Robert Mundell[*]

Acceptance of an Honorary Degree from the University of Bologna: Rimini, September 2, 2006[**]

Magnifico Rettore, dear colleagues, distinguished guests, ladies and gentlemen:

I am very grateful for the honor you have conferred on me by making me Doctor Honoris Causa in the Political Economy of Markets at the University of Bologna. I am complimented by the expressions of praise and commendation in which you have addressed me. It is especially gratifying to me to receive this degree from one of the oldest universities in the world, in a city where I spent two years of my youth-and in which my second son was born.

Bologna University was a model for many other universities in Italy, Europe and the world. Its influence has been as a deep river, spreading light among the dark shadows of man's ignorance. In the Middle Ages it numbered Petrarch and Dante among its students and in recent years it has had Umberto Eco and Romano Prodi among its professors. As a new graduate I am flattered to be in such distinguished company.

Bologna is the oldest university in Europe. Next week I will be in China, at the Yuelu Academy of Hunan University, in Changsha, the capital of Hunan province. This academy, founded in A.D. 976, was a leading center of Confucius Studies during the Song dynasty. It is considered by some the oldest university in the world, defined as the academic establishment of higher learning in continuous operation. By the same criterion, Al-Azhar University, in Cairo, Egypt, founded in A.D.988, places second, followed by Bologna, precisely a century later. Who knows, perhaps someday there might be a connection between these magnificently old important universities!

I want to thank you also for mentioning my contributions to economic theory and policy. I would like to take a few minutes to elaborate on my interventions in economic policy, starting with the Mundell-Fleming model and the theory of the monetary-fiscal policy mix.

My early work in economics had been on the pure theory of international trade but I moved on to developing what became the Mundell-Fleming model when I taught at the University of British Columbia in 1957-58 and at Stanford University in 1958-59.

I continued my work in this area in my years teaching in the John Hopkins University Center in Bologna and at the International Monetary Fund. When I arrived at the IMF in the fall of 1961, I was asked by Jacques Polak, the Director of Research, to work on the major economic problem confronting the new Kennedy administration. In his election campaign John Kennedy had promised to "get the economy moving again" but by the fall of 1961 the economy had not responded and there was much discussion of the need for alternative policies.

I used the Mundell-Fleming model to show that the policy mix adopted by the administration was incorrect. It was

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[**] Discorso pronunciato presso il Polo Scientifico Didattico di Rimini il 2 settembre 2006, in occasione del conferimento della Laurea Honoris Causa in Economia e Politica dei Mercati, disponibile anche all'indirizzo http://www.robertmundell.net/pdf/AcceptanceSpeech_BolognaUniversity.pdf (ripubblicazione autorizzata dall'autore) [N.d.r.].

exactly opposite to what was required to bring the economy back toward equilibrium. To achieve the government's objective, the administration would have to reverse the policy mix, using monetary policy to control the balance of payments and fiscal policy to stimulate the economy. I put this idea in a neat four-quadrant diagram with arrows showing the directions in which monetary and fiscal policy would have to be adjusted. The memorandum I wrote was circulated to all IMF members in the fall of 1961 and published in the IMF Staff Papers in March 1962.

The result was, as they say, history. Within a year of its publication, President Kennedy announced the reversal of his policy mix. It had its fruition in policy in 1964. Tragically, Kennedy, struck down on November 22,1963 by an assassin's bullet, never lived to see the success of his new policy, which resulted in the longest economic expansion (until then) in US history.

Kennedy's policy had a sequel twenty years later in the tax cuts of the Reagan Revolution. I had come to Columbia University in New York in 1974, and started what came to be called "supply-side economics" that fall with colleagues like Arthur Laffer and Jude Wanniski at the now-famous meetings at the Restaurant Michael One in Wall Street. The basic idea of supply-side economics was that the tax and regulatory system in the U.S. was asphyxiating the economy. Tax rates went up to 70% at the federal level alone, and inflation was insistent in pushing taxpayers into higher tax brackets without any increase in their real income. The result was diminished incentive to invest and produce and what came to be called "stagflation" on a major scale.

The necessary remedy was, as in the Kennedy years, a drastic change in the policy mix. It was necessary to use monetary policy to control inflation and tax cuts to increase investment and growth. During the presidential election campaign of 1980, Ronald Reagan accepted the Kemp-Roth Bill as a platform for tax cuts; this bill provided for a 30% across the board cut in tax rates and an immediate cut in the tax rate in the highest income tax bracket to 50 per cent.

In the 1980 election, Reagan won election to the Presidency and the Senate became Republican, but the House of Representatives was still controlled by the Democrats. Would the Democratic-dominated House of Representatives pass the Reagan bill for tax cuts? It seemed unlikely early in 1981.

But in one of the great ironies of history, help came from a completely unexpected quarter. In April 1981, a young man named Hinkley, trying to impress screen heroine Jodie Foster, shot and wounded the president. This was an event that shook the world. But it had an unexpected effect on the tax bill. We cannot say for sure that the tax bill would have failed in the absence of Hinkley's bullet. But sometimes even catastrophes have a silver lining.

What is sure is that the president's aplomb and humor under fire - like the Western heroes he sometimes played in the movies - won him the public's undying admiration. The snide jokes about Reagan and his B-movies suddenly became unfashionable. It became politically risky for members of the House to deny Reagan the program on which he had won election. The result was the Economic Recovery Act establishing the Reagan revolution.

Just three weeks ago, on August 13, 2006, supply-siders celebrated the twenty-fifth anniversary of the Economic Recovery Act establishing Supply-Side Economics as the most important force in economic policy since the Keynesian Revolution.

It is important to understand an important difference between the Kennedy and Reagan tax cuts. Both were designed to increase employment and output, but they came at it from different directions. Whereas the philosophy behind the Kennedy tax cuts was essentially Keynesian, to stimulate demand, the Reagan tax cuts were designed to increase supply, increasing the incentives to produce and save, work and invest. The Kennedy tax cuts were based on Demand-Side Economics, the Reagan tax cuts were based on Supply-Side Economics.

From the end of 1982, the economy soared. Further tax cuts in 1986 brought the tax rate in the highest bracket down to

28%, the lowest it had been since 1932, when Reagan left the Presidency. The economy had what Robert Bartley, the editor of the Wall Street Journal, called "the seven fat years" of the second-longest expansion up until then in US history.
Looking back over the event, we can pose a question that I hope you will not consider more a candidate for Trivial Pursuits! What movie in all history has made the greatest contribution to global GDP? My answer is, hands down, "Taxi Driver," the 1974 Martin Scorcese movie starring.
Robert de Niro and Jodie Foster about a taxi driver (de Niro) stalking the president to impress his girl friend. This is the movie that started Hinkley's fetish with Jodie Foster that set him off on the mad chain of events that had its unlikely sequel in the Supply-Side Tax Revolution.
The economic benefits from the tax cuts are enormous. Taking into account the fact that we still enjoy their legacy today, that they helped propel the Silicon Valley IT revolution, and that supply-side philosophy spread to Europe and much of the rest of the world, it would be not unreasonable to estimate their total contribution in several trillions of dollars!
Poor "Gone with the Wind"! Poor "Star Wars"! Poor "Titanic"!
Let me now turn to a third episode of policy that I was associated with. This is the creation of the euro. I started thinking about currency issues when I was at the London School of Economics in 1955-56. The 1956 Treaty of Rome creating the Common Market for six countries in Europe set me thinking about the subject of currency areas and flexible exchange rates. My adviser at LSE, was Sir James Meade, who would share the Nobel Prize in Economics with Bertil Ohlin in 1977. Meade had written a pamphlet arguing for flexible exchange rates among the Six. I was not willing to accept Meade's argument that flexible exchange rates would be advantageous for the six countries pursuing increased economic integration.
To make a long story short, I finished the final draft of my 1961 AER article on Optimum Currency Areas when I was in Bologna. I had become a believer in the merits of a European currency. In December 1969 I presented a paper entitled "The Case for a European Currency" to the American Marketing Association in New York. This paper contained perhaps the first explicit plan for a European currency, which I called the "europa". My views were written up and circulated in the Chase-Manhattan Bank Letter. Through this connection, I received a request for copies of my paper from the Monetary Committee of the European Economic Commission, and I invited one of the committee members, Boyer de la Giroday to my Conference on Optimum Currency Areas, held in March 1970 in Madrid.
For a couple of weeks in the summer of 1970 I was a guest of the European Commission and wrote some memos containing alternative routes to a European currency. In that fall, the Werner plan came out and established the goal of European Monetary Union. In the following years I was made a member of a Study Group on European Currency that included Sir James Meade (who had meanwhile become a convert to a European currency), Bertrand de Juvenal and others.
The euro is now a great success: In the euro area, every household has a world-class currency, every firm has a continental capital market and every country has a better policy mix. Inflation throughout the euro has been rubbed out, transaction costs associated with currency-changing have been eliminated, and information costs have been reduced to a minimum. I don't think any country will want to undo the great experiment or go back to the interest rates its people faced before the euro came into being.
The euro is by no means the end of the process toward European integration. The Treaties of Dublin and Maastricht made a kind of commitment to a European Federation. The rejections of the French and Dutch referenda show that the opinions of the public cannot be taken for granted. But the rejections are not tragedy. They are opportunities to go

forward in a new way. The New Europe of the Germanic, Latin and Slavic nations need a more coherent decision-making framework. In the next round of constitution consideration I would hope there is more academic input and discussion about competing alternatives.

It may be that the major problems faced by Europe are not economic. Picasso once said that computers are useless: all they give are answers! The destiny of mankind is not decided by material computation. The problems of the European Union are harder to solve than the problem of making rich countries richer.

Europe is a wonderful invention and the E.U. is completely unique in history. It is made more remarkable by histories of countries that go back thousands of years and cultures that lifted global civilization to heretofore undreamed of levels. North America is of course the beneficiary, the son of Europe. But Europe has to keep moving. The proverbial bicycle cannot be allowed to stall. It is quite likely that the new form into which what is now a European Confederation evolves will not reflect any existing model but will be a composite that will require some new, creative thinking. It is a challenge for creative academics as well as able statesmen.

Mr. President, it is good to be here in Rimini. I am glad to see that the University of Bologna has left behind its ancient custom of the middle ages that forbids its professors to teach outside the city walls! Decentralization has allowed partly autonomous institutions to flourish in Cesena, Forli, Ravenna and here in Rimini. My congratulations on this venture in Rimini, and best wishes for its continuing success.

Finally, let me conclude by thanking you with all my heart for the honor which you have awarded me today. I shall do my best to be worthy of it.