

The Bulgarian National Bank and the Political Process: 1997 – 1999

Dr Krassen Stanchev

This book deals with the current regulation of the Bulgarian banking system and its main problems. Next chapter aims to describe the setting of the political debate on the central bank's role under limited monopoly on the money supply after a currency board was introduced in 1997.

Political Aspirations and Currency Board

In 1998 neither bank regulation nor the role of the central bank, as prescribed by the law, could be seen to be outcome of gradual changes prompted by economic developments over the recent years and of the reform endeavor. The authors of this book rather analyze the half-expressed positions in political disputes and the following decisions, part of which remained unclear. The lack of understanding is of use to those politicians who defend the state involvement in the economy and the philosophy of redistribution. Precisely these aspirations are reflected by public opinion and the media. I expect that these aspirations will intensify in 1999 and will fuel the attacks on the currency board.

Practically no public discussion on the role, mission and values of the central bank took place in 1991-1992 (the first laws on the central bank, commercial banks and crediting after the onset of transition in Bulgaria) or in 1997 when the currency board was introduced. Neither was there a substantial parliamentary debate. The brief minutes of the respective sittings in the Parliament show that its members have spent much more time discussing the remuneration of central bankers than on what their work should be. During 1991-1995 the Agency for Economic Coordination and Development (AECD) was the single exponent of a critical view on the policy of the central bank. After 1995 the status of the Agency was relegated to that of a department in the Finance Ministry, with one unit observing the reform in the banking sector. And developments in the banking sector after 1995 stood in sharp contrast with the calm forecasts of this state body, presumably a corrective and a "brains trust" in the regulation of banks. The IMF and the foreign creditors were the only sources of institutional critique against the central bank in 1996. The "inside critique" took a direct form: loss of credibility, flight from the national currency and withdrawal of the deposits.

Such a reaction of the “public opinion” in the existing situation is correct and economically the only reasonable one. A more precise and timely information about the central bank’s policy and the status of the individual banks would probably have resulted in a faster loss of confidence, but also in a differentiated attitude towards individual banks and lower depositors’ losses. Reticence and the aggregate nature of the knowledge about banks in general prevented savers from rational choosing in which bank to deposit their money. In 1995 and particularly in 1996-1997 their “aggregate” response was a general avoidance of banks as a whole.

The possible introduction of a currency board and the inherent risks thereto were discussed in October 1996 - February 1997. This arrangement was initially proposed by Bulgarian analysts and institutions, though later interpretations leave the impression that the idea originated from the IMF. But still, the involvement of the IMF in the debate immediately before the presidential elections in 1996 was an influential factor in shaping the political environment in which the currency board was later introduced. This involvement provided a substantial backing to the currency board solution through an implicit (and later committed) support to the balance of payment. On the other hand, the IMF thus underpinned a new beginning in the Bulgarian policy by enhancing the respect and confidence in the new system. Parties to the debate were the newly elected president, the government, members of Parliament, managers of the Central bank, Chambers of Commerce, foreign investors, the IMF and World bank missions, investment bankers, Bulgarian and foreign analysts.

The subject and the participants at the debates can be structured as follows:

- the question who will introduce the currency board acquired importance for politicians¹;
- the technical parameters of the introduction of the board were left to the IMF and were only rarely discussed in public.

However, the involvement of the IMF gave the currency board a further interpretation as a system imposed from abroad. The board was by and large associated with the name of Michael Depler - the director of the IMF’s First European Department. The following phrase circulated among the politicians: “Economically I accept the currency board, but politically I am against it”. Regardless of the fact that most of the groups in the Parliament voted “for” the introduction

¹ Judging by the press releases, the then opposition leader - present Prime Minister presented the problem to the IMF in the following manner: the socialists are not able to introduce the currency board regime and to stabilize the economy, but we are able to do so.

of the currency board system, the explanations for such a vote indicate that under normal circumstances it would rather be “no”.

A specific institution (voluntary operating) was born in this period, which proposed alternative solutions adapted to different political scenarios: the Council for Economic Policy of the newly elected, but still not in office president Petar Stoyanov. During December 1996 - February 1997 the Council discussed the different scenarios and outlined a solution even to the worst of them – lifting the restrictions on foreign currency deals, acknowledgment of the actual substitution of the lev as a means of payment – which would materialize if the socialist government remained in power faced by a militant opposition. Under such a scenario an IMF-backed currency board could not be introduced.

The Council is no longer active in 1999 and some of its members hold positions in the Central Bank. The government elected with full constitutional mandate has assumed its responsibilities. Foreign advisors contact the president on an individual basis. The government has at its disposal its own commissions and think tanks. Until mid-1998 non-government economic experts held meetings with members of the Cabinet and the majority in the Parliament at specially arranged forums. The government perceives no need for exogenous reflection, especially after the three-years agreement with IMF was signed in the autumn of 1998. The supervisory functions of the IMF and the World Bank concerning the achievement of various parameters of the agreement are considered to be sufficient corrective to the policies of the government and the central bank. This in turn nourishes accusations that the economic policy decisions are taken outside Bulgaria. At the same time, the government makes no efforts to offer a vision on “what follows after the three-years agreement”, or “what is going to happen after 2001”.

An essential question to be posed is: to what extent can the inner consistency of the currency board be reproduced; to what extent can it generate confidence itself? The answer to this can be searched for both in the field of policy and in the practical handling of money and monetary institutions on the part of members of the society.

Experience and the attitude to it

It is well known that from mid-February 1997 until the legal introduction of the currency board in July 1997 the central bank did not provide financing to the government and the commercial

banks and operated as if the currency board was already introduced. Such a behavior was the technical basis for the agreement struck between IMF and the Caretaker cabinet in April 1997 which threw open the door to an agreement with other creditors from the Paris Club and the Group of 24ths. In other words, we have recent domestic evidence that, quite apart from the legal regulation of the central bank, the economic rationalism and monetary policy stability reflect values and political notions.

Pressed by the circumstances, the newly elected Parliament introduced changes in the legislation regulating the activity of the central bank, which gave a legal form to the practical reassessment of values. The Law on the BNB envisions a more complicated political procedure required for implementing changes in the central banking system which was established in 1997. It provided for the switching to the Euro (see article 29, paragraph 2 of BNB's Act) after 1 January 1999 without political dispute. BNB is authorized to take the technical decisions.

For the currency board regime to be changed a legislative act is required, together with an initiative for such changes and the respective readings. Actually the strength of the currency board system and the mechanisms for changes in it are not a separate problem. The fixed exchange rate and its final institutionalized form – the currency board are capable to reproduce stability given sufficient flexibility and competitiveness of the economy as a whole; these latter features are able to moderate and overcome external shocks to an extent, regardless of the fixed exchange rate. At the same time, if an initiative for changes in the currency board legal base arises in the situation of economic disarray and disorientation of values, it can itself create instability.

The political rationalization of the experience of the last two years, even if not persistent and somewhat half-expressed, evolved into a disagreement with the currency board system on the part of the opposition in 1999. It progressively acquires the form of discontent with financial discipline. The domestic dispute preceding the introduction of the system is now forgotten, save for the IMF's initiative. The signatures under the agreement struck before the last elections have faded. The memory for the vote for the law - still an expression of the sovereign will of the Bulgarian Parliament - is withered as forget-me-not. Increasingly perceived as something externally imposed, the currency board is adduced as an excuse for economically sound activities, which would be reasonable in any situation of transition (tightening the financial discipline, closing loss-making enterprises, rationalization of budget expenditures, privatization and restructuring). The rhetorical transference is on a whole range of reasonable actions: the

currency board is externally imposed, hence the discipline, liquidation, restructuring, etc. are imposed as well.

Even though it originated within the opposition, such kind of political disagreement with the currency board undermines slowly but irrevocably the confidence in the system. The politicians' job is not to use this system as an excuse, but to convert the rational economic actions in values.

“The health of the money” and other values

Every citizen's handling of money can in practice generate confidence in the domestic currency only if it proves its reliability on a daily basis. The institutions of money circulation would work in the same direction, if they do not run against individual assessment and experience.

No in-depth specialized discussion on the health of the national currency has taken place in Bulgaria. Alternatives to the monetary policy and central bank supervision implemented in 1991 – 1996 were proposed mostly by foreign observers and institutions and were not presented or discussed in the specialized press. This is still true for the conjectures and explanations of the stability of the currency board mechanism already almost two years after its introduction. The first deep consideration of the role of the central bank as a monopolist in money emission and a money supply regulator took place just in the beginning of 1999 (on the occasion of BNB's 120th anniversary) in a narrow circle of experts, and was not attended by political leaders or the media. This discussion, together with the bank archives and reviews, published on the occasion of the anniversary, undoubtedly show that every possible form of central banking has been used in Bulgaria and so none of them contradicts Bulgarian history². The editor of those volumes thinks that most of this history could be viewed as a precursor of the current situation.

Probably the only form not experienced with in independent Bulgaria is free banking. This is a monetary system with no central bank, in which bank notes and coins are issued by legally unrestricted commercial banks. The best described system of this type operated in Scotland in 1716 – 1844³. Other, less completed forms of such a system can also exist. In mid-19th century, during the time of Otoman Empire, a similar system was in place in the lands of nowadays Bulgaria where several convertible currencies circulated, exchangeable for gold coin or napoleon, while crediting was left to the free assessment and contracting between those who

² See: 120 years Bulgarian National Bank: 1879 – 1999. Under the general editing of Roumen Avramov. Sofia, BNB, 1999.

³ See: Lawrence H. White, Free Banking in Britain: Theory, Practice and Debate, 1800 -

supplied and those who demanded loans. Ivan Bogorov (in the mid-1870s) recommended that Plovdiv create several free credit institutions, following the experience of other cities. The essence of that form of free banking, even though half-way, was that beyond the reserve convertible currency, used for domestic payments, remains the freedom of negotiating the terms of credit. The totally unknown or only scarce usage of the free provision of formal banking services in modern Bulgaria and the dominance of the central bank is may be one of the reasons that even today a “care for the system” function is attributed to the central bank, without mentioning that such a function can well be performed by independent institutions at acceptable cost.

After the introduction of the currency board there are two examples that illustrate this overloaded care of the central bank for the business of every citizen, which in fact deprives economic agents of the responsibility for risk taking. These are namely the fund for deposit guaranteeing and the credit register. The central bank is partially involved in the management of the former and entirely manages the latter. The professional discussions in 1997 on the possible alternatives of regulation of these two institutions⁴ were totally dominated by the support for the over-personal responsibility of the central bank. In the field of deposit regulation the Estonian model implemented together with the currency board – avoidance of common over-bank guarantee fund and voluntary insurance of deposits - proved totally unacceptable⁵ . What concerns the credit register, no support was found for a private (or at least not connected with the central bank) publicly accessible institution (institutions), which makes easier the inspection of the credit history of different clients of the banking system and is developed on the basis of qualitative indicators of their behavior as debtors⁶ .

Let us now turn back to the “health” of the national currency as a value. Obviously the purely legal guarantees for the stability and protection of the interests of bank clients are not sufficient to ensure currency reliability. They boil down to bank supervision, the establishment of qualification requirements for bank management, the requirement that bankers avoid conflict of

⁴ Founded entirely or partly by the Institute for Market Economics.

⁵ In the debate in Bulgaria such model was defended by the former deputy governor of BNB Emil Harsev, Sir Andrew Walters and the author of these lines. The administration of the fund for deposit guaranteeing in its present form was the ground for institutional conflict: the commercial banks capitalize the fund, but in fact in is administrated under the supervision of the central bank and the ministry of finance; practically this worsens the possibility of interbank exchange of information.

⁶ Since 1993 several initiatives for such regulation of the information about debtors are known. None of them transcends the routine protection of debtors – in this case by barring immediate access to their “debtor biography”. One should also note that this routine was transferred to bank management even after the introduction of the currency board.

interests and deem the interests of their clients to be more important than their own interests, and the relative independence of inside control (subordinate only to the shareholders).

A currency is considered reliable if it serves satisfactorily all the functions of money and permits the agents in a given economy to participate effectively in the exchange. In other words, the currency enjoys the confidence of the citizens if each of them alone has confidence in it; i. e. he exchanges commodities and services, measures value and accumulates wealth via or in this particular currency.

In certain market sectors in Bulgaria there is denomination or even actual settlement of the deals in foreign currency. Probably in these sectors the said functions are easier to serve in foreign currency and at lower cost. From the point of view of the central bank and the legal institutions however, such currency behavior could be treated as illegal. However it is out of doubt that the currency board, together with the whole institutional framework, could generate confidence if they maintain the mobility in the economy and do not try to adjust the real economic activity to their own liking.

The problem with the political process still remains even after 1999. There is lack of critical mass to shift the reading of economic developments towards a pragmatic approach.