Credit and Bankruptcy in a Temporary Equilibrium Model

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Abstract

A temporary general equilibrium in bankruptcy model with finite periods was analyzed in this paper, which (i) every consumer only issues one type of bond to financial market in each period; (ii) the bank has right to circulate currency, and never face bankruptcy. The model was an extesion of the Bankruptcy model in Eichberger(1989), based on the assumptions that the occurrence of moral hazard is prevented by the credit scheme law, which depends on the current information and forecast function. The main result of this paper enables as to develop the liquidation rule without penalties. This rule can also be used to interpret liquidating distribution in Bankruptcy Act. In addition, the bankruptcy mechanism plays an effective role even if the chain reaction bankruptcy occurred. Moreover, we can prove that the economy will never collapse in an overlapping model which has some newborn in every period.

JEL classification:D52; D53; D59

Keywords: Temporary equilibrium; Bankruptcy; Credit scheme; Liquidation rule; Money

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