Financial Development, Growth, and the Distribution of Income

Jeremy Greenwood and Boyan Jovanovic

Abstract

More

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A paradigm is presented in which both the extent of financial intermediation and the rate of economic growth are endogenously determined. Financial intermediation promotes growth because it allows a higher rate of return to be earned on capital, and growth in turn provides the means to implement costly financial structures. Thus financial intermediation and economic growth are inextricably linked in accord with the Goldsmith-McKinnon-Shaw view on economic development. The model also generates a development cycle reminiscent of the Kuznet hypothesis. In particular, in the transition from a primitive slow-growing economy to a developed fast-growing one, a nation passes through a stage in which the distribution of wealth across the rich and poor widens.