Wisdom from

Hannes Androsch, former Austrian finance minister and head of Creditanstalt-Bankverein, and now industrialist and entrepreneur, tells it as only a wily European policy veteran can. A TIE *exclusive interview.*

TIE: **Let's start with the macro picture. Eurozone inflation appears to be dropping. The U.S. economy is OK but hardly overheated. And the price of oil has dropped, lessening the European Central Bank's ability to use that as an excuse for tightening. One would think a pause in the ECB's tightening should be a certainty, but it's not. Any comments?**

Androsch: Over the last couple of years we observed the most dynamic economic development in the world economy in quite a few decades. Yet Europe and the eurozone specifically did not fully participate in that development. The consequence is enormously high unemployment and the deteriorating fiscal position of many countries—Germany, Italy, and France, to name a few. The ECB is obliged to focus on fighting inflation, not promoting general economic development, and they are overdoing it. Having avoided the mild recession in 2000–01, they contributed to the sluggish growth we witness in Europe this year. Things are a little bit neutral. But we are not fully using the growth potential I think Europe has in order to reduce the unemployment situation and in addition improve the fiscal situation. Although the ECB has lately been increasing interest rates, I would suggest, along with many others in the economic policy field, that they should stop.

TIE: **Is there confusion about the significance of the drop in the price of oil? For instance, some within the ECB say that rising oil prices are dangerous because they contribute to headline inflation, and eventually core inflation**

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
888 16th Street, N.W., Suite 740
Washington, D.C. 20006
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com

"The ECB is overdoing it."

Hannes Androsch

the *Graybeards*

tracks headline inflation. On the other hand, when oil prices drop—while the natural conclusion would be less pressure to raise short-term rates—the ECB's argument becomes, "No, the price drop will stimulate the economy too much so it moves closer to full capacity and an overheating situation." There doesn't appear to be a clear consensus yet on what happens particularly if the price were to drop another $5–$10, particularly as the world economy is slowing.

Androsch: Given the fact that you have a demand debt, there's no reason to be concerned an increase on the demand side is dangerous. We like the old price system sureties, but the world economy has changed. Both China and India—the two most important emerging economies—play an increasingly important role, and of course also on the demand side they're thirsty for oil and they're hungry for raw materials. On the other hand, China has added an additional 1.5 billion workers to the world labor market, putting strong pressure on the work side. In many areas the extra workers see very little increase in terms of real income. And on the other hand, the surplus countries—oil-exporting countries specifically—have increased their absorption capacity so there is not the danger of global demand debt to the same extent as we observed in the 1970s. We are facing the huge disequilibrium between the United States and the Far East, while Europe has a more balanced external situation. It is fair to say that the establishment of the monetary union and the introduction of the euro was indeed a success, but the situation is unbalanced. We are focusing on monetary policy, but we are still fragmented in the area of economic policy. That has to be changed.

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TIE: **How sustainable is the monetary union? If you compare the balance sheets of the Club Med coun-**

tries—Portugal, Greece, and Italy—to the balance sheet of a Latin American country, the Latin American country looks significantly better these days. Italy, for instance, has fallen so far behind its largest trading partner Germany in the last five years that in the past the Italians would have obviously devalued their currency in response. But they've lost that ability by being part of the Eurozone. It was assumed that lower bond rates would compensate for the lack of ability to devalue. How sustainable is this situation?

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Androsch: In the decades after the Second World War, the custom was to make the necessary adjustments by the exchange rate. Since we began the monetary union, countries no longer can rely on that instrument, so they make monetary adjustments in real terms. Paying higher interest rates is the first consequence.

I'm not terribly concerned with the danger to the monetary union. After all, given the economic performance differences between the fifty states in the United States, nobody doubts that the United States will remain a dollar area.

***TIE:* There's a sense that the U.S. economy is growing at a steady but less robust rate. European policymakers seem to feel that economic activity will shift to Asia, and that the European economies will be largely unaffected by this slowdown. This view is contradicted by a lot of policymakers who say a U.S. economic slowdown is globally threatening because so much of the world is still export-oriented. The one reliable economic engine in Germany, for example, is exports. The argument in Japan is that for every 1 percent the U.S. economy drops below the 2.5 percent level, Japan would drop 1.5 percent. China probably would drop 2 percent because it's so heavily dependent on the American consumer. What's your view of the importance of the U.S. economy?**

Androsch: But at the same time one has to consider the fact that China runs extremely high savings rate of almost 50 percent. They have the largest room for maneuvering in the sense of shifting from an export-oriented policy to an internal growth-oriented policy. It would be in their interest to make that adjustment. But to some extent this applies also to Japan and definitely to India.

***TIE:* The demographics in China are even worse than they are for Japan. The aging of China's population makes the shift to a consumer economy difficult.**

Androsch: That's an issue for the longer run. In the short run, as long as it's moderating, a certain slowdown in the United States and a slowdown in China's extremely high growth rate to more moderate levels, along with a reduction of the U.S. deficit, would help to reduce the dangers of unsustainable imbalances. I share the view of the Bank for International Settlements that inflation is less of a danger than the imbalance in the world economy between the major players. A U.S. slowdown would dampen the price pressures for raw materials, specifically natural gas. A little cooling of the world economy from a growth rate of 5 percent to 4 percent would probably improve the situation without the consequences of a shock, particularly in the area of exchange rates.

***TIE:* Federal Reserve Chairman Bernanke believes the U.S. current account deficit stems in large part from the lack of non-American investment opportunities round the world. What do you think?**

Androsch: The concern is that a current account deficit could happen in Europe, too, as well as the deindustrialization that the American economy has undergone over the twenty years. There's no exchange rate level that would allow an economy to recuperate from that situation. Once lost, the investment base is almost impossible to reestablish. We should take a moral lesson from the experience of the United States and do whatever we can to secure our industrial base.

One basis for growth is the Schumpeterian model, through innovation. Given the high level of incomes in the most developed countries, we should concentrate much more on innovation, education, and research. The United States is far ahead of Europe in research and innovation.

***TIE:* The pressure within Europe to keep the euro from rising against the dollar appears to be growing.**

Do you sense a feeling in the private sector in Europe that the central bankers better not do anything that encourages a runaway currency at this time? Moreover, how sustainable is the situation in China, where the currency seems to be manipulated by authorities without an adequate reflection of the fundamentals?

Androsch: All major currencies are managed to a certain degree in different ways, but they are not regulated like the markets and for good reason. Otherwise we wouldn't need the central bank—there'd just be a run on the markets. The Chinese have started to revalue the yen cautiously and that is understandable. They so far have moved a little bit too slowly, but on the other hand it would not have been wise to jump to a higher valuation of the yen. China plays an enormous role in the entire region given its size, so focusing on bilateral relations in the trade balance with the United States is important, not a stand-alone issue.

TIE: **Several years ago Warren Buffett said the collapse of the U.S. dollar was a slam dunk and he invested heavily on that bet. He has lost a billion dollars since. Are you surprised that the dollar hasn't weakened more given the huge imbalances?**

Androsch: If you focus too heavily on one economic measure—the trade balance or the current account balance, for example—then of course it's surprising that the dollar's not weaker. On the other hand, the United States enjoyed a much faster expansion than we did in Europe. That is counterbalancing to some extent in terms of purchasing power considerations. From an industrialist's point of view, the euro is over-valued and we have great problems to overcome. Look at the situation for instance with spare parts, where we generate the production cost in euros but get the price in dollars. As long as we cannot beat the difference in the dollar price we get caught in a very competitive market. From this end, a dollar/euro exchange rate of $1.10 or $1.20 would be more justified than $1.30.

TIE: **In the past several years Europe has undergone a massive amount of M&A activity, with more expected. It's driven in part by a lot of German companies opening up to non-German board members who are demanding a more aggressive approach to management and market share.**

Androsch: Things are improving, but the degree of integration is of course much more advanced in the United States than for Europe's huge common market. Economic patriotism is just another word for protectionism. And not only in France. Specific laws limit the labor market with the new member states to our own disadvantage, for we accept illegal immigration instead of opening the doors legally. But look at the United States. You introduced NAFTA and now you're talking about building walls. If it is not a contradiction then I don't know what a contradiction is.

We should take a moral lesson from the experience of the United States and do whatever we can to secure our industrial base.

TIE: **Do you get the sense that the private sector is restructuring itself faster than the public sector? A lot of the optimism seems to have faded. Even German Chancellor Angela Merkel, who many thought would take on reform of the labor markets, just sits there.**

Androsch: The situation in Europe is improving in the sense that we are slowly overcoming the fragmentations. But we are still focused within our national borders instead of going out and taking advantage of a market of 450 million consumers. The situation is improving but still it doesn't move fast enough. And we are doing a far less in the field of research and development. The United States spends $100 billion more than the European Union. It's ridiculous. Of the top universities, a number are in the United States and only a few in Europe. Our educational system needs improvement. On average Europe is better, but at the top level the United States is far better. And the children have to catch up with the Chinese. They're concentrating very heavily on their tertiary level of education.

TIE: **If you had to take your entire personal net worth today and invest it for the next twenty years, would you choose China or India?**

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Androsch: The companies in which I have an interest are those places already, and also in South Korea. They're looking for a facility in the United States and they're going to set up one in the Ukraine. That's my answer.

TIE: **Let me ask you another question about where you see the world. Today a meeting of finance ministers of the G7 would include United States, Canada, Japan, France, Italy, Germany and Russia. Fifteen years from now, if there is a G7, who will be in it?**

Androsch: Depending on any group, Europe is speaking with one voice. The rising partners include Brazil, Russia, the oil exporting countries, and definitely China and India. So we have to say farewell to the old industrial order institutions. We had some quite successful coordination of the shock experience of the 1970s and 1980s, and now we have too much of a unilateral approach. Is it going to work? No player is big enough to run the show on its own. We should bring the major players to the same table to achieve better understanding and increase the minimum of coordination.

TIE: **Where do you see the Austrian economy going in the next couple of years?**

Androsch: In the last six or seven years Austria has not done as well as it could have despite the pick-up from the opening of the eastern parts of Europe. If we start to change our growth and economic policy, we could do better. We cannot avoid being influenced by the general development in the European Union, and the European Union cannot decouple itself from the development of the world economy. But assuming that the world economy does not collapse, it may slow down, with a dampening effect on some prices for materials and energy. We could then achieve a reasonable growth period of four or five years.

TIE: **Do you worry about the demographics in Austria just as the Germans worry about theirs?**

Androsch: Austria has a growing population. We have artificial migration—40,000 Germans are permitted to come work in the Austrian tourist industry. The Germans say that without their workers, Austrian tourism would break down. And we have other illegals from Eastern Europe. In the business of caring for older people, there are another 40,000 immigrants. We still face an aging society but immigration so far is overbalancing that. And an aging society is not a disadvantage if people work longer like in Scandinavia. One of the problems is how to finance the pensions. There are other results and consequences, but nobody has so far really tried to show the overall consequences of the demographic changes.

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TIE: **Austria contrasts, then, with Germany and France in how they handle immigrants and all the complications such as rising Muslim immigration.**

Androsch: France and Germany have greater problems. Austria holds an advantage because going back to the days of the monarchy, we were a multinational and multireligious entity. In the nineteenth century we already had an Islamic population, and since that time Islam is a recognized religion and we pay their religious teachers. We are far ahead of Germany.

TIE: **Your name was included on a list of people able to see value in a company and move quickly. So what have you been up to? A lot of *TIE* readers would be interested to know.**

Androsch: I started as a certified accountant. I entered politics as Austria's finance minister and held that post for eleven years. Next, I served as head of Creditanstalt-Bankverein for eight years, did a stint at the World Bank, and finally started my own consulting business, becoming an industrialist and entrepreneur.

TIE: **Are you having fun?**

Androsch: Great fun. I'm still interested in politics and economic policy.

TIE: **Thank you very much.** ◆