“Financial development and inequality in the global economy”

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We use a model with heterogeneous firms, firm-specific wages and a financial friction to study the implications of better quality of the financial system for unemployment and wage inequality. In the closed economy, a less severe moral hazard problem on the asset market allows firms at the lower end of the productivity distribution to secure external finance and to start production. This leads to lower average productivity and profits in the industry translating to a lower unemployment rate. In the closed economy, there is no effect on within-group wage inequality. However, if fixed export costs select the most productive firms into export markets in the global economy, better financial institutions have a different effect for exporters and domestic firms. As low-productive companies benefit relatively more, wage inequality decreases.