DISTINGUISHING CONSTRAINTS ON FINANCIAL INCLUSION AND THEIR IMPACT ON GDP AND INEQUALITY*

Era Dabla-Norris
Yan Ji
Robert M. Townsend†
D. Filiz Unsal

December 18, 2014

Abstract

We develop a micro-founded general equilibrium model with heterogeneous agents to identify pertinent constraints to financial inclusion. We evaluate quantitatively the policy impacts of relaxing each of these constraints separately, and in combination, on GDP and inequality. We focus on three dimensions of financial inclusion: access (determined by the size of participation costs), depth (determined by the size of collateral constraints resulting from limited commitment), and intermediation efficiency (determined by the size of interest rate spreads and default possibilities due to costly monitoring). We take the model to firm-level data from the World Bank Enterprise Survey and World Development Indicators for six countries at varying degrees of economic development—three low income countries (Uganda, Kenya, Mozambique), and three emerging market countries (Malaysia, the Philippines, and Egypt). The results suggest that alleviating different financial frictions have a differential impact across countries, with country-specific characteristics playing a central role in determining the linkages and trade-offs among inclusion, GDP, inequality, and the distribution of gains and losses. (JEL C54, E23, E44, E69, O11, O16, O57)

*This paper is part of a research project on macroeconomic policy in low-income countries supported by U.K.’s Department of International Development (DFID). This paper should not be reported as representing the views of DFID. We thank Abhijit Banerjee, Andrew Berg, Adrien Auclert, Francisco Buera, Stijn Claessens, Wei Dou, David Marston, Catherine Pattillo, Rafael Portillo, Alp Simsek, Iván Werning, Hongkai Zhang, and seminar participants in the IMF Workshop on Macroeconomic Policy and Inequality, and the MIT Macro and Development Lunch for very helpful comments. All errors are our own.
†Corresponding Author: Robert M. Townsend, Massachusetts Institute of Technology, Department of Economics. 77 Massachusetts Avenue; Room E17-230 Cambridge, Massachusetts 02139; (617) 452-3722; rtownsen@mit.edu