A Schumpeterian Growth Model with Financial Intermediaries

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Abstract

I introduce financial intermediaries into the Aghion, Howitt, and Mayer-Foulkes's(2005) Schumpeterian growth model. They collect deposits from households, provide funds for entrepreneurs and monitor the entrepreneurs. I analyze effects of the financial intermediaries on technological progress and economic growth. I show that the financial intermediaries need to monitor in an economy where the legal protection of creditors is not enough. Monitoring by the financial intermediaries increases the cost of entrepreneurial innovation. Thus, in an economy with monitoring by the financial intermediaries, it resolves moral hazard problems; however, it will impede technological innovation and economic growth if the monitoring cost is extremely high.

Keywords: Endogenous growth, Innovation, Financial intermediaries

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