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Debt maturity and the liquidity of secondary debt markets^{*}

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Abstract

We model the debt maturity choice of firms in the presence of fixed issuance costs in the primary market and search frictions in the secondary market for debt. In the secondary market, short maturities improve the bargaining position of sellers, which reduces the required issuance yield. Long maturities reduce reissuance costs. The optimally chosen maturity trades off both considerations. Equilibrium exhibits inefficiently short maturity choices. An individual firm does not internalize that a longer maturity increases expected gains from trade in the secondary market, which attracts more buyers and, hence, facilitates the sale of debt issued by other firms.

JEL classifications: G12, G32

Keywords: Debt maturity, Search, Liquidity.

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