

POLICY MODEL FOR BULGARIA'S TRANSITION FROM CURRENCY BOARD ARRANGEMENT TO EUROZONE MEMBERSHIP

Todor Tanev¹

Abstract

The study of the global and local aspects of Bulgaria's possible future entry into the Eurozone is partly based hereunder on the study of the evolution of the Polish, Estonian, Lithuanian and other strategies for joining the Eurozone. The reason for that is that there are fewer analyzes of the Bulgarian situation, which is still unfolding. The Polish, Estonian, Lithuanian and other cases overtake the Bulgarian one for several years. Therefore, in some places, the text below is a compilation of texts of research articles on these close cases. Poland is the largest economy among the New Accession countries in the EU. Estonia and Lithuania are small economies but used to have currency board arrangements before adopting the euro exactly as the plans for Bulgaria are. Moreover, all these countries were part of the Eastern bloc unlike Greece and this makes them useful examples. Of course, there are also historical, cultural, political and economic differences that also need to be highlighted.

Introduction

The decisions for Bulgaria's entry into the Eurozone are political, using economic arguments. Among the main policy issues that need to be resolved in this process are the following:

- Should Bulgaria insist on entering the Eurozone immediately, claiming that it has formally met the criteria for it, or should it wait until the country is well prepared for it whatever this means (basically, the so-called Maastricht criteria plus new criteria added to them lately by the ECB);
- Even if Bulgaria becomes prepared to enter the Eurozone, should its government insist on joining the Eurozone immediately afterwards, or it might look for ways to delay the entry, with the views of constant need for improvement;
- What degree of autonomy and discretion should be secured by the Bulgarian Central Bank and the government, in view of possible failures of the common currency, future European or global economic crises or significant problems with the liquidity of Bulgarian banks in the future;
- To what extent have Bulgaria's banking sector and government gained sufficient level of discipline, as a result of the 22-year currency board arrangements and to what extent do the general principles and instruments of the currency board, need to be preserved even after the country's entry into the Eurozone within the new law on the BNB;
- Is it necessary - and if so, in what way - to adopt special rules ensuring the stability of the banking sector in Bulgaria in Bulgaria, that stem for example from the principles of the Chicago Plan; etc.

¹ Todor Tanev is a Professor, Dr.Habil (SC) at the Department of Public Administration, Sofia University "St. Kliment Ohridski"

The Eurozone as an economic and political objective

The Eurozone project was simultaneously economic and political in nature from its very inception. Quite naturally, so is any decision on joining it or staying out. It is impossible to draw a line separating these two dimensions. The political and economic arguments related to the super- and supranational monetary integration and Bulgaria's participation in it should be considered always together.

In fact, the current institutional setup of the Eurozone experiences potential weakness. This may threaten its stability or involve significant costs in the long-term. The costs would probably take the form of output and employment volatility. High level of indebtedness of some member states is a fact alongside with strong structural divergence between the Eurozone countries. The latter exists mostly in terms of production structure and the quality of human capital, but also in the level of capital resources, etc.

The solutions that could limit these shortcomings are unclear so far. The future of the Eurozone is not clear in the prevailingly normative documents like the reports of the European Commission or the President of the European Council. These are Strategic Risks. The economic crisis in Europe had many faces in various European economies. There is a rich literature about the nature of the crisis in Europe – its sources, mechanics, symptoms, effects and implications.

Bulgaria's strategic goals: three tiers of definition

Bulgaria's entry into the Eurozone is not an end in itself. It is an action of profound importance as it stems from the country's main strategic goals. Becoming a Eurozone member should foster the achievement of Bulgaria's main strategic goals.

However, there are coexistent different perspectives to the definition of the country's strategic goals.

One can assume that in a democracy, the different views on this issue are expressed by the various political parties from the entire political spectrum. The majority party has more power of definition of the national interest than the minority parties. Indeed, this is the local political tier of the national interest.

However, this is not all the truth. The economy of the country is more than just local horizon. It is related to the economy of the European Union. The latter interprets Bulgarian national interest in its entity. The EU interprets it in the context of the interest of the entire Union. As far as the EU governing institutions are politically related to the ruling party in the country, this interpretation is dependent to a certain extent to that of the ruling party. This is the global political tier of national interest.

On the other hand, there is one more view to the national interest different from the view of local political actors and global forces. This is the view of particular sub-national players – individual corporations and banks. From the political theory perspective, their interpretations should not be regarded as political. However, from a practical point of view, this is precisely what happens: specific private entities are trying to impose their private definitions of national interest by influencing political parties to act in a way that supports their own interests. This is the political micro-tier of the (somewhat distorted) national interest.

The following may be attributed to Bulgaria's strategic goals beyond the context of interests and the three tiers of their manifestation.

Bulgaria's economic growth in a competitive global economy is naturally the country's primary economic objective. Together with this fundamental goal, the long-term strategies concentrate on the growth in investment (mostly foreign), growth of the jobs market and ultimately – rise in the level of GDP per capita.

The question of the monetary integration to the Eurozone is subordinated to these goals. Becoming or not a member of the Zone is not a sign of cultural "belonging to modern civilization", but a

strategic question of national interest. Bulgaria has problems with insufficient reforms, including the banking sector reforms that are a matter of utmost interest to solve.

We must be clear that monetary and financial sector stability is only one of many elements of a healthy economy. It is necessary but not sufficient. It will not solve all problems. These are mostly neutral experts that are in position to judge what is good for the country as a whole without regard to specific political or economic interests or both. Therefore, it is important to develop such a scholarly (not academic) viewpoint; it is politically neutral though not abstract and thus can serve practical goals in helping the formation of an adequate policy for Bulgaria.

However, from the opposite point of view, any suggestion about public interest should be synchronized with interests of the ruling party. No abstract point of view can eventually become a policy unless it is synchronized with the balance of interests. Therefore, the goal hereby is this “hybrid” policy bridging together the abstract definition of national interest with its political definitions as they appear at three parallel tiers. Experts have to judge in a cool way which features of the Eurozone are more likely to foster economic growth and which ones increase the risk of economic imbalances.

Strategic alternatives for Bulgaria

If the ideological context is isolated, there is more than one alternative for Bulgaria’s accession to the Eurozone. Moreover, it is not just about two alternatives, one being “getting in” while the other “staying outside” the Eurozone. A considerably delayed entry into the Euro area could also be viewed as an alternative. Also, an assessment of the pros and cons of retaining the status quo needs to be included in the set of strategic alternative considerations since the “non-action alternative” is compulsory for policy analysis. Of course, there is still an opportunity for a very different alternative policy – neither status-quo, nor positive or negative about joining, but rather different – e.g., returning to the situation before the currency board (before the current status-quo).

None of the existing alternatives is predetermined. Predetermined solutions are always impaired basis of strategic governance. Any analysis supporting the decision whether and how to join a monetary block like should include not only expected positive, but also expected negative effects in the case of joining. Retaining the local currency may bring about potential benefits (e.g. exchange rate flexibility) and disadvantages (e.g. exposure to speculative attacks or higher costs of borrowing). Therefore, the decision on whether to retain an independent currency or the present currency board arrangement requires adequate evaluation of the pros and cons.

Moreover, neither the alternatives per se, nor the set of alternatives is static. Reckoning with the dynamics of change is an absolute condition for proper policy decision making. The reason for this condition is that entering the Eurozone is a particularly long-term issue. The decision on it would possibly spread over many decades. Today's alternatives will not be alternatives tomorrow, and today's preferences will not be the preferences of tomorrow.

Staying outside of the Eurozone (still not rejecting this to happen in future) does not simply mean the extrapolation of the current situation; instead, it is also dynamic. Any member state evolves together with the union. The EU to which Bulgaria joined in 2007 has changed; it will continue changing in future. Both the positive and the negative consequences will evolve and, as a result, any evaluation should be expected to do so.

The scenarios covering a wide range of time inevitably incorporate a number of speculative elements. The crisis and slowdown of the economy in Europe makes the developments in the Eurozone very dynamic. Moreover, the crisis has changed the institutions of the Eurozone. The authors of scenarios are obliged to adjust to that dynamism. They have no choice but speculate about the potential future scenarios as well as their positive and negative aspects.

An account should be taken not only of the existence of multiple alternatives as well as the fact that they are a dynamic variable. There is still another feature that determines the conditionality of the decisions related to the future membership in the Eurozone of Bulgaria. Bulgaria is a strongly

specific European country. For this reason, it does not evolve in sync with the Eurozone and will never have full synchronization with it. In this respect, Bulgaria is distinguished even from the rest of “new member states” of Central Europe whose changes appear to be more related to the changes in the Eurozone.

Therefore, it is fully legitimate to formulate speculative statements on the future evolution of the Eurozone at the time when deciding about the optimal point of entry.

The initial Euro-optimism

Like in all new accession countries, the Eurozone was perceived by Bulgarian governments, elites and regular public opinion as a land of prosperity and stability (low interest rates, no considerable risks for a mighty continental scale economy foreseen or even expected, expected constant economic growth). This perception was overwhelming Bulgaria in the years before its accession to the EU in 2007 and even after that.

There were also negative perceptions in the country. They were not, however, a matter of scepticism, but rather of negativism – a profound negative attitude toward the West. Bulgaria's belonging to the European sphere in whatever context was seen as another form of retreat to the West. However, a relative minority of Bulgarians benefiting from the old Communist regime shared these views. Neither then, nor now did this group have an organized protest potential and therefore deserves no attention. However, what deserves attention is the rather uncritical attitude towards Europe, which also affected the successive governments of Bulgaria.

Like in Poland, Bulgaria's strategy of the entry in the Eurozone is largely based on the “endogeneity argument”. It is the belief in the “ever closer” trajectory of the integrating economies. On the one hand, such an expectation of a single-colored uninterrupted advance toward “progress” is characteristic of Europe and very uncharacteristic for other cultures like the American. On the other hand, the same view was reinforced during the decades of communist ideology by disciplining a trust into an ever approaching (but never reached) state of absolute historical achievement. Naturally, such a view is ideological. It is a simplified vision of the future. It not only does not correspond to reality but also blocks the effort to develop a more critical attitude towards the future.

This endogeneity argument in the “new accession countries” like Poland, the Czech Republic and Hungary has long become obsolete. Bulgaria It continues its uncritical existence mostly in Bulgaria. However, even in these “new accession countries”, governments in the past often enough did not doubt the fully positive outcome of their countries' joining the Eurozone. It was not the political orientation of the government but rather the context of the later economic crisis in Europe that proved decisive in shaping some precaution in these countries and even Bulgaria.

All considerations regarding Bulgaria's accession to the Eurozone were focused on the economic growth paradigm especially before the economic crisis in 2007. Bulgarian governments' policy in view of the “forthcoming accession to the Eurozone” has ever since been in line with the EU Commission – considered a sort of a so-called “Yes Sir” policy. It is unclear, however, why governments have continued to be optimistic to the same extent and yet based on optimistic theory to this day after all crises and accumulated doubts. Apparently, this seems to be based on the idealistic and apparently over-simplistic ideological vision that the adoption of the Euro in Bulgaria as well as everywhere else in the EC should increase income both in the short- and long-term – with no careful research on whether this is really the case. No risks have ever been seriously considered and are still not seriously considered. Only recently is the possibility of increased risk of macroeconomic instability and slowdown in economic growth considered. However, this is not considered in an internal plan – if “something bad” happens it would be “from the outside”, and Bulgaria's lasting and only task is “to write its homework” (for to meet the Maastricht criteria), as per the words of Prime Minister Borisov.

The commitments accepted so far and to be accepted in future

Bulgaria, like the rest of EU new member states from Central and Eastern Europe, is formally obliged to adopt the single currency. However, Bulgaria unlike Poland does not take advantage of the derogation (in the meaning of Article 122 of the Treaty establishing the European Community). This temporary derogation does not, however, exempt any member state from the obligation to adopt the euro. Bulgaria, like most other member states from outside of the Eurozone (unlike the UK and Denmark who negotiated retaining a special status in this regard) must work towards the introduction of the euro as soon as possible.

Originally, the European and the Bulgarian side agreed upon Bulgaria's adherence to the so-called Maastricht criteria as a prerequisite of the accession of the country to the Eurozone. This should happen as fast as possible. The Maastricht single currency criteria impose limits on inflation, government debt, budget deficits, the long-term interest rate and the exchange rate between the national currency and the euro. The purpose of these criteria of convergence was to ensure the preservation of price stability in the euro area and after the accession of new countries to the currency.

With the exception of the increase in the deficit in 2014, Bulgaria formally fulfills these criteria. This is considered a consequence of the 22-year existence of a successful currency board. It might be also a consequence of the European accession and structural funds as far as Bulgaria was relatively little affected by the economic and financial crisis in the EU at the end of the first decade of the 21st century.

However, the bank crisis inside the country in 2014, when the fourth-largest bank (Corporate Commercial Bank, CCB) was bankrupt as a result of bad loans against the backdrop of Greece's financial problems, forced the ECB to consider adding more requirements to the initial set of Maastricht criteria. These would be in the area of banking sector stability and probably also in the field of necessary reforms in the judiciary. Bulgaria is likely to be accepted in the Eurozone waiting room (the so-called ERM 2 mechanism) as early as the summer of 2019. Then, probably Bulgaria will be required to become a member of the banking union and to allow auditing of a banking sector by European institutions.

European financial institutions appear to be attempting to expand their requirements related to Bulgaria's accession to the Eurozone even beyond that. The unreformed judiciary in Bulgaria is a chronic problem of primary importance. This state of affairs is expected to negatively affect the situation of Bulgaria as a potential member of the Eurozone. The ECB, the European Development Bank and other European financial authorities would hardly allow such a source of tension to penetrate the Eurozone and create problems that will recall the problems in Greece. That is why they will probably demand from Bulgaria real reforms in the judiciary and anti-corruption measures in addition to fulfilling the Maastricht criteria.

Thus, the obstacles to the next steps in joining the Zone could be political rather than economic. This, however, is subject of political analysis.

Public perceptions of the entry into the Eurozone

Above all, we have to distinguish between scepticism/optimism towards the EU membership and the membership of the country in the Eurozone. The government is the basic opinion leader and manipulator. However unlike the Czech Republic or Hungary, nearly all Bulgarian political parties, ruling or opposition, left, centrist or right wing, manifest their positive attitude first and foremost toward the EU membership and to a slightly lesser extent to the membership of Bulgaria in the Eurozone.

At the same time, there is no active public debate about the accession to the Eurozone. Public opinion polls repeatedly show the persistence of a paradox in mass opinion: euro-scepticism (negative attitude towards supranational monetary integration in Europe) exists alongside uncritical EU-optimism (prevailing positive opinions of Bulgarians towards the EU membership

and most other aspects of the European integration project). Thus, public debate not only differs but is also weaker and partial when compared to debates taking place in the “Vishegrad Four” countries.

For several years, opinion polls show that Bulgarians are satisfied with EU membership but somewhat hesitant about Bulgaria entering the Eurozone. The rate of scepticism/negativism about the latter however is considered weaker than in Poland and the Czech Republic (Eurobarometer of 2014). Still, like in most Central and East European countries that have not yet entered the Eurozone, there is a simultaneous enthusiasm of the population towards the European integration in general (“EU optimism”) alongside fear from membership of the single currency (“euro-scepticism”).

In Bulgaria, the latest study by Eurobarometer shows that the share of Bulgarian citizens who expect a rise in prices after the adoption of the euro is 69% and this share remains stable of the previous similar survey conducted in April 2016, barely 17% of Bulgarians expect prices to remain stable. Concerns about rising prices are shared by the majority in the other EU member states that are about to adopt the euro at some point - 76% in Poland, 72% in the Czech Republic, 69% in Croatia, 58% in Sweden and 53% in Hungary and Romania await price rises. The question is how reasonable these fears are.

This scepticism was exacerbated by the economic crisis that hit Europe in 2008, however in a much smaller scale given the later entry of Bulgaria to the EU just a year before. In addition, Bulgarians are witnessing the success of countries that have recently joined the Eurozone. In none of these have prices grown as high and as fast as previously in East Germany. However, it should be noted that Bulgarian citizens and companies are strongly influenced by the situation in neighboring Greece. The public opinion about the euro in Bulgaria differs from other Central and East European members of the EU also due to the unique economic development of the country given the positive effect of the currency board on inflation for over 20 years. The greater majority of Bulgarians perceive the entry into the Eurozone somewhat more relaxed, considering it (right or wrong) as a continuation of the existence of the currency board arrangement.

The development of public opinion in Bulgaria is somewhat surprising. While EU-optimism and euro-pessimism were high in the first years of the country’s EU membership, there has been a slow but clear move backward in both tendencies in recent years. Currently Bulgarian citizens appreciate the entry into the Eurozone relatively higher than before. At the same time their pessimism for the future of European integration is growing. The number of supporters of the introduction of the euro in Bulgaria is due to the understanding that while it will be beneficial for Bulgarian companies however it would not be such for family budgets for the first years.

Throughout the years of Bulgaria’s accession to the EU, price levels across most product groups have come closer to convergence. There is less difference in prices between Bulgaria and the countries in the Eurozone not only adjusted to purchasing power, but even physically.

The increasing positive attitude towards the inclusion of Bulgaria in the Eurozone is due to a great extent to the active and persistent advocacy of the government, which actively creates positive public opinion for the accession of the country to the Eurozone. Another powerful reason for the existing public attitudes described remains the effect of the currency board, which most of the employees consider as a source of their income stability. It needs to be mentioned that this is a personal motivation that excludes any assessment of the business.

The majority of Bulgarian citizens’ concerns are based on the view that the Bulgarian economy is unprepared and very weak. Therefore, they think, the country’s inclusion in the Zone will make it economically very vulnerable to direct competition. Naturally, the other part of the Bulgarian citizens, who are nostalgic for the communist regime and therefore EU-sceptics, are simultaneously euro-sceptical.

A popular attitude, prevailing in Bulgarian public opinion, is that if joining the Eurozone appears a mistake, the fault would be of those outside and inside Bulgaria who have “pressed” it to become

a member. Therefore, the government in whose mandate Bulgaria enters the Eurozone, not the government that initially negotiated the terms of Bulgaria's accession to the EC, will bear the historical responsibility for negative consequences.

This paradox is not specific of the political elites in the country. Much of them are both EU-optimists and euro-optimists. On the contrary, another part of the elites, which originated from the former communist elites are strongly EU- and therefore euro-sceptics. Either way, in both main types of political elites in Bulgaria, EU-optimism / pessimism goes hand in hand with euro-optimism / pessimism.

Perceptions of the Bulgarian government for entry in the Eurozone

The stable pro-EU orientation of all Bulgarian governments started being manifested long before the country's accession to the EU. As a result, they consider the Euro as a main instrument for economic integration of the continent, macroeconomic stability, reduction of inflation, economic growth and international role of the single currency in making Europe "strong". Staying outside of the Eurozone is perceived as a temporary state of non-full-membership contrary to the long-time strategy of both Bulgaria and the EU.

The inevitable costs and risks of joining the Eurozone are interpreted as inferior to the benefits since decades. There is a lasting opinion among politicians from all major parties that the anticipated positive outcomes would outweigh the expected negative outcomes. They expect that the adoption of the euro would result in an expansion of economic growth and thus increased welfare. The adoption of the euro is expected also to lead to a fall of interest rates and increase in macroeconomic stability and credibility of the country, intensification of trade, growth in investment (both domestic and foreign) and ultimately – rise in the level of GDP per capita.

Bulgarian governments are EU optimistic: they do not seriously consider future crisis in the Eurozone. The country is not strongly related to the European economic structure, so Bulgaria did not suffer much from the negative consequences of the European economic crisis. No deeper understanding of the crisis is searched for despite the fact that the ruling political elites consider the economic slowdown as a "Eurozone crisis". Moreover, the Eurozone became somewhat economically stronger than before the crisis; this serves as a catalyst of euro-optimism. Overall, the Eurozone seems to Bulgarian political decision makers a good place to join than before the crisis.

Bulgarian governments view joining the Eurozone largely uncritically. No mistake following the full support for the country's entry into the Eurozone is expected. If things go wrong for some reason, its origin is expected to be only external to Bulgaria. In other words, Bulgaria is not going to be the source of any mistake in joining the Zone. If a problem occurs, it is expected to be generated in the EU.

Bulgarian governments are running a small economy at a difficult time when the country opens to global competition, a time when corruption and the crackdown of the judiciary are chronic problems. Therefore, the main contributions that the Bulgarian governments have attributed after 1989 are the entry of the country into NATO and the EU. This may explain why the current government, which rules over the last decade with brief interruptions, wants to get attributed with the same type of merit: the country's entry into the Eurozone. This is the most serious political capital that it can provide. Its ideology is that becoming a member of the Eurozone is undoubtedly the only positive step it can do.

Need of exhaustive balanced consideration of all factors

The potential opportunities and challenges for Bulgaria's Eurozone membership are not predetermined.

Accepting the condition to substitute local currency with the euro should not be interpreted one-sidedly. The Central European countries, mainly Poland but partly the Czech Republic and

Hungary as well – two countries that have accepted the same condition by becoming EU members – apparently deflect their entry into the Eurozone. They are growingly euro-sceptic without this implying that they are EU-sceptical. Any condition in an agreement may be renegotiated or executed when the consent party is ready or decides to fulfill it.

Despite the long period of low public interest to that issue until recently, Bulgaria's potential entry to the Eurozone becomes a growingly vital theme. The government is still the most active among all and defenders of a strictly pro-euro position. This is why political and economic elites (i.e. businesspersons, academics, commentators, experts, journalists and many others) refer to its views when discussing the prospects for substitution of the local currency with the euro.

There are country-specific as well as European concerns involved in the assessment of this issue. Country-related are arguments such as the future of the local labor market, real estate market, interest rates, financial system, public debt, etc. Up to now most concerns while deciding on Bulgaria's adoption of the euro are exclusively about the consequences for Bulgaria's economy.

However, an adequate political decision should take into account also the effect of the Bulgarian membership in the Eurozone for the European economy. Entering the Zone is not a problem for Bulgaria alone. Bulgaria will need to meet consistently not only the EU general recommendations, but even more important, the European primary and secondary legislation regulations. Therefore all considerations must rest on the right proportion between local and European concerns.

Optimism based on positive cultural biases towards Europe must give way to realism, based on the right mix of internal and external criteria. Risks are objective and therefore should be considered on the basis of facts. Risks on the way to the Eurozone are such as lack of real economic convergence of Bulgaria with the European economy, low rate of competitiveness, structural disproportions and imbalances, inefficiencies, etc. Altogether this constitutes a package of risky challenges. The inevitable shocks and the mechanisms for absorbing them are not considered systematically.

The Bulgarian government seems very hasty to push the country into the Eurozone sooner rather than later. This political decision does not make possible all factors to be considered and compared carefully. Moreover, stable consensus develops slowly. Such is the case with Poland, where euro-scepticism took 15 years to develop. The rule of the thumb is that the longer an important decision takes to make, the more scepticism it would reflect. Poland has 3 consecutive reports on its readiness to enter the Eurozone, created in a sequence of 5 years from each other. Without being against entering the Eurozone, each next is becoming more precautionary for the country's adopting the euro. Thus, the ultimate shape of the Polish policies on the issue of admission to the Eurozone is to enter it but at an indefinite future moment. Apparently, the Bulgarian government deliberately opposes the longer process of reflection and debate just to prevent the development of euro-scepticism. It wants to achieve a great "historical" result of its overall existence at any cost – "the completion of the European integration of Bulgaria."

General PROs and CONs about the entry into the Eurozone

Even though Bulgaria plans to join the final stage of the Monetary and economic union, different arguments exist that it is still problematic enough. The Bulgarian government considers two types of risks when entering the Eurozone – economic and political.

The economic threats to the stability of the Bulgarian economy after the accession to the Eurozone include:

- The possible negative consequences of macroeconomic imbalances in view of low interest rates which may lead to an excessive expansion of credit and thus potential emergence of bubbles in the real estate market;
- The expected significant raise of foreign net debt (as made evident by the accession of Estonia and Lithuania);
- The danger of divergence in business cycles (asymmetric shocks); etc.

Therefore the main negative consequence foreseen repeatedly however largely underestimated is “the loss of an independent monetary policy”, risk of a credit boom, loss of competitiveness because of the excessive growth of prices and wages, and an increase of the foreign debt. What should be considered in this context as well is the ongoing economic crisis across Europe, and the associated turbulence inside the Eurozone that has to be calculated with a greater attention.

The political risks are related with the possible loss of power and threats to interests of political actors at the three tiers above described (global, local and micro). Among the most important are:

- The loss of discretion power and at the expense of stronger control by relevant EU institutions (ECB, EC, etc.), resulting in less opportunities for independent economic policy of the government.

- The lasting decrease of popular support in view of any level of rising of prices;

- The unsatisfactory share of the total sum of the foreign exchange reserve accumulated during the currency board to be used for government projects.

What should be considered in addition is Bulgaria's unpreparedness as far as the stability of the banking sector is concerned, the high rate of corruption, and the lasting problems in the judiciary. All these risks contradict the policy recommending joining the Eurozone at the earliest opportunity, i.e. just after fulfilling the Maastricht convergence criteria, as repeated by Bulgarian government officials for years now.

However, the opposite arguments possess also certain value. Entering the Eurozone brings positive developments almost for sure if unexpected serious shocks – political and economic – do not occur. The EU integration gives Bulgaria access to the Single Market, which stimulates export growth: every emerging market is much export-dependent. The other explanation is related to the large flows of EU funds (cohesion and structural funds) which boosted public investment on an unprecedented scale. However, these two factors diminish when Bulgaria loses its competitive advantage (based on low labor costs as in the past).

This feeds optimistic expectations of many politicians as well as citizens. Social attitudes towards European integration, be it political or economic, are a function of the extent to which society benefits from integration.

However, the issue of PROs and CONs the entry into the Eurozone has another strategic aspect. This entry is not a process that is isolated from what has happened in advance that the entry builds on. The question is, how does the entry into the Eurozone affect the achievements of the currency board era in the country? Is it desirable to end its existence resulting from the end of the existence of the local currency, or quite on the contrary – can - and should – the currency board regulations continue existing after the adoption of the euro? Should the Eurozone be interpreted as a version of the currency board arrangement, and to what extent?

Countries and their monetary authorities are increasingly choosing final forms of floating or fixed exchange rates at the expense of different intermediate variants in which some form of controllable or controlled sailing (more or less), or a fixed rate in any announcements limits. The reason is that these intermediate variants are much more susceptible to speculative attacks by market players and therefore require a very serious resource in the form of foreign exchange intervention assets.

Given this, the realistic options for getting out of a currency board are either a transition to freely floating exchange rate, or taking the last step along the way to the most extreme form of fixed rates, namely joining to monetary union. Switching to a classic fixed exchange rate or some form of administered exchange rate means that it would open the door to speculation and respectively - the risk of a rapid depreciation of the currency.

This is also the opinion of the prominent Bulgarian economist Rumen Avramov, according to whom “the currency board, like any system based on clear rules, is highly vulnerable to the prospect of a change in established rules. The greatest risk comes from the opportunity to introduce a floating rate as the economy has lost its reflexes to adjust and operate in a floating exchange rate.

Publicly announced the prospect of introducing a floating rate would be equivalent to an invitation to speculative attack against the lev and would create expectations and pressure for devaluation.” In other words, the only option for a sustainable and manageable exit from the currency Council of Bulgaria is the adoption of the euro and joining the euro area. All remaining options for replacing the currency board with another currency-exchange regime will open a wide door for speculation, the very moment they start discussing officially. They will inevitably create an incentive for an attack against the lev and the tall risk of devaluation.

The economic PROs

Government officials and many economists expect some of the benefits to be experienced even during Bulgaria’s entry to the Eurozone’s so-called “waiting room” (ERM 2). Bulgaria’s membership in the Eurozone may secure more fully the strategic goals of economic policy: attracting foreign investment, developing the labor market, increasing wages, and positively changing the structure of production. As a result of this, indirect achievement of other cardinal goals can be expected, such as a reduction in emigration, etc. More precisely, the PROs of Bulgaria’s joining the Eurozone as repeatedly expressed by proponents can be summarized as follows:

- The very preparation for admission to the Eurozone alone (the stay in the ERM 2) is expected to be an incentive to accelerate reforms in many sectors. The fulfillment of Bulgaria’s commitments will be of benefit to the country immediately.
- A strong “pro” argument is the success examples of other “formerly less developed” and “transition” economies such as Slovenia, Slovakia, Ireland, Estonia, Latvia, Lithuania after they accepted the Euro. One use of these examples is as an argument against sceptics’ claim that Bulgaria would follow necessarily the negative development pattern of Greece.
- Soon after Bulgaria joins the Eurozone, this would cause a strong positive impact on all economic indicators as well as the overall domestic business climate. Among the expectations of the adherents of Bulgaria’s becoming an Eurozone member is lower interest rates on loans; cheaper and more affordable financing for businesses and households; greater stability of the national economy; reduction of investment risk; increase in foreign direct investment and overall investment activity; increase the country’s credit rating, and a reduction in foreign exchange costs for businesses; a reduction in the risks to the banking system; strict external oversight over the banking system (which means minimizing the risk of affairs such as CCBs).
- Joining the Eurozone would have an effect on Bulgaria’s international image and stance – an increase of the external confidence of the country is to be expected. For each country that has adopted the euro since 2007, there is a clear increase in credit rating of the three major agencies. With the adoption of the euro, the risk for the country decreases in general and this inevitably leads to an improvement in credit rating. Moreover, joining the Eurozone leads to better evaluation of credit risk by international credit rating agencies. From the point of view of local businesses and citizens, this positively affects local credit markets by automatically leading to lower interest on loans from Bulgarian banks to local physical and legal entities. The positive effect of rising sovereign credit rating in most countries is seen with the country’s acceptance in the ERM 2. A further rise usually follows the formal adoption of the euro. The increase of the rating is further making the countries more attractive to investors. This overall effect became evident in the examples of the Baltic republics that joined the euro last after a considerable stay in the Eurozone’s “waiting room.”
- A significant improvement in the area of interest rates and access to ECB instruments is expected after joining the Eurozone. This would cause benefits from interest rates for citizens and businesses. Bulgaria’s accession to the Eurozone to benefit from two of them the above three

instruments: primary credit facility to obtain overnight liquidity under the form of eligible assets, and deposit foundation at national central banks and deposit facility as a threshold for the overnight market interest rate. Permanent ECB mechanisms would have a positive effect on the banking system institutions, and hence - on the economy as a whole, as they represent an active monetary policy instrument that is not available to the BNB because of the constraints imposed by the currency board. Access to the refinancing of the ECB's banks and the euro area money market, would resulting in a cheaper financial resource, both because of the higher liquidity in this market and the reduction of transaction costs, eliminating currency risk and currency conversion costs, and so on reducing interest rates on loans granted by banks. This would also be the effect of reducing mandatory minimums reserves maintained by the banks with the respective national central bank. Being outside the euro area, Bulgaria suffers the crises worse, refunds are significantly slower. In other words, joining the single currency would help to reduce the power of external economic shocks for the country as well as for faster recovery from them.

- Another PRO argument is the introduction of a Single Supervisory Mechanism and European Banking Union. This would cause positive effects on the financial sector. Apart from the easier and cheaper access to resources, the banks in Bulgaria after joining the Eurozone would be positively affected by the Single European Monetary Oversight Mechanism (EMS). This is the first pillar of the so-called European Banking Union, the other two being the Single problem banks restructuring mechanism and the European Deposit Guarantee Scheme for banks. The supervisory authority at EU level is the European Central Bank. Upon accession of Bulgaria to the euro area and the EMN, the ECB will assume responsibility for overseeing the so-called major credit institutions (if any, to meet criteria of significance), subsidiaries and branches of banking groups that are monitored at European level, plus the three largest local banks (according to assets irrespective of their size and significance criteria. Responsibility for the supervision of all other banks in the local market will continue to bear the BNB, though that it will work “in close cooperation” with the ECB and will exercise oversight across the board methodology with the ECB. In the case of Bulgaria, there are currently no banks that meet the criteria for significance. This means that the three largest banks will fall under the direct supervision of the ECB as well as those local banks which are subsidiaries or branches of the large European groups. The minimum period for which the ECB undertook direct supervision and responsibility for a particular bank on the local market is 12 months. Another thing to keep in mind is that the ECB can decide at any time or temporarily suspend the supervision of local banks while the local supervisor authority does not take the necessary measures prescribed by the ECB or definitively ceases supervision.

- A significant advantage seen by experts in joining the Eurozone is the opportunity for relying on European bank support mechanisms in case of crisis. The Zone offers so far few such mechanisms to support member states in a fiscal or banking crisis. Most are transient in nature with the aim to become permanent after restructuring. One such is the European Financial Stability Facility (EFSF) that works after a Member state has issues a request for support, a rescue program has been negotiated with the European Commission, and the IMF is adopted unanimously by the Eurogroup (the Finance Ministers in Brussels). The European Financial Stabilization Mechanism as an emergency funding program depends on the funds raised on the financial markets and guaranteed by the European Union Commission through the budget of the European Union. Other mechanisms are the Bank union which consists of a single surveillance mechanism, a single problem resolution mechanism and a single Deposit Guarantee Scheme.

- The reduction in transaction costs is traditionally highlighted an advantage for businesses and citizens when adopting the common currency. In the case of Bulgaria, however, currency risk

for the euro does not exist because of the functioning currency board and a fixed exchange rate between the lev and the euro. However, the Bulgarian businesses and citizens will also benefit from lower transaction costs after the adoption of the euro in the country by other, non-exchange rate reasons. Among them are both the cost of conversion of the lev in euro and vice versa (the so-called conversion costs), as well the cost of bank transfer charges to the euro area.

The economic CONs

- According to euro-sceptics, the euro is not a panacea for solving all problems. They claim that it contains many, and serious, risks. This would inevitably have an impact on Bulgarian economy on the long run. However, the defenders of the Euro argue that risks always exist; this means that risks would exist also if Bulgaria stays out of the Eurozone. Such risks are neither less in number nor less threatening with any connection to the size of the economy. They usually point out the Brexit as an example of such risks.

- The alleged loss of political sovereignty is an argument often repeated. The loss of the lev and the Bulgarian government's power of discretion, the independence of the national central bank would be a serious constraint to the stability and development of the economy. The euro would cause the intrusion of "non-Bulgarian economic policies" carried out by EC bureaucracies and the ECB. Moreover, the symbols of the national currency, the national central bank and the discretion power of the government are presented as the last stronghold of "national sovereignty and Bulgarian statehood."

- The alleged loss of economic sovereignty is another chief argument. Bulgaria would be deprived of its own monetary policy and thus of the possibility to control its banking sector, interest rate, job market, investments market and all the rest of negative consequences of losing economic sovereignty. The government / central bank will not be capable to use the economic instrument of "planned devaluation of the national currency" following some examples such as Hungary in the 1990s. There will be no lender of last resort in the country.

- Sceptics fear that the current stable 2:1 exchange rate Lev/Euro will be lost after entering the Eurozone since the Lev needs to find its actual market exchange rate against the euro. However, proponents of the euro think that due to the freedom of exchange that Bulgaria has now, on the first day of unpegging, Bulgarians will simply start exchanging levs for Euros, so the lev will die on its own. However, this has been a fact for a long time because the currency board pegged the lev to the euro. Interestingly, the same critics are concerned that the currency board would be dropped, and thus politicians would misuse the currency reserve - a prospect that is just as likely to happen when Bulgaria is already in the Eurozone as it is today when it is still out of it.

- Sceptics argue that Bulgaria is unprepared for the strict rules of the banking union, which would prevent it from carrying out the necessary radical reforms in the public sector. On the contrary, optimists claim, the chance that these reforms will happen becomes much bigger and more realistic from now on.

- A populist negative motif often repeated and broadly shared in Bulgaria is that joining the Eurozone would bring a tremendous rise of prices "close to two times the current prices" as it might have happened in the past in East Germany. In fact, sceptics' predictions about the rise in prices are for 50%. The opposite opinion to this is that Bulgaria should not focus on pervasive risks since the risk is only one: Bulgaria to waste "the rare historical chance integrating to the monetary union it has currently".

- Another argument against joining the Eurozone is that "we" (Bulgaria) would be pressed to start helping countries in trouble once in the Eurozone. However, in fact this is Bulgaria that got

help from the EC for years so far via the European structural funds, etc. Apparently, given its current economic state, Bulgaria would need more help, for sure. (In the past communist period Bulgaria was obliged to constantly help pro-communist and pro-Soviet revolutions in Africa, Asia and Latin America – this argument is largely fed by such memories.)

- Some critics attack the Euro on its most positive side: easy loans in hard currency. They argue that easy and cheap loans offered from European banks would end up in Bulgarian government starting to take loans and dissipate money like “the Greek governments” did in the past, and Bulgaria would sink like Greece based on new big state borrowings. There is no mechanism known to stop politicians from acting so, say critics.

- There are also new arguments, mainly related to the forthcoming membership in the banking union as a condition for entry to the Zone required by the ECB. The membership of Bulgaria in the banking union would mean, according to critics of the entry to the Eurozone, Bulgaria to become almost enslaved by the European financial institutions, to become too subservient to the ECB's orders. They claim that doing so, specifically in the period before the introduction of the Euro, would be very risky. However, defenders of the entry to the Eurozone counter its critics by arguing that the worries and risks are only for those involved in bad banking who have something to hide (e.g., financing of own business with depositors' money). For defenders, the inspection and control from the outside can only be positive.

- The logics of the “pro” argument in this case is that Greece should not have been accepted in the Eurozone, not because it was less developed, but because it was accepted while being still unprepared by having not met the conditions, that these conditions were still not well formulated unlike nowadays, that Greek governments have falsified the economic indicators reported to ECB for years, that Greece suffered because of the irrational and irresponsible economic policy of its governments, etc. Another use of that argument is against opponent's motif that small and underdeveloped countries (like Bulgaria) suffer from the euro while bigger like Germany gain from it within the common market. Smaller EU member countries that later accepted the Euro became prosperous.

The political CONs and PROs

Political CONs and PROs are in fact opposite opinions about one and the same issues. They are based on presuppositions, interpretations and speculations about one and the same data, arguments or scenarios. This makes political Pros and CONs differ from economic ones. Political PROs and CONs are not objective. They are rather contextual and interpretative. Here follow some of the most systematically used ones:

- Bulgaria is still not ready to join the Eurozone despite the fact that it meets some of the Maastricht criteria as a result from the positive outcome of the successful currency board. However, some politicians who are strong supporters of Bulgaria's entry to the Eurozone argue that this fact should not be considered a serious problem. According to such government officials, one of the most important policy arguments in this context is that countries are more likely to satisfy the criteria for entry into a currency union only after having started to take steps toward economic integration rather than before that. This suggests that the convergence is likely to increase after the moment of accession.

- Staying out of the Eurozone would work for Bulgaria's independence. However, different political parties support opinions that staying outside would make the country's economy more vulnerable to Russian, American, Turkish or other influence in a time of stronger global centrifugal processes. Unlike the EU that guarantees some national political autonomy like the Baltic countries the rest of superpowers in the gravity of one or more of which Bulgaria would fall (e.g. Russia,

USA, etc.) would cause the opposite effect. The adoption of the euro is another instrument of securing such relative political autonomy of the country.

- Some politicians speculate that Bulgaria would suffer from serving the interests of the ECB, Germany, Brussels and so forth after adopting the European currency. Proponents of the entry to the Zone claim that Bulgaria would receive lasting and powerful support of EU for its accession to the Eurozone because of some “hidden” reasons like: (1) The need of a positive development in the Union to serve as “compensation” of Brexit, (2) Europe would need money for meeting the hardships of Brexit and thus would require Bulgaria’s currency reserves accumulated and therefore will support the country’s entry to the Eurozone; (3) By accepting Bulgaria to the Zone, the EU might isolate troublesome member countries like Poland and Hungary (which are outside the Eurozone), and therefore support Bulgaria.

- The end of the currency board arrangement paralleling the entry in the Eurozone would trigger fast and strong inflation claim many Bulgarian politicians mostly from the left end of the political spectrum. Quite often they are speculating with the public fears from rising prices after the changeover. Numerous right wing economists and politicians also support this view since they are strong proponents of the successful currency board that rescued Bulgaria from hyperinflation 22 years ago. The question is how reasonable these fears are. The data for inflation in consumer prices shows that most of the countries that joined the Zone over the past 10 years, reported a lower monthly inflation though on an annual basis the picture is more mixed. Obviously, inflation or deflation at the time of accession (whether it was monthly or annual) depends on many other factors – economic cycle, international commodity prices, wage growth and domestic credit, exchange rate, etc. In an analysis of 2009 the ECB concludes that overall inflation is largely unaffected by adoption of the euro. The fears of high inflation when adopting the euro are exaggerated according to proponents of its use in Bulgaria; even in the worst case scenario, they claim, inflation would remain below one percent. However, it should be borne in mind that most research show a relatively stronger inflationary effect on some services (personal services, restaurants, household services and more. under), which means that households and individuals who use these services to a greater extent will be more affected. In general this case concerns the middle class and the better-off part of the population they consume such services more often and in larger volumes.

- One powerful counterargument is that the entry to the Eurozone would inevitably cause foreign European (mostly German) banks enter Bulgaria offering very cheap loans in Euro, so Bulgarians would start taking loans mainly to buy homes and the governments would also take loans for government projects. This would make Bulgaria repeat the Greek scenario of economic collapse. However, critics of the pessimists argue, Greece and Bulgaria left 10 years ago from the same starting position of too high government debt, large deficits, macroeconomic instability; while Greece adopted the Euro Bulgaria got a currency board arrangement. In just one decade, from 1997 to 2007, Bulgaria managed to cut government debt to a low level, below 20% of GDP. This was accomplished as a result of disciplined fiscal policy and high real economic growth, and in addition there was a certain contribution from the privatization proceeds. For the Greek debt, the situation is the opposite. In other words, in good times the Greek debt remains high stable, and in bad times grows uncontrollably. In bad times the Bulgarian debt slightly grows then decreases again, while Greek debt grows a lot but does not decrease. According to Eurostat, for the past two decades, Bulgaria has achieved the largest reduction in government debt among all EU countries. This shows that there is a fundamental difference between Bulgaria and Greece largely due to the currency board arrangement. Bulgaria is the best example of budgetary discipline in the EU,

Greece is the worst example. The question unanswered is what will happen after a decision for its end is made.

- The next serious concern with getting into the Eurozone is that Bulgaria is weak and weak countries weaken after the adoption of the common currency at the expense of strong countries getting even better off (Germany considered most often in that role). However, all Central and Eastern Europe countries that have adopted the euro – the two Baltic countries, Slovakia and Slovenia – have healthy economic growth rates and accelerated them to 5%, while Poland, the Czech Republic and Hungary grew by about 4%. In other words, entry into the euro area has no negative effect on the catch process. The same is true of the fiscal indicators. Only Slovenia from the euro area countries has a debt above the limit because of the banking crisis.

- A CON argument with great importance is that the economic growth slows down due to ERM 2 and the adoption of the euro. Proponents of the entry to the Zone however claim that Slovakia for example increased its GDP per capita in terms of purchasing power parity almost twice as fast as the Czech Republic, the two countries starting 2 decades ago from a very similar point but the first having entered the Zone.

- Perhaps one of the most serious, if not the very most serious political concerns about Bulgaria's entry to the Eurozone is that the government will spend more and more irresponsibly, especially in view of the end of the currency board arrangement. One of the arguments against joining the Eurozone is the expected reduction in the interest rates on which government debt can be financed and the loosening of fiscal policy support of close-to-power businesses. This is one of the reasons Greece to find itself in the situation it has been in the last 10 years. However, the situation with the new EU Member States that have already joined Eurozone, is very different, claim critics of euro-sceptics. There was a period in which these countries join the Exchange rate mechanism (ERM 2), not the Eurozone itself. Interest rates in Bulgaria, although outside of ERM 2 are not much different from those of the latest Eurozone member states. If the government wants to spend indiscriminately because of the cheap financing, it can do so right now.

- Perhaps the greatest concern about entering the Eurozone from a currency board arrangement is whether the central bank's foreign hard currency reserve fund is going to be left to freely float. This is the 100% money with the BNB as coverage of the local currency in circulation and deposits of commercial banks, government deposit, which represents liabilities to government and is part of the fiscal reserve and liabilities to other depositors and the deposit of the Banking Department of the BNB. Some observers argue that after the adoption of the single currency these funds will be "released" and will be at least part of them may be invested in the Bulgarian economy. With the accession of the country to the euro area, the Bulgarian National Bank, as part from the Eurosystem¹, is obliged to transfer part of its foreign reserves to European Central Bank. The ECB's foreign reserve management targets are: liquidity, security and return.

The real problems of entering the Eurozone

The problems of Bulgaria's entry into the Eurozone at the moment seem to be related to the following:

1. The currency and fiscal discipline of the government - should the currency board principles beyond the acceptance of foreign currency such as the ban on government borrowing from the central bank, etc. should be maintained;
2. Preserving the discipline of the central bank and especially of its Banking and Supervision department;
3. Overcoming the problems in the commercial banking sector, especially banking supervision;

4. The rules under which the portion of the accumulated bank reserve in hard currency will be spent during the currency board;

5. Etc.

Political arguments are very important in the context of entering the Eurozone. Bulgaria cannot give up its obligations as they appear in the accession to the EU treaty it signed, where it has committed itself to the introduction of the single European currency. If Bulgaria gives up the introduction of the Euro and returns to the Lev after leaving the currency board this would bring many negative consequences – economic as well as political. The Lev has gone bankrupt once already. Bulgarians are paying by using the Lev which is in fact nothing other than a “cloning” of the Euro (as Steve wrote wittily).

Some believe that the BNB has “traditions” and will therefore respect the ECB's relations. This is debatable. Rather than going back to the failed old organization of self-standing monetary policy and dubious banking supervision, it is better to accept directly subordination to the ECB and its control when the Euro is being introduced. The currency board itself is not an anachronism; as long as there is a lag in the growth of economic development, it is due to the inadequate policy of governments during the existence of the board that either stopped the reforms or lagged behind the introduction of policies that had to be taken.

Despite the success, the currency board began being viewed lately as anachronism no matter the Bulgarian Currency Board is a “modern” or “second generation” currency board which gives the central bank some autonomy to take care of the liquidity of banks within certain limits. For a number of reasons, the entry into the Eurozone is considered a progressive move now which requires Bulgaria to exit the currency board. There are various reasons for this. One of the main points is that substituting the Bulgarian currency with the Euro will fulfill the disciplinary role of the currency board by adding some instruments to BNB that would accelerate the country's economic development.

One other argument is Bulgaria's potentially problematic banking sector. Dishonest banks that are not prevented from their corrupt practices by lending to friends or just lend carelessly are too risky in the pre-accession to the Eurozone period. These practices jeopardize depositors' funds, cause banking failures or bailout, or both. So, the biggest problem for any central bank whether it is a currency board or regular central bank is that kind of banking – weak or corrupt banks. A board itself would not solve that problem as well illustrated by the famous Bulgarian CCB bankruptcy in 2014 despite the well-functioning currency board arrangement.

The discipline of the government and the central bank is not the only major problem. Bulgaria has a serious problem with banking supervision.

There exist major deficits in the system of institutions which have direct supervisory functions over the banking sector in the country. These deficits are expressed in all directions: (i) their capacity, (ii) their functions and (iii) their management. Most of the significant problems are related to their ineffective or inadequate performance.

The institutions in the system (1) apply highly formalized approach, (2) they implement their functions passively and formally and (3) they tend to transfer responsibility to others institutions. The result is a wide range of inadequate and ineffective execution of control powers in a broad range by: (1) taking partial actions, (2) being not focused on the relevant issues, (3) taking measures that are not timely, (4) refusing oversight activities, and (5) applying a highly formalized approach. Significant deficits are found in the capacity of the supervising institutions. The lack of prepared experts and financial resources is not as much the problem that stands in the foreground. The real problems are (1) the ways in which the management of the supervising bodies is constituted and (2) the lack of independence from external influences (above all political, but not only). In this connection, other underlying problems emerge: (1) the politically influenced changes of the legislation determining the criteria for selection of supervising bodies as well as the way their management is constituted; (2) the formal application of the rules and procedures prescribed, (3)

the lack of transparency and adequate consideration of members of such bodies; (4) the dominance of the political affiliation criterion over expertise in these cases.

The high degree of influence of political affiliation in the choice of leadership of formally independent regulatory institutions is indicative. Representatives of the ruling parliamentary majority are elected as heads of the three basic supervising institutions - the BNB, the Financial Supervision Commission and the Commission for Public Supervision of Registered Auditors. Moreover, in two of these three cases, the chair of the relevant parliamentary committee, which organizes the election procedure, is elected to the highest managerial position.

These are precisely the deficits in the way management of independent supervisory are elected that undermines the independence of the bank supervising process and hinders the control activities. This problem leads to the lack of supervision authority over the supervising bodies and their members who possess political protection.

The official policy of joining the Eurozone

The geopolitical choice of Bulgaria is made. Bulgaria is governed by staunchly pro-EU coalitions and the euro-sceptic views spread among the Bulgarian society are weakest among the EU East periphery countries. As far as euro-scepticism is concerned, it is most often related to EU-scepticism spread among government opponents and communist regime nostalgic circles. Practically all political parties support the entry into the Eurozone - the ruling GERB party, the balancing "Turkish" MRF, some of the right-wing "patriotic" parties, and the euro-left. Altogether the vast majority of political forces in Bulgaria support the adoption of the euro as well as most of the possible requirements for this to happen. Bulgaria according to them is in the EU and a member of NATO.

The Economic and Social Council of Bulgaria (ESC) is perhaps the main generator of arguments related to Bulgaria's potential entry to the Eurozone. This institution concentrates a wide range of expertise based on the so-called tripartite principle – generalizing on the opinions of representatives of the government, business and employed. Their opinion is that Bulgaria's accession to the so-called "waiting room" and to the Eurozone itself must be considered a leading strategic priority of economic policy and therefore immediate national goal.

The official policy justification is based on the presumption that the Maastricht criteria are the best orientation points for macroeconomic development and fulfilling them alone would bring an excellent impulse for the economy. The government's Bulgaria is governed by staunchly pro-EU coalitions and the Euro-sceptic views spread among the Bulgarian society are weakest, spread among government opponents expectation is that the very participation of Bulgaria in the Eurozone may enhance the real convergence of economic cycles of the Bulgarian economy with the rest of Europe. Forecasts were made that the transaction costs for the substitution of the local currency with the euro would be lower than the immediate profits even when the overall effect of stimulating the economy are not considered. It is expected that investment flows would become more intense which would integrate Bulgarian economy more strongly with the West. Additionally, once in the Eurozone or even in its "waiting room", the local labor market would undergo sufficient further reforms and thus get integrated with the wider European labor market. Bulgarian political decision makers expect that the country's entry to the Eurozone would bring stabilization and better protection against any future potential asymmetric shocks. This is expected to lead towards increased GDP and consequently increase of the living standard of the Bulgarians.

The government documents related to Bulgaria's entry to the Eurozone suggest that it is a question of when, and not if, Bulgaria should join the Eurozone. The government's position on this question is steady: the sooner the better because Bulgaria would be able to enjoy the benefits of the monetary integration faster. Therefore, all debate is mostly focused on the technical aspects of fulfilling the convergence criteria. Most of the negative consequences expected (like loss of independent

monetary policy, exchange rate-related instruments, etc.) are neutralized by the excessive use of political counter-arguments.

The Bulgarian government strategy of integration with the Eurozone has been focused on 4 priorities so far: (1) To orient and steer Bulgarian economic policy towards permanent compliance with the convergence criteria, in particular with regard to fiscal discipline; (2) To take additional measures to strengthen the potential of the Bulgarian economy, including in the industrial sphere; (3) To carefully prepare the country to meet the set of technical and organizational aspects of the process; (4) to support the EU integration and work for strengthening of European institutions despite Bulgaria has limited influence over institutional design in the Eurozone.

Political decisions derive from the interests of their subjects. There are no political decisions that do not stem from interests. Only those of the objective arguments used to protect subjective interests are included into the real policy that will be followed. People do not follow the objectively best plans, but those that they interpret as best. Therefore, the issue of Bulgaria's entry into the Eurozone needs to be placed in the context of the interests of all stakeholders.

Political interests have metamorphoses at three different tiers. These are the global macro tier, the local macro tier and the micro tier. What will ultimately happen is a result of the interaction between the metamorphoses of the definitions of the interests by all stakeholders at the three tiers.

First "Global" Tier: Political Strategy

The first (and highest) tier of political decision making is the *global* one. This level differs significantly from the second *local* and third *micro* levels. Here are the large themes of national interests, democratic stability or the international relations concerned with these issues. The global tier is the area of *strategic* governance where strategic decisions are made. These are decisions that produce the *long-term* effects beyond the scope of present-day partisan politics and political mandates. Global decisions are related to international relations.

In the latter sense, the effect of strategic decisions about money and banking made today comes after 10, 20 or more years. Global decisions also affect the entire nation or at least substantial segments of it. Therefore these decisions imply abstaining from direct instrumental partisan motivation and, instead, maintaining cooperative interest.

When a bank issues currency to its customers it must provide the same amount of Euro's to the BNB. From the macroeconomic point of view (and the point of view of international politics) such political behavior will ensure a higher credit rating for the country as well as more predictability and hence a rise in foreign investment. All these are conditions for strengthening the democratic order in the country in a long-term perspective. The same definitely strengthens the international image of the government (which is important for governments of small economies).

The democratic model thus supported is close to the liberal. In applying the currency board rules to the local banking system, several democratic macro-political conditions are simultaneously provided: (1) minimalized government intervention, (2) minimal pressure from external political as well as economic factors, (3) independence from a foreign coercive supervising institutions (4) maximum freedom of market actors, (5) equity and personalized risk, (6) no refinancing of banks through the state budget and stable banking sector.

The general problem at this global level is what political decisions should be made and whether they will be authentic Bulgarian or imposed more or less from outside. Above all, it is important to assess their strategic value for the next generations. This will be the political responsibility of Bulgaria's current government in view of decades ahead.

The main issues at this level would be resolved via dialogue between the Bulgarian government and the European financial institutions. The interests of both parties coincide only partially: interpretations of interests are not only incomplete but will certainly differ to the last moment.

The basic interests of the European financial institutions related to the entry of Bulgaria into the Eurozone are clearer, although they are yet to be clarified as a result of the dialogue with the

Bulgarian side. Europe wants Bulgaria to be a stable and reliable member of the community that uses a common currency. However, the problem is how this can be realized. Following the European economic crisis and the serious problems with Greece, the formal fulfillment of the Maastricht criteria does not fully represent the European interest any longer.

It is for this reason that the European institutions follow a policy characteristic of the West European continental political culture. Instead of introducing more and more liberal market decisions, they are inclined to extend the initial set of requirements with new ones. Some of the new are financial, such as the requirement for Bulgaria to join the banking union. Others are purely political, above all deep judiciary reforms and profound measures against corruption. Apparently, this European attitude is inspired by the problems that Bulgaria has in the banking sector, not in the monetary sector. As long as such serious problem exists, a satisfactory degree of stability in the banking sector can be achieved not with practically impossible political means such as those listed above but with familiar economic tools such as banking reserves on deposits.

Twenty-two years ago, Bulgaria solved its currency and inflation problems through purely market financial, not coercive measures, adopting the currency board arrangement. A similar though not the same solution is likely to be found for its banking sector for the future. As is known, the currency board is a tool that deals greatly with inflation but is inadequate in the field of prudential banking. However, there are financial instruments in this area that can be applied. They resemble the currency board arrangement but applied to banks. Such instruments are most often derived from the principles of the so-called "Chicago Plan". Currency board and prudential banking regulations can complement each other.

Bulgaria's entry into the Eurozone creates certain risks but also opportunities. The criticism that the currency board receives in the last year or two does not mean that all its principles must be disregarded after the adoption of the euro. There are international experts who recommend that the currency board regime should proceed in a new way after the adoption of the euro, and this should be enshrined in the new law on the Bulgarian National Bank. They recommend adding some of the principles of the Chicago plan to a modified version of the Currency Board in Bulgaria in order to ensure the stability of the banking sector. While currency board principles provide government discipline against central bank borrowing, the principles of the Chicago plan provide for bank discipline against bad loans and overcoming temporary liquidity problems.

What degree of freedom of the Bulgarian government will be negotiated is an important strategic issue. In this context, several issues of cardinal importance will be addressed. One of them is the degree of discretionary financial power of the Bulgarian government. Another is what conditions will henceforth guarantee the financial discipline of the government. An important question will be how much of the currency reserve accumulated during the currency board the Bulgarian government will allocate to the European Central Bank as a reserve for the new currency. It will be important to decide how to further inspect Bulgarian banks – whether with greater or lesser interference from the ECB.

National authorities of countries with troubled banking sectors should consider establishing currency board type rules on bank deposits rather than abandoning the currency board rules. The Currency board arrangement as well as the Chicago Plan based instruments are powerful means of political and economic independence, that is, discretion power so much needed by governments. Both secure discretion power and therefore an opportunity for the national government to act at the international political stage relatively independent of the influence of foreign macroeconomic and macro political institutions and pursue its geopolitical strategy. The cost would be to limit the possibility for the central bank to provide loans for government projects and to secure the liquidity of banks faced with a liquidity problem.

Second “Local” Tier: Political Plan

The second (lower) tier of political decision making about money and banking is the *local* one. *Tactical* political and economy decisions are made at this level. Most of Political Science is concerned with this context: political elections, political support, political parties, parliamentary struggles, government endurance and the like. Public management theory is also concerned with issues at this level such as tactical governmental decisions, public *policy*, *laws*, etc.

Ruling *parties* want to rule after their rule, therefore, breaking up with a currency board arrangement unleashes serious new opportunities that they otherwise do not have – this has not been well explored yet. The currency board and the Chicago plan instrument seem to be strongly tied to this level as well and not just with the global strategic one. Their application creates opportunity for the government that introduces them to enjoy broad public support and therefore political endurance.

The currency board and the Chicago plan guarantee depositors' money in banks. Liquidity problems would be resolved in an easier and more efficient way instead of using taxpayers' money via the state budget, a common solution imposed by jeopardized governmental regimes in the past. People are quite sensitive to the problems of justice and fairness, and both the currency board and Chicago plan provide advantages to the ruling party that dares to implement it. Moreover, the Chicago plan creates grounds for overcoming the *risks* usually faced by medium and small businesses as well as ordinary depositors. This segment is very sensitive to the issue of taking risks. They would like and support the government which unloads them from financial risks in the way they liked the governments that have introduced the currency board arrangement.

The currency board rule of one hundred percent backing can be applied only to transaction accounts (demand deposits) or can also include savings deposits or even short-term time deposits. This fits Bulgarian political culture as well. It is risk free for depositors.

It is said that the ECB has no arguments to reject Bulgaria's accession to the Eurozone because, as a result of the successful currency board arrangement, the country formally fulfills all the requirements for that. However, the problem is different – it is a matter of the second “local”, not the first “global” political tier. Bulgaria has problems with insufficient banking sector reforms, not just with the weak reforms in the judiciary. This fact is known not only by the Bulgarian political parties but also by the European political institutions. The formal implementation of European requirements does not mean that all that is needed has been fulfilled. A problem is then how Bulgaria will behave while in this waiting room and, more important, after leaving it.

A serious issue at the second “local” level is how the government will spend that part of the huge amount of hard currency that the central bank has accumulated during the currency board arrangement after Bulgaria leaves it and after it passes over the rest to the ECB against the euro when it replaces the lev. Throughout the Bulgarian Presidency of the European Council and the months until the end of 2018 this problem was among the main motives of the opposition against the government. The opposition insisted that the ECB and other EU political bodies should take sides in the dispute and curb the Bulgarian government.

Third “Micro” Tier: Political Consent

The Bulgarian banking system is sick due to the model of banking that was introduced and applied throughout the transition and still. It does not imply only long-term earning from a classical banking business. Some banks in the near past and possibly even today rely on high interest rate deposits for financing half-legitimate business. Sometimes money from Bulgarian banks cross boundaries reaching offshore destinations in secret.

The European Commission, the IMF and the World Bank reiterate in their reports that there is a problem with related transactions and loans to related persons and firms as well as the concentration of credits. Some suspect this is masked by the BNB Banking Division using inadequate net corrections in asset quality check, whereby corrections if real should exceed

sufficiently the banks' own equity capital and significantly over the stress tests. (The inadequateness of the central bank's operations in the CCB crisis has not been overcome accordingly.)

Bulgarian taxpayers already suffered from the notorious CCB crisis in 2014-2015. They would hardly agree to be deprived of a further great amount reaching a high as 10 billion to cover the deficits accumulated by a new wave of bad credits. This time it protests are probable in an attempt to seek publicly account from the government, the BNB and other institutions. However, the opposite is also possible: many taxpayers have a short memory and low financial culture.

Unlike the latter European taxpayers will dislike paying few billion euros for Bulgarians cheated by their own banks. They would not allow another bank crash in a country that is willing to enter the Eurozone. No European government would risk that as well. What is going on in the Bulgarian banking sector is therefore observed by the relevant European financial institutions from close.

No government that allows refinancing of commercial banks by closing eyes or secretly supporting the central bank in its refinancing activities would remain unnoticed. These actions are quickly detected. Plans of refinancing the liquidity of commercial banks through the European Central Bank seems more or less impossible. No country would be accepted to the Eurozone before enough is known about its banking sector and adequate measures are been taken. That is why governments that consciously and effectively set barriers to bad intentions gain support, and their governance enjoys stability.

A system based on the currency board and Chicago plan principles would set a protective wall between banks' monetary and payment services and their investment/credit services. Banks' investments and loans would no longer be financed by deposits used for payments. The banking sector would be safer and sounder as a result.

Conclusion

In this third and final aspect of the political process, it should be pointed out that the Chicago plan creates the best opportunity for the government to cope with bank corruption by a single move. This is very efficient. However, in this way, the Bulgarian government will also overtake the actions in the same direction of the ECB and will show strength in foreign and domestic politics. For all the reasons mentioned in this paper, the Chicago plan can be considered not only as an economic but also a political instrument that provides all positive consequences for the Bulgarian government.

SOURCES

Ahmet Asici, Charles Wyplosz. Art of Gracefully Exiting a Peg. The Economic and Social Review, Vol. 34, No. 3, Winter 2003, pp. 211–228

Author/Editor: Andres Sutt ; Basil B. Zavoico ; Adalbert Knöbl Publication Date: May 1, 2002

Blomberg, S. Brock, Jeffry Frieden, Ernesto Stein. Sustaining Fixed Rates: The Political Economy Of Currency Pegs In Latin America. Journal of Applied Economics. Vol VIII, No. 2 (Nov 2005), 203-225

Fabris, N., Rodić, G., (2013) The Efficiency of the Currency Board Arrangement. In: Journal of Central Banking Theory and Practice, 2013, 1, pp. 157-176

Hanke, S. H. (2007), Bulgaria and Bosnia After Ten Years. Globe Asia, September Issue, pp. 166-168

Hanke, S. H. and Schuler, K. (1994), Currency Boards for Developing Countries: A Handbook, San Francisco: Institute for Contemporary Studies Press

Hefeker, Carsten. (1997), Interest Groups and Monetary Integration: The Political Economy of Exchange Regime Choice, Boulder, Westview Press

IMF Working Papers. The Estonian Currency Board : Its Introduction and Role in the Early Success of Estonia's Transition to a Market Economy. 2002

Leblang, David (2003), “To devalue or to defend? The political economy of exchange rate policy”, International Studies Quarterly 47: 533-560

Pavlov, K. N. (1999) Currency Board Solution in Bulgaria, Research made by NATO Fellowship, June 1999.

Reidel, Rafael. The evolution of Polish central bank's views on Eurozone membership. In: Post-Communist Economies. Vol. 29 Number 1 March 2017. PP 106-116.

Асоциация „Прозрачност без граници“. Оценка на системата за почтеност в банковия сектор в България. Изток-Запад, София, 2017 (стр. 21-22) [Asotsiatsia „Prozrachnost bez granitsi“. Otsenka na sistemata za pochtenost v bankovia sektor v Bulgaria. Iztok-Zapad, Sofia, 2017 (str. 21-22)]

Институт за пазарна икономика, Годишен доклад на ЕЦБ за надзорната дейност 2017. ИПИ 2018 [Institut za pazarna iкономика, Godishen doklad na ETsB za nadzornata deynost 2017. IPI 2018]