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Author: Michael Irlacher. Florian Unger.

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Capital Market Imperfections and Trade Liberalization in General Equilibrium*

Michael Irlacher
University of Munich[†]

Florian Unger
University of Munich[‡]

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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

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†Corresponding author: Department of Economics, D-80539 Munich, Germany; e-mail: michael.irlacher@econ.lmu.de

‡Department of Economics, D-80539 Munich, Germany; e-mail: florian.unger@econ.lmu.de