

The currency board and the single European currency – the valuations in the accounting

Ivaylo Tonchev¹

¹ University of Economics Varna, Bulgaria
tonchev@ue-varna.bg

Abstract. The aim of the publication is to present opinions of prominent economists, politicians and researchers concerning the policy of introducing the euro in Bulgaria as the main monetary unit. The research method is content analysis of publications from specialized economic publications, from non-specialized publications, interviews of economists, politicians and businessmen. The scope of the research covers specificities of the process of switching from one currency unit to another influenced by policy decisions has a significant impact on the accounting estimates applicable in the financial statements of economic operators. Public attitudes both for introducing and refusing to maintain the currency board are analyzed. The practical implication of the paper concerns new rules that have to be adapted directly relevant to the introduction of the single European currency (EUR).

Keywords: accounting valuations, currency board, euro, risk.

Received: 25.10.2022

Revised: 08.11.2022

Accepted: 14.11.2022

Published: 30.12.2022

1. Introduction

In recent months, after Bulgaria and the world came out of the grip of COVID-19, prominent figures from the world joined in the discussion taking place in the public, media and economic scientific space. As names of one of the most prominent participants in the discussion can be indicated: Steve Hanke, Levon Harpanzorian, Asen Vasilev, Georgi Saryski and others.

The adoption of the euro in the EU Member States has been and will be a very important and essential step towards full community accession. With this step, the country concerned declares not only its affiliation and the sharing of common European interests, policies, culture and values, but also shares the burden of economic responsibility for the stability of the single common European currency.

All this, as well as several other prerequisites, determine the topicality of the question Of and against the Euro. Of course, such debates and discussions are not and are not conducted only in Bulgaria, they are of serious political and public interest in other Member States.

This publication aims to provide an overview of the latest reasons, positions and opinions for and against the adoption of the euro as a national currency, as well as the impact of this process on accounting assessments.

2. Main body

In recent months, a significant person about the transition of the Bulgarian economy and what happened (from a financial and economic point of view) in the 1990s has come up with a startling stance on Bulgaria's entry into the Eurozone. In an interview with BTV for the show "This Morning" with interviewer Zlatimir Yovchev with guest Prof. Steve Hanke, known in Bulgaria as "The Father of the Currency Board", an adviser to President Petar Stoyanov, winner of doctoral honoris cause from the Bulgarian Academy of Sciences, the question "Who will win and who will lose the most if Bulgaria joins the Euro zone?" – his answer was "... the Bulgarian people will lose out on this." From this moment on, the discussion between politicians, economists and the CITIZENS of Bulgaria has become significant. As talking points of his position, the interview can be taken (Hanke, 2022)out: 1) the risk of higher inflation will be increased; (2) the lack of an economic analysis of

the benefits and costs of switching from the currency board system to the euro; 3) why do "this thing secret"; 4) "... why abandon something that works?" the currency board said.

Another famous and public figure involved in the debate is Levon Hampartoonian, who was deputy minister of economy in the cabinet of Ivan Kostov, former Executive Director of the Privatization Agency, twice banker of the year, winner of the Burov Prize. In a transmission to BNT 1 – Levon starts the day expressing the view that we have already joined the euro through the (Hampartoonian, 2022) currency board, as well as since 2007 with our entry into the European Union (EU) and the adoption of the obligation to introduce the euro. Earlier, that Bulgaria did not meet the criteria for introducing the euro, Hampartoonian reacted sharply and said that it was controversial to what point he was the father of the currency board in Bulgaria. He is a wonderful university lecturer, but he is not responsible in the way that politicians and people who live here. According to Hampartoonian, the adoption of the euro is useful for Bulgaria and is a geopolitical anchor that will keep us in the orbit of the EU and THE EU. In front of another media, Bloomberg TV Bulgaria in the show "Club Investor" with host Ivaylo Lakov – Hampartoonian declares "The political risk to Bulgaria is one of the highest of the countries in the EU because of the ambivalent position of politicians regarding the EU, NATO and the entry into the euro area. This uncertainty discourages long-term foreign investment in Bulgaria and they are redirected to politically more stable countries." (Hampartoonian, 2022) .

Asen Vasilev – Acting Deputy Prime Minister and Minister of Finance (for the periods 12.05.2021 – 16.09.2021 and 13.12.2021 – 02.08.2022) publicly shares his views on the introduction of the euro, stating several reasons: "The first is that with the currency board we have already introduced the euro into the economy... Officially adopting the euro gives us a place in the room where decisions are made about what the policy should be and our voice will be heard." (Vasilev, 2022)

Of course, there are opinions at the other pole, like the businessman and active participant in economic shows and debates – Ivaylo Penchev, who, when participating in TV1, tv show "The Questions" (Penchev, 2022) says "the adoption of the euro tells the world: We are so lame that we do not deserve independent monetary policy and should be managed by European officials... I do not share the euphoria that we will become dependent on something else from the EU. It's not going to affect businesses in a particular way, people might get poor.'

Ass. Georgi Saryski from the Institute of Economic Research of BAS, before "TRUD" states "The radicals for the euro often put a sign of equality between our currency board and the entry into the euro area, only nothing can be further from the truth". He also shares the view that "... Bulgaria will lose the right to an independent monetary policy" with the adoption of the euro. As an example of a negative impact on small economies after the adoption of (Sarysk, 2022) the euro, he points to Greece, which in 2007 was 93% of the European standard, now reaches only 65%, in Slovakia the indicator is deteriorating by 8 points, and this trend is observed in other countries on the periphery of the European Union. conclusion says that this initiative is insane and why all the haste is.

After the debate about the impact of the euro on the economic situation of the country when it was introduced, it is inevitable to ask the question: How would the new monetary unit affect the valuations of resources owned and managed by business?

This cannot be answered unilaterally for a number of reasons:

- 1) The uncertainty of whether Bulgaria will be able to meet the requirements for entering the euro area;
- 2) The level and rate of inflation for the foreseeable future, both nationally and globally;
- 3) Market volatility due to global resource limitation (from a macro economic point of view) as well as market risk;
- 4) The global political risk influenced by the increasing approval of patriotic parties and increased military action worldwide, as well as the short terms of office of the Council of Ministers;

In the context of the existing reality and economic environment, an attempt will be made to analyze and assess the impact for some of the factors advocated above on estimates of assets reported and managed by the business.

According to IFRS 7 Financial Instruments: Disclosure – Under Market Risk defines "The risk that the fair value or future cash flows of the financial instrument will vary due to changes in market prices. Market risk consists of three types of risk: currency risk, interest rate risk and other price risk.'. In the context of the definition presented, the materiality of the currency risk that would occur when entering the euro zone is clearly highlighted. For currency risk, a legal definition can again be found in IFRS 7– the risk that the fair value or future cash flows of the financial instrument will vary due to changes in exchange rates. Interest rate risk is known as a risk that the fair value or future cash flows of financial instruments will vary due to changes in market interest rates. At first reading, there is a great closeness/ similarity between the definitions of currency risk and interest rate risk, but nevertheless they are different factors capable of influencing the assessment of the property condition of the enterprise. It should not be overlooked that definitions speak of a financial instrument,

but should not be overlooked and forgotten (without putting in place equality) that an enterprise is a set of rights and obligations expressed from a financial accounting point of view such as assets (resources) and liabilities (sources). On the basis of this reasoning, the definitions of the risks concerned presented and adopted above could also be applied in full to the non-financial (material) resources that an entity manages and exploits.

Some measures have been debated intensively in recent months, both nationally and globally, concerning the overcoming and/or retention of inflation. A number of countries and global financial institutions have implemented less popular measures so far, such as increasing the cash mass, directly interfering with market mechanisms, such as withholding the prices of basic resources (electricity, fuels), subsidising households in order to ensure their standard of living and maintaining the stock market, leading to the preservation of the revenue side of indirect tax (VAT) budgets, excise duties, etc.), an increase in the budget deficit financed by new loans/debts, etc.

The elements of these monetary and fiscal policies will lead to changes in interest rates globally by the European Central Bank (ECB) and the Federal Reserve (Fed). A Reuters poll (Todor Shishkov, 2022) published by CAPITAL shows the ECB will raise interest rates by nearly half a percentage point by the end of the year and even more drastic measures. The Fed raised its key interest rate by half a point, the sharpest rate hike since 2000. Economists and CNBC executives say the Fed's efforts to curb inflation will lead to recession.

From a financial and accounting point of view, such an increase in the underlying values will lead to an appreciation of the loan financial resource, which will put investors ahead of the choice of investing in property/equity instruments (such as shares, units, etc.) or debt instruments (such as bonds, deposits, etc.). This will lead to caution on the part of investors and the banking sector (risk assessment more conservatively), which in turn will reflect a decrease in investment in companies, while in the short term it will support production volumes, but in the long term it will shrink them (due to the lack or limitation of the introduction of innovation). The development of most modern corporations is based on investing borrowed funds, not so much on reinvesting accumulated profits. This approach has enabled them to make future payments based on new production capacity. But how would that affect the valuations of the resources held by the business. The basic rules of the economy do not give way to all actions, namely as production capacity decreases and supply decreases, as production volumes shrink, a unit of manufactured product will have to bear most of the constant/overhead costs, which in turn will lead to a rise in the prices offered by a producer. After all this, the market will increase the price levels not only of production raw materials, but also of basic resources. In the face of inflation, which some economists see as creeping, in recent months we have seen its impact on purchasing power, there will be a need to update estimates of business-owned production resources. i.e. the impact of interest rate risk will be material in the long term.

Combined interest rate risk with foreign exchange – characteristic of our country under the terms of a policy of switching to another currency (euro) and the presence of inflation not only domestic, but also globally, will again lead to substantial price volatility. As mentioned above, in several countries on the periphery of the euro area since the adoption of the euro, there has been a decrease in the indicator of a European average standard. The latter is a clear sign of a decrease in purchasing power and consumption, which is largely due to speculative increase (rounding) in prices from currency conversion (calculation) to the new base currency. The change in market prices (estimates) of at least 8 points is substantial and will again lead to the need to review and update the valuations of managed resources by the business.

3. Conclusion

In conclusion, it can be summarized that accounting is facing a new reality and a dynamic economic environment influenced by several factors, such as political, market, interest rate, foreign exchange. All of them will cumulatively have a serious impact on market valuations of resources that will need to be transferred to previously acquired resources from the business to represent the financial and property situation of the reporting agents properly and fairly. All this should happen with the application of a single methodology to respect the principle of comparability. An ongoing question arising from the above-mentioned factors, risks, changes concerning valuations is "Will there be a specific regulatory framework in force or will the general rules set out in the accounting bases (Accounting Standards) apply?". The final answer for the adoption of the EUR is in the hands of Bulgaria's political elite. What will happen in a highly volatile political environment is yet to be seen. In summary of the positions presented by prominent politicians and economists, a unified position supported by strong arguments on the single European currency cannot yet be highlighted.

Literature

- Hampartsunyan, L. (2022a). *The day begins*. *BNT1*. 14 May.
- Hampartsunyan, L. (2022b). *The political risk for Bulgaria is the highest among the EU countries*. [online] *Klub Investor*. 21 May. Available at: <https://www.bloombergtv.bg/a/20-klub-investor/106702-hampartsumyan-politicheskiyat-risk-za-balgariya-e-nay-visok-sred-stranite-ot-es> [Accessed 21 May 2022].
- Hanke, S. (2022). *The Bulgarian people will lose from the adoption of the euro*. [online] *This morning*. 13 May. Available at: <https://btvnovinite.bg/predavania/tazi-sutrin/prof-stiv-hanke-ekskluzivno-pred-btv-balgarskijat-narod-shte-zagubi-ot-priemaneto-na-evroto.html> [Accessed 13 May 2022].
- Penchev, I. (2022). *Is there a blockage in the control system*. [online] *TV1*. 6 Jul. Available at: <https://youtu.be/WRyeqqKCvDs> [Accessed 6 Jul. 2022].
- Sariyski, G. (2022). *Joining the Eurozone is a crazy initiative*. [online] *TRUD*. 2 Jun. Available at: <https://trud.bg/duz-grigor-sarian-institute-for-economic-research-of-ban-pre-labor-entry-in-euro/> [Accessed 2 Jun. 2022].
- Shishkov, T. (2022). *Reuters poll: ECB to raise interest rates in July*. [online] *CAPITAL*. Available at: https://www.capital.bg/biznes/finansi/2022/05/19/4347371_prouchvane_na_reuters_ecb_shte_vdigne_lihvit_e_prez_juli/ [Accessed 19 May 2022].
- Vasilev, A. (2022). *With the currency board, we actually introduced the euro*. [online] *DNES.BG*. 13 May. Available at: <https://www.dnes.bg/eu/2022/05/13/asen-vasilev-s-valutniia-bord-realno-sme-vyveli-evroto.529931> [Accessed 13 May 2022].