

**Back to the future:  
the macroeconomic consequences  
of readopting a national currency  
in Italy**

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Economic Modelling  
Volume 64, August 2017, Pages 524–538

Withdrawal of Italy from the euro area: Stochastic simulations of a structural macroeconometric model 

Alberto Bagnai<sup>a</sup>,   Brigitte Granville<sup>b</sup>,  Christian A. Mongeau Ospina<sup>a, c</sup>, 



<https://doi.org/10.1016/j.econmod.2017.04.010>   [Get rights and content](#)

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## Content

- One telling anecdote (out of many)
- Motivation of the paper.
- Why it can't last.
- Analytical issues and scientific literature.
- The model.
- The scenarios.
- Conclusions.

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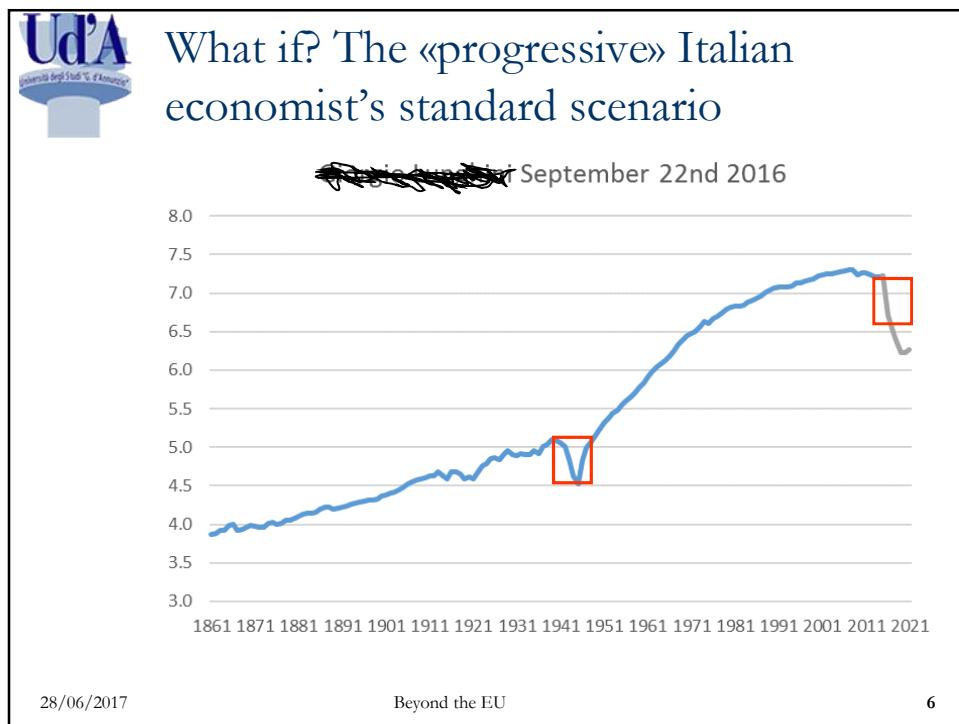
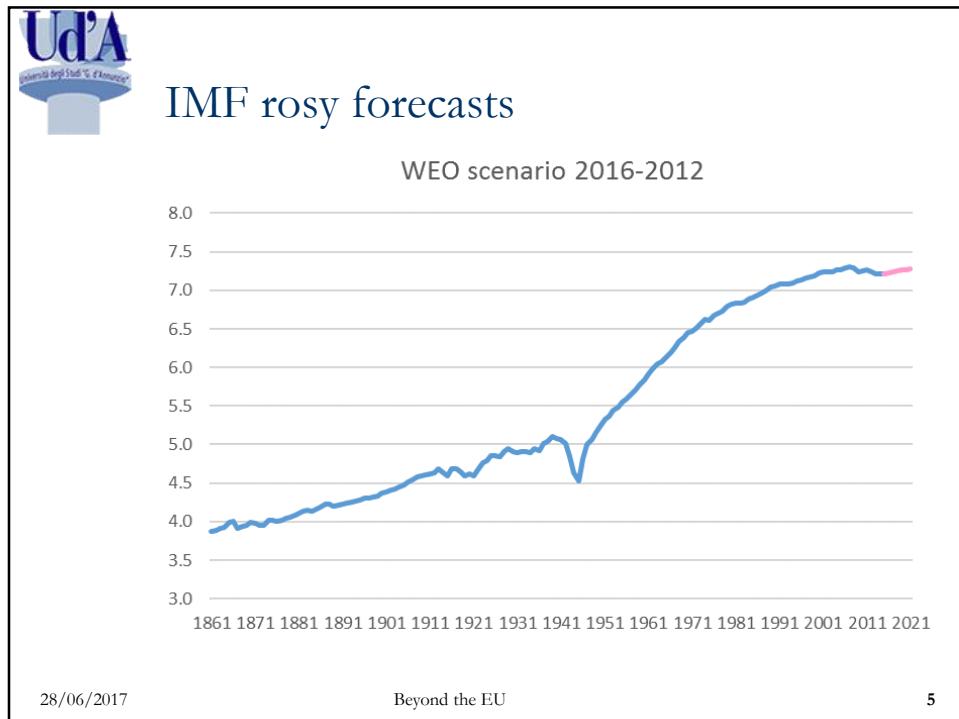
## 155 years of Italian GDP



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 I know it is unbelievable, but here it is...

**il manifesto** quotidiano comunista

ANNUNCI (HTTP://ILMANIFESTO.INFO/SEZIONI/ANNUNCI/)  
TRATTIVE (HTTP://)

ABBONATI (REGIST)  
ENTRA (LOGIN)

COMMENTI (HTTP://ILMANIFESTO.INFO/SEZIONI/COMMENTI/)

## Le conseguenze di un'uscita dall'euro

Come conseguenza di tutto ciò, la caduta del Pil dell'Italia sarebbe pari a circa il 40% nel primo anno e al 15% negli anni successivi per almeno un triennio.

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## Where do these figures come from?

 UBS

**UBS Investment Research  
Global Economic Perspectives**

6 September 2011  
[www.ubs.com/economics](http://www.ubs.com/economics)

**Euro break-up – the consequences**

We estimate that a weak Euro country leaving the Euro would incur a cost of around EUR9,500 to EUR11,500 per person in the exiting country during the first year. That cost would then probably amount to EUR3,000 to EUR4,000 per person per year over subsequent years. That equates to a range of 40% to 50% of GDP in the first year.

The only way to hedge against a Euro break-up scenario is to own no Euro assets at all.

**Translation: «Follow our disinterested advice: bring your money to UBS!»**

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## Conclusion and moral

- Mario Nuti, associate editor of the Cambridge Journal of Economics, intervened with six other heterodox colleagues, pointing out the absurdity of this scenario.
- The answer was: «I was trying to fight populism».
- ...

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## Populism then...



### Nicholas Kaldor (1971)

It is a dangerous error to believe that monetary and economic union can precede a political union. For if the creation of a monetary union and Community control over national budgets generates pressures which lead to a breakdown of the whole system it will prevent the development of a political union, not promote it.

«The dynamic effects of the common market»,  
*The New Statesman*

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**Ud'A**  
Università degli Studi "G. d'Annunzio"

...and now!

Domenica 5 Giugno 2016, 10:25

**Padoan: «Berlino condivide i rischi o questo euro non ha senso»**

PER APPROFONDIRE: berlino, euro, padoan, rischi



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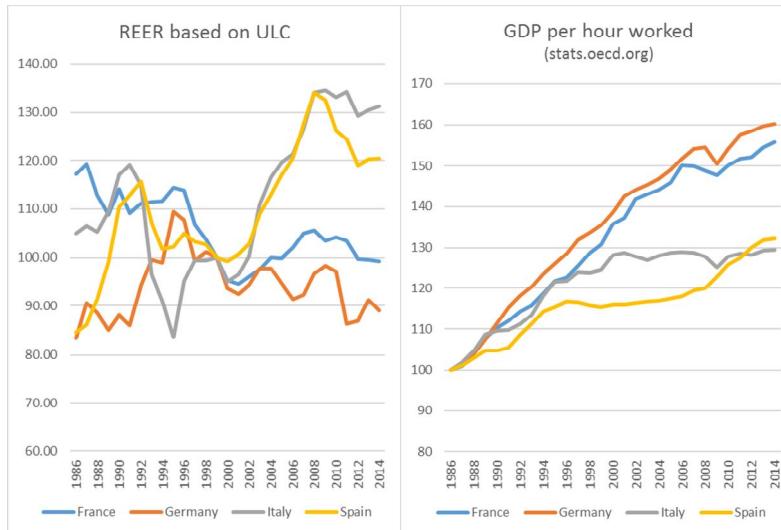
Motivation: the need for a professional analysis of an exit scenario

- It is not an «action plan» for managing a euro exit or a euro collapse.
- A professional assessment of the macroeconomic consequences.
- Is that true that it will be worst than WWII?
- An assessment is needed, because historical experience and scientific literature provide a completely different picture.

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## Why it can't last: monetary integration vs. real disintegration



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## Why it can't last: monetary integration vs. real disintegration

### The Real Exchange Rate and Economic Growth

Dani Rodrik

John F. Kennedy School of Government  
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Economists have long known that poorly managed exchange rates can be disastrous for economic growth. Avoiding overvaluation of the currency is one of the most robust imperatives that can be gleaned from the diverse experience with economic growth around the world, and it is one that appears to be strongly supported by cross-country statistical evidence (Razin and Collins 1997, Johnson, Ostry, and Subramanian 2007, Rajan and Subramanian 2007).

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## Why it should not last (unless you legitimately like neoliberal policies)...

- Factor mobility as a panacea: the (flawed) neoliberal foundations of Europe:
  - ignores the destabilising effects of capital movements on income distribution (huge literature, including the IMF! Furceri and Lungani, 2015), favoring private indebtedness (Perugini et al, 2015, «Inequality, debt and financial crises»), thereby leading to crises used to alter the income distribution further (Diwan, 2001).
  - ignores the destabilising effects of labor movements: skill-biased internal migration (Fatas, 1998; Pasimeni, 2014).
- The «vincolo esterno» as a Trojan horse for neoliberal policies
  - the advantage of tying one's hand (Giavazzi and Pagano, 1991), provided austerity is expansionary...
  - the single currency as a «challenge to the European social model» (Featherstone, 2001).

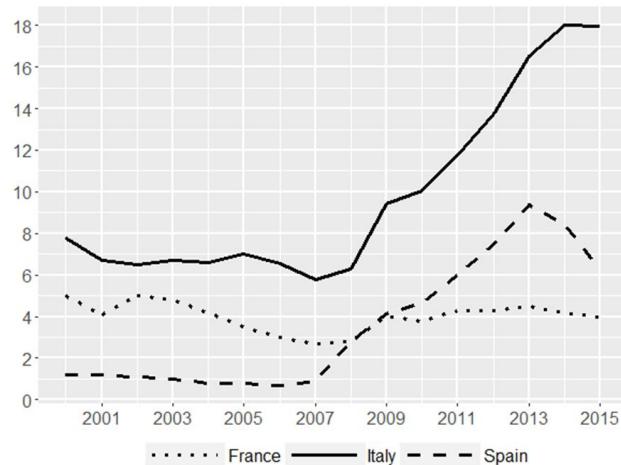
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## NPL/GDP: when adjustment can occur only through income...



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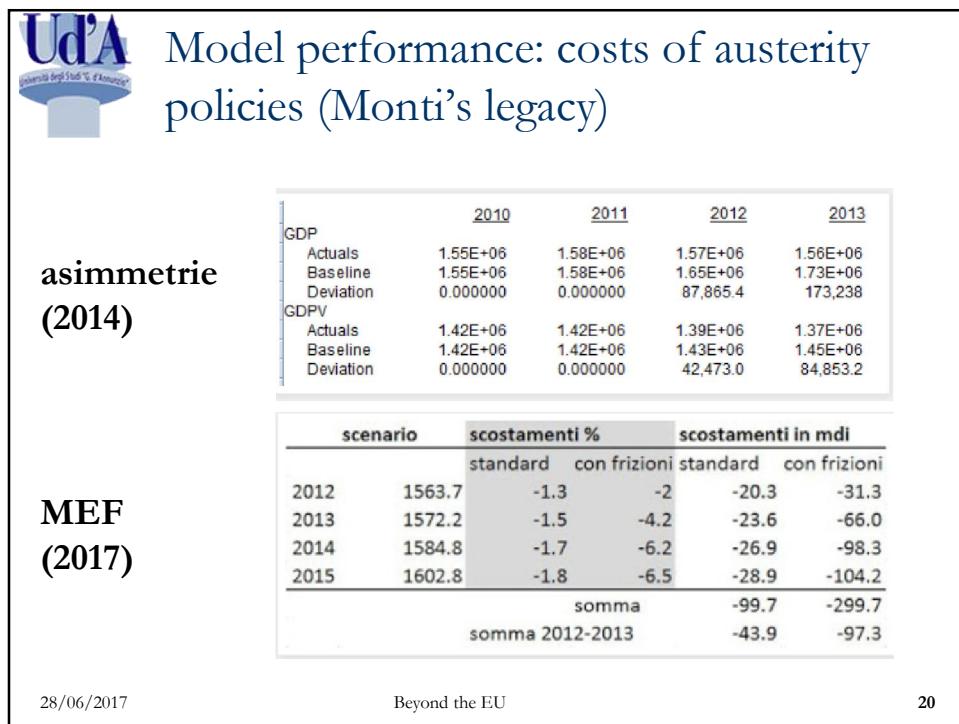
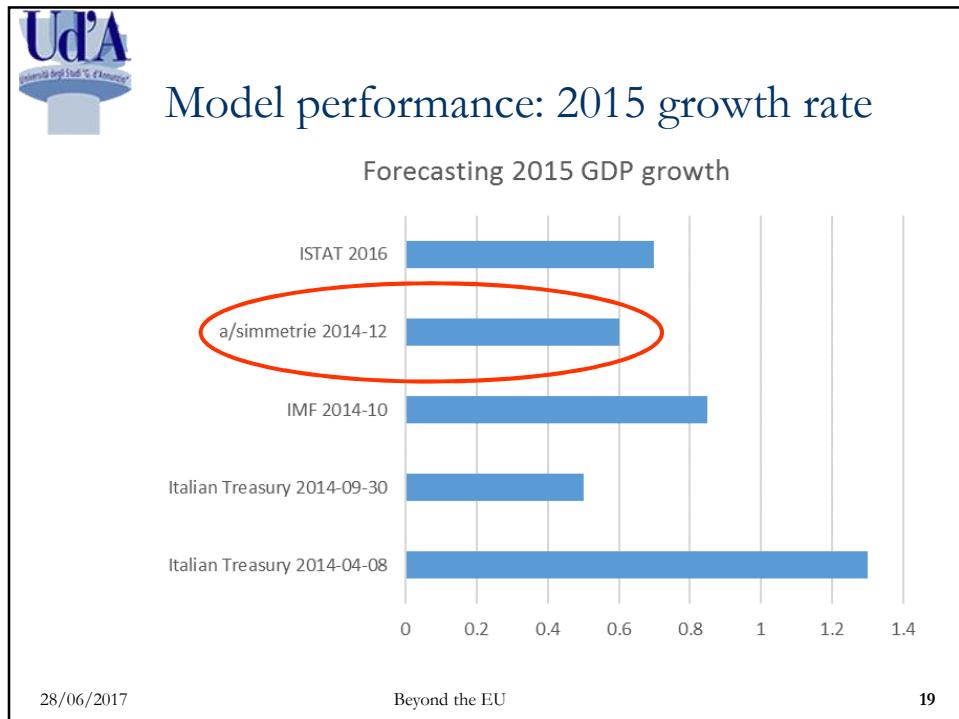
## Model features

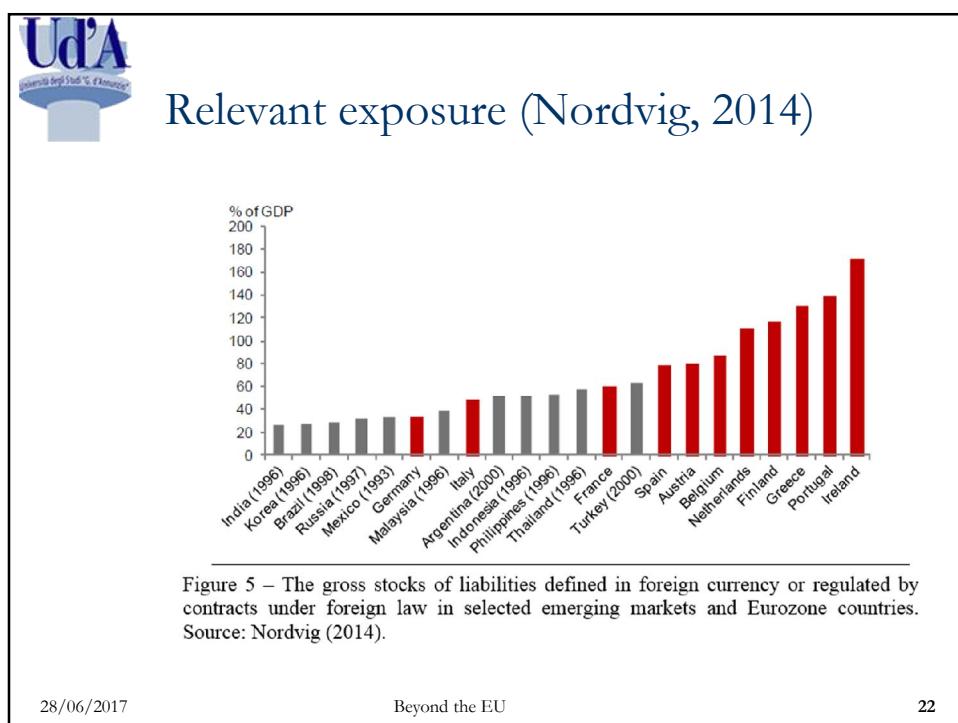
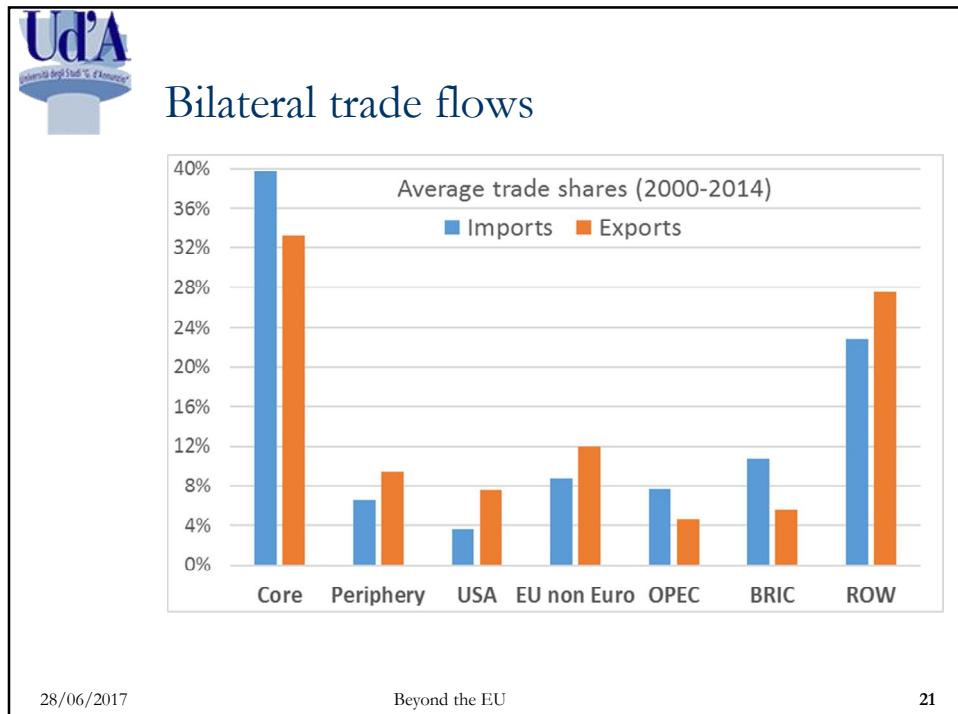
- Standard AS/AD model, 140 equations, 55 exogenous variables
- Disaggregation of trade among 7 main partner areas
- BEER estimation (Clark and McDonald, 1998) of the currency misalignment (as in Coudert et al., 2013)
- Endogenization of the recessionary «balance sheets effects» of a large devaluation (Cespédes, 2005; Nordvig, 2014; see also Durand and Villemot, 2016)
- Sovereign debt spread as a function of macroeconomic fundamentals (Gödl and Kleinert, 2016)

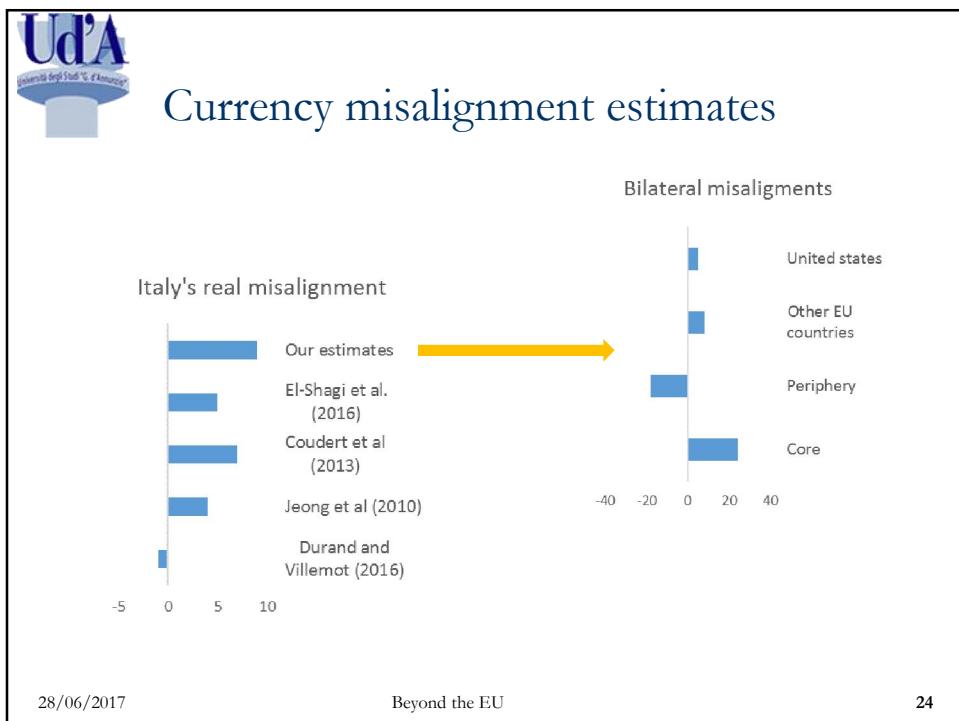
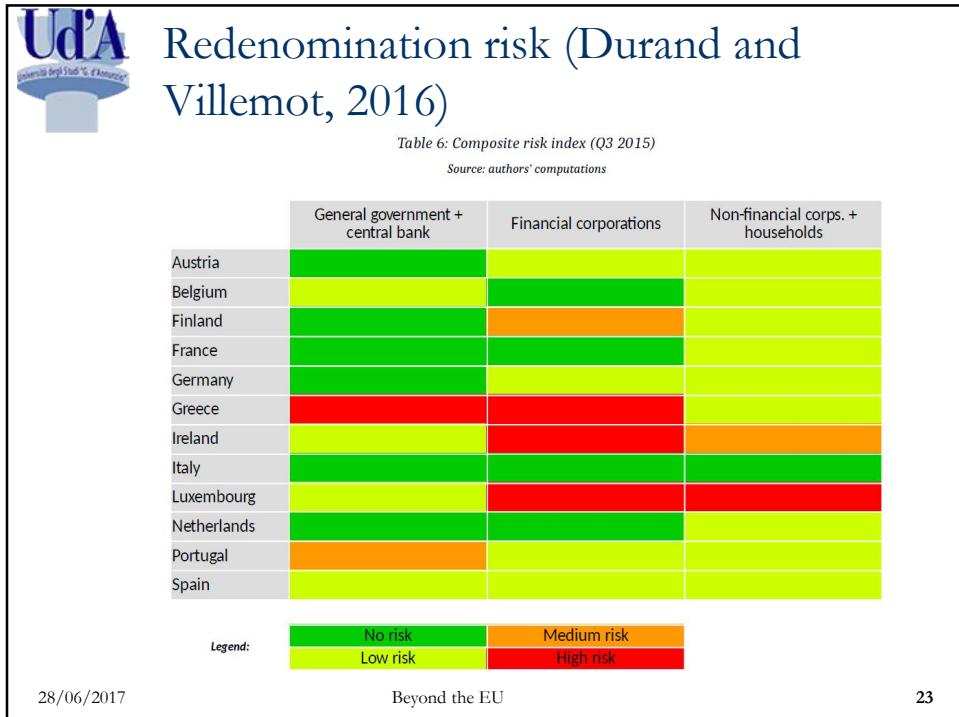
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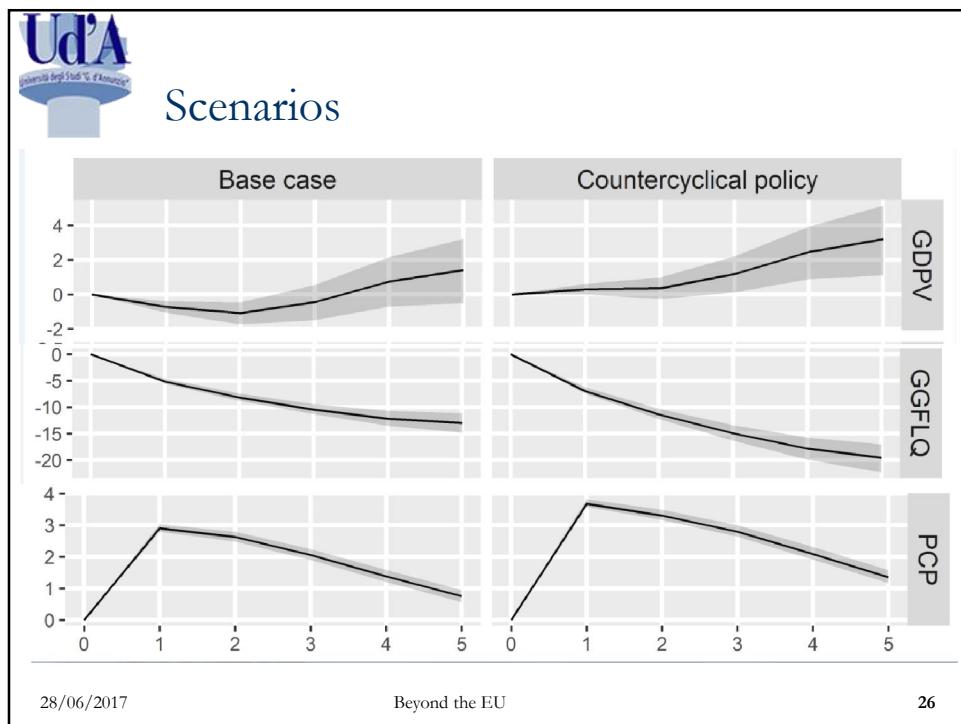


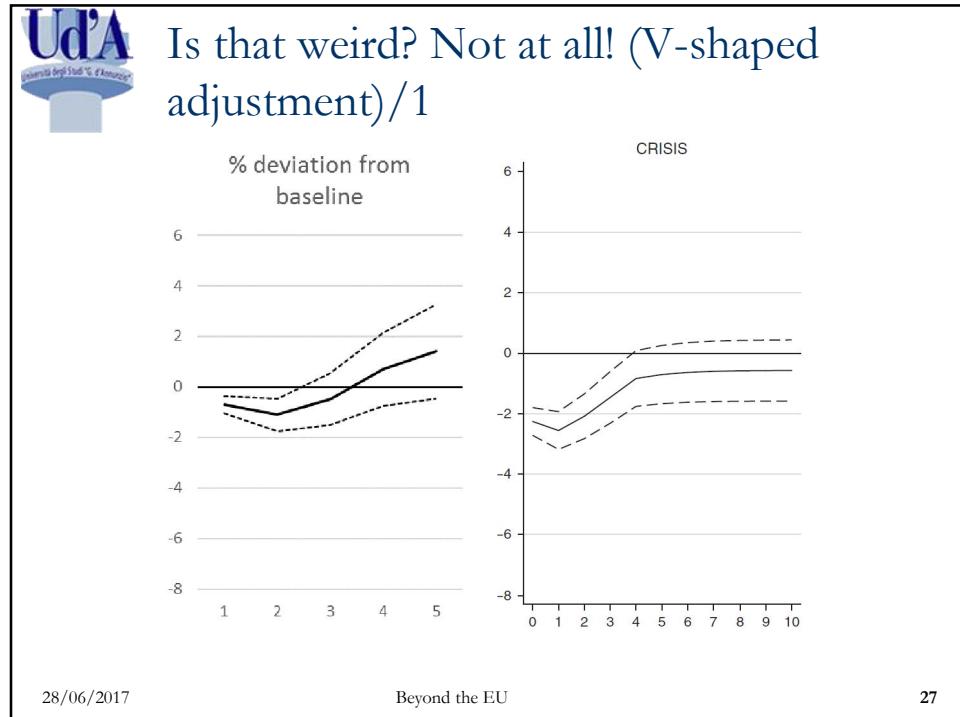


**Scenarios**

- a) ~~Base case~~
- b) Banking crisis
- c) Banking crisis under active fiscal policies

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**Is that weird? Not at all! (V-shaped adjustment)/1**

**Article**

**Output Recovery After Currency Crises**

SHEIDA TEIMOURI & TAGGERT J BROOKS

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This study examines the shape and dynamics of output recovery following currency crises characterized by currency crashes or large reserve losses. Our estimation allows output to follow U, V and L-shaped paths following each type of currency crises. The results indicate that output recovery after currency crises is, on average, V-shaped. In addition, currency crises initially lead to a decline in output, but the output fully recovers to its non-crisis level within three years. Currency crises characterized by large reserve losses lead to a smaller initial output cost, but a larger decline in output in the long run.

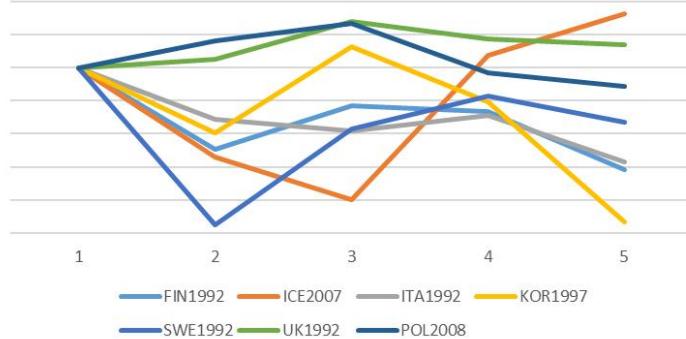
*Comparative Economic Studies* (2015) 57, 75–102. doi:10.1057/ces.2014.45

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## Is that weird? Not at all! (Real interest rates) /2

Real interest rates in currency crises



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## Is that weird? Not at all! (No hyperinflation) /3

WHY ARE RATES OF INFLATION SO LOW AFTER LARGE DEVALUATIONS?

Ariel Burstein  
 Martin Eichenbaum  
 Sergio Rebelo

Working Paper 8748  
<http://www.nber.org/papers/w8748>

NATIONAL BUREAU OF ECONOMIC RESEARCH  
 1050 Massachusetts Avenue  
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 February 2002

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