

# Imperfect Contract Enforcement and Nominal Liabilities

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## Abstract

This paper shows that fiat money circulates in an equilibrium in an overlapping generations model if there exists incomplete enforcement of credit contracts by the court. This friction makes money serve as both a payment instrument for real transactions and an instrument for liability settlements. Thus, nominal credit contracts are adopted endogenously. This result holds even if the economy is dynamically efficient. Given dynamic efficiency, the socially optimal policy is intra-period elastic supply of money without overnight money supply. This result implies that money stock ceases to be the nominal anchor if the optimal money supply policy is implemented in a dynamically efficient economy.

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