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FINANCIAL FRICTIONS AT ENTRY, AVERAGE FIRM SIZE, AND PRODUCTIVITY

ABSTRACT

We document cross country-evidence showing financially under-developed economies have lower productivity investment, a smaller employment share of large firms, and smaller average firm size within sectors. We present a tractable model with heterogeneous entrepreneurs that face financial constraints limiting investment at entry. The model can be solved analytically, making clear predictions for the impact of constraints on outcomes of interest consistent with the evidence we document. The calibrated model can account for about one fifth of the variance in observed average firm size and TFP across countries, all substantial relative to the literature.

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