Financial Crises, Debt Volatility and Optimal Taxes

Working Paper No. 839 Keep in mind

AUTHOR OR EDITOR Julian A. Parra Carmiña O. Vargas AUTHORS AND/OR EDITORS Vargas-Riaño, Carmiña Ofelia
We study nancial crises in a small open production economy subject to credit constraint and uncertainty on the value of debt repayments. We nd that the possibility of reducing the severity of future crises encourages the central planner (CP) to increase both the crisis frequency and current debt. The CP equilibrium can be implemented by a macro-prudential tax on debt and, only during crises, subsidies on consumption and a tax on non-tradable labor. The welfare gain of implementing such equilibrium is small for the baseline scenario but very sensitive to changes in debt volatility and the economy?s degree of openness.

Update 31/10/2014 10:23 a.m.