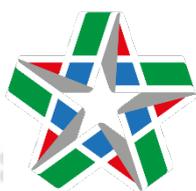


# NEWSLETTER

March 2022

n. 22



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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 | Ukraine and Russia: the war that has changed the world | March 9



**Ambassador Giampiero Massolo** (*President, Fincantieri; President*)

**Admiral Giampiero Di Paola** (*former Minister of Defence and former Military Chief of Staff, Italy*)

So many things have changed in just a few weeks, starting from Russia's invasion of Donbass on February 24<sup>th</sup>, 2022. Russian forces are invading from the Northern border towards Kiev and from the Eastern border controlling an even larger portion of the Donbass region. According to Admiral Di Paola, it is clear that Vladimir Putin believed that it would only take a few days to take control of the capital Kiev and, as a consequence, of Ukraine. Therefore, Russia did not employ the full military power it had. After experiencing a strong resistance by Ukrainian military forces and population alike, Putin is now increasing its pressure. Kiev is the main target, followed by the southern port of Odessa in an attempt to isolate the country from sea access. A successful attack on Kiev requires urban warfare, which would be very costly for its population. The Ukrainian resistance is still very strong, also thanks to vast supply of military capability, e.g. anti-tanks and anti-rockets. In the end, it is hard to make a prediction on the future of this war, depending on how the negotiation between Ukraine and Russia will evolve. However, nobody knows on what terms Vladimir Putin will agree to settle and what he is willing to give up.

Certainly, Putin is in a difficult position following the consolidation of the relationships of the international community, and especially between the United States and Europe within the NATO alliance. Sanctions against Russia are likely to remain in place even after the war is over and its actions will not be easily forgotten. We need to be ready to consider a rebirth of a cold war in Europe, with a united front against Russia for years. A new security architecture in Europe will evolve, but it cannot be designed with Putin in control of Russia. Indeed, Europe needs to move forward on strategic issues including energy, defence and greater political integration. In an era of power competition, in order to prevent future crises like this, Europe needs to be prepared: the best way to prevent a war is to be ready for a war and to win it, if you are forced to do it.

On a similar note, Ambassador Massolo believes that we are under a long-lasting toxic cloud and everybody will pay a price for it. Fighting, even for the sake of freedom, requires costs. The current situation can be analysed under three perspectives, which are strongly linked with each other: what is happening on the ground in Ukraine; what a potential settlement would look like; how a security framework in Europe will look like. Putin is advancing unacceptable revindications and requests; however, he underestimated both the Ukrainian resistance and the West unity. Despite the complications, Putin is going forward. The task of the West is to try to make Russian situation on the ground as complicated as possible. It is foreseeable that Russian forces will ultimately prevail, but it is important that they achieve an only partially positive outcome: if they prevail too much, they will be in a strong position at the negotiating table at the end of the war. For now, Putin cannot withdraw, and the West is supporting the Ukrainian resistance and humanitarian corridors. It is hard to foresee an end game but there are four elements to consider for a settlement on Ukraine: its neutrality, no-government change with a form of territorial integrity, a way of stocking stock for Crimea and Donbass, a form of broader international guarantee of Ukraine. On this last point, a new security order is likely to take place, especially in Europe. Whatever order will substitute the current liberal western one will put Europe in a worse situation. Every change will be at European detriment, proving that Europe only observes while the United States and Russia decide.

## PROJECT SYNDICATE

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### CAN THE WORLD AFFORD RUSSIA-STYLE SANCTIONS ON CHINA?



**Kenneth Rogoff** (*Professor of Economics and Public Policy, Harvard University; Recipient of 2011 Deutsche Bank Prize in Financial Economics; former Chief Economist, International Monetary Fund; author*)

*Many academic studies suggest that sanctions on China or a break in Sino-American economic ties probably would have a smaller quantitative impact than one might think, at least over the medium to long term. But that is a theory better left untested.*

CAMBRIDGE - As the global economic fallout from the current Western-led sanctions against Russia becomes clearer, are we watching a preview of what a trade and financial rupture with China might look like? Perhaps, but many academic studies of globalization's net benefits suggest that sanctions on China or a break in Sino-American economic ties probably would have a smaller quantitative impact than one might think, at least over the medium to long term.

This is true for both the United States and China, which are large and relatively diversified economies. So, while an economic rupture with China may hurt the US and Europe less than one might assume, sanctions on China also might not prove nearly as effective as the measures against Russia have been.

To get an idea of the magnitude of the effects involved, consider the current debate in Europe on restricting Russian gas imports. Judging by European policymakers' hesitancy, one might think that cutting off energy supplies from Russia, which provides about 35% of Europe's natural gas, would doom the continent to an epic recession. But careful academic studies, including one by UCLA economist David Baqaee and co-authors, estimate that the negative effect of such a step on the German economy, which is particularly vulnerable, would likely be well under 1% of GDP, or 2% in an extreme scenario.

As with many similar thought experiments on the gains from globalization, much depends on one's assumptions about an economy's flexibility, about alternative sourcing (Germany can draw on reserves and US liquefied natural gas), and about how sticky preferences are. The fact that Europe can use its gas reserves and LNG imports from the US gives it time to adjust, and in the longer run the costs of not relying on Russia for energy would be small indeed. Using a very different methodology, the European Central Bank comes to a broadly similar conclusion. True, both studies acknowledge great uncertainty, and policy matters: a Europe-wide mechanism to share gas resources would even the burden. But if one believes that the actual economic impact of cutting off Russian energy is so modest, then it is difficult to understand Europe's reluctance to do so now.

That said, the effects of deglobalization, like the effects of globalization, tend not to be distributed equally. Europe's caution may well have much to do with pressure from lobby groups representing regions and industries that will be most affected by an embargo on Russian energy.

China, of course, is not Russia. Its economy is ten times larger; over the past three decades, it has moved to the center of global trade and finance. As a critical supplier of intermediate inputs in manufacturing as well as the final link in the Asian supply chain, China has literally become the workshop to the world. As an importer, it is now even more significant than the US in sectors ranging from basic commodities to European luxury goods.

China has over \$3 trillion in foreign-exchange reserves, and is a major holder of US government debt. Its savings and portfolio preferences have long been a major contributor to today's very low interest-rate environment. So, wouldn't world output fall massively if geopolitical tensions suddenly forced China into economic isolation, perhaps together with a group of other autocracies including Russia and Iran? Interestingly, canonical trade and finance models do not predict such catastrophic outcomes, at least not in the medium to long term. For example, one recent study found that decoupling global value chains, which would be hugely affected by a reduction in trade with China, would cost the US only 2% of GDP. For China, the cost might be higher, but still only a few percentage points of GDP.

While the literature on financial globalization also is extensive, the bottom line is the same: Openness to international lending and investment generally benefits a country, but the gains are quantitatively smaller than one might expect, especially where regulation is weak.

One can conclude the impact of a US-China economic split would be bigger by assuming that deglobalization would lead to a dramatic reduction in the variety of goods available to consumers, higher markups by local monopoly suppliers, and less “creative destruction” in the economy. Still, it is not easy to show that the effects of trade sanctions would be as crippling for either the US or China as they have been for Russia’s much smaller and less diversified economy.

More subtly, but perhaps as important, global financial pressures can sometimes force even autocratic governments to adopt better policies and institutions, with central bank independence being a leading example. In 2014, after Russia’s illegal annexation of Crimea, fear of a global bond-market reaction to the resulting sanctions apparently discouraged President Vladimir Putin from firing the central bank head, Elvira Nabiullina, when she raised interest rates to painful levels to fight inflation. In the event, she was widely credited with having prevented financial crisis and default. The Russian central bank’s status today is such that Putin is rumored to have refused Nabiullina’s resignation in the wake of the Ukraine invasion.

My best guess, while acknowledging the difficulty of proving the point, is that an overshoot in deglobalization could easily be disastrous, particularly in undermining innovation and dynamism. But many academic studies estimate a smaller-than-expected quantitative impact from a US-China economic rupture. That is the theory, at least. It would be much better not to test it.

## WHY CHINA WON’T MEDIATE AN END TO THE UKRAINE WAR



**Joseph S. Nye, Jr.** (*Professor, Harvard University; author of “Do Morals Matter? Presidents and Foreign Policy from FDR to Trump”*)

*If there is one person other than Vladimir Putin who can end Russia’s war in Ukraine, it is Chinese President Xi Jinping. But Xi has so far remained on the sidelines and is likely to stay there, owing to various domestic political vulnerabilities and his own lack of courage and imagination.*

CAMBRIDGE – Russian President Vladimir Putin thought he could quickly capture Kyiv and replace Ukraine’s government. Whether he was misled by poor intelligence or by his own fantasies about history, his “smash and grab” failed in the face of effective Ukrainian resistance. He then turned to a brutal bombardment of cities like Mariupol and Kharkiv to terrorize the civilian population into submission – as he had previously done in Grozny and Aleppo. The tragic upshot is that Ukraine’s heroic resistance has been accompanied by increasing civilian suffering.

Is there any way to end this nightmare quickly? One possibility is for Chinese President Xi Jinping to see that he has a “Teddy Roosevelt Moment.” After the brutal war between Russia and Japan in 1905, Roosevelt stepped in to mediate. He pressed hard for the parties to compromise and ultimately prevailed, thereby boosting America’s global influence and winning himself a Nobel Peace Prize.

Turkey, Israel, and France (among others) are attempting to mediate in Russia’s current war, but they do not have nearly as much leverage with Putin as his ally Xi does. The question is whether Xi has the imagination and the courage to use it.

The answer, thus far, is no. While China has long portrayed itself as a defender of the principles of sovereignty and territorial integrity, it has tolerated Putin’s brazen violation of the United Nations Charter. When the UN Security Council voted on a resolution condemning Russia’s invasion, China abstained. China has criticized Western sanctions against Russia and parroted Russian propaganda about the war being caused by America’s own plans to pursue NATO enlargement, even though it had been clear for years that NATO members were not going to vote to admit Ukraine.

China’s unwillingness to criticize Russia has left it sitting on the diplomatic sidelines, unable to wield influence commensurate with its growing economic and military strength. Although Chinese censors limit most news about the war, some in Beijing have openly wondered whether China’s current diplomatic stance best serves its national interests. For example, Wang Huiyao, the president of the Center for China and Globalization in Beijing, has suggested that China should mediate to give Putin an “offramp” from his disastrous Ukraine policy.

Why might this be in China’s interest? For one thing, China’s current position undermines its claim to be a defender of sovereignty, which it uses to appeal to its neighbors in Southeast Asia. Equally important, the war is blunting China’s soft

power in Europe, which accounts for five times more of China's trade than Russia does. The war has also driven up the price of China's oil and grain imports. Grain prices will become even more salient if China experiences the same degree of severe flooding that it did last year.

As the war drags on and Western sanctions increase, there is also a danger that secondary sanctions will spill over and harm China. Providing Putin with a face-saving offramp could address this and the other dangers the war poses. And it would deepen Russia's growing dependence on China and boost China's own global image and standing. Xi might even win a Nobel Peace Prize.

Of course, there would be costs associated with such an initiative. Cautious Chinese diplomats see the war in Ukraine as a decidedly European conflict. If it saps the strength of older powers such as Europe, the United States, and Russia, China can benefit by standing back and letting the conflict burn itself out. Moreover, although the war is weakening an ally (a potential cost), it also has changed the global political agenda in ways that are advantageous to China. No longer can the US talk about a pivot to Asia, where it would focus its attention on China.

After the 2008 financial crisis, Chinese leaders concluded that the US was in decline, and this led them to abandon Deng Xiaoping's patient and cautious foreign policy. Nationalism has since been rising in the country, and Xi has expressed the hope that China will decisively displace the US geopolitically by 2049 – the centennial of the People's Republic.

The primary obstacle to Xi's dream is of course the US, followed by China's lack of allies other than Russia. Xi and Putin have forged a personal relationship that has reinforced what was previously an alliance of convenience. Even if the war in Ukraine has made that alliance somewhat less convenient, Xi may still feel that it is prudent to "dance with the one who brought you to the party."

Besides, initiating a Rooseveltian move would probably require more imagination and flexibility than the Chinese leadership is capable of. One also must consider a domestic political element that a Chinese friend recently pointed out to me: With Xi seeking a third presidential term this year, what matters most to him is maintaining the Communist Party's control of the country and his own control of the party.

As economic growth has slowed, the party has increasingly relied on nationalism to legitimize its rule. That is why Chinese official media and nationalistic websites have repeated Putin's claims that Ukraine is a puppet of the West, and that Russia is standing up to America's bullying of both Russia and China. Support for Putin's war is in keeping with China's nationalist "wolf warrior diplomacy."

But while Putin's invasion has upended world politics, it has not changed the underlying balance of power. If anything, it has slightly strengthened the US position. NATO and America's alliances have been reinforced, with Germany embracing a far more muscular defense posture than at any time in decades. At the same time, Russia's reputation as a formidable military power has suffered a serious blow. Its economy is weakened, and its soft power lies in tatters. China can no longer tout the alliance of autocracies as proof that the East wind is prevailing over the West.

China could still change the dynamic by seizing its Teddy Roosevelt opportunity. But I doubt that it will.