SAE./No.109/June 2018

Studies in Applied Economics

THE PATH AHEAD FOR BULGARIA - THROUGH THE EYES OF STEVE HANKE

Steve H. Hanke

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

***Subsequently published
in KSP Journals,
March 2020***

The Path Ahead for Bulgaria - Through the Eyes of Steve Hanke

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, a contributing editor at *Central Banking* in London, and a contributor at Forbes. 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.

The Path Ahead for Bulgaria - Through the Eyes of Steve Hanke

By Prof. Dr. Steve H. Hanke

1. **What do you remember about Bulgaria since you came here for the first time?**

In January 1990, I became the chief economic adviser to the reform government of Ante Marković in the Socialist Federal Republic of Yugoslavia. Shortly thereafter, Mrs. Hanke and I began to visit Bulgaria. In those early years of visiting Sofia, we always stayed at the Sofia Hotel Balkan; remembrances include: many hospitable Bulgarians who took very good care of us; excellent yogurt; and great opera. Outside the hotel, it was impossible to find edible restaurant food. This was striking given the excellent reputation of Bulgaria's cuisine. And that was not all that was in short supply. I recall the first time Mrs. Hanke and I visited TZUM. There were simply no goods. Also, the dilapidation of the buildings and capital stock in Sofia stood out. Lastly, the large packs of wild dogs that roamed Sofia's streets in the early 1990s left a lasting impression.

Now, Mrs. Hanke and I have many Bulgarian friends. We have watched some of our friends' children grow from infancy to adulthood. While yogurt and opera are still first-rate, there are now many restaurants in Sofia that serve real Bulgarian cuisine. Moreover, the quality of the capital stock has improved. Just take a look at the airport, and compare it to old photos of the airport circa 1990! Dogs no longer roam the streets of Sofia, and there are many more stores, all filled with goods. So, things have changed for the better. That said, Sofia is still Sofia, and Bulgarians are still Bulgarians. Those are things Mrs. Hanke and I like. When we step off the plane in Sofia, we know we are in Bulgaria.

2. **Let's talk about the hyperinflation from the beginning of 1997. What were the reasons for this catastrophic crisis with melting down the savings accumulated for dozens of years, bank bankruptcies etc.?**

Bulgaria's hyperinflation peaked at a monthly rate of 242% in February 1991. It was entered into the Hanke-Krus hyperinflation table, which was published in the chapter titled "World Hyperinflations," in the *Routledge Handbook of Major Events in Economic History* (2013). Bulgaria is one of the fifty-eight countries in the rouges gallery that have experienced hyperinflation—an inflation rate in excess of 50% per month. The cause is always the same. I know, because I have anticipated, measured, and been involved in stopping more episodes of hyperinflation than any other living economist. So, just what causes hyperinflation? Hyperinflation occurs when government expenditures exceed, by a wide margin, the sources of government revenue from taxes and the issuance of bonds to the public. To fill the gap, the fiscal authorities issue bonds that are bought by the central bank. This causes the proverbial "printing presses" to be turned on. Then, the money supply surges, and with that, inflation surges, too.

3. **Please, tell us more about the process of establishment the Currency Board in our country.**

My experience in Bulgaria illustrates the virtue of patience. When Mrs. Hanke and I first traveled to Sofia, our objective was to present the currency board idea to Bulgarian officials, intellectuals, and the general public. After our initial trips, we concluded that Bulgarian economists had never heard the words "currency board," and had no idea how such a monetary regime would work. In consequence, I developed a blueprint, including a draft law, for a Bulgarian currency board system. The blueprint was contained in a monograph, which was the first of three books I co-authored with Dr. Kurt Schuler on a currency board for Bulgaria. This first book was published in 1991 by the International Freedom Foundation in Washington, D.C. It carried the title "Teeth for the Bulgarian Lev: A Currency Board Solution."

Armed with that book, Mrs. Hanke and I made several visits to Bulgaria after its publication. Even though the currency board generated genuine interest in certain circles, the official response was always negative. The oft-repeated refrain of the former Governor of the Bulgarian National Bank, Prof. Todor Valchev, was typical of government officials: "thank you for your interest in Bulgaria and your proposal, but we know the realities of the local situation and have everything under control."

Once hyperinflation broke out in 1996, that refrain rang hollow, and things began to change rapidly. In December of that year, the Bulgarian Ambassador to the U.S. requested that I present my currency board ideas in Washington, D.C. In the same month, a pirated version of a book Dr. Kurt Schuler and I had co-authored in English was translated into Bulgarian, and it reached the top of the best-seller list in Sofia. In late February, Mrs. Hanke and I traveled to Sofia, and President Petar Stoyanov invited me to become his adviser, to draft a currency board law for Bulgaria, and to explain to Bulgarian politicians and the public how such a system would halt hyperinflation.

The currency board was installed on July 1, 1997. Inflation and interest rates plunged immediately. I can recall the genuine pleasure (perhaps relief, too) President Stoyanov displayed when he congratulated me on the outstanding results produced during the first few months of the currency board. It was then that the President confessed that he had hoped the currency board would kill hyperinflation, but that he had had reservations and was amazed when the currency board worked even more rapidly than I had predicted. Much later, President Stoyanov confided to Mrs. Hanke and me during one of our private meetings that, without the stability created by the currency board, Bulgaria would have had much more difficulty entering the North Atlantic Treaty Organization (NATO) in 2004 and the European Union in 2007.

4. How did Bulgaria change after 1 July 1997? After the establishment of the Board?

Bulgaria was stabilized. And as I love to say, "Stability might not be everything, but everything is nothing without stability." At last, fiscal discipline was delivered to Bulgaria because of the hard budget constraint imposed by the currency board. Fiscal deficits and debt levels are now very low—some of the lowest in Europe.

The currency board has worked exactly as I designed it to. It has proven to work well in both fair and foul weather. Indeed, it has performed well in times of stress: for example, in the Asian Financial Crisis (1997-98), the Russian Ruble Crisis (1998), the Great Recession (2009), and the Corporate Commercial Bank collapse (2014).

5. **What were the economic goals in 1997 when you became advisor to President Petar Stoyanov? Were they achieved at the end of your mandate in 2001?**

My main goal was to introduce a currency board that would kill hyperinflation and establish stability in Bulgaria. This goal was accomplished, and is to this day, recognized as a significant achievement. Indeed, after 20 years, the Bulgarian public still holds the currency board in high esteem. Also, in the academic realm, the Bulgarian Academy of Sciences and the Varna Free University have recognized my achievements by granting me doctorate degrees *honoris causa*.

After hyperinflation, Bulgaria's next big problem to solve was corruption. Mrs. Hanke and I alerted President Stoyanov to this problem. We presented him with hard evidence to support our concerns. Unlike hyperinflation, we had no magic potion to administer to the patient. We simply advised that the size and power of the State had to be cut back to combat corruption. If the power of the State was not reined in, we warned that corruption would be Bulgaria's Achilles' heel. As, I write today, I am certain of the truths we conveyed to the President almost 20 years ago.

6. **It has always been interesting to me how Professor Hanke explains the still-existing nostalgia of Communism, socialist ideas, the big state, and so on in Bulgaria... And how can such nostalgia be overcome?**

I think the nostalgia for the Communist era stems from many complex forces. One factor is that for many generations Bulgarians have been under the yoke of outside powers: for example, Constantinople and Moscow. In the Communist era, Bulgarians dreamed of being free citizens, not just inhabitants of a non-free state. Well, now many perceive that they are under a new yoke—the yoke of Brussels. So, expectations haven't been met. And when expectations aren't met, people always reminisce about the "good old days." When it comes to remembering what things were like in the "good old communist days," people's memories play tricks on them. The scholarly literature in psychology has proven that: if you ask people what happened even a few months ago, their memories are very faulty. People tend to recall what they would have liked to have happened in the past, not what actually happened.

One way to overcome the grip of nostalgia is to take a look at today's reality. To do so, we can look at "Hanke's Annual Misery Index: The World's Saddest (And Happiest) Countries," which was published in *Forbes* magazine (February 2018). The Misery Index is the sum of the unemployment, inflation, and bank lending rates, minus the percentage change in real GDP per capita. In my ranking of 98 countries, Bulgaria comes out with pretty respectable marks—thanks in large part to its currency board. Bulgaria ranks one notch better than Australia and only two notches behind France. That's not bad. Indeed, it's hard to believe, given what I first saw of Bulgaria many years ago.

Originally published in Bulagrian by *Business Quarterly: Journal for Economy and Freedom* as "Пътят на България през очите на проф. Стив Ханке." May 13, 2018