

LSF Lunchtime Seminar:

A Theory of Debt Accumulation and Deficit Cycles

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Abstract

This paper introduces a tractable model of sovereign debt in which governments face intertemporal tradeoffs between (i) preferring more primary deficits to less and (ii) avoiding costly defaults. Governments run deficits when debt and, then, the marginal costs of increasing debt are low. After an extended period of debt accumulation, the probability of default increases, and so do the marginal costs of running debt. Eventually, debt reaches a critical level relative to the size of the economy, a fiscal tipping point, after which debt accumulation stops, with governments cycling between deficits and surpluses, until perhaps a time of default. The main conclusions are that (i) fiscal tipping points typically occur at about 80-90% from default; (ii) the probability of future defaults increases with governments' myopia, macroeconomic stability, the ease at which defaulted governments re-gain access to capital markets (leading to "serial defaulting"), or debt markets illiquidity; (iii) fiscal austerity may arrive too late: "debt intolerance" arises around the fiscal tipping point.

Thursday 10 October 2019

12:30 – 13:45pm

Location

Faculty of Law, Economics and Finance
JFK Building
29, avenue Kennedy L-1855 Luxembourg
Ground Floor, Nancy-Metz Room

Langue

English

Registration

- Free seminar
 - Registration by e-mail to lsf-events@uni.lu
(please specify full name and institution)
- Before 7th October 2019**

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