Financial Intermediation and Entrepreneurial Activity

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A Non-Technical Summary

This paper studies the effects of financial intermediation on aggregate levels and the distribution of resources in an economy with wealth-constrained heterogeneous agents and occupational choice. Whether an agent becomes an entrepreneur depends on a realized entrepreneurial ability and accumulated assets needed to finance a business project with uncertain returns. I compare a steady state of an economy with financial intermediation to an economy in which entrepreneurs must finance their projects only from their savings. The simulated benchmark economy matches well the U.S. data on the distribution of occupations and resources. The efficiency and welfare losses in the economy without financial intermediation are large and since the workers bear most of the adverse effects, the economy is also more unequal. Finally, a transition from the steady state of the economy without financial intermediation simulates the process of financial development: both measures of inequality decline monotonically during the transition.