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A Micro Level Perspective of Euroization in Albania

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The wiiw Balkan Observatory

Global Development Network Southeast Europe

A Micro Level Perspective of Euroization in Albania[1]

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Abstract

This research investigates what drives the euroization in Albania. By using survey data collected in one of the main Albanian cities, we find that factors like remittances, financial literacy, perception of high inflation and trust in financial system play an important role in the extent of euroization together with the experience of past events. Factors related to the future, such as the expectation on the exchange rate fluctuations, seem to not be correlated with the extent of euroization. As regards the current Eurozone crisis, its impact on euroization results to be mediated by the (mis)trust in EURO rather than local currency.

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Introduction

The IMF concluding statement, issued on October 2012, says that "*since the onset of the global crisis in 2008, Albania has avoided a sharp fall in output and maintained banking system stability, thanks to a fiscal stimulus, sound monetary policy and effective macroprudential actions*".[3] Based on the most extensive and credible international and national sources, Albania seems to have done important progress over the last decade improving infrastructure (transportation and electricity supply), fiscal and legislative system and what is more important has saved somehow herself from the 2008-2009 financial crisis. Although this salvage from the crisis is still debatable from the Albanian political parties, it remains a fact that Albanian financial system was not so directly exposed to financial risk due to its weak development and the economy was not integrated into the EURO zone. In effect, the GDP growth has decreased from 2009 to 2011 but still remains positive and all macroeconomic statistics related to the economic growth, unemployment, inflation and banking system show that macroeconomic stability is preserved.

Despite macroeconomic stability, de facto euroization is very spread in Albania and EURO has massively replaced LEK, the local currency, in real estate market, touristic packages, private university fees, flight or ferry tickets, and in some cases apartment renting.[4] This phenomenon is common for the Balkan countries (such as Serbia, Croatia, Macedonia and Bosnia-Herzegovina) who have not introduced EURO yet and also for the Central, Eastern Europe countries as shown in the Austrian National Bank reports.

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[3] See Concluding Statement of the 2012 Article IV Consultation Mission, October 2012.

[4] EURO was introduced on January 1, 2002. Some countries adopted officially EURO by joining the European Monetary Union (EMU) – de jure euroization - and such euroization is considered as bilateral while some others adopted it unilaterally, without joining EMU and without explicit prior sanction by the EMU institutions. De facto euroization or unofficial euroization occurs when individuals or firms voluntarily choose to use EURO as a transaction currency (currency substitution) or as value storage (asset substitution. We use the term de facto euroization because Albania has not unilaterally introduced EURO as Kosovo and Montenegro did (de jure).

Why people in Albania keep EURO while the economy is stable? Is it because they mistrust the Albanian currency or mistrust the banking system? Do they want that EURO be officially adopted? These questions will be addressed in this research by using survey data collected in one of the main cities of Albania.

Those in favor of euroization (or dollarization) claim that by adopting a stronger currency than the local one may help to avoid currency and balance of payment crises and lead to a reduction of interest rates and exchange rate volatility. Those against it, state that adoption of a foreign currency implies also a loss of segniorage on the monetary policy and income as the opponents of euroization used to claim. However, is EURO a stable currency? One of the euroscectics, Paul Krugman (2012) claims that this EURO "is built on shaky foundations, and that will continue to be the case until a common European bank guarantee scheme is established. In the meantime, the system can quite comfortably survive if it is treated to a sufficiently strong dose of inflation".[5]

Nevertheless the macroeconomic importance of the phenomenon of euroization, this research looks into it from the individual point of view by using survey data run in one of the main cities of Albania. A micro approach is very relevant especially in countries like Albania where the cash circulation is widespread and therefore foreign currency denominated cash is underestimated by the macroeonomic monetary statistics. Accordingly, the variables accounting for the extent of currency and asset substitution are regressed on a set of explanatory variables proposed by the literature such as: the role of past inflation, the future fluctuations of exchange rates, the network effects, financial literacy, trust in banking system and EURO/LEK, remittances and visits abroad and personal characteristics such as age and occupation.

The results show that the phenomenon of currency substitution is mainly driven by variables related to the past and present rather the future. The role of remittances is confirmed together with the financial literacy and trust in financial

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[5] See Interview with Paul Krugman, September 2012;
http://www.presseurop.eu/en/content/article/2648061-paul-krugman-euro-shaky-construction?xtor=RSS-18

system. As regards the current Eurozone crisis, its impact on euroization results to be mediated by the (mis)trust in EURO deposits rather than lek deposits.

The paper is organized as follows: Section 2 deals with the literature review, Section 3 describe the Albanian macroeconomic prospect and Section 4 the survey sampling and summary statistics; in Sections 5 and 6 the estimation methodology and results are discussed while Section 7 present the conclusions.

2. Literature Review

The literature on the euroization phenomenon and its persistence has revealed several potential factors driving this process that can be related to past experience and future expectations. Starting with the factors related to the past experience, Feige et al. (2003) and Nicolo et. al. (2005) argue that the lack of confidence in local currency and credibility of economic policy due to past events may affect the euroization in the way that high confidence in the banking system may help to increase the share of foreign currency deposits but decrease that of foreign currency cash.[6] As regards the factors related to the future expectations, Ize and Yeyati (2003) state that euroization occurs when expected volatility of inflation exceeds the volatility of exchange rate.

Other factors result to be important determinants of euroization. Feige at al. (2003), Oomes (2003) and De Freitas et al. (2004) emphasize the role of the network effect or externalities and the role of transaction costs. In effect, Feige and Dean (2004) observe that for those highly euroized CE-SEE (Central, Eastern and South-eastern Europe) countries, the use of foreign currency for transaction purpose is almost irreversible for network reasons even if they may undertake macroeconomic measures to reduce inflation risk. Also Ize and Yeyati (2003) argue that portfolio decisions are highly linked with the extent of euroization. On the other hand, another strand of literature highlights the importance of individual characteristics on euroization. In this view, Seater (2008) argues that high-income households are more prone for currency substitutions than low-income households. Apart this, the portfolio decisions are

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[6] Yeyati (2006) differently defines it as the "collateral cost of low institutional credibility".

determined by the macroeconomic indicators such as fluctuations in the interest rates, exchange rates and the inflation rates and the perceived risks of financial assets as well as the trust in the banking system.

In the last five years, OENB experts have contributed a lot to the topics of euroization in Central, Eastern and South Eastern European (CESEE) countries thanks to the availability of the OENB EURO Survey which is quite unique in the fact that provides micro data on euroization for several CESEE countries. Dvorsky et al. (2009) present some evidence of household's reactions to the crisis by using the third wave of the OeNB EURO Survey, (conducted when the global financial crisis had arrived in Europe (more precisely in October/November 2008) and show that although people's general assessment of the economic situation and their trust in banks have both deteriorated substantially this has not (yet) changed people's behavioral patterns in terms of their foreign currency holdings. In particular, the dissemination of EURO cash holdings and euro-denominated savings deposits remained stable relative to earlier waves of the OeNB EURO Survey.

Furthermore, the OeNB EURO Survey's spring wave conducted in May and June 2010, at a time of drastic consequences of the crisis in the EURO zone, reported that the CESEE households do still have more confidence in EURO and EU institutions than their own currencies and governments. Consequently, they didn't reshuffle their portfolio diversification plans and their euroization tendency. Stix (2010) questions the persistency of euroization in Croatia, Slovenia and Slovakia and finds that while the positive role of network effects, remittances, education and income is confirmed by the data, the role of expectation on inflation rates and exchange rates is not.

Recent research on euroization, (Nicolo et al.2005, Scheiber and Stix, 2009) show, that the CESEE households are highly sensitive to changes in trust in institutions and what is more importantly to changes in the trust in banking system and local currency. But, while the response in sentiments to the crisis is immediate - the OENB experts report – the real effects on the economic situation of these countries come in a

sluggish way and EURO remains more trusted than the local currencies as a safe haven currency. [7]

3. Euroization trend in Albania

Conditional on the data availability, different indicators are used to measure euroization at a macro level. One of these indicators is the percentage of foreign currency deposits to total deposits, defined as foreign deposit currency (FCD) substitution or asset euroization. Another indicator of euroization which may be considered as more suitable in case of transition economies, where the citizens do not have both financial literacy and trust in institutions and thereafter avoid to channel their savings through the banking system, is the percentage of foreign currency cash (FCC) to the total cash.

In Albania, while the former indicator ranges from 30% in 2002 to 49% in 2011, according to the Bank of Albania, only estimates are available for the later. To mention some estimates, Sojli (2004), by taking into account the FCC, finds that euroization in Albania was at 36% in 2002 while Muco et al. (2006) find a higher level of euroization at approximately 45% in 2005. They also suggest that while a de jure euroization seems somehow an unrealistic proposal due to its technical and political complexities, a "consensual euroization" that trades off some of the rights of joining EMU for more "convergence criteria" may sound more rational. Xhepa (2002) reviews the phenomenon of euroization and its consequences on the Albanian economy emphasizing the importance of a real convergence to EU economy in terms of GDP per capita, average price level, economic structure, liberalization of capital markets and labor mobility.

How did Albanian financial authorities manage the Eurozone debt crisis? According to IMF report (2011) "without any implications on the direction of causality, empirical analysis on data in some South and Eastern European countries shows that a

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[7] See Beckman and Scheiber (2012): Focus on European Economic Integration   Q2/12 report.

higher degree of Euroization is associated with higher default probabilities and higher nonperforming loan levels." However, in case of Albania, it seems that the banking system has been resilient to the crisis as banks were not exposed to any risk and were well-capitalized.[8]

Indeed, in the beginning of Eurozone crisis, the last quarter of 2008 and the first quarter of 2009, confidence of the public in the banking sector was shattered and this was reflected in massive savings withdrawing and a reduction of the total amount of deposits by 8.6%. To preserve the parameters of the financial stability and of the activity's capitalization one of the measures undertaken by the Bank of Albania in March 2009 concerned to some amendments to the law "On deposits insurance" which consisted mainly in raising the amount of insured deposits from 700 000 to 2 500 000 lek. Afterwards, in the last trimester of 2009 and subsequently, the deposits increased by 1.6% and the confidence in the banking system seems to have been rebuilt.

To conclude, the drop in deposits due to the lost confidence in the beginning of the crisis was temporarily, and currently deposits have surpassed the level reached in the last trimester of 2008. Specifically, according to the Bank of Albania, deposits in August 2012 reached the highest level of 930 billion lek rewarding in this way the attractive savings campaigns undertaken by Albanian banks during the seasonal summer period the emigrants visit the country. However, it is one thing to point out that such a deposit increase is driven by deposits in foreign currency which almost equalized the share of lek deposit for the first time in these twenty years (Figure 1, Appendix A).

4. Description of survey sampling and data

The survey was conducted in the city of Elbasan, Albania during the period February-March 2012 by using snowball sampling technique. 350 individuals were subject to this survey but only 309 interviews were valid and such number exceeds

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[8] See IMF Country Report No. 11/313.

0.1% of the city population (124863).[9] The survey inquiries into the extent and the reasons that drive the phenomenon of euroization (currency substitution). The survey is made of 3 modules: 1) socio-demographic module (gender, residence, household size, civil status, age, education level, occupation sector); 2) portfolio diversification (expected inflation, expected exchange rate, cash in foreign currency (FCC), deposits in foreign currency (FCD), current account, salary account, deposits and credit cards, loans (evaluation, deposit and inflation) and 3) crisis impact on the euroization (whether was personally affected by the crisis, changes in EURO holdings, reliability of EURO versus reliability of Lek, trust on financial institutions, remittances trend changes). The last question was related to the desirability of EURO in Albania.

Starting with the characteristics of the sample, Table 1 (Appendix A) shows that 56% of them are women, living mainly in the city of Elbasan; 44% of them live in households composed of 4 members and 22% in households with less (more) than 4 members. While half of them are aged from 35 to 51 years, 31% are younger than 31 years. Finally, the sample is obviously biased towards tertiary educated (67%) and secondary educated (27%).

The interviewees were asked on their perception on inflation trend in the last twelve months and their expectation on local currency exchange rate versus Euro. As Table 2 (Appendix A) shows, almost 65% of the sample say that prices increased a lot in the last twelve months and only 6% didn't perceive higher inflation. According to the latest statistics, inflation was recorded at the low level of 3% in the last 12 months preceding the survey month. As regards a potential depreciation of the local currency

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[9] Snowball sampling or chain sampling, is a non-probability sampling technique where the sample group appears to grow like a rolling snowball as the existing study subjects recruit future subjects among their acquaintances. The advantages of snowball sampling are mainly cost-saving and the easiness to locate people of specific population. The disadvantages come from the potential unrepresentativeness of the selected sample which can produce biased results.

versus the Euro, almost half of the sample expect a potential depreciation of Lek versus 16% who say no.

How do the interviewees diversify their portfolio? Starting from their cash holdings, Table 3 (Appendix A) shows that cash held in EURO prevails in 30% of cases succeeded by the cash in USD (9%) and Pound (4%); the interviewers keep cash in foreign currency mainly as a general reserve (66%), for payments abroad (50%) and inside the country (33%). While almost 82% of the sample declare to have a bank deposit or bank account, it comes out that in almost 70% of the cases it regards a salary account and 42% a bank deposit (Table 4, Appendix A). As shown in Table 4 (Appendix A) almost 29% of the deposits are held in EURO and 77% in Lek. Most of the interviewees declare to keep EURO in cash or in deposits primarily as a general reserve and secondly for payment abroad. The same ranking of motives is also revealed by the OeNB survey inferring that in SEE countries EURO is mainly kept as a store-of-value while in the CEE zone the transaction motives prevail. [10]

How is the global financial crisis perceived by the interviewees? 80% say that the crisis has really affected their financial situation, purchasing power and saving value versus 60% who mention their employment status (Table 5, Appendix A). As regard the potential impact of the crisis on the predominance of EURO holding, in Table 6 (Appendix A), we notice that 8-9% keep more cash and deposits in EURO than in Lek due to the crisis while 37% and 29% keep more cash and deposits in Lek. Here we should note that almost 50% of the sample don't answer or say to not know how to answer which implies that the interviewees seem to not be able to assess the question. However when asked on their portfolio diversification, 27% say to keep more deposits than cash, but this percentage diminishes to 23% due to the crisis. On the reverse trend (more cash than deposits), we don't notice a significant change due to the crisis.

How has the crisis affected the reliability of EURO and Lek? As shown in Table 7 (Appendix A), almost 23% find less reliable deposits in EURO versus 26% deposits in Lek while 22% seem to invariably trust both currencies. Asked on the trust in

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[10] See Scheiber and Stix (2009), OeNB Working Paper 159.

governmental institutions, Albanian and foreign banks and European Union institutions, almost 40% of the sample doesn't trust in the government versus 25% who doesn't trust in Albanian Banks and 21% the foreign banks while only 9% seem to not trust in the EU institutions. It's is clear that the interviewees mistrust more Albanian institutions than foreign institutions. The percentage of those who trust in EU institutions is at 66% similar to the statistics of 70% revealed in the OENB survey. The same holds for those who trust in governmental institutions (45% trust them in our survey compared to 43% in the OENB EURO survey).

Asked whether they withdrew their deposits in 2008 feared by the outset of financial crisis, only 13% of the sample say to have behaved in this way versus almost 40% who say no. As regards remittance receiving, Table 8 says that 78% of the sample doesn't receive remittances versus 3 and 12% who receive frequently and infrequently. While 25% say that the flow of remittances has dropped in the last 12 months, 23% don't confirm this decreasing trend. Finally, 62% of the sample are categorically against EURO as the unique currency in Albania versus 22% who favors its official use.

5. Econometric analysis and variable description

To figure out the main determinants of the euroization phenomenon in Albania we start by estimating several regressions following Probit methodology and the main dependent variables (DV) are given as:

1) DV1 is a discrete variable saying whether an individual holds EURO or not to capture currency substitution;

2) DV2 is a discrete variable saying whether an individual holds EURO cash or not to capture circular currency substitution;

3) DV3 is a discrete variable saying whether an individual holds EURO deposits or Lek Deposits to capture asset substitution;

Nevertheless, individuals do not face separately the problem of currency substitution and deposit substitutions. Instead, the decision to hold cash or assets and the decision to hold these assets in local or foreign currency may be jointly taken and

therefore should be jointly estimated. To account for the simultaneity of these two decisions we use Bivariate Probit based on the assumption that the errors terms of the two regressions follow a bivariate normal distribution.

The explanatory variables are related to the suggested variables by the existing literature as follows:

A)   Factors related to the past experience

    a. Age – under the assumption that older people have experienced more banking crisis episodes and should invest more cautiously. A positive effect of age on foreign currency holding is expected if the tendency in the past was also such that people were more used to hold foreign currency or deposits. Otherwise a negative relationship is expected between age and EURO holding.

    b. Perceived inflation in the last year - under the assumption that a high level of perceived inflation will make people to trust less to local economy and local currency and will make EURO more desirable.

    c. Confidence in the banking system – people with low trust in banking system should be less likely to hold Euro.

    d. Network effect (a dummy variable saying whether it is common in Albania to keep EURO deposits - under the assumption that one is more induced mimic the others and hold foreign currency if other do.

    B) Factors related to future expectations

    a.   Expected exchange rate fluctuations under the assumption that the expectation of unstable exchange rate system will make EURO more desirable.

C) Factors related to individual characteristics

a. Financial literacy - the individuals are asked whether the interest rates of EURO deposits are lower than those of Lek deposits. Our expectation is: the more financially acknowledgeable individuals are the more they will invest in EURO and deposits.

b. Remittances must be one of the most important factors for the degree of euroization and portfolio diversification in a migratory country like Albania.

In this survey we can recover info on the regularity of remittance receipt rather the amount of remittances. The expectation is that those who receive remittances are more likely to keep EURO.

c. The number of visits abroad in the last 12 months under the assumption that persons who those who travel more often are more likely to keep EURO for lowering the transaction and conversion costs in the future visits.

6. Estimation results

6.1 Probit estimates

The estimations results where the dependent variable is DV1 –representing the currency substitution or the overall degree of euroization - are given in Table 10 while Table 11 and 12 respectively show the results where the dependent variable is DV2 – currency substitution in cash and DV3 – deposit substitution.

Using the same ordering of variables as in the previous section, we notice that *age is negatively correlated both with currency and deposit substitution*; namely, people older than 50 are less likely to hold Euro, either in deposits or in cash. This somehow seems at odds with the findings of Stix (2010) for Croatia, Slovenia and Slovakia but may be due to the fact that differently from citizens of Central-Eastern European countries, Albanian people were not familiar with foreign currencies and financial portfolio assets before the 1990s due to the total isolation of Albanian state and economy; Albanian citizens started to approach their neighbouring countries only in the early 90s. In the same time, individuals at their 50s have migrated less than younger generations and for that reason have less experience with assets denominated in foreign currencies too.

Next, *the perceived level of inflation* in the last year seems also an important factor that determines the preference of keeping Euro. As emphasized in the Section 3, the interviewees had higher perception of inflation although the official rate of inflation in the last year was quite stable at around 3%. Nevertheless, it appears that those who perceived an increase in prices in the last year are more likely to keep EURO but they don't show any clear-cut preference for diversifying their portfolio or keeping more

deposits in EURO than in Lek. As regards the factors related to the future, the results do not reveal any significant relationship between the *expectations on the exchange rate fluctuations* (whether Lek will be devaluated versus Euro) and the degree of euroization.

The information whether Albanian financial system can be considered as stable is used as a proxy for measuring the *confidence in the banking system.* This variable doesn't seem to be significant in explaining the preference for holding EURO in cash, while it results significant in case of EURO deposits. Specifically, those who say that the Albanian financial system is stable are less likely to hold EURO deposits than Lek deposits. As argued by Feige et al. (2003), this negative relationship between EURO deposits and confidence in the banking system can be due to the past events and the questionable credibility of economic policy.

In addition, bearing in mind that the majority of the commercial banks in Albania are of foreign ownership, trust in foreign banks is used also among the explanatory variables and as expected, this variable results to be positively related to both preference for currency substitution and preference for deposit substitution. Also, *credibility of international institutions* (EU institutions) was questioned to the interviewees but the estimation results do not help to discern a clear relationship between EURO preferences and trust in EU institutions and this may be due to a lower variability displayed by this variable.

The coefficient related to the network effect is not statistically significant; on the other hand, *financial literacy* appears to be positively related with the preference for holding EURO both in cash and in deposits. This finding is in line with Stix (2010) who instead uses education as a proxy of financial literacy. Other personal characteristics such as gender or employment status and households characteristics such as household size do not help to explain the preference of the interviewees for holding EURO in cash or in deposits.

The role of remittances and the visits spent abroad is also investigated in these regressions. Remittances have shown to be an important financial source in supporting Albanian households in their economic life. As such, they can be considered as a proxy

for household wealth status as well. As expected, those who receive remittances are more likely to hold EURO and show a clear preference for keeping deposits in EURO rather than in Lek, that is, for diversifying their portfolio. This finding suggests that the receipt of remittances may play an essential role in explaining the degree of euroization and deposit substitution.[11] Also it may be interpreted by using Seater's conjecture (2008) - that is - higher income lead to an increase in currency substitution or the tendency of euroization. The number of visits abroad in the last 12 months has also the expected sign implying that those who travel more often are more likely to keep EURO for lowering transaction and conversion costs in the future visits. This fact is more evident when the number of visits is higher than one.

Last estimated coefficients are related to the desirability of EURO as official currency and the safety of EURO deposits against Lek deposits. Unsurprisingly, the results reveal that both these variables explain the preference of individuals for currency and deposit substitution; namely those who want EURO be official currency in Albania and those who consider EURO deposits safer than Lek deposits are more likely to keep EURO in cash or in deposits. The latter can be considered also as a proxy of mistrust in local currency.

6.2 Bivariate Probit estimates

As shown in Table 13, where the bivariate results are given, the estimated coefficient of correlation between the two equations – where the dependent variable is currency and deposit substitution - indicate that there is a positive and significant correlation between the unobserved factors affecting both currency substitution and deposit preference. On one hand, in case of currency substitution equation, the explanatory variables show the same trend both in significance and sign as in the univariate case. On the other hand, except two variables, namely perception of high inflation in the last year and the visits abroad, the other explanatory variables result to

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[11] The IMF report 2011 state that "remittances also helped promote financial development in Albania through the increasing demand of banking access and services from both senders and receivers and raising banking deposits and credit to GDP".

be insignificant in case of asset substitution. This insignificance may be caused by the limited number of observations in the latter regression.

6.3 Estimation results on Crisis

Is the euroization driven by the lack of confidence in local currency or the stability of Euro? Has the global economic crisis had any impact on the trustiness of Euro? The summary statistics show that the uncertainty against EURO deposits has increased from 12% to 23% due to the crisis. It is important to consider here that the survey took place in February- March 2012 when the Greek debt seemed to be at an irreversible point and its consequences were already felt in Albania through the trade sector and migration actors (financial and human capital). Also, the fear that Greek crisis would migrate to its neighbouring countries, as it happens with other EU countries, might be a an non-negligible factor in persuading people to lose trust in Euro.

In this research, the crisis impact on currency substitution is estimated through the probit regressions described above and including among the existing set of explanatory variables an extra variable, namely whether deposits in EURO are considered as unsafe due to the crisis. First, as shown in Table 14, the information as regards the perceived uncertainty of deposit in EURO and Lek due to the crisis is used to proxy the crisis' impact on the confidence on the foreign deposit and the results indicate a significant and negative relationship between the preference to keep EURO deposits and the mistrust in EURO deposits. On the other hand, it seems that the mistrust in Lek deposits attributable to the crisis does not explain the extent of euroization (Table 14, specification 2). These results imply that rather than mistrust in the local currency it is the (mis)trust in EURO currency that may determine the euroization trend in the future. Next, individuals are asked whether the crisis has really affected the value of their savings, purchasing power, family financial situation, their employment prospect and finally the value of the house. These variables are separately used for measuring the crisis impact on the euroization and the results are given in the Table 15. It appears that only those who say that the global crisis has

affected their purchasing power, family financial situation and employment prospect are less likely to keep EURO deposits while those who blame the global crisis for the devaluation of their housing and savings do not show a significant relationship with the euroization. The insignificance of the latter variable is not strange considering that the housing market in Albania has not incurred a severe shock as it happens in the EU neighbours.

7. Conclusion

This paper is a first attempt at identifying the determinants of euroization at the individual level using survey data collected in one of the main Albanian cities. To establish what are the main variables that determine the preference for asset and currency substitution, several probit and biprobit regressions are run.

Results show that factors related to past experience prevail in explaining euroization. For example, older people are less likely to hold EURO than younger ones and this may be due to the lack of past experience in managing foreign currency denominated assets and financial portfolio experienced in the Albanian society before the 90ies. High perception of inflation in the last year seems also to be correlated with preferences for holding EURO but not with preferences for diversifying the financial portfolio. As regards the factors related to the future, the results do not reveal any significant relationship between the *expectation on the exchange rate* fluctuations in the next years and with the degree of euroization. While network effect is not statistically significant, *financial literacy* appears to be positively related with the degree of euroization and asset substitution. *Confidence in the Albanian financial system* is important in explaining the preference for holding EURO in deposits but not in cash; instead, trust in foreign banks result to better explain the preference of people for currency substitution.

Remittances and the frequency of visits abroad play an essential role in explaining the degree of euroization but not that of deposit substitution. This impact of remittances on euroization might be exogenous (one keeps EURO because receives Euro) or endogenous (receiving EURO implies higher income). The latter is related to

Seater's conjecture (2008) - that is - higher income lead to an increase in currency substitution or the extent of euroization.

Is the current Eurozone crisis having an impact on how the individuals view the stability of EURO and consequently the extent of euroization? The results show that those who declare to be really affected by the crisis in terms of purchasing power, family financial situation and employment prospect, are less likely to hold EURO than the others. However, the decision to hold EURO or not is entirely attributable to the (mis)trust in EURO deposits rather than lek deposits. These findings suggest that the Eurozone economic crisis have negatively influenced the individuals' assessment as regards the credibility of EURO versus lek and may have consequences in the future extent of euroization. This result is also confirmed by the positive correlation between the desirability of EURO adoption as official currency and the preference for currency substitution.

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Appendix A

Figure 1: Deposits in lek and foreign currency during the period Jan. 2011- Aug. 2012

(extracted by the Economic Albanian Journal "Monitor": blue line refers to deposits in lek and red line to deposits in foreign currency)

Ecuria e depozitave sipas monedhës

mln lek

— lek — valute
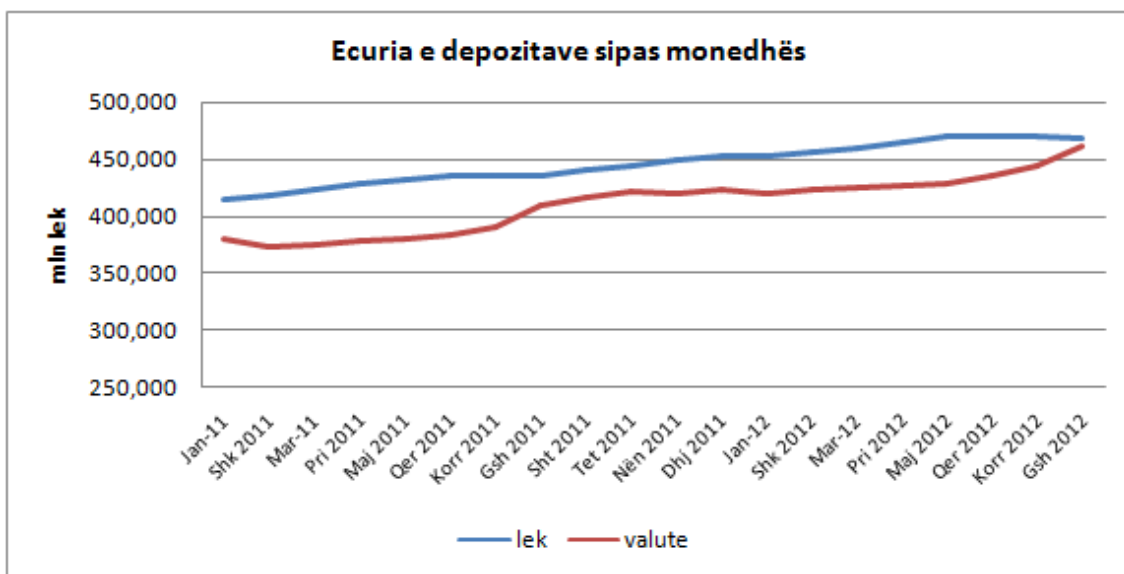
Table 1: Individual Characteristics

Gender	in %	Residence	in %	Household size	in %	Civil status	in %	Age	in %	Education	in %
Male	44	Elbasan	82,2	<4	22,4	married	240	<35	31	primary	6,23
Female	56	villages	17,8	4	43,51	single	56	<51	48	secondary	26,89
				>4 & <6	22,08	widow	1	>50	21	tertiary	66,89
				6	9,74						
mean									42,17		
Total	309		309		308		297		303		305

Table 2: Perception of last year inflation and expectations on Lek depreciation

Prices have changed in the last 12 months?		*Lek will depreciate relative to EURO in the next years?*	
increased a lot	65,02	Yes	47,65
increased a little	26,07	No	16,11
not changed	5,94	don't know	31,21
decresed	2,31	no answer	5,03
don't know	0,66		
Total	303	Total	298

Table 3: Foreign Currency in Cash

Cash in	yes	no	Don't know	No answer	Total
EURO	30,00	65,00	1,33	3,67	300
USD	9,09	84,85	0,87	5,19	231
CHF	0,93	92,59	0,93	5,56	216
Pound	4,09	90,00	0,91	5,00	220

Table 4: Assets composition and deposits in EURO and Lek

	Deposits or bank account	Only deposits	EURO deposits	Lek Deposits
Yes	81,58%	42,43%	28,68%	76,74%
No	18,42%	57,57%	71,32%	23,26%
Total	304	304	129	129

Table 5: Have you been really affected by the crisis as regards?

	Yes	No	Don't know	no answer	Total
employment	57,14	33,59	2,32	6,95	259
purchasing power	76,98	14,68	4,76	3,57	252
savings value	77,78	15,08	2,78	4,37	252
financial situation	80,74	11,85	1,85	5,56	270
appartment value	40,38	34,74	10,33	14,55	213

Table 6: Portfolio diversification due to the crisis

	LEKE>EURO	EURO>LEKE	Same	Don't know	no answer	Total
Cash	37,19	8,42	16,14	11,23	27,02	285
Deposits	28,57	7,89	15,41	7,89	40,23	266

	Deposit>Cash	Deposit<Cash	Same	Don't know	no answer	Total
Portfolio Diversification	27,38	21,67	9,51	8,75	32,7	263
Portfolio diversification due to the crisis	22,99	23,72	13,5	9,12	30,66	274

Table 7: Crisis impact on the reliability of currencies and institutions

How have crisis affected the reliability of EURO/LEKE?	More reliable	Less reliable	the same	don't know	no answer	total
Deposits in EURO	21,68	22,57	22,57	19,03	14,16	226
Deposits in Leke	19,6	25,6	22	18	14,8	250

Do you trust in:	yes	somehow	no trust	don't know	no answer	total
State Institutions	25,53	26,24	39,36	2,48	6,38	282
Albanian Banks	25	32,97	25,36	10,14	6,52	276
Foreign Banks	30,94	32,73	21,22	8,27	6,83	278
EU Institutions	49,09	25,09	8,73	10,91	6,18	275

Table 8: Remittances

Do you receive remittances?

No	Regularly	no regularly	don't know	no answer	total
78,08	2,74	11,99	0,68	6,51	292

Has the flow of remittances change in the last 12 months?

Decrease	No	Increase	don't know	no answer	total

25,19	23,26	1,94	5,04	44,57	258

Table 9: Do you prefer that EURO be the unique currency in Albania?

Yes	22,41
No	62,21
No answer	15,38
Total	299

Table 10: Estimation results: Holds EURO or Not

	Specification One	Specification Two	Specification Three
	coef/t	coef/t	coef/t
Household size Less than 4	0,005	-0,100	0,009
	(0,023)	(-0,390)	(0,040)
Household equal 4	-0,374*	-0,477**	-0,414**
	(-1,911)	(-2,117)	(-2,087)
Female	-0,015	0,149	0,023
	(-0,078)	(0,690)	(0,119)
Age [18-29]	0,620**	0,742**	0,642**
	(2,252)	(2,418)	(2,307)
Age [30-38]	0,834***	0,823***	0,786***
	(3,370)	(2,992)	(3,126)
Age [39-49]	0,460*	0,437	0,456*
	(1,859)	(1,580)	(1,806)
Public employee	-0,080	-0,004	-0,033
	(-0,382)	(-0,016)	(-0,153)
Private employee	0,266	0,167	0,214
	(0,951)	(0,534)	(0,759)
Infation was high in the last 12 months	0,332*	0,285	0,328*
	(1,854)	(1,438)	(1,809)
Lek will be devaluated in the next 5 years	0,022	0,116	0,015
	(0,127)	(0,599)	(0,088)
Financially illiterate	-0,431**	-0,448**	-0,420**
	(-2,240)	(-2,045)	(-2,163)
Network effect	0,160	0,140	0,027
	(0,855)	(0,658)	(0,126)
Trust in Foreign banks	0,532***	0,400*	0,526**
	(2,619)	(1,698)	(2,546)
Trust in EU Institutions	-0,329	-0,134	-0,358*
	(-1,603)	(-0,571)	(-1,717)

Receive Remittances	0,799***	0,699***	0,851***
	(3,447)	(2,703)	(3,652)
Have been abroad only once in the last 12 months	0,407*	0,383	0,410*
	(1,767)	(1,455)	(1,774)
Have been abroad at least once in the last 12 months	0,752***	0,779***	0,712***
	(3,296)	(3,134)	(3,079)
Euro should be official currency		0,827***	
		(3,726)	
Albanian Financial system is stable			-0,060
			(-0,292)
Deposits in Euro safer than deposits in lek			0,450**
			(2,273)
_cons	-1,178***	-1,683***	-1,330***
	(-2,822)	(-3,429)	(-3,095)
Number of observations	309	253	309
Adjusted R2	0,209	0,240	0,222

note: *** p<0.01, ** p<0.05, * p<0.1

Table 11: Estimation results: Holds EURO Cash or Not

	Specification One	Specification Two	Specification Three
	coef/t	coef/t	coef/t
Household size Less than 4	0,033	-0,080	0,029
	(0,144)	(-0,306)	(0,124)
Household equal 4	-0,360*	-0,484**	-0,396*
	(-1,790)	(-2,091)	(-1,947)
Female	0,049	0,263	0,084
	(0,250)	(1,162)	(0,422)
Age [18-29]	0,690**	0,799**	0,734**
	(2,392)	(2,448)	(2,508)
Age [30-38]	0,881***	0,877***	0,844***
	(3,443)	(3,085)	(3,252)
Age [39-49]	0,675***	0,655**	0,683***
	(2,589)	(2,239)	(2,581)
Public employee	-0,134	-0,092	-0,100
	(-0,627)	(-0,389)	(-0,463)
Private employee	0,100	-0,110	0,068
	(0,345)	(-0,333)	(0,233)
Infation was high in the last 12 months	0,191	0,124	0,183
	(1,024)	(0,599)	(0,967)

Lek will be devaluated in the next 5 years	0,060	0,213	0,063
	(0,341)	(1,069)	(0,353)
Financially illiterate	-0,405**	-0,434*	-0,390*
	(-2,022)	(-1,885)	(-1,932)
Network effect	0,111	0,049	0,019
	(0,572)	(0,222)	(0,086)
Trust in Foreign banks	0,518**	0,407*	0,516**
	(2,529)	(1,712)	(2,486)
Trust in EU Institutions	-0,212	-0,036	-0,244
	(-1,031)	(-0,152)	(-1,168)
Receive Remittances	0,773***	0,664**	0,826***
	(3,194)	(2,422)	(3,394)
Have been abroad only once in the last 12 months	0,239	0,207	0,240
	(1,031)	(0,775)	(1,035)
Have been abroad at least once in the last 12 months	0,599**	0,630**	0,574**
	(2,537)	(2,457)	(2,407)
Euro should be official currency		0,762***	
		(3,318)	
Albanian Financial system is stable			-0,075
			(-0,349)
Deposits in Euro safer than deposits in lek			0,370*
			(1,795)
_cons	-1,295***	-1,820***	-1,431***
	(-2,973)	(-3,543)	(-3,189)
Number of observations	285	234	285
Adjusted R2	0,178	0,208	0,187

note: *** p<0.01, ** p<0.05, * p<0.1

Table 12: Estimation results: Holds EURO Deposits or Lek Deposits

	Specification One	Specification Two	Specification Three
	coef/t	coef/t	coef/t
Household size Less than 4	-0,169	-0,079	-0,133
	(-0,450)	(-0,171)	(-0,335)
Household equal 4	-0,334	-0,053	-0,520
	(-0,998)	(-0,125)	(-1,450)
Female	-0,105	-0,139	-0,110
	(-0,335)	(-0,378)	(-0,323)
Age [18-29]	0,899*	1,425**	1,263**
	(1,816)	(2,306)	(2,281)

Age [30-38]	1,353***	1,660***	1,548***
	(2,986)	(3,051)	(3,060)
Age [39-49]	0,589	0,262	0,670
	(1,232)	(0,451)	(1,275)
Public employee	-0,424	-0,376	-0,332
	(-1,265)	(-0,931)	(-0,935)
Private employee	-0,165	-0,356	-0,260
	(-0,405)	(-0,718)	(-0,615)
Infation was high in the last 12 months	0,170	-0,130	-0,014
	(0,559)	(-0,379)	(-0,044)
Lek will be devaluated in the next 5 years	0,563*	0,795**	0,554*
	(1,873)	(2,197)	(1,786)
Financially illiterate	-0,547*	-0,638	-0,538
	(-1,711)	(-1,611)	(-1,609)
Network effect	0,119	0,349	0,407
	(0,394)	(0,934)	(1,140)
Trust in Foreign banks	0,605*	0,323	0,669*
	(1,676)	(0,738)	(1,750)
Trust in EU Institutions	-0,057	0,313	-0,108
	(-0,161)	(0,753)	(-0,283)
Receive Remittances	0,663*	0,754*	0,720*
	(1,882)	(1,845)	(1,946)
Have been abroad only once in the last 12 months	0,236	0,336	0,266
	(0,622)	(0,769)	(0,682)
Have been abroad at least once in the last 12 months	0,691**	0,801**	0,655*
	(2,049)	(1,978)	(1,896)
Euro should be official currency		0,823**	
		(2,029)	
Albanian Financial system is stable			-0,753**
			(-2,058)
Deposits in Euro safer than deposits in lek			0,975***
			(2,890)
_cons	-1,088	-1,374	-1,444*
	(-1,471)	(-1,563)	(-1,769)
Number of observations	131	107	131
Adjusted R2	0,230	0,321	0,296

note: *** p<0.01, ** p<0.05, * p<0.1

Table 13: Bivariate probit estimation

	Specification One		Specification Two		Specification Three	
	Euro coef/t	Deposit coef/t	Euro coef/t	Deposit coef/t	Euro coef/t	Deposit coef/t
Household size Less than 4	-0,008	0,395*	-0,007	0,376*	-0,114	0,464**
	(-0,037)	(1,845)	(-0,032)	(1,749)	(-0,447)	(1,982)
Household equal 4	-0,382*	0,088	-0,422**	0,084	-0,482**	0,071
	(-1,953)	(0,490)	(-2,131)	(0,468)	(-2,144)	(0,349)
Female	-0,023	-0,251	0,013	-0,241	0,160	-0,247
	(-0,121)	(-1,440)	(0,067)	(-1,372)	(0,737)	(-1,261)
Age [18-29]	0,613**	0,634**	0,637**	0,639**	0,722**	0,347
	(2,217)	(2,486)	(2,281)	(2,488)	(2,337)	(1,209)

	(1)	(2)	(3)	(4)	(5)	(6)
Age [30-38]	0,838***	0,733***	0,791***	0,729***	0,822***	0,778***
	(3,394)	(3,277)	(3,153)	(3,226)	(2,991)	(3,160)
Age [39-49]	0,458*	0,101	0,455*	0,123	0,420	0,164
	(1,849)	(0,465)	(1,801)	(0,559)	(1,515)	(0,677)
Public employee	-0,079	0,118	-0,030	0,126	-0,000	0,094
	(-0,378)	(0,614)	(-0,139)	(0,648)	(-0,000)	(0,439)
Private employee	0,258	0,518**	0,206	0,467*	0,161	0,563**
	(0,925)	(1,977)	(0,729)	(1,763)	(0,514)	(1,970)
Infation was high in the last 12 months	0,344*	0,411**	0,336*	0,432***	0,310	0,452**
	(1,909)	(2,475)	(1,848)	(2,585)	(1,552)	(2,473)
Lek will be devaluated in the next 5 years	0,005	-0,039	0,000	-0,047	0,095	-0,006
	(0,028)	(-0,240)	(0,002)	(-0,287)	(0,488)	(-0,032)
Financially illiterate	-0,445**	-0,293	-0,432**	-0,290	-0,456**	-0,257
	(-2,315)	(-1,609)	(-2,226)	(-1,593)	(-2,083)	(-1,259)
Network effect	0,176	0,159	0,044	0,003	0,172	0,178
	(0,945)	(0,912)	(0,205)	(0,016)	(0,811)	(0,928)
Trust in Foreign banks	0,549***	-0,058	0,543***	-0,092	0,431*	0,168
	(2,710)	(-0,309)	(2,636)	(-0,490)	(1,822)	(0,784)
Trust in EU Institutions	-0,328	0,196	-0,363*	0,176	-0,154	-0,012
	(-1,605)	(1,026)	(-1,741)	(0,915)	(-0,660)	(-0,056)
Receive Remittances	0,802***	0,079	0,857***	0,093	0,710***	0,108
	(3,453)	(0,342)	(3,668)	(0,402)	(2,730)	(0,422)
Have been abroad only once in the last 12 months	0,418*	0,342	0,422*	0,339	0,392	0,347
	(1,822)	(1,525)	(1,835)	(1,513)	(1,505)	(1,401)
Have been abroad at least once in the last 12 months	0,751***	0,570**	0,712***	0,607***	0,781***	0,493**
	(3,267)	(2,515)	(3,054)	(2,628)	(3,118)	(2,043)
Albanian Financial system is stable			-0,062	0,305		
			(-0,305)	(1,614)		
Deposits in Euro safer than deposits in lek			0,451**	0,068		
			(2,274)	(0,366)		
Euro should be official currency					0,832***	-0,197
					(3,742)	(-0,934)
_cons	-1,169***	-0,794**	-1,316***	-0,875**	-1,709***	-0,826*
	(-2,794)	(-2,080)	(-3,058)	(-2,252)	(-3,456)	(-1,878)
/athrho	0,256**		0,258**		0,304**	
	(2,343)		(2,312)		(2,434)	
Number of observations	309		309		253	
Log-likelihood						

note: *** p<0.01, ** p<0.05, * p<0.1

Table 14: Euroization and the unsafety of Euro/Lek deposit due to the Crisis
(Dependent Variable: Holds Euro or not)

	Specification One	Specification Two
	coef/t	**coef/t**
Deposits in Euro not safe at all due to the crisis	-0,569**	
	(-2,272)	
Deposits in Lek not safe at all due to the crisis	-0,020	-0,021
	(-0,086)	(-0,093)
Household size Less than 4	-0,419**	-0,397**
	(-2,105)	(-2,012)
Household equal 4	-0,063	-0,018
	(-0,325)	(-0,094)
Female	0,631**	0,631**
	(2,288)	(2,292)
Age [18-29]	0,849***	0,861***
	(3,413)	(3,458)
Age [30-38]	0,468*	0,478*
	(1,869)	(1,917)
Age [39-49]	-0,129	-0,107
	(-0,610)	(-0,508)
Public employee	0,301	0,288
	(1,054)	(1,022)
Private employee	0,334*	0,319*
	(1,858)	(1,775)
Infation was high in the last 12 months	0,045	0,041
	(0,257)	(0,236)
Lek will be devaluated in the next 5 years	0,481	0,449
	(1,462)	(1,319)
Financially illiterate	0,138	0,173
	(0,734)	(0,927)
Network effect	0,446**	0,514**
	(2,150)	(2,519)
Trust in Foreign banks	-0,263	-0,306
	(-1,264)	(-1,480)
Trust in EU Institutions	0,753***	0,746***
	(3,239)	(3,154)
Receive Remittances	0,466**	0,402*
	(1,970)	(1,733)
Have been abroad only once in the last 12 months	0,748***	0,752***
	(3,256)	(3,284)
Have been abroad at least once		-0,246

in the last 12 months

		(-1,078)
_cons	-0,942**	-1,104***
	(-2,197)	(-2,613)
Number of observations	309	309
Adjusted R2	0,223	0,212

note: *** p<0.01, ** p<0.05, * p<0.1

Table 15: Euroization and the crisis effect on the value of savings, purchasing power, family finance, employment prospect and housing
(Dependent Variable: Holds Euro or not)

	Specification One	Specification Two	Specification Three	Specification Four	Specification Five
	coef/t	coef/t	coef/t	coef/t	coef/t
Crisis has really affected the value of savings	-0,011				
	(-0,060)				
Crisis has really affected the purchasing power		-0,353**			
		(-1,967)			
Crisis has really affected the family finance			-0,480**		
			(-2,441)		
Crisis has really affected the employment prospect				-0,384**	
				(-2,028)	
Crisis has really affected the value of the house					-0,133
					(-0,679)
Household size Less than 4	0,005	-0,005	0,011	-0,008	0,015
	(0,024)	(-0,021)	(0,046)	(-0,033)	(0,066)
Household equal 4	-0,375*	-0,395**	-0,372*	-0,387*	-0,368*
	(-1,912)	(-2,003)	(-1,884)	(-1,958)	(-1,876)
Female	-0,013	0,011	0,067	-0,007	-0,012
	(-0,069)	(0,059)	(0,343)	(-0,034)	(-0,062)
Age [18-29]	0,620**	0,622**	0,602**	0,565**	0,597**
	(2,252)	(2,241)	(2,159)	(2,021)	(2,151)
Age [30-38]	0,836***	0,840***	0,855***	0,795***	0,840***
	(3,353)	(3,371)	(3,416)	(3,173)	(3,388)
Age [39-49]	0,461*	0,485*	0,506**	0,477*	0,462*
	(1,859)	(1,934)	(2,008)	(1,908)	(1,861)
Public employee	-0,081	-0,115	-0,167	-0,174	-0,092
	(-0,386)	(-0,541)	(-0,776)	(-0,804)	(-0,438)
Private employee	0,265	0,278	0,222	0,264	0,265

	(0,949)	(0,994)	(0,793)	(0,941)	(0,952)
Infation was high in the last 12 months	0,335*	0,371**	0,395**	0,417**	0,341*
	(1,820)	(2,041)	(2,151)	(2,249)	(1,896)
Lek will be devaluated in the next 5 years	0,023	0,066	0,109	0,039	0,026
	(0,133)	(0,374)	(0,610)	(0,225)	(0,152)
Financially illiterate	-0,430**	-0,378*	-0,351*	-0,418**	-0,422**
	(-2,232)	(-1,936)	(-1,789)	(-2,159)	(-2,191)
Network effect	0,160	0,189	0,205	0,219	0,167
	(0,857)	(1,008)	(1,084)	(1,153)	(0,893)
Trust in Foreign banks	0,533***	0,563***	0,554***	0,554***	0,542***
	(2,616)	(2,736)	(2,700)	(2,709)	(2,656)
Trust in EU Institutions	-0,327	-0,298	-0,291	-0,309	-0,328
	(-1,584)	(-1,436)	(-1,405)	(-1,497)	(-1,596)
Receive Remittances	0,798***	0,726***	0,771***	0,756***	0,785***
	(3,437)	(3,103)	(3,309)	(3,237)	(3,377)
Have been abroad only once in the last 12 months	0,407*	0,407*	0,418*	0,472**	0,407*
	(1,765)	(1,738)	(1,776)	(2,008)	(1,761)
Have been abroad at least once in the last 12 months	0,752***	0,738***	0,755***	0,782***	0,780***
	(3,296)	(3,231)	(3,287)	(3,417)	(3,362)
_cons	-1,178***	-1,109***	-1,132***	-1,064**	-1,169***
	(-2,820)	(-2,643)	(-2,695)	(-2,499)	(-2,790)
Number of observations	309	309	309	309	309
Adjusted R2	0,209	0,219	0,224	0,219	0,210

note: *** p<0.01, ** p<0.05, * p<0.1

Appendix B

Survey structure

1. Gender, place, household size, civil status, age, education level, occupation sector
2. Expected inflation
3. Expected exchange rate

A) cash in foreign currency (FC)
   a. in %
   b. reasons

B) Deposits
   a. evaluation on deposits

C) cash > deposit?

D) Current account, salary account, deposits and credit cards
   a. Deposits in FC
   b. %
   c. Currency
   d. Reasons to keep it
   e. Deposit and inflation
E) Loan
   a. Evaluation on loans
   b. Have a loan
   c. Planned to loan
   d. For what reason
   e. Difficult to pay it, delay, why,
   f. Why a loan in EURO
F) Crisis impact
   a. Personally affected by the crisis
   b. Cash EURO > Cash Leke
   c. Deposit EURO > Deposit Leke
   d. Cash > Deposits
   e. Reliability of EURO versus reliability of Lke
   f. Trust in government, banks, EU
   g. Withdraw deposits in 2008?
   h. What happened after
   i. Travel abroad
   j. Get remittances
   k. Remittances trend change?
   l. Any payment in EURO?
G) Do you want EURO be official currency in Albania