

The Counteracting Effects of Credit Constraints on Productivity: Theory and Evidence

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Financial constraints may have counteracting effects on aggregate innovation and growth. We develop a model that shows that, on the one hand, a decrease in financial constraints makes it easier for good innovators to further innovate, while, on the other hand, it allows less efficient incumbent firms to remain on the market, thereby discouraging entry and the reallocation of resources to more efficient firms. Our contribution stems from the combination of those two effects that have so far largely been studied on their own. Using a large French firm-level dataset and an unexpected exogenous shock to firm-level financial constraints, we identify these two counteracting effects. At the aggregate level, we find an overall concave effect of credit constraints on growth and offer an explanation for the dynamics behind the low constraints and low productivity growth that we observe in developed economies for already several years.