FACULTY OF LAW, ECONOMICS AND FINANCE

Abstract :

In infinite horizon economies with limited commitment, collateral requirements and default penalties, Páscoa and Seghir (2009) have shown that, in the absence of debt constraints, harsh default penalties may induce agents to run Ponzi schemes that jeopardize equilibrium existence. We appropriately modify the definition of finitely effective debt constraints, introduced by Levine and Zame (1996) (see also Levine and Zame (2002)), to encompass models with limited commitment, default penalties and collateral. Along this line, we introduce in the setting of Araujo, Páscoa and Torres-Martínez (2002), Kubler and Schmedders (2003) and Páscoa and Seghir (2009) the concept of actions with finite equivalent payoffs.

We show that, independently of the level of default penalties, restricting plans to have finite equivalent payoffs rules out Ponzi schemes and guarantees the existence of an equilibrium that is compatible with the minimal ability to borrow and lend that we expect in our model. An interesting feature of our debt constraints is that they give rise to budget sets that coincide with the standard budget sets of economies having a collateral structure but no penalties (as defined in Araujo et al. (2002) and Kubler and Schmedders (2003)). This illustrates the hidden relation between finitely effective debt constraints and collateral requirements.

. . . .

Dr Yiannis Vailakis's research interests cover general equilibrium theory, macroeconomics and optimisation with applications to economic theory. His work on general equilibrium includes the exploration of models with asymmetric information, transaction costs, endogenous borrowing constraints, default and collateral. His work on macroeconomics involves the analysis of dynamic general equilibrium models that depart from the standard neoclassical framework in various aspects (endogenous and embodied technological progress, heterogeneous agents, recursive preferences). His work on optimisation covers dynamic programming and fixed point theory.

Dr Vailakis has recently been working on general equilibrium models that explore the implications of default and collateral in financial markets. Emphasis has been given to model default and collateral in environments where agents have divergent and possibly incorrect beliefs about endogenous economic variables, as well to extend the existing literature in a direction (infinite horizon setting) that makes the models tractable to many practitioners in applied macroeconomics.

UNIVERSITÉ DU LUXEMBOURG

FACULTY OF LAW, ECONOMICS AND FINANCE

The Center for Research in Economic Analysis of the University of Luxembourg is pleased to invite you to the Lunchtime Seminar in Economics:

Endogenous debt constraints in collateralized economies with default penalties

(joint with V. Filipe Martins da Rocha)

By Yiannis Vailakis

University of Exeter Business School

September 29, 2010

13:00 – 14:00

148, avenue de la Faïencerie
L-1511 Luxembourg
Room BRC201

Lunch is planned for the participants

Registration: by email to fdef-colloques@uni.lu

Contact : Elisa Ferreira (+352 46 66 44 6336)

UNIVERSITÉ DU LUXEMBOURG