Accepted Manuscript

Capital goods trade, relative prices, and economic development

Piyusha Mutreja, B. Ravikumar, Michael Sposi

PII: S1094-2025(17)30092-3
DOI: https://doi.org/10.1016/j.red.2017.11.003
Reference: YREDY 846

To appear in: *Review of Economic Dynamics*

Received date: 30 June 2017
Revised date: 11 October 2017

Please cite this article in press as: Mutreja, P., et al. Capital goods trade, relative prices, and economic development. *Review of Economic Dynamics* (2017), https://doi.org/10.1016/j.red.2017.11.003

Capital Goods Trade, Relative Prices, and Economic Development

Piyusha Mutreja B. Ravikumar Michael Sposi *

November 10, 2017

Abstract

International trade in capital goods has quantitatively important effects on economic development through capital formation and TFP. Capital goods trade enables poor countries to access more efficient technologies, leading to lower relative prices of capital goods and higher capital-output ratios. Moreover, poor countries use their comparative advantage and allocate their resources more efficiently, and increase their TFP. We quantify these channels using a multisector, multicountry, Ricardian model of trade with capital accumulation. The model matches several trade and development facts within a unified framework. Frictionless trade in capital goods reduces the income gap between rich and poor countries by 40 percent. More than half of the reduction in the income gap is due to the TFP channel.

Keywords: Income differences; Capital goods trade; Relative prices; Investment rate.
JEL Classification: O11, O4, F11, E22.

*Previous versions of this paper were circulated under the title "Capital Goods Trade and Economic Development." We thank Marianne Baxter, David Cook, Stefania Garetto, Bob King, Logan Lewis, Ben Moll, Samuel Pienknagura, Diego Restuccia, Andrés Rodríguez-Clare, Richard Rogerson, John Shea, Dan Trefler, and Xiaodong Zhu for valuable feedback. We are also grateful to seminar audiences at Arizona State, Boston, Carnegie Mellon, Chicago Fed, Cornell, Dallas Fed, Durham, Florida State, IMF, Indiana, ISI Delhi, Philadelphia Fed, Princeton, Ryerson University, Seoul National, St. Louis Fed, SUNY Albany, Swiss National Bank, Texas A&M, Tsinghua, Alicante, Basel, Houston, Maryland, UNC Charlotte, Notre Dame, Rochester, Southern California, Toronto, Western Ontario, York, and conference audiences at Cowles, ISI, MadMac Conference in Growth and Development, Midwest Macro, Midwest Trade, Southern Economics Association, System Committee of International Economic Analysis, Conference on Micro-Foundations of International Trade, Global Imbalances and Implications on Monetary Policy, and XVII Workshop in International Economics and Finance. The views in this paper are those of the authors and do not necessarily reflect the views of the Federal Reserve Bank of Dallas, the Federal Reserve Bank of St. Louis, or the Federal Reserve System.
Affiliations and emails: Syracuse University, pmutreja@syr.edu; Federal Reserve Bank of St. Louis, b.ravikumar@wustl.edu; Federal Reserve Bank of Dallas, michael.sposi@dal.frb.org.