BULGARIA ON THE ROAD TO THE EUROZONE: NOMINAL CONVERGENCE CRITERIA AND POLICIES ADJUSTMENT

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ABSTRACT

The paper discusses the adjustment of the Bulgarian economy to the integration process in the EU and the European Monetary Union as regards the prospects to join the EMU. The economic and financial integration of Bulgaria since the start of its official membership in 2007 coincided with the Global financial and economic crisis and with the European sovereign crisis in the European Moneraty Union (EMU) as the "core' of the EU integration. The last decade the integration process has been challenged by the deep institutional reforms as crucial for deepening and enlarging the EMU. The macroeconomic performance of Bulgaria is revealed with regard to the compliance with the macroeconomic nominal convergence criteria for the EMU. The real convergence is discussed to outline the ongoing reforms to speed up economic growth and competitiveness in compliance with the EU law and regulation. Conclusions and future prospects are summarized for the Bulgaria's EMU entry as a challenge and opportunity for further integration of Bulgaria the EU.

Key-words: European integration, EMU, Maastricht criteria, financial stability, EU reforms in the financial sector, financial integration.

JEL: G12,G28,G32,F36,F450.

1. Introduction

The preparation for adoption of the Euro in Bulgaria has been perceived as a priority goal of the EU accession since the conclusion of the Treaty of Accession of Bulgaria to the EU on April 25, 2005 until present. As regards the process of structural adjustment Bulgaria has embarked on the road to economic and monetary integration with the EMU much earlier at the very beginning of the its EU preaccession period since mid 90s and especially since the adoption of the Currency Board regime in 1997. Choosing the German mark to be the monetary anchor of the Currency board regime Bulgaria followed the strategy to replace it with the Euro since its introduction in 1999 at the third stage of the EMU of the EU. The Euro as an anchor of the Currency board in Bulgaria has been a strong factor of Bulgaria's financialisation during the transition from centrally–planned to market economy by fulfillment of the Copenhagen criteria. Bulgaria's EU membership has opened new possibilities and challenges to adjust to the EU single market's free movement of goods, services, capital and work force on the basis of the EU law, i.e. the acquis communitaire.

According to the 2005 Stategy of the Bulgarian National Bank the preparedness for the EMU could have been achieved in a foreseable medium term due to the favourable economic growth trends and the fiscal and monetary stability of the Bulgarian economy by that time. Besides

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since Bulgaria has started its EU membership as of January 1st, 2007 there has been a rather optimistic belief among policy makers in Bulgaria that the compliance with Maastricht criteria is to be on the basis of the well functioning Currency board.
The case of Bulgaria's experience on the road to the EMU is indicative of the complexity of the process of country's progress in achieving compliance with the criteria for the EMU as well as of the role of the political factors to achieve the preparedness for the EMU. The analysis reveals that Bulgaria' s progress to join the EMU has depended on the structural adjustment to the EU Single market as well as on the improvement of the institutional capacity and economic governance to comply with the Union's requirements in favour of achieving convergence criteria.

The acknowledgement of the EMU's success in its progress to enlarge and deepen the European monetary integration involves also the jugdement that the EMU has developed further its institutional architecture and regulatory capacity. Following the Global financial crisis and the European sovereign crisis the progress of the EMU governance has raised the significance of the EMU for the regulatory changes in the macroprudential policy, banks' risk management and banking supervision systems of EU member states. Bulgaria has been involved in this process of banks' çonsolidation and financial sector risk management by deepening the compliance with the EU law. Thus the postponement of Bulgaria's entry to the EMU has become as part of differentiated integration a challenge of raising the costs of compliance to the newly designed institutional architecture of the EMU and regulations of its capacities and instruments. [2]

Since 2014 the banking system and financial intermediation of Bulgaria have been the main sphere of the process of compliance on the road to the EMU. On the 10th of July 2020, Bulgaria was accepted as a member of the ERM II and the Banking Union (the so-called "euro area waiting room") in response to the country's efforts and the political will to join the euro area expressed in the Official letter submitted at the end of June 2018 expressing the committment to enter into a "close cooperation" agreement with the European banking union. For the last 4 years as being a member of the Banking Union and ERM II Bulgaria has undertaken steps for the introduction of the Euro being on clear terms that achieving compliance with the EMU criteria is necessary. But the political crisis in the last three years has led to subsequent changes of Government causing the failure to meet the accession criteria, as well as the non-adoption of the legislative framework. Thus the original euro adoption plan has not been accomplished as expected. An updated "National Plan for the Introduction of the Euro in the Republic of Bulgaria" with a new target date of 1 January 2025 was adopted by Decision 797 of the Council of Ministers of 13 November 2023.
Since Bulgaria joined the ERM II of the EMU in 2020 much more comprehensive approach has been applied that relies on the political will and commitment to prepare for the Euro by mobilising efforts to raise public confidence and information in all sectors, public institutions and the private sector for preparation to join the euro area.
Since 2021 the political turmoil in Bulgaria has been prolonged for nealy 3 years and the unfavourable economic performance due to the external and domestic factors of the energy crisis and the war in Ukraine have caused slowdown of growth in 2023 to 1.8 percent driven by a decline in private investment due to uncertainty and by the unwinding of the inventory buildup of 2021–2022. In spite of the fact that headline inflation decelerated to 3.1 percent in March 2024 as a result of the lower energy and food prices, core inflation remains stickier

[2] As stated in the Article1(3)Treaty of European union(TEU) and the Treaty on the Functioning of the European Union within or outside the Treaties of the EU in the field of European economic and monetary policy the differentiated integration is the cooperation of some but not all EU member states.

(3.9 percent), with services prices still growing by 5 percent. The inflation has remained higher than the price criterion for the EMU. Despite sustained wage and pension growth and inflationary pressures of 2024 budget, inflation is projected to continue declinining, but it has remained higher than required by the criterion of price stability.

The European Commission, in a Convergence Report dated 10/06/2024, announced that the Republic of Bulgaria is not yet fully ready to join the Eurozone on the 1st of January 2025 due to the non-fulfilment of one of the accession criteria - price stability. Therefore, the new target date for the introduction of the euro remains open for the time being and is subject to a decision of the Government of the Republic of Bulgaria following a favourable convergence report of the European Commission and a Decision of the Council of the European Union on the adoption of the euro by the Republic of Bulgaria adopted in accordance with Article 140(2) of the Treaty on the Functioning of the European Union.

The analysis comprises three main parts of discussion of the present issues of Bulgaria's EU economic and financial integration. The first part presents the outstanding characteristics of the main stages of the preparation of Bulgaria to the EMU.

The second part discusses the macroeconomic performance of Bulgaria with focus on the public finances's compliance with the Maastricht criteria as required by the framework for EU convergence. The third part presents the real convergence of Bulgaria as an ongoing further adjustment to the requirements for the EMU entry. Conclusions are drawn with regard to medium term official forecasts for the economic development and the achievement of further progress to join the EMU.

2. The Macroeconomic performance of Bulgaria and the nominal convergence with the Maastricht criteria

The issues of the entry criteria for the EMU as a set of Maastricht criteria from the first stage of the EMU in the 90s have raised a number of questions about the proper *"fitness" of a country to comply*. As regards the set of Maastricht criteria of convergence for example, Kozluk (2005, p. 439-474) finds that some of the EU accession countries are better prepared for the single currency membership than some of the more established members had been at the introduction of the EMU.The differentiation between the strictness of Maastricht criteria for EMU entry, on one hand and the reconsidered since 2005 framework of the Stability and Growth pact applied to member states of the EMU allowing flexibility to adapt, has been considered with regard to some recommendations for unification of fiscal deficits requirements for both EU members and the EMU entry (Nuti, 2006).

But the compliance with the fiscal sustainability criteria has gained new aspects of importance as the European sovereign debt crisis has evolved since 2010. As previewed by Mongelli (2002, p.34) the costs from negative external effects have become "very high for the EMU because not one, but more, member countries were to run sizeable and protracted budget deficits, accumulating an unsustainable public debt, eventually some pecuniary externalities might ripple through the currency area." The negative consequences of the crisis have made the compliance with *the nominal and real convergence indicators* need a much more essential prerequisite for the EMU entry.

As the COVID-19 crisis has hit hard the European economies and the recovery has been slow and not good enough (in spite of significant differences among countries) to stimulate growth. The questions about the growth model and the reforms of the European integration have been raised again. The EU membership of Bulgaria could not facilitate the the catch-up model of growth due to the multifold crisis implications as well as because of the ongoing search of proper national policies. These policies are a decisive factor for differences among the growth performance of the countries of Central and Eastern Europe as EU member states. Bulgaria's integration to the EU is important as it supports sound fiscal and financial policies by the strengthening of the EU's current macro-finance assistance arrangements and economic governance improvements. However, the role of proper fiscal policy has become more important not only as instrumental for the EMU entry but because it has to take into account the need to stimulate economic growth. (Becker et al., 2010).

The fiscal vulnerability often arises from implicit liabilities towards the financial sector and for this reason sustainability assessments should also consider private-sector fragility. EU countries' budgets have been involved with providing great amounts of state aid to rescue banks and non-financial intermediaries. The post crisis institutions newly created to tackle the financial instabiliy provide new capacities for of the EMU. Thus for the EU member states like Bulgaria being 'outs' to the EMU, it is important to join the EMU as it may help growth by joining new cooperation agreements that are targeted to increasecompetitiveness and financial stability. The implementation of the Banking and Capital Union is assigned to contribute to the break of the vicious circle between the public debt and banking sector's debt and improve the fiscal consolidation in favour of the EMU (Zimmermann, 2015). By joining the Banking Union in 2020 Bulgaria has undertaken the implementation of banking regulations in favour of financial and fiscal stability.

Macroeconomic performance has allowed to maintain stability but the rate of growth has remained low in recent years. The unsatisfactory growth record has been accornpanied by relatively modest fiscal deficits, low inflation and a stable currency. Growth has been deprived of new capital inflows from abroad as direct and portfolio investments have fallen considerably as result of the Global and the European sovereign crisis. The economic growth has become largely dependent on domestic factors and only to some extent driven mainly by growth in services and manufacturing, the latter aided by an expansion in exports of labor-intensive goods. The acceleration of economic growth is considered a necessary prerequisite to diminish the gap between the GDP per capita of Bulgaria and the average GDP per capita of EU-27 in the period (2003-2023). Since 2012 Bulgaria has performed some improvement of the indicator GDP per capita (PPP) and it has been raised from 47 per cent in 2013 to 64% in 2023 of the average GDP per capita for the EU. but still this is the lowest level among the EU27.

3. Government finances' compliance with nominal convergence criteria

As a new EU member state Bulgaria has no opt-out choice as regards the EMU and thus has the status of a Member State with a derogation. The convergence with the EMU requirements has been most pertinent by the gradual process of alignment of Bulgaria's *fiscal polic*y with EU requirements. With the efforts for the implementation of Maastricht criteria for EMU Bulgaria has achieve progress towards macroeconomic nominal convergence (criterion on price stability, sound public finances, exchange rate, short-term and long-term interest rates).

Objectively the economic growth in terms of positive rates since 2004 has made possible to *maintain the public finances adequately* and to achieve a Government budget surplus since 2004 up to 2009. At the same time complex political and economic reasons justify the postponement of Bulgaria's participation in ERM II as the Convergence report points out to the need of decreasing the external imbalances and improve the laboour market. In practice, the deterioration of the indicator for government deficit for 2009 up to 4.3% of the GDP led to the imposition by the European Commission to Bulgaria a procedure for excessive deficit. In the subsequent years, by adhering to the new rules and requirements to the government finances, during the period (2010-2013).

As seen in Table 2, due to the higher level of public expenditures in 2014, the Government budget deficit was increased to 5.4 % of GDP. In 2015 Bulgaria has again restored the compliance with Maastricht criterion by adhering to consolidation of fiscal policy and improving the discipline of execution of the Government budget.

Table 1: Bulgaria compared to EU27 and Euro area: Government budget deficit/surplus (2014-2023) (as % of GDP, annually)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Bulgaria	-5.4	-1.9	0.3	1.6	1.7	2.1	-3.8	-3.9	-2.9	-1.9
European Union - 27 countries (from 2020)	-2.5	-1.9	-1.4	-0.9	-0.4	-0.4	-6.7	-4.7	-3.4	-3.5
Euro area - 19 countries (2015-2022)	-2.6	-2.0	-1.5	-1.0	-0.4	-0.5	-7.0	-5.2	-3.7	-3.6

Source: Eurostat, datasets Government deficit/surplus, debt and associated data, 2024,gov_10dd_edpt1

In 2015-2019 Bulgaria has performed steadily with adequate fiscal discipline the compliance with the Maastricht criteria as a main target of the Government fiscal policy in its Convergence Programmes. Since 2020 due to the COVID-19 crisis and the Ukranian war Government budget deficit raised by introducing temporary fiscal support for businesses and households during the Pandemic and subsequent energy crisis.. Bulgarian household consumers were protected from rising energy costs through regulated prices. They were frozen in December 2021 at levels from July 2021 to March 2022 and increased by 3.4% for electricity and 24% for heating in the second half of 2022. Heating prices increased by 8% in July and then by 14% in November. Targeted heating aid for the heating season linked to income has also been introduced. Non-household consumers were compensated through a support scheme that applied to all companies, regardless of their consumption. The scheme currently covers all non-domestic consumers for electricity costs above €102/MWh. The scheme to support non-household consumers was partially financed by a special levy on windfall profits of certain state-owned enterprises in the energy sector in 2022. Bulgaria applies the EU solidarity levy in the implementation of Council Regulation (EU) 2022/1854.

From January 2023, the country also applies caps on the profits that energy producers can receive from the wholesale market. These caps include approximately EUR 90/MWh for nuclear power plants and EUR 180/MWh for renewable electricity generators. The revenues from this measure are transferred to the "Security of the Electricity System" Fund.[3] Although energy prices have decreased, uncertainty remains regarding, which requires continued efforts to structurally reduce gas demand.[4]

[3] Bulgaria has taken steps to guarantee the security of energy supplies. It fulfilled its gas storage obligations, filling 91.53% of the only Chiren underground gas storage facility by November 1, 2022. It secured supplies of liquefied natural gas (LNG) to compensate for natural gas supplies interrupted by Gazprom in April 2022, the operation of the gas interconnector between Greece and Bulgaria began in October 2022, while the construction of the Kostinbrod natural gas pipeline to connect Bulgaria and Serbia began in February 2023.

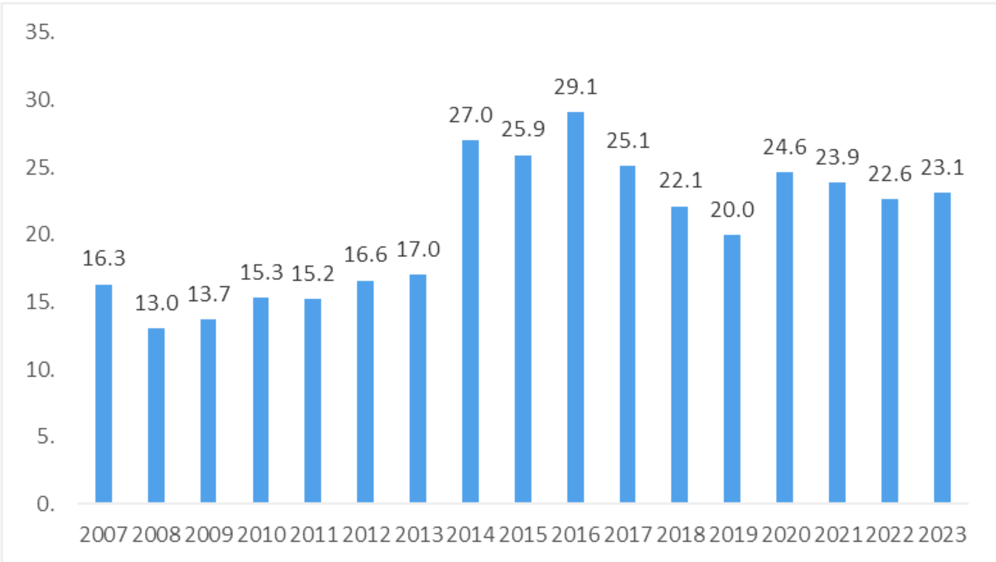
[4] COMMISSION STAFF WORKING DOCUMENT, 2023 Country Report – Bulgaria,{COM(2023) 602 final}

The public deficit was 2.8% of GDP in 2022, a decrease of more than 1 percentage point compared to the previous year. Revenue growth more than offset spending growth in part due to higher prices for some products subject to indirect taxes, such as food and energy. Continued wage increases also contributed positively to revenues through higher labor taxes. Measures to minimize the impact of high energy prices had a net budgetary effect of around 1% of GDP in 2022, as they were partly financed by a tax imposed on the windfall profits of state-owned enterprises in the energy sector.

Bulgaria has reduced considerably the Government deficit in 2022-2023 and being below the EMU threshold is among the countries with moderate fiscal risks. The primary budget deficit on a cash basis for 2023 is 1.5% of GDP. The low level of interest costs of Govennment debt (0.4% of GDP for 2023) explains the still weak pressure of servicing the government debt. This helps better maintainance of fiscal capacity. According to the European Commission Spring Forecast for 2024 the budget deficit is projected to reach 2.8% and 2.9% in 2024 and 2025, driven mainly by increased public expenditures on pensions and wages. General government debt is set to increase to 24.6% of GDP by 2025. (EC, 2024)

As regards the *EMU criterion for an average annual rate of growth of the public debt-to-GDP* Bulgaria has had consistently consolidated its fiscal policy throughout the period (2011-2023) and fiscal discipline has been much strict to keep much lower level of Government debt than the EMU treshold of 60 percent of GDP. (See Fig.2)

Figure 1. Bulgaria: Government debt as % of GDP, annual)

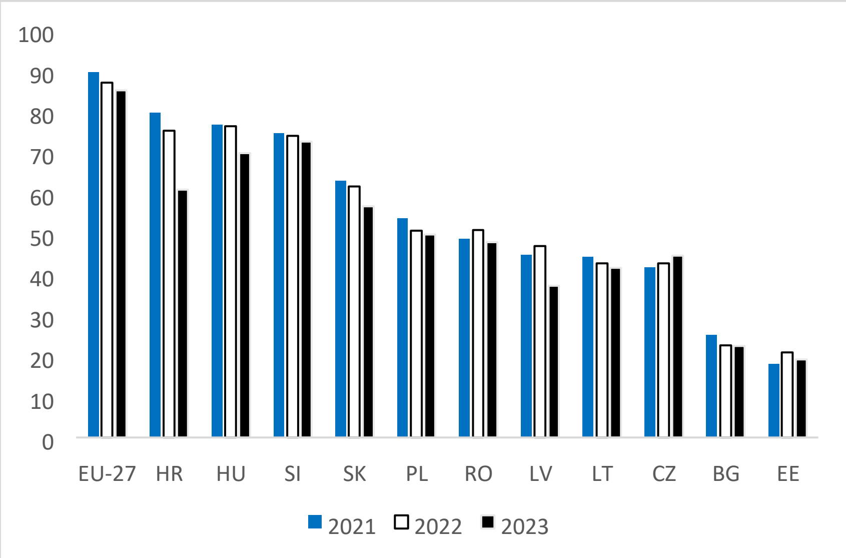


Source: Eurostat (2024).

The need to provide state aid to cover the deposit guarantees repayments after the closure of Corporate commercial bank and to apply the liquidity support for other 2 domestic banks in crisis had caused rapid increase of the Government debt-to-GDP ratio in 2014 to 26 %. The steep rise of this ratio caused the assessment of Bulgaria as a country with imbalances by the European Commission's Alert mechanism for greater macroeconomic imbalances for 2014. In 2016 the Government debt raised up to 29.1 % of the GDP which is the highest level reached since Bulgaria's accession to th EU.

In the period (2027-2020) Bulgaria followed medium-term path of maintaining the fiscal stability by the implementation of the Convergence Programmes of the Ministry of Finance until 2022. As seen on Graph 5 the ratio of Government debt to GDP of Bulgaria is lower compared to this indicator for EU member states from Central and Eastern Europe. According to the 2023 Convergence programme, the general government debt-to-GDP ratio is expected to increase from 30.7% at the end of 2024 to 37.1% by the end of 2026.The forecast set in 2024 by the Convergence programme previews the level of Government debt of Bulgaria to increase in the next three years (2025-2027) both in nominal level and as a ratio of GDP under the assumption to secure the fiscal capacity by larger volumes of new debt financing. (Ministry of Finance,2024)

Figure 2. Bulgaria: Government Debt in comparison with EU27, Euroarea and EU Member States in Central Europe, 2021-2023 (% of GDP)



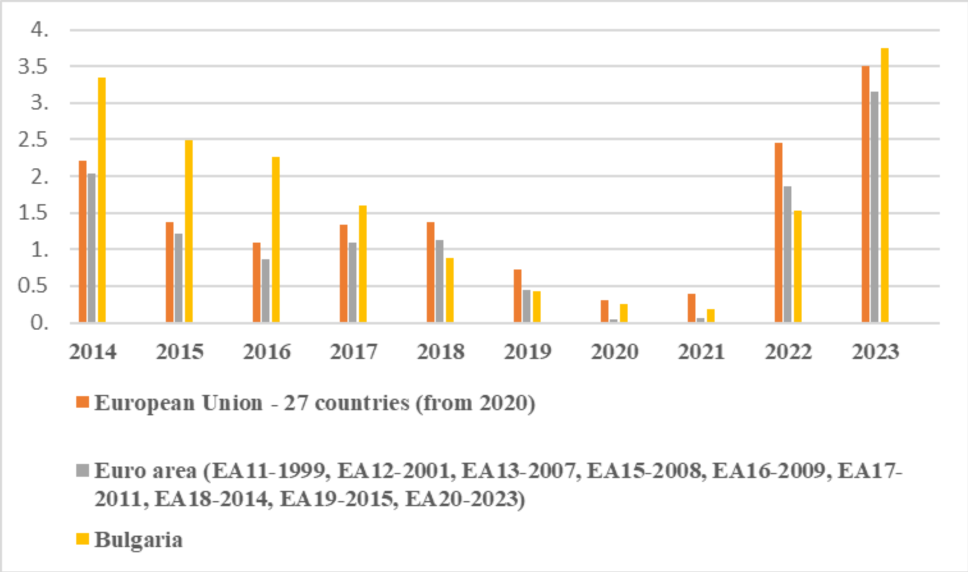
Source: Eurostat, 2024.

According to the EU spring forecast in 2024 projections an increase of the General Government debt-to-GDP ratio is expected to reach 27.3% in 2025, 30.0% in 2026 and 30.7% in 2027, with an average annual growth rate for the period 2025–2027 of 1.9 p (EC,2024).

Long term interest rates

The Maastricht EMU convergence criterion series relates to interest rates for long-term government bonds denominated in national currencies. Based on Bulgaria's government bond yields on the secondary market, gross of tax, with a residual maturity of around 10 years.4

Figure 3. Interest rate: EMU convergence criterion bond yields of Bulgaria compared to EU and Euro area (2014-2023)



Source:Eurostat, 2024

Bulgaria has performed progress of convergence of the long term interest rates on the Bulgarian Government debt. Bulgaria has had average long-term interest rates that were – to different degrees in separate years – much below the reference value for the interest rate convergence criterion.

As seen on Fig.6, since 2015 up to 2022 the long term interest rates on the Bulgarian Government securities have fallen considerably which had also been a factor to lessen the pro-inflationary impact of both servicing the debt as well as resorting to issuance of new debt. The higher level of the values of the long term interest rates on the 10-th year Government securities of Bulgaria since 2022 reflects the overall change of the inflation trends in the EU but may be regarder as a consequence of the specifics of Bulgaria's worsened economic situation and political uncertainty in this period.

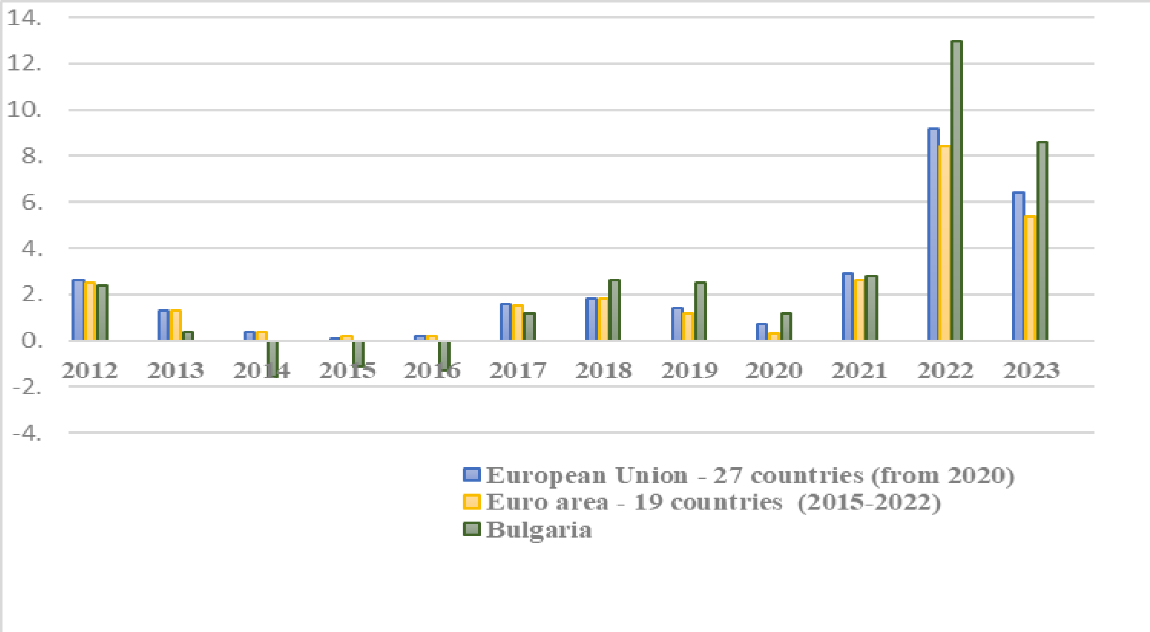
The price stability and price convergence have been a target of the Bulgarian Government and Bulgarian central bank's policies since the pre-accession period to present times. For assessment of the level of inflation as EMU criterion of nominal convergence are used the Harmonised Indices of Consumer Prices (HICPs) as required under Article 121 of the Treaty of Amsterdam. Bulgaria has complied with the requirements of the Eurostat methodology of measuring the HICP. The comparison of Bulgaria's HICP trends with the Euro area and EU27 show the differences and similarities in price adjustment as a result of the integration process.

For the period (2004-2008) Bulgaria has not accomplished the price criterion as the inflation was higher than the referent valueof EMU threshold. The structural readjustment and credit expansion related to the higher rates of Bulgaria's growth caused higher rates of inflation in the period (2004-08). The economic decline had caused a reversal of this trend since 2009 onwards by the recorded relatively stable process of deflation.

The fall of the Bulgaria's HICP index since 2014 was partly a result of lower commodity prices and the overall deflation trend due to the slow recovery after the Global and European sovereign debt crisis,. Since 2014 the external factors have played a bigger role in the domestic price

formation of Bulgaria due to the high openness of the Bulgarian economy and the high degree of import dependencies that influence the import prices. Energy and food prices have been a major component of imported inflation especially if it is taken in consideration that these commodities have large share of the Bulgarian basket of the Harmonised index of Consumer Prices (HICP). Their influence on the price level in Bulgaria is big and due to this, after the Global crisis the observed decline of international prices of oil, energy resources and foods has been reflected in the prolonged deflationary trends in
Bulgaria in 2014-2016.

Figure 4. Bulgaria compared to EU27 and Euro area: HICP- Inflation in 2012-2023 (as rate of change, annual)

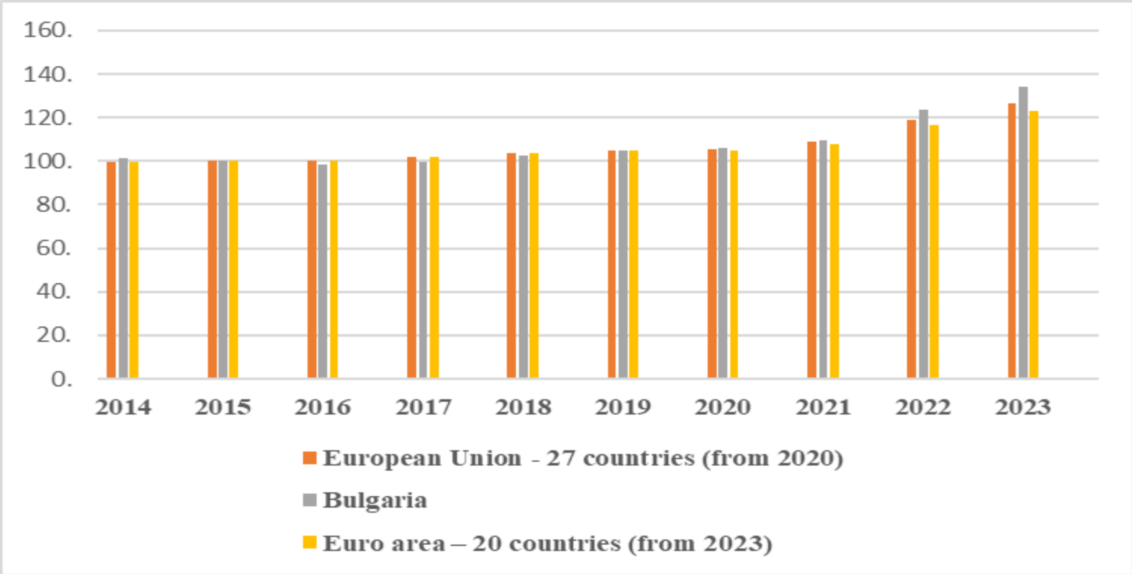


Source: Eurostat,2024.

In 2021 -2023 the inflation gradually picked up again, largely reflecting an increases of the commodity prices,wage growth and sharp increases of energy prices, etc. Domesstic factors (especially including labour shortages and tight labour market) brought to sharply rising nominal unit labour costs. After several years of some increases, the wage growth has been the highest in the EU in recent times. The level of domestic inflation has become important for the nominal convergence as it has two-sided risks. On one side, the higher rate of inflation worsens the cost competitiveness as compared with the euro area trading partners and the rest of the EU. On the other side, the wage growth is indispensable for diminishing the deepness of differences of the level of incomes in Bulgaria with the EU. The HICP and core inflation-based real effective exchange rates have followed trend of appreciation, with nominal appreciation playing only a small role under the Currency board arrangement and the large share of trade with the euro area.

In 2020-2023 the increased values of HICP of Bulgaria reflect higher rate of inflation as a result of the economic slowdown due to the COVID-19 and the war in Ukraine. Domestic factors of inflation include labour shortages, lack of adequate market competition and incomplete regulation of consumer protection. Following certain moderation, the inflation has followed a declining trend in 2024 but the risks of uncertainty of the international and domestic environment remain. There is still a risk of core inflation being persistent. The convergence adjustments could take the form of further increases of energy and services'prices as well as a rise of nominal wages.

Figure 5: Harmonised index of consumer prices (HICP): Bulgaria compared to EU and the Euro area (2014-2023) , average index and rate of change annually



Sourece of data: Eurostat, 2024.

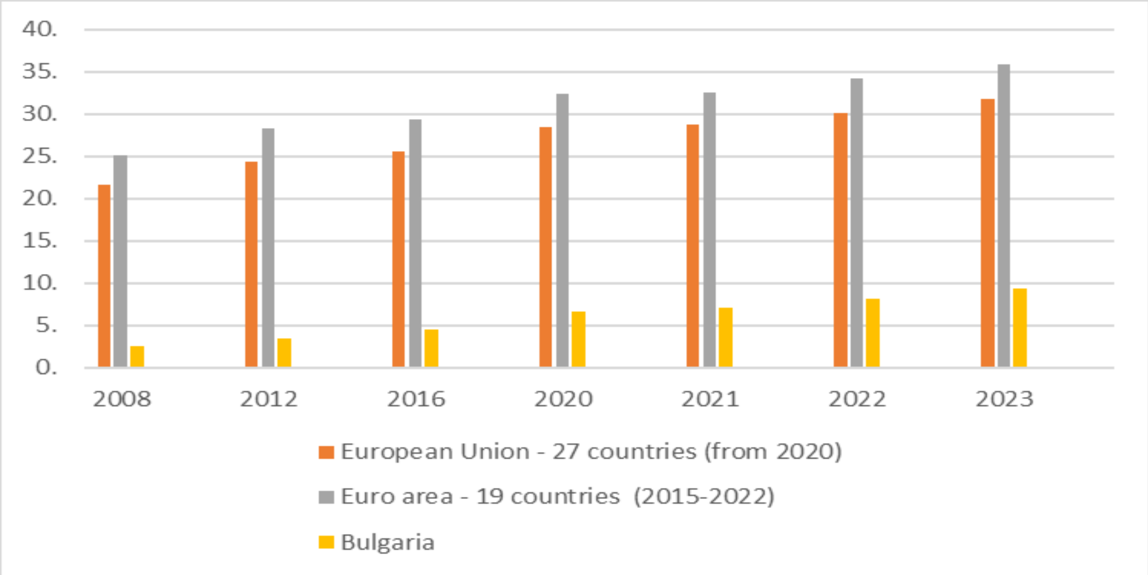
Source: Eurostat, 2015 (Bulgaria – HICP – Overall index, Annual rate of change, Eurostat, Neither seasonally nor working day adjusted, Unit Percentage).

The overall trend of price convergence of Bulgaria is indicative of the raised degree of interdependences with the Euro-area which inevitably have led to adjustments of prices and incomes at a higher degree in crisis times.(Fig. 6).

But as regards the adoption of the euro the problem of the pro-inflationary factors and their evaluation is an important issue of the forecast of medium and long term inflation trends and the ongoing readjustment of the Bulgarian economy to the global trends. Many new EMU countries have experienced a rise of inflation after joining the EMU. In a monetary union, there are a number of factors that exercise upward pressures on inflation and due to this inflation may become self-sustained and give rise to an abrupt adjustment. Since the nominal interest rate is fixed at the union level, any shock bringing inflation above the union average will reduce the real interest rate and fuel further inflationary pressures, in a self-reinforcing mechanism for instance by stimulating credit expansion.

However, also being out of the EMU has its risk of adverse impact of the pro-inflationary trends through the channels of imported inflation. These risks may be even higher for a country that is out of the EMU if one takes into consideration the exchange rate risks related to impact of the import prices in euros and import prices in US dollars.

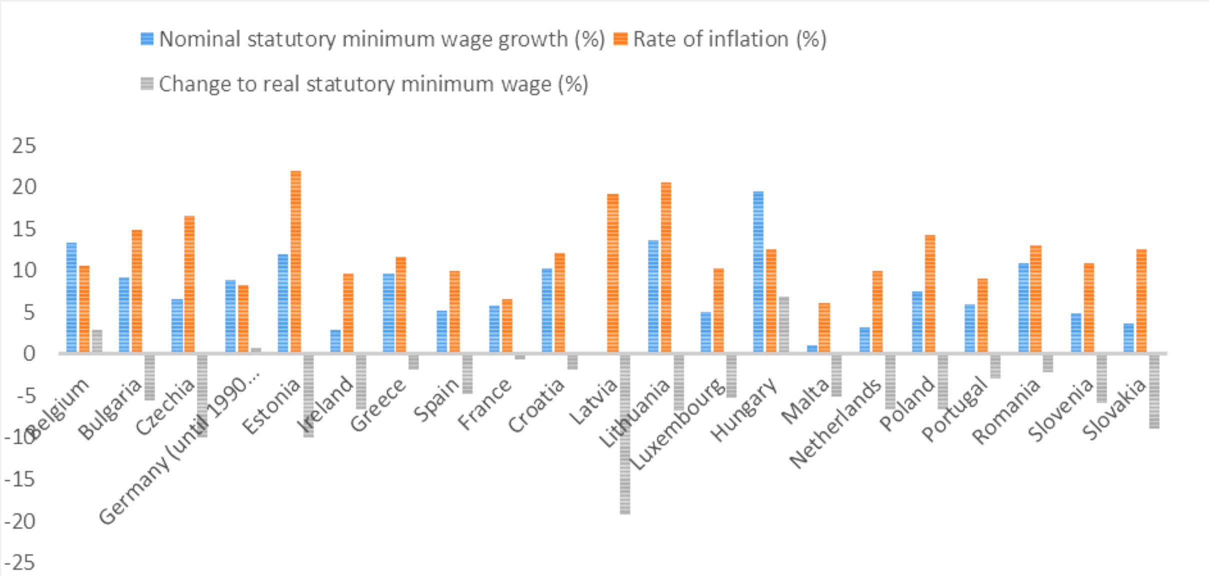
Figure 6. Bulgaria compared to EU27 and Euro area: Labour costs in the period (2008 – 2023), **(annual data - NACE Rev. 2)**



Source: Eurostat,2024. Last data update 11/04/2024.
Labour Costs (D) cover Wages and Salaries (D11) and non-wage costs (Employers' social contributions plus taxes less subsidies: D12+D4-D5)

The data shown in Fig, 7 confirm the great differences of labour costs per hour in Bulgaria compared with the average values of this indicator for the EU27 and the Euro-area.This indicator shows the low level of labour costs in the country during the last decade as a factor of stagnation of wages and incomes and inadequate labour policies.The resulting differences have caused higher labour migration out of the country as well as labour shortages that exert pressures for wage growth and are pro-inflationary because of need to raise the wages.
In Bulgaria, the situation is indicative of the negative impact of the inflation since 2021, not only because of the lowest amount of the statutory nominal minimum wage compared to EU member states, but also because of insufficient increase of the nominal minimum wage by 9.2% from April 1,2022 as it was already "consumed" by the rising inflation. As of June, 2023 the purchasing power of the statutory nominal minimum wage actually decreased by 6.6% compared to the same period in 2022. Almost 1/5 of the persons employed under the labour and public service legal contracts earn wages anchored to the nominal statutory minimum wage. Thus the workers and employees assigned to the statutory minimum wage have encountered serious difficulties to adjust to the rising cost of living, as the inflation has increased at higher rate due to the rising prices of energy and essential goods and services, which have a high share of expenses in the households'budgets.
As the Fig.8. shows that in Bulgaria the statutory minimum wage is set so low that it left workers living at risk of poverty even before the cost-of-living crisis began. Since 2021 the inflation, also driven by huge increases in profit margins, in addition to supply-side issues, has pushed the value of minimum wages down to a record low.

Figure 7. Rate of Inflation and its Impact on the Nominal Statutory Minimum Wage growth and on the Statutory Minimum Wage in EU Member states in 2022



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Source:Eurostat, 2024

The lowering of inflation rate in Bulgaria will be challenging in the medium term, given the limited scope for any active monetary policy under the existing currency board arrangement. Active labour policies are on the agenda of improving the flexicurity of the labour market in line with the policies of the European Pillar of social rights.

Due to the fact that the GDP per capita in Bulgaria is significantly lower than in the euro area, it is difficult to foresee the exact size of the inflation effect resulting from the structural adjustment of incomes and wages that is underway. On the Government agenda is to introduce an increase of the minimal wage from 2025 onwards as well as to proceed further with the liberalisation of the market for energy supplies which may cause higher inflation. In medium term the economy is expected to grow at a higher rate and as the income convergence proceeds, price level convergence is to continue. The outcome will depend also on the choice of the model of growth of the Bulgarian economy.

The EMU has undergone important institutional and functional changes while the euro area tackles the crisis and reforms its policies and institution. It is acknowledged that the "in-or-out" of the EMU is a question that has become more complex (Rehn, 2013). The design of the EMU reforms is still shaping due to the different approaches of the member states to the issues and the political process (Ville et al., 2015). Surely the present state of the EMU (as considered to be "EMU 2.0.") raises the requirements and the mechanisms and instruments for a higher degree of common system of sharing the burden of making the EMU a more effective and robust functioning Union.

The costs of entering the EMU have grown as a result of the post crisis reforms in the financial integration not only due to enhanced needs of compliance with new legal provisions. The differentiated integration within the EMU gives solid grounds for better access of the EMU member states to the new institutions for sharing the risks and costs of financial integration and its new modalities. The challenge is that the EMU is at a stage to be completed by common policies to ensure a well-functioning monetary union. The problem is to access the implications of the “shift from rules to institutions” in the EMU in order to accomplish completely the Monetary Union. For the future enlargement of the EMU the differentiated integration will play a very important role. Bulgaria’s preparation for the EMU has to take into consideration the fiscal capacity’s needs to join the EMU in its present state of EMU 0.2.

Conclusion

The main macroeconomic challenges to Bulgaria are: (i) how to sustain high GDP growth, and (ii) how to ensure that this growth translates into new employment opportunities. Success in both dimensions will depend on the country's ability to implement the necessary structural reforms. The implementation of the requirements for the EMU entry at the present stage of its new design as EMU 2.0 may be demanding higher costs before being admitted to the full membership. But it is much more rational to get on track of preparation for the EMU entry at a time when the reforms in the EMU are to be introduced

The accession to the euro area has been a strategic goal for Bulgaria for more than a decade but since mid2015 it has entered the stage of undertaking operationally planned activities to make the right choice and engage resourceful means to achieve full integration to the European supervisory and financial architecture. Bulgaria has become involved in the institutional reform process in favour of further deepening the integration in the EU but the reforms tend to raise the transitional costs of joining the new institititutional architecture of the EU integration.

The EMU has gone through a difficult but useful period of analysing the flaws in its original design, and has taken major steps to repair them. The new regulation contains tougher rules for fiscal policies, stronger oversight of macroeconomic imbalances, and a lender of last resort for sovereigns in the form of the European Stability Mechanism.The crisis has pushed the changes for the better to design prospective reforms by focusing on ensuring financial stability and in pursuing financial integration. The newly designed institutions and rules raise higher the requirements to comply with the EMU governance principles and institutions. The Single Market of the EU will be changing as the differentiated integration within the EU proceeds further. Beyond this, it is equally crucial that the reforms will contribute to a more effective and robust functioning of EMU as the core of the European integration.

In summarizing the main trends influencing Bulgaria’s integration to the EMU, one may underline the concerns that the EU integration process could not generate higher centripetal force for improving the rates of growth. Thus there is a need to foster new model of growth in the transformation to climate neutrality. The enlargement of the EMU may proceed further driven by shared policies for convergence support to the “catching-up” development of the new member states from Central and Eastern Europe.

At the present stage the EU faces challenges to implement a comprehensive programme to consolidate the Single market and the Economic and Monetary Union. By choosing priorities for further deepening of integration in the EMU through completion of the Banking and Capital Union and completing the further development of the Single Internal Market European Union’s leadership has laid the focus on policies to boost growth and the competitiveness of the Union.

In the context of the ongoing difficulties in the Eurozone and the EU as a whole out of the economic depression and overcoming the crisis, the medium-term prospects for restoring economic growth are important. Delayed recovery of economic growth in the EU inevitably has an adverse effect on the Bulgarian economy for which the external environment and European integration dependencies do not provide positive incentives for post-crisis development, but much rather determine the necessity of rethinking the alternatives to stimulate the national economy by domestic demand and economic co-operation and trade with all EU partner countries.

As major problems facing the prospects for economic growth in the EU and implications for Bulgaria can be viewed the following structural aspects:

- the challenges facing Bulgaria in relation to structural reforms in the EU post-crisis are determined by the development of the integration concept for Europe of "two speeds". Economic growth in the EU has sustained lower rates. Unemployment reached high levels that determine profound changes in social policy of nation states towards the implementation of the European Pillar of social rights introduced since 2017.. Economic convergence in Bulgaria has to proceed with taking consideration of social cohesion and active labour policies.
- the transition to long-term investment and growth as a priority for economic governance in the EU is crucial for Bulgaria. The question remains topical how to foster growth and raise competitiveness in order to avoid the risk to enter the second “lost "decade due to low rates of economic growth.

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