Jiří Rusnok: Currency, taxes and other institutes of financial law

Welcome speech by Mr Jiří Rusnok, Governor of the Czech National Bank, at the Currency, taxes and other institutes of financial law conference, Faculty of Law, Charles University, Prague, 20 September 2018.

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Good morning, everyone.

It is an honour and a pleasure for me to welcome you to today's conference on the currency, taxes and other institutes of financial law. The 100th anniversary of the foundation of the independent Czechoslovakia is a good opportunity to look back and identify the main features of our national economic history. As you know, we have been through four periods since 1918 – the period of political and economic emancipation from Austria-Hungary, the wartime economy, the era of central-planning-based totalitarian communism, and finally almost three decades of democracy and a market economy. So, more than enough has happened in our country over the last 100 years.

Although these periods could not have been more different, two common features have appeared in various guises. I would characterise them on the one hand as economic moderation, prudence and discipline, and on the other as a struggle for economic independence and a willingness and ability to bear the consequences. Let me give some examples of both.

Czechoslovakia's founding fathers Tomáš Garrigue Masaryk, Karel Kramář and Alois Rašín were well aware that nurturing a sound financial environment was crucial to the prosperity of the young nation. The Czech Lands had been a key industrial and economic part of the former Austria-Hungary and hence had a relatively well-developed banking sector. An awareness of the close links between government finances, the banking sector, firms and households shaped the economic policy of the First Czechoslovak Republic.

Karel Engliš worked systematically to balance the budget and deserves most of the credit for sorting out public finances in the early 1920s. In 1927 he submitted three tax laws that substantially lowered corporate taxation and supported the creation of capital. At the same time, though, he tied the tax reform, which led to lower revenues, to cuts in government expenditure and a streamlining of the civil service. So, Rašín and Engliš established a trinity of traditions in our country: a stable currency, sound government finances and non-inflationary economic policy. These traditions became a theoretical, practical and moral legacy for subsequent generations of economic policymakers.

It is unusual these days to look back to the communist period for economic inspiration. The socialist system was inefficient and cumbersome and discouraged initiative and innovation. Central planning by definition made the system less adaptable to change and created an economy of shortage. Despite this, the Czechoslovak version of socialism tried to eliminate the most glaring imbalances and preserve basic macroeconomic equilibrium. Fortunately, our central planners didn't cause any major imbalances in the consumer market in the 1980s, so the savings surplus wasn't as large as in other communist countries. Not that I want to defend the past economic regime in any way, of course, but let's not forget that it had elements which can be traced back at least implicitly to the pre-war period.

An explicit return to the three traditions I mentioned is the central feature of our post-1989 economic history. Many of us clearly remember that the liberalisation of prices and foreign trade in 1991 was accompanied by effective stabilisation measures. These included an appropriate devaluation of the koruna against a basket of currencies and the maintenance of balanced budgets or even slight surpluses. It is therefore no accident that in 1991 inflation was "only" 56% here, as compared to triple figures in Poland and often quadruple figures in other transforming economies.

The Czech National Bank embraced the legacy of price stability right from its establishment in 1993. The maintenance of a fixed exchange rate until 1997 was a condition for attaining single-digit inflation and provided a fixed point in the unstable transformation environment. The switch to inflation targeting in 1998 marked the start of a roughly ten-year transition to price stability according to the definition long applied in advanced market economies. Maintaining price stability is not just our constitutional duty, but a long-standing legacy that we proudly embrace.

The second feature of our economic history that I mentioned at the start is an ability to cope with the consequences of the struggle for economic independence. The currency separation – a reform implemented by Alois Rašín in 1919 – entered the annals of Czech economic history long ago. It was aimed at nothing less than separating currency circulation in Czechoslovakia from that in the other parts of the former Austria-Hungary. I won't expand on all the ways this bold step could have gone wrong. I will point out, though, that the way it was done and the way it turned out are seen as impressive to this day, as the Czechoslovak koruna went on to become one of the most stable currencies in Europe. However, this was due to many other accompanying measures, not just the separation of the currency. In other words, the currency was only as strong as the foundations of the set of economic policies in place at the time.

As you all know, we tried a currency separation again in February 1993. Again we had nothing to be ashamed of, as not a single drop of blood was shed in the process. Savings started to spill over from Slovakia into banks in the Czech Republic as soon as the former federation broke up. The general level of uncertainty also increased, affecting the foreign exchange market. But despite all that, the excellent organisational preparations for this step, stared secretly in the middle of the previous year, allowed the operation to be conducted quickly and efficiently. The architects of this currency separation deserve great recognition, because everything began to return to normal soon afterwards and the previous uncertainty quickly faded away. It is no secret that they were inspired primarily by Rašín's separation and its success, and they themselves later became a source of inspiration for currency separations in other economies gaining independence.

All this tells us that the Czech nation is reasonably good at running its own macroeconomic, monetary and financial affairs. It has never had to resort to an exchange rate arrangement such as a currency board, and it has enjoyed the benefits of relative economic and monetary independence. Although at times the exchange rate of the koruna has been a source of domestic economic volatility, at other times it has done a great job of absorbing external shocks. Until quite recently, we were also using the koruna exchange rate as an unconventional monetary policy instrument to help us achieve the inflation target. Our ability to conduct our own monetary policy successfully is one reason why the Czech Republic is not currently seeking to adopt the euro any time soon.

To sum up, the past 100 years have not been a series of random economic events. Despite all the discontinuities, there has been some continuity. In the same way that we inherit various physical and personality traits from our forebears, economists learn their craft from those that came before them and pave the way for those that come after. I am sure this conference will bear me out on that.

I wish you an interesting debate. Thank you for listening.