



WHAT HAPPENED TO BULGARIA AND THE EUROZONE

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Abstract: *The topic of the adoption of the euro in Bulgaria is as well-worn as it is relevant with each subsequent year because the country is on the threshold of the euro zone, but something is still missing. Expectations for admission at the beginning of 2024 turned out to be impossible because Bulgaria did not meet the requirements for inflation levels, although it was exemplary in this indicator in recent years. It turned out that all efforts were in vain, but there is still hope that within one to two years the economic indicators will stabilize and the country will become a full member of the Eurozone. The purpose of this report is to examine the state of convergence indicators in Bulgaria, Croatia and Romania for the period 2020-2022 and to try to trace the reasons for our not being admitted to this monetary union, which is so important to us.*

Key words: *euro, euro zone, inflation Bulgaria, Croatia, Romania*

JEL: *E3, E4, E5*

I am almost convinced that the subject of the euro adoption in Bulgaria is one of the most researched in the field of monetary theory and policy, together with the currency board. The topic is interesting, incredibly significant and always relevant. Especially in the last 3 years, because after enormous efforts, Bulgaria was accepted into ERM II. Expectations and hopes for admission in January 2024 will not be fulfilled. The reasons for this failure are many, but the most obvious is the failure of the state to deal with one of the main criteria for convergence – the inflation level. Another reason is the lack of a clear and consistent policy on the subject, the non-adoption of key laws that precede the euro, especially the lack of will and responsibility caused by the political crisis in Bulgaria since 2020.

Nobel laureates in economics, Joseph Stiglitz and Paul Krugman, draw gloomy predictions for the future of the Eurozone, built on its fundamental inconsistencies with Robert Mundel's theoretical formulation of the "optimal currency area". They highlight two main groups of reasons for this: first, the deep differences in the economic structure and level of development of the Eurozone countries, and second, the impossibility of conducting a unified fiscal policy. In particular, Paul Krugman (2016) believes that the creation of a "working Eurozone" requires reforms in two main directions: reforming the structure of the European Union; and "crisis policy" reforms. Thus, the question is to what extent a political consensus will be reached between the

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countries of the Eurozone, which will allow the implementation of radical reforms and the gradual harmonization of the fiscal policies of the countries of the Union. (Gechev, R., Beev, I., Hristozov, Y., 2020). We are still waiting for these fundamental reforms in the Eurozone, which will make it an even stronger monetary union. I have done a lot of research on the subject and the following is a critical analysis of some of my previous comments.

In one of my articles from 2015, "Bulgaria's way to the Eurozone. With or without a currency board" (Hristozov, Y., 2015) I have made the forecast that our country will join the waiting room within three years, and the Eurozone within five. Turns out I was wrong. I have a few more experiences on the subject, mostly as a fierce defender of the thesis that the adoption of the euro does not in itself lead to high inflation, especially if this act is accompanied by the right measures. Inflationary uncertainty is considered to carry risks for the real economy. In the article "Does the introduction of the euro lead to high inflation? Myth or fact?", I look at one of the most frequently asked questions when countries join the eurozone and adopt the single currency, which is: will this process lead to higher prices? (Hristozov, Y., 2019). Similar is my research on "The Baltic states joining the eurozone and its effects on inflation" (Hristozov, Y., 2018). In both, the weak influence of the adoption of the single European currency on inflation is unequivocally proven, as the studied countries have all adopted the euro after 2007. Even most experienced deflation in the months following adoption. People with non-expert understanding do not understand that even if inflation is observed, firstly it is not excessive, secondly it is certainly not a consequence of the euro.

Our most serious study on the subject is from 2020 with the title "Expected effects of the euro adoption in Bulgaria" (Gechev, R., Beev, I., Hristozov, Y., 2020). The article interprets facts related to the accession to the Eurozone of selected (representative) EU member states and the expected effects on Bulgaria's economy. The main contribution is the derivation of the "critical zones" of impact from the possible negative effects, made on the basis of a careful study of the experience gained in the countries that have already introduced the single currency. In this publication, we have made a forecast for admissions in the waiting room in 2020 and in the Eurozone at the earliest in 2023. It turns out that we are forecasting too optimistically.

The next part of the report compares the fulfillment of the convergence criteria of three countries (Bulgaria, Croatia and Romania) for three years, from 2020 to 2022 inclusive. At the date of the analysis, all three countries are outside the Eurozone. Two of them (Bulgaria and Croatia) are in ERM II, while Romania is not, and Croatia joined the euro area in January 2023. The choice of these countries is dictated by the fact that they follow a close policy towards the EU and the Eurozone. Croatia was admitted to the EU much later than Bulgaria and Romania but managed to outrun them significantly. Bulgaria and Romania are walking hand in hand on the road to European

integration. The convergence criteria are clearly defined, the analysis will compare the data according to Eurostat. For inflation and interest rates, the data are real, according to Eurostat statistics. For state surplus/deficit and for state debt, the data for 2022. are estimated according to the ECB, due to the lack of statistics yet in Eurostat. The following table shows the values of the convergence indicators.

Table 1. Economic indicators of Convergence

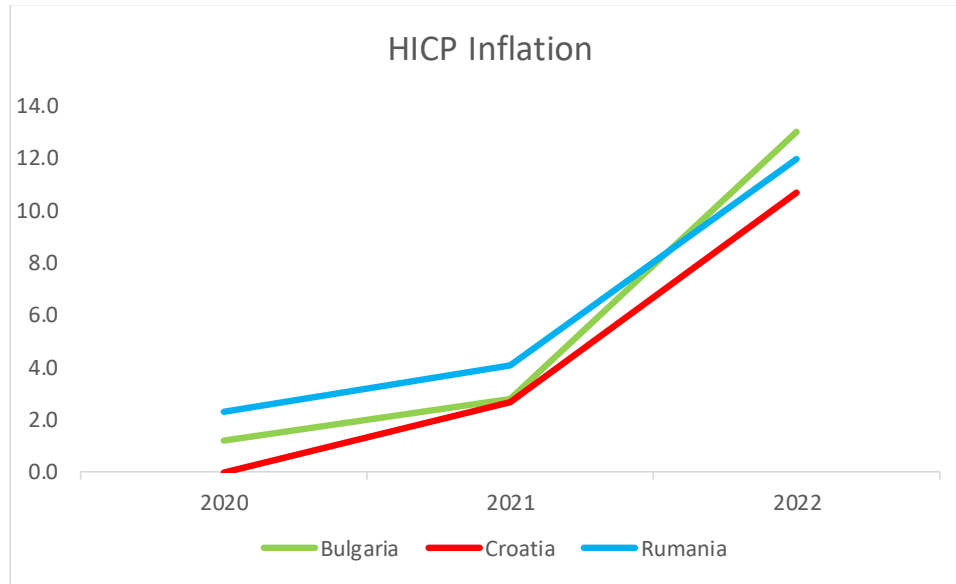
		HICP inflation	General government surplus (+)/ deficit (-)	General government debt	Long term interest rate
Bulgaria	2020	1,2	-4,0	24,7	0,3
	2021	2,8	-4,1	25,1	0,2
	2022	13,0	-3,7	25,3	1,5
Croatia	2020	0,0	-7,3	87,3	0,8
	2021	2,7	-2,9	79,8	0,4
	2022	10,7	-2,3	75,3	2,7
Rumania	2020	2,3	-9,3	47,2	3,9
	2021	4,1	-7,1	48,8	3,6
	2022	12,0	-7,5	50,9	7,5

Source: Eurostat, ECB, own calculations

1. HICP-Inflation.

Figure 1 compares the levels of inflation for the three countries for the period 2020-2023. It is noteworthy that the highest levels of accumulated inflation for the entire period are observed in Bulgaria, followed by Croatia and lastly Romania.

Fig. 1. Average annual percentage change of HICP Inflation



Source: Eurostat, ECB, own calculations

Inflation rates in Croatia for the period were between 0% and 10.7%. At the time of the April 2022 Convergence Report, the 12-month average rate of HICP inflation in Croatia as of April 2022 was 4.7%, i.e., below the reference value of 4.9% under the price stability criterion. But the levels at the end of 2022 turned out to be higher - 10.7%. This did not prevent Croatia from adopting the euro, i.e., a compromise on the part of the ECB is observed. In the last ten years, the rate of inflation in Croatia fluctuated in a relatively wide range - from -0.8% to 4.7%, with an average of 1.1% for the period.

Bulgaria has higher inflation rate than Croatia, but lower than Romania. In 2022, the 12-month average rate of HIPC inflation in Bulgaria 13%, i.e., well above the price stability benchmark of 4.9%. The interesting thing is that Bulgaria overtakes Croatia and Romania for 2020. One of the main reasons is the huge dependence of the Bulgarian economy on Russian energy resources. The ECB's April 2022 data on a year-ago basis was for 5.9% inflation, but inflation ended up being double by the end of the year. Over the past ten years, this rate has fluctuated in a fairly wide range – from -1.7% to 5.9%, with an average of 0.9% during the period. The rate of inflation is expected to hold and remain high until at least mid-2023, and in my opinion until the end of the year. The state is trying to implement an effective policy against speculation, but at this stage the effects are not visible. The measures taken are expected to have some impact after the middle of the year.

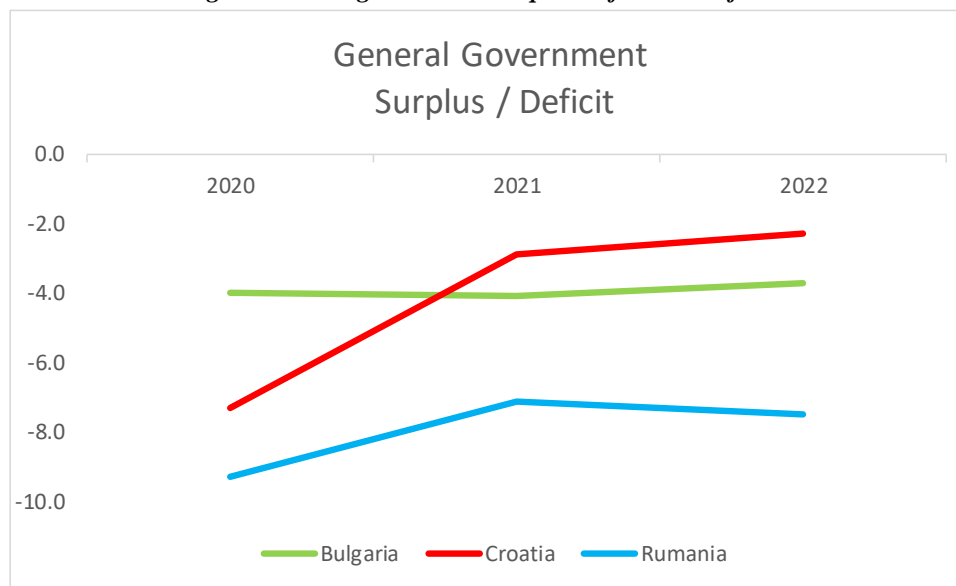


Romania has the highest inflation of the three countries, except in 2022, when Bulgaria overtakes it. ECB data in April 2022 for the 12-month average rate of HICP inflation in Romania was 6.4%, i.e., well above the price stability benchmark of 4.9%. But at the end of the year, it turned out to be a much higher 12%.

2. General Government Surplus/ Deficit.

Due to the lack of data for 2022 at the time of preparation of the analysis for the year, the forecast data of the European Commission, which are also included in the convergence report, are used.

Fig. 2. General government surplus/deficit as % of GDP



Source: Eurostat, ECB, own calculations

Croatia's budget balance is above the reference value in 2020, -7.3. In 2020, the budget balance of the general government sector in Croatia was slightly below the 3% deficit reference value. In 2021, it is again below the reference value in the amount of 2.3.

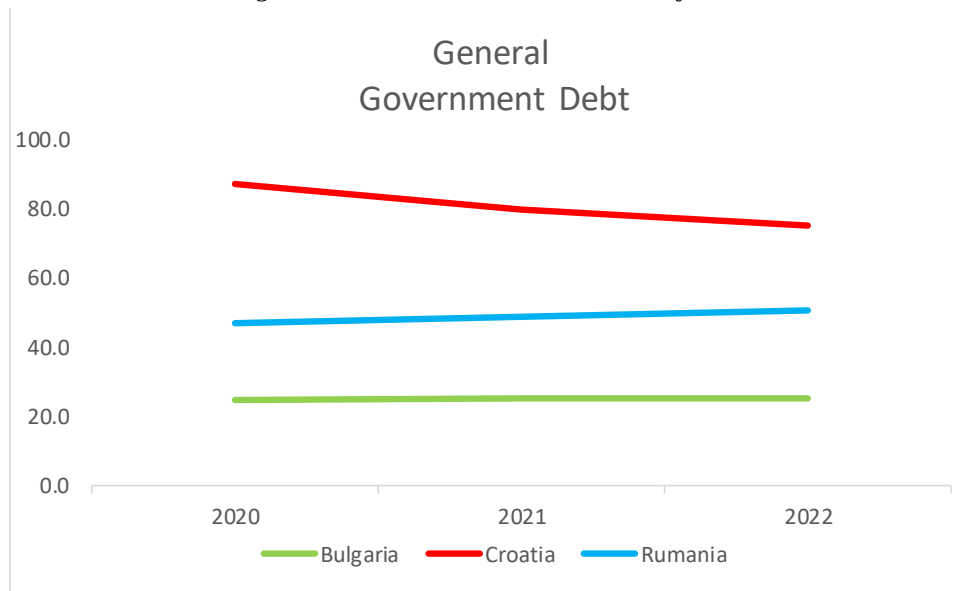
The situation in Bulgaria is different. In the three years researched, the budget balance was above the reference value, but with exceedingly small changes, while the situation was more serious in Romania, where a deficit in the range of -7.1 to -9.3 was observed. Figure 2 clearly shows how Romania overtakes Bulgaria and Croatia in this indicator in a negative order. One of the reasons for Croatia's handling of the indicator is the pledge to adopt the euro and the safeguards of the Stability and Growth Pact, although Bulgaria and Romania are much earlier subject to

measures under the Pact. Exceeding the reference values in Bulgaria are considered extraordinary and temporary.

3. General Government Debt

Due to the lack of data for 2022 at the time of the preparation of the analysis for the year, the estimated data of the European Commission are used, which are also included in the convergence report.

Fig. 3. General Government Debt as % of GDP



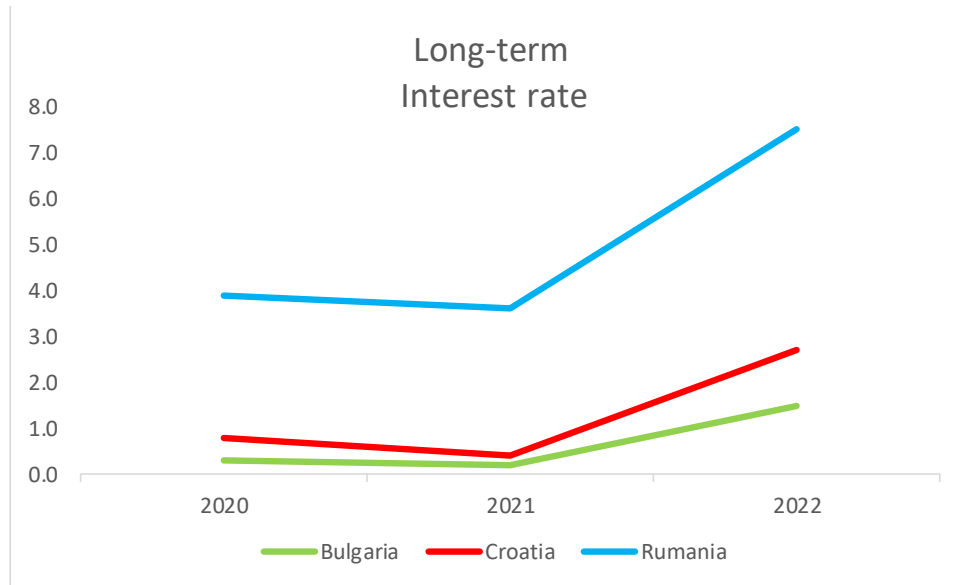
Source: Eurostat, ECB, own calculations

Croatia's debt ratio is above the benchmark of 60% but trending downward. In 2021, the debt ratio is 79.8% of GDP, but this represents a decrease of around 7.5 percentage points from the peak of 87.3% of GDP recorded in 2020 and is in line with the reduction benchmark of debt, which meant compliance with the debt criterion. According to this indicator, Croatia is in last place.

The best values for this indicator are of Bulgaria. The debt ratio is in the range of 24-25%, which is well below the benchmark of 60%. Bulgaria is one of the leaders in the EU in terms of the indicator. In Romania, the situation is also within the recommended value. Values from 47 to 51% are observed there. The levels of this indicator are once again an example of the compromise made towards Croatia.

4. Long-term Interest Rate

Fig. 4. Average annual Long-term Interest Rate



Source: Eurostat, ECB, own calculations

According to data from the Convergence Report, during the reference period from May 2021 to April 2022, long-term interest rates in Croatia averaged 0.8%, which is below the reference value of 2.6% under the interest rate convergence criterion. Long-term interest rates in Croatia have been declining since 2012, with 12-month average rates falling from just below 7% to below 1.0%. The average levels of long-term interest rates in Bulgaria are the lowest – 0.3 to 1.5% in 2022. Long-term interest rates in Bulgaria have been decreasing since 2012. Only Romania does not meet the requirements of this criterion to date, where the levels are 3.9% in 2020, to an impressive 7.5% in 2022. The data are from Eurostat.

Conclusion

Although they were admitted together in ERM II in 2020, Croatia managed to adopt the euro, while Bulgaria is still unable to meet this challenge. Although no striking differences are observed regarding the convergence criteria. A compromise was made with Croatia, but not with Bulgaria. What is worse in this case is that there is no longer any hope for Bulgaria's accession in 2024. An optimistic option is 2025, but it all depends on the economic and financial state of the country.

Perhaps Bulgaria will overtake Romania, which is not yet a member of ERM II, and both countries will not join the eurozone at the same time. The reason for Bulgaria's backwardness lies



in the incompetent financial and budget policy in recent years and the indiscriminate pouring of money into the economy, the allowing of speculation and cartels, which led to excessive inflation in the country.

A sound economic policy and structural reforms are needed to lead to a stable and sustainable convergence. Perhaps the moment for the adoption of the euro in this economic and political instability should be shifted by one or two years and this will be for the good of Bulgaria. This time should be used to convince the public of the benefits of the euro and stop speculation on the subject.

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