment of ERM, the deutsche mark (DM) emerged as a second vehicle, particularly in intra-EU markets. The Euro will be expected to succeed the DM in that role. Over the foreseen future, the US dollar will remain dominant at the international level.

*B. The Euro and international portfolio holdings*

The money market of the Euro was born mature and fully integrated. "Most analysts expect international portfolio shifts to take place into the increasingly deep, broad, and liquid Euro market" (Bekx 1998:14). As a result, the international demand for financial assets denominated in Euro, relative to the demand for assets in the constituent currencies, is expected to rise. The stability effects of the stable policy-mix in the EMU area will also add to the attractiveness of these assets. These are likely to produce a stronger demand for Euro assets over time (Bekx op cited).

*C. The Euro and international financing*

The developments in the EU financial markets will enhance efficiency and thus reduce the cost of corporate finance. This will encourage EU companies to opt for corporate finance and away from bank loans. This will reduce the demand for bank credit, which will pressure them to be more efficient. Eventually, the cost of credit will be cheaper in the EU because of this higher competition.

Currently, most non-EU countries' reserves and debts are mainly expressed in dollars and yens. Countries which have an important share of their trade with EU countries will have an incentive to convert part of their reserves and debts into Euros.

*D. The Euro and foreign direct investment*

Both the EU's inward and outward FDI have already undergone a substantial change since the creation of the internal market. The introduction of the Euro will only reinforce that process. The EU's outward FDI will gain from the growth and efficiency dividends at home. However, the same factors will

render investments more attractive at home, which may incite EU’s TNCs and MNCs to relocate their activities at home.

#### 4. THE EMU IMPLICATIONS FOR DEVELOPING AND OIC COUNTRIES

Most of the impact of the Euro's introduction on non-EU countries will be transmitted through its effect on world trade and on capital markets. Thus, the Euro's external effects would be largest on adjacent economies in western Europe, and on developing and transition economies; particularly those with strong trade and finance links with the EU.

The US, Japan and the EU together assume 50.5 and 54.9 per cent of developing and OIC worlds' total trade value (Table 9). Of these, the EU is the largest trade partner with both groups, but far more so with the OIC group. In 1997, the EU total trade with the OIC and the DCs groups was 29.7 and 21.3 per cent as against 12.5 and 18.8 per cent for the US, and 12.8 and 10.5 per cent for Japan respectively (Table 9). The OIC group share in world trade represents a small proportion of these important economic powers by contrast. In 1997, total OIC trade amounted to 7.5 per cent of world trade, about 6 per cent of the EU's total trade and 10 per cent of the DCs total (Table 5). Therefore, the Euro's effect is expected to be one-directional, that is, while policies in the EMU area will definitely affect developing and OIC countries, the reverse scenario is not likely.

	Billions of US dollars			In per cent <sup>1</sup>	
	Exports	Imports	Trade Balance	Exports	Imports
World	442.78	383.49	59.29	7.9	7.0
Industrial world	253.73	230.18	23.55	7.0	6.4
EU	111.9	130.2	-18.3	5.7	6.2
Developing world	234.63	153.67	80.96	11.9	8.1

<sup>1</sup> Percentages are calculated for each category's total.

Source: IMF, *Direction of Trade Statistics Quarterly*, December 1998.

In 1997, the EU's trade with the DCs, as a group, was the second largest after intra-EU trade. However, regional dispersion of the EU-DCs trade was noticeably skewed as regional ranking shows, viz., Asia 7.6, Europe 7.2, Western Hemisphere and Africa 2.4 each and the Middle East with 2.3 per cent. In the EU-OIC case, the order is reversed with the Middle East share largest 2.3, then Africa 1.4, Asia 1.3 and Europe 1.2 per cent. This distinction is notable in the EU-OIC economic co-operation (Table 4).

OIC members, which are party to regional economic groupings such as the Euro-Mediterranean region, Asean, the GCC and CFA franc zone, appear to have strong external links with the EU (Table 8). Asean and GCC OIC members have fairly good links with the US and Japan. In addition, EU-GCC trade is partly made of oil, which is affected by many other factors. Thus, the OIC countries in the Mediterranean region and Africa—particularly in the CFA franc zone—will be the most affected by the Euro. For those with strong affiliation to other economic blocs, the link will moderate the effect of the Euro upon them.

#### **4.1. Trade and output effects of expected gains in EU's output**

The higher expected import demand in the EMU area (discussed earlier) is expected to generate increased demand for DCs exports in general, but more so for countries and regions with particular links to the EU. This is expected to have positive effects on trade and output of these countries. In addition, the financial linkages of the Euro-pegged OIC economies will form another transmission link through which similar economic benefits may be channelled. A rough indication of the first round effects of a 1 per cent rise in the EU GDP on these EU partners' trades and GDPs is thought to range between 0.7-1.6 per cent and 0.2-0.5 per cent respectively (IMF 1998:150). Accordingly, the OIC member countries that are partners in the Euro-Mediterranean agreements, and the OIC members in the CFA franc zone will receive the most of the discussed benefits. However, it is also these countries that will bear most of the brunt of any negative developments in the EMU front.

#### **4.2. The Euro trade linkages and primary-producing countries**

The Euro output-enhancing impacts, through trade, are likely to be less robust on OIC primary-producing countries. The supply of primary goods is less sensitive to demand shifts in the short run. In addition, the income elasticity of demand of primary products tends to be rather low. However, over the longer term, the extent of the impact is likely to pick up, particularly if increased demand for primary products is sustained. Thus, in the case of the CFA franc zone countries, initial impacts are likely to be through the financial transmissions (discussed earlier). For the other many OIC primary-producing countries in Africa and Asia, there may not be much of an impact in the short term, since both the EMU demand and finance links to them are rather weak. Over a longer time horizon, these links are expected to grow stronger, particularly when the Euro assumes an increased role in international and

development finance. From then on, Euro-based FDI and aid packages may form the necessary links between these countries and the Euro.

### 4.3. Linkages from trade in services

Merchandise trade data may underestimate the effect of the Euro on many economies, as it does not include trade in services, which is more important for many developing countries. The OIC world overall is a net recipient in the international service trade with the rest of the world, but with the EU in particular. Thus, inasmuch as the EU financial markets' promised productivity and competitiveness gains materialise, the OIC world may gain. However, for the relatively few OIC countries whose trade in services contributes substantially to their GDPs, service trade represents an important channel for the EMU effects on them. Countries such as Turkey, Egypt, Morocco and Tunisia will be directly affected by developments in the Euro through tourism receipts.

	Partner countries						
	Trade <sup>1</sup>				Output <sup>2</sup>		
	Euro area	other advanced	DCs & TCs <sup>3</sup>	Total	Euro area	other advanced	DCs & TCs <sup>3</sup>
Euro area	51.0	30.8	18.2	22.9	11.7	7.1	4.2
Denmark	47.1	40.2	12.7	23.6	11.1	9.5	3.0
Greece	57.5	21.4	21.1	14.6	8.4	3.1	3.1
Sweden	44.5	43.1	12.3	29.1	13.0	12.6	3.6
United Kingdom	49.4	34.9	15.7	22.3	11.0	7.8	3.5
Japan	11.3	54.7	34.1	8.2	0.9	4.5	2.8
United States	13.8	53.6	32.6	9.4	1.3	5.0	3.1
Asia	12.5	67.7	19.8	19.7	2.5	13.3	3.9
Africa	39	34.4	25.8	19.5	7.7	6.7	5.0
<i>CFA franc zone</i>	48.1	23.7	<b>28.2</b>	25.5	12.3	6.1	<b>7.2</b>
Mid East and Europe	26.9	42.8	<b>30.2</b>	25.6	6.9	11.0	<b>7.8</b>
Centre & East Europe	51.0	16.1	32.8	32.9	16.8	5.3	10.8
Western Hemisphere	13.3	61.4	25.3	14.8	2.0	9.1	3.7

<sup>1</sup> Imports of goods from and to partner countries as percentage of total imports plus exports.

<sup>2</sup> Average of imports plus exports of goods from and to partner countries as a per cent of GDP.

<sup>3</sup> DCs: Developing countries and TCs: Countries in Transition.

Source: IMF, *World Economic Outlook*, October 1998.

### 4.4. Trade diversion due to improved productivity in the EU area

As was mentioned earlier, efficiency may bring about positive effects to the EU partners. However, with increased productivity and other cost savings of the EMU materialising in the EMU area, competitiveness of EU firms may

increase. This will divert trade from non-Euro suppliers, especially when their currencies are tied to the Euro and cannot adjust to reflect relative productivity changes. “On balance, however, it is likely that the net positive spillover of new trade resulting from higher Euro-area output will outweigh the diversion of existing imports to provide a net positive effect of Euro growth on these countries” (IMF 1998:150-1).

#### **4.5. Linkages due to local currency peg to the Euro**

OIC countries who were previously pegged to one currency in the EU—the CFA franc— or to a basket of EU currencies will most probably shift to a Euro peg. These countries will, accordingly, have become pegged to a larger and more diversified economic base than before. From this perspective they may benefit since, for them, changes in the Euro exchange value will not affect their competitiveness with the Euro. However, a higher EMU exchange rate volatility relative to that under the EMS will affect the pegged currencies’ terms of trade and competitiveness vis-à-vis dollar- and yen-based economies. “The extent to which changes in the value of the Euro vis-à-vis the dollar and yen affect the competitiveness of developing countries that peg to the Euro will depend on how close an approximation the Euro is to the country’s effective exchange rate basket.” (IMF 1998, p.151).

On the drawbacks side, the Euro peg will keep the linked countries, more or less, direct subjects to the EMU monetary policy, more particularly, to the EU’s interest rates policy which will directly affect financial flows and debts (Table 7). Thus, to prevent the negative effects of exchange rate movements, countries would be advised to link their currencies to basket pegs that better represent the portfolio of their trade and financial links. In the case of many OIC countries in Africa and the Mediterranean region, the Euro may be the perfect representation for such a basket. Only now, the basket is also a single currency, which should reconcile the common trade-offs of having to adopt one system of pegging, or the other. The Euro-peg should bring to these countries the benefits of both worlds.

#### **4.6. Euro exchange rates and debts**

Extreme exchange rate movements of the Euro will have direct impacts on Euro-linked, heavily-indebted countries, such as those in the CFA zone. A rise in the Euro’s exchange value vis-à-vis the dollar, for example, will reduce the local currency costs of the debts denominated in dollars; however, a fall will cause exactly the negative scenario. For HIPCs<sup>17</sup>, the impact of this on their debt servicing is likely to be minimal due to the preferential terms upon which their debts are based.

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<sup>17</sup> HIPC: The Heavily Indebted Poor Countries.



Country	External debt (as share of GDP, 1997)	Share of long-term debt denominated by selected currencies, 1996			
		Euro area currencies <sup>1</sup>	US \$ and Japan yen	UK£ and Swiss franc	Multiple currencies
<b>CFA franc zone</b>					
Benin	61.3	10.3	55.2	0.3	15.5
Burkina Faso	56.6	3.7	61.0	--	21.3
Cameroon	109.6	52.7	12.8	2.0	10.9
Chad	55.4	6.5	53.4	--	25.6
Comoros	95.2	17.6	31.6	--	4.7
Gabon	80.5	53.8	12.4	5.6	9.3
Mali	113.9	20.4	27.1	3.7	19.0
Niger	69.8	32.7	39.4	1.1	3.7
Senegal	68.2	15.6	47.5	0.5	14.9
Togo	87.9	10.1	54.7	12.0	8.4
<b>Europe</b>					
Albania	35.5	18.8	75.5	--	--
Turkey <sup>2</sup>	46.3	19.9	63.3	3.1	12.1
<b>MENA<sup>3</sup> region</b>					
Algeria	64.0	26.9	51.0	1.5	7.8
Egypt	38.9	30.8	47.8	3.9	7.8
Iran	13.6	11.9	83.6	0.4	2.4
Jordan	82.5	16.0	52.1	7.9	12.7
Lebanon	26.1	8.9	65.0	0.1	6.8
Morocco	60.2	25.1	35.4	0.2	24.0
Syria	46.1	2.9	85.8	0.7	2.4
Tunisia	52.8	19.7	30.6	0.1	25.5

Source: IMF, *World Economic Outlook*, October 1998.

<sup>1</sup> Euro area currencies are composed of the Deutsche mark and the French franc.

<sup>2</sup> Turkey is also a part of the MENA region.

<sup>3</sup> Middle East and North Africa.

	Billions of US dollars			In per cent <sup>1</sup>	
	Exports	Imports	Trade Balance	Exports	Imports
<b>All EU-OIC</b>	<b>130.2</b>	<b>111.9</b>	<b>18.3</b>	<b>6.2</b>	<b>5.7</b>
<b>1. By geographical regions and countries:</b>					
<b>Africa</b>	<b>25.0</b>	<b>29.5</b>	<b>-4.5</b>	<b>1.2</b>	<b>1.5</b>
Algeria	4.9	9.5	-4.6	0.2	0.5
Benin	0.4	0.1	0.3	0.0	0.0
Burkina Faso	0.2	0.1	0.1	0.0	0.0
Cameroon	0.8	1.8	-1.0	0.0	0.1
Gabon	0.7	0.4	0.3	0.0	0.0
Guinea	0.4	0.4	0.0	0.0	0.0

**Table 8 (continued)**

<b>EU-OIC Trade: By Regions, Countries, and Economic Groupings, 1997</b>					
	<b>Billions of US dollars</b>			<b>In per cent <sup>1</sup></b>	
	<b>Exports</b>	<b>Imports</b>	<b>Trade Balance</b>	<b>Exports</b>	<b>Imports</b>
Mali	0.3	0.1	0.2	0.0	0.0
Mauritania	0.3	0.3	0.0	0.0	0.0
Morocco	5.9	5.4	0.5	0.3	0.3
Mozambique	0.1	0.1	0.0	0.0	0.0
Niger	0.2	0.1	0.1	0.0	0.0
Nigeria	3.0	5.1	-2.1	0.1	0.3
Senegal	0.9	0.3	0.6	0.0	0.0
Sierra Leone	0.1	0.2	-0.1	0.0	0.0
Sudan	0.4	0.2	0.2	0.0	0.0
Togo	0.3	0.1	0.2	0.0	0.0
Tunisia	5.9	4.8	1.1	0.3	0.2
Uganda	0.2	0.5	-0.3	0.0	0.0
<b>Asia</b>	<b>23.2</b>	<b>28.0</b>	<b>-4.8</b>	<b>1.1</b>	<b>1.4</b>
Bangladesh	0.7	2.1	-1.4	0.0	0.1
Brunei Darussalam	1.2	0.6	0.6	0.1	0.0
Indonesia	9.1	9.7	-0.6	0.4	0.5
Malaysia	9.9	12.9	-3.0	0.5	0.7
Pakistan	2.3	2.7	-0.4	0.1	0.1
<b>Europe</b>	<b>27.8</b>	<b>15.6</b>	<b>12.2</b>	<b>1.3</b>	<b>0.8</b>
Albania	0.5	0.2	0.3	0.0	0.0
Azerbaijan	0.3	0.1	0.2	0.0	0.0
Kazakhstan	0.9	0.9	0.0	0.0	0.0
Kyrgyz Republic	0.1	0.1	0.0	0.0	0.0
Tajikistan	0.1	0.1	0.0	0.0	0.0
Turkey	24.8	13.5	11.3	1.2	0.7
Turkmenistan	0.2	0.1	0.1	0.0	0.0
Uzbekistan	0.9	0.6	0.3	0.0	0.0
<b>Middle East</b>	<b>54.1</b>	<b>38.6</b>	<b>15.5</b>	<b>2.6</b>	<b>2.0</b>
Bahrain	0.8	0.3	0.5	0.0	0.0
Egypt	7.6	2.9	4.7	0.4	0.1
Iran	5.5	6.8	-1.3	0.3	0.3
Iraq	0.2	1.5	-1.3	0.0	0.1
Jordan	1.3	0.2	1.1	0.1	0.0
Kuwait	2.5	1.6	0.9	0.1	0.1
Lebanon	3.5	0.2	3.3	0.2	0.0
Libya	3.1	8.8	-5.7	0.1	0.4
Oman	1.5	0.2	1.3	0.1	0.0
Qatar	2.3	0.1	2.2	0.1	0.0
Saudi Arabia	14.7	11.9	2.8	0.7	0.6
Syrian Arab Republic	1.5	2.3	-0.8	0.1	0.1
UAE	8.7	1.6	7.1	0.4	0.1
Yemen	0.9	0.2	0.7	0.0	0.0
<b>Western Hemisphere</b>	<b>0.1</b>	<b>0.2</b>	<b>-0.1</b>	<b>0.0</b>	<b>0.0</b>
Guyana	0.1	0.2	-0.1	0.0	0.0

	Billions of US dollars			In per cent <sup>1</sup>	
	Exports	Imports	Trade Balance	Exports	Imports
<b>2. By main regional economic groupings</b>					
Euro-Mediterranean Region <sup>2</sup>	58.5	47.6	10.9	2.8	2.4
GCC Region <sup>3</sup>	30.5	15.7	14.8	1.5	0.8
Asean Region <sup>4</sup>	20.2	23.2	-3.0	1.0	1.2
Lomé agreement <sup>5</sup> and CFA Zone <sup>6</sup>	8.4	10.0	-1.6	0.4	0.5

Study calculations.

Data Source: IMF, *Direction of Trade Statistics*, December 1998.

<sup>1</sup> In per cent of EU-DOT World total (column 1, Table 4).

<sup>2</sup> OIC countries in this region are: Morocco, Algeria, Tunisia, Libya, Egypt, Independent Palestinian Territories, Lebanon, Syrian A. R. and Turkey.

<sup>3</sup> Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE.

<sup>4</sup> Three of the six Asian members are also OIC members: Brunei, Malaysia and Indonesia.

<sup>5</sup> Almost all African and Pacific countries have been party to agreements of Lomé.

<sup>6</sup> Ten of the fourteen CFA franc zone countries are OIC members: Benin, Burkina Faso, Cameroon, Chad, Comoros, Gabon, Mali, Niger, Senegal, and Togo.

<b>A. OIC group trade (totals) with the EU, US and Japan, by region</b>												
	Group's total		of which in Africa		in Asia		in Europe		in the Middle East		in Western Hemisphere	
	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s
<b>1. EU</b>	111.9	130.2	29.5	25	28	23.2	15.6	27.8	38.6	54.1	0.2	0.1
<b>%</b>	<b>25.4</b>	<b>34.0</b>	<b>50.6</b>	<b>58.6</b>	<b>16.4</b>	<b>16.3</b>	<b>42.4</b>	<b>47.6</b>	<b>21.9</b>	<b>38.8</b>	<b>31.3</b>	<b>19.6</b>
<b>2. US</b>	61.4	42	12.3	2.5	31.6	17	2.4	4.3	15	18.2	0	0
<b>%</b>	<b>13.9</b>	<b>11.0</b>	<b>21.1</b>	<b>5.9</b>	<b>18.5</b>	<b>12.0</b>	<b>6.6</b>	<b>7.3</b>	<b>8.5</b>	<b>13.0</b>	<b>0</b>	<b>0</b>
<b>3. Japan</b>	66.5	40	0.9	0.6	28	25.9	0.4	2.9	37.2	10.5	0	0
<b>%</b>	<b>15.1</b>	<b>10.4</b>	<b>1.5</b>	<b>1.5</b>	<b>16.4</b>	<b>18.2</b>	<b>1.1</b>	<b>4.9</b>	<b>21.1</b>	<b>7.6</b>	<b>0</b>	<b>0</b>
<b>1+2+3</b>	239.8	212.2	42.7	28.2	87.6	66.2	18.4	34.9	90.8	82.8	0.2	0.1
<b>%</b>	<b>54.4</b>	<b>55.3</b>	<b>73.2</b>	<b>66</b>	<b>51.4</b>	<b>46.4</b>	<b>50.2</b>	<b>59.8</b>	<b>51.5</b>	<b>59.4</b>	<b>31.3</b>	<b>19.6</b>
<b>totals</b>	442.8	383.5	58.3	42.7	170.6	142.5	36.8	58.4	176.5	139.4	0.6	0.5
<b>B. DCs trade (totals including OIC) with the EU, US and Japan, by region</b>												
	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s
<b>1. EU</b>	439.2	386.5	49.9	45	144.6	148.7	117.9	113.5	70.1	41	56.7	38.2
<b>%</b>	<b>22.2</b>	<b>20.4</b>	<b>45.9</b>	<b>41.5</b>	<b>13.5</b>	<b>14.3</b>	<b>43.5</b>	<b>43.4</b>	<b>40</b>	<b>21.3</b>	<b>16</b>	<b>13.2</b>
<b>2. US</b>	420.8	305.8	20.5	7.5	221.6	127.6	12	12.1	22.5	24.8	144.3	133.8
<b>%</b>	<b>21.3</b>	<b>16.2</b>	<b>18.8</b>	<b>7</b>	<b>20.8</b>	<b>12.3</b>	<b>4.4</b>	<b>4.6</b>	<b>12.8</b>	<b>12.8</b>	<b>40.7</b>	<b>46.1</b>

<b>Table 9 (continued)</b>												
<b>Exports and Imports of OIC and Developing Worlds to and from the EU, US and Japan, 1997: Totals and regional distributions</b>												
In Values (Billions of US \$) and Percentages												
<b>A. OIC group trade (totals) with the EU, US and Japan, by region</b>												
	<b>Group's total</b>		<b>of which in Africa</b>		<b>in Asia</b>		<b>in Europe</b>		<b>in the Middle East</b>		<b>in Western Hemisphere</b>	
	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s	Exp.'s	Imp.'s
<b>3. Japan</b>	185.5	217.7	4.7	4.2	126.1	177.5	5.3	4.6	38.3	11.6	11.2	19.8
<b>%</b>	<b>9.4</b>	<b>11.5</b>	<b>4.3</b>	<b>3.8</b>	<b>11.8</b>	<b>17.1</b>	<b>1.9</b>	<b>1.8</b>	<b>21.9</b>	<b>6</b>	<b>3.2</b>	<b>6.8</b>
<b>1+2+3</b>	1045.	910	75	56.7	492.3	453.8	135.2	130.2	130.9	77.3	212.2	191.9
<b>%</b>	<b>52.9</b>	<b>48.1</b>	<b>69</b>	<b>52.3</b>	<b>46.1</b>	<b>43.7</b>	<b>49.8</b>	<b>49.7</b>	<b>74.7</b>	<b>40.1</b>	<b>59.8</b>	<b>66.1</b>
<b>totals</b>	1977.	1891.2	108.7	108.4	1067.	1038.2	271.2	261.7	175.1	192.8	354.6	290.1
<b>C: Percentages of the OIC of the DCs total trade shares, by region</b>												
	Exp.'s	Imp's	Exp.'s	Imp's	Exp.'s	Imp's	Exp.'s	Imp's	Exp.'s	Imp's	Exp.'s	Imp's
<b>1. EU</b>	25.5	33.7	59.1	55.6	19.4	15.6	13.2	24.5	55.1	132	0.4	0.3
<b>2. US</b>	14.6	13.7	60.2	33.5	14.3	13.3	20.3	35.2	66.6	73.4	0	0
<b>3. Japan</b>	35.8	18.4	18.3	15.2	22.2	14.6	7.7	62.5	97.3	91.1	0	0
<b>1+2+3</b>	22.9	23.3	56.9	49.7	17.8	14.6	13.6	26.8	69.4	107.1	0.1	0.1
<b>totals</b>	22.3	20.3	53.6	39.4	16	13.7	13.6	22.3	100.8	72.3	0.2	0.2

Study calculations.

Data Source: IMF, *Direction of Trade Statistics Quarterly*, December 1998.

## 5. POLICY ISSUES

### 5.1. Legal and administrative requirements

With the introduction of the Euro, numerous legal and administrative implications have occurred following the EMU, such as the repeal of the ECU on January 1, 1999. Similar laws have been planned to take effect on January 1, 2002, the most important of which is the annulment of the 11 national currencies of the EU11. After June 2002, national currencies of the EU11 will no longer be legal tender, nor will any financial transaction based upon them. Almost all financial dealings and accounts in the EMU area have been converted into Euros in January 1999. The OIC countries, who have not yet done so, need to timely adjust their legal and administrative frameworks in line with the developments in the Euro area. For example, Turkey's central bank circular No. 98/4 recognised the Euro as a convertible currency as from January 1, 1999, at the exchange rates declared by the ECB. Other acts that will have legal implications on EU partners are:

- Conversion of outstanding bonds into Euros and issue of new bonds denominated in Euros with effect from January 1, 1999.

- Conduct of foreign currency transactions in Euros and abolition of national foreign exchange markets.
- Legal changes in the fundamental condition of the new Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) payments system.
- Changes in the terms and conditions of individual financial deals due to modification in the terms of issue and conversion. The notable changes amongst these will be the changes in market references such as:

In the procedure for calculating accrued interest rates on floating securities and bonds, the Euro interest method (Actual/360) will be introduced. Calculations of most fixed interest deals will remain mostly as before, on the actual number of days involved (Actual/Actual method).

As of 1999, the reference interest rate of floating-rate deals, the FIBOR rate, old and new, will be replaced by the EURIBOR rate; or in other cases LIBOR to EURO LIBOR.

## **5.2. Questions of currency pegs and reserves**

To avoid the destabilising effects of exchange rate movements of the currency (or the basket of currencies) pegged, the OIC countries should choose a currency peg which best reflects the composition of their trade, debt and other financial links. It is expected that the role of the Euro as an exchange rate anchor for non-EU currencies will gradually increase overtime. Thus, OIC states which have notable links with the EU, but which peg their currencies solely to the dollar, may now benefit from attaching some weight to stability vis-à-vis the Euro. The Euro is also expected to play a similar alternative role in most international finance operations. Non-EU states may stand to benefit from the growing role of the Euro. In the long run, the Euro’s role may even extend to financial reserves. At which time, many OIC states may find it more prudent to convert a proportion of their reserve holdings into Euros.

## **5.3. The information requirement**

Authorities in the OIC countries have a responsibility to inform their citizens of the developments and the likely effects of the Euro on them. This information should essentially and promptly be made available and accessible

to the business community in general, but particularly to those with commercial links to EU.

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