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Trade Policy and Firm Boundaries

by Laura Alfaro, Paola Conconi, Andrew F. Newman and Harald Fadinger

Abstract

We examine how trade policy affects firms' organizational choices. We embed a model of firms' vertical integration decisions into a standard perfectly-competitive international trade framework. In the model, integration decisions are driven by a trade-off between the pecuniary benefits of coordinating production decisions and the managers' private benefits of operating in preferred ways. The price of output is a crucial determinant of this choice, since it affects the size of the pecuniary benefits: higher prices lead to more integration. Through its effect on product prices, trade policy also has an impact on firm boundaries. We use a unique dataset that allows us to construct firm-level indexes of vertical integration for a large set of countries. In line with the predictions of our model, we obtain three main results. First, higher tariffs lead to higher levels of vertical integration. Second, differences in ownership structure across countries, measured by the distance in sectoral vertical integration indexes, are smaller in sectors with similar levels of protection. Finally, ownership structures are more alike for members of regional trade agreements.

Keywords: Trade; Policy; Ownership; Business and Government Relations; Vertical Integration; Boundaries;

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