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ON WHY BULGARIA SHOULD NOT FORMALLY JOIN THE EUROZONE

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Johns Hopkins Institute for Applied Economics,
Global Health, and Study of Business Enterprise

On Why Bulgaria Should Not Formally Join the Eurozone[1]

by Steve H. Hanke

About the Series

The *Studies in Applied Economics* series is under the general direction of Prof. Steve H. Hanke, Co-Director of The Johns Hopkins Institute for Applied Economics, Global Health, and the Study of Business Enterprise (hanke@jhu.edu).

About the Author

Steve H. Hanke is a Professor of Applied Economics and Co-Director of the Institute for Applied Economics, Global Health, and the Study of Business Enterprise at The Johns Hopkins University in Baltimore. He is a Senior Fellow and Director of the Troubled Currencies Project at the Cato Institute in Washington, D.C., a Senior Advisor at the Renmin University of China's International Monetary Research Institute in Beijing, a Special Counselor to the Center for Financial Stability in New York, and a contributing editor at *Globe Asia Magazine* and at *Central Banking* in London. Prof. Hanke is also a member of the Charter Council of the Society of Economic Measurement and of Euromoney Country Risk's Experts Panel.

In the past, Prof. Hanke taught economics at the Colorado School of Mines and at the University of California, Berkeley. He served as a Member of the Governor's Council of Economic Advisers in Maryland in 1976-77, as a Senior Economist on President Reagan's Council of Economic Advisers in 1981-82, and as a Senior Advisor to the Joint Economic Committee of the U.S. Congress in 1984-88. Prof. Hanke served as a State Counselor to both the Republic of Lithuania in 1994-96 and the Republic of Montenegro in 1999-2003. He was also an Advisor to the Presidents of Bulgaria in 1997-2002, Venezuela in 1995-96, and Indonesia in 1998. He played an important role in establishing new currency regimes in Argentina, Estonia, Bulgaria, Bosnia-Herzegovina, Ecuador, Lithuania, and Montenegro. Prof. Hanke has also advised the governments of many other countries, including Albania, Kazakhstan, and Yugoslavia.

Prof. Hanke has been awarded honorary doctorate degrees by the Bulgarian Academy of Sciences, the Universidad San Francisco de Quito, the Free University of Tbilisi, Istanbul Kültür University, and Varna Free University in honor of his scholarship on exchange-rate regimes. He is a Distinguished Associate of the International Atlantic Economic Society, a Distinguished Professor at the Universitas Pelita Harapan in Jakarta, Indonesia, a Professor Asociado (the highest honor awarded to international experts of acknowledged competence) at the Universidad del Azuay in Cuenca, Ecuador, and a Profesor Visitante at the Universidad Peruana de Ciencias Aplicadas (the UPC’s highest academic honor). In 1998, he was named one of the twenty-five most influential people in the world by *World Trade Magazine*.

Prof. Hanke is a well-known currency and commodity trader. Currently, he serves as a member of the Supervisory Board of Advanced Metallurgical Group N.V. in Amsterdam and Chairman Emeritus of the Friedberg Mercantile Group, Inc. in Toronto. During the 1990s, he served as President of Toronto Trust Argentina in Buenos Aires, the world’s best-performing emerging market mutual fund in 1995.

Prof. Hanke’s most recent books are *Zimbabwe: Hyperinflation to Growth* (2008) and *A Blueprint for a Safe, Sound Georgian Lari* (2010), *Juntas Monetarias para Paises en Desarollo* (2015), and *Currency Boards for Developing Countries: A Handbook* (2015).

Prof. Hanke and his wife, Liliane, reside in Baltimore and Paris.

1. Bulgaria installed a currency board system in July 1997.
2. Bulgaria's currency board allows Bulgaria to issue its own currency that trades at a fixed exchange rate with the euro, is fully backed by euro reserves, and is fully convertible with euros. These features mean that the lev is a clone of the euro and that Bulgaria is part of a unified euro currency area, without being formally part of the so-called Eurozone. So, Bulgaria maintains its sovereignty over its monetary system because Bulgaria can unilaterally change its anchor currency – to the U.S. dollar, gold, or any other currency, for example – without asking any other country or organization for permission to do so.
3. Bulgaria's currency board has been very successful.
    a. It stopped the hyperinflation in 1997, which peaked at a monthly rate of 242% in February 1997.
    b. It has allowed Bulgaria to weather all external financial crises, including the collapse of the Russian ruble in 1998, the Great Recession of 2009.
    c. It also allowed Bulgaria to weather the internal banking collapse of KTB, which occurred in 2014 (and which was not caused by, or had any connection to, the currency board system, but rather the Banking and Supervision Departments of the BNB).
    d. Most importantly, since the government cannot borrow from the currency board (BNB), fiscal discipline is imposed on Bulgaria's politicians. Since the installation of the currency board in 1997, fiscal deficits have been controlled and so has the level of Bulgaria's debt, regardless of the political party in power.
4. Why would anyone want to try to fix something that is not broken? No smart person would attempt to do so.
5. That is one reason why formally joining the Eurozone would not be wise. But there are other reasons.
6. By joining the Eurozone, Bulgaria would give up its sovereignty over its monetary system. This sovereignty is valuable, particularly if the euro gets into trouble. If that happens, Bulgaria can immediately switch to a superior anchor currency.
7. Why would any sane person want to join and be locked into a club whose very future is so uncertain?
8. Why would anyone want to give up known rules of the road and fiscal discipline for a moral hazard that encourages bad fiscal behavior – like that of Greece? Maybe that is exactly what some Bulgarian politicians who advocate formal membership in the Eurozone are dreaming about. Maybe they are tired of the tight straightjacket that the currency board makes them wear.
9. The stability given by Bulgaria's currency board might not be everything, but everything is nothing without stability.
10. Bulgaria would make a big mistake if it gave up another piece of its sovereignty to formally join the Eurozone. If it joined the Eurozone, it would have to discard one of the

few Bulgarian institutions that works well and is controlled by Bulgarians in exchange for an unclear and potentially unstable arrangement that Bulgaria cannot control.

Steve H. Hanke, the Father of Bulgaria's currency board, is a Professor of Applied Economics at The Johns Hopkins University and Director of The Johns Hopkins Institute for Applied Economics, Global Health, and the Study of Business Enterprise. He served as an adviser to Bulgaria's President (1997-2002) and was awarded a Doctorate *honoris causa* by the Bulgarian Academy of Sciences in 2013.

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