

Mojmír Hampl: States as debtors

Speech by Mr Mojmír Hampl, Vice Governor of the Czech National Bank, to the Alpbach Financial Market Symposium, Alpbach, Austria, 2 September 2011.

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I would like to thank the organizers for inviting me to this wonderful and amazing place. And that is not a platitude; I really mean it. It is my first time here in Alpbach, and I can only hope that it is not the last after I finish my presentation.

Concerning the sovereign debt crisis, we are describing it as something absolutely fatal. But from a bird's eye view – as was said by several speakers yesterday – sovereign debt problems and overindebtedness of nation states are nothing new. Europe as a continent has a rich experience with such problems.

The Czechs share a long part of their history with Austria, so many might remember from their textbooks the sovereign instabilities and crises of the 19th and 20th centuries, for instance the well-known crash of state finances in 1811, in the middle of the wars against Napoleon. That crash was followed by a drastic monetary reform, default of the Austrian empire and a search for a better way.

This time is different, however, at least in the following respects:

1. We forgot that this can happen, that sovereigns can become perfectly insolvent just like any other debtor, and states behaved accordingly.
2. This is the first time in 60 years or so that a sovereign crisis has hit the developed world, the rich world, not the developing one, the hardest. To demonstrate that: almost 80% of all the IMF's rescue loans have gone to Europe! Over 40% have gone to the Eurozone itself, and the share is going to rise. The developed world is not accustomed to this.
3. This time the problem of sovereign debt has appeared at a time of peace and prosperity.
4. Moreover, the Eurozone – a monetary union without a state – is a completely new, unprecedented arrangement.

Typically, the solution to such a crisis used to be: inflation, default or monetary reform, very often accompanied by currency devaluation, or a combination of all these. Please note that typically when the IMF organizes a programme for a developing country, it requires a partial default or devaluation to disburse funds.

Nothing like that is possible within the Eurozone – monetary solutions are unavailable for the weakest sovereign links. And only default remains. Or, of course, a bail-out, i.e. shifting the debt burden from some countries to others.

But, history seems to suggest quite clearly that without some form of debt reduction (or default, if you wish) it will be really hard to get sovereigns functioning normally again.

Are there any OTHER alternatives? Yes, either very fast growth or slow deleveraging. The first option is possible, but unlikely. The second option might mean not one, but two “Japanese” lost decades. Moreover, the second option might also endanger the strong economies.

So, once again, without one form of debt reduction or another, it will be really hard to move forward.