Mojmír Hampl: To be or not to be in the eurozone? An answer from Prague

Speaking points by Mr Mojmír Hampl, Vice Governor of the Czech National Bank, at St. Antony's College, University of Oxford, Oxford, 21 May 2018.

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Ladies and gentlemen,

Good afternoon. First let me thank Dr Charles Enoch for his kind invitation to speak here today. It is really an honour for me.

I was thinking for quite some time about what approach to take today. Should it be a totally rigorous, perfectly balanced and as-full-of-data-as-possible description of the macro and monetary realities of our country? Or should it be more the personal testimony of a policy maker co-responsible for the monetary zone called the Czech Republic for almost 12 years now? On the advice of my adviser I decided that the second option might be more appropriate. We should listen at least sometimes to our good advisers after all.

So, the Czech Republic is a mid-sized European country of 10.5 million inhabitants. It entered the EU in 2004 and has no opt-out from euro adoption, so legally we are obliged to join and to make every effort to be there as soon as possible.

Yet there is basically no major political power in our country pushing for euro adoption at the moment. It is not part of the real political agenda, and we now have a fourth or so government in a row declaring that this issue will be left "for the next government after the next elections" – so it is being postponed to political infinity. The anteroom for euro adoption, the ERM II, is not being considered either. This approach has the full backing of the central bank.

Ten years ago, supporting the euro was a sign of "good social morals among the better classes", whereas today only the brave confess to ardently supporting it. That's how much the mood of the elite and the electorate has changed over the last decade. Why is that so? Here my eight personal comments come into play.

1. **The euro and political union**:

   A stateless monetary union is inherently unstable. A currency is usually a consequence, not a cause, of the establishment of a state. In Europe, however, we began to build the "currency house" from the roof down, and then in 2008 everyone was very surprised at how the tiles flew off when the first wind appeared. Is there a prospect of a political union – a single European state – in the pipeline? Even if there is, do we want to be part of it? If the question is no, which would seem to be the case, thoughts of introducing the euro in the Czech Republic should, for that reason alone, be left on the back burner.

2. **Autonomous monetary policy**:

   Autonomous monetary policy is a kind of "absorber" of economic shocks. It is meant to reduce their impact and smooth the economic cycle. It prevents an economic contraction being borne by the unemployed and those on low incomes more than is necessary. Domestic monetary policy does that via the Czech National Bank. Certainly, the more flexible is your economy (public finances, the labour market and so on), the easier it is to cope with shocks and the less monetary policy is needed. However, the case of the Eurozone shows how tricky it is when the absorber in the form of monetary policy is switched off and nothing replaces it. The shocks are bigger and hurt more. Listeners themselves can answer the question of whether the labour market and labour law are likely be made more or less flexible (and dismissals made easier) in the future. In doing so, they will answer the question of whether there will be a need in the future for more or less domestic monetary policy in the Czech Republic, a country whose conservative population is so averse to upswings and downswings.

3. **The "convergence trilemma"**:

   The standard "monetary trilemma", which you know very well (a country cannot simultaneously have a fixed exchange rate, an open capital account and autonomous monetary policy), is accompanied in a converging economy of our kind with something I call the "convergence trilemma". No country can simultaneously have high convergence growth, a fixed exchange rate and low macroeconomic imbalances, be they internal or external. In our case, catching up with our wealthier, low-inflation Western peers means a long term tendency for our currency to appreciate. This is hardly consistent with a permanently fixed exchange rate.

4. **The paradox of the Eurozone**:

   The Eurozone paradox is that the best possible members of the club are the countries that are so stable themselves in monetary and economic terms that they don't need "to buy in stability". Such countries have fewer and fewer reasons to adopt the euro. Conversely, the more a country begs to have the euro, the bigger the problem will be. This explains why almost no one is conducting a euro debate in Sweden, even though it does not have a derogation and many would like to see it in the Eurozone. Canonically, the same goes for us: either we can continue to stabilise ourselves, in which case we don't need the euro, or we will destabilise ourselves, but in that case we will potentially harm others in the euro club and Eurozone membership will be a hindrance in bad times.

5. **There's no story in our case**:

   The Baltic states took the euro as a geopolitical and security safeguard and paid a huge economic price for permanently fixing their currencies to it. Slovenia wanted to cut itself off from the Western Balkans. Slovakia wanted to seal the reforms of former Prime Minister Mikuláš Dzurinda. Germany gained unification in exchange for the euro. The southern countries (Italy, France and Spain) gained the stability of the German mark because they were unable to create such a currency at home. And those who were tied to the German mark long before the euro was created (Austria and the Netherlands) simply remained bound to Frankfurt after the Eurozone was established, only the Bundesbank building was replaced all of a sudden by the ECB building. There's no basic euro story like this in the Czech Republic. Why should we try to create one artificially? Our story is one of maintaining monetary stability across regimes and governments and of keeping the koruna as the name of our currency continuously since the time of Emperor Franz Joseph (his monetary reform established a new currency – the crown, or koruna – throughout the Austro-Hungarian Monarchy in 1892) regardless of totalitarianism and the horrors of the 20th century. Neither the Nazis, nor the Communists had any tendency to rename the currency and kept this old monarchist name despite otherwise changing basically everything, and for the worse. Our country – unlike the rest of the Central Europe – has never experienced hyperinflation in its modern history, and this monetary stability has always served the entrenched mentality of small Czech savers well. Domestic scepticism about the euro – that's our authentic Czech story.

6. **The Slovak economic miracle**:

   It is, of course, impossible not to make comparisons with our eastern neighbour Slovakia, the only member of the Visegrád club to have adopted the euro, which it did in 2009. Unfortunately, here more than anywhere else it holds that the data say nothing and interpretation holds sway. So how about this? For years before and after introducing the euro, the Slovak economy has constantly been catching up with the wealthier countries, including us. We, meanwhile, are constantly catching up with the countries to our west. Economics rather relies on the poorer catching up with the wealthier. And the richer a country is, the harder it is to catch up. Looking at the numbers, Slovakia is still 10% behind the Czech Republic in terms of economic output and above it in terms of the price level. It's a poorer and more expensive country. Yet tens of thousands of Slovaks still travel from this euro paradise to the Czech Republic to work and study. An equal but opposite flow is nowhere to be seen.

7. **The Prague-Copenhagen connection**:

   I have to add with some bitterness that many in the Czech Republic like having their own currency but not necessarily their own monetary policy. This magical contradiction can be seen in the pleiad of ostensibly conservative political opponents of the euro in the revitalised euro debate. In one breath they say that we should not adopt the euro – so that we can keep our own currency and hence retain the ability "to weaken the koruna in bad times" – and then criticise the Czech National Bank for doing exactly that in the bad times of 2013. They then happily add that Greece would have benefited from having its own currency and that Germany is profiting from the euro being weaker than the Deutschmark would have been. The same, however, doesn't go for the Czech Republic after 2013. These endearing inconsistencies are present throughout the population. Here again, however, the Eurozone and its satellites offer parallels. The Danes have a fixed exchange rate against the euro (and previously had a fixed rate against the mark) and thus in effect "buy in" monetary policy from Frankfurt. They have their own notes and coins but not their own monetary policy. Note this fine "Scandinavian paradox": the Danes have an opt-out from the euro following their 2000 referendum, yet they do not make their own monetary policy, nor did they before the euro was created, whereas the Swedes do not have an opt-out (although they have been trying not to fulfil the criteria and not to join ever since rejecting the euro in their 2003 referendum), yet they pursue autonomous monetary policy. I sometimes wonder whether the Czech sitting-on-the-fence approach is heading towards the Danish model. It wouldn't be my choice, but it's good to be prepared.

8. **Macro costs and micro benefits**:

   The Eurozone has so far failed to make its member states wealthier quicker (the non-euro EU states are constantly growing faster on average) or to make them converge structurally. Rather, one could argue that the opposite is true. A truly strong measurable result of the euro is lower and less volatile inflation. This is hard to see as a bonus for our country, where we are consistently achieving the same objective with our own currency. The oft-mentioned bonus of lower interest rates due to the euro does not apply to us either. We have long known what it's like to live with rates below the Eurozone level. Likewise, it's hard to believe that the euro will deepen our trade relations with the euro countries given that we are one of the few countries enjoying not only growing trade, but also a constantly rising trade surplus with Germany. The euro has micro benefits at firm level, but unfortunately they come with the aforementioned macro costs. The latter are constantly rising and their final size and structure are impossible to quantify. Besides the known contribution to the stability funds, they include mandatory participation in the banking union, which is another unfinished structure.

For a country of our type, currency arrangement and monetary history, joining the Eurozone is generally an extremely tough question. It was ever thus, but it is currently all the more so. Adopting the euro today would be like being the last to arrive at a party, one where all the food and drink has gone and the other guests are looking for someone to help pay the bill. The British journalist David Marsh, one of the foremost experts on the anatomy of the establishment of the single currency, summed it up brilliantly: “the Eurozone doesn’t need new members, it needs new creditors”.[1] And when such a consistent defender of mainstream economic thinking as the American Kenneth Rogoff announces that it is “fairly obvious that the euro was not necessary to the success of the EU, and instead has proved a massive impediment”[2], even staunch supporters of the euro in our country probably took notice.

The pragmatic Anglo-Saxon approach of “if it ain’t broke, don’t fix it” suits the Czech Republic generally, and especially on this point. In the case of the euro, it holds true here more than anywhere else that we are not rich enough to afford to repeat the potential mistakes of others. We make enough of our own.

Thank you for your attention.

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1 Marsh, D.: “Řecko se zbaví eura, doufejme že kultivovaně,” Lidové noviny, 19 October 2011.

2 Rogoff, K.: “The eurozone must reform or die,” Project Syndicate, 14 June 2017.