

EURO: MYTH AND REALITY

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Abstract:

Last year the Euro turned 25. In this work, we discuss future opportunities and challenges for the use of the euro at three levels. First, taking stock from the Euro Area (EA) achievements in the global rivalry, we summarize the euro's international role and its potential to replace the American dollar as the currency of choice. Second, the paper highlights controversy between the catalytic role of the euro for further economic integration in Europe in an environment of global market and political fragmentation and its use as a political symbol. Based on the findings, we discuss the need Bulgaria as an EU member to strengthen its economic governance in response to challenges.

JEL Classifications: E020, F31, F33, F65, F360, H1

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Introduction

This work has three interrelated goals and consists of three sections. First, based on the theory of currency globalisation, we evaluate the perspective of the euro as an international currency. Second, the paper summarizes the scope and limitations of the Euro's integration power taking stock from application of the theory of optimum currency areas (OCAs) to the EA's economic and monetary convergence in the last 25 years. This approach touches upon the political and economic fundamentals of the euro and helps to better determine the cost-benefit balance for its current and potential users within the evolving legal, institutional and regulatory architecture of the European Union (EU). An in-depth summary of the literature on currency globalisation and OCAs is intentionally omitted here as it is outside of the scope of the current work. A good overview, however, can be found respectively at Bénassy-Quéré (2015) and Alesina et. al. (2003).

¹ Disclaimer: The opinion expressed here is entirely of the author and should in no way be attributed or linked to that of the institutions in which he has worked or is working, or to their policies. Any inaccuracies, omissions or errors are entirely the fault of the author.

Third, based on above findings and Bulgaria's own experience as an EU member, the paper adds value to the ongoing domestic debate for adoption of the euro on January 1, 2026. The analysis intentionally goes beyond the traditional discussion on Bulgaria's ability to sustainably meet the Maastricht Criteria for nominal convergence. We apply literature on sound economic governance² that followed the groundwork of Acemoglu et. al. (2005) to assess ability of the Bulgaria's policies and institutions to deliver sustainable growth and income catch up within an incomplete monetary and economic union. This approach focuses on the role of institutional strength, policy coordination, and accountability, elements which are also well incorporated in the theories of currency globalisation and OCAs.

Perspective of the Euro as an International Currency

The euro emerged as a fundamental political project in the late 1980s and early 1990s which European Union (EU) leaders established to integrate Europe. It is often considered as one of the most significant financial, economic and political moves in modern European history, which has also triggered the global popularity of the currency unions in that period. In line with the three-stage process initiated under the 1987 Single European Act and 1992 Maastricht Treaty, the euro was first introduced in 1999 as a virtual currency with the functionality of an accounting unit. On January 1, 2002, physical notes and coins were also circulated to serve as a means of exchange and store of value for more than 300 million Europeans from the then 12 EA member countries. Since then, the EU has grown to 27 members, and the EA has enlarged to 20 members³. The latter members consist of mostly small and open economies from Central Eastern and Southeastern Europe (CESEE) without systemically important financial markets.

Early predictions were that the euro could challenge the US dollar as a global currency soon after its introduction but did not materialise. The main factors behind these expectations, however, were not related to the internal market strength. Bergsten (1997) stressed serious US macroeconomic policy lapses, and Chinn and Frankel (2005) highlighted success of the EA Eastern enlargement. The first decade of EU existence coincided with a surge in globalisation, which also fuelled such expectations but underestimated deficiencies in the EU architecture. The new monetary regime in Europe has supported global growth in the early 2000s, mainly through plentiful debt finance. Within the EU, this has benefited the countries with big trade and current account deficits, such as France, Spain, and most of the new EU member states. Increasing EU financial

² A good overview of the underlying governance principles and policies is provided at the IMF (2018a).

³ As of April 30, 2025, the EA members are Austria, Belgium, Croatia, Cyprus, Estonia, Germany, Greece, France, Finland, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovak Republic, Slovenia, and Spain. The EU members which do not use the euro as a national currency are Bulgaria, Czechia, Denmark, Hungary, Poland, Romania, and Sweden.

market regionalisation in the 2000s has helped the EA economies to better withstand global shocks than it would otherwise have done. The benign global economic and financial conditions have also eased pressure on European institutions. This has made institutions less vigilant to underlying vulnerabilities of the national economies and potential risks associated with growing budget deficit and public debt (Marsh, 2009).

A deeper dive in the EU architecture reveals a few important nuances and flaws related to the size and depth of the market and its political power. The introduction of the euro and establishment of the 1999 EA, within the EU, with the highly independent European Central Bank (ECB) as a new common emission bank has brightened prospects of European financial markets development. However, some of the EU members with systemically important markets, like the United Kingdom (UK) and Denmark⁴, used the opt-out clauses in the Maastricht Treaty to signal their intention to remain outside the EA, while another systemic market country - Sweden⁵ - delayed the euro adoption. The UK's rejection to become a member of the EA from the very beginning significantly reduced the euro's ability to become a global reserve asset. Additionally, this rejection constrained development of the euro bond markets in the long run (Portes and Rey, 1998). Posen (2008) implies that the EAs political influence remains considerably low beyond its close neighbourhood too. Thus, launching the euro as an international currency has not fundamentally changed the post-World War Two (WWII) Bretton-Woods international monetary system.

Chances the euro to rise as a number one world currency further deteriorated in the 2010s. The UK exited the EU in 2020. Following the 2007-09 Global Financial Crisis (GFC) and 2011-13 European Sovereign Debt Crisis (ESDC), the EA legal, institutional and financial architecture underwent abrupt changes, like introduction of the European Stability Mechanism (ESM) and plans for creation of Banking, Fiscal, and Capital Market Unions. These changes were not always well sequenced in terms of time and policy, and some of them remain incomplete (IMF, 2018).

Inconsistent communication policy has also limited the chance of the euro becoming a global currency. From the very beginning of the EU's third phase, the ECB has highlighted that establishing the euro as a dominant global currency has never been the primary objective (ECB, 1999). Since 2019, the ECB has changed its attitude to currency internationalisation and framed the issue in geopolitical terms (Spielberger, 2025). In November 2023, the ECB launched the digital euro preparation project after consultations with the European Parlia-

⁴ In difference to the British Pound, however, the Danish Krone has been included from the very beginning in the so-called EA waiting room - the Exchange Rate Two Mechanism (ERM II).

⁵ Sweden is the only founding EMU member which approved the Maastricht Treaty in the 1994 referendum and joined the EU next year without considering an opt-out for the euro adoption. Since then, the country sustainably meets the nominal convergence criteria most of the time. Sweden would have adopted the euro on 1 January 2006, but the 2003 referendum rejected membership of the EA, and the government decided to delay inclusion of the Swedish Krone into the ERM II.

ment (ECB, 2024a), which could become a game-changer. Depending on its legal and institutional design, however, introduction of the digital euro may further complicate macroeconomic policy transmission too.

According to the most recent ECB report on the international role of the euro (ECB, 2024), the euro remains the second most important currency in the international monetary system. This is despite the persistently declining share of the EA in the global GDP at purchasing power parity (PPP), which was 17 percent in 1999 and less than 12 percent in 2023. The share of the United States in the global GDP at PPP has also fallen, from 25% to 17%. In view of the size criterion, it is the Chinese renminbi, and not the euro, that should be expected to rival the dollar in the foreseeable future, given that the share of China in the global GDP at PPP has risen from 10 to 22% over the same period.

Depth and stability of currency and financial markets appear less favourable to the euro than the dollar because of structural factors, like the banking-centric financing model, incomplete capital market union, and lacking fiscal backstop (Bénassy-Quéré, 2015). Approximately 30% of the 2023 global foreign exchange turnover⁶, 23% of the global debt and 20% of the central banks' foreign exchange reserves were in euro. Yet, the euro remained far behind the US dollar which held 87%, 63% and 58%, respectively. The changing global economic landscape also increases the onus on European policymakers to create the conditions for the euro to thrive. Its international role can be primarily supported by deeper and more complete EU market and adequate policies, but the pace of economic integration and lack of sufficient political and military power limit its geopolitical influence (Tokarski, 2024). The current US policy-making under the president Trump administration has had a strong impact on the value of the dollar, yet the euro has gained little ground as an international reserve currency. This is due to rising competition from the emerging commodity-based currencies.

One can conclude that it is a myth that the euro to become a currency of choice in the 2030s. Nonetheless, the reality is that monetary integration is one of the few areas where the EA has already managed to achieve a high degree of strategic autonomy. The euro has become a full-fledge regional currency, even though the EA is often seen in isolation from the EU with the post-GFC amendments to the 2009 Treaty of the Functioning of the EU. The adoption of the euro has united EU financial markets too, which is critical in the current times of global fragmentation and flailing multilateralism.

The Fundament of the Euro

Establishment of the EA in 1999 with the independent ECB and the 2002 introduction of paper euro were well in line with the OCA theory. These have

⁶ Since transactions in foreign exchange markets always involve two currencies, foreign exchange turnover shares add up to 200%.

denationalised money in Europe and put its North and South in an irreversible legally binding marriage, despite their diverse culture and differences in economic and institutional structures. The project has also attracted the countries from the CESEE to consider EU accession immediately after the successful transition from plan to market. The euro has pushed the continent towards a pan-European financial and business system of globalising trade and investment.

At the same time, the cost-benefit analysis under the OCAs theory of adopting a common currency has little applicability to many of the new members of the EU from CESEE. These markets are non-systemic for the EA and so small that the macroeconomic cost of embracing the euro is negligible (Buiter and Sibert, 2006). This is a common real-world argument, one that has led many small nations to abandon their currencies in the past too. Nitsch (2006) also concluded that the CESEE countries achieve high intra EU-trade integration before adopting the euro but converge less in terms of the real income without having the common currency as national.

Adequate deepening of the common market is what matters most for the EU from the sustainable economic welfare perspective. Marsh (2009) highlighted that in the early 21st century, the EU has emerged as a dynamic marketplace containing many trans-national companies that benefit from the ongoing globalisation. Introduction of the euro contributed through reduction and stabilisation of the EA interest rates in the 2000s, which converged toward the low German benchmarks. The single currency has also enhanced price transparency, boosted intra-EU trade, and strengthened the EU global economic influence (Padoa-Schioppa, 2004). Before GFC, businesses operating within the EA benefited from reduced transaction costs and easier financial planning, which boosted welfare too.

Unfortunately, the increase in the pace of globalisation has also unleashed new forces, like rising inequalities and disparities among the EU members and integration fatigue. Surprisingly, early warning signals for policy mismatches have emerged in some of the founding members with the most dynamic economies. These include Ireland, Netherland and France, as evident from the revised Treaty referendum setbacks in 2000s. The signals have been underestimated during the initial euphoria caused by the euro adoption. The inadequate knowledge and capacity for macroeconomic management at both national and EU level, have also provoked the unnecessary 2005 relaxation of the Stability and Growth Pact (SGP) rules during the upside of the EA business cycle (Schuknecht et. al., 2011).

Later, during 2007-9 GFC and 2011-13 ESDC, chaotic political efforts to please the hyper-nervous EA citizens and markets triggered a chain reaction of nationally minded policy measures across the continent, which endangered the integrity of the euro. The Draghi (2012) political message that „*within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough.*“ well summarises the difficult, unpopular, weak-sequenced and costly expediency-centric reforms. These reforms have had three main

consequences, namely: i) made participation of the forthcoming members in the EA less rewarding, ii) turned the integration process against the EU founding values to put citizens' wellbeing at the centre of unification, and iii) widened the gap between governments, including the European Commission, and people. They have also brought initially unexpected higher intensity to resistance against deepening of the economic integration and have strengthened protectionist and populist forces, as evident from the most recent election results for the European parliament.

The myth that the euro itself can guarantee economic stability, prosperity and equality for citizens in all members has been shattered in the 2010s as EA members have been forced to face the complex reality. While the euro has facilitated trade and investment by eliminating exchange rate fluctuations, it has also exposed structural weaknesses in both the EA institutional architecture and in the economies with weak macroeconomic fundamentals and policies. Another myth that the euro creates a level playing field and puts all member countries on equal footing has been dismantled. In the 2010s, countries such as Greece, Spain, and Italy have struggled most under the single currency, as they have been unable to regain competitiveness simply through an exchange rate devaluation. Lack of political will and the inability to induce the necessary internal devaluation led to a prolonged instability and caused overall slowdown in the EA growth potential. This is despite the ECB's unconventional monetary policy of zero-lower bound rates.

The euro, currently interpreted mostly as an emblematic political project to circumvent the needed austerity and structural adjustments in many European economies, confronts the objective requirements of today's fragmenting global markets. It demonstrates that political ambition sometimes comes at the expense of economic pragmatism, as structural differences among member states remain unresolved. The ECB's common monetary policy of one-size-fits-all cannot always suit the diverse financial and economic conditions within the EA. The ECB is also poised to keep interest rates too low (Bletzinger and Wieland, 2017), mainly due to the lack of a well-functioning fiscal union where the central authority can effectively redistribute resources to struggling regions. This exacerbates asymmetric shocks and makes the affected countries prone to crises.

The establishment of the 2011 ESM to compensate for the incomplete fiscal union has a few distinguished features. The ESM has temporarily alleviated the citizens' high initial pains from the European sovereign-banks nexus through debt restructuring in members such as Spain, Portugal, Ireland and Greece. In contrast to the International Monetary Fund (IMF), however, its financing structure does not offer the needed credible backstop going forward because of heavy reliance on borrowed resources in an environment of already highly indebted sovereigns. Recent ESM reforms, which have strengthened the EA burden sharing potential through additional debt accumulation, have been widely criticised.

De Grauwe (2013) concluded that the ESM architecture could be a deterrent for new members or countries in financial distress. Stiglitz (2016) underscored

that the ESM is a costly solution because it can force members to impose inadequate austerity conditions. Blyth (2016) noted that pressures for political realignment across crises cases that compound the economic problems of stagnation in the whole EA harm overall growth potential of the region. Matthijs and Blyth (2015) observed that commitment of large amounts of potential taxpayers' money to the ESM sidelines the EA and EU institutions from the macro policy decision-making, while putting the European Council firmly in charge of crisis management. To counterbalance the latter, the post-GFC architecture developed a sophisticated multi-layer balance of power among the EU institutions⁷, which risks timely responses to potential vulnerabilities and risks.

One can hardly conclude whether the post-GFC institutional reshuffles in the EU lead to guaranteeing conditions established by the OCAs theory, as well-demonstrated by the analysis of the UK's Treasury (2016). This is because of the sharp division between the political economy and the economic welfare gains from euro membership in the 2020s. The forthcoming EA and EU members may not benefit as much as the founding members from the „creation of extra trade“ since this effect may have already been exhausted, as indicated by earlier analysis of Baldwin (2006). Trade data in the last two decades suggest that the trade and current account deficits in most of the EU members have deteriorated. In the current globalized market, importing goods allows the nation to consume at a lower cost, while export reflects the true economic cost of the resources used in making them, so exporting per se is negative from the welfare perspective.

From a political and economic policy perspective, things are just the other way around. Policymakers often hear from exporters who want improved access to foreign markets, as well as from domestic firms who want protection from foreign competition. Policies that promote imports are a hard sell, but consumers who benefit from cheaper imports rarely connect trade policy to the prices they pay in the shops. In this political climate, policies that promote exports are win-win, politically speaking. However, today's reality makes such a macroeconomic policy implementation difficult in the EU given the EA vulnerabilities to shocks. For example, the Russia's invasion of Ukraine has sent food and energy prices soaring, hammering the terms of trade for import-dependent nations and Trump's trade policy has rippled outward, potentially crippling financial systems and inflicting serious harm on the global economy.

Going forward, inevitably the EU should also properly address emerging security challenges triggered by higher confrontation between global powers in the 2020s. Those chiefly include, cyber and hybrid threats related to digitisation and penetration of artificial intelligence, declining cash usage and rising transaction costs following the growing mutually imposed economic sanctions. All

⁷ The European Commission gained sizable future power in monitoring member states' fiscal policies through the „European Semester“. The ECB won large discretionary powers not just over monetary policy, but also over the macro- and prudential banking supervision and banks' resolution. The European Parliament managed to stage a major coup against the European Council by launching a system of „Spitzenkandidaten“ during the European elections.

these risks require even more sophisticated EU coordination and institutional architecture. Such an environment may further challenge the effectiveness of the ECB monetary policy and increase social division in the backdrop of proprietary financial solutions, like fintech and cryptocurrencies, in attempts to preserve national economic sovereignty. Although such an analysis remains beyond the scope of this paper, the post-GFC EA experience with technological innovation in finance suggests one should not exclude a need for another intervention of epochal proportions by the ECB, including through introduction of the digital euro.

What matters most for Bulgaria's decision to join the EA on January 1, 2026?

Bulgaria's experience with the EU discussed below suggests that domestic political leaders and policymakers are behind the curve on the complex and evolving nature of the EU architecture and related economic challenges and opportunities. They remain generally short-term looking, retroactive and prone to ad hoc, untested or unjustified decisions that are often detrimental to the long-term well-being of citizens. This governance style has been facilitated by the inadequate institutional capacity and incomplete frameworks, which result in low transparency, minimal accountability, and slow pace of convergence to the EU average GDP per capita at PPP. High domestic political instability further exacerbates these issues.

Preoccupied by its own transition challenges, Bulgaria was on a different page during the late 1980s and early 1990s when the EU project gained a momentum and many CESEE countries started its practical implementation through privatisation and sharp market liberalisation. Low political priority of the EU membership led to a prolonged accession process and deprived the 1990s domestic macro-stabilisation from a credible anchor. For instance, the domestic political debate to request membership in the EU took five years. Not surprisingly, the first readiness assessment prepared by the European Commission in mid-1997 was negative, also reflecting the previous year's deep domestic economic and political crisis.

Bulgaria's painful transition from plan to market in the 1990s ended with the mid-1997 introduction of the D-mark based currency board arrangement (CBA) and the legal provisions the exchange rate to be automatically re-based to the euro at the time of its appearance. At that time, the country made a strategic political choice to use the euro as a nominal anchor for its macroeconomic stabilisation in contrast to foreign trade structure, which suggested the US dollar as a base currency (Manchev, Mihaylov, 1997). Geographically closely linked to Europe, in the 2000s Bulgaria became one of the constant number of countries which strongly rely on the euro as a reserve currency and a currency to issue external debt. Nonetheless, while the trade flows swiftly adapted and the EU share in the Bulgaria's foreign trade of good and services reached 60 percent in the 2000s, the accession remained protracted.

It took eight months of the Bulgarian government to adopt a national negotiation strategy in 1998, and the process started in early 2000 after an action plan was adopted in response to the 1999 Commission progress assessment. The strategy, however, brought clarity that Bulgaria will maintain macroeconomic policy compliant with the CBA and seek an ERM II and as early-as-possible euro adoption without changing the initially set exchange rate. These switched off expectations that the foreign exchange rate regime change can be a risk factor at the time of euro adoption. The actual political priority of the full-fledged integration in the EA and euro adoption in the remained low, although success of the first wave of the Eastern EU enlargement with 8 countries on January 1, 2004, gave impetus to the process. Later in that year Bulgaria fulfilled the EU political criteria and signed the Maastricht Treaty to join the EMU on January 1, 2007, albeit with a derogation regarding use of the euro as a national currency.

It took another 13 years before the government to negotiate inclusion of the Bulgarian Lev in the ERM II in mid-2020, a legally binding step under the Maastricht Treaty before the euro adoption. Despite the progress in the various aspects of convergence well-documented by Simeonov (2022), Bulgaria was subject to additional conditionality concerning various aspects of economic governance, like regulation and supervision of banks, management and accountability of the state-owned enterprises, implementation of the anti-money laundering (AML), counterterrorism financing (CFT), and insolvency frameworks (ECB, 2020). Bulgaria did not observe sustainably the nominal convergence criteria and missed the opportunity to join the EA together with Croatia on January 1, 2023, after expiration of the minimum required period in the waiting room. With ambition to adopt the euro on January 1, 2026, immediately after reaching the Maastricht inflation value criterion in February 2025, the government requested an extraordinary Convergence Report from the EC and ECB, expected in June.

The prolonged uncertainty associated with the euro adoption may be close to an end soon, but it does not end the overall economic uncertainty in the country related to the legally irrevocable participation in the EA. Lack of trust and confidence in the EA fundament has already been deeply rooted in the domestic expectations. On one hand, uncertainty surrounding the use of the euro in Bulgaria was fuelled by the unresolved dilemma in the 2010s EU legal framework concerning the process. For a long time, the Bulgarian authorities were stuck between fulfilling the official nominal convergence criteria in the Treaty or debating the additional sustainability criteria steadily imposed by the European Council in line with the post-GFC EA architecture. This increased the role of political judgement and thus a sense of unequal treatment of the new ERM II participants, which adversely affected the already shaken domestic macro policy consensus and social support for the process. On the other hand, a series of domestic and external shocks, such as 2011-13 ESDC, the Russia's occupation of Crimea in 2014, the 2022 war in Ukraine, the global COVID-19 pandemic, and failure of the fourth largest Corporate Commercial

Bank in 2014, misaligned the macroeconomic policy. The authorities deviated from the sustainable multi-annual budget frameworks and debt management strategies, established in the 2010s in line with the requirements of the EU's SGP and European Semester.

Bulgaria is a good example of the lacking macroeconomic policy consensus, fragmented policy frameworks, and highly politicised economic knowledge. These have been well noted by the development partners. From the very beginning of Bulgaria's accession in the EU, the process was accompanied by additional conditionality imposed by the European Council. Together with Romania, Bulgaria remained under the Cooperation and Verification Mechanism (CVM) for a long time after their EU accession. Bulgaria was also placed twice in the joint World Bank Financial Action Task Force (FATF) and the EU MONEYVAL grey list. In 2000-2006 this was due to deficiencies in its AML/CTF frameworks. The 2023 FATF decision was provoked by concerns about the effectiveness of AML/CTF regime implementation. During the period 2010-12 Bulgaria was under the EC's excessive deficit procedure.

Governance failures have had the economic welfare cost since Bulgaria remains at around 66 percent of the EU-average income per capita at PPP. The country still struggles to join the Organisation for Economic Cooperation and Development (OECD, 2024) and has lower international credit ratings, compared to many EU peers. In the early 2020s, the Bulgarian macroeconomic policy stance has steadily diverged from the disciplining pattern implied by the CBA. This has yet again raised the fear of the public debt spiral (Oresharski, 2024) and has resulted in increasing economic and political vulnerability. However, unlike the early 1990s, Bulgaria still has low public debt and an adequate foreign reserve level in accordance with the international standards. Therefore, there is no immediate need for official stabilisation financing from the EU.

Concluding remarks on the way forward

The euro can hardly replace the American dollar and become the number one world currency in the foreseeable future. Nevertheless, the euro has already demonstrated its huge potential to integrate Europe further, if not used as a political symbol and considered as a universal solution to Europe's economic challenges. The European political leaders and policymakers should make the EA economic governance less costly and more consistent with the OCAs theory requirements.

For Bulgaria, we can conclude that the CBA itself or its replacement with the ECB monetary policy with the euro adoption on January 1, 2026, would not automatically resolve governance issues. In addition to political will, a huge investment in theoretical and practical knowledge on the global and EU economy is a critical precondition to rebuilding social cohesion and anchor expectations.

The concrete ideas on how to accumulate such knowledge and use it efficiently to improve governance should include: i) adoption of an adequate and transparent capacity-building strategy to strengthen the democratic and accountable rule-based governance; ii) establishment of an independent high-level domestic publicly funded institution for macroeconomic analysis and forecasting which can help improving knowledge transfer in the long run; and iii) enhancement of the domestic intra-institutional coordination to make the formally existing domestic Financial Stability Council a fully operational body.

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