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Wai-Hong Ho[1]

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This paper examines the effect of externalities on the consequences of financial market globalization in a two-country growth model augmented with domestic credit market imperfections. Following the endogenous growth literature, externalities are byproducts of capital production. Unlike previous studies, I find that their formation matters. Specifically, when transnational externalities consist solely of a rich country's capital stock, financial market globalization brings about world-wide gains in growth. However, when these externalities are a product of both the rich and the poor countries' capital stock, this globalization process only fosters growth in the rich country. Furthermore, if such externalities are sufficiently weak, both the rich and the poor countries may become locked in a stage with no meaningful growth.

JEL Classification: E44, F63.

Keywords: Credit market imperfection, endogenous growth, externalities, International knowledge spillovers, symmetry-breaking.

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