Mojmír Hampl: The euro – the case of the European monetary integration project and its former hegemon

Speech by Mr Mojmír Hampl, Vice Governor of the Czech National Bank, at the Mont Pelerin Society Annual Conference, Prague, 4 September 2012.

*   *   *

Many thanks to the organizers for their kind invitation – I'm really honoured to speak on such a distinguished panel.

But excuse me first for making a small detour: the organizers forgot to mention in my CV that I also had the honour – together with a group of distinguished colleagues (some of whom are here today) – to help launch *Laissez Faire* here 14 years ago. This is a magazine devoted to the promotion of liberal/libertarian ideas in the Czech public domain ("liberal" not in the American sense of this word). Such libertarianism is rather unusual intellectual equipment for a poor central banker, especially in the current times. However, I very much believe it is an advantage, and many of the ideas mentioned in *Laissez Faire* are very much missing from normal European policy debates. What a shame.

But back to the topic:

What is the euro? As Barry Eichengreen demonstrated, it is a really unique animal, a unique monetary arrangement. I do not buy into many of Barry Eichengreen's ideas, but I do agree with this particular statement. Why? Here is my definition of the euro.

It is a "currency without a state", in which a group of fiscally sovereign countries shares a single currency and a single central bank issuing fiat paper money, yet evidently lacks a clear monetary hegemon.

So the euro is not just a different version of the gold standard, as Balczerowicz, de Soto and many others argue. Not least because of the fact that unlike any commodity standard, the euro lacks anything resembling an ultimate numéraire.

And more importantly, within the eurozone Germany is not a monetary *hegemon* anymore.

Yes, the German mark and the Bundesbank were clear monetary *hegemons* in Western Europe in the pre-euro era. And remember, it was argued that the euro would become "the German mark for the whole of Europe" in the many public debates that went on in Germany prior to its introduction.

Yet it is evident that it could not and cannot function in this way. Yes, monetary unification in Europe does not make much sense without Germany. This is still true. But my definition of a clear *hegemon* is: it should have the right to set the rules and to force others to behave accordingly, the right to enforce the rules. And it has to have the right even to breach the rules itself and still not allow the others to breach the very same rules.

But this is not true for Germany after the introduction of the euro. To put it simply, eurozone membership turned Germany *from a hegemon into just one important player* in rule making and practical policy making. If I use a simple analogy from the world of motoring, in the German mark era Germany controlled the steering wheel, pedals and gearstick of the monetary vehicle, whereas in the euro era – and especially since the crisis broke out – it has had a firm foot only on the brake. And only sometimes, one must add.

Why is that? Well, in a euro-style monetary union, many important issues are put to a vote (or complicated negotiations), and *votes and negotiations typically have different outcomes than dictates or decisions of a hegemon*. If there had ever been a notion that the euro could be as depoliticised as the former mark, it simply had to fail. In reality it *had to be* more politicised by definition. The euro could not be a depoliticised German mark, because in many key decisions and respects it had to be a rather more politicised French franc, Italian lira or Spanish peseta. Otherwise, it seems to me, it could not have come into being in the existing set-up in the first place.

A bitter remark: Allan Meltzer once said the ECB's biggest advantage over the US Federal Reserve System is that it doesn't have a government standing against it. This, he believes, is the best safeguard of the ECB's independence. But the opposite and rather bitter argument can also be made. The ECB at times has to stand against *all 17 governments* of the eurozone member states.

I do not want to talk about nominal and real convergence, about rigidities, OCA arguments etc. Rather, let's take one example. Many complain that it is so hard to make real macroeconomic adjustments within the current eurozone, among its individual states. But if I understand monetary history correctly, the eurozone was created partly to ***make standard adjustments more complicated***. The fear of constant "humiliating devaluations" was one of the reasons why some countries wanted so much to have a single currency with Germany and wanted a transfusion of credibility for their own economies. So the desire to free ride on the credibility of the former *hegemon* was a part of the very basic idea of some, monetary weaker, countries.

We are so happy to have got rid of humiliating devaluations, but we have not offered any better adjustment mechanism instead. When market forces appear on a different front – say, the bond market – many in the EU want to destroy or bypass these forces again and not to adjust the economies that have imbalances.

The funny thing is that many are happy that the supposed tragedy of devaluations is over, but what we are now requiring of the southern axis of the eurozone is ***a competitive devaluation***. But in a harder-to-achieve form: a so-called internal devaluation. So we have got rid of the politically unpleasant adjustment mechanism and have very little instead.

Yes, the enlightened founding fathers (such as Otmar Issing) knew many of these things in advance and tried to minimize the free-riding by setting certain safeguards against it. Despite that, I believe many must be bitterly disappointed or shocked that many of these good rules proved to be so time-inconsistent, or dynamically inconsistent.

Yes, many good rules have already been breached or are close to being breached (some of the Golden Rules of European law, one should add):

- the no bail-out clause
- flirting with monetary financing of sovereign debts
- consideration of something like potentially permanent public support for financial institutions operating on the single market

I believe that these rules are especially dear to this audience. So one has to ask: What are the prospects of the project when to keep it going you need first to breach some fundamental rules that should have created a solid and long-lasting basis for it?

It is by definition hard to enforce rules among sovereigns, even when those rules are more important than fiscal or monetary ones – look at the United Nations, for instance. So the only thing that remains rather difficult to understand is the former hegemon's efforts to resolve what is, for it, the awkward situation of non-compliance with and infringement of the rules of the club (including its own infringements) *by creating new and ostensibly better rules for the same club with the same members*.

Yes, Otmar Issing, for instance, rightly warns against Eurobonds and simple fiscal unification, but with the European Stability Mechanism and the planned banking union we are effectively creating something like common fiscal liabilities and common bonds, just with less transparency.

Arguably, the German mark was – from a monetary point of view – a rather well administered pan-European public good. After the euro, this public good became overconsumed. Philipp

Bagus, sitting today here in this room, argues that the euro is a classical example of a "tragedy of the commons" from the start, and that the smaller and weaker countries therefore inevitably ended up racing to make maximum use of the commons for their own benefit at the expense of the rest, thereby destroying this shared asset. The German mark can indeed be viewed as a sort of *public good* that became the subject of decisions made outside the public sphere in Germany and hence was fundamentally transformed.

The average quality of the public good called monetary stability and good currency in the eurozone will very probably go down with the ultimate demise of the former European monetary *hegemon*. Let that be a warning to those countries which have not yet signed up to the monetary integration project. The fall of the former *hegemon* is relevant not only for the current crisis, but also for the future of the monetary order in Europe. And here I do not see any positive perspectives, I must bitterly admit. I am not saying that the euro has to collapse, but I am pretty sure that if it prevails, it will be a completely different currency implying completely different monetary conditions from what the Germans in particular hoped for.

And Germany faces a tough choice – further integration or a perfect monetary order. This question is rather new and painful. The answer to it will influence all of us, I believe. So let's wish them good luck.

Thank you for your kind attention.