

Workshop on

International Outsourcing



Institutions and Offshoring Decision

Marcella Nicolini

1-2 June 2007

University of Helsinki, Economicum Building

Institutions and Offshoring Decision

Marcella Nicolini*

January, 2007

Abstract

The knowledge-capital model of the multinational enterprise incorporates in one framework two types of foreign direct investment: on one side, there is the horizontal type of FDI, which corresponds to the market seeking motivation, on the other side, there is the cost reduction motive, which correspond to the vertical FDI. Recently, several papers have proven that also the institutional environment of the receiving country can influence the choice to establish an FDI in a foreign country. Past literature has always considered institutional quality at country level. The property rights theory suggests that contract enforcement matters differentially across sectors, being more important for sectors that produce more complex goods. This paper is the first attempt to test whether institutions matter differentially across different sectors in FDI decision. Using data on U.S. Direct Investment Abroad, I find that institutional characteristics of the country and the industry positively affect the volume of offshoring that takes place between U.S. companies and their affiliates. I show that the suggested argument is strong for the intermediate products, while the evidence is weak for those products ready for sale. This confirms that the contractual determinants of trade are not at work for these goods, whose production has not been split between parent company and foreign affiliate.

*Università degli Studi di Milano and ISLA, Università "L. Bocconi", via Gobbi 5, 20136 Milano. Tel: ++39 02 5836 5423. email: marcella.nicolini@unibocconi.it

1 Introduction

The knowledge-capital model of the multinational enterprise incorporates in one framework two types of foreign direct investment. On one side, there is the horizontal type of FDI, which corresponds to the market seeking motivation. Usually, it is to a foreign direct investment in a high-income country, whose market is of interest to the multinational corporation. Multinationals prefer to serve the foreign market with local production, in order to avoid the costs associated with international trade. On the other side, there is the cost reduction motive, which correspond to the vertical FDI. This type of foreign investment is usually directed to low-income countries, whose markets are less interesting for the multinational enterprise. The aim of this investment is to exploit the comparative advantages of the countries in the production of goods: lower production costs attract part of the production process of multinationals.¹

Recently, several papers have proven that also the institutional environment of the receiving country can explain FDI inflows. First, a good institutional environment raises productivity, which in turn attracts FDI. Secondly, poor institutions are an additional cost to foreign direct investments, and, finally, a foreign direct investment is vulnerable to uncertainty, due to high sunk costs. All these factors suggest that a good institutional environment in the recipient country is preferred by multinational companies.

The novelty of this paper is that I prove that institutions matter differentially across different sectors. Contracts literature suggests that contract enforcement impacts differentially across sectors, being more important in those sectors that produce more complex goods. Thus, the institutional environment of a country does not impact in the same way on multinationals's decision of offshoring, but it will be more relevant for those sectors that produce more complex goods. These are the sectors that rely more heavily on contract enforcement.

The aim of the present work is to show how institutional quality, and complexity of goods can explain the flows of intra-firm trade between U.S. multinationals and their foreign affiliates. I find, indeed, that institutional characteristics of the country and the industry positively affect trade flows between U.S. companies and their affiliates. In the analysis, I exploit several measures of intra-firm trade flows. First, I consider the sum of total intra-firm trade flows, running in both directions. Then I employ separately trade flows from U.S. parent companies to foreign affiliates, and vice versa. Finally, I exploit the difference between good shipped for simple resale in the foreign market, and goods shipped for further manufacturing. I show that the suggested argument is stronger for the intermediate products, in comparison with total flows of intra-firm trade. The evidence is instead weak for those products ready for sale. This confirms that the contractual determinants of trade are not at work in the case of final goods.

The remainder of the paper is structured as follows. Section 3.2 reviews the literature on contacts and international fragmentation of production. Section

¹Good references on multinationals and foreign direct investments are Markusen (2002) and Barba Navaretti Venables (2004). See also the review by Markusen and Maskus (2001).

3.3 outlines the empirical model, Section 3.4 presents the data. Section 3.5 deals with some econometric issues and presents the results. Finally, Section 3.6 concludes.

2 Institutional Quality, Contracts and Offshoring

Several papers have underlined how the choice of starting a foreign direct investment can depend also on the quality of the institutions of the receiving country. Wei (2000) finds that inward flows of foreign direct investments are reduced by high levels of corruption in the recipient country. Globerman and Shapiro (2002, 2003) suggest that institutional quality has a positive impact both on inward and outward FDI, while Aizenman and Spiegel (2002) demonstrate that the share of FDI is decreasing in corruption levels. Habib and Zurawicki (2002) find that absolute difference in a corruption index between two countries has a negative impact on bilateral FDI.²

Bénassy-Quéré, Coupet and Mayer (2005) estimate a gravity equation for bilateral FDI stocks that includes institutional quality measures for the two countries, and find that the measures of institutional quality are both positive and significant. Alfaro, Kalemli-Ozcan and Volosovych (2005) find that institutional quality, as instrumented by its historical determinants, is an important determinant of capital flows, defined as FDI plus portfolio equity. Using a data set that covers the period 1970-2000, they demonstrate that the Lucas' paradox (1990) may be explained by differences in institutional quality. The institutional environment explains also capital volatility: lower levels of institutional quality implies higher capital volatility.

The Grossman-Hart-Moore model has given inspiration to a number of papers in international trade literature, which have been focusing on the limits on the firm, and the choice between outsourcing and internalization. McLaren (2000) considers the choice made by the final good producer and the input supplier located in the same country, between arm's-length production and integrated procurement. In equilibrium, thickness of the market favours outsourcing. Grossman and Helpman (2002) model the choice between integration and outsourcing, in a closed economy framework. The mode of organization is determined in equilibrium by the trade off between the costs of running a larger and less specialized organization and the costs of imperfect contracting and search frictions. Grossman and Helpman (2005) present a monopolistic competition model in which firms outsource part of their production, and choose between outsourcing at home or abroad. They show that an improvement of contract enforcement in a country raises the relative profitability of outsourcing there. In another paper (2003), they consider firms that acquire their inputs from another country, where production is cheaper. The authors neglect the determination of the location of component production, and focus on the choice between outsourcing and FDI. The firms choose in this model between outsourcing in the foreign country and foreign direct investment. This choice depends on industry size, contracting environment and relative wages. Ottaviano and Turrini (2003)

²See also Elliot (1997) on the role of corruption in international economics.

consider the choice of the multinational to serve a foreign market with exports or foreign direct investment. If FDI is chosen, the firm chooses also between self-production and outsourcing of intermediate inputs. Their model predicts non linearities between FDI and trade costs: foreign direct investments may emerge with both low and high trade costs. Ornelas and Turner (2005) consider the firm's choice between a standardized intermediate input produced at home, or a customized input produced abroad. They focus on the effect of a trade liberalization in a model with contact incompleteness, and show that a trade liberalization may prompt vertical integration.

All these models assume that hold up occurs only between the supplier of the intermediate input and the final producer. Antràs instead follows the works of Grossman, Hart and Moore (1986, 1990) and allows for the possibility of hold up also within firm boundaries. In his model (2003) he builds a property-rights model of the boundaries of the firm. He predicts that costs of outsourcing are increasing in the capital intensity of the imported good, thus, capital-intensive goods will be produced within the firm. He provides empirical evidence that U.S. intra-firm trade takes place mostly in capital-intensive sectors, with capital abundant countries. Antràs and Helpman (2004) combine the within sectorial heterogeneity modelled by Melitz (2003) with the model of the firm boundaries developed by Antràs (2003) and focus on the choice between integration or arm's length relationship for the production of intermediate inputs, both at home and abroad. The firm faces two different decisions: the first is whether to produce a component at home, or in foreign country. The second is whether to produce within firm boundaries, or outside it, with an arm's length contract. According to productivity and sectorial characteristics, four different organizational forms exist in equilibrium. This model endogenizes both outsourcing and location decision.

Few empirical works exist in this stream of literature, mainly due to data limitations. Feenstra and Hanson (2005) look at processing imports and exports in China, with data at HS 8-digits level. They possess information on the ownership structure, and find that the allocation of ownership and control is generally shared between foreign and local parties. Swenson (2005) focuses on the determinants of outsourcing abroad. Using data on the offshore assembly program (OAP) of the United States, she shows that outsourcing activity is responsive to country's costs and industry characteristics. Using a rich data set on U.S. firms, Bernard, Jensen and Schott (2005) show that multinationals have a constant breakdown of trade between intra-firm and arms' length transaction, which equally cover the trade flows of multinationals. Moreover, also the share of exclusively arm's-length exporters or importers has remained substantially stable over the period considered.³

³Their newly created data set has also firm level information on the amount of goods exchanged through arm's length relationships.

3 The Empirical Model

A huge bulk of theoretical literature has shown how contractual imperfections determine the choice of the firm between production in house or subcontracting, either at home or abroad. I do not inspect the determinants of these choices, instead I focus on multinationals and the organization of production within them. Multinational enterprises split the production process between parent company and affiliates located in other countries. The focus of the analysis is the offshoring of production, while outsourcing decision is neglected. I consider only those goods whose production takes place entirely within multinational boundaries, although in different countries. Thus, production has been offshored, but not outsourced. Of course, part of the production may have been outsourced too, unfortunately, I do not possess any information on the entity of the outsourcing activity implemented. Therefore, I limit my analysis to the flows of goods that are produced in house. I analyse the impact that institutions have on the organization of production within multinational firm boundaries.

The hypothesis that I want to test is that institutional quality of the country of the affiliate affects the production choice of the multinational firm. Following the Grossman-Hart-Moore framework, and, more recently, Antràs (2003), I suppose that hold-up concerns exist also within an integrated firm. As Grossman and Hart (1986) note: "integration shifts the incentives for opportunistic and distortionary behaviour, but it does not remove these incentives". Thus, if the firm decides to integrate its external supplier, this does not eliminate the risk of opportunistic behaviour. As the risk of hold-up is present, I expect that the fragmentation of production will be favoured in countries that present a better contract enforcement. Therefore, institutional quality matters for organization of production within firm boundaries, with better contract enforcement favouring offshoring within firm boundaries.⁴

Costinot (2004), Levchenko (2004) and Nunn (2004) have shown that a poor contracting environment impacts differentially across sectors, being more detrimental to sectors that produce more complex goods. In other words, a good enforcement of contracts is a source of comparative advantage in the production of those goods that require a large number of intermediate inputs, and consequently a large number of contracts with several input suppliers, in order to be produced.

Taken as given the choice to produce abroad through an FDI, I expect that good contract enforcement in the host country favours offshoring of production in more contract-dependent sectors. More institutionally dependent goods will be produced preferentially with affiliates located in countries with good institutional quality.

Of course, testing the institutions hypothesis, I have to control for the standard determinants of offshoring of production. Two different reasons may motivate foreign direct investments. The first is the market access motive, which corresponds to the horizontal type of foreign direct investment. The second is the

⁴Better contract enforcement favours in the same way also international outsourcing outside firm boundaries.

cost reduction motive, that pushes multinationals to fragment their production in order to reap cost gains, which corresponds to the vertical FDI framework. The knowledge capital model shows that these two forms can coexist. Hanson, Mataloni and Slaughter (2001) provide empirical evidence that nowadays multinationals' expansion strategies have both vertical and horizontal features. Accordingly, I have to consider both types of determinants together.

The horizontal motive can be tested with country characteristics, sectorial characteristics and trade costs measures. In order to test the vertical motive, I have to consider that costs vary across countries and industries according to comparative advantage. I enrich the standard test of the vertical FDI, considering institutional quality as an additional source of comparative advantage in the production of complex goods. This is a safe assumption, as several authors⁵ have already demonstrated that institutional quality can be a source of comparative advantage in the production of more complex goods, which require a large number of contracts in order to be produced. The aim of the empirical analysis is thus to test whether the institutional comparative advantage matters in multinational choices of production.

The equation that I estimate is the following:

$$flow_{ict} = \alpha + inst_{ict} + hor_{ict} + ver_{ict} + \varepsilon_{ict}$$

where i is the sector, c the country and t the time period. hor_{ict} corresponds to a set of variables that determine the choice to establish an horizontal direct investment abroad, ver_{ict} is a set of measures of production costs, which vary across countries and sectors and $inst_{ict}$ is a measure of the institutional quality driven comparative advantage. I use intra-firm trade flows as a measure of the offshoring activity by multinationals.

4 The Data

The data used in the analysis come from the data set on U.S. Direct Investment Abroad, maintained by the Bureau of Economic Analysis (BEA), U.S. Department of Commerce. I employ different measures of sales between non-bank U.S. multinationals and their majority-owned nonbank affiliates. These are enterprises in which the U.S. entity has at least a 51% equity stake. I use data from the benchmark surveys in years 1994 and 1999. Although data on direct investment abroad are available for every year, only benchmark surveys contain the information on the intended use of the good traded, namely the choice between further manufacturing or resale.⁶ Data from the BEA data set on intra-firm trade have been extensively used in the literature, among other by Hanson, Mataloni and Slaughter (2001), Antràs (2003), Helpman, Melitz and Yeaple (2003) and Yeaple (2003, 2006).

As dependent variable I consider in turn several measures on intra-firm trade flows. First, I use the value of total intra-firm trade, which I obtain summing

⁵Costinot (2004), Levchenko (2004), Nunn (2004), Acemoglu Antràs Helpman (2006).

⁶See Appendix 3.7.1 for further information on data issues.

trade flows running in both directions. Then, I inspect separately trade flows of goods from foreign affiliates to parent companies⁷ and trade flows from U.S. parents to foreign affiliates. Finally, I exploit the distinction between goods shipped for further manufacturing and good shipped for resale. Unfortunately, this information is available only for trade flows to foreign affiliates.⁸

Institutional dependence at sectorial level, $inst_i$, is measured using different indexes of concentration of intermediate input use.⁹ Instead of limiting my analysis to standard measures used in literature, I develop a number of alternative measures of concentration of intermediate input use. The measures that I use are: entropy, normalized entropy, exponential index, Herfindahl index, normalized Herfindahl index, Gini coefficient, concentration coefficient, share of top 10, 20 and 30 intermediate inputs in total intermediate good expenditure. I use also the number of intermediates employed in the production. This is a rawer measure of complexity of an industry, as it gives the same weight to large and insignificant inputs, ignoring differences in the entity of various inputs. Table 3.1 in Appendix shows the definitions of these indexes of concentration. I compute these indicators using the U.S. Input-Output Table for 1992¹⁰ and for 1999. I am assuming that the existing structure of intermediate inputs use in the United States is driven by technology differences across sectors, and that these technological differences carry over to the other countries. All these measures, except entropy and the number of intermediate inputs, increase with concentration. Then, I multiply by -1 the measures, in order to have a set of indexes that increases with the number of inputs, and therefore the number of contracts.

Measures of institutional quality, $inst_c$, are taken from the Governance Matters IV Database (Kaufmann *et al.* 2005). This data set, maintained by the World Bank, provides six different indexes of institutional quality, that range from -2.5 (poor quality) to 2.5 (good quality)¹¹. These indicators focus on different aspects of institutional quality: Voice and Accountability, Political Instability and Violence, Government Effectiveness, Regulatory Burden, Rule of Law, which refers specifically to the level of contract enforcement, and Control of Corruption. These measures are based on a large number of individual variables, which measure the perceptions of governance. For a description of the variables, see Appendix 3.7.1. Table 3.2 shows the correlation between different measures of institutional quality at country level. All correlations are positive and significant at 1% level. Then multiplying $inst_c$ and $inst_i$, I obtain a measure of institutional dependence that is country and industry specific.

I assume that there are no factor intensity reversals, thus implying that factor shares are fixed for each industry across countries. Therefore, factor intensities can be ranked using factor share data for just one country. I use U.S. industry

⁷This measure has been employed also in Yeaple (2003).

⁸Another attempt to exploit the information on the intended use is Yeaple (2006).

⁹The use of measures of concentration, like Herfindahl index, as an indicator of product complexity is acknowledged in literature, see Blanchard Kremer (1997) and Cowan Neut (2002).

¹⁰US Input-Output table for 1994 is not available.

¹¹These indexes have mean zero and a standard deviation of 1.

data for reasons of availability, moreover they are the most satisfactory, as the United States are the largest and most diverse industrial economy. Data for factor intensities come from the U.S. Manufacturing database maintained by NBER and U.S. Census Bureau’s Center for Economic Studies for 1994 and 1996¹². $capital_i$ is a measure of capital intensity, and is equal to one minus the share of total compensation in value added. $skill_i$ is a measure of skilled labour intensity, and is equal to the ratio of non production workers to total employment, multiplied by the total share of labour in value added.

I test the relevance of comparative advantage in intra-firm flows by an interaction of factor intensities and relative factor prices.¹³ To determine relative factor prices I use relative factor abundance, taken from Hall and Jones (1999). The abundance of skilled labour $skill_c$ is measured by the human capital to labor ratio, which is based on the education levels reported in Barro and Lee (2000). The abundance of capital $capital_c$ is measured by the investment based measure of the capital to labor ratio, sourced from Hall and Jones (1999).

I add a set of variables to control for the classical determinants of FDI. In order to control for the horizontal motive for foreign direct investment, I include a measure of market size, namely the log of GDP in current U.S. dollars, taken from the World Development Indicators. The measures for tariffs are taken from the CEPII tariffs data set. Tariffs are measured at the bilateral industry-level in percentages. NTBs are classified following Haveman’s (2003) treatment of TRAINS. I include a measure of transport cost, (freight plus insurance) taken from the Feenstra World Trade Flows Dataset. I add some measures of scale, in order to test the horizontal FDI hypothesis. I build a measure of plant level scale economies as the number of production workers per establishment. It is the average size of a plant in the U.S. by industry, that gives a measure of plant-level fixed costs. The variable $cscale$ is a measure of corporate scale economies, and is the average number of non production workers per company.¹⁴ Finally, I control for fiscal regime in the foreign country, using several proxies taken from the World Development Indicators. Following the literature, I consider the highest marginal corporate tax rate, which is the highest rate shown on the schedule of tax rates applied to the taxable income of corporations. I use also a measure of the taxes on income, profits and capital gains as a percentage of the total revenue. I also control for the role of the value added tax.¹⁵

5 Econometric Analysis

5.1 The Choice of Estimation Technique

The dependent variable, $flow_{ict}$, assumes only positive values and is not continuous, moreover it presents a large number of zero observations. Using Shapiro-

¹²Data for 1999 are not available, I used data for 1996 as it is the most recent year available.

¹³This choice reflects the test of comparative advantages suggested by Romalis (2004).

¹⁴Data come from the 1992 Census of Manufacturers and 1997 Manufacturing Economic Census.

¹⁵For a review of the role of corporate taxation on FDI, see Devereux Griffith (2002).

Francia test for normality, I find that all different measures of trade flows are not normally distributed, nor are their logarithmic transformations. Given the distribution of my dependent variable, I might think of a Tobit estimator. This is not a good choice, as it requires the dependent variable to be continuous.¹⁶

Alternatively, I may refer to the family of count data models. Several reasons suggest that this could be the optimal choice. First, the dependent variable is integer, and does not have a continuous distribution. Besides, Hausman, Hall and Griliches (1984) note that "[t]he "zero problem" [...] is a natural outcome of the Poisson specification. In contrast to the usual logarithmic regression specification we need not truncate an arbitrary continuous distribution". Therefore, a count data model is a better solution to the problem of zero flows of intra-firm trade. Finally, Santos Silva and Tenreyro (2005) suggest that the widely adopted log-linearization of the dependent variable, estimated by OLS, produces inconsistent estimates in presence of heteroskedasticity.

Among count data models, Poisson regression model¹⁷ is the first choice. Poisson distribution requires that mean and variance assume the same value for the dependent variable. This is often difficult to find in the data, therefore in this cases the solution is to move to the negative binomial regression model, that allows mean and variance to differ. Alternatively, another way to treat overdispersion is to consider models that take into account the overrepresentation of zeros in the sample: these are the zero inflated Poisson model and the zero inflated negative binomial model.

A quick look at summary statistics of the different dependent variables considered in the analysis is presented in Table 3.3. It shows that all these different measures of trade flows present overdispersion, as the mean is clearly larger than the standard deviation. Figure 3.1 shows the plot of the probabilities observed, and the probabilities predicted by the different models considered.¹⁸ The graph shows that Poisson model is unable to predict correctly the observed distribution. The other distributions seem to fit better our data, especially negative binomial regression and zero inflated negative binomial regression. This qualitative analysis suggests the use of a negative binomial or a zero inflated negative binomial regressor. Among these, Long and Freese (2005) suggest that negative binomial is to be preferred as it is simpler.¹⁹

In order to choose, I estimate the simplest equation of interest using different regressors, then I perform a number of test in order to choose the correct estimator. Table 3.4 shows the results of the regression of the total intra-firm flows on the interacted term between institutional quality at country level, and institutional dependence at industry level. First, I observe that the coefficient of interest is always positive and significant, across different regressors. Moreover, the magnitude of the coefficient is rather stable. Observing the likelihood ratio

¹⁶See Wooldridge (2002) p. 520.

¹⁷This is a common choice when using this data set on intra-firm trade, see Yeaple (2006).

¹⁸Figure 3.1 shows the observed and predicted probabilities for total intra-firm trade flows. The analysis with the other measures of intra-firm trade provides similar results, therefore the other figures are not reported.

¹⁹See Long and Freese (2005) p. 260.

test that compares each model with the intercept only model, I notice that all the models have an explanatory power. In order to compare these non-nested model, I look at the Bayesian Information Criterion. Smaller values of BIC mean better fit of the estimate. This would suggest that the Negative Binomial Regression is the one that captures better the nature of the data. Following Raftery (1996), I observe that an absolute difference in BIC larger than 10 can be interpreted as a very strong evidence that the estimate with lower value of BIC is to be preferred. I notice that the difference in BICs between the NB and ZINB models is lower than 10, suggesting a less strong difference between the models. This confirms the qualitative analysis of the distributions represented in Figure 3.1, in which negative binomial and zero-inflated negative binomial seem the two specifications to be preferred. I obtain analogous results observing the Akaike's (1973) information criteria: in this case, there is no longer evidence in favour of the negative binomial against the zero-inflated negative binomial.²⁰

To properly determine the correct regressor, I perform a number of tests. A goodness-of-fit test for the Poisson specification is implemented: the statistic rejects the hypothesis that data are Poisson distributed. A Vuong (1989) test of ZIP versus standard Poisson gives a positive and significant statistic, 6.80, thus favouring the ZIP model. Although ZIP does not seem to perform well looking at BIC statistics, it is nevertheless to be preferred to the standard Poisson estimator. The reason is that including the zero inflation process is a way to take into account the overdispersion present in the data. Anyway, as overdispersion is a problem in the data, negative binomial is to be preferred. The likelihood ratio test of α , the overdispersion parameter, equal to zero strongly rejects the null hypothesis: thus, I can affirm that overdispersion is present in the data, and negative binomial distribution better fits the data. Finally, a Vuong test of ZINB versus NB suggests that NB is to be preferred.

The last column of Table 3.4 presents the same model, estimated using OLS. The dependent variable in this specification is $\log(flow_{ict} + 1)$. The coefficient estimate is close to the ones predicted using the other estimators. Nevertheless, the Breusch-Pagan test rejects the null hypothesis of homoskedasticity.²¹ Monte Carlo simulations performed by Santos Silva and Tenreyro (2005) show that estimates using log-linearized models are severely biased in presence of heteroskedasticity. Therefore, the log-linearized model is not a suitable choice, and the negative binomial regression will be employed in the following analysis.

²⁰ Akaike (1973) information criterion and Bayesian information criterion (Raftery 1996) are both measures of model fit adjusted for the number of parameters. AIC is based on the log likelihood, while BIC is based on the deviance. Baltagi (2001, p.78) remarks that BIC is to be favoured because it is consistent (if the sample goes to infinity, the probability that it will choose the correct model from a finite number of model goes to 1). A consequence of this property is that in small samples, BIC tends to wrongly choose underfitting models and can have very low probabilities of correctly selecting a model which has a large number of free parameters. AIC instead seems more balanced in small samples, but can suffer from a tendency to overfit in larger samples. I look at both statistics, and they provide the same indication.

²¹ I also plot the residuals versus fitted values, observing a pattern between the two.

5.2 Results

I start the empirical analysis using as dependent variable total intra-firm trade flows running in both directions, from parent companies to foreign affiliates and vice versa. Table 3.5.a shows the results. In addition to the interacted term between institutional quality at country level and institutional dependence at industry level alone, I control for the impact of the two variables alone. The amount of trade flows between parent companies and foreign affiliates can be affected by the size of the parent company. One could expect that larger industries present larger flows of intra-firm trade. Therefore, I control for the parent company size, measured by total sales by parent companies included in the BEA data set.

Column (1) in table 3.5.a shows that the institutional variable has a positive and significant coefficient, as expected. Thus, intra-firm trade flows are positively affected by good levels of contract enforcement, especially in contract-intensive industries. The size of the coefficient remains quite stable across different specifications. Column (2) adds a measure of market size, in order to test for the horizontal type of FDI. I observe a positive and significant coefficient, that confirms the presence of a market seeking motive. Again, the size of the coefficient attached to the institutional variable is rather stable. My measure of plant scale economies has a negative and significant coefficient. This confirms the idea that opening a new plant is unfavourable in presence of plant scale economies. Instead, the corporate scale variable has a positive and significant coefficient, suggesting that there is an incentive to the opening of subsidiaries in case of this scale economies. Tariffs have a negative impact on trade flows, as expected: column (4) shows the effect of tariff barriers, while column (5) shows that also non-tariff barriers to trade, proxied by a measure of their coverage, have a negative, although not significant, impact. Freight and insurance costs have a negative and significant coefficient. Also Hanson, Mataloni and Slaughter (2003) find that higher trade costs reduce the demand for intermediate inputs shipped by U.S. parent companies to their foreign affiliates. Column (6) controls for the role of the corporate tax rate. As expected, I find a negative coefficient, although not significant. Also the value added tax proves to have a negative impact.

Table 3.5.b shows some robustness checks, with the inclusion of classical determinants of comparative advantage. I find that the interacted terms for skill and capital are both generally not significant. Tables 3.5.a and 3.5.b report the test for the hypothesis that the overdispersion parameter, α , is equal to zero. The likelihood ratio test always rejects the null hypothesis, thus showing again that the estimator to be employed has to take into account overdispersion.

I then decompose the total measure of intra-firm trade flows into its two components: trade flows from the parent company toward foreign affiliates, and flows of goods from the affiliate to the U.S. parent company.

Looking at trade flows running from affiliates to parent companies, I observe that the institutional variable is generally positive albeit not significant across different specifications presented in table 3.6.a. Control variables have the ex-

pected coefficients, and are generally significant. Table 3.6.b reports the results including additional controls for the comparative advantage motive.

Considering in turn trade flows from U.S. companies to foreign affiliates, I obtain again a positive and significant coefficient for the institutional variable. Control variables for horizontal FDI always present a positive and significant coefficient. Table 3.7.b shows the results that include comparative advantage variables.

Comparing the log likelihood across different sets of estimates, I observe that splitting the dependent variable into its two components improves the fit of the estimates: log likelihood is always larger in absolute terms in estimates presented in table 3.5.a and 3.5.b, in comparison with results shown in tables 3.6 and 3.7.

I can decompose further my dependent variable. Trade flows from the U.S. to foreign affiliates can be disentangled into flows of goods shipped for further manufacturing, and flows of goods shipped to foreign affiliates for resale. I look first at trade flows of goods shipped for further manufacturing. I observe again that the coefficient attached to the institutional variable is positive and significant across the different specifications. This is an additional confirmation of my hypothesis. I find that the choice of the multinational firm in the fragmentation of the production process is influenced by the comparative advantage given by the good contract enforcement of the country in which the affiliate is located. Of course, other country or industry characteristics may influence this choice. These have been controlled for in the alternative specifications presented in tables 3.8.a and 3.8.b.

If I consider, finally, the flows of goods shipped for resale, I observe that the coefficient for $inst_{jct}$ is generally negative, and never significant. The coefficient for the other control variables maintain instead the same level of significance. The results shown in tables 3.9.a and 3.9.b confirm the intuition that the contractual determinant of offshoring is not at work when considering goods that do not need further manufacturing or, in other terms, final goods.

In order to assess the relevance of the institutional variable across different sets of estimates, I compute the marginal effects. Table 3.10.a and 3.10.b present marginal effects for the institutional variable across different specifications. The first line shows the marginal effect when the dependent variable in the equation is the amount of goods shipped from U.S. companies to foreign affiliates. The other two lines present the marginal effects computed when the dependent variable is the flow of goods shipped for further manufacturing, and the flow of goods shipped for resale.

I discern that the marginal effects are larger than the estimated coefficients when considering trade flows to foreign affiliates, and goods shipped for further manufacturing. Looking at the marginal effects for the regressions on the goods for resale, I observe that they maintain approximately the same size of the coefficient estimates. Thus, I can affirm that the institutional variable impacts on the choice of splitting the production between two countries, but has a negligible

impact when considering intra-firm trade flows of final goods.²²

5.3 Robustness

So far I have not inspected the time-varying dimension of my dataset. All previous estimates pool together observations from two different time periods. As Greene (2001) suggests, given the short time period, one could simply add time dummies to the model. Therefore, I reestimate the previous equations adding a time dummy. Results do not change.²³

Table 3.11 shows that the inclusion of a set of country dummies, industry dummies or both does not change the result that intra-firm trade is increasing in country's institutional quality and sector's institutional dependence. It suggests also that it is important to take into account these effects.

Thus, I move to panel estimates. My data vary over three dimensions: country, sector and time. In order to keep all the observations, my group variable is given by country-sector pairs. The panel data method allows individual effects, both fixed and random, to vary across groups: as this controls for heterogeneity, Cameron and Trivedi (1998) suggest that the Poisson longitudinal model may be sufficient. The choice of the negative binomial regressor was previously motivated by the need to properly take into account overdispersion of the data, but panel methods control for this through the individual effects, therefore there is no need to move to a negative binomial panel model.

As regards the choice between fixed or random effects, I would *a priori* choose fixed effects, as I could expect country-sector effects to be correlated with the other regressors.²⁴ Unfortunately, fixed effects estimator has a number of shortcomings. It is not possible to obtain coefficient estimates for time-invariant regressors,²⁵ as they are absorbed by the fixed effects. Groups in which trade flow does not change in time are dropped: given the short time span, only two years, this is likely to occur.²⁶ As my panel is unbalanced, all the group with only one observation are dropped with fixed effects, but not with random effects. Finally, Greene (2001) notes that as individual effects are estimated with $T(i)$ observations, a short time period implies a small sample bias and inconsistent estimates for the effects. At least, Cameron and Trivedi (1998) prove that this is not the case with Poisson fixed effect estimators.

In order to choose between fixed and random effects, I consider a baseline specification using different dependent variables, and perform a Hausman test. Table 3.12 shows that coefficient estimates are very close between fixed and ran-

²²The marginal effect is actually never statistically different from zero.

²³These estimates are not reported, but are available upon request.

²⁴Random effects are assumed i.i.d. $[0, \sigma^2]$ and hence uncorrelated with the other regressors. If the effects are correlated with the regressors, this leads to inconsistent estimates in case of random effects, whereas the fixed effects estimator is consistent.

²⁵In my dataset, capital and skilled labour endowments are time invariant.

²⁶Consider a country-sector combination in which no FDI, and therefore no intra-firm trade, was present in 1994. If any multinational starts an FDI in the following five years, I will observe again an absence of trade flow for this country and sector pair. In the panel fixed effect estimate, these two observations will be dropped.

dom effects. Hausman test rejects the null hypothesis of absence of correlation between individual effects and the other regressors, thus suggesting that the effects should be considered as fixed. Also the value of the loglikelihood suggests that fixed effects should be preferred.

Fixed effects Poisson estimation confirms the results obtained in the previous subsection. Tables 3.13.a and 3.13.b report the marginal effects computed for the institutional variable across different specifications. Like in Tables 3.10, the first line shows the marginal effect when the dependent variable is the amount of goods shipped from U.S. companies to foreign affiliates. The other two lines present the marginal effects computed when the dependent variable is the flow of goods shipped for further manufacturing, and the flow of goods shipped for resale. The coefficient of interest is positive and significant, both considering trade to foreign affiliates, and trade of goods for further manufacturing. Instead, trade of goods for resale seems affected negatively by the institutional quality variable: the coefficient is now negative, and usually significant.

6 Conclusions

Classical determinants of foreign direct investments are the market access motive, and the cost reduction motive. On one side, the market seeking motivation corresponds to the horizontal type of FDI. Usually, this corresponds to a FDI in a developed economy, whose market is of interest to the multinational corporation, which prefers to serve it with local production, in order to avoid the costs associated with international trade. On the other side the cost reduction motive correspond to the vertical FDI. This type of foreign investment is usually directed to developing countries, whose market is less interesting for the multinational enterprise. The aim of this investment is to exploit the comparative advantages of the countries in the production of goods. Thus, usually these investments are located in developing countries with low labour costs.

Recently, several papers have proven that also the institutional environment of the receiving country can influence the choice to establish an FDI in a foreign country. Past literature has always considered institutional quality at country level. The property rights theory suggests that contract enforcement matters differentially across sectors, being more important for sectors that produce more complex goods. This paper is the first attempt to test whether institutions matter differentially across different sectors in FDI decision.

Using data on U.S. Direct Investment Abroad, I find that institutional characteristics of the country and the industry positively affect the volume of offshoring that takes place between U.S. companies and their affiliates. I first consider total intra-firm trade flows, in both directions. Then I consider separately trade flows from U.S. parent companies to foreign affiliates, and vice versa. Finally, I exploit the difference between good shipped for simple resale in the foreign market, and goods shipped for further manufacturing. I show that the suggested argument is strong for the intermediate products, while the evidence is weak for those products ready for sale. This confirms that the contractual

determinants of trade are not at work for these goods, whose production has not been split between parent company and foreign affiliate.

References

- [1] Acemoglu, Daron, Philippe Aghion, Rachel Griffith and Fabrizio Zilibotti, 2005, "Vertical Integration and Technology: Theory and Evidence", mimeo
- [2] Acemoglu, Daron, Pol Antràs and Elhanan Helpman, 2005, "Contracts and the Division of Labor", NBER Working Paper No. 11356
- [3] Acemoglu, Daron, Pol Antràs and Elhanan Helpman, 2006, "Contracts and Technology Adoption", mimeo
- [4] Acemoglu, Daron, Simon Johnson, and James Robinson, 2001, "Colonial Origins of Comparative Development: An Empirical Investigation", *American Economic Review*, 91: 1369–1401
- [5] Acemoglu, Daron, Simon Johnson and James A. Robinson, 2002, "Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution", *The Quarterly Journal of Economics*, 117: 1231–1294
- [6] Aghion, Philippe and Jean Tirole, 1997, "Formal and Real Authority in Organizations", *Journal of Political Economy*, 105(1): 1-29
- [7] Aizenman, Joshua and Mark M. Spiegel, 2002, "Institutional Efficiency, Monitoring costs, and the Investment share of FDI", NBER working paper No. 9324
- [8] Akaike, Hirotugu, 1973, "Information Theory and an Extension of the Maximum Likelihood Principle" in *Second International Symposium on Information Theory*, ed. B. Petrov and F. Csaki, 267-281, Akademiai Kiado, Budapest
- [9] Alfaro, Laura, Areendam Chanda, Sebnem Kalemli-Ozcan and Selin Sayek, 2004, "FDI and Economic Growth: the Role of Local Financial Markets", *Journal of International Economics*, 64(1): 89-112
- [10] Alfaro, Laura, Sebnem Kalemli-Ozcan and Vadym Volosovych, 2005, "Capital Flows in a Globalized World: the Role of Policies and Institutions", NBER Working Paper No. 11696
- [11] Anderson, James E. and Douglas Marcouiller, 2002, "Insecurity and the Pattern of Trade: an Empirical Investigation", *The Review of Economics and Statistics*, 84(2): 342-352

- [12] Antràs, Pol, 2003, "Firms, Contracts, and Trade Structure", *The Quarterly Journal of Economics*, 118(4): 1375-1418
- [13] Antràs, Pol and Elhanan Helpman, 2004, "Global Sourcing", *Journal of Political Economy*, 112(3): 552-580
- [14] Baltagi, Badi H., 2001, *A Companion to Theoretical Econometrics*, Blackwell Publishers
- [15] Barba Navaretti, Giorgio and Anthony J. Venables, 2004, *Multinational Firms in the World Economy*, Princeton University Press, Princeton and Oxford
- [16] Barro, Robert J. and Jongwha Lee, 2000, "International Data on Educational Attainment, Updates and Implications", NBER Working Paper No. 7911
- [17] Bartelsman, Eric J. and Wayne Gray, 1996, "The NBER Manufacturing Productivity Database", NBER Technical Working Paper No. 205
- [18] Becker, Gary and K. Murphy, 1992, "The division of labor, coordination costs, and knowledge", *The Quarterly Journal of Economics*, 107(4): 1137-1160
- [19] Bénassy-Quéré, Agnès, Maylis Coupet and Thierry Mayer, 2005, "Institutional Determinants of Foreign Direct Investment", CEPII Working Papers
- [20] Bernard Andrew B., J. Bradford Jensen and Peter K. Schott, 2005, "Importers, Exporters and Multinationals: A Portrait of Firms in the U.S. that Trade Goods", CES Discussion Papers 05-20
- [21] Busse, Mathias, 2004, "Transnational Corporations and Repression of Political Rights and Civil Liberties: An Empirical Analysis", *Kyklos* 57(1): 45-66
- [22] Busse, Matthias and Carsten Hefeker, 2005, "Political Risk, Institutions and Foreign direct Investment", HWWA Discussion Paper No. 315
- [23] Busse, Matthias and José Luis Groizard, 2006, "Foreign Direct Investment, Regulations and Growth", World Bank Policy Research Working Paper No. 3882
- [24] Cameron, Colin A. and Pravin K. Trivedi, 1998, *Regression Analysis of Count Data*, Cambridge University Press
- [25] Devereux, Michael P. and Rachel Griffith, 2002, "The Impact of Corporate Taxation on the Location of Capital: A Review", *Swedish Economic Policy Review*, 9: 79-102

- [26] Drabek, Zdenek and Warren Payne, 2002, "The Impact of Transparency on Foreign Direct Investment", *Journal of Economic Integration*, 17(4): 777-810
- [27] Durham, Benson J., 2004, "Absorptive Capacity and the Effects of Foreign Direct Investment and Equity Foreign Portfolio Investment on Economic Growth", *European Economic Review*, 48(2): 285-306
- [28] Elliott, Kimberly Ann, 1997, *Corruption and the Global Economy*, Institute for International Economics, Washington
- [29] Feenstra, Robert C. and Gordon H. Hanson, 2005, "Ownership and Control in Outsourcing to China: Estimating the Property Rights Theory of the Firm", *The Quarterly Journal of Economics*, 120(2): 729-762
- [30] Feenstra, Robert C., Robert E. Lipsey, Haiyan Deng, Alyson C. Ma, Hengyong Mo, 2005, "World Trade Flows: 1962-2000", NBER Working Paper No: 11040
- [31] Gastanaga, Victor M., Jeffrey B. Nugent and Bistra Pashamova, 1998, "Host country reforms and FDI Inflows: How Much Difference do they Make?", *World Development*, 26(7): 1299-1314
- [32] Gattai, Valeria, 2005, "From the Theory of the Firm to FDI and Internalisation: a Survey", FEEM Working Paper No. 51.05
- [33] Globerman, Steven and Daniel M. Shapiro, 2002, "Global Foreign Direct Investment Flows: The Role of Governance Infrastructure", *World Development*, 30(11): 1899-1919.
- [34] Globerman, Steven and Daniel M. Shapiro, 2003, "Governance Infrastructure and U.S. Foreign Direct Investment", *Journal of International Business Studies*, 34: 19-39
- [35] Greene, William H., 2001, "Fixed and Random Effects in Nonlinear Models", mimeo, New York University
- [36] Greene, William H., 2003, *Econometric Analysis*, Prentice Hall
- [37] Grossman, Sanford, and Oliver Hart, 1986, "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration", *Journal of Political Economy*, 94: 691-719
- [38] Grossman, Gene M. and Elhanan Helpman, 2002, "Integration versus outsourcing in industry equilibrium", *The Quarterly Journal of Economics*, 117: 85-120
- [39] Grossman, Gene M. and Elhanan Helpman, 2003, "Outsourcing versus FDI in Industry Equilibrium", *Journal of the European Economic Association*, 1: 317-327

- [40] Grossman, Gene M. and Elhanan Helpman, 2005, "Outsourcing in a Global Economy", *Review of Economics Studies*, 72: 135-159
- [41] Habib, Mohsin and Leon Zurawicki, 2002, "Corruption and Foreign Direct Investment", *Journal of International Business Studies*, 33(2): 291-307
- [42] Hall, Robert, and Chad Jones, 1999, "Why Do Some Countries Produce So Much More Output per Worker than Others", *The Quarterly Journal of Economics*, 114: 83-116
- [43] Hanson, Gordon H., Raymond J. Mataloni and Matthew J. Slaughter, 2001, "Expansion Strategies of U.S. Multinational Firms", NBER Working Paper No. 8433
- [44] Hanson, Gordon H., Raymond J. Mataloni and Matthew J. Slaughter, 2005, "Vertical Production Networks in Multinational Firms", *The Review of Economics and Statistics*, 87(4): 664-678
- [45] Harms, Philipp and Heinrich W. Usprung, 2002, "Do civil and Political Repression Really Boost Foreign Direct Investment?", *Economic Inquiry*, 40(4): 651-663
- [46] Hart, Oliver and John Moore, 1990, "Property Rights and the Nature of the Firm", *Journal of Political Economy*, 98: 1119-1158
- [47] Hausman, Jerry, Bronwyn H. Hall and Zvi Gliliches, 1984, "Econometric Models for Count Data with an Application to the Patents-R & D Relationship", *Econometrica*, 52(4): 909-938
- [48] Helpman, Elhanan, 2006, "Trade, FDI, and the Organization of Firms", NBER Working Paper No. 12091
- [49] Helpman, Elhanan, and Paul R. Krugman, 1985, *Market Structure and Foreign Trade*, MIT Press, Cambridge, MA
- [50] Hermes, Niels and Robert Lensink, 2003, "Foreign Direct Investment, Financial Development and Economic Growth", *The Journal of Development Studies*, 40(1): 142-163
- [51] Heston, Alan, Robert Summers and Bettina Aten, 2002, Penn World Table Version 6.1, Center for International Comparisons at the University of Pennsylvania (CICUP).
- [52] Hines, James R. Jr, 1995, "Forbidden Payment: Foreign Bribery and American Business after 1977", NBER Working Paper No. 5266
- [53] Holmstrom Bengt and Paul R. Milgrom, 1994, "The Firm as an Incentive System", *The American Economic Review*, 84(4): 972-991

- [54] Jensen, Nathan M., 2003, "Democratic Governance and Multinational Corporations: Political Regimes and Inflows of FDI", *International Organisation*, 57-3: 587-616
- [55] Jun, Kwang W. and Harinder Singh, 1996, "The Determinants of Foreign Direct Investment in Developing Countries", *Transnational Corporations*, 5(2): 67-105
- [56] Kaufmann, Daniel, Aart Kraay and Massimo Mastruzzi, 2005, "Governance Matters IV: Governance Indicators for 1996-2004", mimeo, World Bank
- [57] Kaufmann, Daniel and Shang-Jin Wei, 1999, "Does "Grease Money" Speed Up the Wheels of Commerce?", NBER Working Paper No. 7093
- [58] Knack, Stephen and Philip Keefer, 1995, "Institutions and Economic Performance: Cross-country Tests Using Alternative Institutional Measures", *Economics and Politics*, 7: 207-227
- [59] Koukhartchouk, Oxana and Mathilde Maurel, 2003, "Accession to the WTO and EU Enlargement: What Potential for Trade Increase?", CEPR Discussion Paper No. 3944, Centre for Economic Policy Research, London
- [60] Kwan, Chi Hung, 2002, "The Rise of China and Asia's Flying-Geese Pattern of Economic Development: An Empirical analysis Based on U.S. Import Statistics", Nomura Research Institute Working Paper No. 52
- [61] La Porta, Rafael, Florencio Lopez-De-Silanes, Andrei Shleifer and Robert W. Vishny, 1998, "Law and Finance", *Journal of Political Economy*, 106: 1113-1155
- [62] Lee, Jeong-Yeon and Edwin Mansfield, 1996, "Intellectual Property Protection and U.S. Foreign Direct Investment", *The Review of Economics and Statistics*, 78(2): 181-186
- [63] Levine, Ross, 2000, "Bank-based or Market-based Financial Systems: Which is Better?", William Davidson Institute Working Paper Series No. 442
- [64] Long, J. Scott and Jeremy Freese, 2005, *Regression Models for Categorical Dependent Variables using Stata*, Stata Press Publication, College station, Texas
- [65] Lucas, Robert E. Jr., 1990, "Why Doesn't Capital Flow from Rich to Poor Countries?", *The American Economic Review, Papers and Proceedings* 80(2): 92-96
- [66] Manera, Matteo and Marzio Galeotti, 2005, *Microeconometria, metodi ed applicazioni*, Carocci Editore

- [67] Markusen, James R. and Keith E. Maskus, 2001, "General-Equilibrium Approaches to the Multinational Firm: A Review of Theory and Evidence" in James Harrigan and E. Kwan Choi (eds.), *Handbook of International Trade*, Basil Blackwell, London
- [68] Markusen, James R., 2002, *Multinational Firms and the Theory of International Trade*, The MIT Press, Cambridge, MA
- [69] Mataloni, Raymond J., 1995, "A Guide to BEA Statistics on U.S. Multinational Companies", *Survey of Current Business* 75: 38-55
- [70] Mauro, Paolo, 1995, "Corruption and Growth", *The Quarterly Journal of Economics*, 110: 681-712
- [71] McLaren John, 2000, "'Globalization" and Vertical Structure", *The American Economic Review*, 90(5): 1239-1254
- [72] Melitz, Marc J., 2003, "The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity", *Econometrica*, 71(6): 1695-1725
- [73] North, Douglass C., 1981, *Structure and Change in Economic History*, W.W. Norton Co., New York
- [74] North, Douglass C., 1990, *Institutions, Institutional Change and Economic Performance*, Cambridge University Press
- [75] North, Douglass C., 1991, "Institutions", *Journal of Economic Perspectives*, 5(1): 97-112
- [76] Nunn, Nathan, 2004, "Relationship-Specificity, Incomplete Contracts, and the Pattern of Trade", forthcoming *The Quarterly Journal of Economics*
- [77] Ornelas, Emanuel and John Turner, 2005, "Trade Liberalization, Outsourcing, and the Hold-Up Problem", mimeo, University of Georgia
- [78] Ottaviano, Gianmarco I. P. and Alessandro Turrini, 2003, "Distance and FDI when Contracts are Incomplete", CEPR Discussion Paper Series No. 4041, Centre for Economic Policy Research, London
- [79] Raftery, A. E., 1996, "Bayesian Model Selection in Social Research". in P. V. Marsden (ed.), *Sociological Methodology*, 26:111-163, Blackwell, Oxford
- [80] Rauch, James E., 1999, "Networks versus Markets in International Trade", *Journal of International Economics*, 48: 7-35
- [81] Rauch, James E., 2001, "Business and Social Networks in International Trade", *Journal of Economic Literature*, 39: 1177-1203
- [82] Rauch, James E., and Vitor Trindade, 2002, "Ethnic Chinese Networks in International Trade", *The Review of Economics and Statistics*, 84: 116-130

- [83] Santos Silva João M.C. and Silvana Tenreyro, 2005, "The Log of Gravity", forthcoming in *The Review of Economics and Statistics*
- [84] Shleifer, A., and Robert W. Vishny, 1993, "Corruption", *The Quarterly Journal of Economics*, 108: 599-617
- [85] Smarzynska, Beata K. and Shang-Jin Wei, 2000, "Corruption and Composition of Foreign Direct Investment: Firm-Level Evidence", NBER Working Paper No. 7969
- [86] Spencer, Barbara J., 2005, "International Outsourcing and Incomplete Contracts", NBER Working Paper No. 11418
- [87] Stevens, Guy V. G., 2000, "Politics, Economics and Investment: Explaining Plant and Equipment Spending by U.S. Direct Investors in Argentina, Brazil and Mexico", *Journal of International Money and Finance*, 19: 153-183
- [88] Swenson, Deborah L., 2005, "Overseas Assembly and Country Sourcing Choices", *Journal of International Economics*, 66: 107-130
- [89] Tirole, Jean, 1988, *The Theory of Industrial Organization*, MIT Press, Cambridge, MA
- [90] Tobin, James, 1958, "Estimation of Relationships for Limited Dependent Variables", *Econometrica*, 26: 24-36
- [91] U.S. Bureau of Economic Analysis, 1998, "U.S. Direct Investment Abroad: 1994 Benchmark Survey, Final Results", U.S. Government Printing Office, Washington, DC
- [92] U.S. Bureau of Economic Analysis, 2004, "U.S. Direct Investment Abroad: Final Results From the 1999 Benchmark Survey", U.S. Government Printing Office, Washington, DC
- [93] U.S. Census Bureau, 1996, "1997 Economic Census General Summary. Manufacturing", Subject Series
- [94] U.S. Census Bureau, 2001, "1992 Census of Manufacturers. General Summary", Subject Series
- [95] Vuong, Quang H., 1989, "Likelihood ratio tests for model selection and non-nested hypotheses", *Econometrica*, 57: 307-334
- [96] Wheeler, David and Ashoka Mody, 1992, "International Investment Location Decisions: The Case of U.S. Firms", *Journal of International Economics*, 33: 57-75
- [97] Wei, Shang-Jin, 1997, "Why is Corruption so Much More Taxing than Tax? Arbitrariness Kills", NBER Working Paper No. 6255

- [98] Wei, Shang-Jin, 2000, "How Taxing is Corruption on International Investors?", *The Review of Economics and Statistics*, 82(1): 1-11
- [99] Williamson, Oliver, 1975, *Markets and Hierarchies: Analysis and Antitrust Implications*, Free Press, New York.
- [100] Williamson, Oliver, 1985, *The Economic Institutions of Capitalism*, Free Press, New York.
- [101] Wooldridge Jeffrey M., 2002, *Econometric Analysis of Cross Section and Panel Data*, MIT Press, Cambridge (MA)
- [102] World Bank, 2005, *World Development Indicators 2005*
<http://publications.worldbank.org/WDI>
- [103] Yeaple, Stephen Ross, 2003, "The Role of Skill Endowments in the Structure of U.S. Outward Foreign Direct Investment", *The Review of Economics and Statistics*, 85(3): 726-734
- [104] Yeaple, Stephen Ross, 2006, "Offshoring, Foreign Direct Investment, and the Structure of U.S. Trade", *Papers and Proceedings, Journal of the European Economic Association*, 4

7 Appendix

7.1 Data Description

7.1.1 Intra-firm trade

The data on intra-firm trade come from the Bureau of Economic Analysis (BEA) surveys of U.S. direct investment abroad. Data are available annually from 1977 to 2004, but the data for benchmark years are more comprehensive. Benchmark surveys (or censuses), are conducted every five years. They cover virtually the entire population of foreign affiliates in terms of dollar value, and they obtain more data items than are collected in the non-benchmark surveys. The BEA conducts sample surveys in the non-benchmark years. These information are reported in the annual time series. Reports are not required for small affiliates in the sample surveys. Instead, BEA estimates the data for these affiliates by extrapolating forward their data from the most recent benchmark survey on the basis of the movement of the sample data. Thus, coverage of the affiliate universe is comparable in benchmark and non-benchmark periods. Some data cells are suppressed in order to avoid disclosure of individual firm data. These are treated as missing values. In some other cells data are suppressed, but the value suppressed is known to be between $-\$500,000$ and $\$500,000$. In this case, I assign a value of $\$0$. For a description of these data, see Mataloni (1995).

7.1.2 Definitions of Measures of Institutional Quality

Governance Matters IV Dataset (Kaufmann *et al.* 2005) provides six measures of institutional quality. These are indexes that range from -2.5 to 2.5, with low values corresponding to poor institutional quality. These indicators are based on a huge amount of variables that measure the perception of government quality, which belong to 37 separate data sources, constructed by 31 different organizations. These measures are:

Voice and Accountability: measures the level of political, civil and human rights.

Political Instability and Violence: measures the likelihood of violent threats to, or changes in, government, including terrorism.

Government Effectiveness: measures the competence of the bureaucracy and the quality of public service delivery (the quality of public service provision, the quality of the bureaucracy, the competence of civil servants, the independence of civil service from political pressures, and the credibility of the government's commitment to policies).

Regulatory Burden: measures the incidence of market-unfriendly policies, as for example price controls or inadequate bank supervision, as well as perceptions of the burdens imposed by excessive regulation in areas such as foreign trade and business development.

Rule of Law: measures the quality of contract enforcement, police, and courts, as well as the likelihood of crime and violence. This is our preferred variable as it refers specifically to the quality of contract enforcement.

Control of Corruption: measures the exercise of public power for private gain, including both petty and grand corruption and state capture.

7.2 Country List

The countries included in the analysis are: Argentina, Australia, Austria, Bahamas, Barbados, Belgium, Bermuda, Brazil, Canada, Chile, China, Colombia, Costa Rica, Czech Republic, Denmark, Dominican Republic, Ecuador, Egypt, Finland, France, Germany, Greece, Guatemala, Honduras, Hong Kong, Hungary, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Republic of Korea, Luxembourg, Malaysia, Mexico, Netherlands, Netherlands Antilles, New Zealand, Nigeria, Norway, Panama, Peru, Philippines, Poland, Portugal, Russia, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Taiwan, Thailand, Trinidad and Tobago, Turkey, United Arab Emirates, United Kingdom, United Kingdom Islands Caribbean, Venezuela.

7.3 Tables

Entropy	$E = - \sum_{i=1}^n p_i \ln p_i \quad \text{where } 0 \leq H \leq \ln n$ $\text{and } p_i = \frac{x_i}{X} = \frac{x_i}{\sum_{i=1}^n x_i}$
Normalized Entropy	$E_0 = \frac{E}{E_{\max}} = \frac{E}{\ln E} \quad \text{where } E \text{ is Entropy}$
Exponential Index	$EX = e^{-H} = \prod_{i=1}^n p_i^{p_i}$
Herfindahl Index	$H = \sum_{i=1}^n p_i^2 = \sum_{i=1}^n \frac{x_i^2}{X^2}$ $\text{where } \frac{1}{n} \leq H \leq 1$
Normalized Herfindahl Index	$H^* = \frac{H - \frac{1}{n}}{1 - \frac{1}{n}} \quad \text{where } 0 \leq H^* \leq 1$
Gini Coefficient	$G = \frac{2}{n^2 \bar{x}} \sum_{i=1}^n \left(\left(i - \frac{n+1}{2} \right) x_i \right)$ $\text{where } 0 \leq G \leq 1 \text{ and } \bar{x} = \frac{1}{n} \sum_{i=1}^n x_i$
Concentration coefficient	$C = \frac{n}{n-1} G \quad \text{where } G \text{ is Gini Coefficient}$
Share of top 10 intermediate inputs	$S = \sum_{i=1}^{10} p_i \quad \text{where } x_i \text{ are in decreasing order}$
Number of intermediate inputs	$N = \sum_{x_i \neq 0} 1$

Table 3.1: Definitions of Concentration Measures

	voice	polstab	goveff	regqual	rulelaw	contrcorr
voice	1					
polstab	0.75	1				
goveff	0.76	0.83	1			
regqual	0.71	0.77	0.89	1		
rulelaw	0.74	0.88	0.94	0.84	1	
contrcorr	0.76	0.83	0.95	0.84	0.96	1

All correlations are significant at 1% level

Table 3.2: Correlations between Different Measures of Institutional Quality

Variable	Nobs	Mean	Std. Dev.	Min	Max
Total intrafirm trade	655	563.52	4239.36	0	81829
Trade to U.S. parents	576	313.35	2378.82	0	44697
Trade to foreign affiliates	589	320.23	2151.56	0	37132
Further manufacturing	590	284.55	1870.35	0	35059
Resale	630	17.76	322.88	0	7990

Table 3.3: Descriptive Statistics

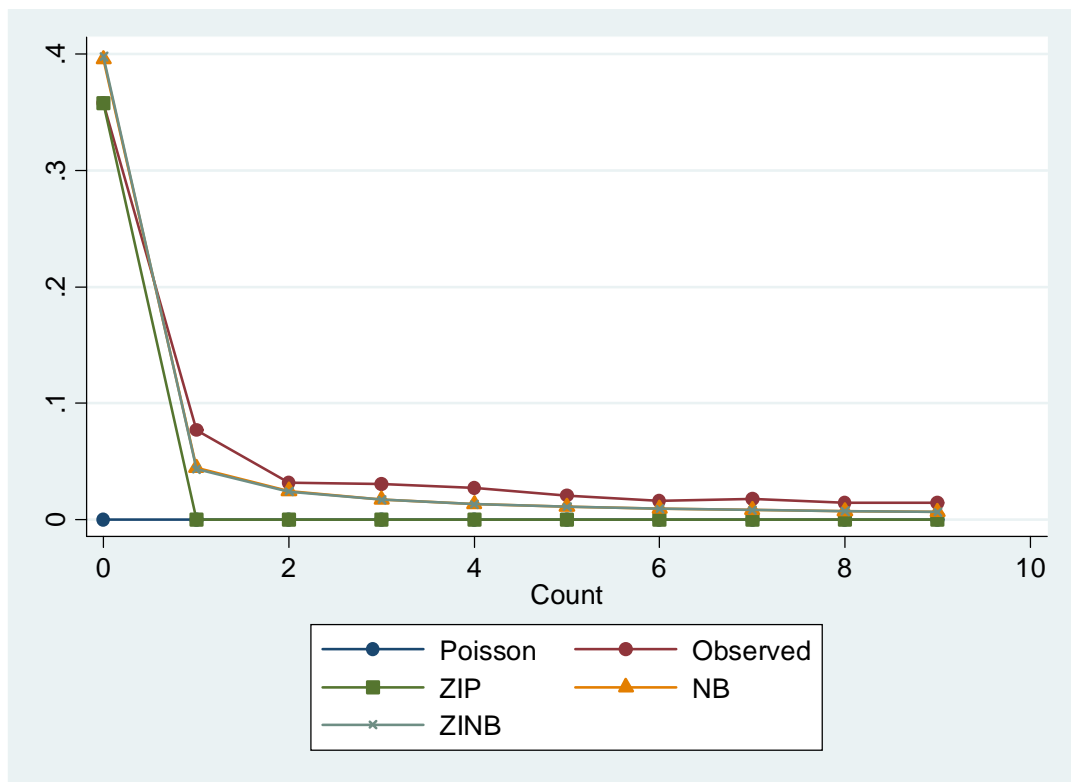


Figure 3.1: Distributions

Dep Var: Total intrafirm flows					
	Poisson	ZIP	NB	ZINB	OLS
inst _i *inst _t	.239*** (.0006)	.189*** (.0006)	.238*** (.037)	.225*** (.037)	.234*** (.031)
constant	5.460*** (.003)	6.047*** (.003)	5.461*** (.154)	5.523*** (.161)	1.835*** (.133)
LR chi2(1)	185247.07	111042.60	38.67	33.44	
Prob>LR	0.000	0.000	0.000	0.000	
BIC	1944724.47	1692784.02	1639.99	1647.50	
AIC	3133.01	2710.54	9.04	9.04	
Specification Tests	1946513 0.000	6.80 0.000	1.9e+06 0.000	.01 0.496	
Adjusted R ²					.08
BP Test					18.87 (0.000)

Standard errors in parentheses; * significant at 10%; ** significant at 5%;
*** significant at 1%

Table 3.4: Choice of the Estimator

Dep. Var: Total intrafirm flows

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
inst _t *inst _c	0.352*	0.428**	0.312*	0.376**	0.643***	0.424**	0.418**	0.158
	(0.21)	(0.18)	(0.18)	(0.18)	(0.21)	(0.18)	(0.20)	(0.18)
inst _t	-0.145	0.0925	0.353	0.167	0.0849	0.0928	-0.118	0.499*
	(0.29)	(0.27)	(0.26)	(0.27)	(0.33)	(0.27)	(0.29)	(0.27)
inst _c	-0.432	-0.701	-0.358	-0.587	-1.554**	-0.692	-0.619	-0.132
	(0.67)	(0.59)	(0.58)	(0.60)	(0.70)	(0.59)	(0.65)	(0.57)
sales	1.955***	2.304***	2.158***	2.291***	2.074***	2.301***	2.091***	2.066***
	(0.22)	(0.23)	(0.42)	(0.23)	(0.27)	(0.23)	(0.25)	(0.43)
market size		1.150***	1.261***	1.092***	1.256***	1.168***	1.096***	0.946***
		(0.083)	(0.086)	(0.088)	(0.11)	(0.095)	(0.096)	(0.11)
corp. scale			0.0484***					0.0316**
			(0.014)					(0.014)
plant scale			-0.0410***					-0.0315***
			(0.0080)					(0.0080)
tariff				-0.00827***				-0.00538**
				(0.0020)				(0.0021)
NTB					-0.827			
					(0.56)			
corp. tax rate						-0.00837	0.0126	-0.00958
						(0.020)	(0.023)	(0.020)
VAT							-0.176***	
							(0.033)	
freight								-16.21***
								(3.19)
constant	-18.82***	-54.15***	-55.59***	-52.56***	-53.79***	-54.32***	-48.30***	-45.09***
	(2.88)	(3.91)	(5.82)	(4.01)	(4.64)	(3.92)	(4.24)	(6.30)
LR Test H ₀ :α=0	1.6e+06	1.4e+06	1.4e+06	1.0e+06	1.1e+06	1.4e+06	1.2e+06	7.0e+05
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Log likelihood	-2792.52	-2648.64	-2636.06	-2547.97	-2057.46	-2648.55	-2365.15	-2525.57
Observations	626	603	603	561	425	603	511	560

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.5.a: Total Intra-firm Trade

Dep. Var: Total intrafirm flows

	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
inst _t *inst _c	0.354*	0.295	0.428**	0.321*	0.369*	0.286	0.311	0.0768
	(0.21)	(0.18)	(0.21)	(0.19)	(0.21)	(0.20)	(0.20)	(0.20)
inst _t	-0.576**	-0.0950	-0.712**	0.0815	-0.165	-0.696**	-0.739***	-0.382
	(0.28)	(0.26)	(0.31)	(0.28)	(0.31)	(0.28)	(0.28)	(0.28)
inst _c	-0.559	-0.0599	-1.305*	-0.434	-0.833	-0.868	-1.128	-0.269
	(0.70)	(0.61)	(0.73)	(0.64)	(0.70)	(0.68)	(0.69)	(0.70)
sales	1.889***	2.134***	2.481***	2.375***	2.093***	1.898***	1.314***	0.587
	(0.23)	(0.22)	(0.28)	(0.27)	(0.29)	(0.45)	(0.30)	(0.60)
skill _t *skill _c	-20.67	-9.323					-34.55	-36.82
	(20.3)	(20.5)					(22.5)	(23.1)
skill _t	42.42***	18.63					77.93***	83.07***
	(16.1)	(16.5)					(18.3)	(23.9)
skill _c	2.672	-1.494					4.051*	3.276
	(2.24)	(2.27)					(2.35)	(2.46)
cap _t *cap _c			-1.041	-2.741	-0.544	-2.119	-3.547**	-5.320***
			(1.47)	(1.68)	(1.85)	(1.41)	(1.56)	(1.74)
capital _t			5.379	27.31	5.756	13.90	44.45***	65.38***
			(15.5)	(17.6)	(19.5)	(14.6)	(16.5)	(18.8)
capital _c			1.769*	2.026*	1.106	2.624***	3.658***	5.144***
			(1.03)	(1.19)	(1.31)	(0.98)	(1.08)	(1.20)
corp. scale						0.0679***		0.00874
						(0.015)		(0.023)
plant scale						-0.0395***		0.00762
						(0.0085)		(0.016)
tariff								-0.00327
								(0.0026)
corp. tax rate					-0.00840			
					(0.025)			
VAT					-0.210***			
					(0.035)			
market size		1.171***		1.088***	0.963***			
		(0.091)		(0.11)	(0.11)			
constant	-21.31***	-52.20***	-37.79***	-73.57***	-55.02***	-37.85***	-59.92***	-69.67***
	(3.37)	(4.03)	(10.9)	(12.8)	(14.2)	(10.6)	(12.0)	(13.7)
LR Test H ₀ :α=0	1.5e+06	1.3e+06	1.6e+06	1.4e+06	1.1e+06	1.5e+06	1.5e+06	1.1e+06
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Log likelihood	-2757.67	-2618.50	-2752.18	-2629.30	-2347.00	-2740.26	-2735.37	-2636.46
Observations	608	585	608	585	499	608	608	578

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.5.b: Total Intra-firm Trade, Robustness

Dep. Var.: Intrafirm trade to U.S. parents

	(1)	(2)	(3)	(4)	(5)	(6)	(8)
inst _t *inst _c	0.316 (0.29)	0.313 (0.26)	-0.0117 (0.29)	0.119 (0.27)	0.641** (0.30)	0.316 (0.26)	-0.337 (0.29)
inst _t	-0.00309 (0.40)	0.462 (0.39)	1.056** (0.43)	0.631* (0.37)	0.333 (0.50)	0.463 (0.39)	1.319*** (0.43)
inst _c	-0.201 (0.92)	-0.0446 (0.87)	0.947 (0.96)	0.287 (0.88)	-1.277 (1.01)	-0.0507 (0.87)	1.572* (0.94)
sales	2.088*** (0.31)	2.498*** (0.33)	2.650*** (0.63)	2.409*** (0.34)	2.213*** (0.40)	2.503*** (0.33)	2.290*** (0.67)
market size		1.170*** (0.12)	1.290*** (0.12)	0.956*** (0.13)	1.504*** (0.18)	1.163*** (0.14)	0.807*** (0.17)
corp. scale			0.0479** (0.021)				0.0141 (0.022)
plant scale			-0.0520*** (0.012)				-0.0257** (0.013)
tariff				-0.0635*** (0.012)			-0.0409*** (0.012)
NTB					-3.229*** (0.89)		
corp. tax rate						0.00361 (0.037)	-0.0318 (0.039)
VAT							
freight							-19.48*** (5.49)
constant	-21.73*** (3.99)	-59.14*** (5.70)	-65.07*** (8.83)	-52.24*** (5.95)	-63.37*** (7.23)	-59.14*** (5.70)	-46.26*** (9.95)
LR Test H ₀ :α=0	8.4e+05 (0.000)	7.5e+05 (0.000)	7.5e+05 (0.000)	5.6e+05 (0.000)	5.9e+05 (0.000)	7.4e+05 (0.000)	3.8e+05 (0.000)
Log likelihood	-1762.93	-1687.56	-1679.58	-1618.87	-1313.35	-1687.55	-1608.48
Observations	547	526	526	487	365	526	486

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.6.a: Intra-firm Trade to U.S. Parents

Dep. Var.: Intrafirm trade to U.S. parents

	(9)	(10)	(11)	(12)	(13bis)	(14)	(15)	(16)
inst _i *inst _c	0.249 (0.28)	-0.137 (0.29)	0.280 (0.29)	0.216 (0.28)	0.207 (0.28)	0.0187 (0.29)	0.0931 (0.28)	0.0205 (0.29)
inst _i	-0.325 (0.36)	0.533 (0.38)	-0.455 (0.40)	0.405 (0.39)	0.414 (0.40)	-0.227 (0.38)	-0.336 (0.37)	0.0630 (0.39)
inst _c	-0.0143 (0.92)	1.801* (0.97)	-0.631 (0.99)	0.338 (0.94)	0.344 (0.94)	0.241 (0.98)	-0.158 (0.93)	0.390 (0.99)
sales	2.078*** (0.32)	2.315*** (0.32)	2.847*** (0.40)	2.688*** (0.39)	2.644*** (0.40)	2.300*** (0.66)	1.569*** (0.40)	0.368 (0.84)
skill _i *skill _c	-54.02** (26.3)	-30.06 (27.2)					-70.89** (30.4)	-94.79*** (35.9)
skill _i	73.88*** (20.1)	39.76* (20.9)					109.8*** (24.8)	142.6*** (36.0)
skill _c	5.936** (2.89)	-0.490 (2.97)					7.358** (3.14)	8.012** (3.77)
cap _i *cap _c			-0.136 (2.29)	-0.275 (2.54)	-0.241 (2.53)	-1.627 (2.14)	-5.387** (2.37)	-9.071*** (2.66)
capital _i			-5.805 (24.2)	-0.0869 (26.3)	-0.161 (26.2)	7.953 (22.2)	63.90** (25.3)	114.6*** (28.9)
capital _c			1.145 (1.61)	0.0643 (1.87)	0.0590 (1.86)	2.236 (1.50)	4.880*** (1.64)	7.016*** (1.83)
corp. scale						0.0672*** (0.023)		-0.0474 (0.038)
plant scale						-0.0431*** (0.013)		0.0460* (0.026)
tariff								-0.0783*** (0.024)
corp. tax rate					-0.0181 (0.042)			
VAT								
market size		1.198*** (0.13)		1.131*** (0.17)	1.164*** (0.19)			
constant	-28.56*** (4.68)	-59.61*** (5.83)	-36.38** (17.1)	-59.03*** (19.2)	-58.92*** (19.0)	-40.55** (15.9)	-81.31*** (18.1)	-100.6*** (20.9)
LR Test H ₀ :α=0	7.8e+05 (0.000)	6.9e+05 (0.000)	8.0e+05 (0.000)	7.3e+05 (0.000)	7.2e+05 (0.000)	7.8e+05 (0.000)	7.5e+05 (0.000)	5.5e+05 (0.000)
Log likelihood	-1740.56	-1667.41	-1740.95	-1678.77	-1678.67	-1735.08	-1728.43	-1662.45
Observations	530	509	530	509	509	530	530	502

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.6.b: Intra-firm Trade to U.S. Parents, Robustness

Dep. Var.: Intrafirm trade to foreign affiliates

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
inst _t *inst _c	0.401*	0.406**	0.363**	0.356**	0.496**	0.409**	0.511***	0.300*
	(0.21)	(0.18)	(0.17)	(0.18)	(0.21)	(0.18)	(0.19)	(0.16)
inst _t	-0.184	-0.0176	0.0905	0.0540	0.215	-0.0194	-0.179	0.0898
	(0.28)	(0.25)	(0.23)	(0.26)	(0.33)	(0.25)	(0.27)	(0.23)
inst _c	-0.629	-0.837	-0.684	-0.719	-1.221*	-0.849	-1.119*	-0.725
	(0.67)	(0.58)	(0.54)	(0.59)	(0.71)	(0.58)	(0.63)	(0.53)
sales	1.790***	2.034***	1.497***	2.014***	1.874***	2.040***	1.862***	1.542***
	(0.22)	(0.21)	(0.39)	(0.22)	(0.24)	(0.21)	(0.23)	(0.39)
market size		1.197***	1.315***	1.158***	1.280***	1.231***	1.148***	1.081***
		(0.078)	(0.082)	(0.083)	(0.099)	(0.091)	(0.090)	(0.10)
corp. scale			0.0571***					0.0433***
			(0.013)					(0.013)
plant scale			-0.0341***					-0.0289***
			(0.0073)					(0.0071)
tariff				-0.00702***				-0.00359*
				(0.0019)				(0.0021)
NTB					-0.0319			
					(0.55)			
corp. tax rate						-0.0130	0.0108	-0.0110
						(0.018)	(0.019)	(0.018)
VAT							-0.159***	
							(0.030)	
freight								-15.76***
								(2.92)
constant	-17.09***	-52.07***	-48.97***	-50.89***	-52.91***	-52.59***	-47.13***	-41.66***
	(2.84)	(3.62)	(5.17)	(3.70)	(4.16)	(3.67)	(3.89)	(5.47)
LR Test H ₀ :α=0	7.5e+05	6.1e+05	6.1e+05	4.6e+05	5.1e+05	5.9e+05	5.1e+05	3.1e+05
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Log likelihood	-2471.37	-2320.58	-2306.60	-2232.29	-1815.86	-2320.30	-2071.39	-2207.90
Observations	561	541	541	501	381	541	457	500

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.7.a: Intra-firm Trade to Foreign Affiliates

Dep. Var.: Intrafirm trade to foreign affiliates

	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
entrerule	0.381*	0.381**	0.534**	0.299	0.500**	0.437**	0.387*	0.158
	(0.22)	(0.18)	(0.22)	(0.19)	(0.20)	(0.20)	(0.21)	(0.21)
inst _i	-0.519*	-0.155	-0.734**	0.0937	-0.221	-0.822***	-0.765***	-0.421
	(0.29)	(0.26)	(0.31)	(0.27)	(0.29)	(0.28)	(0.28)	(0.28)
inst _c	-0.793	-0.643	-1.710**	-0.574	-1.456**	-1.441**	-1.526**	-0.696
	(0.71)	(0.60)	(0.74)	(0.63)	(0.68)	(0.67)	(0.70)	(0.69)
sales	1.732***	1.943***	2.133***	1.961***	1.833***	1.571***	1.075***	0.412
	(0.23)	(0.21)	(0.27)	(0.25)	(0.25)	(0.42)	(0.29)	(0.59)
skill _i *skill _c	-3.987	4.409					-14.02	-13.83
	(21.0)	(20.9)					(23.4)	(23.4)
skill _i	24.28	5.299					60.24***	59.01**
	(16.6)	(16.9)					(18.8)	(23.8)
skill _c	1.464	-1.741					2.613	1.704
	(2.30)	(2.27)					(2.42)	(2.47)
cap _i *cap _c			-1.075	-3.804**	-2.019	-1.944	-2.569*	-3.877**
			(1.38)	(1.55)	(1.60)	(1.32)	(1.48)	(1.68)
capital _i			7.495	40.54**	21.92	13.00	34.90**	49.28***
			(14.5)	(16.3)	(16.9)	(13.7)	(15.7)	(18.5)
capital _c			1.787*	2.812***	2.173**	2.517***	2.979***	4.136***
			(0.96)	(1.07)	(1.10)	(0.91)	(1.04)	(1.16)
corp. scale						0.0688***		0.0171
						(0.015)		(0.023)
plant scale						-0.0369***		0.00317
						(0.0082)		(0.016)
tariff								-0.00209
								(0.0026)
corp. tax rate					-0.0133			
					(0.020)			
VAT					-0.193***			
					(0.031)			
market size		1.197***		1.185***	1.050***			
		(0.085)		(0.098)	(0.097)			
constant	-18.40***	-50.10***	-35.19***	-81.07***	-65.96***	-33.45***	-49.25***	-54.64***
	(3.32)	(3.85)	(10.1)	(11.9)	(12.4)	(10.0)	(11.6)	(13.7)
LR Test H ₀ :α=0	7.0e+05	5.7e+05	7.1e+05	6.0e+05	4.8e+05	6.9e+05	6.8e+05	5.1e+05
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Log likelihood	-2441.67	-2298.68	-2433.35	-2300.01	-2050.60	-2421.00	-2418.73	-2329.89
Observations	544	524	544	524	446	544	544	515

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.7.b: Intra-firm Trade to Foreign Affiliates, Robustness

Dep. Var: Goods for further manufacturing

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
inst _t *inst _c	0.363*	0.370**	0.316*	0.313*	0.394*	0.372**	0.522***	0.251
	(0.21)	(0.18)	(0.17)	(0.18)	(0.21)	(0.18)	(0.20)	(0.16)
inst _t	-0.185	-0.00142	0.119	0.0783	0.281	-0.00596	-0.226	0.0980
	(0.28)	(0.26)	(0.24)	(0.26)	(0.33)	(0.26)	(0.27)	(0.24)
inst _c	-0.536	-0.741	-0.558	-0.602	-0.928	-0.752	-1.157*	-0.617
	(0.67)	(0.58)	(0.55)	(0.59)	(0.70)	(0.58)	(0.63)	(0.53)
sales	1.807***	2.019***	1.598***	1.997***	1.807***	2.027***	1.948***	1.717***
	(0.22)	(0.22)	(0.39)	(0.22)	(0.24)	(0.22)	(0.23)	(0.39)
market size		1.160***	1.283***	1.118***	1.206***	1.193***	1.139***	1.029***
		(0.079)	(0.083)	(0.083)	(0.098)	(0.094)	(0.092)	(0.10)
corp. scale			0.0548***					0.0410***
			(0.013)					(0.012)
plant scale			-0.0351***					-0.0317***
			(0.0074)					(0.0072)
tariff				-0.00711***				-0.00331
				(0.0019)				(0.0021)
NTB					-0.0790			
					(0.56)			
corp. tax rate						-0.0124	0.0123	-0.00927
						(0.019)	(0.020)	(0.019)
VAT							-0.159***	
							(0.030)	
freight								-18.25***
								(2.89)
constant	-17.37***	-51.02***	-49.42***	-49.78***	-50.40***	-51.58***	-47.93***	-42.27***
	(2.85)	(3.65)	(5.22)	(3.72)	(4.10)	(3.74)	(4.01)	(5.43)
LR Test H ₀ :α=0	6.7e+05	5.4e+05	5.4e+05	4.1e+05	4.5e+05	5.3e+05	4.6e+05	2.8e+05
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Log likelihood	-2427.38	-2281.58	-2267.98	-2202.40	-1798.51	-2281.35	-2037.10	-2175.26
Observations	562	542	542	505	385	542	458	504

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.8.a: Trade in Goods for Further Manufacturing

Dep. Var: Goods for further manufacturing

	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
inst _t *inst _c	0.359*	0.326*	0.493**	0.270	0.503**	0.377*	0.369*	0.137
	(0.21)	(0.18)	(0.22)	(0.19)	(0.20)	(0.20)	(0.21)	(0.20)
inst _t	-0.545*	-0.158	-0.716**	0.0811	-0.280	-0.775***	-0.773***	-0.400
	(0.29)	(0.26)	(0.30)	(0.28)	(0.29)	(0.27)	(0.28)	(0.27)
inst _c	-0.756	-0.494	-1.594**	-0.513	-1.466**	-1.278*	-1.467**	-0.654
	(0.70)	(0.60)	(0.73)	(0.64)	(0.69)	(0.67)	(0.69)	(0.69)
sales	1.757***	1.903***	2.184***	1.979***	1.982***	1.785***	1.124***	0.733
	(0.23)	(0.22)	(0.27)	(0.25)	(0.27)	(0.42)	(0.29)	(0.58)
skill _t *skill _c	-7.440	3.908					-21.34	-19.97
	(21.7)	(21.3)					(24.0)	(24.0)
skill _t	27.93	7.075					66.25***	60.75**
	(17.2)	(17.2)					(19.2)	(24.1)
skill _c	1.821	-1.750					3.236	2.259
	(2.40)	(2.32)					(2.49)	(2.54)
cap _t *cap _c			-1.308	-3.788**	-2.794*	-1.997	-2.838*	-3.950**
			(1.41)	(1.56)	(1.64)	(1.34)	(1.50)	(1.70)
capital _t			9.669	40.05**	29.72*	13.09	37.48**	48.52***
			(14.9)	(16.5)	(17.4)	(13.9)	(15.9)	(18.6)
capital _c			1.933**	2.813***	2.695**	2.555***	3.145***	4.177***
			(0.97)	(1.08)	(1.12)	(0.92)	(1.04)	(1.16)
corp. scale						0.0673***		0.0172
						(0.015)		(0.022)
plant scale						-0.0401***		-0.00234
						(0.0083)		(0.016)
tariff								-0.00192
								(0.0026)
corp. tax rate					-0.0112			
					(0.021)			
VAT					-0.188***			
					(0.032)			
market size		1.161***		1.137***	1.060***			
		(0.085)		(0.099)	(0.10)			
constant	-19.08***	-48.87***	-37.31***	-79.83***	-73.32***	-36.22***	-52.04***	-58.04***
	(3.39)	(3.88)	(10.3)	(12.0)	(12.8)	(10.2)	(11.7)	(14.1)
LR Test H ₀ :α=0	6.3e+05	5.1e+05	6.3e+05	5.3e+05	4.3e+05	6.1e+05	6.0e+05	4.6e+05
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Log likelihood	-2398.54	-2260.12	-2390.69	-2262.41	-2017.80	-2377.77	-2375.50	-2295.61
Observations	546	526	546	526	448	546	546	519

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.8.b: Trade in Goods for Further Manufacturing, Robustness

Dep. Var: Goods for resale								
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
inst _t *inst _c	-0.642 (1.14)	-0.906 (1.07)	0.221 (0.85)	-0.540 (1.06)	-0.562 (1.21)	-1.162 (1.07)	-0.792 (1.16)	0.270 (0.88)
inst _t	2.683 (1.91)	3.853** (1.81)	1.162 (1.50)	3.309* (1.74)	2.837 (2.03)	4.121** (1.80)	3.273* (1.94)	1.126 (1.53)
inst _c	3.779 (3.77)	3.965 (3.53)	0.570 (2.79)	2.619 (3.50)	2.982 (4.04)	4.262 (3.48)	3.150 (3.77)	0.0502 (2.88)
sales	4.409*** (0.90)	3.062*** (1.00)	-1.394 (1.27)	2.523** (1.06)	2.786** (1.09)	2.744*** (0.98)	2.967** (1.17)	-1.447 (1.40)
market size		2.488*** (0.42)	2.332*** (0.38)	2.684*** (0.47)	2.992*** (0.50)	2.592*** (0.41)	2.246*** (0.41)	2.712*** (0.46)
corp. scale			0.224*** (0.035)					0.206*** (0.039)
plant scale			-0.0529*** (0.018)					-0.0486** (0.020)
tariff				-0.0726** (0.035)				-0.00830 (0.035)
NTB					-2.323 (1.44)			
corp. tax rate						0.119** (0.055)	0.111** (0.055)	0.0932* (0.054)
VAT							-0.163 (0.10)	
freight								-0.543 (12.7)
constant	-64.71*** (13.0)	-116.9*** (17.2)	-54.35*** (19.7)	-112.8*** (18.7)	-123.1*** (18.7)	-120.0*** (16.8)	-109.2*** (19.9)	-65.85*** (22.2)
LR Test H ₀ :α=0	7.9e+04 (0.000)	6.4e+04 (0.000)	4.6e+04 (0.000)	5.7e+04 (0.000)	5.1e+04 (0.000)	6.0e+04 (0.000)	4.9e+04 (0.000)	1.6e+04 (0.000)
Log likelihood	-322.20	-299.56	-283.75	-268.69	-281.42	-297.40	-279.33	-267.68
Observations	600	577	577	536	396	577	481	535

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.9.a: Trade in Goods for Resale

Dep. Var: Goods for resale

	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
inst _t *inst _c	-1.153 (1.22)	-1.179 (1.00)	0.389 (1.16)	0.0394 (1.03)	-0.983 (1.15)	0.719 (1.00)	0.473 (1.27)	0.115 (1.11)
inst _t	3.614** (1.59)	4.953*** (1.53)	3.022** (1.49)	3.961** (1.58)	4.791** (1.99)	0.288 (1.44)	2.308 (1.52)	1.226 (1.57)
inst _c	5.671 (3.76)	3.382 (3.24)	0.152 (3.84)	0.659 (3.29)	2.724 (3.74)	-1.063 (3.30)	-0.655 (3.93)	0.539 (3.59)
sales	3.473*** (1.04)	2.299*** (0.82)	1.976* (1.05)	2.251*** (0.84)	1.874 (1.17)	-1.597 (1.31)	0.836 (1.04)	-1.491 (1.81)
skill _t *skill _c	120.8 (86.9)	103.7 (70.7)					95.82 (101)	17.30 (89.8)
skill _t	-136.3** (68.8)	-154.0** (63.3)					8.995 (80.6)	-15.18 (88.1)
skill _c	-10.71 (8.74)	-2.347 (6.96)					-5.387 (9.77)	-0.436 (9.67)
cap _t *cap _c			-6.092 (6.19)	-4.764 (5.34)	-23.93** (11.1)	-1.863 (5.50)	-1.915 (7.18)	-0.945 (6.28)
capital _t			84.84 (65.5)	71.06 (58.0)	288.8** (125)	26.26 (59.3)	58.44 (74.5)	16.79 (68.5)
capital _c			5.915 (4.71)	4.283 (4.24)	21.18** (9.21)	2.731 (4.20)	2.611 (5.48)	2.011 (4.67)
corp. scale						0.232*** (0.047)		0.210** (0.100)
plant scale						-0.0511** (0.026)		-0.0411 (0.067)
tariff								-0.0218 (0.052)
corp. tax rate					-0.00612 (0.083)			
VAT					-0.356*** (0.12)			
market size		2.802*** (0.41)		2.615*** (0.43)	2.270*** (0.39)			
constant	-44.09*** (13.8)	-109.8*** (15.6)	-112.7* (59.6)	-171.0*** (51.4)	-345.9*** (111)	-21.14 (53.3)	-77.35 (68.7)	-16.78 (58.2)
LR Test H ₀ :α=0	6.6e+04 (0.000)	3.2e+04 (0.000)	7.2e+04 (0.000)	5.9e+04 (0.000)	4.4e+04 (0.000)	5.9e+04 (0.000)	5.6e+04 (0.000)	1.9e+04 (0.000)
Log likelihood	-317.51	-288.50	-309.98	-286.99	-256.60	-301.24	-307.45	-290.96
Observations	582	559	582	559	469	582	582	553

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.9.b: Trade in Goods for Resale, Robustness

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Trade to foreign af.	70.563* (37.321)	28.259** (12.736)	22.083** (10.377)	28.614* (14.813)	53.612** (23.871)	28.390** (12.662)	41.065*** (15.989)	18.962* (10.477)
Further manif.	58.076* (33.823)	24.166** (11.937)	17.996* (9.801)	23.303* (13.642)	40.044* (21.894)	24.320** (11.891)	39.341*** (15.226)	14.316 (9.454)
Resale	-0.840 (1.463)	-0.096 (0.112)	0.006 (0.025)	-0.042 (0.081)	-0.134 (0.279)	-0.089 (0.083)	-0.132 (0.191)	0.006 (0.021)

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.10.a: Marginal Effects

	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Trade to foreign af.	62.249* (35.823)	27.707** (13.445)	79.149** (33.296)	21.971 (13.934)	38.702** (16.005)	56.245** (26.139)	48.510* (26.834)	18.974 (24.749)
Further manif.	52.882* (31.975)	22.016* (12.463)	66.186** (29.898)	18.423 (13.038)	36.347** (15.126)	43.610* (23.263)	41.625* (23.870)	14.695 (21.920)
Resale	-1.053 (1.104)	-0.048 (0.041)	0.119 (0.389)	0.0008 (0.023)	-0.004 (0.006)	0.129 (0.202)	0.118 (0.338)	0.022 (0.216)

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%

Table 3.10.b: Marginal Effects, Robustness

Dep. Var.: Intrafirm trade to foreign affiliates			
	(1)	(2)	(3)
inst _i *inst _c	0.269*	0.345*	0.284**
	(0.15)	(0.19)	(0.13)
inst _i	-2.289***		
	(0.44)		
inst _c		-0.411	
		(0.61)	
Constant	12.49***	2.901***	2.719***
	(1.69)	(0.31)	(0.62)
Observations	561	561	561
Dep. Var: Goods for further manufacturing			
inst _i *inst _c	0.247*	0.309	0.311**
	(0.15)	(0.19)	(0.14)
inst _i	-2.249***		
	(0.45)		
inst _c		-0.331	
		(0.61)	
Constant	11.96***	2.765***	2.181***
	(1.71)	(0.32)	(0.56)
Observations	562	562	562
Dep. Var: Goods for resale			
inst _i *inst _c	0.287	-0.349	0.197
	(0.55)	(0.77)	(0.49)
inst _i	-1.070		
	(2.18)		
inst _c		3.632	
		(2.58)	
Constant	4.105	-3.827***	1.330
	(7.92)	(1.09)	(1.92)
Observations	600	600	600
Country dummies	Yes	No	Yes
Sector dummies	No	Yes	Yes
Time dummy	Yes	Yes	Yes

Standard errors in parentheses; * significant at 10%;

** significant at 5%; *** significant at 1%

Table 3.11: Alternative Specifications

	Intrafirm trade to foreign affiliates		Goods for further manufacturing		Goods for resale	
inst _i *inst _c	0.407*** (0.0096)	0.393*** (0.0094)	0.326*** (0.011)	0.313*** (0.010)	-1.965** (1.00)	-0.900 (0.60)
inst _i	-0.0440** (0.019)	-0.114*** (0.018)	-0.0322 (0.020)	-0.107*** (0.019)	7.931*** (2.12)	3.771*** (1.22)
inst _c	-0.562*** (0.040)	-0.572*** (0.039)	-0.410*** (0.041)	-0.416*** (0.040)	21.23*** (3.27)	21.96*** (2.63)
sales	0.723*** (0.015)	0.747*** (0.015)	0.904*** (0.017)	0.929*** (0.016)	-10.36*** (1.02)	-10.57*** (1.00)
market size	3.019*** (0.085)	2.433*** (0.078)	2.792*** (0.088)	2.191*** (0.077)	17.47*** (3.05)	6.816*** (2.00)
constant		-66.318*** (1.893)		-62.772*** (1.878)		-49.744 (58.251)
Log likelihood	-5970.94	-7564.02	-5228.87	-6792.07	-193.68	-538.10
Estimation	FE	RE	FE	RE	FE	RE
Hausman test		651.27 (0.000)		1376.62 (0.000)		33.97 (0.000)

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%;
Estimates with country-sector effects

Table 3.12: Panel Estimates: Fixed Effects versus Random Effects

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Trade to foreign af.	0.389*** (0.0094)	0.407*** (0.0096)	0.243*** (0.010)	0.375*** (0.0097)	0.131*** (0.014)	0.435*** (0.0097)	0.489*** (0.010)	0.236*** (0.011)
Further manif.	0.321*** (0.010)	0.326*** (0.011)	0.190*** (0.011)	0.275*** (0.011)	-0.0248 (0.016)	0.350*** (0.011)	0.379*** (0.011)	0.171*** (0.012)
Resale	-0.902* (0.49)	-1.965** (1.00)	-0.166 (0.64)	-0.737 (0.96)	0.649 (0.61)	-1.605 (1.01)	-4.872*** (0.94)	-0.579 (0.66)

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%; Estimates with country-sector fixed effects

Table 3.13.a: Panel Estimates: Marginal Effects

	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Trade to foreign af.	0.236*** (0.011)	0.312*** (0.011)	0.398*** (0.012)	0.466*** (0.012)	0.642*** (0.013)	0.330*** (0.012)	0.354*** (0.012)	0.364*** (0.013)
Further manif.	0.223*** (0.011)	0.291*** (0.012)	0.350*** (0.013)	0.408*** (0.013)	0.572*** (0.014)	0.289*** (0.013)	0.316*** (0.013)	0.308*** (0.014)
Resale	-1.284* (0.69)	-4.350*** (0.87)	-1.313*** (0.38)	-1.161*** (0.45)	-2.303*** (0.54)	-1.006* (0.52)	-1.619*** (0.41)	

Standard errors in parentheses; * significant at 10%; ** significant at 5%; *** significant at 1%; Estimates with country-sector fixed effects

Table 3.13.b: Panel Estimates: Marginal Effects, Robu