Dollarization and Euroization:
A Post-Keynesian Institutionnalist View

Preliminary version

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Abstract:
The paper focuses on the costs of officially and full dollarization/euroization from a post-keynesian institutionalist perspective with a special focus on the case of Kosovo. First, we clarify the notion of dollarization/euroization by using two criteria: (i) a quantitative criterion to assess the degree of dollarized/euroized monetary practices of an economy; (ii) a qualitative - or institutional - criterion to distinguish between cases of informal dollarization/euroization and cases of official dollarization/euroization. This allows us to show the specificity of the case of Kosovo, that of a fully and officially euroized economy voluntarily giving up sovereignty. The paper then highlights the macroeconomic costs and constraints from a post-keynesian perspective that euroization implies for the financial stability and growth regime of the Kosovar economy. The arguments against dollarization/euroization range from the claim that such monetary arrangements imply giving up the central bank's role as lender of last resort (LOLR), to the claims that they involve a deflationary growth dynamics, and that they slow down adjustments to external shocks. In absence of a domestic LOLR, the banking system might be extremely vulnerable. To assure a favourable growth dynamics, dollarized/euroized countries need to implement export-led growth strategies, as well as promoting a high degree of trade and investment links with the issuer of the foreign currency. The paper underlines that two institutional characteristics specific to Kosovo make it possible to cushion the weight of these macroeconomic constraints: (i) the significant presence of foreign banks; (ii) the decisive role of the diaspora, in particular through remittances. The paper concludes that dollarization/euroization regimes are asymmetric monetary unions. These monetary regimes are not sustainable without a strong external financial dependence as well as monetary and financial integration to the core economy. They could sense only for very small economies with sufficient capital inflows as well as commercial, financial and eventually political links with the core economy – like Kosovo with the Eurozone and the prospect of one day joining the Eurozone. But this is not the case of Ecuador where the economy is extremely vulnerable to the dollarization constraints.

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I. INTRODUCTION

The paper focuses on the costs of officially and full dollarization/euroization from a post-keynesian institutionalist perspective with a special focus on the case of Kosovo.

First, we clarify the notion of dollarization/euroization by using two criteria to differentiate between the many cases of dollarized/euroized countries: (i) a quantitative criterion to assess the degree of dollarized/euroized monetary practices of an economy; (ii) a qualitative - or institutional - criterion to distinguish between cases of informal dollarization/euroization and cases of official dollarization/euroization. This allows us to show the specificity of the case of Kosovo, that of a fully and officially euroized economy voluntarily giving up sovereignty.

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In absence of a domestic LOLR, the banking system is extremely vulnerable. The inelasticity of central bank money supply have some negative impact on the credit supply dynamics, and thereby on economic activity. In the case where the central bank refuses all accommodation, interest rates violently increase. If the country's economy is not able to record a current account surplus to accumulate more reserves, then there is a persistent stagnation dynamics or restriction of credit. To assure a favourable growth dynamics, dollarized/euroized countries need to implement export-led growth strategies, as well as promoting a high degree of trade and investment links with the issuer of the foreign currency.

The paper underlines that two institutional characteristics specific to Kosovo make it possible to cushion the weight of these macroeconomic constraints: (i) the significant presence of foreign banks; (ii) the decisive role of the diaspora, in particular through remittances.

The paper concludes that dollarization/euroization regimes are asymmetric monetary unions. These monetary regimes are not sustainable without a strong monetary and financial integration to the core economy. They could make sense only for very small economies with sufficient capital inflows as well as commercial, financial and eventually political links with the core economy – like Kosovo with the Eurozone and the prospect of someday joining the eurozone. This is not the case of Ecuador where the economy is extremely vulnerable.

II. DOLLARIZATION/EUROIZATION: A TAXONOMY

Considering that an economy is "dollarized" or “euroized” does not provide any indication about the degree of impregnation of the foreign currency in the monetary practices of an economy (Fields and Vernengo 2013, Ponsot 2019). Dollarization/euroization concerns both economies in which a foreign currency circulates alongside the domestic currency, and economies in which the US dollar/the Euro prevails as the exclusive monetary sign. Two cases must be separated.

In the first case, dollarization/euroization characterizes a phenomenon of monetary plurality (Blanc and al., 2018); it may be described as *partial dollarization*. In this narrow sense, it refers to massive currency substitution, in which a country, supplements its domestic unit account with a foreign currency. In these situations, sovereignty is already eroded because the national currency is competing with a foreign currency. The legitimacy of the national legal tender unit of account is challenged.

In the second case, dollarization/euroization refers to a phenomenon of monetary exclusivity; it can be described as complete or *full dollarization/euroization*; there is no longer any national currency in circulation. Currency substitution is complete.

This distinction is useful but it invites us to ask whether this intrusion of a foreign currency is accepted, tolerated or even formalized by the sovereign state. This is why a second level of distinction should be considered between, on the one hand, cases where the foreign currency is used by economic agents despite its prohibition or the absence of its legal tender, and, on the other hand, cases where the use of this currency is officially recognized by the authorities for certain uses, or even completely legalized. In the first case, we talk about *de facto dollarization/euroization* or informal dollarization/euroization. The second case is related to *de jure dollarization/euroization* or official dollarization/euroization. Here, dollarization/euroization is institutionalized and reflects a strong political choice by the public authorities.

The manipulation of the legal and institutional framework remains, however, the main lever available to the authorities to try to neutralize the dollarization/euroization process. The State has the privilege of defining the national unit of account. The exclusivity of legal tender conferred on the domestic currency can therefore, in principle, be maintained, whatever the level of dollarization/euroization. Deciding that only the unit of account recognized by the State is legal tender is not, however, a sufficient condition to divert economic agents from the competing currency. More than maintaining the legal tender status of the domestic unit of account, it is in fact the preservation of the latter in transactions carried out by the State that proves to be the determining criterion. By accepting the settlement of taxes only in the unit of account that it has itself defined, the State obliges economic agents to obtain adequate means of payment and to use the unit of account "accepted by the State" as underlined by the Institutionnalists (Aglietta, Ould-Ahmed and Ponsot 2018) or, from a different perspective, the Modern Monetary Theory (Wray 2022).

Following these double criteria of dollarization/euroization, we can establish a taxonomy of dollarization/euroization highlighting four typical dollarization/euroization schemes (figure 1). The case of official and full dollarization/euroization is the most extreme case in terms of loss or absence of sovereignty: the sovereign national currency does not exist or has been removed from circulation. The attributes of monetary sovereignty are abandoned with the withdrawal or the absence of legal tender and the liberatory power of the domestic unit of account. The only legal tender is the sovereign currency of a foreign economy. In the case of Ecuador, the US dollar plays this role since 2000. In the case of Kosovo, the euro plays this role since 2002.

Figure 1
Taxonomy of the four typical dollarization/euroization regimes

		Qualitative criterion **Level of formalization of dollarization/euroization**	
		De facto (informal)	**De jure (official)**
Quantitative criterion **Level of foreign currency use**	**Partially dollarized/ euroized**	Most common cases of currency substitution. Spontaneous process resulting from a choice by private agents. E.g.: most peripheral economies, Latin America, Maghreb...Kosovo at the end of the 1990s.	Semi-official" dollarization (dual regimes with or without currency board). Generally accompanied by a phenomenon of institutional resistance: the authorities maintain the domestic legal tender and the obligation to pay taxes in this unit of account only E.g. Guatemala, Liberia, Lebanon, Zimbabwe before 2016, Kosovo with the officialization of the Deutsche mark in 1999
	Fully dollarized/ euroized	Lack of political sovereignty (political separatism, conflict and post-conflict situation, decomposition of a state entity). Ex: East Timor before 1999	Capitulation of the political authorities. E.g.: Ecuador in 2000 Building of a new political entity. E.g.: Montenegro, Kosovo after 1999

Source: Ponsot (2018)

III. THE FIRST STEPS TOWARDS THE EUROIZATION OF KOSOVO: THE WAR, THE UNMIK AND THE GERMAN MARK

On January 1, 2002, 12 member countries of the European Union began withdrawing their national currencies from circulation and replacing them with euro bills and coins. Two other territorial entities which are not members of the EU, and which did not have at the time the official status of candidate country, have also formalized the choice of the euro as the only legal tender currency.

These countries are Montenegro and Kosovo, respectively former republic and autonomous province of the Socialist Federal Republic of Yugoslavia (SFRY). Both have adopted the euro independently, without any negotiations with the EU, i.e., without having to meet the Maastricht criteria, but also without any commitment from the EU.

This original process of euroization is very particular for many reasons:

(i) the euroization of Kosovo was preceded by a dollarization process with the Deutsche Mark between 1999 and 2002;

(ii) (ii) the euroization was established in a context combining post-conflict reconstruction and the emergence of a new political entity. It is only on February 17, 2008, that the Kosovo Assembly declared Kosovo an independent state, which was recognized by the United States and most EU member states - but not by Russia and China.

(iii) (iii) the decision to introduce the euro in 2002 was the result of an exogenous process. It was not taken not by the local Kosovars representatives but rather by the United Nations Interim Mission (UNMIK).

Bunjaku (2015) divides the monetary process toward the euro into three parts. The first one refers to the time period from the last 1980s to 1990. Former Yugoslavia was still a legal entity internationally recognized but began to encounter severe economic difficulties. In 1990, austerity measures were undertaken. The convertible dinar was set up, switching exchange rate from managed float to fixed regimes. The austerity reforms aimed to struggle inflation that had reached 2,600 percent by the end of 1989. These austerity orientations coincided with political tensions amongst the federal entities of former Yugoslavia.

The second period, from 1990 to 1999, started the partition of the Republics of former Yugoslavia. It is characterized with huge economic and political instability, and it resulted with war in Republic of Croatia, Bosnia and Kosovo. The federal government main preoccupation was financing the military expenses. The exchange rate was switched from fixed to floating. This time period was characterized with the highest inflation rate in the history of former Yugoslavia. The federal financial institutions lost their financial credibility and moral integrity. Therefore, all the ingredients were gathered to make disappear the confidence in the domestic currency and to enhance currency substitution. Although the dinar was official currency in circulation in Kosovo, during that time period the Deutsche Mark became de facto the currency used to manage daily payments and financial transactions. After the war, in June 1999, an international administration was established in Kosovo through U.N. Security Council Resolution 1244, administering the territory until early 2008. The U.N. Interim Administration Mission in Kosovo (UNMIK) was designated as the authority holding civilian responsibility over Kosovo, while NATO's presence in Kosovo (Kosovo Force/KFOR) was responsible for safeguarding security.

Finally, the last period towards to the euro started in the year 1999, when the (UNMIK) Regulation No. 1999/4 of 2 September 1999 on the Currency permitted the Deutsche Mark to be used as a means of payment for official accounts and payments. A particularity of this officialization of the currency substitution is that it is not the decision of the representatives of the Kosovars but an exogenous decision of the authorities mandated by the UN: "This is an important first step towards the creation of functioning banking, payments and fiscal systems in Kosovo," said Joly Dixon, Deputy Special Represenitive for Economic Reconstruction and Development. "The dinar is the currency of all of the Federal Republic of Yugoslavia. This regulation does not impose the use of Deutsche Mark However, it recognizes that the Deutsche Mark has been the preferred currency in Kosovo for some time. It is now necessary to put this on a firm legal basis." ("Kouchner Signs Regulation on Foreign Currency", Press release). 2 September 1999).

Svetchine (2005) minimizes the thesis of the exogenous character of the decision to adopt the Deutsche Mark. According to him, it was actually the people of Kosovo who adopted the Deutsche Mark as its common currency. It was above all a pragmatic decision based on the practices already at work. The adoption of the Deutsche Mark followed two decades of extreme monetary instability, accompanied by a high-rate of it unofficial use as a reserve value and exchange currency. During the pre-conflict period, the German mark was the most commonly used currency, and there was a significant amount of cash in circulation. The population was familiar with this currency.

All that the UNMIK's Regulation did was identify the Deutsche Mark as the currency used for formulation of budgets, financial statements, and the accounts of public organizations, agencies and institutions, including UNMIK itself. The officialization rule provided the freedom of choosing, for any contract or other voluntary transaction, a broadly accepted currency. And it removed all controls or limitation of currency exchange, possession, use, or establishment of any currency, in cash or bank accounts, located within or outside the territory of Kosovo. Adoption of the new monetary scheme, based on the use of the Deutsche Mark, was introduced as a "natural choice".

The adoption of the Deutsche Mark by Kosovo has been a kind of unilateral dollarization. There were no negotiations with Bundesbank in Deutschland or the European Central Bank at that time. The Deutsche Marks in circulation came mainly from German banks, without any identified request to import funds from the authorities. This can be explained by the fact that many Kosovars work abroad and send money back to their home country.

IV. THE EURO AS LEGAL TENDER: HOW TO IMPROVE POST-CONFLICTUAL RECONSTRUCTION AND BUILD SOVEREIGNTY WITHOUT ITS OWN CURRENCY?

In early 2002, the replacement of the euro legacy currency in the Eurozone countries, made it necessarily also the replacement of the Deutsche Mark in Kosovo. The former BPK (now CBK – Central Bank of the Republic of Kosovo) was entrusted with leading this project in terms of ensuring a swift and safe changeover to the euro, and to the lowest cost possible. The conversion of Kosovo to the euro was formalized through the Directive issued by UNMIK, namely Directive No. 2001/24. The euro was unilaterally adopted as the only currency (Constitution Art. 11), while the Serbian dinar was illegally used in small Serbian enclaves and North Kosovo, closed to the frontier with Serbia.

The unlimited external support to this project by UNMIK and EU provided the support for amending and approving the basic legislation. In contrast to the adoption of the Deutsche Mark as the main currency in Kosovo in 1999, switching to euro currency – in particular the introduction of euro banknotes and coins- was made in strong cooperation with the European

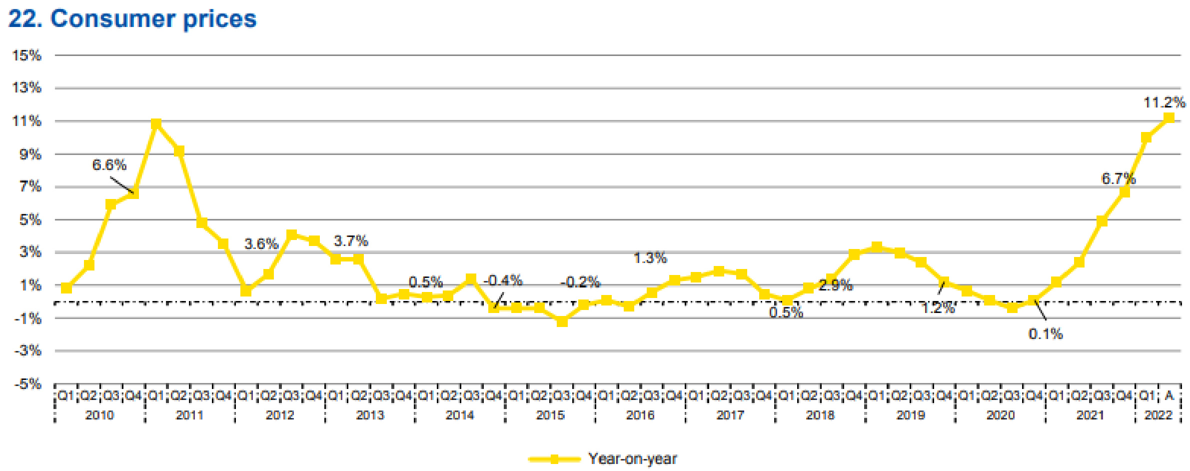
Central Bank, as well as some national central banks of Eurozone. The CBK also received strong support from the IMF, ECB, central banks of Austria and Germany, as well as private German banks (Commerzbank and Raiffeisen Zentral Bank).

However, it should not be assumed that the decision to switch to the euro was based on a general consensus. Kosovar representatives in fact put forward the option of a sovereign currency for Kosovo. For instance, Ibrahim Rugova, the late former President of Kosovo suggested the idea of adopting its owned currency, the Dardan - a name that recalls the ancient name of the region, Dardania. Rugova finally accepted the euro for Kosovo: “We have the euro as a currency, which means a lot. It has not just stabilized the situation in Kosovo politically and economically, but also facilitated the direct contact that we have with Europe.”

It was estimated that the import of 500 million euros was needed to finalize the conversion into euro by 28 February 2002. The first contingent with Euro (about 100 million euros) was brought to Kosovo in December 2001. During the period of December 2001 to January 2002, over 1 billion Deutsche Marks were exported, while over 350 million euros were imported. At the same time, nearly 10 million Deutsche Mark coins were repatriated, while about 7 million euro coins were imported, which, in terms of logistics, reflected the transportation of 100 tons of coins. All this operation also had a significant cost in terms of transport and security, while CBK was the only institutional channel through which the Euro was imported and the Deutsche Mark was repatriated. On 1 January 2002, all customer accounts held in the CBK and commercial banks were converted from DEM currency to the EUR currency at an irreversible exchange rate of DEM 1.95583 for one EUR. During January and February 2002, both currencies (the euro and the Deutsche Mark) were in circulation, while the conversion of the amounts was made under the pre-determined conditions.

Most analysts of Kosovo’s euroization insist on its advantages. According to the advocates of euroization, the latter supported the development of the financial sector. In the beginning, there was no bank in Kosovo and virtually all transactions were made in cash. However, two years witnessed a rapid development of financial intermediation in Kosovo, especially the banking sector. Between March and November 2001, six banks were established, which brought much needed competition in the banking sector. In 2002 and 2003, seven commercial banks in Kosovo expanded significantly. Euroization permits the reduction of cash from circulation and the development of financial intermediation. Setting maximum limits on the amounts of exchange, as well as clearly defining the deadline period of dual currency circulation, greatly encouraged holders of cash to deposit their money in banks, rather to risk not to be exchanged in time. This strategy helped to consolidate the confidence in the banking system. The adoption of the euro as a national currency brought also monetary stability in Kosovo (figure 2).

Figure 2
Kosovo – Inflation rate



Source: Central Bank of the Republic of Kosovo

The risk of devaluation of the national currency disappeared. CBK, which acts as a fiscal agent of the Government of the Republic of Kosovo, does not take any exchange risk, and manages the official reserves. These reserves are mainly invested in euro zone countries, in the central banks and financial institutions with good rating. The introduction of the euro significantly simplified and reduced transaction costs both within and outside of Kosovo, especially when considering the importance of trade within the economy of Kosovo. Neighboring countries, mainly former Yugoslav republics, remain the main trade partners of Kosovo. However euro currency, the same as Deutsche Mark before 2002 is widely used in the region.

Euroization in Kosovo had also some long-term policy objectives. Euroization in Kosovo was expected to foster economic stability, solve the problem of reliability, and mainly to increase fiscal discipline by eliminating the possibility of reproducing the money to cover fiscal deficits. After a longer period of time this was expected to increase foreign direct investment.

V. THE CONSTRAINTS OF EUROIZATION FROM A POST-KEYNESIAN INSTITUTIONALIST PERSPECTIVE

Magnin and Nenovsky (2022) explore the hypothesis of the emergence of a "dependent capitalism" in Central and Eastern Europe. A kind of dependent capitalism would have emerged in Central and Eastern Europe and the Baltic States over the last 30 years as part of the process of socio-economic transformation that began in 1990. According to them, euroization would be entirely imposed by external actors and serves their interests. The dependence to foreign capital of Kosovo - as well as Montenegro, also under full and official euroization – would be even stronger for them, particularly in the monetary area.

By adopting a post-keynesian institutionalist perspective (Ponsot 2003, 2019, Missaglia 2020, Fields and Vernengo 2013), we corroborate some of these points of view. The Post-Keynesian arguments against dollarization range from the claim that such monetary arrangements imply giving up the central bank's role as lender of last resort (LOLR), to the claims that they involve a deflationary growth dynamics, and that they slow down adjustments to external shocks.

From a post-keynesian view, money is endogenous. There is a kind of accommodation of the central bank to offer all the liquidity needed by the banking system. In absence of a domestic LOLR, the banking system of countries under euroization might be vulnerable. In order to make up for the loss of LOLR, the banking systems under euroization need to develop an increased openness to foreign capital. In the case of pressure on domestic banks liquidity, the presence or the support of foreign banks to the domestic banking system could ensure the necessary provision of liquidity. The solution consists in trying to find an indirect external agent capable of taking on the function of the LOLR. To assure financial stability of their banking system, dollarized/ euroized countries need strengthened direct or indirect connection with the financial system of the country that issues the reference currency – i.e. in the case of Kosovo, strong financial integration with the Eurozone or at the least with the ECB.

Fortunately, banks in Kosovo generally have high liquidity ratios and it is expected that the largest banks would receive liquidity support from their parent groups in emergency times. During the Covid pandemic crisis, the degree of interconnection of foreign banks with their parent banks has increased, driven by increased insecurities and at the same time the need to provide emergency liquidity lines, i.e. increase the absorption capacity for possible loss as a result of the pandemic crisis. The liquidity position of the banking sector remained favorable, characterized by an increase in key liquidity indicators, thanks to exceptional easing measures taken by the Central bank, namely the moratorium, the suspension of regulatory provisions on provisioning and regular credit classification, as well as the restructuring of loans. (Central Bank of the Republic of Kosovo 2021b).

However, banks' ability to respond to a system-wide liquidity shock is limited by (i) some liquid assets are in the form of government bonds, which may not be immediately tradable; (ii) the coverage of the deposit insurance is not high enough to substantially reduce the risks of bank runs. This is why the Central Bank of the Republic of Kosovo recently launched a repo and overnight liquidity facilities for banks (with capacity €100 million) to complement the ELA (€92 million). But according the latest country report of the IMF (2022, p.49): "these resources are insufficient to respond to systemic wide shocks".

The inelasticity of central bank money supply might have some negative impact on the credit supply dynamics, and thereby on economic activity. An apparent "paradox in credit policy" (Skenderi & alii 2015) implemented by commercial banks in Kosovo is the contrast between the low interest rates for deposits (negative rate for banks) and the very high rates for loans (positive rate for banks). According to the Post Keynesian framework, the absence of a flexible supply of Central bank liquidity does not have an impact on credit quantities but on credit prices. In a modern capitalist economy, the supply of credit money is endogenous. The banks' main role is the *ex nihilo* creation of credit money in the light of business credit requirements. Once the credit money has been created, the banks need to refinance themselves by turning to the Central Bank, which then accommodating bank's reserve needs. In the case where the Central Bank refuses all accommodation, interest rates might violently increase. According to this logic, dollarization regimes are aberrant since no central bank is able to guarantee banks refinancing *a posteriori*. Interest rates seem doomed to be higher than in an economy under central banking regime. This is what is occurring in Kosovo.

If the country's economy is not able to record a current account surplus to accumulate more reserves in foreign currency (figure 3), then there is a persistent stagnation dynamics or restriction of credit. Dollarization thus obliges economies wishing to secure regular growth to ensure, in the medium and long term, a structural surplus of their balance of payments. One option is a current account surplus; but this is not the most common scenario in developing economies. If the current account is of manageable proportions, it can be compensated by stable inflows of capital, for example in the shape of foreign direct investments (FDI). The important thing is to maintain net capital inflows of dollars over the long term.

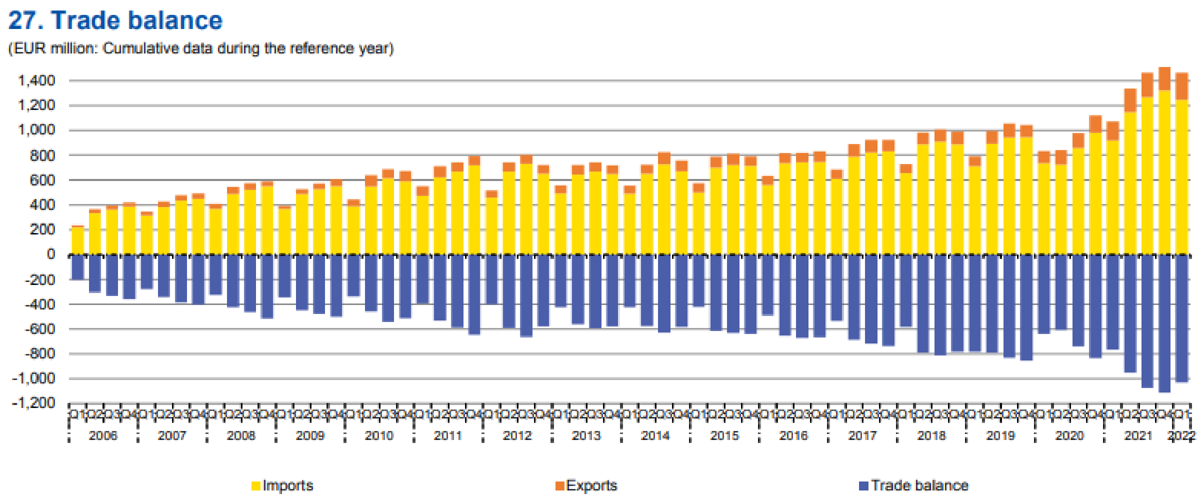
To assure favorable growth dynamics, dollarized/euroized countries need to implement export-led growth strategies, as well as promoting a high degree of trade and investment links with the issuer of the foreign currency. Euroized economies capacity to grow depends on their ability to sell goods to the countries of the euro area and to attract foreign capital from these countries.

Under dollarization and euroization, both monetary and exchange rate policies are removed. Vulnerability to asymmetric shocks is undeniable. Since the adoption of the euro in 2002, average inflation rate has been low in Kosovo. Over the course of these 20 years, total rise in prices amounted to less than 40%. However, the inflation rate may sometimes be high (for instance in the years 2011 and 2022) and because of euroization the central bank cannot conduct an active independent monetary policy. These occasional drastic shifts in inflation were caused mainly by changes in food and international commodity prices and political turmoil. They were partly countered by investments in infrastructure.

The adjustment, in terms of economic activity and employment, tends to be particularly severe. Deprived of exchange rate flexibility and the right to juggle with interest rates, the authorities may be tempted to use fiscal policy as a counter-cycle weapon. Fiscal activism in dollarized/euroized countries is nevertheless limited, as proved by Izurieta (2002). There is not really room for independent fiscal policy because there is no mechanism of deficit financing other than borrowing at market-determined interest rates. The statutes of the central bank make it impossible to monetize public deficits. The government budget deficit averaged 0.12% of GDP between 2000 and 2017, reaching an all-time high of 7.17% of GDP in 2007 and a record low of -4.58% in 2004. National debt increased from €1.2 billion in 2017 and to €1.3 billion by the end of 2020 (19.6% of GDP). These are low figures in comparison with other Southeast European countries (BTI 2022 Country Report). Kosovo Government measures to address the crisis caused by the Covid-19 pandemic have only moderately increased the budget deficit as well as public debt.

In sum, exchange rate, monetary and fiscal policies are all removed at once. Under these circumstances, the burden of the adjustment would principally fall on prices and wages. The size of the nominal wage adjustments is usually smaller than that observed on prices. If wages flexibility proves insufficient, the volume of employment becomes the adjustment variable.

Figure 3
Kosovo – Trade Balance



Source: Central Bank of the Republic of Kosovo

VI. FOREIGN BANKS AND THE DIASPORA SUPPORT

Because of being part of euro area, Kosovo would have benefited from foreign loans with lower interest rates than other neighboring countries, by ranking Kosovo in a safer place for investors and a more stable place (Hajdari 2020). Badivuku & Maloku (2016) and Tyrbedary (2006) shares this optimism regarding economic development of Kosovo. Euroization was supposed to increase foreign direct investments inwards in Kosovo. However, as underlined by Bunjaku (2015), foreign direct investments in Kosovo didn't show any significant increase since the adaptation of euro as official currency of Kosovo. Moreover, the foreign direct investments inwards in Kosovo showed a tendency of decline. Despite the security of the euro, euroization has not implied FDIs. Fortunately, Kosovo can count on two other inflows of capital to limit the balance of payments constraint and cushion the constraints of euroization: (i) the close connection with foreign banks; (ii) and the incomes coming from the diaspora.

The banking system in Kosovo is largely integrated to foreign banks. Of the 10 banks licensed by the Central Bank of the Republic of Kosovo, 8 are owned by foreign capital - corresponding to 85.8% of total bank assets (May 2022). The banking sector is dominated by capital of European origin, which accounts for 55.8% of total assets of the banking sector (figure 4). Raiffeisen Bank Kosovo and ProCredit Bank are traditionally the largest in terms of assets and show strong profits. Banks originating from Turkey have recorded a slight decline in market share, with a 16.0

percent share in 2020. Of the 30 microfinance institutions, 13 are foreign-owned. Foreign ownership accounts for 92.1 percent of MFI assets.

Figure 4
Kosovo – Total assets and foreign ownership of banks (March 31, 2022)

		Total Assets	
Banks	Foreign country ownership	in EUR (000)	in % of total assets
Raiffeisen Bank Kosovo	Austria	1,202,457	21.6%
NLB Bank	Slovenia	930,574	16.7%
ProCredit Bank Kosova	Germany	850,763	15.3%
Banka Kombetare Tregtare	Albanie	811,237	14.6%
TEB Bank	Turkey, France	723,004	13%
Banka Ekonomike e Kosovoes	-	433,639	7.8%
Banka Per Biznes	-	372,216	6.7%
IS Bank	-	123,250	2.2%
Ziraat Bank	Turkey	84,610	1,5%
Credins Bank	Albania	32,055	0.6%
Total		**5,563,805**	**100%**

Source: Kosovo Banking Association (2022)

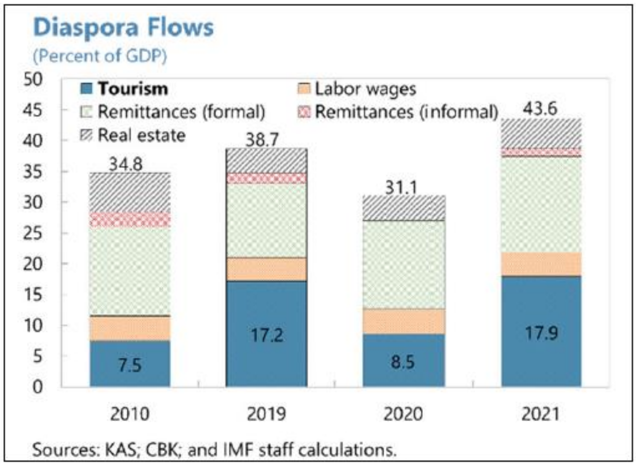
Kosovo’s economy and its euroized growth model are heavily dependent on its large diaspora. Strong emigration since the 1990s (especially to advanced European economies and the U.S.) is reflected in a migrant-resident ratio within the 30-40 percent range, one of the world’s highest. Remittances in Kosovo come mainly from Germany and Switzerland with 40.0% and 18.6%, respectively, of total remittances received until September 2021. A considerable amount of remittances was received also from the USA (7.3% of total remittances).

Total foreign remittances to Kosovo grew to 1.15 billion euro in 2021 from 979.9 million euro in 2020. Total foreign remittances to Kosovo increased by 5.4% year-on-year to 351.5 million euro ($371.3 million) in the first four months of 2022. In April 2022 alone, total foreign remittances reached 110.1 million euro, up from 90.5 million euro in April 2021 (Central Bank of the Republic of Kosovo, 2022).

Hospitality services targeted at Kosovars living abroad represent a substantial portion of the country’s exports of services and is reflected in the strong seasonal pattern of economic activity in the summer months and other holidays. Formal and informal remittances also prop up domestic incomes significantly.

Strong ties between the diaspora and the motherland helped Kosovo during the pandemic. Over 2020-21 diaspora inflows held up better than envisaged, helping cushion the shock and supporting the recovery. Remittances and compensation of seasonal migrants largely surpassed their pre-pandemic level in both 2020 and 2021. In turn, the recovery of tourism flows in 2021 was much stronger than that in traditional tourism-exporting countries. The number of visitors from abroad received by Kosovo through September 2021 increased with respect to its pre-pandemic level of 2019, compared to significantly lower levels for all other European countries (figure 5).

Figure 5
Kosovo – Diaspora Flows (as percent of GDP)



In terms of transferring channels, more than half of remittances (57.9%) came through money transferring agencies, which in Q4 2021 marked a decline of 4.9%. Remittances received through banks marked an increase of 14.7% and comprise 15.6% of total remittances received in Q4 2021. As a result of the opening of the borders and easing of containment measures, also remittances through "informal" channel have increased by 7.9%, reaching the level of EUR 75.6 million in Q4 2021.

VII. CONCLUSION

Dollarization/euroization regimes implies asymmetric monetary unions. These monetary arrangements are not sustainable without a strong monetary and financial integration to the economic and political area which issues the legal tender. Dollarization/euroization makes sense only for very small economies with sufficient commercial, financial and eventually political links with the core economy. This is not the case of Ecuador with the US dollar, where the economy is extremely vulnerable to the constraints of dollarization.

The case of Kosovo is quite different. Euroization in Kosovo was a direct result of political and economic disintegration of the former Yugoslavia, and the intervention of the United Nations. Monetary sovereignty was not the priority after the Kosovo war, and the financial connection to the euro, thanks to the foreign banks and the role of the diaspora, made the euroized economy more resilient. Since the war in Ukraine, the Kosovar authorities have insisted on the need to further anchor the independent state to the EU. The Kosovar Prime Minister announced Friday, June 10, 2022 that Pristina would apply for candidate status in the European Union by the end of the year: “Europe is our destiny, Europe is our future”.

This prospect of integration into the EU, when the country already has the euro as its official currency, opens the way to an exit from euroization from above. While Kosovars are overwhelmingly in favor of the euro, there has been regular resurgences of debate around a dardan for Kosovo. These are very often sovereigntist impulses that emerge at the time of elections. For instance, in 2014, the governor of the Central Bank, Bedri Hamza, announced at a summit held a few days ago in Montenegro, his intention to introduce a national currency for the young Balkan republic. The appointment of Bedri Hamza by the head of the government, Hashim Thaçi, was met with some protest, as the new governor was very closely linked to the ruling party. The de-euroization hypothesis did not help to consolidate confidence in the authorities: how can one have confidence in the durability of this very particular monetary regime if the hypothesis of an exit from euroization is regularly raised?

This touches on a sensitive point, common to other official dollarization regimes: their solidity rests largely on their irrevocability, despite the limits of dollarization. In Ecuador, the repeated rumors of an exit from dollarization, when Rafael Correa was president (2007-2017), contributed to weaken expectations and the political regime in place (Ponsot 2019).

While exiting euroization with the adoption of a national currency does not seem a solid option, Kosovo could therefore explore another path; full monetary integration to the euro. But is it the best option to promote development and full employment? The eurozone as a way out of euroization will undoubtedly be one of the major questions about the future of Kosovo's economy.

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