

## **TRADE, FOREIGN INPUTS AND FIRMS' DECISIONS: THEORY AND EVIDENCE**

Maris Bas

### **NON-TECHNICAL SUMMARY**

The globalization process is characterized by a predominant role of trade in intermediate goods. We focus on the impact of foreign inputs on firms' export decisions. In developing countries, the access to more efficient and sophisticated (or higher quality) imported intermediate goods affects factor prices and therefore the competitiveness of domestic firms. The aim of this paper is to investigate the effect of different channels through which input trade liberalization affects firms' decisions to participate in the foreign market. Using firm level data from two Latin American developing countries, Chile and Argentina, we find descriptive evidence showing that industries that have lower import tariffs (for Argentina) or that rely more on imported intermediate goods, have a larger number of exporting firms and higher export sales relative to low imported intermediate input industries. We develop a theoretical model that rationalizes these features.

The main contribution of the theoretical model to the existing literature is to develop a trade model of firms with different productivity levels to study how the access to high quality-cheaper foreign intermediate goods affects domestic firms' performance. In the theoretical framework, changes in the industry imported input intensity (or in import barriers on intermediate goods) reduce relative factor costs and enhance the competitiveness of domestic firms. Firms producing in foreign input intensive industries, have larger profits, a higher probability of exporting and also larger export sales. The model predicts that the positive effect of firm productivity on the

volume of export sales and on the probability of exporting is more pronounced in industries that rely more on foreign intermediate goods or that have lower input tariffs.

The model predictions are then tested using firm-level panel data on Chile and Argentina's manufacturing sector. Our results highlight that input trade liberalization has positive effects on the extensive and intensive margin of trade. Between 1992 and 1996, the reduction in input tariffs in Argentina: (i) increases firms' export sales up to 27 percentage points, and (ii) raises the probability of exporting by 5,5 to 8 percentage points. We also provide empirical evidence on the differential effect of firm productivity on export activity depending on whether the firm belongs to an industry with input tariff cuts above or below the median. Our results also support the existence of a heterogeneous impact of firms' efficiency on export activity depending on the imported intermediate goods intensity: considering only firms producing in industries with imported input intensity over the median, the impact of firm productivity on export sales and export participation doubles.

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