NEWSLETTER

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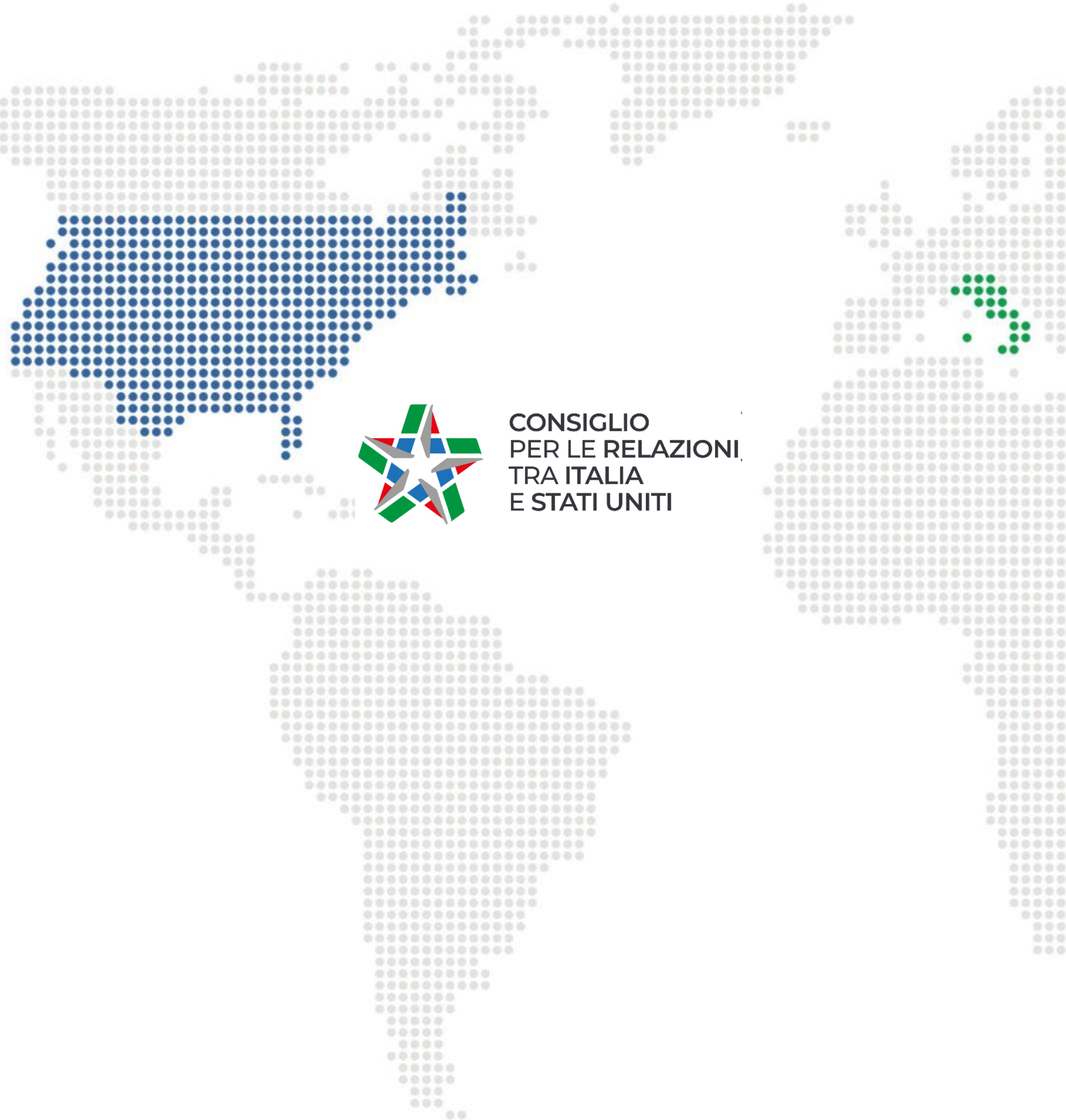

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ABOUT THE COUNCIL FOR THE UNITED STATES AND ITALY

The Council for the United States and Italy is a private non-profit organization, founded in Venice in 1983 by Gianni Agnelli and David Rockefeller, who served as honorary presidents until 2003. Marco Tronchetti Provera followed them as Chairman, then Sergio Marchionne until 2018. Domenico Siniscalco is the current Chairman, Gianni Riotta Executive Vice Chairman. The Council for the United States and Italy promotes and creates economic relations between Italy and the United States, linking them to Europe, Asia and Africa through knowledge and free trade. Its members are leaders in the economy, industry, finance, technology, services, consulting, law, and culture - a team in which economic growth is viewed as promoting humanity and wealth as a cultural value to be shared.

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

WEBINAR | The Cultural Revolution Hitting Boardrooms| June 15 @ 5 pm

Dambisa Moyo *(Co-Principal of Versaca Investments, Global Economist, Author & Board Member)*

As she defines herself, Dr. Moyo is an unconventional board member of global and complex organizations. Thanks to a wide experience in different companies across the world, she has a unique point of view on corporations and their role in the future.

After the 2009 financial crisis, there has been a rise in anti-corporations and anti-capitalist sentiment. It is now time to reassert the role of corporations globally, not only as jobs providers but also as important drivers for innovation. The responsibility of corporations will be always more critical, especially after Covid-19: the pandemic accelerated a set of risk that were already around e.g. low economic growth, rising public debt, collapse of aggregate demand, demographic shifts, increasing inequality. In addition to this, ordinary people often do not understand what the mandate of boards is and how they can affect change. Traditionally, boards have threefold reasons of existence:

1. Oversighting strategy in terms of products, competition, consumers, etc.;
2. Hiring policy in terms of who and why you hire, which becomes especially important for the CEO;
3. Broadening responsibility about the ESG after 2019 for climate change, voters' rights, pay equity, gender and racial rights. These rights all come with trade-offs: the very complex nature of these issues suggests that there is no end-point and no straight solution to them.

If we look at SMEs, they can also contribute towards more diverse leadership even in homogenous societies as Italy: ultimately, standards or restrictions to enhance diversity such as window-dressing are not satisfying towards the goal of (racial and gender) equality: discrimination cannot be fought with discrimination. Rather, the focus should be on transparent processes for choosing candidates with higher standardization of processes. Heterogeneity should also be reached at board level to keep up with the rising diversity in the customer base of the corporation.

Studies confirm that corporations that are more diverse in terms of gender and race perform better in terms of return on equity, return on capital, etc. In order to survive, thrive and compete, boards and corporations have to evolve to meet the moment: it is an existential responsibility.

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AMERICA'S MUDDLED INDUSTRIAL POLICY

Anne O. Krueger *(Senior Research Professor of International Economics, Johns Hopkins University School of Advanced International Studies; Senior Fellow, Stanford University)*

With the US Innovation and Competition Act of 2021, America is fully embracing industrial policy as the all-encompassing solution to a wide range of economic, social, and strategic problems. But all of the objectives articulated in the bill could be achieved more effectively by other means.

WASHINGTON DC – When a government sets out to "pick winners" and support designated industries, products, or firms through subsidies, tariff protections, tax breaks, and other measures, it is pursuing an industrial policy. For advocates of this approach, the idea is that the state should step in to boost "particular industries that are considered strategically important" when it is expected that markets and the private sector will not do so on their own.

Despite its long history of failures, industrial policy is back on the agenda in the United States. In early June, the US Senate passed the US Innovation and Competition Act (USICA) of 2021, which envisions a more active role for government in the economy. According to Senate Majority Leader Chuck Schumer, the legislation will "jumpstart American competitiveness and make one of the most significant government investments in American innovation and manufacturing in generations." The bill will now go to the House of Representatives, where it is expected to pass.

Most people agree that the government has an important and appropriate role to play in providing infrastructure, education, health care, social services, and other public goods such as basic research. But the USICA is full of provisions that are geared toward other objectives. As analysts from the American Action Forum explain, the bill incorporates several provisions that are meant to counter "Chinese influence domestically and abroad." These include increased funding for applied research through the National Science Foundation (NSF), the creation of more domestic research hubs, and stronger measures to increase diversity in STEM (science, technology, engineering, and mathematics) educational and research activities.

Although these provisions may well achieve their objectives for regional development and diversity, they are unlikely to strengthen America's manufacturing and defense capabilities. The NSF is being directed to support applied research that could be pursued more productively by the private sector; and a new NSF directorate would be tasked with ensuring an equitable distribution of research funds to create domestic jobs. Yet as The Wall Street Journal's editorial board points out, "effective research is about ideas, not jobs."

The bill also allocates resources for pairing weaker research universities with top ones (defined as those that received more than $100 million of federal research funding within the past three years); for improving STEM education in rural communities; and for funding domestic technology hubs that can emulate the successes of Silicon Valley. Yet while the American education system has weaknesses, its research universities aren't one of them.

America's top research universities are a source of national strength on the world stage. To shift resources away from them deliberately in an effort to assist weaker institutions makes little sense from either an investment or a strategic perspective.

Moreover, there are far better ways to pursue the USICA's various social and economic goals. Chief among these is to strengthen technical training. There is ample evidence that the US has a shortage of workers with the technical qualifications needed for today's labor market. Other countries have closed this gap by developing more effective training and apprenticeship programs. Improving curricula and school performance at the elementary and secondary levels would equip more young people for further technical training and for science education in universities.

While strengthening the US education system would yield large returns over the longer run, reforming immigration rules to admit more foreign STEM workers would strengthen America's research capabilities immediately. These measures to improve the quality of the US labor force would do far more for innovation and competitiveness than many of the USICA's provisions.

Elsewhere in the text of the bill, the authors have presumed, dubiously, that the government is good at identifying and funding specific applications of basic research. For example, they focus heavily on semiconductors, allocating $52 billion for a new "Creating Helpful Incentives to Produce Semiconductors for America Fund" at the Department of the Treasury ($24 billion of which would be appropriated for 2022 alone).

These funds are to be used to encourage the construction of domestic facilities "for the fabrication, testing, or advanced packaging of semiconductors at mature technology nodes." But as Scott Lincicome of the Cato Institute has documented, the US semiconductor industry is already healthy and profitable, accounting for nearly 50% of global semiconductor sales. Recounting the history of failed efforts in the 1980s and 1990s to support domestic semiconductor production, he points out that most of America's imported semiconductors come from its allies, further reducing the need for a strategic intervention in the sector.

Governments have a poor track record of identifying "winners" – be it a company or a category of technology – whereas private companies have proved better at transforming new discoveries into new products or cost savings. That is why the US state traditionally has stuck to funding basic research.

The USICA's aim of strengthening America's research capabilities is uncontroversial and praiseworthy, in principle. But while the NSF's funding certainly should be increased, that doesn't mean it needs a new directorate. And while American education and training certainly should be improved and made more accessible, that doesn't mean the government should oversee applied research, or that funding should be redirected away from world-leading universities.

HOW GREAT POWERS SHOULD COMPETE

Michael Spence *(Nobel laureate in economics; Professor of Economics Emeritus and former dean, Graduate School of Business at Stanford University)*

Both China and the West espouse some version of multilateralism. But unfettered strategic competition, together with relentlessly negative rhetoric, precludes effective multilateralism, not least by disrupting trade and technology transfer – a crucial driver of development.

MILAN – At the recent G7 and NATO gatherings, China was singled out as a strategic competitor, a calculating trading partner, a technological and national-security threat, a human-rights violator, and a champion of authoritarianism globally. China denounced these characterizations, which its embassy in the United Kingdom called "lies, rumors, and baseless accusations." The risks that such rhetoric poses should not be underestimated.

Many in the West disapprove of China's single-party governance structure, just as vocal elements in China disparage Western liberal democracy, which they argue is in terminal decline. The real danger, however, is that officials on both sides seem to have embraced a zero-sum framework, according to which the two sides cannot simply co-exist; one side must "win." By this logic, both sides must always be trying to crush the competition. So, for China, the West – especially the United States – must be seeking to reverse its rise (which, in reality, was facilitated in no small part by the US). And, for the West, China is determined to leverage its economic might, including its huge internal market, to reshape the global system in its image and to its benefit.

The more often leaders repeat these narratives, the more likely ordinary citizens are to become convinced that they are true. Rising fear and resentment on both sides increases the risk that the narratives will become self-fulfilling prophecies. In the meantime, the focus on bilateral competition obscures the needs and interests of people in emerging markets and developing economies. Yes, China and the West espouse some version of multilateralism. But unfettered strategic competition precludes effective multilateralism, not least by disrupting trade and technology transfer – a crucial driver of development. China and the West urgently need a new framework for understanding the state of the world and their place in it. Such a framework must recognize, first and foremost, that properly regulated economic competition is not a zero-sum game.

In static terms, normal economic competition bolsters price efficiency and helps to align supply and demand. In dynamic terms, it leads to what Joseph Schumpeter dubbed "creative destruction" – a powerful mechanism for translating knowledge, ideas, and experiments into new products, services, and cost-reducing processes. In other words, it leads to advances in human well-being. There is no reason to think that cross-border competition cannot produce the same benefits. On the contrary, experience shows that it can, so long as supporting legal and regulatory structures are in place and the playing field is level. Admittedly, delivering these conditions – especially a level playing field – is difficult on an international scale, but that doesn't mean it can't be done.

Strategic competition is a different story. After all, there are powerful dual-use technologies – often emerging from non-defense sectors – that advance both economic and national-security objectives. Leaders should not pretend this is not the case. But that, too, does not mean countries are condemned to play a zero-sum game, focused on making (or keeping) others weak. Instead, China and the West should agree to achieve and preserve a degree of economic, technological, and defense parity.

This means abandoning efforts to block the diffusion of knowledge and technology – an enterprise that is rarely effective in the long run. Such an approach would avoid greater fragmentation of the global economic system, which is particularly damaging to third parties. And it would deter offensive use of military or technological capabilities – vital in an environment where neither side trusts the other.

But a system that minimizes the need for trust does not justify mutual villainization. There is nothing wrong with preferring the governance system in one's own country, including its particular balance of individual rights and collective interests. Such preferences are based on factors like personal experience, education, and values, not objective fact. There is no clear evidence that one particular system of governance guarantees economic and social development. Both democracies and single-party systems have produced good and bad development outcomes. It seems that the most important precondition for development is leaders' commitment to an inclusive vision of human well-being.

When we assume that our own preferred system is objectively superior, and demonize alternatives, we end up mis-framing the terms and likely outcomes of economic and strategic competition. Worse, competition over governance distracts from more productive dimensions of interdependence.

IS THE FED GETTING BURNED AGAIN?

John B. Taylor *(former under-secretary, US Treasury; Professor of Economics, Stanford University; Senior Fellow, Hoover Institution)*

As in the stagflationary 1970s, the US Federal Reserve is once again denying that its own policies are the reason for a recent surge of inflation, even though there is good reason to think that they are. It is not too late to learn from past mistakes and reverse course – but the clock is quickly ticking down.

STANFORD – Fifty years ago, on June 22, 1971, US Federal Reserve Chair Arthur Burns wrote a memorandum to President Richard Nixon that will long live in infamy. Inflation was picking up, and Burns wanted the White House to understand that the price surge was not due to monetary policy or to any action that the Fed had taken under his leadership. The issue, rather, was that "the structure of the economy [had] changed profoundly." Accordingly, Burns was writing to recommend "a strong wage and price policy": "I have already outlined to you a possible path for such a policy – emphatic and pointed jawboning, followed by a wage and price review board (preferably through the instrumentality of the Cabinet Committee on Economic Policy); and in the event of insufficient success (which is now more probable than it would have been a year or two ago), followed – perhaps no later than next January – by a six-month wage and price freeze."

Perhaps owing to Burns's reputation as a renowned scholar (he was Milton Friedman's teacher) and his long experience as a policymaker, the memo convinced Nixon to proceed with a wage and price freeze, and to follow that up with a policy of wage and price controls and guidelines for the entire economy. For a time after the freeze was implemented, the controls and guidelines seemed to be working. They were even politically popular for a brief period. Inflation inched down, and the freeze was followed by more compulsory controls requiring firms to get permission from a commission to change wages and prices. But the intrusive nature of the system began to wear on people and the economy because every price increase had to be approved by a federal government bureaucracy. Moreover, it soon became obvious that the government controls and interventions were making matters worse.

Ignoring its responsibility to keep inflation low, the Fed had started letting the money supply increase faster, with the annual growth rate of M2 (a measure of cash, deposits, and highly liquid assets) averaging 10% in the 1970s, up from 7% in the 1960s. This compounded the impact of the decade's oil shocks on the price level, and the inflation rate shot into double digits – rising above 12% three times (first in 1974 and then again in 1979 and 1980) – while the unemployment rate rose from 5.9% in June 1971 to 9% in 1975.

As we know now, the US economy's performance in the 1970s was very poor owing at least partly to that era's monetary policies. This was when the word "stagflation" was coined to describe a strange mix of rising inflation and stagnant economic growth. As James A. Dorn of the Cato Institute recently recounted, Nixon's "price controls went on to distort market prices" and are rightly remembered as a cautionary tale. "We should not forget that the loss of economic freedom is a high price to pay for a false promise to end inflation by suppressing market forces". As it happens, Choose Economic Freedomis the title of a book that I published last year with George P. Shultz, who passed away in February at the age of 100. Schultz had gained decades of wisdom and experience as both a diplomat and economic policymaker, serving as the Nixon administration's budget director when Burns wrote his audacious memo. In an appendix to our book, we included the full text of that document, because it had only recently been discovered in the Hoover Institution archives.

It should now be recognized as required reading for anyone seeking to understand the recent history of US economic policymaking.
The Burns memo is a perfect example of how bad ideas lead to bad policies, which in turn lead to bad economic outcomes. Despite Burns's extraordinary reputation, his memo conveyed a set of terrible policy recommendations. By blaming everything on putative structural defects supposedly afflicting the entire economy, the memo's worst effect was to shun the Fed's responsibility for controlling inflation, even though it was clearly responsible for the rising price level.
By the same token, good ideas lead to good policy and good economic performance. As Schultz and I showed, this was certainly the case in the 1980s. The Fed reasserted itself as part of a broader economic reform, and the economy duly boomed.
The message from this historical experience – and many other examples in the United States and elsewhere – should be abundantly clear. And while history never repeats itself, it often rhymes, so consider where we are midway through 2021: inflation is picking up, and the Fed is once again claiming that it is not responsible for that development. Instead, Fed officials argue that today's surge in prices merely reflects the bounce back from the low inflation of the last year.
Worse, the Fed's policy is even more interventionist now than it was in Burns's day. Its balance sheet has exploded from massive purchases of Treasury bonds and mortgage-backed securities, and the growth rate of M2 has risen sharply over the past year. The federal funds interest rate is now lower than virtually any tested monetary policy rule or strategy suggests it should be, including those listed on page 48 of the Fed's own February 2021 Monetary Policy Report.
It is not too late to learn from past mistakes and turn monetary policy into the handmaiden of a sustained recovery from the pandemic. But time is running out.