

NEWSLETTER

April 2022

n. 23



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This monthly newsletter is prepared jointly by the Council for the United States and Italy and The European House - Ambrosetti.

WEBINAR | Energy: the 2022 Outlook | 9th April



Franco Bernabè (*Chairman, Acciaierie d'Italia*)

Over the past year, three factors greatly contributed to shaping the energy market: the post-COVID19 recovery, the COP26 in Glasgow and the most recent Russia-Ukrainian war. According to Franco Bernabè, all these elements will determine some long-term structural effects. In addition to this, the unprecedented increase in the price of gas during the second half of 2021, before the eruption of the Russia-Ukrainian war, contributed to determining some short-term effects on the gas market resulting in a mismatch between the demand and the supply. Short-term effects on the gas market were also determined by a shortage in the electricity generated by renewable sources (the insufficient production of renewables added demand on the LNG market), a strong demand for LNG coming from China, Japan and Korea, and the fact that many plants were under maintenance. All of this contributed to the rise of prices due to additional pressure on the gas market and the decision of Russia to stop its sells on the spot market, giving priority to the long-term market.

Short-term effects also include the drop in European investments in exploration and infrastructures since 2015 and the pressure coming from shareholders and the financial community to divert investments of oil companies from traditional fossil fuels to the green agenda which created an explosion in the price of energy before the eruption of the war. On top of that, it came the Russia-Ukrainian war and the sanctions. Even if on the oil market the sanctions do not apply, most of Western traders stopped buying Russian oil which found new consumers in countries that usually face difficulties in accessing the normal supply region. Still, the relevant market is the one of gas where we should expect some long-term effects, starting from the fact that the pipeline project Nord-Stream 2 will most likely not come into operation.

As a reaction, the European Commission issued the REPowerEU document which foresees to achieve complete independence from Russian gas by 2030. The idea of such reduction can be defined as heroic, but it is interested to look at the instruments that Europe is putting in place to achieve such ambitious goal. Europe believes to make it by increasing demand of energy through pipeline, biomethane and the rest will come from energy savings and most likely the reduction by 1° in the heating systems over the next winter. This brings to a major short-term consideration, implying that Europe will increasingly rely on gas coming from Algeria and Spain through major regasification plants. In turns, this will slow down the European green transition and Europe might have a hard time in meeting the set targets.

However, the continuous innovation in the renewable energy sector contributes to an optimistic scenario for the near future, given the dramatic reduction in prices during the past ten years. Moreover, there is the need to invest in the accumulation of power, given the discontinuous nature of renewable sources.

WEBINAR | War in Ukraine and its Consequences for the United States | 21st April**Gerard Baker** (*Editor at large, The Wall Street Journal*)

Besides from energy security concerns, the war in Ukraine has brought to attention its considerable geopolitical impact on the international relations. According to Gerard Baker, this war has several implications both for the United States' domestic and foreign policy. The first element to highlight is the universal surprise on how Russian military has poorly performed, contrary to the overall expectation. On the other hand, there has been a universal feeling of admiration for the Ukrainians who showed courage and preparedness in fighting against Russian invasion. So far, the general view is that this conflict has been going in a way that was not expected. Looking at the impact on the US, in terms of US domestic policy, the war had a unifying effect: despite the political divisions that characterized American politics over the past five years, with the eruption of the war there has been a strong galvanizing effect in uniting the country. Despite Putin tried in the past years to divide Americans, at the end it seems he united them. Both Democrats and Republicans seem to be asking for more responsibility from the US, which until now has mainly pushed European countries to be in front line. Therefore, common criticism is mainly referred to the demand for a greater intervention coming from the Biden administration to support Ukraine. At a general level, there is overall agreement on what to do to have a confrontation between US-NATO and Russia.

The question is there: what is the ultimate objective of this war? The US seems to be fighting for freedom and democracy, which is a morally challenging position, with Ukrainians having lots of losses and destroyed cities. Therefore, a deal would be a morally acceptable solution to this conflict. There is a more cynical view coming from those who believe that the US has some interests in having a long war, which consequences might turn into an advantage for the Americans, especially if Ukraine will manage to inflict some damage to Russia.

In terms of foreign policy, over the past years the importance of Europe and the role of NATO downgraded leaving the floor to the rise of China and Asia as key global players. This war is now rising concerns both in terms of the importance of NATO and future actions that the US should take with China. China is of growing concern for the US, given the recent alliance that the China sealed with Russia which might contribute to revive a sort of "Cold War mentality". That alliance, announced just ahead of Russia invasion of Ukraine, had the effect of refocusing the US foreign policy on the longer-term strategic challenge. Therefore, NATO and Europe are again seen by the US as strategic players in facing the Russian threat and China is forcing the US to think about a strategic geopolitical shift in their approach.

The final question relates to the main concern: how will the war escalate? There are different views on the US: one of them believes that Putin will not stop until he will achieve his goal, others see it differently as they believe that Putin will not go until the end as he will realize the consequences that such actions might trigger. It is hard to say what will happen next, for the time being it is important to highlight the unifying effect the war had on the domestic US policy and how the US are beginning to see from a different perspective the role of Europe and NATO in facing Russia.

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IS DIPLOMACY BETWEEN RUSSIA AND THE WEST STILL POSSIBLE?



Richard Haass (*President, Council on Foreign Relations*)

It may well be that constructive relations with Russia do not emerge until well into a post-Putin era. But this in no way alters the West's interest in seeing that relations do not fall below a certain floor in the interim.

NEW YORK – Amid more than two months of intense media focus on the war in Ukraine, one story was largely overlooked. In late April, the United States and Russia carried out an exchange of prisoners. Russia released an American (a former marine) whom it detained some three years ago, while the US released a Russian pilot imprisoned over a decade ago on drug smuggling charges.

What makes the exchange noteworthy is that it took place at a time when Russia's brutal invasion of Ukraine has brought relations with the US to their lowest point since the end of the Cold War. The US has opted to avoid direct military involvement in the war, but it is doing a great deal to affect its trajectory, including providing Ukraine with large quantities of increasingly advanced arms, intelligence, and training so that it can successfully resist and potentially defeat the Russian forces. The US has also taken steps to strengthen NATO and impose severe economic sanctions on Russia.

The war is likely to stretch on for some time. Although Ukraine's fundamental interest is to end the war and prevent more death and destruction, President Volodymyr Zelensky's desire for peace is conditional. He seeks to regain territory that Russia occupies and ensure the country's sovereignty is respected so that, among other things, Ukraine can join the European Union. He also wants those responsible for war crimes to be held accountable.

Russian President Vladimir Putin, for his part, needs to achieve an outcome that justifies his costly invasion lest he appear weak and be challenged at home. There is little chance that a peace could be negotiated that would bridge the gap between these two seemingly irreconcilable positions. It is far more likely that the conflict will continue not just for months, but for years to come. This will be the backdrop for US and Western relations with Russia.

One possibility for the West would be to link the entire relationship with Russia to Russia's actions in Ukraine. This would be a mistake, though, because Russia can affect other Western interests, such as limiting the nuclear and missile capabilities of Iran and North Korea, and the success of global efforts to limit the emissions that cause climate change.

The good news is that, as the prisoner exchange demonstrates, profound differences over Ukraine need not preclude conducting mutually useful business if both sides are willing to compartmentalize. But protecting the possibility of selective cooperation will require sophisticated, disciplined diplomacy.

For starters, the US and its partners will need to prioritize and even limit their goals in Ukraine. This means renouncing talk of regime change in Moscow. We need to deal with the Russia we have, not the one we would prefer. Putin's position may come to be challenged from within (or he may succumb to reported health challenges) but the West is not in a position to engineer his removal, much less ensure that someone better replaces him.

Likewise, Western governments would be wise to put off talk of war crimes tribunals for senior Russian officials and stop boasting about helping Ukraine target senior Russian generals and ships. The war and investigations are ongoing, and the Russians need to see some benefit in acting responsibly. The same holds for reparations.

Similarly, although Russia will likely find itself worse off economically and militarily as a result of initiating this war of choice, the US government should make clear that, contrary to Secretary of Defense Lloyd Austin's remarks, America's goal is not to use the war to weaken Russia. On the contrary, the US should underscore that it wants the war to end as soon as possible on terms that reflect Ukraine's sovereign, independent status.

As for the war in Ukraine, the West should continue to provide support for Ukraine and prevent escalation by avoiding direct combat. The Kremlin, though, should be made to understand that this restraint is premised on its not widening the war to a NATO country or introducing weapons of mass destruction, at which point such self-imposed Western limits would disappear. The West also should consider carefully its war aims and how to pursue them. The goal should be that Ukraine controls all its

territory, but this does not necessarily justify trying to liberate Crimea or even all of the eastern Donbas region by military force. Some of these goals might be better sought through diplomacy and selective easing of sanctions. But, until Russia's behavior changes, sanctions should not just remain in place but be extended to cover energy imports that are funding the Russian war effort.

Diplomacy is a tool of national security to be used, not a favor to be bestowed, and it should continue to be pursued with Russia. Private meetings between senior civilian and military officials of Western countries and Russia should resume, in order to reduce the risk of a miscalculation that could lead to confrontation or worse, and to explore opportunities for limited cooperation.

It may well be that constructive relations with Russia do not emerge until well into a post-Putin era. But this in no way alters the West's interest in seeing that relations do not fall below a certain floor in the interim.

TO FIGHT INFLATION, FIGHT PROTECTIONISM



Pinelopi Koujianou Goldberg (*Professor of Economics, Yale University; Former World Bank Group chief economist and Editor in-Chief of the American Economic Review*)

Surging inflation has made it much more difficult for US President Joe Biden's administration to justify a continuation of Donald Trump's protectionist policies. Though "openness" and "globalization" may have fallen out of political favor, free trade remains sound economic policy.

NEW HAVEN - One of the main goals that US President Joe Biden has set for his administration is to empower American workers and the country's middle class. Many believe that globalization (along with several other factors) contributed to stagnating real wages, rising inequality, and the sense that American workers have lost out to workers in other countries with lower labor standards. But in its attempt to reverse these trends, the Biden administration has embraced protectionist rhetoric and policies that will cause American workers to lose once again.

Though any mention of the word "openness" is met with suspicion nowadays, the surge in inflation – the US Consumer Price Index was up 8.3% in April – has nonetheless prompted a discussion among economists about whether trade liberalization (and openness more generally) could be used to rein in rising prices. Since one of the main arguments for free trade is that it lowers prices for consumers, the link between open borders and inflation is worth contemplating.

To be clear, no reasonable economist claims that the recent inflation is the result of trade restrictions. By now, the causes are well understood to be a combination of pandemic-driven supply-side shortages, policy-fueled demand, and further supply-side disruptions caused by Russia's war in Ukraine. But as policymakers struggle to contain inflation without causing a recession, they must recognize that "Buy American" requirements, tariffs, and immigration restrictions may be making a bad situation worse.

According to a recent Peterson Institute for International Economics (PIIE) policy brief, a feasible reduction of trade barriers "could deliver a one-time reduction in [CPI] inflation of around 1.3 percentage points." The study is conservative, focusing only on trade restrictions that can plausibly be lifted in the short term, and its authors are careful to emphasize that the result would be a one-time outcome. The proposed reduction of trade barriers would not solve the problem of rising prices; but it would make today's high prices lower.

US consumers would welcome such short-term relief. If the Biden administration finds it necessary to sell oil out of the Strategic Petroleum Reserve despite its commitment to addressing climate change, why shouldn't it also recognize the need to reverse Donald Trump's tariffs? In 2021, according to the PIIE brief, these duties still applied to more than half of US imports "subject to high tariffs, penalty duties, or severe quotas."

Perhaps more importantly, openness, whether it is free trade or immigration, also contributes to consumer welfare in indirect ways. Though these effects are often hard to quantify, they are of first-order importance, which is why economists often turn to first principles when debating them.

One of the most important benefits of free trade is that it exposes domestic firms (and labor markets) to greater competition, which induces them to keep prices low and to innovate constantly to stay ahead of the curve. Similarly, immigration eases labor-supply shortages, and high-skilled newcomers can boost productivity and innovation. Forward-looking countries understand this and embrace immigration. The United Kingdom, for example, has adopted a new skilled-worker visa program that welcomes graduates of top global universities.

It is deeply misguided to restrict trade and immigration at a time when rising domestic prices are of paramount concern. Now

that everyone is fixated on inflation, it is worth considering why inflation was so low these past two decades, despite full employment in the United States (prior to the pandemic) and despite ultra-expansionary monetary policies. Globalization (now a loaded term) arguably had a lot to do with it, as did automation (another loaded term).

The prospect of outsourcing jobs to lower-wage countries or to machines constrained workers' bargaining power. At the same time, foreign competition constrained domestic firms' pricing power (though there is ample evidence that the cost reductions they achieved by globalizing production still allowed them to make hefty profits).

Workers and firms face a different reality today. Their jobs and businesses seem more secure now that the US has turned inward and embraced protectionism. The "Great Resignation" and other developments have reduced the supply of workers, increasing the bargaining power of those still in the labor force.

This could be a positive development, except that the high inflation rate has undermined efforts to make the average American worker better off. While nominal wages in the US rose by 5.6% in the year ending in March (more than an extrapolation of the earlier trend would have implied), that month's 8.5% inflation rate implied that real wages fell by 2.7%.

If there is any silver lining to today's inflation, it lies in the lessons that this episode has provided to policymakers and the public alike. Because the benefits of open borders (lower prices) are less salient than the costs (lost jobs or lower wages), and because consumer interests are not organized, while worker interests often are, there is a bias toward protectionist sentiment. Today's inflation highlights the need to resist this bias.

The current decline in real wages is a reminder that our well-being depends not only on the nominal wages we earn as workers but also on the prices we pay as consumers. Open borders can help keep prices low during a challenging time. Reversing the tariffs imposed by the Trump administration would be a step in the right direction.

DARON ACEMOGLU SAYS MORE...



Daron Acemoglu (*Professor of Economics, MIT; Co-author with James A. Robinson of "Why Nations Fail: The Origins of Power, Prosperity, and Poverty" and "The Narrow Corridor: States, Societies, and the Fate of Liberty"*)

*This week in Say More, PS talks with **Daron Acemoglu**, Professor of Economics at MIT and co-author, with James A. Robinson, of "Why Nations Fail: The Origins of Power, Prosperity, and Poverty" and "The Narrow Corridor: States, Societies, and the Fate of Liberty".*

Project Syndicate: *Last July, you wrote that economists and investors were right to be apprehensive about deficit spending, public debt, and the risk of sustained price growth, but "it would be a mistake to respond to these concerns by pumping the brakes on the economy." US inflation has now reached its highest level in decades, and the US Federal Reserve is taking increasingly aggressive action to rein it in. Is the Fed doing enough? How concerned are you that sharp tightening will stifle the economic recovery, especially given the additional inflationary pressures stemming from the war in Ukraine?*

Daron Acemoglu: Well, I am concerned. It's hard not to be. What I emphasized last July was that high inflation and deficit spending carry significant risks, but not trying to save US democracy carries even larger ones. We've gotten the worst of both worlds: inflation rates are very high, and democracy is in even more trouble now than it was then. Six months before the US midterm elections, it seems incontrovertible that the Republican Party has become the party of Donald Trump, whose explicit support has practically become a prerequisite for GOP candidacy. To many well-educated, left-leaning Americans, this is still incomprehensible – and that, I suspect, is an important part of the problem. To safeguard US democracy from Trumpism, we must first understand why people are drawn to it.

Rather than label Trump supporters misguided or even "deplorable" – an approach that merely deepens the schism in American society – we must recognize that a very large share of the Americans who have not benefited from economic growth and who have felt cast aside, both economically and socially, support Trump. We must acknowledge their suffering, and work to ease it. Economic growth that brings some degree of shared prosperity is the surest way to help this group – as well as many others – in the United States. This is why delivering job and wage growth, and thus showing that US democracy works, is so important.

In the meantime, however, it is clear that Trump is a hugely flawed – indeed, truly awful – emissary for discontented, economically disadvantaged Americans. He is a corrupt, mendacious, and unstable would-be authoritarian. So, the defining

question of US politics becomes: Can anybody wrest these discontented voters from Trump's grip? Worryingly, the answer may well be no, at least in the near future.

High inflation is also an important problem. The expectation that prices will rise and wages will keep increasing removes firms' price-raising inhibitions. With that, inflation becomes self-sustaining.

To be sure, there's nothing magic about the Fed's longstanding 2% inflation target. If everybody agreed that a 3% target was acceptable or even superior, inflation could run at that level without destabilizing the economy. The problem is the sense that we are facing runaway inflation, which fuels discontent and creates instability.

Of course, the war in Ukraine is not helping, and not just because it is placing upward pressure on energy and food prices. The conflict also generates a huge amount of uncertainty. The danger that we could sleepwalk into a much bigger conflict remains very real.

Yes, indeed, these are worrying times.

PS: In March, you argued that the war should spur action to close tax havens, arguing that Russian oligarchs and others elites had no incentive to rein in authoritarian leaders because Western countries' policies and financial systems provided an attractive haven to stash their ill-gotten gains. Today, Western leaders seem convinced that sanctions against oligarchs can affect Russian President Vladimir Putin's calculations in Ukraine. Can they, or are oligarchs' holdings already too integrated into Western economies? What steps would increase the pressure on Russia's economic elites in the short term?

DA: The system of tax evasion and money laundering we have for the world's ultra-rich is truly shameful – doubly so, because this is not a sin of omission, but commission. The United Kingdom, for example, has purposely positioned itself as the banker and the butler to the crooked. The international financial system more broadly has been fueled by ill-gotten money from Russia, Ukraine, China, and the Middle East. Ending these flows of illicit money is essential to build better institutions, and it is a moral imperative.

I also genuinely believe that Putin would not be where he is today – having turned Russia into a mafia state controlled by former KGB lackeys – had it not been for the largesse that the West has shown to current and past Russian oligarchs. That is why I was heartened that the West took meaningful action against Russia and its oligarchs.

Will the sanctions topple Putin? I'm not sure. He has such a strong grip on Russian institutions, and his security services are so powerful and ruthless, that there is very little room for maneuver. But his regime will get weaker, not least because its ideological basis is being challenged. Russians might be facing Soviet-style repression, but these are not Soviet times. With only a VPN – and, to some extent, even without one – they can access information from all over the world. Many have personal contacts in Ukraine and even in the West. Opinions will shift over time.

For now, the West should do more to support Ukraine, beginning with ending all energy imports from Russia. There is also space to increase pressure on Russian oligarchs. Even if some of their yachts and mansions have been confiscated, many of their families continue to live lives of luxury in Western countries, funded by assets that were stolen from the Russian people. While it is true that some of those assets are too integrated into the Western financial system to be confiscated, much more can and should be seized. And, of course, the West must announce a credible plan to prevent the future laundering of ill-gotten wealth.

PS: US President Joe Biden's administration is also cracking down on cryptocurrency firms to prevent them from helping Russia evade sanctions. Last October, you suggested that Bitcoin ultimately has little to offer beyond a "puerile libertarian fantasy" and support for criminal activities. How salient is the risk of sanctions-evasion via alternative currencies, and how would an appropriate regulatory response work? Does Ukraine's embrace of cryptocurrencies to help fund its war effort point to genuine benefits that should be taken into account?

DA: It is a huge risk. Digital currencies are part of the reason why fighting money-laundering is much harder today than in the past. As for Ukraine, I don't think cryptocurrencies are really helping; after all, it has the West's support, so it doesn't need cryptocurrencies to receive funding. What is helpful is a good digital infrastructure, which is completely separate from crypto-tools and may or may not benefit from a blockchain-type decentralized ledger, as it enables the rapid transfer of funds from individuals, charities, and nongovernmental organizations.

As far as I can see, cryptocurrencies are helping only Russia. So now we can add "helping a truly evil regime" to cryptocurrencies' rap sheet, right under "boosting carbon emissions" and "facilitating crime."

BY THE WAY . . .

PS: The US Labor Department's March jobs report showed unemployment declining to just 3.6%, nearly a 3% drop from when Biden took office. Clearly, the US has made progress in creating jobs. But to what extent are they the kind of "good jobs" you

have called for? More broadly, one would expect today's employment picture to benefit the party in power, so why are the Democrats projected to take a shellacking in November's midterm elections?

DA: Headline unemployment is only one of the statistics we should consider. The employment rate among men in their prime working age, for example, is much lower than it was a few decades ago. More importantly, many of the jobs that are being created are not “good jobs.” While wages have risen over the last few years, inflation has risen faster, meaning that real wages have declined for many workers.

True, wages at the bottom of the distribution have increased faster, and the conditions of some of the lowest-paid hospitality workers have improved. But, while this is to be celebrated, my belief continues to be that the US has a good-job problem, which can be tackled only with much more concerted efforts to redirect technology and create labor-market institutions that encourage investments in labor and labor-complementary innovation.

PS: Your 2012 book “Why Nations Fail: The Origins of Power, Prosperity, and Poverty”, co-authored with James A. Robinson, examines the role of political and economic institutions in countries' development. When it comes time for Ukraine to rebuild, an outpouring of international support is likely. How can these resources be leveraged to help Ukraine – where governance was rife with weaknesses before the war – establish an institutional framework capable of supporting the country's reconstruction?

DA: Yes, rebuilding Ukraine will absolutely be a top priority, and success will require not only pouring resources into the country, but also building better institutions. On that front, I think there are reasons to be hopeful.

Even before the Russian invasion, Ukrainian democracy was on a positive trajectory, with Ukrainian youth, especially in major cities, among the most politically active and pro-democratic groups in the West. The war has united Ukrainians and deepened their commitment to freedom and democracy. I expect this to translate into a post-war consensus on the need to build institutions that are capable of delivering justice, controlling corruption, and creating a level playing field for new investments in technologies.

The West can help, but I hope that the West will also learn from its past mistakes – not least in Afghanistan, where its 20-year “nation-building” adventure was a colossal failure. The key lesson is that the West cannot just pour money into a country and dish out advice without understanding the local context. Ukrainian democracy can be built only by Ukrainians, and the West should humbly recognize that.

PS: You have described your 2019 book, “The Narrow Corridor: States, Societies, and the Fate of Liberty”, also co-authored with Robinson, as a kind of continuation of Why Nations Fail, as it takes a broader view of political and economic development and the dynamics of institutions. What topics are you taking up in your next book?

DA: I am currently working with Simon Johnson on a book on technology and inequality. The main argument is that policymakers and economists have been mesmerized by technology, as if it will by itself create shared prosperity and solve our deep-rooted social problems.

Using a rich array of historical evidence, Simon and I argue that technology brings benefits for most people only when it is not biased against labor, and when it is embedded in an institutional framework that empowers workers and citizens. Shared prosperity is much more contingent than we have come to believe. This is important today, because current digital technologies and, increasingly, artificial intelligence are going in the opposite direction – increasing inequality, impoverishing low-skill workers, and strengthening authoritarian governments and large, centralized (and, in essence, anti-democratic) companies.

Beyond elucidating the problem, Simon and I try to articulate new ideas for how to reverse these trends.