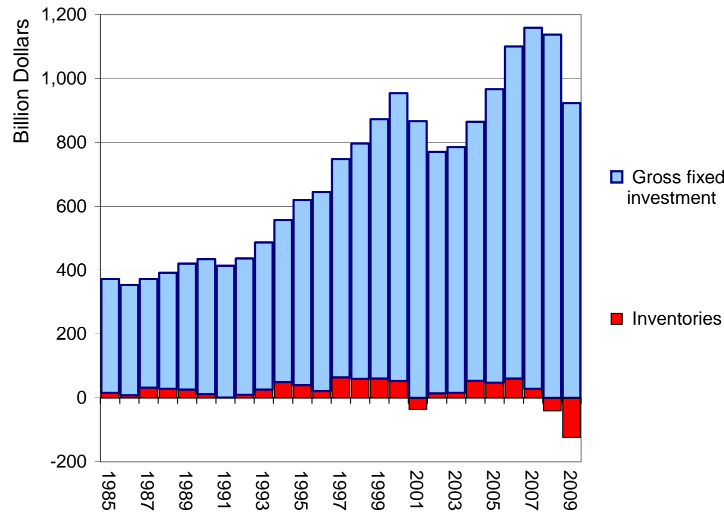

Figure 11. Capital Expenditure of U.S. Non-Financial Firms (Source: Federal Reserve Flow of Funds, Table F102)

evidence that credit spreads have substantial effect on macro activity measures, and Hall (2010, 2011) models fluctuations in fixed investment through financing costs that are amplified by distortions in the product market. Ohanian (2010) is more skeptical about the effect of financial frictions citing the large cash holdings in firms, and the fact that firms rely mostly on internal funds for fixed investment. The business cycle accounting literature in the manner of Chari, Kehoe and McGrattan (2007) finds lack of clear-cut quantitative evidence on deviations of fixed investment relative to the benchmark model. The contribution of our paper relative to this large literature is to highlight the working capital channel of financial frictions, and show how financing cost can impact output even in a model without physical capital or labor/product market distortions.

Working capital is more familiar to the literature on financial crises, especially those in emerging economies. Calvo, Izquierdo and Talvi (2006) document several stylized facts that appear consistently during financial crises, such as the fact that credit and total factor productivity drop sharply with the