THE CURRENCY BOARD, THE EURO, AND BULGARIA - A CASE STUDY

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Submitted to Central European University - Private University
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In partial fulfilment of the requirements for the degree of Master of Economic Policy

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Vienna, Austria
2023

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ABSTRACT

This writing aims to present the reasoning behind several historical events in the economic history of Bulgaria. The transition period crisis to the introduction of the Currency Board Regime in the country. What facilitated it, why it was the best remedy for the problem that preceded the country to how it shaped the attitude towards the adoption of the Euro in the member state.

From an analysis of the literature a very important background was provided to better understand the comparisons between similar currency regime cases. Romania, Estonia, Lithuania, Latvia, Argentina were all used to understand the situation better.

Understanding the historical differences stemming from even before the Second World War is key to understanding the problems of today. Especially important when confronted with the fact that Bulgaria has been in a political disarray for the past three and a half years with the adoption of the Euro being a focal point in political rhetoric.

Keeping up the political stability and promoting educational campaigns have been the main policy recommendations that could be advised to political actors.

ACKNOWLEDGEMENTS OR DEDICATIONS

First and foremost, I would like to thank Prof. Julius Horvath from the Department of Economics and Business of the Central European University, Vienna. Him introducing the subject of Economic History to me was the prime motivation for me to pursue this topic.

Second, I would like to think prof. Robert Lieli and Kriszta Fogarasi for helping me out during the last two academic years.

Third, all my esteemed colleagues and closed ones for providing support and always been there for me.

Lastly, my home country of Bulgaria and its turbulent history that provided the academic literature to write this thesis.

TABLE OF CONTENTS

CONTENTS

LIST OF FIGURES, TABLES, OR ILLUSTRATIONS

LIST OF ABBREVIATIONS

LLR – Lender of Last Resort

BNB – Bulgarian National Bank

CBA – Currency Board Arrangement

CB – Currency Board

EU- European Union

INTRODUCTION

From economics and monetary theory, to post-communism studies and history this thesis aims to present the peculiar Bulgarian case of its currency board and how it still remains relevant to this day. Regarded as one of the most widely approved policy decisions of the country's modern history, the currency board and Euro adoption play a significant role in modern political and academic debate.

The currency board which stemmed from the economic crisis of the transition period has been seen as a precursor to the adoption of the Euro in the country. With every milestone that the country achieves the debate is once again reinvigorated. Whether it has been the democratic transition, economic development, or the accession to the EU in 2007, Euro adoption and by this extension the currency board has been in the back mind of policy makers.

Due to the popularity of the issue amongst public debate it trickles down from the political and academic elite to the average voter. With seemingly every person having an opinion it also transgresses into political campaign slogans. From populist tying the adoption of the Euro to losing your national identity and sovereignty to more moderate politicians using it as an example for development and progress, commonly referring to it as "getting the transition done".

From corruption, extortion scandals, orchestrated assassination attempts, to cupboards filled with gold bars and pictures of the ex-prime minister sleeping next to a handgun the political life in the calm country of sunny Bulgaria has been anything but that.

The country has been plagued by a political crisis for the last 3 years. The ongoing chaos has presented the country with five general elections (the most recent one in April 2023) which led to the conclusion of a rotating government that leads social scientists and experts to think that this will not be the end of the crisis.

The aim of this thesis will be to connect and showcase how the evolution from the disintegration of communism to how the currency board took place, and tell the story of the country in the last 30 years through the lens of economics, politics, and history.

CHAPTER I

The chapter will focus on describing the situation in the country, what led to taking the decision, and the history of currency boards. The period that will be discussed will be that of 1996-1998, the period in which the decision for the currency board took place.

The Currency Board

The current currency board arrangement was introdued on the 1st of July 1997. At first pegged to Germany's Deutsche Mark at a 1:1 exchange rate (later on the Euro). The economic crisis and hyperinflation forced the country's policy makers to seek outside help. Which period you discuss? The current currency board arrangement was proposed by the International Monetary Fund during the crisis. Much like this paper now, back then the debate amongs the Bulgarian policymakers was centered around learning from how the countries in the 20th century dealt with hyperinflation. Hyperinflation is associated with a monthly rate of price increase exceeding 50 per cent. It is a serious macroeconomic problem and usually takes place as a result of internal economic and political crisis associated with failed or inadequate response to external shocks and big domestic and external debt. All inflationary cases have common roots and namely internal imbalances: large budget deficits. The inflationary consequences and how different policy makers dealt with them vary according to the countries and regions they are in. In the case of Bulgaria, and what makes it different from the cases of Argentina (currency board introduced in 1991), Estonia (1992), and Lithuania (1994) is that the latter countries introduced the board in order to prevent future crises whereas the Bulgarian case was to put an end to a current one (Zloch-Christy, 1998).fine

The structural problems of Bulgaria's government, banking crisis that started in 1996, and the failure of earlier stabilization programmes further caused public outcry and consequences of the macroeconomic situation threatened the country's stability. The complications from the banking crisis forced 1/3 of the banks in the country to be shut down with the Bulgarian National Bank (central bank) limiting the amount of banks that could be closed and injecting liquidity, and the repurchasing of government bonds further increased inflation. Hyperinflation, high interest rates on government debt in combination with large spending from the central bank were all problems that a potential currency board could fix. The debate however was not on what it could fix but would it be successful in implementation. The implementation could be complicated due to the size of the banking sector (larger than in other countries where such a regime worked out) and the need for a Lender of Last resort (LLR) (Gulde, 1999).

With the change in legislature and the parliamentary support for these changes the currency board was introduced. Inflation at 1% in 1998 from 13% with the expansion of foreign reserves to more than 3billion$ as well as the basic interest rate of the BNB falling to 5.2% the currency board helped. Bringing inflation down helped with stabilizing the situation in the country both economically and politically. With the currency board in place households were protected from the potential economic downfall and policy makers focused their attention to accession towards the European Union.

Macroeconomic indicators before and after Bulgaria's adoption of a currency board
(percent)

				First quarter	
	1995	1996	1997	1997	1998
Real GDP growth	2.1	—10.9	...	—6.9	3.5
Inflation[1]	32.9	310.8	2,040.4	578.5	1.0
Fiscal balance (percent of GDP)	—6.4	—13.4	—62.1	—2.1	1.3
Bank financing of fiscal balance	4.9	14.5	40.7	—3.2	—0.3
Growth in reserve money	50.5	92.4	780.0	780.0	9.8[1]
Growth in real broad money	5.1	—45.4	—75.3	—32.3	2.8
BNB credit to banks (percent change in monetary liabilities)	—7.8	122.4	67.5	4.5	—36.6
Foreign reserves including gold (million dollars)	1,546.0	781.0	826.0	2,474.0	3,056.0
In months of imports	2.9	1.6	1.7	5.1	6.1
Nominal interest rate differential[2]	19.4	116.6	128.6	0.03	0.38
Exchange rate (lev/U.S. dollar)	70.7	487.4	1,021.9	1,776.5	1,675.1
Exchange rate (lev/deutsche mark)	49.3	313.4	946.9	1,000.0	1,000.0

Source: IMF.
[1] Twelve-month change, end of period.
[2] End-of-year differential between three-month deposit rates in Bulgaria and Germany.
... Indicates data not available.

Figure 1

Source (Gulde, 1999).

A lot of academic literature was written in the late 1990s and early 2000s to explain the rising popularity of currency boards over the years. Originally a colonial concept and thought of as only being able to work in very specific circumstances usually restricted to island economies smaller not as diversified ones. With the number of currency boards diminishing steadily from the 1960s-1980s, the 1990s saw a reinvigorated interest in them. Being succesful in stabilizing the economy and inflation in Argentina in 1991, to the two Baltic states Estonia and Lithuania achieving credibility for their respective currencies, and of course the help that the currency board provided in stabilizing the economy of Bulgaria in 1997.

A currency board combines three elements: an exchange rate that is fixed to an "anchor currency," automatic convertibility (that is, the right to exchange domestic currency at this fixed rate whenever desired), and a long-term commitment to the system, which is often set out directly in the central bank law. The main reason for countries to contemplate a currency board is to pursue a visible anti-inflationary policy. A currency board system can be credible only if the central bank holds sufficient official foreign exchange reserves to at least cover the entire narrow money supply (Enoch & Gulde, 1998).

The modern currency boards have been a very reliable tool in curbing inflation and stabilizing an economy. The examples of Argentina and Bulgaria in the 1990s further promoting their credibility. Currency board countries have experienced lower inflation and higher (if more volatile) GDP growth than floating regime and simple pegs (Ghosh, Gulde, Wolf, Haan, & Pagano, 2000).

Just because it is a useful tool however, does not mean that it is a simple task to accomplish. The necessary changes in legislature, wide support from the political system, require a certain degree of political stability that some states do not always possess. Under the right circumstances such a currency arrangement could work and stabilize the economic situation but it is dependent on several factors. You need to have “good institutions” and obvious political stability in the country.

In the older historical context, the currency boards originated from the British colonial rule in Mauritius in 1849 and spreading to other colonies and territorial possessions. With the notion of a currency board appearing in literature as early as 1890s and different monetary unions and common currencies emerging even before that (Flandreau, 2006).

The popularity of the currency boards peaked around the 1950s (see table) and gaining renewed popularity around the 1990s. Here's where academia distinguishes between two very important historical events. The currency boards that were in operation from the colonial period to the end of the Second World War and the ones operating afterwards. The so called "modern day currency boards" in Bosnia-Herzegovina, Bulgaria, Estonia, Honk Kong, and Lithuania (Hawkins, 2015).

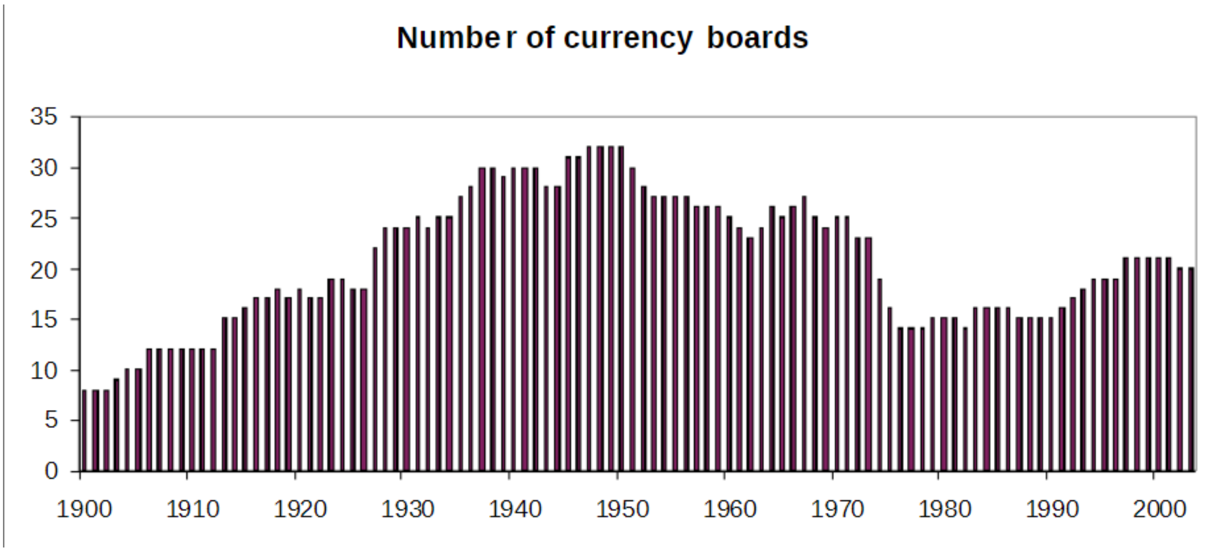

Figure 2

Source (Hawkins, 2015).

The distinctions in literature continue between the „orthodox" and 2nd generation currency boards. The orthodox one being typical of the colonial system which completely excludes monetary policy entangling the country in the real economy and liberalizing the balance of payments. In this type of currency board there is no possibility for a central bank that can discretely intervene due to the relationship between the balance of payment, reserve money, and the interest rate dynamics. The liberalization of balance of payments that occurs in the orthodox currency board arrangement does not permit for an interventionist central bank (Schuler, 2007), (Nenovsky & Hristov, 2002).

The so called 2nd generation currency boards (CBs) is defined by academics as an emerging form of CBs, gaining popularity after the 90s. They vary in the ways in which they let the Central Bank intervene in cases of systematic risk and in the way that it can act as a lender of last resort. In the cases of Honk Kong SAR, Argentina, Bulgaria, Estonia, Lithuania the flexibility of all central banks was respected in different ways allowing all of the countries above to perform some sort of discretionary monetary policy (Nenovsky & Hristov, 2002).

The peculiarity of the Bulgarian case consists of the role that the Bulgarian National Bank (BNB) plays. Authors have called it like a hybrid of an orthodox central bank and a classical central bank. The ability to conduct monetary policy still exists despite the currency peg towards the euro and the function of a lender of last resort still exists (Nenovsky & Hristov, 2002), (Nenovsky & Rizopoulos, 2003).

From this we can conclude that the Bulgarian currency board arrangement is orthodox in design with some additional ways in which the Central Bank can intervene. It seems that during the 90s in the economies of transition currency boards were one of the ways such transition economies like the Baltic states, Bulgaria managed to fight hyperinflation and pave the path for European Union membership and eventual adoption.

CHAPTER II

The 2nd chapter of this thesis will look at the change of monetary regime in Bulgaria and compare it to other such instances.

Bulgaria and Romania compared

The change of a monetary regime has been looked at as an instrument of institutional change over the years. The cases of Bulgaria and Romania can be viewed as an extension to this literature and can serve as good examples of institutional changes through monetary policies in economies of transition (Nenovsky & Rizopoulos, 2003).

Policy makers stand by their respective decisions, ones defending the currency board and the others the inflation targeting. Both countries presented the case of a floating exchange rate at the start of the transition that proved a futile ground for embezzlement and machination schemes that played around currency manipulations (Nenovsky, Tochkov,Turcu , 2013).

Through the decisions made in these two countries which have more in common than just being geographical neighbors. Sharing a common Ottoman past, becoming Soviet satellites to sharing the common economic issues of economies in transition in the 1990s. However, both countries decided to solve their respective issues in different ways. Bulgaria through the introduction of the Currency Board and Romania through inflation targeting.

In ways similar to the gold-exchange standard, the currency board in Bulgaria is extremely restrictable monetary system that eliminates monetary policy with the exception of statutory reserve management and the regulation of the banking system. The exchange rate is fixed by law, the monetary base covered by highly liquid foreign assets, and the Bulgarian National

Bank (BNB) is a Lender of Last Resort (LLR). Limited however to very specific situations of systemic risk which depend on the conditions of the payment system and on the surplus of foreign reserve over liabilities. On the assets side of the Currency board's (CB) balance sheet there are no domestic assets, securities of the Bulgarian government, or claims on the banking sector. All of this makes discretionary monetary policy impossible. However, it became an anchor that stabilized the economy of the country and steered it towards the path of EU accession along with Romania (Nenovsky, Tochkov,Turcu , 2013).

The decisions were influenced by several factors which can be viewed through the lens of history as well. Similarly, to the 1990s, during the 1920s and 1930s both countries were facing a similar decision. Stick to the orthodoxy of strong fiscal discipline, adhere to the gold standard, servicing foreign debt was the path that Bulgaria chose in that 10-year period. Whereas, the northern neighbor chose to use foreign loans to stimulate their domestic industry and devaluate during the 1920s-1930s.

With policy makers in Sofia historically preferring "orthodox" and very fiscally conservative solutions and management of public finance. Whereas, the ones in Bucharest preferring flexibility and more liberal approaches to conducting monetary policy (Nenovsky, Tochkov,Turcu , 2013).

Academics have conducted several comparative analyses of the two countries between the interwar period and post 1989 similarities. Even though, there is a lot of them the major changes occurred during the 45 years of the Cold War period (Frusetta & Glont, 2009).

During the 45 years of being satellite states to the Soviet Union the two countries adopted different attitudes to their economic policy-making. Bulgaria followed the Soviet-style of economic vision as part of its national and foreign policy in rapprochement with the Soviet Union (Volokitina, 2020). Bulgaria even trying on two separate occasions to become part of the Soviet Union (unsuccessfully) prompting Soviet leaders to make remarks to the country of that of an "obedient poodle". In comparison in 1964 Romania demanded autonomy from the communist party in Moscow, one can immediately see the differences during the Cold War Era that trickled down to economic policy making as well (Aldcroft & Morewood, 1995).

The 1990s faced the two countries with similar problems again. The economic crises that both countries experienced in 1996-1997 influenced the separate monetary regimes that followed. Due to the history of policy-making in Bulgaria being so closely related to the Soviet Union's the crisis was more severe. In combination with the crumbling banking sector and political crisis the country was experiencing severe struggles. Differences in accumulation of foreign debt, size of economy (Romanian economy is three times the size of the Bulgarian), levels of inflation at the start of the transition period (Inflation in Bulgaria was lower than in Romania) were all vital in the way that the two countries could approach the problem. The adoption of the currency board was a severe answer to a severe problem, whereas in Romania the solution was enhancing its discretionary monetary policy and the introduction of inflation targeting in 2005 (Nenovsky, Tochkov,Turcu , 2013).

The inflation targeting helped Romania deal with the global financial crisis of 2008-2009 specifically in dealing with high commodity and fuel prices and their effects on inflation. Further research proving weak links between advanced inflation targeting and unemployment during the crisis. Nevertheless, the country had to get help from the IMF for fiscal stimulus. (Filho, 2010).

The banking sector during the global financial crisis also was felt differently in the countries, in Romania the crisis failed to support the recovery of the economy with banking activity almost stopping for a few years (RĂDULESCU, 2014), (Popescu, Meiță, & Popa, 2016).

The difference is approaches to the crisis of the 1996-1997 in both countries led to significantly different outcomes in the 2008 global financial crisis. Yes, Romania was more attractive for Foreign Direct Investment (FDI) during the early years of accession towards the European Union but this also led to different structures of the banking sectors and the historically different approaches to public finances also played a role. The Bulgarian banking sectors was safer due to the majority of bad loans being absorbed by the control large EU banks had in their subsidiaries in the country (Nenovsky, Tochkov,Turcu , 2013).

Sharing a lot of history between themselves, the differences in approaching monetary and economic policy issues ever since the end of the First World War have reflected and influenced the decisions and reality of today. The traditionally "orthodox" monetary policy makers in Sofia to the "flexible" ones in Bucharest, these differences followed suit throughout the Cold War era as well. Culminating in the way the two states handled the transition crises and paving the way for EU membership respectively. After 2007 (EU accession) the competition now is placed on anti-corruption practices and securing EU funds.

The Argentinian Story

Argentina, a country that was among the richest countries before the 1930s now presents another view of the currency board regimes. The view of what can go wrong when not implemented properly. The South American country which has been plagued by politics of populism, corruption issues, and outside meddling in its politics is somewhat similar to the case of Bulgaria. Nowhere the same in size, the two countries have one thing in common – they both adopted a currency board regime in the 1990s.

The chaotic nature of politics during the Cold War in Argentina made the country go through several economic crises over the last 40 years. Two instances of hyperinflation made the

Argentinian government of the 1990s to introduce through legislature a currency board pegging the peso to the United States Dollar.

Why is it different? The Argentine currency board deviates from the “orthodox” one:

The Currency Board was integrated into the Central Bank with no designated CB accounts losing its role as lender of last resort (LLR).

With 20 per cent of the money–base cover was to be provided in the form of dollar short–term Argentinian public debt, rather than through international reserves. As well as the Argentine financial system had demanding capital requirements and series of liquidity provisions. Banks were obliged to hold 21 per cent of all deposits in liquid international reserves at the Central Bank or at Deutsche Bank New York. The Central Bank has also a contingent line of credit with a dozen international banks covering 10 per cent of deposits in the banking system (OECD Working Papers, 2002).

Argentina abandoned its currency board in January 2002. To some scholars, this emphasized the reality that currency boards are not irreversible and may be abandoned in the face of foreign exchange speculators' speculation. However, Argentina's system was not an orthodox currency board because it did not fully adhere to currency board norms - a point that many blame for the country's demise. They contend that Argentina's monetary system was an incoherent blend of currency board and central banking components. The “convertibility law” by the BCRA (Banco Central de la Republica Argentina, also known as the Central Bank of Argentina) did not create a currency board, instead the country had a Central Bank with a pegged exchange rate distinguished by the uniqueness of being able to convert pesos to dollars on demand (Hanke, 2003).

Even though the situation in the country improved initially with the implementation of the Currency Board even with a small post-stabilization boom it nevertheless did not fix the problems of the country to this day (Hanke & Schuler, 2015).

The Baltic States comparison with Bulgaria

The three Baltic countries: Estonia, Latvia, and Lithuania all had one goal in mind when devising their currency boards – Euro adoption. The success is evident from history, Estonia transitioned from the board to the Eurozone in 2011, Lithuania in 2015, and Latvia in 2014.

Scholars agree that discipline is paramount to the overall framework of the currency board. They can be used as stabilizing anchors in economies of transition (The Baltic states, Bulgaria) but this requires strong fiscal discipline and political stability. Yet while performing well on inflation and trend growth, the Baltics also experienced pronounced economic volatility, with Latvia in particular going through a marked boom-bust episode (Wolf, 2015).

The Estonian and Bulgarian case of a currency board adoption have been academically analyzed since their successful implementation. Both cases provide an example of using the Euro as an anchor currency during their transition periods. The exposure towards euro-dollar was one of the main disadvantages of the establishments of both regimes, paling in comparison to the risk of prolonging the economic crisis further. The motivation behind the Euro peg was stabilization of the economic and political situation in the two countries, the further intertwining of the economies with European markets, and paving the way for European Union membership and eventual adoption of the Euro (Kalcheva, 2003).

Specific Characteristics of Currency Boards in Estonia and Bulgaria

Estonia	Bulgaria
Introduced June 1992 by monetary act	Introduced July 1, 1997 by law
Fixed exchange rate 1 DEM = 8 EEK; 1 EUR = 15.6466 EEK	Fixed exchange rate 1 DEM = 1 BGN; 1 EUR = 1.95583 BGN
Currency board liabilities—100 percent covered by interest-bearing and high quality foreign currency reserves denominated in DEM (EUR)	Currency board liabilities—at least 100 percent covered by assets in foreign currencies (DEM, EUR, USD, CHF, JPY) and gold
Full convertibility for current account; full convertibility for capital account since 1994	National and reserve currencies are freely convertible; full convertibility for capital account since 2000
The Central bank of Estonia was established in 1992 in accordance with the currency board principles	Bulgarian National Bank reorganization: Issue Department holds all monetary liabilities, deposits from banks and nongovernment deposits, government deposits, and Banking Department deposits; Banking Department holds all other assets and claims on the Central Bank and acts as a fiscal agent with the International Monetary Fund (IMF)
Open financial system—active role of Estonian banks on international financial markets	Open financial system
13 percent minimum reserve requirements, imposed on commercial banks	11 percent minimum reserve requirements, imposed on commerial banks
No lender of last resort facility—has no excess coverage	Strictly limited lender of last resort facility—has excess coverage
Earns seignorage of interest	Earns seignorage of interests and commissions
The central bank does not give credits to the government	The central bank is in charge of lending IMF funds to the budget
Limited use of monetary policy instruments by the central bank	Limited use of monetary policy instruments by the Ministry of Finance
Standing facility, deposit facility, and certificates of deposit	Fiscal Reserve Account
Floor but no ceiling for money market rates	Base interest rate is determined by interest auction
Implementation of real-time gross settlement systems and reform of monetary policy framework	Implementation of real-time gross settlement systems

Figure 3

Source: (Kalcheva, 2003).

From the table above, we can observe the comparative analysis done by scholars when discussing the differences of the two monetary regimes. Immediately the differences in the institutional set up of the two central banks are evident. The Estonian central banks' direct participation aimed to isolate the economy from currency speculation and external financial shocks, with the role of LLR (lender of last resort) not being ruled out.

The BNB's (Bulgarian National Bank) set up varies in the legislative structure that provides some limited scope for a LLR. If the system is exposed to liquidity risk, the central bank may extend collateralized credits to the financial institutions and banks.

Bulgaria and Estonia remain the only two countries to have their currency pegged directly to the Euro, different than the countries in the eurozone that have a managed or floating rate.

If we view the monetary regime change in those countries as a "game" we can see some of the underlying issues that potentially prevented Bulgaria's accession to the Eurozone and not that of Estonia and the other Baltic states.

(Nenovsky & Rizopoulos, 2003) classify the main players that influenced the monetary regime change in Bulgaria (the adoption of the currency board) as:

1. Foreign creditors (private and official) – who had a very strong interest in introducing and maintaining the Currency Board due to the foreign exchange reserves being invested in German and U.S securities.
2. The IMF as a separate player (creditor to Bulgaria and debtor to the U.S Treasury) – the main direct initiator for the monetary regime change in the country. Interested in having the currency board operational as long as successfully possible as it enables the country to service its foreign debt.

3. Households (final domestic creditors) – interested in the stability that the board regime provided after the hyperinflation and economic crisis
4. The government (domestic and external debtor)- not as happy initially since it limits their powers but viewed as a very necessary decision to the crisis. After the stabilization and economic growth due to the introduction of the board it is interested in continuing to support it.
5. The Bulgarian National Bank (domestic creditor of last resort) – opposed initially at first due to losing its ability to conduct monetary policy. The BNB in the 90s was openly viewed as a lender of first, not last resort with managers of the Bank participating with other parties from government in speculative operations related to exchange rate movements.
6. Market-oriented commercial banks and private-owned companies (domestic creditors) – their primary interest Is a stable economic environment which allows them to continue business operations so the currency board at first was a positive for them
7. Subsidy and crony-oriented commercial banks, state-owned and private-owned companies (domestic debtors) – have no interest in the currency board arrangement since it prevents their "wealth distribution" practices and have a critical interest in the effects of the monetary crisis
8. Politicians and bureaucrats (domestic debtors)- like the previous ones they had no immediate interest in the introduction of the board but it was their only option to survive the economic crisis and not lose their gained wealth.

One of the major motives behind the monetary regime change was the desire of interested actors or "players" to the greater access of resources that the economic stability provided.

This period of transition (both economic as well as political) has been also analyzed through Game Theory Interpretation to explain why Bulgaria and Romania handled their transition period poorer than that of the Baltics and Central European countries (Ialzanov & Nenovsky, 2011) .

CHAPTER III

The Euro adoption or accession to the EMU (European Monetary Union) has been a goal that the country has sought even before the accession in the European Union. One of the major constraints of the proposed currency board regime was that no country has joined the Eurozone with one.

Bulgaria and the Euro

Many academic articles, papers have been written on the benefits of joining the Eurozone from the perspective of Bulgaria. While there is criticism against the whole project from scholars such as critique of the institutional set up behind the Euro. Identifying the structure of the Eurozone as the main problem behind the currency union, mainly the asymmetry of the monetary union, as well as the policies of the zone contradicting the interests of some of its members (Stiglitz, 2016).

The advantages and disadvantages of the Euro adoption have been illustrated numerous times in Bulgarian academic literature. To briefly summarize them and better help pain the picture of the attitude in the country towards the European common currency I will dedicate a few points to them as per (Yotzov, 2023).

The advantages have been theorized to be the following:

- Facilitation of the national market and integrating it into a wider supranational one
- Reduction in transaction cost by exchange rate risks, better international trade and larger foreign trade volume (albeit not by much)
- Reduced possibility for a national government to monetize the deficits

- Growth, employment, will be unaffected
- The Financial sector of the country aims to reap the most benefits with interest rates on loans decreasing, liquidity in the banking sector will remain high due to direct ECB funding, direct supervision by the ECB providing an extra layer of security, change in the tax system (an advantage from a policy maker perspective)

The disadvantages have been characterized as loss of monetary sovereignty (something that the country gave up 25 years ago with the Currency Board…) this however has played special role in populist remarks and rhetoric in the political scene of the country. Rising inflation and an upwards effect on consumer prices but it is considered to be a negligible one (Petranov, Zlatinov, & Atanasov, 2022).

The reason why some member states have opted out of joining the Eurozone (Romania, Czechia, Hungary, Poland) is they want to keep using their monetary policy instruments. This argument does not hold in the Bulgarian case as it abandoned them with the introduction of the CBA (currency board arrangement).

Having a common monetary policy with the Euro does not mean having the same inflation differentials. Due to the differences in economic development and other factors. The period in the country that followed after the introduction of the currency board regime has been also related to stringent public finance policies partly due to the fact that it requires very strong fiscal discipline in order to operate an orthodox currency board arrangement. The other benefits like controlling budget deficits can be obstructed by special interest and cronyism. The final advantage of the arrangement for Bulgaria has been undoubtedly the convergence of interest rates to the reserve currency country level, however the interest rates of the country were higher due to the risks related to the country and exchange rates (Ialzanov & Nenovsky, 2001).

Two countries in ERM II, one in the Eurozone

Bulgaria and Croatia both joined the ERM II in July 2020, with Croatia adopting the euro in 2023 after satisfying all the prerequisites. The situation in my home country has been different however. The adoption of the Euro which has been seen by scholars and academics as a clear move to further deepen the integration of the country into the European Union. The convergence level of Bulgaria is still disappointing, 53% of the EU average the country is simply not ready for a short stay in the "waiting room". Due to the COVID-19 crisis this could further complicate the budget deficits and the stability of interest rates criteria (Chobanov, 2020).

The cases of both Bulgaria and Croatia has been used in analyzing the benefits of close co-operation and the double requirement for joining the banking union as well as ERM II. The point of the requirement being linkage of the banking sectors of "countries willing to adopt the Euro" to the Banking Union. The clear benefactors are the bank who fall under the supervision of the ECB in the two countries (only certain banks fall under this criteria) adding a layer of "credibility and security" in their respective markets (Nieto & Singh, 2022).

The similarity between the Bulgarian and Croatian cases are again in the institutional set up of the Currency Board Arrangements of both countries. Despite this, Croatia managed to join the Eurozone whereas Bulgaria had issues with price stability and central bank legislation.

Chapter IV

From the analyzed literature one can interpret that the Bulgarian government needs to prioritize fulfilling the Euro adoption criteria and ERM II nominal criteria. The last three years have characterized the Bulgarian political scene by exposed corruption scandals, protests, and election cycles.

Despite political instability, one of the widely regarded opinions of voters and politicians in the country is the need for a currency board. There is no active campaign to abandon it, only to not adopt the Euro.

With the emergence of new political parties, COVID-19 crisis that worsened the imported inflation, as well as the economic problems from the War in Ukraine made the previous plan to adopt the Euro by 2024 impossible.

The Political Crisis and its implications

With 5 general elections in two years, the situation in the country reflects that of the Euro adoption, uncertain. To help better illustrate the situation of the country here are the election results with brief descriptions of the political parties and their attitudes towards adopting the Euro (see table.)

Party	Leader	%	Seats	+/–
GERB—SDS	Boyko Borisov	25.39	69	+2
PP–DB	Kiril Petkov	23.54	64	-9
Revival	Kostadin Kostadinov	13.58	37	+10
DPS	Mustafa Karadayi	13.18	36	0
BSPzB	Korneliya Ninova	8.56	23	-2
ITN	Slavi Trifonov	3.94	11	+11

Figure 4

Source: (Bulgarian Parliament, 2023). The + / - are seats lost or won in Parliament.

GERB-SDS a coalition of two centre-right parties who were the main reason for the protest that sparked the political crisis in the country three years ago. Advocates for further Euro integration but also populistic and falling in line with other Christian Democratic parties in Europe.

PP-DB coalition of six parties across the political spectrum that emerged as the opposition due to the protests of the last three years. The main advocates for adoption of the Euro as well as further integration in general in the country, they lost the most seats in the recent election however.

Revival ultra-nationalistic right win, anti-EU, anti-NATO, anti-LGBT, anti-vax, pro-Russia party. Their electoral performance since their creation with analysts predicting an even better one if snap elections are to emerge again. The main opposers to the Euro and the reason why it is even discussed among the public, gathering over half a million signatures against the adoption (Camut, 2023).

DPS, the party of the Turkish minority with sanctioned by the Magnitsky act members of parliament (Prince, 2021). They are largely in favour of political and economic stability of the country as per Nenovsky's thesis on cronies benefitting from further protection of redistributed wealth (Nenovsky & Rizopoulos, 2003).

BSPzB the remnants of the Bulgarian Communist Party with only a very small minority of its Members of Parliament holding any pro-EU views whatsoever. Also, opposition to further EU integration and pro-Russia views (Centre for Strategic and International Studies, 2021).

ITN, the party formed by ex-showmen and musicians with heavily nationalistic views, described by academics as "banal", also against Euro-adoption and further EU integration (Brankova, 2021).

The political gridlock in the country came to an end with a deal involving rotating Prime Ministers and governments, as well as the promises to enact anti-corruption reforms. The government comprising of the first two parties (GERB-SDS + PP-DB) will attempt to govern the country and put an end to the crisis paving the way to further EU integration.

That being said, the politics of today may not always shape the future. While writing this thesis, events keep unfolding and the prospects of Euro adoption is not in the clear horizon even with all the criteria that has been met. The current adoption target is 2025 or further (Tsolova, 2023).

A choice that should come from pure economic pragmatism has turned into a petty political showmanship with parties tying it to losing sovereignty and identity. For this reason, understanding the current political situation of today is vital to understanding the attitude and ambitions of the policy makers towards adopting the Euro.

What needs to be done?

From a policy perspective point of view keeping the political stability is of paramount importance just as during 1996/1997. Fortunately, this time the country is not facing an economic crisis as well but a rising far-right wave that if given the opportunity will go against everything that the political elite has been trying to avoid.

Consensus on economic issues has been achieved especially in regards towards the CBA (currency board adoption).

The main policy recommendation will be to keep the current rotating government and try to maintain economic stability in the financial sector.

The second main policy recommendation would be for the government to actively promote educational information campaign to explain the benefits of Euro adoption.

Conclusion

To conclude, this thesis presented a perspective on a deeply divisive issue trying to present the history behind an economic decision. It illustrated the complicated currency boards, their kinds, and the history behind them. It compared different country cases to better provide understanding for the complicated situation in Bulgaria. The analysis of the political climate of the country tried to present the reader with much needed background towards how realistic Euro Adoption is and why it plays a role in political campaigns despite it needing to be a pragmatic decision.

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