Abstract

This paper studies the extensive and intensive margins of firms' global sourcing decisions. First, it presents three new facts on U.S. firms' import behavior that highlight the importance of the extensive margin in explaining cross-sectional variation in U.S. import volumes. These facts motivate the development of a quantifiable multi-country global sourcing model with heterogeneous firms, in which firms self-select into importing based on their productivity and country-specific variables (wages, trade costs, and technology). The model delivers a simple closed-form solution for firm profits as a function of the number and characteristics of the set of countries from which a firm has invested in being able to import. A key feature of this derived profit function is that the marginal increase in profits from adding a country to the firm's set of potential sourcing locations depends on the number and characteristics of other countries in the set. This makes the analysis of the extensive margin of sourcing more complicated than in models of exporting, where entry is typically assumed to be independent across markets. Under plausible parametric restrictions, however, selection into importing features complementarity across markets. In this case, we can use standard monotone comparative statics techniques to show that the sourcing strategies of firms follow a strict hierarchical structure, as in exporting models. In our empirical implementation of the model, we also exploit these complementarities to develop an algorithm, similar to Jia (2008), to feasibly estimate the fixed costs of sourcing from different countries.