Countercyclicality of financial crisis interventions in an open economy with credit constraint

Borradores de Economia
Número:
989
Publicado:
Miércoles, 1 Marzo 2017
Clasificación JEL:
F34, F41, G01, H23, D62
Palabras clave:
Restricción de crédito, Crisis financiera, Controles de capital
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In an open-economy model with collateral constraint, Schmitt-Grohé and Uribe (2016) propose a procyclical policy (it calls for capital controls that are higher during crises than during normal times) that supposedly solves the externality problem that results from the underestimation of the social costs of decentralized debt decisions. We show that such policy does not solve the problem and recall that previous literature has established that a countercyclical tax on debt (positive during normal times and nil during crisis) does. We also show that the externality problem can be solved as well by a countercyclical subsidy on consumption (positive during crises and zero in normal times). The latter result, however, is not a robust policy recommendation because it is not a solution if we remove the assumption that lenders overlook the effect of lump-sum taxes on borrowing capacity.