Accepted Manuscript

Access to Finance, Product Innovation and Middle-Income Traps

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PII: S1090-9443(16)30326-X
DOI: 10.1016/j.rie.2017.03.004
Reference: YREEC 716

To appear in: *Research in Economics*

Received date: 27 December 2016
Revised date: 3 March 2017
Accepted date: 9 March 2017

Please cite this article as: Pierre-Richard Agénor, Otaviano Canuto, Access to Finance, Product Innovation and Middle-Income Traps, *Research in Economics* (2017), doi: 10.1016/j.rie.2017.03.004

Highlights

- Interactions between access to finance, product innovation, and labor supply are studied in an OLG model
- Distribution of skills is endogenous
- Lack of access to finance has an adverse effect on innovation activity, directly and indirectly
- indirect effect operates through decision to invest in skills
- Multiple steady states may emerge if monitoring costs fall with number of successful projects
- One is a middle-income trap, with small labor force and low wages in innovation, and low growth
- Alleviating constraints on access to finance may help to escape from that trap.