Abstract

Net capital inflows are negatively correlated with productivity growth in a cross-section of developing and emerging countries observed between 1980 and 2000 (Gourinchas and Jeanne, 2013). This is the so-called allocation puzzle, and in this paper I provide a view from trade on it. Specifically, I formulate, calibrate and compute a quantitative trade model à la Dekle, Eaton and Kortum (2007), augmented to incorporate the key ingredients of a two-sector model of monopolistic competition à la Krugman and Venables (1995). The model provides an intuitively appealing explanation for the allocation puzzle, and a calibrated version of it replicates well the key patterns in Gourinchas and Jeanne’s data.