Distinguishing Constraints on Financial Inclusion and Their Impact on GDP, TFP, and the Distribution of Income

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Abstract

We develop a tractable general equilibrium model with heterogeneous agents and multiple sources of financial frictions to study how different constraints interact in equilibrium. We highlight, distinguish, and quantitatively evaluate their differential impacts, thereby uncovering the rich interactions among these constraints. The impact of financial inclusion in an economy depends not only on which constraint is alleviated, but also on the tightness of other constraints. Policy instruments should target the most binding constraint, which likely varies across countries. Moreover, there are important between financial inclusion, GDP, and the distribution of income. The transitional dynamics also differ from what happens in steady states. Policy makers should be concerned about both.

Keywords: Financial frictions; Occupational choice; Income distribution; Welfare; Transitional dynamics. (JEL: C54, E23, E44, E61, O11, O16, O57)

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