View from Bulgaria: A Brief Look at Preparing for EU Accession and the Euro

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Bulgaria stands poised for accession into the European Union (EU) by 2007. The European Commission (EC) declared Bulgaria to be a "functioning market economy", a precondition for entry. Moreover, Prime Minister Simeon Saxe-Coburg said his country should be ready to join the European Monetary Union (EMU) by 2010. This brief explores Bulgaria's economic climate and possible obstacles it must overcome as it prepares for membership into the EU and adoption of the Euro.

OVERVIEW

Although Bulgaria is still poor relative to other EU members, its economy is growing by a steady annual rate of 5% or so since 2000. The IMF has called Bulgaria's performance "excellent". Indeed, Bulgaria has made considerable progress since its painful transition from the communist era marked by a roughly 30% percent drop in GDP between 1989 and 1997. The government introduced measures to reduce corporate tax, curb corruption, and attract foreign investment. The government also implemented programs that helped restructure the country's foreign debt using strict fiscal policies and implementation of a currency board, helping to increase exports and decrease interest rates. The government also employed policies for the privatization of major state monopolies. But while macroeconomic data reveal private sector growth, a double-digit increase in exports and imports and higher foreign investment, incomes and living standards remain low.

Economic Statistics - Bulgaria

	1999	**2000**	**2001**	**2002**
GDP per head ($ at PPP)	4,840	5,250	5,630	6,010
GDP (% real change pa)	2.30	5.40	4.10	4.80
Government consumption (% of GDP)	8.87	9.73	9.46	10.03
Budget balance (% of GDP)	-0.95	-1.00	-0.86	-0.68
Consumer prices (% change pa; av)	2.57	10.32	7.36	5.81
Public debt (% of GDP)	86.68	77.08	69.94	55.87
Labor costs per hour (USD)	0.61	0.58	0.63	0.71
Recorded unemployment (%)	14.13	18.65	18.08	17.71
Current-account balance/GDP	-5.03	-5.57	-6.19	-4.35
Foreign-exchange reserves (m$)	2,892	3,155	3,291	4,407

– The Economist (2004)

Three instruments, financed by the European Community, assist the applicant countries of Central and Eastern Europe with their pre-accession preparations: the Phare programme (for consolidation of institutions, participation in Community programmes, regional and social development, industrial restructuring and development of the small-business sector); SAPARD (Special Accession Programme for Agriculture and Rural Development); and ISPA (Instrument for Structural Policies for Pre-Accession), that finances infrastructure projects in the fields of environment and transport. The support provided by these programs focuses on the Accession Partnership priorities that are intended to help the candidate countries meet the criteria for EU membership.

For the years 2000-2002, total financial assistance to Bulgaria amounts to around EUR 100 million annually from Phare, EUR 53 million from SAPARD, and between EUR 83 and 125 million from ISPA.

EU CRITERIA AND THE CONDITIONS OF MAASRICHT

Convergence criteria or macroeconomic tests outlined in Maastricht are provisions that the member states must pass to join the European Monetary Union (see table 1). Maastricht treaty conditions specify that the applicant countries have functioning market economies; are capable of dealing with competitive pressures and market forces in an enlarged Single European Union; that they can ensure stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities, and that they must be able to take on the obligations of membership, including adherence to the aims of economic and monetary, and political union.

At the European Council Copenhagen summit, a list of negotiation chapters for accession into the EU were described. By October 2002, Bulgaria had met almost all of them. Specifically, the following negotiation chapters have been closed: free movement of capital, company law, fisheries, taxation, financial control, economic and monetary union, statistics, social policy and employment, industrial policy, small and medium-sized enterprises, science and research, education and training, telecommunications and information technology, culture and audio-visual policy, consumers and health protection, customs union, external relations, common foreign and security policy, and institutions.

Table 1

Maastricht Convergence Criteria	Explanation
Inflation	Not more than 1.5 % over the average index of customer prices of the three of the countries in the EU with the lowest index of inflation
Long term interest rate	Not higher than 1 1/2% of the average inflation rate of the three countries with the lowest individual rates.
National deficit	Not more than 3% of GDP.
National debt	Not more than 60 % of GDP.
Exchange rates	Countries must join the European Monetary System (EMS) and join an exchange rate band with other countries. These bands lock nations' monetary exchange rates to one another with only a fluctuation of +/- 2.5%. To meet the Maastricht criteria, a country must be a member of the EMS for at least two years.

BULGARIA AND THE EURO - POSSIBLE IMPACTS

Assuming Bulgaria passes the convergence criteria, adoption of the Euro could affect its small economy in many ways. Among these are:

- Decrease costs for currency operations and reduction of currency risk for businesses and investors.
- Decrease costs for property and investments
- Decrease rates of interest that should, in turn, stimulate private investments in the country.
- Increase trade within the EU.
- Improve business cycle synchronization with other EU member economies.
- Elimination of exchange rate fluctuations with the EU community.
- Increase opportunity for foreign investment due to a more stable economic environment.
- Decrease monetary financing of national debt.
- Increase costs for small and middle size businesses and costs for the financial services sector during the period of transition to the EMU.

LOOKING AHEAD

As Bulgaria moves forward, policy makers may be confronted by tough questions such as:

- Will there be structural changes to the Bulgarian economy from incorporating the Euro (even with other factors staying equal)?
- Will the Bulgarian economy suffer from competitive pressure from the other EU member states? Which sectors will be most affected? And, what are the prospects for consolidating those sectors?
- Will Bulgarian policies succeed in facilitating export flows and investment flows into the country?
- Can Bulgaria maintain its current growth rate of 5% per annum?

While necessary steps have been made to pass Maastricht criteria, Bulgaria's biggest hurdles for inclusion into the EU are implementing judicial reforms and the reducing organized crime and corruption. Courts suffer from inefficiency, political influence, and the high level of organization crime. Though legislative measures have been made to fight corruption and organized crime, only a reformed judicial system can implement them successfully.

As Bulgaria moves ahead, it also needs to continue making progress on economic and administrative policy reforms; foreign investment must increase; and tight fiscal policy should be used to decrease its trade deficit and ensure an inflation pace not exceeding 1.5 % than the three best performing EU national economies is maintained. Moreover, the unemployment rate must drop so the average Bulgarian can feel the impact of economic progress.