Mojmír Hampl: Is the euro zone still an attractive target for countries outside the euro? A view from the Czech Republic

Speaking points by Mr Mojmír Hampl, Vice Governor of the Czech National Bank, at the conference “Are we on the verge of a new Euro Crisis?”, Copenhagen, 4 September 2018.

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Ladies and gentlemen,

Good afternoon. First of all, let me thank Lars Christensen for his kind invitation to speak here today in front of such a distinguished audience. It is really an honour for me and I am also glad to be in Copenhagen again.

In this talk I will try to shed some light on what appears to be a puzzling attitude of some new EU member countries towards the common currency.

I will use the example of my home country, the Czech Republic. 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 enter the Eurozone as soon as possible.

Yet no major political force in our country pushes for euro adoption at the moment. Talks about joining the Eurozone are simply not part of the 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 antechamber for euro adoption, the ERM II, is not being considered either. And this approach has the full backing of the central bank.

Ten years ago, supporting euro adoption in our country 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 seven personal comments come into play.

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.

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. Certainly, the more flexible is your economy (in terms of 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.

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.

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 and credibility”. 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 it will represent. 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.

There’s no story in our case

The Baltic states took the euro as a geopolitical and security safeguard and paid an 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 and Denmark for that matter) 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 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.

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 or their autonomous central bank. 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. You in Copenhagen 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. You have your own notes and coins but not your own monetary policy. Note this fine “Scandinavian paradox”: you have an opt-out from the euro following the 2000 referendum, yet you do not make your own monetary policy, nor did you 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.

The price of entering goes up, or the Bulgarian thorny road to the euro

Yes, some new EU members are still keen to join the Eurozone. Especially in Bulgaria, the desire is understandable: the country has held a fixed exchange rate visa-à-vis the euro since the common currency’s inception. Just like Denmark, Bulgaria has outsourced its monetary policy to Frankfurt, but unlike Denmark, it would also like to become an official member of the club to enjoy all the benefits of using one of the most prestigious world currencies. On paper, at least, Bulgaria appears to be an ideal candidate: unlike many of the current members of the Eurozone, it actually fulfils the key Maastricht criteria. But the idea of Bulgarian membership is not an appetizing one to many technocrats at the ECB and to the representatives of some Eurozone member states. So, for many years, Bulgarians have been tacitly discouraged from applying to ERM II, the antechamber of the euro. This year, however, they tried their luck: perhaps they felt that the conditions would never get any better than under Bulgarian presidency of the EU and Jean-Claude Juncker’s vocal emphasis on how the euro should become the currency of the entire Union. Complicated negotiations followed, and their result is of key importance to all EU member countries outside the Eurozone. It’s not enough that Bulgaria fulfils the important Maastricht criteria: new criteria were thought up specifically to make the Bulgarian path to the euro as difficult and humiliating as possible. Prior to entering ERM II, Bulgaria has to join the Banking Union, pay its share in the ESM, and let the ECB conduct a deep audit of its financial sector. In other words, it has to pay all the costs of Eurozone membership many years before it becomes a member – and without any assurance that it will be accepted to the club at all. Crucially, in line with the principle of “equal treatment”, in the future all countries wishing to enter ERM II are expected to follow these humiliating conditions. Well, in my eyes, that provision practically closes the door to euro membership for countries such as the Czech Republic: it is difficult to imagine how any government with a trace of honour left would choose for the country to go through such an ordeal.

In sum, I would say that the pragmatic Anglo-Saxon approach of “if it ain’t broke, don’t fix it” suits the Czech Republic and other Central European countries well on the point of independent monetary policy. 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.