Global Sourcing and Multinational Activity A Unified Approach

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Multinational firms (MNEs) accounted for 42 percent of US manufacturing employment, 87 percent of US imports, and 84 of US exports in 2007. Despite their disproportionate share of global trade, MNEs’ input sourcing and final-good production decisions are often studied separately. Using newly merged data on firms’ trade and FDI activity by country, we show that US MNEs are more likely to import not only from the countries in which they have affiliates, but also from other countries within their affiliates’ region. We rationalize these patterns in a unified framework in which firms jointly determine the countries in which to produce final goods, and the countries from which to source inputs. The model generates a new source of scale economies that arises because a firm incurs a country-specific fixed cost that allows all its assembly plants to source inputs from that country. This shared fixed cost across plants creates interdependencies between firms’ assembly and sourcing locations, and leads to non-monotonic responses in third markets to bilateral trade cost changes.