ИНСТИТУТ ЗА ИКОНОМИЧЕСКИ ИЗСЛЕДВАНИЯ НА БЪЛГАРСКАТА АКАДЕМИЯ НА НАУКИТЕ
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THE EURO AND BULGARIA – FEARS AND HOPES[2]

The political passions of the last three years have prevented the general public from appreciating the long-awaited event – the accession to ERM II, which is undoubtedly an important achievement and the last step towards full membership of the Eurozone. In a broader sense, the monetary union can be considered as a preparatory stage for the transition of the European Union to the next form – Political Union. In practice, however, this does not happen, and the eurozone expansion process is currently slowing down. The main goal of the proposed article is to dispel some of the fears that have been instilled in recent months, related to the upcoming accession of Bulgaria to the Eurozone. The main theoretical concepts regarding the benefits and disadvantages of joining a monetary union are examined. The initial prerequisites, the structure and functioning of the modern monetary regime, as well as some of the peculiarities in the development of the Bulgarian economy, are analysed.

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1. Brief Description of Monetary Union

In its essence, the theory of optimum currency areas (OCA) is a set of indicators whose values for a given group of economies influence the assessment of whether the existence of a common currency for these economies is justified. The OCA can also be defined as the optimal geographical area for one currency, or several currencies whose exchange rates are fixed. The currency or currencies within a currency area have the same fluctuation in exchange rates relative to currencies outside the particular area. The borders of the OCA are determined by the sovereign states that have chosen to participate in it.

Traditionally, each country maintains its own national currency. However, according to (Mundell, 1961)[3] this is not the most efficient method for achieving high results. According

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[3] Although it's common to regard Mundell as the father of the OCA, (Friedman, 1953) noted much earlier that "*A group of politically independent nations all of which firmly adhered to, say, the gold standard would thereby in effect submit themselves to a central monetary authority, albeit an impersonal one. If, in addition, they firmly adhered to the free movement of goods, people and capital without restrictions, and economic conditions rendered such movement easy, they would, in effect, be an economic unit for which a single currency would be appropriate.*"

to this theory, countries with strong economic ties have the opportunity to integrate a common currency mechanism. In this way, the possibility of a higher convergence of the capital markets, which significantly facilitates trade, increases. Achieving a common currency for a certain group of countries comes at the cost of losing: income from seigniorage, the possibility of monetary and fiscal policy interventions to stabilise the economy, as well as a certain degree of sovereignty (depending on the cultural heritage and traditions of a certain people). In a nutshell, *an area needs a separate currency if the economic costs of adjustment through changes in wage and price levels, or through factor mobility (labour and capital), would be higher than those of altering the exchange rate*. The case for separate currency areas clearly holds only if the impact of a shock varies between areas: i.e., is asymmetric. If the impact were to be the same on all, the exchange-rate changes needed for adjustment would be the same for all, in which case separate currencies would serve no purpose. The OCA theory indeed implies that any two countries generally experiencing symmetric shocks, and trading significant proportions of their GDP bilaterally, should fix their exchange rates.

Mundell outlines the criteria necessary for a region to meet the requirements for an OCA and subsequently profit from the benefits of a common currency:

- ***Mobility of production factors*** – OCA should be characterised by high internal and low external mobility of production factors. This largely limits the risks of external shocks entering the economic space;
- ***Price and wage flexibility*** – if nominal prices and wages in the countries of the area are flexible with each other, interventions in the presence of negative externalities are less likely to be associated with high levels of unemployment and inflation over a long period of time;
- ***Mobility of the labour force*** within OCA – includes free movement of labour and elimination of cultural restrictions that “stop” this movement – language barriers, differences in the functioning of institutions and others. If there is an asymmetry in the economy and a sharp decrease in employment, in the presence of its own currency, unemployment is corrected by reducing relative wage levels. Labour mobility offers an alternative option where the labour force for vacant jobs is contracted through emigration.

After Mundell, (McKinnon, 1963), (McKinnon, 1969) and (Kenen, 1969) further developed his theory by proposing new criteria for defining an OCA by bringing in some additional factors:

- *Fiscal integration* – according to Kenen, fiscal integration at the regional or local level can help to overcome asymmetric shocks. In practice, the theory looks like this: if there is an asymmetric shock in one country of the OCA, it receives a transfer to compensate for it from the rest of the zone, as payments to the general budget are reduced, which does not affect the funds received under the planned programs;
- *A high degree of openness of the economy* – countries that carry out intensive trade with each other form an OCA. The relative price between domestic and foreign goods should be identical or similar. The more open the economy, the less the importance of the exchange rate for competitiveness;

- *Similarities in inflation rates* – when inflation rates between different countries are similar, this ensures stability. It also reduces the need for nominal adjustments in exchange rates;
- *Integration of financial policies* – countries that demonstrate high degrees of integration in terms of financial trade achieve, in the long run, a wealth effect due to capital flows;
- *Political integration* – the leading criterion in choosing to integrate a single currency. Political integration includes the observance of joint commitments and cooperation on the integration of common economic and financial issues. The criterion of solidarity also derives from political integration. It is based on the belief that if the common monetary policy goes against any of the member countries of the currency area, then the other countries should be willing to "pay this price" in the name of the common interest.

These authors, in practice, identified the characteristics that potential members of the single currency area should (ideally) possess before abandoning nationally tailored monetary policies and exchange rate adjustments and exposing the gains resulting from the use of a single currency among economies. Other authors further developed the theory, and thus the literature was enriched with more features related to the identification of candidates for participation in a single currency area, while at the same time proposing more detailed estimates of the benefits and costs of the common currency. However, it is generally believed that the original three collaborators laid the foundation for substantially all subsequent work in this field.

2. Pros and Cons of OCA

2.1. General rules

The unification of countries under the idea of a common currency area aims to transform external shocks for the group into internal ones, thus reducing their uncertainty and facilitating its management. Other advantages of the area are the reduction of transaction costs, the elimination of currency risk and the increase of competition at more easily comparable prices. A major drawback of the theory of an OCA is the presence of multiple criteria, some of which even report contradictory results. The lack of structured information makes quantitative and qualitative assessment difficult when analysing the degree of integration of a specific country. These undoubtedly are the main pros and cons, but a proper study would require a deeper analysis.

Monetary union theorists have long initiated a debate about the benefits and costs of adopting a single currency. This debate, which continues to this day, has important implications for the motivation to form a single currency area among a group of partner countries. Some of the properties of OCA still need to be better formulated and analysed in more detail, and in general, a unifying framework is lacking. Different boundaries of a currency area can be drawn by invoking different properties – something known in theory as an "indeterminate problem" because the properties of an OCA can point in different directions. For example, a country may be quite open to mutual trade with a group of partner countries, leading to a preference for a fixed exchange rate regime or even monetary integration with major trading

partners. However, this country may exhibit low mobility of factors of production and labour with respect to these trading partners, suggesting that instead a flexible exchange rate may be more desirable to deal with shocks originating from countries outside this country group. The problem can be further complicated in cases (which are often observed) when the free movement of labour is deliberately restricted. In theory, it does not matter what grounds are used to impose these restrictions.

There may be a "*mismatch problem*". For example, small economies, which are more open, should preferably adopt a fixed exchange rate or even monetarily integrate with their major partners. However, these small economies tend to be less differentiated in production than larger ones. In this case, they would be better candidates for a flexible exchange rate, according to the principle of diversification in production. The problem, thus is how to rank the different criteria of OCA. Price and wage flexibility and the mobility of factors of production (including labour) have a particularly vital role in the debate. The integration of financial markets is also considered very feasible. However, until the mid-1980s, for several European countries, full capital mobility and convertibility were the exception rather than the rule. Inflation differentials were still relatively small but not insignificant at the time of the oil shocks. Economic openness and the diversification of production and consumption tend to show their effects through product and labour markets. It turns out that the political will for integration is understood as a crucial prerequisite for the initiation of integration in most of the other areas.

Prioritising the criteria (especially in cases where they contradict each other) is also essential. It is clear that price and wage flexibility are leading because they allow a quick response to possible shocks. Openness and similarity in shocks are also important. But if the members of a currency area are financially integrated, a high similarity of shocks among them is no longer a strict necessary condition. This has relevant implications for the debate over the size of such a currency area. The mobility of the factors of production is highly desirable, but it entails some costs and cannot effectively deal with some shocks in the short run. On the other hand, short-term capital movements can contribute to easing the adjustment process and the flexibility of fiscal policy should be increased to undertake expenditure absorption policies if necessary.

2.2. More on advantages

An obvious advantage of the euro is the elimination of exchange rate risks. In the floating exchange rate system, continuous changes in exchange relations hamper trade, creating difficulties for exporters and importers. Constant fluctuations in exchange relations between two or more currencies increase uncertainty and risk for firms engaged in foreign exchange and discourage the transfer of goods and services across national borders. From this point of view, the adoption of a common currency creates enormous advantages such as deeper economic integration; increased specialisation and an increase in trade volume.

An important benefit of the common currency is the reduced possibility for national governments to use discretionary monetary policy to achieve short-term goals, especially when they are politically motivated. With a single currency, the government would have

limited opportunities to use inflation as a method of financing the budget deficit. And last but not least, the common currency makes countries observe economic discipline and meet their convergence criteria. To reap the benefits of specialisation and cooperation through a single and wider market, national governments will have to abandon unwise monetary and fiscal policies and restructure public spending by eliminating chronic budget deficits.

2.3. More on disadvantages

There is no doubt that the introduction of the euro has had a strong positive impact on the volume of trade flows and increased efficiency as a consequence of the division of labour. But this is not a panacea. Like other modern currencies, the euro is fiat money and is based on trust, which is fragile, especially when dispersed between different countries with varying degrees of economic development.

Another serious disadvantage of the common currency is that it (to some extent) limits the freedom of citizens in terms of their choice of what currency to keep their assets. When a common currency becomes legal tender in different countries, every citizen in those countries is forced to accept and use that currency. In practice, the existing national monopolies represented by the national central banks have been replaced by a centralised, stronger and supranational monopoly. In the absence of competition between national currencies, the existence of a single currency provided by a monopoly may lead to any specific adverse effects of any monopoly. The losses arising from the supranational monopoly can (in principle) be overcome only by imposing specific standards on the best currencies existing before the creation of the monetary union. In the case of Europe, this means that the standards of the Bundesbank will become valid for everyone else. The problem is that the standards of the Bundesbank are consistent with the economic characteristics of Germany and not of the euro area as a whole.

Another drawback can be outlined – the huge centralisation and the inevitable bureaucracy in decision-making. In turn, the concentration of power increases the likelihood of making mistakes that will be transferred to the entire monetary union, not just to a country taken individually. Obviously, with the introduction of a single currency, national governments cannot exert direct pressure on their own national central banks to monetise their budget deficits, but the advantage of a common monetary policy could be destroyed by the concentration of powers in the hands of a small group of technocrats.

3. On the Criticisms of the European Monetary Union

In the context of the debt crisis in the Eurozone some ten years ago, the question of whether and to what extent the common currency is to blame seems quite logical. The answer that one of the most respected economists gives (Stiglitz, 2016) is quite categorical – he pushes his thesis that the creation of the euro was (in his words) a "*fatal mistake*". Stiglitz insists that the debt crisis was linked to the decision made back in 1992 to adopt a common currency without providing the institutions through which it would work. In this regard, he mentions that "*Good currency agreements do not guarantee prosperity, but flawed currency*

agreements can lead to recessions and depressions" (Ibid., p. 16). His arguments are that, in general, the monetary union is built on a flawed neoliberal strategy postulating the efficiency of financial markets, which ultimately led to a debt crisis and an entire lost decade for Europe. The main problem of the euro is recalled – the monetary union is asymmetric, and the centralised monetary policy comes into insurmountable contradiction with the implemented national policies regarding fiscal affairs, incomes, employment, etc. In short, with the introduction of a common currency, economic integration far outstripped political integration – something that (according to Stiglitz) is not only wrong, but also extremely dangerous, as it leads to an increase in financial instability, hinders real convergence, leads to economic inequality (both between individual countries and within each one) and ultimately has a negative impact on the development of the democratic process. "*As we have noted, one of the reasons for the failure of the Eurozone is that economic integration has overtaken political integration. The hope was that politics would catch up with economics. But as division and lack of democracy grow, the likelihood of this happening decreases*" (Ibid, p. 61).

That the Eurozone is not an optimum currency area (according to Mundell, McKinnon, and Kenan's criteria) has been known for a long time. The question is whether this can be compensated by the imposition of some restrictions, as envisaged by the Stability and Growth Pact in an earlier period, or the Euro-Plus Pact in a later one. It turns out that the restrictions themselves are not convincingly formulated and, what is even worse, they are very often not respected even by the countries that most insisted on their imposition – France and Germany. In such conditions, it is very easy to conclude that the common currency is not fully fulfilling its purpose and is indeed directly related to the debt crisis. It sounds implausible that the euro is the root cause of the crisis, but it seems entirely plausible that the common European currency is a serious obstacle to overcoming, or at least mitigating, the consequences of the debt crisis.

Stiglitz's criticism of the premature introduction of the euro is not new. He has been one of the main critics since the birth of the idea of a common currency, his arguments being based on the failure to fulfil the criteria for an OCA (mobility of production factors; similar business cycles; symmetry of shocks; significant fiscal transfers; homogeneity of collective preferences, etc.). However, this "*scientific principle*" seems rather strange and even excessive. Theoretical approaches in the field of economics have never had the power of categorically established regularities. Certainly, not all criteria are met, and this is hardly possible. It is worth noting that even the creator of the theory of OCA, Robert Mundell was an active supporter of the idea of a common currency, despite the obvious discrepancy with some of the criteria. In fact, the big question here is whether the process of European integration should be based on the neoliberal approach (i.e., be the result of ongoing market processes) or decisively break with it and transfer the sovereignty of monetary policy to a new central institution. It is strange that Stiglitz, who is usually at the forefront of the fight against neoliberalism, in this case, defends it.

Another important point is that Stiglitz's approach is not always balanced. For example, when he examines the problems in the countries on the periphery of the Eurozone, which he calls "*victims*" (especially in the case of Greece), the author is highly critical of the actions taken by the so-called Troika (IMF, ECB and EC, which he calls the "*culprits*"), but does not analyse the policies of these countries, and in particular in the pre-crisis period, which were

decisive for the subsequent problems. According to the author, the victims were powerless to prevent the massive inflows of capital that degenerated into current account deficits and/or rapid price increases of both real and financial assets. At first glance, this argument sounds convincing, but it conceals the guilt of the so-called *victims* who had opportunities to react, but because of opportunistic interests intertwined with political bargaining, they chose not to take any action until it was too late. A comparison of the economic policy implemented immediately before the global financial crisis in countries such as Greece, Spain, Portugal, and Italy will find many similarities that are easily associated with the problems that followed. The question of how much the global crisis is to blame for the debt crisis in Europe and how much it is caused by the common currency is not well understood. In other words, would there have been a debt crisis if there had not been a global financial crisis that started in the US but whose effects quickly spread around the world and especially in Europe?

Proponents of the euro note that from its inception, it has been both an ***economic project***, aiming at prosperity based on the results of economic integration, as well as a ***political project***, aimed at bringing different countries closer together and ensuring a peaceful existence through the irreversible interlinking of economies. In today's troubled times, the importance of political integration is hard to overstate. Of course, fulfilling both goals at the same time would be wonderful, but that is not happening. The fear is that the euro is failing on both fronts, threatening not only economic prosperity but potentially peace in Europe. "*The euro has failed to achieve either of its two principal goals – prosperity and political integration – and these goals are now further away than they were before the creation of the Eurozone. Instead of peace and harmony, European countries now view each other with mutual distrust and anger. Old stereotypes are being revived – Northern Europe sees the South as lazy and unreliable, memories of Germany's behaviour during the world wars are stirred up*." (Ibid., p. 37). This quote is indicative of the importance of the European project of which the common currency is only a part.

The euro is sometimes compared to a "*bad marriage"* – i.e. attraction is not enough to build a strong relationship. To recall an old saying, "*True love is not when two people look into each other's eyes, but when they look in the same direction*." The case of the Eurozone is far more complicated because it concerns 20 distinctly different countries that (perhaps?) should not have come together at all and are definitely looking in different directions. If the bad marriage analogy is to be continued, the problems call for a marriage counsellor, and his first question would be: "*Should this marriage be saved*?". Translated into financial language, the question would be: "*The costs associated with ending the monetary union (economic and political) will be huge, but won't the costs of its maintenance be even higher*?" The question is quite logical and simple, but it can hardly be answered unambiguously. At this stage, there is no proven methodology for valuing all the benefits and costs of participating in a monetary union, and it is unlikely to appear in the foreseeable future. ***Invoking only general theoretical principles (such as the criteria for an OCA) cannot help, insofar as the political effects (e.g., keeping the peace in Europe) have practically such high cost, that it makes no sense to use any quantitative evaluation models of benefits and costs.***

Despite the criticisms of the common currency (justified or not), the majority of European economists share the understanding that it is viable, but its substantiation requires decisive

reforms both in the implemented policies and in the institutions. These reforms (a part of which are already underway) can be summarised as follows:

- Creation of a banking union;
- Unification (consolidation) of debt and issuance of common European bonds;
- Reform of the common stability framework by:
  - Reform of the Maastricht criteria;
  - A new growth pact supported by a solidarity stabilisation fund;
  - Acceptance of progressive automatic stabilisers;
  - Strengthening the flexibility of monetary policy;
  - Introduction of additional regulations to limit volatility;
  - Active countercyclical fiscal policy and a sharp increase in fiscal transfers.
- Implementation of a true (real) convergence policy:
  - Discourage trade surpluses (a revival of the Keynesian idea of "taxation of surpluses");
  - Expansionary income and fiscal policies in countries with surpluses;
  - Implementation of industrial and infrastructure policies.
- Policies promoting full employment and growth by changing the mandate of the ECB;
- Commitment to shared prosperity and fighting inequality.

These reforms are indeed needed and most of them have been in the works for a long time. At the same time, however, it must be recognised that procrastination, indecision and (sometimes) unprincipled decision-making present the euro area with additional difficulties. For example, one of the essential missing elements of the euro area was a well-functioning banking union, which exacerbates the contradictions between the need to ensure stability for the banking system in the area as a whole and the economic interests of the individual countries. The vicious circle was not broken until the end of 2014, when the banking union officially started. However, it is still incomplete and will remain so until the creation of the common guarantee fund.

With regard to the proposal for debt consolidation and issuance (by the ECB?) of common European bonds, it is worth mentioning that this idea has also been discussed for a long time. It has its supporters (especially among indebted countries), but the decisive opposition from Germany, supported by the Netherlands, Austria and Finland makes the idea unfeasible at this stage. It is interesting to note that Bulgaria is also one of the countries that opposed common European bonds. More importantly, however, it should be recalled that the European Stability Mechanism (which generated debt of around 700 billion euros) and the Juncker Plan (debt of about 300 billion euros) practically had the characteristics of common European debt. Moreover, the ECB has been (until very recently) exercising a massive policy

of buying government (and not only government) bonds for years, which has led to a sharp increase in reserve money and, accordingly, the ECB's balance sheet, which already exceeds that of the US Federal Reserve. A separate question is how the swollen balance will shrink to more normal sizes.

So far, there is no reasonable answer to the above problem, but what is surprising is what critics of the euro actually expect from the ECB. It is vaguely mentioned that the bank's mandate should be changed, i.e. not only to pursue price stability, but to set employment and growth as ultimate goals – something reminiscent of the discretionary nature of the Federal Reserve's policy. I am convinced that the majority of European monetary policy economists have serious reservations about extending the ECB's mandate. The experience gained in recent decades (especially in the face of inflation targeting) unequivocally shows the effectiveness of a single and clearly formulated mandate. The problems in the euro area are not due to any restriction of the ECB's policy (in fact, the ECB's policy even before the crisis was rather expansionary), but to the premature accession to the monetary union of some countries in Europe's periphery, which happened despite the obvious and gross violation of the Maastricht criteria.

It is also regrettable to note that the ECB's policy really benefits countries with high trade surpluses (mainly Germany), which in turn leads to deepening inequality in both the European Union and the euro area. This, however, represents only "one side of the coin". Yes, Germany definitely has its responsibilities to the stability of the euro area and its policies do not always meet the common interest. But it would be unfair not to note that Germany has also made and continues to make compromises. The Germans were and continue to be satisfied with the policy of the Bundesbank and if in the past there was a referendum on the adoption of the euro (as some political parties in Bulgaria wish today), it is not at all certain whether they would have given up the stability provided by the German mark. The truth is that for Germans, the abandonment of the national currency (which Great Britain, Denmark and Sweden refused to make) was a serious compromise. There is no doubt that Germany is at the heart of the European project, and no one should be surprised that the ECB largely continues the policy of the Bundesbank, but already at European level. This may seem unfair, but this is the price of compromise, and this was the promise of German politicians to the German people to be able to implement the single currency project. As a matter of fact, it must be admitted that in recent years these promises have been more and more drastically broken. Whether by effectively allowing local central banks to issue new euros; whether, by tacit consent, the accumulation of unpaid accounts should be borne by the clearing system; whether through the European version of "quantitative easing" – the ECB is increasingly moving away from the notorious conservative policy of the Bundesbank. If this policy continues, it is not difficult to predict that if inflation persists, discontent with the euro and calls to leave the common currency will move from the periphery of the Eurozone to the centre. And the notion of a single European currency without German participation is, to put it mildly, naive.

In theory, radical structural changes should always meet some criterion of optimal choice. In the case of the euro, the idea that monetary union necessarily requires fiscal union is also a form of optimisation of governance policy. This understanding is so deeply embedded in the theory of the OCA that it has long become a cliché for all opponents of the idea of a common

currency. It is even assumed that the fiscal union should precede the monetary union – something that sounds logical but is far from proven. No matter how similar they may seem at first glance, fiscal and monetary synchronisation is a rather complex issue, as the former is, after all, a one-off act and the latter is a lengthy process. That this is so can be seen even from the historical development of the US, where the process of fiscal convergence between different states is still going on, despite the common monetary unit. It is often pointed out that this requires large-scale transfers between different regions (countries), but is this not the idea of the Structural and Cohesion Funds? Their importance is indeed great and needs to be expanded. However, it should be mentioned that there is still much to be desired in this regard. For example, Germany's net financial contribution to total EU funds is less than 1% of GDP and should be much more. However, calls for increased fiscal transfers often face justifiable dissatisfaction with the way they are spent, leading to a serious problem of aggravating moral hazard.

4. On Some of the Widespread Fears about the Euro in Bulgaria

4.1. Loss of monetary sovereignty

This issue has been touched upon before, when the advantages and disadvantages of the common currency were discussed. It is strange to put forward this argument in the case of Bulgaria, which gave up an active monetary policy 25 years ago. Of the traditional monetary policy instruments, only minimum reserve requirements are available, and they are usually not often used – only in cases of systemic financial difficulties. In the last 25 years, the BNB has only twice resorted to this instrument, and entirely for external reasons. It is even stranger to believe that the loss of monetary sovereignty is an important problem for Bulgaria, but obviously, it was not important for Germany, France, Italy and all other eurozone members.

4.2. Rising inflation

Over the past two decades, we have witnessed several enlargements of the monetary union. It is fair to note that according to various studies, as well-described in (Zlatinov, et al., 2022, pp. 142-156), the effect of converting national currencies into euro does have an impact on consumer prices in an upward direction ***but is generally weak and one-off***. According to Eurostat estimates, the effect of the introduction of the euro in January 2002 (for the countries that joined the euro in 2001) on the total euro area HICP was between 0.1 and 0.3 percentage points. Price increases are most often triggered by transferring some of the additional costs on consumers; rounding prices; the belief of traders that consumers tend to ignore small price changes as they get used to the new currency. On the other hand, there are factors that can contribute to a decrease in some prices – the presence of high competition in some economic sectors, the measures taken by the state to increase transparency in the process of price adjustment, as well as the reduction of transaction costs and currency risk to the economy. The experience of countries which have already adopted the euro shows that price increases due to currency changes are concentrated in a small number of products, mainly in the services sector, such as catering, accommodation services, hairdressing services,

miscellaneous repairs, dry cleaning services, recreational and sports services, etc. As the share of these products in the consumer basket is relatively low, the effect of their appreciation on HICP inflation is expected to be rather small.

The introduction of the euro is often accompanied by an unjustified increase in household perceptions of inflation, which can lead to the formation of negative attitudes towards the single currency – something that can be observed today in Bulgaria. Moreover, if consumers overestimate current inflation, they may at the same time underestimate changes in real wages and purchasing power, which may lead them to decide to cut spending. In such a situation, the introduction of the euro could contribute to short-term negative effects on the real economy. A recent study suggests (Zlatinov, et al., 2022, p. 141) that the gap between actual and perceived inflation at the launch of the euro is less pronounced in the new Member States, partly due to information campaigns and other consumer protection measures, as well as encouraging firms to set fair pricing.

4.3. Increase in money supply

This problem is largely related to the previous one, as the volume of the money supply affects the price level. It is pointed out that most countries outside the euro area currently having significantly stricter requirements. For example, in Bulgaria, minimum reserve requirements (MRR) are at 10%; in Poland it is 3.5%, and in Romania – 8%. The argument is that a reduction of the MRR will naturally lead to a multiple increase in the money multiplier, which in turn will stimulate the money supply in the newly joined country. In addition, it is argued that the effect will be most noticeable in Bulgaria, as far as the difference between the current threshold set by the BNB and the established level in the euro area is the largest. This will most likely lead to a permanent outranking of the rate of money supply compared to that of manufactured goods and services and will accumulate significant inflationary potential that can only be released in one way, namely through outpacing price rises. In other words, the main effect of the forthcoming reduction in reserve requirements is that the purchasing power of savings and fixed incomes after several years of stay in the euro area will be limited or that, at a minimum, its growth will slow down.

It is true that the money multiplier will certainly increase, but the effect on the money supply cannot be predicted, since reserve money will also decrease. It is also not known how the general public would react in terms of the size of the desired cash holdings, and the same applies to commercial banks and their excess reserve. Thus, it is not correct to assume that a reduction in MRR itself would lead to higher inflation. The experience of the Baltic countries that entered the euro area with more or less similar economic fundamentals does not show the existence of such inflationary potential.

4.4. Interest rates

As already hinted, the concerns here are related to a possible shock cut in interest rates, which would prompt households (and the government) to take on more debt. However, analyses show that the Bulgarian banking system is characterised by high levels of liquidity,

significantly exceeding the minimum regulatory requirements. This is due both to the long-established trend of increasing savings and to the consistently conducted countercyclical policy. In view of the rapid transmission of the ECB's monetary policy to interest rates on the interbank money market in Bulgaria, as well as in view of the high liquidity in the banking system, the eventual accession of Bulgaria to the euro area would not have a significant impact on developments in this market. Based on the analysis of the observed trends in deposit and loan rates in the newest euro area member states and in Bulgaria, it can be argued that Bulgaria's possible membership in the euro area would not in itself lead to a significant decrease in these interest rates, which are currently very close to the European ones.

Other possible factors that may affect the dynamics of interest rates are economic growth, the financial stability of the country and prudent fiscal policy. All this, other things equal, would lead to a decrease in the risk premium. The analysis of the dynamics of long-term government bond yields and the change in the credit rating of the newest Member States, compared to Bulgaria, give enough reasons to assume that Bulgaria's future accession to the euro area, even if accompanied by an increase in the country's long-term credit rating, does not necessarily have to be reflected in a decrease in yields on the 10-year bonds.

4.5. Fiscal policy and public debt

There are also widespread fears that joining the euro area will loosen fiscal discipline and lead to higher budget deficits and the accumulation of public debt. The arguments are primarily related to the expected lower interest rates, which may tempt the government to take on more debt. It is true that similar phenomena were observed in some of the countries, but this can in no case be defined as a regularity. It can only be concluded that the common currency does not serve as a guarantor of good fiscal policy. Nevertheless, the issue is indeed important and deserves more attention (Rangelova, et al., 2021).

As rightly observed in one of the peculiarities of the European monetary union is determined by the preservation of national discretion in the conduct of fiscal policy. While fiscal prudence has historically been highly valued as a cornerstone of financial stability, currently, the imposition of shocks of various natures (the global financial crisis; the COVID-19 pandemic; the war in Ukraine) requires more flexible fiscal frameworks and a departure from fiscal conservatism. In other words, prudent fiscal policy should be aimed not only at supporting economic growth but also at building a sustainable model of economic development.

At the same time, in order not to disrupt the monetary union, various safeguards should be applied, which aim at ensuring sustainable fiscal policies during the economic cycle through the achievement of a medium-term objective. The situation is complicated by the fact that the fiscal target varies from one member state to another and relates to the level of the structural budget balance.[4]

[4]As a general rule, the medium-term budgetary objective should not exceed 0.5% of GDP structural deficit, and for Member States with government debt below 60% of GDP and an insignificant risk to the long-term sustainability of public finances, this deficit can amount to -1% of GDP.

From the point of view of fiscal discipline, Bulgaria stands well and there are hardly grounds for serious fears that the adoption of the euro will change the long-term trend of fiscal prudence. Bulgaria clearly maintains the best indicators of budget balance and government debt after Estonia. The average budget deficit for the EU and the euro area for the period 2000-2021 is very close to the Stability and Growth Pact reference value of -3% of GDP. The average value of government debt for the EU and the euro area ranges between 76 and 81% respectively, whereas for Bulgaria, it is below 30% of GDP. Empirical evidence does not give grounds to conclude that joining the euro area leads to an increase in government debt. Such trends can indeed be found, but after the outbreak of the global financial crisis. The data also show that the above conclusion applies to Bulgaria even without being a member state of the euro area, which makes the cyclical impact on the debt behaviour of governments a much more serious factor than the direct effects of entering the single currency area.

When discussing the possible fiscal consequences of adopting the euro, another feature of the Bulgarian tax model should be considered, namely that the focus is on taxing consumption rather than income. The significant predominance of indirect over direct taxation in the country is largely due to proportional taxation (i.e. flat tax), accompanied by low tax rates, which were introduced immediately after the country's accession to the EU in 2007. The hope that this will contribute to higher investment in the economy has proved illusory. As Zlatinov (Zlatinov, et al., 2022, pp. 121-144) notes, the low direct tax rates create strong cyclical dependence of budget revenues on consumption and imports, which are subject to indirect taxes, and limits the government's ability to conduct countercyclical policies. The relatively stable amount of tax revenues, regardless of the cyclical fluctuations in the economy, is an indicator of the depleted capacity of tax policy in the country with marginally low tax rates achieved and the transfer of the entire burden of preserving fiscal sustainability to expenditure policy, which is subject to much more discretionary decisions by the government and, respectively, a source of instability.

On the basis of the above analysis, it can be confidently concluded that the management and state of public finances do not differ significantly from best practices in the field. There are, of course, risks, but they are identified in terms of accelerating inflation and COVID-related fiscal expansion in 2020 and 2021. This will most likely make it difficult to adopt the euro in 2024, but it does not necessarily mean higher deficits and entering a debt spiral.

4.6. Banking sector

Fueled concerns and instilling fears of adopting the euro extend to the banking sector. In this regard, both Bulgaria's participation in the Banking Union and its membership in the euro area are often the subject of speculation and clearly expressed concerns about the consequences on the Bulgarian banking system, on the one hand, and the country's economy as a whole on the other. Some of them are due to an insufficient understanding of the mechanisms of work of the European Union and the euro area, and another – to hidden domestic political goals and a desire to deliberately "process" public opinion to achieve them.

One of the most commonly used claims is that by joining the euro area, Bulgaria should participate in the capital of the European Stability Mechanism, which implies the allocation

of significant funds, which Bulgaria cannot (because it is poor) or should not (because it is not fair) afford. One can often hear the warning that Bulgaria will be forced to buy bonds of other countries to finance foreign economies that are generally more developed than the Bulgarian ones.

These arguments are untenable. Apart from the lack of solidarity (what if Bulgaria had to be saved?), it should also be borne in mind that the quota of the allocated capital should not be paid at all at once, i.e., within a budget year. As rightly noted in (Zlatinov, Nenova-Amar, & Raleva, 2022, pp. 109-123), the situation with participation in the Single Resolution Mechanism is similar, which has long been claimed to burden Bulgarian banks with unjustified costs. This statement has already found enough rebuttals in the facts. For example, the funds transferred to the Single Resolution Fund over the past two years (less than EUR 200 million) represent only a negligible part of banks' assets and could in no way affect financial stability. And last but not least – two years ago, the BNB adopted a special ordinance that practically transposed the ECB's model for financing supervisory activities – namely, by paying fees by supervised entities, i.e. banks. Although it represents a novelty in the relationship between commercial banks and the central bank, in particular, it implies new costs. The size of the latter, however, is neither expected to jeopardise the stability and normal activities of banks, nor even to have a significant impact on the pricing of services to their customers.

4.7. Competitiveness

A common accusation is that Bulgaria is economically not ready and should postpone the adoption of the euro.[5] By this is meant that neither markets nor institutions are ready to resist competition. There were such accusations (they continue to this day) even before Bulgaria's accession to the EU. In fact, here we are talking again about the principles of the OCA, which have already been reflected. The question, however, can be reduced to the simpler question of whether the country would be better off if it remained outside the Eurozone. Examples are given of other new member states that have so far refused to join the ERM II, like Poland, Hungary, the Czech Republic, and Romania. The difference, however, between them and Bulgaria is significant. These countries have said that they will join the Eurozone when a higher level of real convergence is reached – something quite logical and justified in terms of OCA theory. From the point of view of this goal (accelerating real convergence), these countries want to use all possible instruments, including monetary policy. Bulgaria, however, has long abandoned these instruments, or in other words, the real convergence in Bulgaria does not depend on the monetary regime. What's the point of staying out of the Eurozone? It turns out that all the negatives of the lack of monetary policy must be borne (and they are not few) without taking advantage of the positives (they are also not few) of joining the common currency. Such a position is clearly not reasonable (Petranov, et al., 2022).

Some additional arguments can be put forward here. It is clear that joining the euro area might put the local economy to a kind of test in terms of competitiveness. The empirical data,

[5] Such, for example, is the request of the proposed referendum in Bulgaria, which aims to delay the adoption by 20 years.

however, are clear that Bulgaria's macroeconomic characteristics place it much closer structurally to the countries of Central and Eastern Europe than to the peripheral countries of the southern flank of the monetary union. Thus the model of economic growth, based on a small open and highly integrated economy in the EU, puts a very narrow framework for the possibilities of conducting economic policies. In addition, Bulgaria still has considerable room to catch up with the levels of wages, productivity and price levels to those of the euro area, which means that the rates of productivity increase in the short and probably medium term are unlikely to change compared to those observed in recent years. This can be interpreted as meaning that in the short- and medium-term, Bulgaria is not threatened with a loss of competitiveness even after the adoption of the euro.

5. Conclusions

The adoption of the euro has both negative and positive effects. It can definitely be considered proven that a common currency facilitates the specialisation and integration of national markets into a supranational, wider market. It also allows a reduction in transaction costs induced by exchange rate risks, thus increasing the benefits of international trade. To the above must be added the reduced possibilities of national governments to finance deficits by creating (printing) money and monetising existing deficits. The common currency, however, has some shortcomings, such as: the fiduciary nature of this currency; the creation of a supranational monopoly of the European Central Bank; the excessive centralisation of decision-making in the European Union; the suppression of the freedom of choice of European citizens in monetary matters. These shortcomings for some of the countries are sufficient reason for delaying monetary integration, as far as priority is given to real convergence. For other countries, as is the case with Bulgaria, the lack of monetary policy instruments makes such an option unacceptable.

Most recently, the authorities abandoned the officially stated aspiration to join the Eurozone in early 2024. A new target date has not been officially set, but it appears that it will be no earlier than January 2025. Even this date seems too ambitious, given all still high inflation. Political instability also poses threats to the fiscal criterion. The still high distrust in the euro is also a serious problem, overcoming which will require additional efforts.

Regardless of the specific date of joining the euro area, the expected effects are most likely to be the following:

- From the point of view of the real economy, significant changes should not be expected:
  - Growth would not be affected
  - Employment (unemployment) will not be affected either.
  - Inflation may accelerate slightly (due to rounding of prices), but this will have a one-time impact
  - The volume of foreign trade will be affected positively, albeit moderately
- From the perspective of the financial sector, more significant changes can be expected

- Interest rates (especially on loans) will slightly decrease
- Liquidity in the banking system will remain high due to direct access to ECB funding
- The banking system will be safer (supervision by the ECB), but will not be immune from bank failures
- A change in the tax system may be necessary due to increased pressure towards fiscal harmonisation.

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