

Bulgaria and the Eurozone: A Misguided Step?

Description

Seventeen years after joining the European Union and following years of hesitation over adopting the euro, Bulgaria began its path toward Eurozone integration on July 10, 2020, by entering the European Exchange Rate Mechanism (ERM II). A country must participate in ERM II for at least two years before becoming eligible to join the Eurozone. Yet, four years later, Bulgaria has not taken this crucial step.

Bulgaria's integration into the Eurozone represents a crucial step in the country's economic convergence with the rest of the EU. This integration is contingent upon meeting the convergence criteria established in 1992 by the Maastricht Treaty, which aims to ensure that the economies of new entrants are sufficiently aligned with those of existing members to maintain the stability of the monetary union. The Maastricht criteria consist of four main conditions: price stability (requiring low inflation that does not exceed by more than 1.5 percentage points the average of the three EU member states with the best price stability records), sound public finances (a budget deficit below 3% of GDP and public debt under 60% of GDP), exchange rate stability (participation in ERM II without currency devaluation), and finally, convergence of long-term interest rates.



Inflation and Price Stability: Key Obstacles to Adopting the Euro

Bulgaria achieved a significant milestone by joining the European Exchange Rate Mechanism (ERM II) in 2020, marking the beginning of its preparatory period for adopting the euro. The Bulgarian lev has been pegged to the euro at a fixed exchange rate of 1.95583 lev per €1 since the introduction of the currency board in 1997. Following its entry into ERM II in 2020, Bulgaria also committed to maintaining this parity without excessive fluctuations for at least two years, a prerequisite for moving toward adopting the single currency. However, despite this two-year requirement being theoretically sufficient to enter the Eurozone, Bulgaria remains in ERM II four years later.

The country does [meet several convergence criteria](#), particularly in terms of public finances and interest rates. By the end of 2023, Bulgaria had stabilized its public finances, with public debt amounting to 21.6% of GDP and a budget deficit limited to 2.2%. Before the COVID-19 crisis, Bulgaria recorded five consecutive years of budget surpluses. Government forecasts suggest a return to surplus, as evidenced by the 2024 Finance Act, which is explicitly designed to facilitate Eurozone integration.

However, [inflation](#) remains a significant concern. In 2023, annual inflation reached 5.5%, while average inflation for the year was estimated at 8.6%, revealing pronounced price instability. For context, annual inflation, as defined by the Maastricht criteria, measures the change in prices between two specific points in time (in this case, from the end of 2022 to the end of 2023). In contrast, average annual inflation captures internal price fluctuations throughout the year. A combination of low and high average yearly inflation can indicate significant price volatility. Although annual inflation fell to around 3% in early 2024, [the European Central Bank \(ECB\)](#) remains cautious. In June 2024, the ECB declined to support Bulgaria's bid to adopt the euro before the end of the year, citing concerns that average inflation for 2024 could remain elevated, underscoring persistent price instability. This volatility continues to worry the European Commission, contributing to Bulgaria's extended stay in ERM II.

European institutions are also concerned about the country's overall financial stability. Sofia has undertaken major structural reforms to address these concerns, including joining the [European Banking Union \(EBU\)](#) on 1 October 2020.

This move aims to strengthen the ECB's supervision of the Bulgarian banking system to guarantee more excellent financial stability before adopting the euro. However, these efforts are likely to be long and complex, given that Bulgaria remains one of the most corrupt countries in Europe. According to *Transparency International's* Corruption Perceptions Index, [Bulgaria scored 55 in 2023](#) (where 0 represents the lowest level of corruption and 100 the highest), significantly worse than the European average of 40 (for comparison, France scored 29). The European Commission has therefore emphasized the need to strengthen anti-money laundering measures and improve oversight of non-banking financial sectors, such as insurance companies and pension funds.

Political Instability: A Threat to Eurozone Integration

Since 2021, Bulgaria has been grappling with profound political instability, marked by several legislative elections that have failed to produce a stable government. Over four years, Bulgarian voters have been called to the polls six times—a record in the country's recent history. This deadlock stems from the fragmentation of the political landscape, where traditional parties, particularly GERB led by Boyko Borissov, struggle to secure a clear majority. In the June 2024 elections, GERB won 24% of the vote, which was insufficient to secure a parliamentary majority, leaving the country in political limbo. This gridlock has paved the way for the rise of new parties, which are capturing an increasing share of the electorate at the expense of established formations. Among these new players, the far-right *Vazrajdane* (Renaissance) party, led by Kostadin Kostadinov, is gaining traction with its staunchly Eurosceptic rhetoric. In the June 2024 elections, *Vazrajdane* garnered nearly 14% of the vote, making it one of the country's leading political forces.

Vazrajdane opposes Bulgaria's integration into the Eurozone at the center of its platform, arguing that such a move contradicts national interests. Should the party come to power or exert significant influence over the government, it could seek to slow down Bulgaria's integration process into the Eurozone. However, the party's capacity to do more than delay is constrained. Bulgaria's commitment to adopting the euro is enshrined in the European treaties ratified upon joining the EU in 2007. Unlike Poland and Hungary, Bulgaria has already entered the ERM II mechanism, which solidifies its obligation to join the Eurozone once the Maastricht criteria are met. Any withdrawal from this commitment would require a revision of the treaties, a complex process requiring the unanimous agreement of all EU member states. Consequently, even if *Vazrajdane* were to attempt to obstruct the euro's adoption, its efforts would likely result in only a temporary postponement, motivated by political or economic considerations. This delay would serve merely as a reprieve.

Moreover, the nationalist and pro-Russian party does not appear capable of securing an absolute majority in the upcoming elections. Therefore, alliances and coalitions become central to the country's political future: B. Borissov could be tempted to ally with Eurosceptic forces to form a government. This alliance could allow GERB to retain power, albeit at the risk of exacerbating societal divisions. Indeed, the debate over the euro is particularly polarizing in Bulgaria. According to a Eurobarometer survey conducted in 2023, 49% of Bulgarians opposed adopting the euro, while 49% favored it (the remaining 2% declared themselves neutral). This divided situation makes the upcoming elections all the more critical for the future of Bulgaria's integration into the Eurozone.

A Monetary Union Mismatch: A Trap for Bulgaria?

Joining a monetary union offers reduced transaction costs (currency hedging, conversion costs) and increased trade stability. By adopting a common currency, countries eliminate the currency uncertainties that can disrupt international trade, facilitating trade and strengthening economic integration within the zone.

However, in the case of Bulgaria, this advantage is mitigated by the reality of its currency: the Bulgarian lev is solidly pegged to the euro, which considerably limits exchange rate variations between the two currencies. Bulgarian companies, therefore, already enjoy a high degree of stability in their transactions with eurozone countries. As a result, monetary integration will not bring about a radical change in this area, and the impact on the stability of commercial transactions will be relatively limited since the main expected benefits are already primarily in place. Indeed, Bulgarian Europhiles argue that joining the eurozone would improve the country's international image. In reality, simply adopting the euro seems unlikely to improve that image.

On the other hand, one of the major disadvantages for Bulgaria if it joins the eurozone is that the latter is not an optimal currency area (EMA), i.e., a region where countries can similarly absorb exogenous shocks thanks to homogeneous economic structures. Built around criteria that are based on nominal convergence and aim to align the economic performance of member countries on standard indicators, the eurozone does not take into account real convergence, which is the profound economic realities that concern productive structures, levels of economic development, the efficiency of public services and inequalities in wealth between member countries. Yet, these factors are crucial in how a country can absorb and react to economic shocks. However, the economies of the eurozone countries are very different. Some countries are highly industrialized, with strategies to control labor costs, while others rely more on domestic consumption or debt to support their growth. As a result, when the ECB applies a single monetary policy, the effects of this policy can vary considerably from one country to another because of these structural differences. For example, an increase in interest rates could stabilize the economy in a country like Germany but cause serious difficulties in countries with more fragile economies, such as Bulgaria. This lack of real convergence creates macroeconomic imbalances within the eurozone, which tend to worsen over time.

With a single monetary policy, the European Monetary Union cannot implement a unified fiscal policy to offset these imbalances. The European federal budget, which represents only 1.3% of the EU's GDP, is too small to play the stabilizing role seen in other more integrated monetary areas, such as the United States, where the federal budget represents around 35% of GDP.

It is, therefore, clear that by joining the eurozone, Bulgaria will lose its ability to adjust its key interest rate or exchange rate, which could enable it to react to specific economic shocks. But more than that, it will be exposed to uniform monetary policies that do not always take account of its economic reality. The risk is that Bulgaria, as a less developed economy than the countries of northern Europe, will suffer more from the adverse effects of asymmetric shocks without being able to resort to effective adjustment mechanisms.

Ultimately, Bulgaria's most significant disadvantage lies in joining a monetary union that does not address its members' heterogeneous needs. Economic inequalities and tensions within the Eurozone will persist without real convergence, complicating Bulgaria's successful integration.

Thumbnail: Sofia (© Céline Bayou).

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