

A Comparative Study of the Reusable Mortgage Systems in French Civil Code and Chinese Civil Code

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Abstract

The rechargeable mortgage created by French security law reform in 2006 and perfected in several following security law reforms, and the maximum mortgage contained in Chinese Civil Code are both relatively new type of security interests for related parties. Both of them are reusable for parties to secure debt other than the debt designated in the constitution contract. These new types of security interests maintain the safety value of the traditional general mortgage systems on the one hand, and strengthens the superiority of mortgage system on the other hand, by simplifying the procedures of constitution and realization, remarkably reduce the costs of time and money of usage. From the point of view of economic analysis, these new types of security interests not only conform to the economic criterion of Kaldor-Hicks efficiency, but also play an important role for improving the guarantee ability and financing ability of domestic enterprises from either domestic financial market or international market, and further affect the evaluation of performance of the countries in the frame of Doing Business of the World Bank.

Keywords: rechargeable mortgage, maximum mortgage, security interests, economic analysis

1. Introduction

The rechargeable mortgage (*Hypothèque rechargeable* in French) in French Civil Code (hereafter referred as FCC) designates the mortgage constituted for professional purposes by a natural or legal person and which may subsequently be reused to guarantee a debt other than those designated by the initial constituting contract (Art. 2416, FCC). This kind of security interests was created by the French security law reform in 2006 and was considered the most brilliant and important innovation of this reform (Gourio, 2006). After being created, it has been amended and perfected by several subsequent security law reforms, among which the latest one occurred in September, 2021 and doesn't take effect until January 1, 2022. Coincidentally, there exists one kind of comparable mortgage calling the maximum mortgage in Chinese Civil Code (hereafter referred as CCC) promulgated in May, 2020 and come into force in January, 2021. According to article 420 of CCC, the maximum mortgage means the mortgage constituted by the debtor or a third party for securing the performance of debt to occur consecutively within a given period of time and within the limit of a maximum amount agreed. Although this kind of security interests is not properly speaking a new kind of security interests in China, because it had been created by the Guarantee Law promulgated in 1995, and had been reconstructed and perfected by the Property Law promulgated in 2007, the newly effective CCC made some improvements to the maximum mortgage.

Both the rechargeable mortgage and the maximum mortgage are introduced into civil code for stimulating the mortgage financing by lowering the application costs and improving the efficiency of mortgage system, the mechanisms and the paths of institutional design, the systematic values are differently contrived. A comparative study of the two has undoubtedly theoretical and practical values.

2. Mechanisms of the Rechargeable Mortgage and the Maximum Mortgage

2.1 *The Conditions for the Constitution*

Firstly, due to the different legislative patterns of security interests, the rechargeable mortgage in French law is a conventional security interest without dispossession which can only be established on immovable properties, while the maximum mortgage in Chinese law is also a conventional security interest without dispossession, but can be established on both immovable or movable properties.

Secondly, the mechanism of the rechargeable mortgage presupposes two valid written contracts: the initial mortgage contract, also known as the recharge contract, and the recharge contract. The initial mortgage contract is basically a normal notarized mortgage contract, but it must contain a special clause expressly stating the maximum amount secured and that it is a rechargeable mortgage which may later be used to secure debt other than the debt already determined. At the moment of the establishment, the maximum amount and the initial debt secured should be determined expressly in the initial contract, while all other specific debt secured could be unknown, undetermined or indeterminable future debt and will be determined by the recharge contract also notarized. This characteristic turns this mortgage as an exception to the principles of specialty and subordination of security interests. In China, the maximum mortgage shall be constituted by a written contract, in which the parties agree to establish a mortgage with maximum amount for securing the debt to occur consecutively within a given period of time and within the limit of the maximum amount. It requires only one written mortgage contract, and non-intervention of notary. Once the maximum mortgage is effectively constituted (i.e. recorded in the immovable register), all consecutively occurred debt between the parties of the contract shall successively and automatically slide in the mortgage within the maximum amount. The maximum mortgage appears to have relative independence for the following reasons: a. in principle, all secured debt is future, the specific debt secured and final amounts are unknown, undetermined or indeterminable at the moment of the constitution. As an exception, a debt existing before the constitution of the maximum mortgage may be included as the debt secured by the maximum mortgage with the consent of the parties and in this case, the amount of such debt shall be calculated into the extent of the maximum amount. b. the non-payment, transfer or extinction of a specific debt secured does not affect the effect of the maximum mortgage. What's more, when one or some parts of the creditor's right is transferred before the determination of the creditor's right secured by the maximum mortgage, the maximum mortgage may not be transferred, except as otherwise agreed upon by the parties (art. 421, CCC). If we look at this at the angle of the transfer of the creditor's right, it means one or some parts of the creditor's right secured by the maximum mortgage can be legally transferred which will not cause the transfer of the maximum mortgage. As a result, the parts transferred become unsecured claims. This is a remarkable improvement because according to the Guarantee Law, which has been repealed in January 1, 2021, the transfer of one or some parts of the creditor's right secured was strictly prohibited before the determination of the creditor's right secured by the maximum mortgage. These relative characteristics constitute an exception to the principle of subordinate, which is a basic principle of security interests in Chinese law.

Thirdly, under the framework of the rechargeable mortgage, the initial contract must be recorded in the mortgage register for being opposable to third parties, just like a normal mortgage. All recharge contracts shall also be recorded in the mortgage register by making marginal reference beside the initial registration, otherwise they have no opposable effect to any third party. By completing the registration, the creditors secured by recharged mortgages could have the same priority as the initial mortgage (Art. 2419, FCC). For example, there exists a rechargeable mortgage and a normal mortgage on the same immovable, Party A is a creditor secured by the initial mortgage registered on January 1, Party B is a creditor secured by a normal mortgage registered on March 1, and Party C is a creditor secured by a recharged mortgage registered on May 1. If the debtor fails to pay all of the previous debt in due time, the priority of payment among them would be A, C and B. As to the maximum mortgage in Chinese law, the effect of registration depends on the nature of the mortgaged property: if the mortgaged property is immovable, the registration is a compulsory requirement for the validity of the mortgage; if the mortgaged property is movable, the registration is a requirement for being opposable to third parties. After validly constituted, the priority of payments among different creditors are fixed as the rules mentions hereafter.

Fourthly, for the rechargeable mortgage in French law, the total amount of secured debt by all subsequently concluded recharge contracts cannot exceed the available credit line which equals the difference between the maximum amount initially fixed and the unpaid debt previously secured. For the maximum mortgage in Chinese law, the maximum amount of secured debt has double limits: on the one hand, it can not exceed the maximum amount initially fixed in the constitution contract of the maximum mortgage; on the other hand, it can not exceed the amount of debt actually occurred under the framework of the maximum mortgage. In other words, the maximum mortgage has a feature of uncertainty, because the finally fixed amount of secured debt depends on the higher of the amount of debt actually occurred under the framework and the maximum amount initially fixed. So, the determination of the total amount of secured debt, which is vividly called the crystallization of secured debt in theory is a vital factor for the maximum mortgage. According to article 423 of the CCC, the crystallization of secured debt by the maximum mortgage shall occur under any of the following circumstances: a. the agreed term for determining the total amount of secured debt expires; b. in the absence of an agreement on the term for determining the total amount of secured debt or such an agreement is ambiguous, the mortgagee or the mortgagor claims the determination of the total amount of secured debt after the lapse of two years from the date of creation

of the maximum mortgage; c. no new secured debt will be created; d. the mortgagee knows or should have known that the mortgaged property is seized or detained; e. the debtor or the mortgagor is declared bankrupt or is dissolved; f. any other circumstance provided for by any law where the total amount of secured debt is determined.

At last, under the framework of the rechargeable mortgage, the priority between the creditor secured by the initial contract and the creditors secured by the recharge contracts shall be determined as follows: a. in the order of the registration date; b. if several mortgages are recorded on the same date, in the order of the effective date of contracts; c. if the effective date of contracts previously mentioned is the same, all concerned creditors shall be paid in proportion to the amount of their claims (Art.2418, paragraph 3, FCC). Indeed, the rule b est newly refined by the latest reform of security interest law in September, 2021. Admittedly, this new rule is reasonable, because in French law, any mortgage contract should be notarized. The intervention of notary undoubtedly makes credibility to the effective date of mortgage contract, even if such date hasn't been recorded in the mortgage register. In Chinese law, when the same property is mortgaged to two or more creditors, the priority of payments shall be determined according to the following order: a. if all mortgages have been registered, the secured debt shall be paid in the order of the registration of the mortgages; b. the debt secured by a registered mortgage shall be paid prior to the unregistered mortgages; c. for unregistered mortgages, the secured debt shall be paid in proportion to the amount of claims.

2.2 The Application Scope

As to mortgagor, either the mortgagor of the rechargeable mortgage in France or mortgagor of the maximum mortgage in China could be any party to civil legal relations, either natural persons or incorporated, unincorporated organizations, consumers or professionals, provided that he has the capacity for behavior and has the right of disposition of the mortgaged property.

In France, only immovable property could be used as mortgaged property of a rechargeable mortgage or a normal mortgage. While in China, both immovable property and movable property could be used as mortgaged property of a maximum mortgage or a normal mortgage. Concerning the scope of the secured debt in France, according to art. 2417 of FCC, the principal, interests therefrom and other accessorial charges (such as prosecution costs, anticipatory penalties and damages) related to the debt are all secured up to a determined sum that the notarial deed mentions. Among them, interests of the capital were introduced into the scope of secured debt by article 1346-4 of FCC after the reform in 2016, other accessorial charges have just been explicitly into the scope of secured debt by the latest reform in September, 2021. Besides, the brilliant experiences of the rechargeable mortgage have been a good reference to the system of transferring guarantee (Fiducie-sûreté in French) which can be constituted in movable or immovable properties and has been codified into the FCC (Art.2372-5 and Art.2488-5, FCC) by a security law reform in 2009. After this reform, a transferring guarantee can also be rechargeable, provided it is expressly stated in the initial constitution contract that it is rechargeable, which means the guarantor may later use this transferring guarantee for securing debt other than those designated in the initial constitution contract. This reform undoubtedly reduces the costs of time and money of using the transferring guarantee, promotes the application of such guarantee system in credit practice, as well as further stimulates the smooth development of credit transaction.

In China, from June 30, 1995 which is the date of promulgation of the Guaranty Law of the PR, the scope of security interest covers always the principal claim of creditor's right and the interest therefrom, liquidated damages, compensatory damages, and the expenses for keeping the property posted as security and for exercising security interest. If it is otherwise agreed upon by the parties, such an agreement shall prevail. In addition, the general rules of the maximum mortgage are also applicable to pledge, a type of security interests constituted on movable property with transfer of possession of pledged property. When a pledge is constituted by reference to the mechanism of the maximum mortgage, it is called maximum pledge that can be reused by pledgor for securing future debt to occur consecutively within a given period of time and within the limit of the maximum amount agreed. Except the different nature of property and the different publicity mode, the rules applicable to the maximum mortgage are also applicable to maximum pledge. By constitution of a maximum mortgage or maximum pledge, the debt already occurred and the debt which will consecutively occur between two determined parties could be secured by the same security interest. It is very practical and efficient for commercial loan between a business enterprise and the bank with long-term cooperation relationship.

3. Paths of Institutional Design of the Rechargeable Mortgage and the Maximum Mortgage

3.1 Paths of Institutional Design of Rechargeable Mortgage

As previously mentioned, although the rechargeable mortgage in French law and the maximum mortgage in Chinese law is of the same ultimate goal to stimulate mortgage financing by lowering the application costs and

improving the efficiency of mortgage system, the specific realization paths of the systems are differently contrived. As to the rechargeable mortgage in French law, it's most outstanding advantage is that it may subsequently be reused, before payment of the initial debt secured and in the limit of the maximum amount fixed, to secure debt other than the initial debt secured designated by the initial constituting contract. Theoretically, the rechargeable mortgage system is favorable for all mortgagees it secures, because a mortgagee secured by a recharge contract can take the same priority of the initial mortgagee in the face of a mortgagee secured by a normal mortgage. But among mortgagees secured under the framework of the same the rechargeable mortgage, the priority of payment is determined by the date of publicity recorded in the mortgage register, the priority of each mortgagee is subordinated to the mortgagee previously recorded, so the risk of non-payment of each mortgagee is particularly high when the original mortgagee or other mortgagees previously recorded absorb the full value of the mortgaged property, especially when the debt previously recorded is a future debt with uncertain amount, such as a debt for future supply of goods or a revolving credit (Grimaldi, 2006). For the mortgagees in the same the rechargeable mortgage, they find themselves in the same situation as mortgagees secured by several normal mortgages constituted in the same mortgaged property, because they need to comply with the same rule of mortgage previously registered prevails. Finally, all creditors will seek to take advantage of the rechargeable mortgage, and will therefore become mortgagees in the same the rechargeable mortgage. In this sense, the advantages of the rechargeable mortgage are relatively favorable to mortgagor, rather than mortgagees. In the previous example of recharged mortgage, the priority among the mortgagees is A, C and B. But in practice, if B is a rational person and knows the existence of a previously recorded the rechargeable mortgage in the same immovable property, he would not choose to have a new normal mortgage for securing his claims. Because in this case, the new normal mortgage is posterior to the previously recorded the rechargeable mortgage. Even if the amount of B's claims is higher than the maximum amount of the previously recorded the rechargeable mortgage, the best choice for B is to be firstly secured by a recharge contract covered by the previously recorded the rechargeable mortgage, and meanwhile, to seek a normal mortgage for securing the surplus of his claims.

3.2 Paths of Institutional Design of Maximum Mortgage

The maximum mortgage, firstly introduced into Chinese law by reference to Japanese Civil Code, aims mainly to meet the needs of financial institutions who are traditionally the most important creditors in financing activities. Therefore, the maximum mortgage is defined as a security interest securing the debt already occurred and the debt which will consecutively occur between two determined parties. On the one hand, by effectively constituting a maximum mortgage, a business enterprise and the bank with long-term cooperation relationship do not need to constitute different security interests for the recycling credits or other financing activities successively occurred between them or recycling credits. It is really valuable for facilitating financing activities, either from the perspective of saving economic and time costs, or from the perspective of convenience and flexibility. On the other hand, this kind of mortgage is limited to be used by the mortgagor to secure the debt he borrowed from the same determined mortgagee, but cannot be used to secure any other debt.

In addition, in consideration that the financial institutions are relatively dominant in financing activities and the instinct of them is to reduce the risk of non-payment, they will do the best to capture the whole value of mortgaged property even if it exceeds obviously the need of business necessity, so it is difficult to avoid the wastage of credit value of mortgaged property (Liang Huixing & Chen Huabin, 2007).

In conclusion, although French legislator and Chinese legislator aim at stimulating mortgage financing, they adopted different paths of institutional design.

4. Systematic Values of the Rechargeable Mortgage and the Maximum Mortgage

4.1 Economic Analysis of the Reforms of the Rechargeable Mortgage and the Maximum Mortgage

The neo-institutional school advocate that the institutional supplies are always insufficient and limited due to limited rationality of human being and scarcity of resources, and therefore need to be renewed or increased for responding to new demands of society and environment (Furubotn & Richter, 2008). When supply of institution and demand of institution is basically balanced, the institutional system is stable. When the existing institutional supplies cannot satisfy the institutional demands, the institutional system needs to be changed or perfected, then the relative institutional reform will occur.

For responding to the demands of financing practices, the designers of French security law reform, guided by the esprit of respecting the free will and free choices of transaction parties to the maximum, making the best use of properties and further improving the efficiency of security interests, create some new types of security interests in the relative law reforms in this century, by which the institutional supplies of security interests have been increased,

the parties of security interests have the freedom to choose to create a security interest on movable properties or immovable properties, the freedom to register the security interest or not, the freedom to create a normal security interest or a rechargeable security interest like the rechargeable mortgage or rechargeable transferring guarantee, and the freedom to determine the maximum amount of a rechargeable security interest.

The maximum mortgage in Chinese law can be used and reused to secure, within the limit of a maximum amount initially fixed, debt consecutively occurs during a determined period between the determined parties, so the parties do not need to constitute different mortgages for each debt. In a country implementing the market economy, most business transactions are executed on credit. This requires each enterprise to have a certain amount of liquidity for daily activities. Once self-owned liquidity is insufficient, the enterprise needs to borrow money in avoidance of liquidity crisis. This need of liquidity is difficult to determine due to the variable and cyclical occurrences of payment and receipt of cash or cash equivalents of the enterprise. This is a general phenomenon in the market economy, and therefore put forward the demand of increasing relative institutional supply. The creation of the maximum mortgage in law is a positive and effective response to the practical demand. On the one hand, it obviously reduces the costs of time and money of the transactions, but also meets the needs of flexibility and convenience.

From the perspective of interested parties of the reform, if we keep our eyes on the parties of the rechargeable mortgage, we find that this innovative mortgage is obviously and mainly favorable to mortgagor, but it doesn't harm mortgagee. So we may make a conclusion that this institutional reform conforms to the criterion of Pareto improvement, according to which one reasonable reform should make somebody gain more benefits without reducing anyone's benefits or making anyone in a worse situation. However, if we consider notaries and the government as interested parties of the institutional reform, the previous conclusion won't hold up. Because the new institution improves the benefits of the parties, but harms the benefits of the interested parties at the same time. In this case, we need to shift to the criterion of Kaldor-Hicks efficiency in welfare economics, according to which an outcome is efficient if those who are made better off could, in theory, compensate those who are made worse off and so produce a Pareto efficient outcome. The interests of notaries and government will be damaged from the perspective of a single the rechargeable mortgage transaction in isolation, but the relative damages could be compensated by the considerable increment of transactions stimulated by the creation of this new mortgage in general. However, it is still questionable if the government could be considered as an interested party to a law reform. If the answer is positive, the government may lose its neutrality and become a party to compete for benefits with the people. Therefore, the reform of creating the rechargeable mortgage system conforms to the criterion of Kaldor-Hicks improvement (Zeng Rongxin, 2020). The creation of the rechargeable mortgage system into FCC not only increases an institutional supply for the parties of security interests in France, but also enhances the balance of interests between mortgagors and mortgagees. Parenthetically, it improves the attractiveness of French law which is one of the principal objectives of the latest reform in 2021 (Legifrance, 2021). If we take the same criterion of Pareto improvement or Kaldor-Hicks efficiency to evaluate the creation of the maximum mortgage in Chinese law, the result would be the same.

4.2 Analysis from the Perspective of International Financing Competitiveness and Doing Business

In an open world, economic competitions exist not only among enterprises, but also among different countries. That why the World Bank devotes to report the Doing Business of different economies. In the framework of Doing Business of the World Bank, there are eleven primary indicators, while security interests play an important role in the primary indicators of getting credit and resolving insolvency (The world Bank, 2021).

Several scholars have conducted some interesting research at the turn of century. Kiyotaki and Moore firstly constructed a theory of powerful transmission mechanism of security interests in 1997, according to which an ordinary creditor non-secured has no effective legal means to avoid the insolvency of his debtor. Immovable properties and relatively high-value machinery and equipment are not only important factors of production, but also effective properties for securing financing activities for an enterprise (Kiyotaki & Moore, 1997). The value of properties posted as security determines the guarantee ability, and the guarantee ability further determines the financing ability of an enterprise. Conversely, the financing ability will react upon the business ability of the enterprise which will further influence the value of properties posted as security. This is especially the case for intellectual property whose value is normally dramatically influenced by the business operations. When the constant interactions between the value of properties posted as security and business ability occurring different enterprises come together, it will amplify the economic fluctuation and therefor affect the operation of macro economy. In detail, if the macro economy declines, the value of properties of an enterprise will generally be estimated to decline and the potential cash-ability of properties will also obviously be reduced, so the actual guarantee ability and financing ability of the enterprise will be weakened, therefore the enterprise will normally

choose to reduce the investment scale for next business period, then the output of this period will normally become worse; the worse output of this period will further reduce the potential cash-ability of properties for the period after the next, and the vicious cycle will continue. Finally, the macro economy will be negatively affected by the vicious cycle. If the macro economy is on the upswing, the relative interactions will be in a virtuous circle.

On the basis of Kivotaki and Moore's theory, Caballero and Krishnamurthy's research further claims that the analysis of influences of security interests shall be placed under the background of global economic integration, therefore, studies on the powerful transmission mechanism of security interests shall be systematically and dynamically conducted on the interactions between domestic security interests and domestic financing activities, and the interactions between international security interests and international financing activities (Caballero & Krishnamurthy, 2001). On the one hand, the deficiency of overall international guarantee abilities of a countries will obviously restrict the financing ability of domestic enterprises from international financial institutions. In this case, the increasing demand for domestic financing will probably drive the financing rate up, and therefore increase the business cost of enterprises, weaken the current and expected profitability of enterprises. When the decline of macro economy of the country happens, the double negative impacts of decrease of profitability and depreciation of properties will further make enterprises more dependent on domestic financing, and the vicious cycle continues. On the other hand, the constraint of underdevelopment of domestic financing activities will lead the shortage of domestic financing supply and the increasing demand of domestic enterprises for international financing. For obtaining sufficient financing resources, these enterprises have no better choice but to accept the probable undervaluation of properties in the negotiation with international financial institutions even if the macro economy of the country is normal or rising. If the macro economy of the country turns into decline, the depreciation and potential fire-sale price of properties posted as security will directly reduce the actual guarantee ability and financing ability of enterprises, and lead to the undervaluation of the overall guarantee ability of this country to attract international financing resources in current period. The downswing of international financing resources flowed into the country will further aggravate the decline of macro economy of the country and the valuation of properties of enterprise. In a dynamic context, it will further incur to the undervaluation of guarantee ability and financing ability of enterprises of this country in the next period, and will traps the situation into a vicious cycle.

This analysis explains why French legislator and Chinese legislator of security reform aims at improving the attractiveness of French law, and why the World Bank set security interests as important factors of Doing Business. The institutional supply of efficient, practical and cost-effective types of security interests of a country determines directly the guarantee ability of domestic enterprises, and further determines the financing ability of these enterprises either from domestic financial market or international financial market. It is unquestionable that the creation and relative reforms of the rechargeable mortgage in French law is one important institutional innovation for enhancing the guarantee ability and facilitating the financing activities of French enterprises. Nevertheless, in the evaluation executed in the frame of Doing Business of the World Bank, the respective performances of France and China on the item getting credit (which is the superordinate item of security interests) are unsatisfactory: the overall rank of doing business of France is 32 among 190 economies, while the rank of getting credits is 104; the overall rank of doing business of China is 31 among 190 economies, while the rank of getting credits is 80. For further improving the attractiveness of the security interests, there remains a lot of work to do for the legal practitioners, academics and legislators in the two countries.

5. Conclusion

In summary, in a competitive and open international financial market, a country's guarantee ability is a very important factor for getting international financing resources which is generally an important factor for enterprises business and economic growth of a country. Nevertheless, under the influence of powerful transmission mechanism of security interests, a country's domestic economy becomes more sensitive and fragile to international financial market. So, each country needs to perfect the institutional supply of efficient, practical and cost-effective security interests, from both perspectives of domestic financing activities and international financing competitiveness. The rechargeable mortgage and the maximum mortgage are therefore respectively created and perfected in France and in China, and play a positive role in the financing activities of the countries.

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