

How affordable are the costs compared to benefits brought by the euro to the Kosovo's economy

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Abstract

Since January 1, 2002, pursuant to UNMIK Regulation¹ no. 1999/4, the EURO ("EUR") was adopted as the legal currency in Kosovo, and was made the factual currency of the country. All client accounts held by the Central Bank of the Republic of Kosovo (CBK) and commercial banks were converted from DEM into EURO, on an irreversible currency exchange rate of DEM 1,95583 per 1 EURO. As a result, in practice, while the Euro is legal and while accounts are held in this currency, almost all transactions made in Kosovo are titled and made in Euro. The use of a sustainable currency was important to maintaining a macro-economic stability and played a decisive role in rebuilding the people's trust on the financial sector. On the other hand, the CBK does not emit currency, and as such, it does not perform any monetary and exchange policies. The currency regime adopted by Kosovo may be rather challenging, given the absence of traditional monetary instruments and the exchange rates. Therefore, the main concern remains whether fair policies (both fiscal and regulations related to the financial sector) will support this regime. The purpose of this paper is to demonstrate costs and benefit brought upon the Kosovar economy by the use of Euro as a main currency in circulation, and how affordable are the costs in comparison to benefits brought by the Europeanization of the Kosovo's economy.

Key terms: Kosovar Economy, Euro, costs, benefits.

Introduction

One of the numerous challenges arising before Kosovo immediately after the conflict was the selection of a monetary structure. Considering the great rush for possession of cash and currency exchange, and the disappearance of the Yugoslav Dinar

¹ UNMIK - United Nations Mission Interim in Kosovo.

as a means of transaction, it was no surprise that in September 1999, by one of its first rules “On currency allowed for use in Kosovo”, UNMIK legalized the German Mark and other foreign currencies in Kosovo. In fact, it was the Kosovo population itself which had adopted the German currency as its common money. The UNMIK Regulation had only identified the German Mark as the currency in which the budgets, financial records and accounts of public organizations, agencies and institutions, including UNMIK itself, would be formulated. Simultaneously, this rule would offer all stakeholders the freedom to enter into any contract or any other voluntary transaction, based on a generally recognized and accepted currency. Furthermore, this rule had removed all checks and limits of currency exchange from possession, use or placement of any currency, in cash or bank account, transferred within or from outside of Kosovo.

The German Mark was unilaterally adopted, as a *de facto* legal currency, and there were no negotiations with the German Bundesbank or the Central European Bank at that time². Such adoption would come after two decades of extreme monetary instability, associated with a high rate of unofficial use of the German Mark as a reserve value and means of exchange. In the pre-conflict period, the German Mark was the most used currency; there were considerable amounts of cash in circulation. The population had become familiar with the currency. Following adoption of the DEM as a legal tender, unilaterally set by the United Nations Interim Administration Mission in Kosovo (UNMIK), the transition to Euro would come as a natural sequence, implemented by the European Union States³. Remittances sent by the Kosovar diaspora, estimated at €500 million in 2002, had already created a consistent and considerable movement of cash into Kosovo for several years. These incomes were virtually all in cash. After the conflict, in the absence of banking services in Kosovo, the largest part of foreign direct assistance in Kosovo also underlined the necessity of cash.

The CBK aims to implement financial policies which in a close future will make it part of the ECB. The Euro is an official currency in Kosovo, since February 2002, but Kosovo is not part of the EuroZone, since a prerequisite to integration with the ECB and the Euro-Zone is the integration of the country in the EU. The fact that the ECB monitors and oversees the cash flow, transfers, payments, loans in Kosovo already underlines that in a way or another, the CBK is member of the ECB, although not a fully fledged member (it does not enjoy the right of emission of currency). This means that for the Euro is the official currency before membership with the EMU. Therefore, unilateral

² The Fifth Conference of the Bank of Albania, 24-25 March 2005 (Michel Svetchine, Kosovo's Experience with Euroization of its economy), pg. 252.

³ <http://www.bqk-kos.org/?cid=1,135&archive=true>, Euroisation outside euro-zone: assets and challenges the experience of Kosovo, pg. 1.

introduction of the Euro is not an opportunity to avoid steps foreseen by the Treaty on adoption of the Euro.

The beginning of 2009 marked the 10th anniversary of the Euro, the currency which approximated economic and financial policies of hundreds of millions of Europeans. Euro countries now enjoy a larger and safer market, less endangered by depreciation and inflation. The Euro is already the largest currency in Europe and the world wide. The Euro offered Kosovo a stable monetary environment, facilitated economic transactions with the main trading partners of Kosovo, etc., but also brought some costs upon Kosovo as well, such as loss of seigniorage revenues, loss of sovereignty over the monetary policy. Nevertheless, costs may be considered bearable, in comparison to advantages brought to the Kosovar economy by the Euro.

1. Costs and benefits of a common currency

Costs of a monetary union derive from the fact that when a country abandons its own national currency, it also loses an instrument of its economic policy, consequently losing the ability of enforcing national monetary policy and exchange norms. In other words, in a full monetary union, the Central national Bank ceases to exist, or rather loses control. This implies that a country joining a monetary union will not be able to change the price of its currency (by devaluation or revaluation), to determine the amounts of such national currency in circulation, or changing short-term interest rates⁴.

It is widely known that different countries have different economic development rates. Countries with difficulties in trading balances, when joining a monetary union, will not be able to cover for the trade deficits by devaluing national currency, thereby rendering products of that country more competitive in the foreign market. Countries are also different in their fiscal systems. These differences often compel the countries to use different combinations of funding budgetary deficits. The budgetary deficit can be covered by obtaining debts (loans) and by emitting money, or by increasing inflation. Therefore, countries with a less developed fiscal system, in comparison with other countries of the monetary union, will bear higher costs in increasing revenues by increasing taxation rates, although it would be more favourable to increase revenues by inflation. But, these countries, when they join a monetary union, where members are countries with a lower inflation rate, a norm which should be observed, they should either increase their taxes, or let their deficit grow further.

While costs of a common currency are more related to the macroeconomic management of economy, benefits are most probable at the microeconomic level. Elimination of national currencies, and transfer to a common currency, is expected to produce benefits in the economic efficiency, such as:

⁴ Paul De Grauwe: "Ekonomiksi i Unionit Monetar", first edition, 2003.

- Reducing transaction costs between member countries,
- Improving allocation efficiency of price mechanisms,
- Higher transparency fosters competition, thereby bringing benefits to consumers,
- Stimulation of integration in other areas (financial, institutional, political),
- Positive effects in trading flows within the union.

The elimination of transaction costs from a currency to another is surely the most obvious benefit of a monetary union. These costs are eliminated when countries use a common currency. The EC Commission has accounted for these benefits, and has resulted into a figure of between 13 and 20 Billion Euros annually⁵. This makes for one fourth and up to half of 1 percent of the GDP of the Community. This might seem irrelevant at first sight. Nevertheless, it must make part of the list of benefits from a common market. Research in various countries has shown that around 5% of banking revenues are fees paid to banks in exchanging national currency. This revenue source seems to vanish with a monetary union.

Elimination of transaction costs brings about also indirect benefits (although hardly measurable). The introduction of the Euro should provide for a greater transparency in prices, meaning that consumers can now see prices in common currency units and be able to compare and trade better. Lower transaction costs and a greater price transparency, according to Euro supporters, are considered to be the largest benefits of using a common currency.

It is widely known that economic agents base their decisions related to manufacturing, investment and consumption on the information obtained by the price system. If prices are unstable, the number of decisions on these purposes will decrease, therefore meaning that the pricing system will transform into an indicator to render fair economic decisions. Therefore, the use of a common currency, which requires the observation of many criteria set forth by the ECB, decreases inflation risks, and thereby providing a signal to individuals to take decisions on production or investment.

Existence of a common currency also stimulates integration in other areas, financial, institutional or political. Existence of a common currency also fosters a greater trading cooperation within the Union members.

2. Benefits of the Euro to Kosovo

2.1. Support to the development of the financial sector

The financial crisis in the former Yugoslavia had largely ruined the confidence in the banking system of that time. In this manner, with such an experience of inflation and collapse of the Dinar, it would be fairly difficult to regain the trust in a new financial sector in Kosovo, without having a stable currency. Therefore, the adoption of the Euro was a great facility in building

⁵ Paul De Graue: "Ekonomiksi i Unionit Monetar", first edition, 2003, pg. 60.

public confidence in the banking sector, and considering that assets and liabilities of the banking sector are reported in Euros, banks are virtually not exposed to risks of currency discordance (or the risk of exchange rates). As a result of Euro sustainability and stability, almost all deposits are made in Euro⁶.

Euroization supported the development of the financial sector of Kosovo, which needed to rebuild from scratch after the conflict. In the beginning, there were no banks in Kosovo, and practically all transactions were made in cash. For almost two years, the only financial entity in Kosovo was the Micro Enterprise Bank (MEB), which had specialized in micro-loans. During the period between March and November 2001, six banks were established, thereby facilitating the much needed competition in the sector.

In 2002 and 2003, the seven commercial banks of Kosovo expanded exponentially. In due consideration of the low economic development rates and negative experiences with the banks in the past, the banking system in Kosovo is characterized with a high presence of foreign banks. Domination of foreign banks is present also in the number of banks, and percentages of total funds of the banking sector. In 2009, foreign banks had six out of eight commercial banks operating in Kosovo, while making 91.67 percent (91.5 percent in 2008) of total turnover of the banking sector. It is important to underline that the banking sector in Kosovo is expanding its activities. This is shown by a persistent growth in the participation of assets, loans and deposits in the Gross Domestic Product (GDP). The participation of the banking sector in the GDP has grown to 56.5 percent in 2009, from 47.0 percent in 2008⁸. The banking sector means got to a value of 2.1 Billion Euros in 2009, which is an increase of 21.5% from 2008. In volume, loans have grown for 9.2%, fostered mainly by a growth in deposits.

One must mention that all Kosovo banks do achieve, and a majority exceed, the minimal amount of equity of 5 Million Euros as required, thereby ensuring compliance with EU directives.

2.2. Reduction of cash in circulation

Reduction of cash in circulation was one of the key objectives of the CBK. This change provided a unique opportunity in achieving the objective, and at the same time facilitating consolidation of the banking sector. The CBK planned to exchange family amounts of up to 1000 German Marks for free for persons, and established a fee of 2% for amounts between 1000 and 10000 German Marks. This was also the maximum allowed amount of money to be exchanged. Amounts which went beyond 10.000 DM would be placed as banking deposits into Euros.

⁶ <http://www.bqk-kos.org/?cid=1,135&archive=true>, Euroisation outside euro-zone: assets and challenges the experience of Kosovo, pg. 31.

⁷ <http://www.bqk-kos.org/?cid=1,69>, Financial Sector Bulletin, Prishtina 2010, pg. 8.

⁸ <http://www.bqk-kos.org/?cid=1,134>, CBK Annual Report 2009, pg. 40.

Establishment of maximum ceilings over exchange amounts, and a clear definition of a deadline for the period of circulation of both currencies, largely encouraged possessors of such money to deposit their money to the banks, instead of risking loss of deadline. This strategy was then coupled with bank incentives, which had already improved and multiplied their services, to attract new client accounts. This activity was not easy, and was associated with several problems, the biggest obviously being the lack of trust in the banking system. At that time, the commercial banks of Kosovo had only 24 offices, while the CBK operated with a network of 23 offices, in which more than half were small local agencies, working in limited hours, and 7 groups of mobile banks. Nevertheless, the three months period before the change of cash marked an increase of approximately 300 Million Euros in banking deposits. The amount of deposits in the banking sector in 2007 got to the amount of 1.1 Billion Euros, which was 23.5% more than 2006.

The introduction of Euro was finished successfully on 28th of February 2002. From this moment, the Kosovo economy was fully and effectively “euroized”⁹. Euroization is often defined as the adoption of the Euro as a legal and official currency by authorities of a country outside of the Euro-Zone. This means that Kosovo does not have independent monetary policies, and neither does it enjoy any control on interest rates. It is a country which has recognized the Euro as an official currency, but it is yet to become a member of the European Monetary Union.

2.3. Monetary stability

The Euroization brought a long-awaited monetary stability to Kosovo. By decreasing inflation and eliminating risks of exchange rates, Euroization brought to a post-war Kosovo a stable monetary environment, which is much demanded for economic development, though not sufficing alone.

At a time when Kosovo chose Euroization, annual inflation rates were at over 40%. Its official currency (the Dinar) had depreciated totally, and its use was almost non-existent. UNMIK was not only replacing a depreciated national currency, but was also establishing a sound monetary establishment, much necessary for an economic, social and political reconstruction in the years to come¹⁰.

Inflation in Kosovo did not disappear immediately after the introduction of the German Mark, and Euro later. In the years of 2000-2001, Kosovo marked double-figure inflation, helped also by large foreign assistance and private incomes. Consequently, inflation was considerably slowed down, and is now

⁹ Myrvete Badivuku-Pantina: Costs and benefits of Euroization in Kosova, 3rd International Scientific Session “Challenges of the Knowledge Society”, University “Nicolae Titulescu”, 2009, Bucharest, pg. 8.

¹⁰ Erdin Maloku, Monetary policy and the Central Bank of the Republic of Kosovo – advantages and disadvantages of the use of Euro in Kosovo, Prishtina, 2010, pg. 66.

maintaining a figure below average inflation of the Euro-Zone. Obviously, there are other contributing factors apart from Euroization, such as for example the high unemployment and poor economic activities. 2009 had marked a deflation of 2.4%, mainly affected by the lower prices of import.

In general, adoption of the Euro as a national currency brought monetary stability to Kosovo. The risks of depreciation of the national currency were eliminated. The CBK, which operates as a fiscal agent for the local administration, is not subject to exchange risks, while managing official reserves. These reserves are mainly invested in Euro-Zone countries, central banks and financial institutions. In the same manner, the Euroization has prevented a double exchange rate of currency, legally and informally. This fact should have brought a lower cost of loaning and investment growth, in promoting economic growth and welfare.

Nevertheless, the global financial crisis, which affected the whole world, has had its toll in Kosovo, especially in attracting foreign investment and remittances. The internal gross product marked a decrease, economic growth declined to 4.4% in 2009, in a comparison with 5.4% in 2008. Public expenditure marked an increase of 39%, making for 14% of the GDP in 2009. The trading deficit was 37% of the GDP, while exports only marked 8.6% of imports, and only 6% of the GDP in 2009¹¹.

2.4. Reduction of transaction costs

Reduced transaction costs related to a smaller number of foreign exchange transactions are often thought to be one of the major benefits of a monetary union¹².

Euroization eliminates transaction costs with economic partners who also use the Euro, but obviously it does not eliminate transaction costs with countries using other currencies. Elimination of transaction costs should facilitate foreign exchange, and furthermore increase economic productivity. Apart from these, the use of Euro left behind the bureaucratic exchange controls, thereby enabling Kosovo entrepreneurs to trade without any administrative obstacles. Nevertheless, independently of the possibility of Euro benefits in relation to the reduction of transaction costs, it will depend on Kosovo itself to reallocate labour and capital – which earlier were employed in funding foreign trade operations, for a more productive economy, such as other financial and economic activities. However, the low transaction costs brought by the use of Euro must be viewed as an additional factor to economic growth, but not as a key factor. The high trading imbalance continues to be a great challenge for the economy of Kosovo. Heavy reliance of economy on imports,

¹¹ <http://www.telegrafi.com/ekonomi>, The Crisis has hit Kosovo too (Kriza ka goditur edhe Kosovën).

¹² Jan Zika, IES FSV UK, Cost and benefits of a monetary union, European Economic Policies, 2005\2006, pg. 5.

and a low export rate at the same time, has brought to a high trading imbalance in Kosovo. As a result of global crisis in 2009, exports and imports marked a decline, while the trade deficit only marked a modest annual growth rate. High imports have brought to a trade deficit in 2009 to the figure of 1.7 Billion Euros (44.5% of the GDP), while exports were only at 8.6%¹³. As in other years, the deficit was mainly covered by remittances of Kosovars working abroad, and by the donor sector.

2.5. Macroeconomic Stability

Euroization in Kosovo had also several long-term political objectives. Euroization in Kosovo is expected to take care of economic stability, to solve the problem of confidence, and most importantly, to improve fiscal discipline, by eliminating the possibility of emitting money to cover for budgetary deficits. After a longer period, when other conditions are met, all these factors would need to have an impact on attracting foreign direct investments to Kosovo¹⁴. Also, it is thought that the use of a stronger international currency would bring about the decline of interest rates, thereby attracting investment, and as a result, a positive influence in development of economy.

2.6. Declining interest rates

A common currency facilitates the decline of nominal interest rates, thereby promoting investment and economic growth¹⁵. One of the benefits of Euroization was supposed to be the levelling of interest rates in Euro-emitting countries. The introduction of the Euro in Kosovo was expected to decrease capital costs and foster a faster economic growth.

Table 1. Average effective interest rates

Average affective interest rates in commercial banks, in % (August-December 2009)		
	Interest rates	
	Kosovo	EU
Deposits		
Household: over 2 years	5.38	2.53
Non-financial corporate: over 2 years	4.58	2.77
Credits		
Household: up to one year	13.00	7.28
Non-financial corporate: up to one year	15.44	4.17

Sources: CBK, ECB 2009.

¹³ <http://www.bqk-kos.org/?cid=1,134>, CBK Annual Report 2009, pg. 51.

¹⁴ <http://www.bqk-kos.org/?cid=1,145>, Kosovo experience in euroization of its economy.

¹⁵ D.MarioNuti, Cost and benefits of unilateral euroisation in Central Eastern Europe, January, 2002, pg. 7.

Nevertheless, table 9 reflects a large difference between interest rates in EU and in Kosovo. Specifically, interest rates in Kosovo are much higher than EU. Most importantly, the spread of interest rates in Kosovo shows that in Kosovo, households enjoy a discounted loan interest rate versus the non-financial corporations, while it is the opposite in EU. This shows that priorities of financing in the EU are different. In a specific manner, this would be argued with the fact that the capital cost in EU is cheaper for the non-financial corporations than households, thereby encouraging investment. It can be noted thus, that the capital costs for households in Kosovo are cheaper than those for non-financial corporations. This may to an extent explain the slow investment pace in Kosovo.

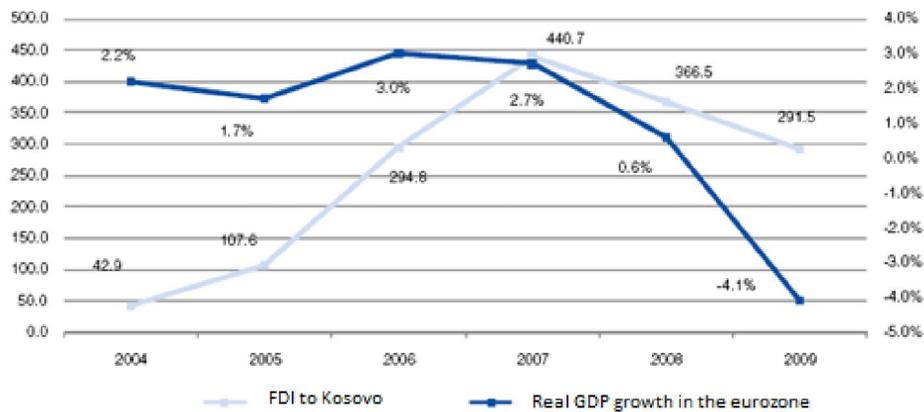
Although interest rates are considered to be rather high for Kosovo, they would be even higher if Kosovo would have its own national currency, since exchange rates would have to cover for risks related to the inflation forecasted on currency fluctuations, to not mention fund costs, which would be much higher for an unsafe and unstable currency.

2.7. Lower currency risks

According to Eichengreen (2002), lack of sustainability of national currency creates a greater risk for failure in payments, which causes a higher debt cost. Many countries which have their own national currencies have to face a higher cost of loans, due to difficulties in performing on their obligations. The EUroization in Kosovo has eliminated the possibility of depreciation of the currency. As such, the internal risk in Kosovo was eliminating by giving domestic enterprises the possibility of easier access to both internal and international financial markets. According to this theory, Kosovo would enjoy an investment growth due to a lower cost, which would in turn reflect in an economic growth¹⁶.

¹⁶ Erdin Maloku, Monetary policy and the Central Bank of the Republic of Kosovo – advantages and disadvantages of the use of Euro in Kosovo, Prishtina, 2010, pg. 70.

Figure 1. Foreign direct investments in Kosovo, and economic growth in the Euro-Zone



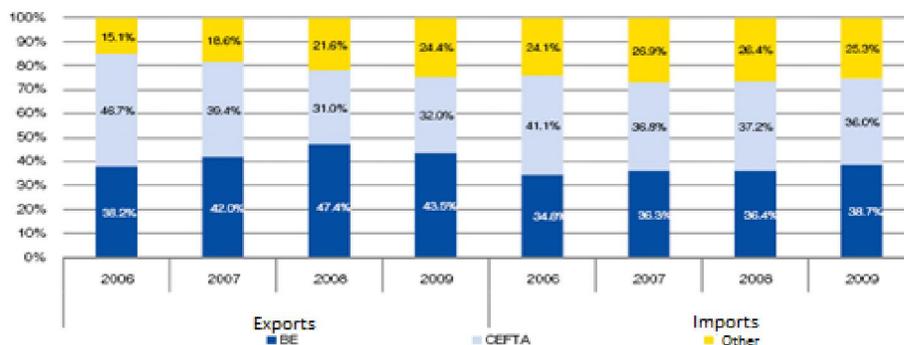
Source: Annual BCK Report (2009)

In contrary to the theory, Euroization in Kosovo did not facilitate the decline of loan costs, nor in the increase of investment. In comparison to other countries of the Western Balkan, which have their own currencies, Kosovo bears a higher loaning cost and a lower economic growth rate. Nevertheless, loan costs and growth are not only dependant on exchange choices. There are other institutional features in Kosovo which largely affect its economic performance, specific being the lack of sustainable state institutions. Furthermore, neither the government nor domestic companies can obtain foreign debts. Lack of clear warranties discourages direct foreign investment.

2.8. Faster monetary integration with the Euro-Zone

One of the arguments for Euroization is a faster economic integration with the Euro-Zone. This requires an increased level of market integration, with the assumption of decreasing trade limitations. There is also an expectation of a better access to international financial markets.

Figure 3. Trading structure by trading partners, in percentages



Source: Annual Report, CBK (2009)

Considering the data in Kosovo, trade in the EU has increased considerably, as a result of lower transaction costs related to the use of the Euro. Main trade partners of Kosovo remain the countries of the European Union (EU) and member countries of CEFTA¹⁷, with which Kosovo, in 2009, had 74.4 percent of its trade. Kosovo exports with EU countries, in 2009, marked a decline of 24.7 percent, which is higher than the decline of exports towards the CEFTA countries, which reflects a higher impact of the economic crisis in the EU countries. Nevertheless, participation of exports with these countries in the total of Kosovo exports was 45.5 percent, which is an increase of 2.8 pp, in comparison with 2008¹⁸.

EU and CEFTA countries were the main trading partners of Kosovo also in imports, with a participation of 38.7, respectively 36 percent in total imports. The greatest participation in imports from the EU countries was taken by German countries, with a value of 235.4 Million Euros, or 12.4% of total imports in 2009.

3. Costs of Euroization for Kosovo

Although as presented above, the Euroization had positive effects for the economy of Kosovo, it also brought its costs. Nevertheless, costs would be bearable in comparison to advantages of euroization. The most obvious costs for the Kosovar economy are considered to be the following:

3.1. Loss of Seigniorage revenues

Seigniorage means the difference between interest earned on securities acquired in exchange for bank notes and the costs of producing and distributing those notes. A key direct cost of Euroization is the loss of Seigniorage revenues by producing domestic currency, because they (member countries) do not represent anymore the producer of an official currency used

¹⁷ Central European Free Trade Agreement.

¹⁸ <http://www.bqk-kos.org/?cid=1,134>, Annual Report 2009 of CBK, pg. 52.

in the country. It is known that the budget deficit may be financed by obtaining a loan and by emitting money or by increasing the monetary basis (by increasing inflation). By Euroization, economies do not have access to printing money, and therefore they cannot generate funding sources in emergency cases¹⁹. When a country joins a monetary union, that country should obviously maintain an inflation rate within the boundaries set by the union. Therefore, less developed countries, when joining a union of more developed countries, they would even have to reduce inflation rates, since developed countries have a lower inflation rate. In this manner, authorities are bound to use various policies, such as emergency taxes to fund their expenditure.

In transition economies, Seigniorage revenues are usually low, maybe 1-2 percent of the domestic product (Shcobert, 2001)²⁰.

In the case of Kosovo, the loss of Seigniorage revenues was considered to be a rather low cost. If Kosovo would have its own national currency, possible revenues from producing money would be negligably low. One must state the fact that when Kosovo had a double currency system (DEM and Dinar), and further turned towards using the strong DEM currency to use the Euro later, the use of domestic currency would be small, considering the fact that the people living in Kosovo would keep their savings in Euro. As a result, in a view of large Euroization, the use of a domestic currency would be very small in Kosovo. In general, the cost incurred due to the absence of sources from making money was strongly displaced by the stability and credibility brought by Euroization.

3.2. Loss of sovereignty over monetary policy

Adoption of a currency other than the national currency makes the monetary policy move from the Central Bank of such a country to the European Central Bank, which is responsible for preserving price stability in the Euro-Zone. Nevertheless, several years ago, the CBAK had initiated a dialogue with the European Central Bank, which concluded with a signature of the Memorandum of Understanding between the two institutions. By this Memorandum, the CBK was exempted from a part of the financial burden related to the transport of banknotes and Euro coins for circulation into Kosovo.

The loss of monetary policy independence in Kosovo should not be taken as a large cost. Since the economy of Kosovo is in transition, it is rather useful for it to have a sustainable monetary policy. Having gone through a hyper-inflation period in its history, it would have been very hard for Kosovo to create confidence in its currency.

¹⁹ Jetmir Likaj, Euroisation in Kosovo : Benefits and costs, Amsterdam, July 2006, pg. 32.

²⁰ Domenico Mario Nuti, Albania and the Euro, pg. 116.

3.3. Loss of “regulatory powers” of national policy

Countries which impose completely free currency exchange rates, and which do not pertain to the monetary union, with a view of potential benefits from trade expansion. A country, when facing a loss of competitiveness of domestic products, by devaluating the domestic currency, it influences the growth of competitive ability of domestic goods, thereby creating opportunities for export growth²¹.

3.4. Difficulties in realizing the function of “creditor of last resort”

The stability of a banking system depends on the abilities of the central bank to provide short-term credit for banks and other financial institutions in case of liquidity risks. This way, the Euroization eliminates the capacity of emitting money, thereby rendering difficult the function of the creditor of last resort. Nevertheless, Chang (2000) and Wojcik (2000)²² argue that there are three other ways of replacing this function. Firstly, the Government may provide liquid funds to commercial banks, or by accumulating foreign reserves or by loaning from international financial institutions. Secondly, the presence of foreign banks reduces the need for a creditor of last resort. The third way is by introducing higher liquidity demands for the domestic banking system.

Firstly, the function of creditor of last resort is rather difficult to substitute in Kosovo. Considering that the Government of Kosovo is facing with a deficit of current accounts of 16% of the GNP, it does not have surplus funds neither great amount of currency reserves.

Secondly, the large presence of two foreign banks, with a deposit market share of 66.8 percent in the banking system of Kosovo, reduces the need for the function of creditor of last resort. Foreign banks can easily obtain funds from their parent institutions in case of risks of liquidity.

Thirdly, the CBK has continuously increased minimum requirements of capital for banks, thereby achieving the level of 5 Million Euros since 2006. According to Basel Standards on sufficiency of capital, the total capital in the banking system marked 17.9 percent of assets pondered on 31 December 2009. This policy may be considered as a substitute of the function of creditor of last resort.

As a conclusion, none of the three alternatives to the function of creditor of last resort can be implemented in Kosovo without incurring major expenditure in the economy as a whole.

²¹ Myrvete Badivuku-Pantina: Costs and benefits of Euroization in Kosova, 3rd International Scientific Session “Challenges of the Knowledge Society”, University “Nicolae Titulescu”, 2009, Bucharest, pg. 10.

²² Jetmir Likaj, Euroisation in Kosovo: Benefits and costs, Amsterdam, July 2006, pg. 31.

Conclusion

The adoption of foreign currency as an anchor in Balkan is not a recent phenomenon. Since the second half of the 20th Century, former Yugoslav countries used DEM, as a first or as a second currency. The political divorce of former Yugoslav republics only strengthened further the role of the DEM in these economies, thereby resulting into recommendations of an official unilateral Euroization. Nevertheless, such an official unilateral Euroization is most like to bring about considerable benefits, but also major costs.

The adoption of the Euro in Kosovo brought more benefits in terms of ensuring macroeconomic stability in economy, which is of major importance. Experiences of inflation, including the financial system collapse in the former Yugoslavia of the 90-ies, undermined the confidence on the national currency, and consequently it brought a high rate of currency replacement, in Kosovo and its neighbours. Considering the unique political and economic status of Kosovo, the necessity of a stable monetary environment, it is essential to construct a sound macroeconomic framework. Therefore, the adoption of the Euro as a legal tender of the territory was associated with numerous benefits.

The Euro brought a much needed monetary stability, by lowering inflation, by eliminating the risks of exchange rates, which as a result, facilitated the reduction of transaction costs and in promoting trade and investment.

However, the theory had been much more promising. In terms of reducing transaction costs, despite the increased trade with the EU, international trade is still concentrated in neighbouring countries which do not use the Euro as an official currency. Although the currency risks have been eliminated, Kosovo is yet to enjoy this benefit, due to a lengthened state status. On the other hand, instead of reducing domestic interest rates, Euroization has not reduced these interest rates. To this day, Kosovo has the highest interest rates in Balkan.

As with any medicine, Euroization has its own side effects. The loss of monetary policy and exchange rates were at the forefront of the argument. Although the adoption of Euro includes some loss of competitiveness in relation to exports, monetary policy only has a provisional effect. The only permanent solution in the way of fiscal policies can pump production and foster exports. Loss of seigniorage is irrelevant in the case of Kosovo, because Kosovo did not have its currency before Euroization.

In facing with possible contractions in using monetary mechanisms, a diligent banking oversight is of high importance. Such careful measures are the best ways to ensure financial stability, as part of a more comprehensive stabilizing objective. Other additional careful measures based on a well maintained financial system, which could be the promoter of objectives to a wider development and growth in Kosovo.

The path towards European integration includes the adoption of the Euro in the future. By making this step, and with the assistance of the international community, Kosovo will not only be prepared for possible integration, but can

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already use the Euro in an active manner, as an instrument to go towards the European Union.

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