

Accepted Manuscript

Title: Capital market imperfections and trade liberalization in general equilibrium

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PII: S0167-2681(17)30339-6
DOI: <https://doi.org/doi:10.1016/j.jebo.2017.11.029>
Reference: JEBO 4211



To appear in: *Journal of Economic Behavior & Organization*

Received date: 18-1-2017
Revised date: 22-9-2017
Accepted date: 27-11-2017

Please cite this article as: Michael Irlacher, Florian Unger, Capital market imperfections and trade liberalization in general equilibrium, *Journal of Economic Behavior and Organization* (2017), <https://doi.org/10.1016/j.jebo.2017.11.029>

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Capital Market Imperfections and Trade Liberalization in General Equilibrium*

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November 29, 2017

Abstract

This paper develops a new international trade model with firm-specific credit frictions and endogenous borrowing costs in general equilibrium. We highlight new implications of globalization when general equilibrium effects on capital markets are present. In particular, we show that globalization increases the share of financially constrained firms and affects producers very differently depending on their exposure to credit frictions. While the positive effect of globalization dominates for unconstrained firms, higher borrowing costs and tougher competition especially hurt credit-rationed producers. We show that these new adjustments increase the heterogeneity among firms and reduce welfare gains from trade. Our theory is consistent with new empirical patterns from World Bank firm-level data. We show that credit frictions are positively related to the degree of product competition and to the variance of sales across firms.

Keywords: Credit constraints, General equilibrium, Globalization, Imperfect capital markets, Welfare.

JEL Classification: F10, F36, F61, L11

*We thank Daniel Baumgarten, Ron Davies, Swati Dhingra, Carsten Eckel, Hartmut Egger, Gabriel Felbermayr, Lisandra Flach, Udo Kreickemeier, Eduardo Morales, Monika Schnitzer, Jens Suedekum, Alexander Tarasov, and Jens Wrona, as well as participants of the Munich “IO and Trade seminar”, Workshop “Internationale Wirtschaftsbeziehungen” in Goettingen, BGPE Research Workshop in Passau, Annual Conference of the European Trade Study Group in Paris, FIW Research Conference in Vienna, HSE Workshop “International Trade and Spatial Economics” in Saint Petersburg, Annual Congress of the European Economic Association in Geneva, and the Annual Conference of the German Economic Association in Augsburg for helpful comments and suggestions. Financial support from the Deutsche Forschungsgemeinschaft through SFB/TR15 is gratefully acknowledged.

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