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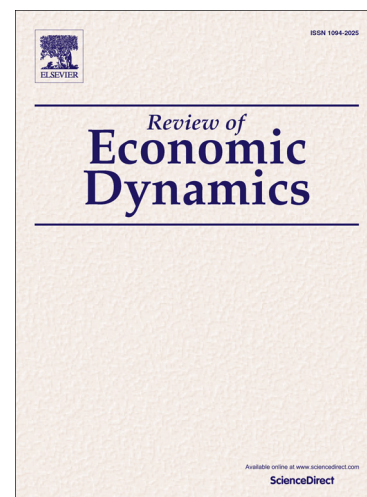
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Capital Goods Trade, Relative Prices, and Economic Development

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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.

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