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International Monetary Equilibrium with Default*

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Abstract

We present an integrated framework for the study of the international financial economy with trade, fiat money, monetary and fiscal policy, endogenous default and regulation. Money is introduced via a cash-in-advance requirement and real trade is endogenous. The standard international finance pricing results obtain. Market incompleteness and positive default in equilibrium allow for the study of the transmission of default through the international financial markets and imply a positive role for policy. Finally, we present an example where, due to the trade-off between the non-pecuniary cost of default and the resulting allocation, a Pareto improvement occurs following an increase in interest rates.

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