

Abstract

This dissertation investigates the impact of uncertainty on the flows of exports, foreign direct investment flows, and on their joint pattern. Several different measures of uncertainty are shown to have a significant effect on the flows of exports, affiliate sales, and on their joint pattern.

In the first chapter of the dissertation, I analyze a firm's choice of serving a foreign market through exports or foreign affiliate sales under uncertainty. The uncertainty in this chapter relates to the stochastic properties of cross-country business cycle co-movement, aggregate country-specific uncertainty, and disaggregated industry-specific uncertainty. I construct a theoretical model that predicts that country pairs with the less correlated unit cost and demand fluctuations trade more, relative to affiliate sales, and that a market with higher industry uncertainty is less likely to be served by foreign affiliates. Using detailed industry-level data on trade and affiliate sales for a large number of home and destination countries, I find empirical support for the model's predictions. In addition, I explore the effects of uncertainty on intensive and extensive margins and find that industry-level uncertainty and country-level uncertainty have differential effects on the intensive and extensive margins of trade and foreign direct investment. The results, further, show that the interaction of the two levels of uncertainty affects the choice between exports and foreign direct investment both on the intensive and extensive margins.

The second chapter introduces risk asymmetry. This chapter analyzes the impact of downside risk on the flow of exports, affiliate sales, and their joint patterns. Existing studies in this field have not considered the effects of risk asymmetry or downside risk because they describe risk only by the variance; therefore, this chapter attempts to fill this gap. Downside risk is measured by the skewness of demand shocks and relates to country demand in the destination market. Using a panel of industry-level data on trade and affiliate sales for a large number of home and destination countries, I find that the volatility and skewness of demand shocks affect the flows of exports and affiliate sales and their joint pattern. By focusing on downside risk, I present novel results. The results show that downside risk explains the variation in the flow of exports, affiliate sales, and the proximity-concentration tradeoff. Additionally, I study the interaction between variance and skewness as an additional measure of risk asymmetry and show that this measure affects the exports, affiliate sales, and proximity-concentration tradeoff on the intensive and extensive margins.

The third chapter analyzes the case of multivariate risk. Decisions under risk are often multidimensional, where the preferences of the investor depend on several factors. The existing literature in international economics and uncertainty has considered the case of a single shock when analyzing the decision-making of multinational enterprises (MNEs) on foreign direct investment (FDI). This chapter aims to fill this gap and analyze the decision of multinationals on where to invest in the presence of two distinct sources of risk. The sources of risk, in this chapter, are related to demand in the foreign market, and the host country's exchange rate. When there are multiple sources of risk, the correlation of these risks matters to the investors. Constructing new large panel data on industry-level FDI, and using firm-level data on Japanese Multinationals, this chapter shows that in the presence of two shocks, MNEs exhibit correlation aversion and that the correlation of two distinct shocks explains the variation in geographic allocation of FDI both at the industry-level and on the firm-level.