customer base and charge a high price in order to generate cash for debt service, thereby foregoing future profits. In summary, the firm's intertemporal pricing strategy previously described is disrupted by the presence of financing constraints.

Another aspect that has attracted the attention of economists trying to build models able to explain the empirical regularity of procyclical factor prices is the behavior of price-cost margins. In particular, if markups are countercyclical, this could explain why the increase in output that follows a positive demand shock is generally accompanied by an increase in the real wage. There are a few alternative explanations for countercyclical markups (see Galeotti and Schiantarelli, 1994, and Sembenelli, 1996): among them, one explanation stresses the impact of capital market imperfections on firms' pricing strategies (Greenwald, Stiglitz, and Weiss, 1984; Chevalier and Scharfstein, 1995, 1996). As argued above, firms under the threat of liquidation are less likely to set low prices in product differentiated industries in order to gain market shares. Since it is in recessionary periods that firms may find it more difficult to raise external funds because the value of collateral is low, they will have a greater incentive to raise price and increase current cash flow in order to meet their liabilities and to finance operations.

The empirical evidence bearing upon the impact of financing costraints on the firm's pricing strategies and the cyclicality of markups is scant and appears to be mostly, if not exclusively, based upon the predictions of models of customer markets. According to this theory, we should expect prices to be affected by financial variables, especially for firms that are thought to be constrained and in periods of low demand. Thus, the data should support the existence of a positive correlation between price and debt. Indeed, this is what emerges from the existing empirical evidence in Chevalier and Scharfstein (1995, 1996), Chevalier (1995), and Phillips (1995). In addition, these studies find that leveraged firms during recessionary periods tend to raise price markups (Chevalier and Scharfstein, 1995, 1996).

Despite the evidence supporting the existence of a link between capital market imperfections and markups in product markets with consumer switching costs, there are a few issues that are still unresolved. Firstly, as noted by Chevalier and Scharfstein