Financial Choice 
and International Trade*

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Abstract

Motivated by existing and new stylized facts, we join the new trade theory with 
a model of choice between bank and bond financing to show the differential effects of 
financial policy on the distribution of firm size, gains from trade, and the real exchange 
rate in a small open economy. Increasing bank efficiency and reducing bond transaction 
costs have *opposite* effects on the extensive margin of trade, aggregate exports, and the 
real exchange rate. Increasing access to export markets generates a financial switching 
channel for gains from trade, allowing firms to overcome high fixed costs of bond 
issuance to secure a lower marginal cost of capital.

Keywords: Financial choice, heterogeneous firms, margins of trade, corporate debt, trade 
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