You are cordially invited to the following seminar Thursday, 20 May from 12:15 – 13:15hrs, ONLINE via ZOOM

The Optimal Design of A Financial Stability Fund
(joint work with Eva Carceles-Poveda, Yan Liu and Ramon Marimon)

We develop a model of the Financial Stability Fund (Fund), which can be set by a union of sovereign countries. The Fund can improve the countries’ ability to share risks, and borrow and lend, with respect to the standard instrument used to smooth fluctuations: sovereign debt financing. Efficiency gains arise from the ability of the Fund to offer long-term contingent financial contracts, subject to limited enforcement (LE) and moral hazard (MH) constraints. By contrast, standard sovereign debt contracts are not contingent and subject to untimely debt roll-overs and default risk. We quantitatively compare the constrained-efficient Fund economy with the incomplete markets economy with default. In particular, we characterize how (implicit) interest rates and asset holdings differ, as well as how both economies react differently to the same productivity and government expenditure shocks. In our economies, calibrated to the euro area ‘stressed countries’, substantial welfare gains are achieved, particularly in times of crisis. Our theory provides a basis for the design of a Fund beyond the current scope of the European Stability Mechanism (ESM), and a theoretical and quantitative framework to assess alternative risk-sharing (shock-absorbing) facilities, as well as proposals to deal with the euro area’ debt-overhang problem’.

Árpád Ábrahám is chair in macroeconomics at the University of Bristol. Previously, he has spent 10 years at European University Institute and before he was working in the USA at the University of Rochester and at Duke University. He has advised until graduation more than 40 doctoral students studying a wide range of macroeconomics problems. His research covers quantitative, theoretical and methodological aspects of economies with (endogenously or exogenously) incomplete markets. His research has been published in the Review of Economic Studies, Journal of the European Economic Association and the Journal of Economic Theory, among others.