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Macroprudential vs. Ex-post Policy Interventions: when Domestic Taxes are Relevant for International Lenders

Working Paper No. 879 Keep in mind
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We argue that international lenders take into account that taxes (or subsidies) affect borrowers' available income for debt repayments. Using an endowment-economy model, we show that by incorporating this fact into the analysis of financial crises from the pecuniary externality perspective, ex-post interventions are completely ineffective to manage crises and, instead, ex-ante capital controls are useful for correcting the externality that stems from the underestimation of the social costs of decentralized debt decisions.

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Update 10:30 a.m., 03/05/2016

Fuente: https://d1b4gd4m8561gs.cloudfront.net/en/borrador-879