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*Pol Antràs, Evgenii Fadeev, Teresa C. Fort, and Felix Tintelnot*

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Pol Antràs  
Evgenii Fadeev  
Teresa C. Fort  
Felix Tintelnot

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**ABSTRACT**

We develop a model of export-platform foreign direct investment (FDI) in which final goods are produced only with labor and there are no fixed costs of exporting. We derive a simple condition that determines whether an MNE's plants are substitutes or complements. This condition is shaped by the relative size of (i) the cross-firm elasticity of demand the MNE faces for its goods and (ii) the within-firm elasticity of labor substitution across the MNE's plants. In two extensions of the model, we show that this complementarity is enhanced by firm-level (rather than plant-level) fixed costs of exporting and of sourcing inputs.

Pol Antràs  
Department of Economics  
Harvard University  
1805 Cambridge Street  
Littauer Center 210  
Cambridge, MA 02138  
and NBER  
pantras@fas.harvard.edu

Teresa C. Fort  
Tuck School of Business  
Dartmouth College  
100 Tuck Hall  
Hanover, NH 03755  
and CEPR  
and also NBER  
teresa.fort@tuck.dartmouth.edu

Evgenii Fadeev  
Duke University  
Fuqua School of Business  
100 Fuqua Drive  
Durham, NC 27708  
evgenii.fadeev@duke.edu

Felix Tintelnot  
Kenneth C. Griffin Department of Economics  
University of Chicago  
5757 South University Avenue  
Chicago, IL 60637  
and NBER  
tintelnot@uchicago.edu

# 1 Introduction

The dominant branch of the economics literature on multinational firms (MNEs) treats their final-good production location choices as substitutes. In these models, global firms face a ‘proximity-concentration tradeoff’ in which their plant-location decisions depend on the cost of production in each country, the size of trade costs between production and consumption locations, and the benefits of concentrating production in fewer locations to reduce fixed overhead costs (Markusen, 1984; Brainard, 1997; Markusen and Venables, 2000; Helpman et al., 2004; Tintelnot, 2017). In these settings, improvements in one country’s productivity generate cannibalization effects that reduce the profitability of operating affiliates in other countries.

Recent empirical work, however, suggests that MNEs’ plant locations may not always be substitutes. Garetto et al. (2019) find that US MNEs’ affiliate sales in certain countries are *unaffected* by their affiliate activities in other countries. Using newly merged data on US firms’ trade and multinational activity by country, Antràs et al. (forthcoming) show that US MNEs are not only more likely to export to countries in which they have affiliates, but also to other countries that are proximate to those affiliates, a fact that is hard to square with canonical ‘export-platform’ FDI models.

This paper provides conditions under which a model of export-platform FDI generates complementarities rather than cannibalization effects across MNEs’ production locations. We first develop a baseline model similar to Tintelnot (2017) in which final goods are produced only with labor and there are no fixed costs to export. Perhaps surprisingly, this model does *not* necessarily generate cannibalization effects. We derive a simple condition that determines whether an MNE’s plants are substitutes or complements. This condition is shaped by the relative size of (i) the *cross-firm* elasticity of demand the MNE faces for its goods and (ii) the *within-firm* elasticity of labor substitution across the MNE’s plants. An MNE’s plants are complements (rather than substitutes) when consumers are particularly sensitive to price differences in the bundles of goods produced by distinct firms, and there is limited scope for a firm to reshuffle its labor across multiple locations to offer its bundle at a lower price. Intuitively, in those situations, an improvement in the productivity of an MNE’s plant reduces the price of the bundle of goods produced by the MNE, and the associated increase in the MNE’s scale leads to an expansion of *all* of its plants (as well as an increased benefit to set up new assembly plants).

Having developed this baseline model, we introduce destination-specific fixed costs of exporting that are incurred at the *firm level*, and show that this extension expands the range of parameter values for which the model delivers complementarity across MNEs’ production locations. Finally, we introduce tradable intermediate inputs and show that whenever global

sourcing entails firm-by-country-specific fixed costs of sourcing shared across all the MNE’s plants, the range of parameter values for which assembly location decisions are complements is again expanded.

Whether MNEs’ final-good location decisions are complements or substitutes directly affects the implications of changes in trade policy on the geography of world production. As we show in [Antràs et al. \(forthcoming\)](#), complementarities in assembly decisions generate *increased* trade in third markets in response to reductions in bilateral trade costs in other countries. Similarly, lower trade barriers faced by foreign affiliates may *raise* an MNE’s domestic activities if its plants are complements. These positive effects contrast with the typical trade diversion effects that feature in past work emphasizing cannibalization effects, and they seem to be in line with the positive indirect effects of trade policy on FDI highlighted in recent work (e.g., [McCaig et al., 2022](#)). Because MNEs dominate world trade, understanding how their trade flows are affected by trade cost increases or decreases is crucial for evaluating the consequences of trade policies.

## 2 A Model of Export-Platform FDI

We begin by developing a simple multi-country model of export-platform FDI similar to [Tintelnot \(2017\)](#).

### 2.1 Environment and Preferences

We consider a world in which individuals in  $J$  countries consume differentiated manufactured goods produced by heterogeneous firms using labor. Although each firm produces a single good, we assume that this firm’s good is differentiated based on its production country and that the same firm may produce in multiple countries.

We index firms by  $\varphi$  and varieties within firms by  $k$ . Given our Armington assumption,  $k$  also corresponds to an index for production locations. We assume a nested CES structure in which the degree of substitutability across varieties produced by different firms may differ from the degree of substitutability across varieties produced by different plants of the same firm. More formally, preferences are represented by

$$U_{Mi} = \left( \int_{\varphi \in \Omega_i} \mathbf{q}_i(\varphi)^{\frac{\sigma-1}{\sigma}} d\varphi \right)^{\frac{\sigma}{\sigma-1}}, \quad (1)$$

where  $\Omega_i$  is the endogenous measure of firms selling differentiated goods in country  $i$ , and where

the firm-specific composite  $\mathbf{q}_i(\varphi)$  is

$$\mathbf{q}_i(\varphi) = \left( \sum_{k \in \mathcal{K}(\varphi)} q_i(\varphi, k)^{\frac{\varepsilon-1}{\varepsilon}} \right)^{\frac{\varepsilon}{\varepsilon-1}}. \quad (2)$$

The set  $\mathcal{K}(\varphi) \subseteq J$  includes the assembly locations from which firm  $\varphi$  sells varieties.

The parameter  $\sigma$  governs the *cross-firm* elasticity of demand for a firm's bundle of products. Our Armington assumption introduces an additional parameter  $\varepsilon$  controlling *within-firm* factor substitutability across a firm's various active plants. Because labor is the only factor of production,  $\varepsilon$  also governs the elasticity of labor substitution within an MNE. In section 3, we extend our results to a more general setting, which encompasses cases with *no* product differentiation by country of production.

It is straightforward to show that the above preferences imply that consumers in country  $i$  spend an amount

$$S_{ki}(\varphi) = \left( \frac{p_i(\varphi, k)}{\mathbf{p}_i(\varphi)} \right)^{1-\varepsilon} \left( \frac{\mathbf{p}_i(\varphi)}{P_i} \right)^{1-\sigma} E_i \quad (3)$$

of their income on variety  $k$  produced by firm  $\varphi$ . In this expression,  $p_i(\varphi, k)$  is the price charged for that variety  $k$ ,  $\mathbf{p}_i(\varphi)$  is the overall price index for varieties sold by firm  $\varphi$ , and  $P_i$  is the economy-wide ideal price index in country  $i$  (see Appendix A for formal definitions).  $E_i$  is total spending on manufactured goods in country  $i \in J$ .

## 2.2 Manufacturing Production

Manufactured varieties are produced under increasing returns to scale and monopolistic competition. The variable  $\varphi$  used to index final-good firms also corresponds to their 'core' productivity, which firms only learn after incurring a fixed cost of entry.

After paying this fixed cost, each firm acquires blueprints to produce varieties of a final good. Although the firm could produce its varieties anywhere in the world, we assume that opening an assembly plant in a given country  $k \in J$  entails a fixed overhead cost equal to  $f_k^a$  units of labor in country  $k$ . In equilibrium, firms therefore open a limited number of assembly plants (possibly a single one). We denote the optimal set of countries  $k \in J$  for which firm  $\varphi$  has paid the associated fixed cost of assembly by  $\mathcal{K}(\varphi) \subseteq J$ , and refer to it as the firm's *global assembly strategy*.

For the time being, we assume that production of final-good varieties requires only local labor. The cost at which a firm can manufacture in each location  $k$  is shaped by its core productivity  $\varphi$ , by firm-location specific wages  $w_k$  (which the firm takes as given), and by a firm-location-specific productivity parameter  $Z_k^a$ . Shipping final goods from country  $k$  to

country  $i$  also entails variable (iceberg) trade costs  $\tau_{ki}^a$ . For now, we abstract from fixed costs of exporting.

### 2.3 Interdependencies in the Intensive Margin

The model delivers a simple, closed-form solution for sales of an assembly plant in  $k$  to each market  $i$  (see Appendix A):

$$S_{ki}(\varphi) = \kappa \varphi^{\sigma-1} \xi_k^a (\tau_{ki}^a)^{1-\varepsilon} \times (\Psi_i(\varphi))^{\frac{\sigma-\varepsilon}{\varepsilon-1}} \times P_i^{\sigma-1} E_i, \quad (4)$$

where  $\kappa$  is a constant,  $\xi_k^a \equiv (w_k/Z_k^a)^{1-\varepsilon}$  captures plant  $k$ 's *assembly potential*, and  $\Psi_i$  is given by

$$\Psi_i(\varphi) \equiv \sum_{k' \in J} \mathcal{I}_{k'}^a \times \xi_{k'}^a (\tau_{k'i}^a)^{1-\varepsilon}, \quad (5)$$

with  $\mathcal{I}_{k'}^a$  taking a value of 1 when  $k' \in \mathcal{K}(\varphi)$ , and a value of zero otherwise. Although both  $\mathcal{I}_{k'}^a$  and  $\xi_k^a$  are firm-specific variables, we omit their dependence on  $\varphi$  to make the notation less cumbersome.

Holding the firm's global assembly strategy fixed, equation (4) indicates that an idiosyncratic increase in plant  $k$ 's assembly potential  $\xi_k^a$  naturally raises sales of this plant  $k$  to all countries  $i \in J$ .

Whether changes in  $\xi_k^a$  generate positive or negative effects on the sales to country  $i$  of plants based in *other* countries  $k' \neq k$  is less clear-cut, and depends on the relative size of  $\sigma$  and  $\varepsilon$ . When the cross-firm elasticity of demand for goods is low relative to the degree of within-firm labor substitution across plants (i.e.,  $\sigma < \varepsilon$ ), cannibalization effects dominate and the sales of a particular plant  $k'$  of firm  $\varphi$  are decreased by efficiency improvements in its other plants. Conversely, when the cross-firm demand elasticity is high relative to the degree of within-firm labor substitution across plants ( $\sigma > \varepsilon$ ), complementarity effects dominate and improvements in plant  $k$ 's efficiency in serving market  $i$  also increase the sales of other plants  $k'$  in  $i$ .<sup>1</sup>

Intuitively, a lower price of variety  $k'$  reduces the share of sales of plant  $k$ , but it also reduces the firm-level price index  $\mathbf{p}_i(\varphi)$  and this shifts spending away from other firms and toward the goods produced by firm  $\varphi$  in all of its locations. If consumers' price sensitivity to  $\mathbf{p}_i(\varphi)$  is greater than the elasticity of labor substitution within the firm ( $\sigma > \varepsilon$ ), the latter effect dominates the former.

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<sup>1</sup>Two recent papers (Antràs et al., *forthcoming*; Garetto et al., 2019) invoke this Armington assumption about preferences *and* assume that  $\sigma = \varepsilon$ . In such a knife-edge case, a firm's sales across its production plants are independent.

## 2.4 Interdependencies in the Extensive Margin

We now analyze the optimal set of countries in which a firm locates final-good assembly plants (i.e., its global assembly strategy  $\mathcal{K}(\varphi) \subseteq J$ ). Starting from equation (4), using the optimal constant markup rule (see Appendix A), and aggregating across export platforms and their destination markets, firm profits (net of the initial entry cost) can be expressed as:

$$\pi(\varphi) = \kappa_\pi \varphi^{\sigma-1} \times \sum_{i \in J} (\Psi_i(\varphi))^{\frac{\sigma-1}{\varepsilon-1}} \times P_i^{\sigma-1} E_i - \sum_{k \in J} \mathcal{I}_k^a \times w_k f_k^a, \quad (6)$$

where  $\kappa_\pi$  is a constant and where  $\Psi_i(\varphi)$  is defined in (5). Solving for the set  $\mathcal{K}(\varphi)$  that maximizes equation (6) is a combinatorial problem, but regardless of its specific solution, we can characterize whether the firm's global assembly location decisions are complements or substitutes.

To build intuition, note that whenever the (cross-firm) elasticity of demand for the MNE's goods is low relative to the elasticity of within-firm labor substitution across the MNE's plants, the profitability of setting up an export platform in country  $k$  is reduced by the existence of assembly plants in other locations  $k' \neq k$  because these other assembly plants cannibalize on plant  $k$ 's sales (as shown in equation (4)). Similarly, setting up a new plant in  $k$  is less desirable, because this new plant would cannibalize sales from existing plants in other locations. These are canonical features of export-platform FDI models; however, equation (6) demonstrates that when within-firm labor substitution is low, the opposite may be true, and extensive margin assembly decisions are complements.

Formally, we consider an idiosyncratic increase from  $\xi_k^a$  to  $\hat{\xi}_k^a > \xi_k^a$  in a given plant  $k$ 's assembly potential. Denote the optimal assembly decisions under  $\xi_k^a$  and  $\hat{\xi}_k^a$  by  $\mathcal{I}^a = (\mathcal{I}_1^a, \dots, \mathcal{I}_j^a)$  and  $\hat{\mathcal{I}}^a = (\hat{\mathcal{I}}_1^a, \dots, \hat{\mathcal{I}}_j^a)$ , respectively. Denote by  $X_{-k}$  the vector  $X$  excluding element  $k$ . For vectors  $X$  and  $Y$ , we say that  $X \geq Y$  if  $X_i \geq Y_i$  for all  $i$ , and  $X > Y$  if  $X \geq Y$  and  $X_j > Y_j$  for some  $j$ . Given this notation, we prove in Appendix A that:

**Proposition 1.** An increase in the assembly potential of a given plant  $k$  from  $\xi_k^a$  to  $\hat{\xi}_k^a > \xi_k^a$  leads to  $\hat{\mathcal{I}}^a \geq \mathcal{I}^a$  whenever  $\varepsilon \leq \sigma$ , but it would not lead to  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$  whenever  $\varepsilon > \sigma$  and  $\mathcal{I}^a$  is a unique solution.

In sum, whenever  $\varepsilon > \sigma$ , this baseline model cannot feature complementarities in the extensive margin of global assembly.



### 3 Beyond Armington

The assumption that goods are differentiated based on their country of production might be unpalatable. If instead MNEs produced a single homogeneous good, its various candidate locations would be perfect substitutes, and cannibalization effects would always dominate. Nevertheless, the vast majority of MNEs are multi-product firms, and a non-trivial part of their operational decisions relate to the optimal allocation of products to plants, taking into account each plant’s productivity in the production of the firm’s various goods, and their relative distance to consumers.

In Appendix A, we build on Tintelnot (2017) and develop a version of our model in which goods are *not* differentiated based on where they are produced.<sup>2</sup> Instead, productivity heterogeneity across a continuum of goods generates a well-defined (and interior) allocation of products to plants. When such productivity dispersion follows a Fréchet distribution with shape parameter  $\theta$ , we obtain an isomorphic set of equilibrium equations (4)–(6) with  $\theta$  replacing  $\varepsilon - 1$  throughout. In such a case, the Fréchet parameter  $\theta$  governs the substitutability of labor across an MNE’s plants.

Even without imposing a Fréchet distribution of productivity, we show in Appendix A that whether assembly plants are substitutes or complements depends on the relative size of the elasticity of demand for the MNE’s goods and the (Allen) *within-firm* elasticity of substitution of labor across the MNE’s active plants. It is important to stress that the relevant margin here is the MNE’s substitution of labor across its existing plants, taking the location of those plants (and their associated fixed costs) as given.<sup>3</sup>

It is also worth emphasizing that even when MNEs produce a limited number of distinct products, the products manufactured in different locations are often *vertically* differentiated, thus bounding the elasticity of labor substitution across an MNEs plants. Indeed, Bernard et al. (2020) find that Danish offshoring firms import the same CN8 products that they also produce in Denmark, though the locally-produced goods are inferred to be of higher quality than the offshored ones.

### 4 Export-Platform FDI Model with Firm-Level Export Costs

We now assume that firms incur fixed marketing costs of  $f_i^x$  units of labor in country  $i$  to sell their varieties in country  $i$ . We use the superscript  $x$  to denote these fixed costs, and assume

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<sup>2</sup>Similar setups are developed in Antràs et al. (2022) and Arkolakis et al. (2023).

<sup>3</sup>Estimates of this elasticity are provided in Muendler and Becker (2010).

they are incurred at the firm, rather than the plant level. Crucially, when a firm pays the fixed marketing cost to sell in country  $i$ , *all* its assembly plants may access that market. This assumption aligns well with the fact that multinational firms often centralize their sales and marketing decisions in a specialized division. We denote the optimal set of countries  $i \in J$  for which a firm with productivity  $\varphi$  has paid the associated fixed cost of marketing by  $\Upsilon(\varphi) \subseteq J$ , and refer to it as the firm's *global marketing strategy*.

It should be clear that these firm-level fixed costs to export have no bearing on equation (4) capturing sales of an assembly plant in  $k$  to each market  $i$ , except that the equation now only applies to destination markets  $i$  in the *firm's* global marketing strategy (i.e.,  $i \in \Upsilon(\varphi)$ ). Holding the firm's extensive-margin strategies constant, whether an idiosyncratic increase in the assembly potential  $\xi_k^a$  of plant  $k$  increases or decreases sales of plants based in  $k' \neq k$  continues to depend only on the relative size of  $\sigma$  and  $\varepsilon$ , with  $\varepsilon > \sigma$  leading to cannibalization and  $\varepsilon < \sigma$  leading to complementarity.

Profits net of entry costs are also given by an expression almost identical to that in equation (6), namely:

$$\pi(\varphi) = \kappa_\pi \varphi^{\sigma-1} \sum_{i \in J} \mathcal{I}_i^x \times (\Psi_i(\varphi))^{\frac{\sigma-1}{\varepsilon-1}} P_i^{\sigma-1} E_i - \sum_{i \in J} \mathcal{I}_i^x \times w_i f_i^x - \sum_{k \in J} \mathcal{I}_k^a \times w_k f_k^a. \quad (7)$$

Despite these strong similarities with our starting model of export-platform FDI, the presence of firm-level fixed costs of exporting carries important implications for the nature of the interdependencies across the assembly plants of a firm. More specifically, denote by  $\mathcal{I}^x$  and  $\hat{\mathcal{I}}^x$  the optimal exporting decisions under  $\xi_k^a$  and  $\hat{\xi}_k^a$ , respectively. We show in Appendix A that:

**Proposition 2.** With firm-level fixed costs of exporting, an increase in the assembly potential of a given plant  $k$  from  $\xi_k^a$  to  $\hat{\xi}_k^a > \xi_k^a$  leads to  $\hat{\mathcal{I}}^a \geq \mathcal{I}^a$  and  $\hat{\mathcal{I}}^x \geq \mathcal{I}^x$  whenever  $\varepsilon \leq \sigma$ , and it may lead to  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$  and  $\hat{\mathcal{I}}^x \geq \mathcal{I}^x$  even when  $\varepsilon > \sigma$ .

This result implies that the model generates complementarities across assembly locations for a wider range of parameter values than our baseline model.

The intuition for this result is as follows. An increase in  $\xi_k^a$  necessarily increases the profits associated with sales emanating from that plant  $k$ . This increase in profitability may lead firm  $\varphi$  to activate export destinations that were not profitable before the increase in  $\xi_k^a$ . Crucially, because plants in other potential assembly locations  $k' \neq k$  would benefit from the activation of such an export destination, this induced change in the firm-level extensive margin of exports may well increase the profitability of activating these other potential assembly locations  $k'$ , especially when cannibalization effects are small.

As we show in Appendix A, the fact that fixed costs of exporting are incurred (in part) at the firm-level is crucial for these results: if these fixed costs were incurred *only* at the plant-level,

we would revert to the result stated in Proposition 1, and complementarities could not arise when  $\varepsilon > \sigma$ .

Having said this, even when fixed costs of exporting have a plant-level component, as long as part of these fixed costs is a firm-level investment, then the enhanced complementarities in Proposition 2 again apply. Similarly, these enhanced complementarities also materialize in a setting in which all of an MNE’s plants need to incur fixed costs of exporting, but these plant-level fixed export costs are *reduced* – but not brought down to zero – by the activation of an export market by another plant of the same MNE, perhaps due to learning as in the empirical literature on ‘extended’ gravity (see, for instance, Morales et al., 2019; Alfaro-Ureña et al., 2023).

## 5 Export-Platform FDI Model with Firm-Level Sourcing Costs

We finally relax the assumption that final goods are only produced with labor and introduce tradable intermediate inputs. Following our approach for preferences, we assume that inputs sourced from different countries are imperfect substitutes, with a constant elasticity of substitution  $\rho > 1$ . Intermediates are produced worldwide by a competitive fringe of suppliers that sells its products at marginal cost. All intermediates are produced with labor under a linear technology delivering  $Z_j^s$  units of output per unit of labor. Shipping intermediates from country  $j$  to country  $k$  entails iceberg trade costs  $\tau_{jk}^s$ . As a result, the cost at which firms producing in  $k$  can procure inputs from country  $j$  is given by  $\tau_{jk}^s w_j / Z_j^s$ .

A firm must incur a country-specific fixed cost  $w_j f_j^s$  to source inputs from a particular country  $j$ . Although this assumption is similar to Antràs et al. (2017), a crucial distinction here is that the fixed cost grants *all* of the firm’s assembly plants  $k \in \mathcal{K}(\varphi)$  access to inputs from that country. We denote the set of countries for which firm  $\varphi$  has paid the fixed costs of sourcing by  $\mathcal{J}(\varphi) \subseteq J$  and refer to it as the firm’s *global sourcing strategy*.

The overall marginal cost for firm  $\varphi$  to produce units of the final-good variety in country  $k$  is given by

$$c(\varphi, k) = \frac{(\xi_k^a)^{\frac{1-\alpha}{1-\varepsilon}} \left( \sum_{j \in \mathcal{J}(\varphi)} \xi_j^s (\tau_{jk}^s)^{1-\rho} \right)^{\frac{\alpha}{1-\rho}}}{\varphi},$$

where  $1 - \alpha$  is the labor share in final-good production,  $\xi_k^a \equiv (w_k / Z_k^a)^{1-\varepsilon}$  is the firm’s assembly potential in country  $k$ , and  $\xi_j^s \equiv (w_j / Z_j^s)^{1-\rho}$  is country  $j$ ’s *sourcing potential*.

Invoking constant-markup pricing, one can show that the sales of an assembly plant in  $k$  to

each market  $i$  (we ignore fixed costs of exporting in this section) are given by

$$S_{ki}(\varphi) = \kappa \varphi^{\sigma-1} (\xi_k^a)^{1-\alpha} (\tau_{ki}^a)^{1-\varepsilon} (\Theta_k(\varphi))^{\frac{\alpha(\varepsilon-1)}{\rho-1}} (\Lambda_i(\varphi))^{\frac{\sigma-\varepsilon}{\varepsilon-1}} E_i P_i^{\sigma-1}, \quad (8)$$

where  $\kappa$  is a constant. The term  $\Theta_k(\varphi)$  is plant  $k$ 's *sourcing capability* (see Antràs et al., 2017), and is given by

$$\Theta_k(\varphi) \equiv \sum_{j \in J} \mathcal{I}_j^s \times \xi_j^s (\tau_{jk}^s)^{1-\rho},$$

where  $\mathcal{I}_j^s$  is an indicator function that takes a value of 1 if the firm activates country  $j$  as a source of inputs, and 0 otherwise. Finally, the term  $\Lambda_i(\varphi)$  is

$$\Lambda_i(\varphi) \equiv \sum_{k' \in J} \mathcal{I}_{k'}^a \times (\xi_{k'}^a)^{1-\alpha} (\tau_{k'i}^a)^{1-\varepsilon} \times (\Theta_{k'}(\varphi))^{\frac{\alpha(\varepsilon-1)}{\rho-1}}.$$

The empirical complementarities in global sourcing documented in Antràs et al. (2017) lead us to impose:

**Assumption 1:**  $\alpha(\varepsilon - 1) \geq \rho - 1$ .

Equation (8) is significantly more involved than its counterpart (4) in our baseline model, but holding the firm's extensive-margin strategies constant, whether an increase in the assembly potential  $\xi_k^a$  of plant  $k$  increases or decreases sales of plants based in  $k' \neq k$  continues to be shaped solely by the relative size of  $\sigma$  and  $\varepsilon$ , with  $\varepsilon > \sigma$  leading to cannibalization and  $\varepsilon < \sigma$  leading to complementarity.

Profits are now given by

$$\pi(\varphi) = \kappa_\pi \varphi^{\sigma-1} \sum_{i \in J} E_i P_i^{\sigma-1} \times (\Lambda_i(\varphi))^{\frac{\sigma-1}{\varepsilon-1}} - \sum_{k \in J} \mathcal{I}_k^a \times w_k f_k^a - \sum_{j \in J} \mathcal{I}_j^s \times w_j f_j^s,$$

for some constant  $\kappa_\pi$ .

Whenever  $\varepsilon \leq \sigma$ , profits continue to feature increasing differences in  $(\mathcal{I}_k^a, \mathcal{I}_{k'}^a)$  for  $k, k' \in \{1, \dots, J\}$  and  $k \neq k'$ . Denote by  $\mathcal{I}^s$  and  $\hat{\mathcal{I}}^s$  the optimal sourcing decisions under  $\xi_k^a$  and  $\hat{\xi}_k^a$ , respectively. In Appendix A, we show that:

**Proposition 3.** With firm-level fixed costs of sourcing, under Assumption 1, an increase in the assembly potential of a given plant  $k$  from  $\xi_k^a$  to  $\hat{\xi}_k^a > \xi_k^a$  leads to  $\hat{\mathcal{I}}^a \geq \mathcal{I}^a$  and  $\hat{\mathcal{I}}^s \geq \mathcal{I}^s$  whenever  $\varepsilon \leq \sigma$ , and it may lead to  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$  and  $\hat{\mathcal{I}}^s \geq \mathcal{I}^s$  even when  $\varepsilon > \sigma$ .

As in the case of firm-level fixed export costs, the presence of firm-level fixed costs of sourcing again widens the range of parameter values for which assembly locations are complements. Intuitively, an increase in  $\xi_k^a$  increases the profitability of plant  $k$ , which in turn increases the

marginal benefit of investing in a larger sourcing capability  $\Theta_k(\varphi)$  for that plant. Since all of the firm's plants now benefit from a new input source country, their sourcing capabilities  $\Theta_{k'}(\varphi)$  tend to be enhanced, and necessarily so under Assumption 1. This larger sourcing capability may in turn increase the profitability of activating other potential assembly locations  $k'$ , especially when cannibalization effects are small.

If fixed costs of sourcing were incurred at the plant- rather than the firm-level, this complementarity force would disappear, and a result analogous to the one in Proposition 1 would apply (see Appendix A). But if fixed costs of sourcing are at least partially firm-level in nature, or if plant-level fixed costs of sourcing are reduced by the activation of a source of inputs by another plant of the same MNE, then the enhanced complementarities captured by Proposition 3 would again materialize.

## 6 Conclusion

We demonstrate that the various plants of an MNE do not cannibalize sales from each other whenever the elasticity of demand for the MNE's goods is low relative to the within-firm elasticity of labor substitution across the MNE's plants. We also show that this complementarity is enhanced by country-level fixed costs incurred at the firm (rather than plant) level to sell those goods or source inputs for their production.

The existence of complementarities in the export-platform strategies of MNEs is important, among other reasons, because it constitutes a potential force contributing to the remarkable dominance of a small number of multinational firms in world trade flows and domestic production, as documented for the case of the United States in Antràs et al. (forthcoming). In addition, the effects of trade policy not only on trade flows, but also on production across countries depend on whether an MNE's plants are substitutes or complements. While increased trade barriers tend to increase domestic production when plants are substitutes, they will instead decrease it if plants are complements.

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# A Appendix

In this Appendix, we present details that were omitted from the main text. We provide proofs for the three Propositions in the paper, and for other results claimed (without proof) in the main text.

## A.1 Formal Definition of Price Indexes

Denoting by  $p_i(\varphi, k)$  the price charged for variety  $k$ , the overall price index  $\mathbf{p}_i(\varphi)$  for varieties sold by firm  $\varphi$  is given by

$$\mathbf{p}_i(\varphi) = \left( \sum_{k \in \mathcal{K}} p_i(\varphi, k)^{1-\varepsilon} \right)^{\frac{1}{1-\varepsilon}}. \quad (9)$$

The economy-wide ideal price index is in turn given by

$$P_i = \left( \int_{\varphi \in \Omega_i} \mathbf{p}_i(\varphi)^{1-\sigma} d\varphi \right)^{\frac{1}{1-\sigma}}. \quad (10)$$

## A.2 Optimal Prices

In this Appendix, we show that firms have an incentive to charge a constant markup over marginal cost for its goods, with the markup being governed by the cross-firm demand elasticity  $\sigma$ .

To simplify matters, we assume, without loss of generality, that  $P_i^{\sigma-1} E_i = 1$ . Because we focus throughout on a firm-level problem, we often omit  $\varphi$  subscripts in variables that are firm-specific, to make the notation a bit less cumbersome.

A firm solves the following problem in each market  $i$ :

$$\begin{aligned} \max_{q_i(k)} \quad & \sum_{k \in \mathcal{K}} (p_i(k) - c_i(k)) \cdot q_i(k) \\ \text{s.t.} \quad & q_i(k) = p_i(k)^{-\varepsilon} \mathbf{p}_i^{\varepsilon-\sigma} \end{aligned} \quad (11)$$

where  $\mathcal{K}$  is the set of active assembly plants,  $c_i(k)$  is the marginal cost of production from plant  $k$  when selling to market  $i$ , and

$$\mathbf{p}_i = \left( \sum_{k \in \mathcal{K}} p_i(k)^{1-\varepsilon} \right)^{\frac{1}{1-\varepsilon}},$$

as indicated in equation (9). The constraint in (11) can easily be derived from equation (3) after setting  $P_i^{\sigma-1} E_i = 1$ .



It is straightforward to verify that:

$$\sum_{k \in \mathcal{K}} p_i(k) \cdot q_i(k) = \mathbf{p}_i \cdot \mathbf{q}_i \text{ where } \mathbf{q}_i \equiv \left( \sum_{k \in \mathcal{K}} q_i(k)^{\frac{\varepsilon-1}{\varepsilon}} \right)^{\frac{\varepsilon}{\varepsilon-1}} = \mathbf{p}_i^{-\sigma}.$$

Therefore, problem (11) can be written as a one-dimensional profit maximization

$$\max_{\mathbf{q}_i} \mathbf{q}_i^{1-\frac{1}{\sigma}} - \mathbf{c}_i \cdot \mathbf{q}_i, \quad (12)$$

where the marginal cost  $\mathbf{c}_i$  for producing a bundle  $\mathbf{q}_i$  is obtained from cost minimization:

$$\begin{aligned} \mathbf{c}_i &= \min_{q_i(k)} \sum_{k \in \mathcal{K}} c_i(k) \cdot q_i(k) \\ \text{s.t. } &\left( \sum_{k \in \mathcal{K}} q_i(k)^{\frac{\varepsilon-1}{\varepsilon}} \right)^{\frac{\varepsilon}{\varepsilon-1}} = 1. \end{aligned} \quad (13)$$

Solving (12) and (13), and substituting optimal  $\mathbf{q}_i$  and  $\{q_i(k)\}_{k \in \mathcal{K}}$  into the demand equations in (11) gives the following optimal prices

$$p_i(k) = \frac{\sigma}{\sigma-1} c_i(k) \text{ and } \mathbf{p}_i = \frac{\sigma}{\sigma-1} \cdot \left( \sum_{k \in \mathcal{K}} c_i(k)^{1-\varepsilon} \right)^{\frac{1}{1-\varepsilon}}, \quad (14)$$

which are a constant markup  $\sigma/(\sigma-1)$  over marginal cost.

### A.3 Expressions in the Main Text

In this Appendix, we explicitly derive the key expressions in the main text. We begin by using the optimal prices in (14) to derive sales from plant  $k$  to market  $i$  (we again omit  $\varphi$  subscripts, for simplicity).

Starting with equation (3) in the main text, we obtain:

$$S_{ki} = p_i(k)^{1-\varepsilon} \mathbf{p}_i^{\varepsilon-\sigma} P_i^{\sigma-1} E_i = \left( \frac{\sigma}{\sigma-1} \right)^{1-\sigma} \mathcal{I}_k^a \cdot c_i(k)^{1-\varepsilon} \cdot \left( \sum_{k \in J} \mathcal{I}_k^a \cdot c_i(k)^{1-\varepsilon} \right)^{\frac{\sigma-\varepsilon}{\varepsilon-1}} \cdot P_i^{\sigma-1} E_i,$$

where  $\mathcal{I}_k^a = 1$  if a firm paid fixed costs of assembly in location  $k \in J$ , and  $\mathcal{I}_k^a = 0$  otherwise. For a firm with productivity  $\varphi$ , the marginal costs are

$$c_i(k) = \frac{1}{\varphi} \cdot \frac{w_k}{Z_k^a} \cdot \tau_{ki}^a,$$

thereby delivering the expression in equation (4) in the main text.

The overall profit for firm  $\varphi$ , equation (6), is

$$\pi(\varphi) = \frac{1}{\sigma} \sum_{i \in J} \sum_{k \in J} S_{ki} = \kappa_\pi \varphi^{\sigma-1} \sum_{i \in J} P_i^{\sigma-1} E_i \cdot (\Psi_i(\varphi))^{\frac{\sigma-1}{\varepsilon-1}} - \sum_{k \in J} \mathcal{I}_k^a \cdot w_k f_k^a,$$

where  $\kappa_\pi = \frac{1}{\sigma} \left(\frac{\sigma}{\sigma-1}\right)^{1-\sigma}$ ,  $\mathcal{I}_k^a = 1$  if  $k \in \mathcal{K}(\varphi)$ , and

$$\Psi_i(\varphi) = \sum_{k \in J} \mathcal{I}_k^a \cdot \xi_k^a (\tau_{ki}^a)^{1-\varepsilon}.$$

With firm-level fixed costs of exporting, the profit function, equation (7), is

$$\pi(\varphi) = \kappa_\pi \varphi^{\sigma-1} \sum_{i \in J} \mathcal{I}_i^x \cdot P_i^{\sigma-1} E_i \cdot (\Psi_i(\varphi))^{\frac{\sigma-1}{\varepsilon-1}} - \sum_{i \in J} \mathcal{I}_i^x \cdot w_i f_i^x - \sum_{k \in J} \mathcal{I}_k^a \cdot w_k f_k^a.$$

In section 5 of the main text, we introduce tradable intermediate inputs. Formally, we assume that firm  $\varphi$  has the following production

$$F_\varphi(\ell, Q_s) = \frac{\varphi}{(1-\alpha)^{1-\alpha} \alpha^\alpha} \ell^{1-\alpha} Q_s^{1-\alpha},$$

where  $\ell$  is labor, and  $Q_s$  is a bundle of inputs

$$Q_s = \left( \sum_{j \in J} \mathcal{I}_j^s \cdot (q_j^s)^{\frac{\rho-1}{\rho}} \right)^{\frac{\rho}{\rho-1}} \quad \text{where } \mathcal{I}_j^s = 1 \text{ if } j \in \mathcal{J}(\varphi) \text{ and } \rho > 1.$$

This production function has the following marginal costs

$$c_i(\varphi, k) = \frac{1}{\varphi} \cdot \left( \frac{w_k}{Z_k^a} \right)^{1-\alpha} \cdot \left( \sum_{j \in J} \mathcal{I}_j^s \cdot \left( \frac{w_j \tau_{jk}^s}{Z_j^s} \right)^{1-\rho} \right)^{\frac{\alpha}{1-\rho}}.$$

Substituting these marginal costs into the optimal prices in (14) we get the sales from plant  $k$  to market  $i$ , written in equation (8) in the main text.

Finally, the profit function with intermediate inputs can be written as

$$\pi(\varphi) = \kappa_\pi \varphi^{\sigma-1} \sum_{i \in J} P_i^{\sigma-1} E_i \cdot \Lambda_i(\varphi) - \sum_{j \in J} \mathcal{I}_j^s \cdot w_j f_j^s - \sum_{k \in J} \mathcal{I}_k^a \cdot w_k f_k^a,$$

where

$$\Lambda_i(\varphi) = \left[ \sum_{k \in J} \mathcal{I}_k^a \cdot (\xi_k^a)^{1-\alpha} (\tau_{ki}^a)^{1-\varepsilon} \cdot \left( \sum_{j \in J} \mathcal{I}_j^s \cdot \xi_j^s (\tau_{jk}^s)^{1-\rho} \right)^{\frac{\alpha(\varepsilon-1)}{\rho-1}} \right]^{\frac{\sigma-1}{\varepsilon-1}}$$

and

$$\xi_k^a = \left( \frac{w_k}{Z_k^a} \right)^{1-\varepsilon} \quad \text{and} \quad \xi_j^s = \left( \frac{w_j}{Z_j^s} \right)^{1-\rho}.$$

## A.4 Relaxing the Armington Assumption

In section 3 of the main text, we argue that our main results are not dependent on the Armington assumption implicit in equation (2). We prove this claim in this Appendix.

### A.4.1 Labor Substitutability in the Armington Model

We first demonstrate that, in our baseline model,  $\varepsilon$  corresponds to the within-firm elasticity of labor substitution across an MNE's plants. In that model, when figuring out the optimal way to allocate labor across plants to sell goods in market  $i$ , for a given assembly strategy  $\mathcal{K}$ , the firm solves the following problem

$$\begin{aligned} c_i &= \min_{\{\ell_{k,i}(\nu)\}} \sum_{k \in \mathcal{K}} w_k \ell_{k,i} \\ \text{s.t.} \quad & \left( \sum_{k \in \mathcal{K}(\varphi)} q_i(k)^{\frac{\varepsilon-1}{\varepsilon}} \right)^{\frac{\varepsilon}{\varepsilon-1}} = 1 && \text{(bundle of products)} \\ \text{s.t.} \quad & q_i(k) = \frac{Z_k^a}{\tau_{ki}^a} \cdot \ell_{k,i} && \text{(production technology).} \end{aligned}$$

The solution to this problem delivers the following cost function

$$c_i = \left( \sum_{k \in \mathcal{K}(\varphi)} \left( \tau_{ki}^a \frac{w_k}{Z_k^a} \right)^{1-\varepsilon} \right)^{\frac{1}{1-\varepsilon}}. \quad (15)$$

Define the conditional elasticity of labor demand in location  $k$  to changes in location  $l$  as

$$\mathcal{E}_{k,l}^i = \frac{\partial \ell_{k,i}}{\partial w_l} \frac{w_l}{\ell_{k,i}},$$

and define the share of variable labor costs associated with selling goods to  $i$  paid to labor in

location  $l$  as:

$$S_l^i = \frac{w_l \ell_{l,i}}{c_i} = \frac{w_l \ell_{l,i}}{\sum_{k \in \mathcal{K}} w_k \ell_{k,i}}.$$

The Allen partial elasticity of substitution is defined as

$$\varepsilon_{k,l}^i \equiv \frac{\mathcal{E}_{k,l}^i}{S_l^i}.$$

For our CES-Armington cost function in (15), we can invoke Shephard's lemma to find:

$$\ell_{k,i} = \frac{\partial c_i}{\partial w_k} = (c_i)^\varepsilon \left( \frac{\tau_{ki}^a}{Z_k^a} \right)^{1-\varepsilon} (w_k)^{-\varepsilon}. \quad (16)$$

The conditional elasticity of labor demand in location  $k$  to changes in location  $l$  is thus

$$\mathcal{E}_{k,l}^i = \frac{\partial \ell_{k,i}}{\partial w_l} \frac{w_l}{\ell_{k,i}} = \left( \frac{\tau_{ki}^a}{Z_k^a} \right)^{1-\varepsilon} \varepsilon (c_i)^{\varepsilon-1} \frac{\partial c_i}{\partial w_l} (w_k)^{-\varepsilon} \frac{w_l}{\ell_{k,i}}$$

Invoking Shephard's lemma and plugging in (16) delivers

$$\mathcal{E}_{k,l}^i = \varepsilon \frac{w_l \ell_{l,i}}{c_i},$$

so the Allen partial elasticity of labor substitution across plants is

$$\varepsilon_{k,l}^i \equiv \frac{\mathcal{E}_{k,l}^i}{S_l^i} = \varepsilon.$$

It is also simple to see from equation (16) that, for two locations  $k$  and  $l$ ,

$$\frac{\ell_{k,i}}{\ell_{l,i}} = (c_i)^\varepsilon \left( \frac{\tau_{ki}^a / Z_k^a}{\tau_{li}^a / Z_l^a} \right)^{1-\varepsilon} \left( \frac{w_k}{w_l} \right)^{-\varepsilon}$$

and thus  $\varepsilon$  also corresponds to the more traditional Hicks elasticity of substitution, defined as

$$\tilde{\mathcal{E}}_{k,l}^i = \frac{\partial \ln(\ell_{k,i} / \ell_{l,i})}{\partial \ln(w_l / w_k)}.$$

It is important to stress that  $\varepsilon$  measures the *intensive-margin* elasticity of labor substitution, taking as fixed the location of the various plants and without consideration to the labor investments that might have been incurred when setting up those plants.

### A.4.2 Labor Substitutability with Productivity differences à la Eaton-Kortum

We next explore the robustness of our results to a version of our model in which goods are *not* differentiated based on where they are produced. This version constitutes a simple extension of the model in [Tintelnot \(2017\)](#).

There is an endogenous measure  $\Omega_i$  of manufacturing firms selling goods in country  $i$ . As in [Tintelnot \(2017\)](#), each of these firms produces and sells a continuum of measure one of varieties of manufactured goods. We continue to index firms by  $\varphi$  and varieties within firms by  $\omega$ . We assume a nested-CES structure in which the degree of substitutability  $\sigma$  across varieties produced by different firms, and the degree of substitutability  $\sigma_w$  across varieties produced by the same firm may differ from each other:

$$U_{Mi} = \left( \int_{\varphi \in \Omega_i} \left( \int_0^1 q_i(\varphi, \omega)^{(\sigma_w - 1)/\sigma_w} d\omega \right)^{\frac{\sigma_w}{\sigma_w - 1} \frac{(\sigma - 1)}{\sigma}} d\varphi \right)^{\sigma/(\sigma - 1)}, \quad \sigma_w, \sigma > 1.$$

These preferences imply that consumers in country  $i$  spend a share

$$s_i(\varphi) = \left( \frac{p_i(\varphi)}{P_i} \right)^{1 - \sigma} E_i \tag{17}$$

of their income on firm  $\varphi$ . In this expression,  $E_i$  is total spending on manufactured goods in country  $i \in J$ ,

$$p_i(\varphi) = \left( \int_0^1 p_i(\varphi, \omega)^{1 - \sigma_w} d\omega \right)^{\frac{1}{1 - \sigma_w}} \tag{18}$$

is the overall price index for varieties sold by firm  $\varphi$ , and  $P_i$  is the economy-wide ideal price index in country  $i$  (given again by equation (10)). Note that, as in our baseline model,  $\sigma$  continues to govern the cross-firm elasticity of demand faced by firm  $\varphi$ .

On the production side, we let firms produce their continuum of products in multiple countries. Given fixed costs of assembly (identical to those in our baseline model), firms will typically produce only in a subset of all countries in the world, and we denote this set  $\mathcal{K} \subseteq J$  as the firm's *global assembly strategy*. Shipping final goods from country  $k$  to country  $i$  entails variable (iceberg) trade costs  $\tau_{ki}^a$ . In line with our baseline model and with [Tintelnot \(2017\)](#), we abstract from fixed costs of exporting.

The marginal cost for firm  $\varphi$  to produce units of final-good variety  $\omega$  in country  $k$  is given by

$$c(\varphi, k, \omega) = \frac{1}{\varphi} \frac{1}{z_k(\varphi, \omega)} w_k, \tag{19}$$

where  $z_k(\varphi, \omega)$  is a firm- and location-specific labor productivity term. Following [Tintelnot \(2017\)](#), we assume that these firm- and location-specific assembly productivity shifters are drawn from the following Fréchet distribution:

$$\Pr(1/z_k(\varphi, \omega) \geq a) = e^{-(Z_k^a a)^\theta}, \quad \text{with } Z_k^a > 0. \quad (20)$$

$Z_k^a$  governs the average productivity of plant  $k$ , while  $\theta$  determines the dispersion of productivity draws across final-good varieties, with a lower  $\theta$  indicating a higher variance, and thus greater benefits from producing final-good varieties in various locations. To ensure a well-defined solution, we follow [Tintelnot \(2017\)](#) in imposing a lower bound on the dispersion in the final-good productivity draws  $z_k(\varphi, \omega)$ :

**Technical Assumption:**  $\sigma_\omega - 1 < \theta$ .

Following the derivations in [Tintelnot \(2017\)](#), it is possible to show that this Eaton-Kortum formulation results in a marginal cost for firm  $\varphi$  of selling its bundle of goods to market  $i$ , which is given by

$$c_i(\varphi) = \kappa \cdot \left( \sum_{k \in \mathcal{K}(\varphi)} \left( \tau_{ki}^a \frac{w_k}{Z_k^a} \right)^{-\theta} \right)^{-1/\theta}, \quad (21)$$

where  $\kappa$  is a constant. As claimed in the main text, this marginal cost is identical (up to a constant) to that in equation (15), with  $\theta$  replacing  $\varepsilon - 1$ . Because firms charge a constant markup  $\sigma/(\sigma - 1)$  over this marginal cost, the rest of the equilibrium conditions of this version of our model, i.e., the analogues of equations (4)–(6), are identical to those in the main text with  $\theta$  replacing  $\varepsilon - 1$ . The isomorphism between (15) and (21) also makes it clear that the Allen partial elasticity of labor substitution across plants is now given by  $\theta + 1$ , and whether assembly locations are complements or substitutes depends on the relative size of the (cross-firm) demand elasticity  $\sigma$  and this labor substitution elasticity  $\theta + 1$ .

It is also worth pointing out that [Tintelnot \(2017\)](#) focused on symmetric CES preferences with a common degree of substitutability across varieties produced by different firms and across varieties produced by the same firm, or  $\sigma = \sigma_\omega$ . The technical assumption  $\sigma_\omega - 1 < \theta$  then led him to assume  $\sigma - 1 < \theta$ , which implies that assembly locations were necessarily substitutes in his framework. But if  $\sigma_\omega < \sigma$ , under our more general nested CES structure, it is perfectly possible for assembly locations to be complements ( $\sigma - 1 > \theta$ ) while ensuring a well-defined firm-level problem ( $\sigma_\omega - 1 < \theta$ ).

### A.4.3 A More General Production Structure

We finally consider a more general production structure that encompasses to two models developed above and more general settings. We focus on the problem of a firm that produces a set of varieties  $\mathcal{V}$  (for simplicity we drop firm-specific subscripts). For each destination  $i \in J$ , varieties are bundled according to

$$Q_i = F_i(\{q_i(\nu)\}_{\nu \in \mathcal{V}}),$$

and consumers have CES preferences over  $Q_i$  across firms, with elasticity of substitution  $\sigma$ . Each variety is produced using labor from different locations in the firm's global assembly strategy according to

$$q_i(\nu) = F_i^\nu(\{\ell_{k,i}(\nu)\}_{k \in \mathcal{K}}).$$

The operating profit function (excluding fixed costs) can be written as

$$\pi^o = \kappa \cdot \sum_{i \in J} c_i^{1-\sigma} \cdot P_i^{\sigma-1} E_i$$

where  $c_i$  is the marginal cost of producing a bundle of goods to be sold in destination  $i$ . These marginal costs come from a cost-minimization problem:

$$\begin{aligned} c_i &= \min_{\{\ell_{k,i}(\nu)\}} \sum_{\nu \in \mathcal{V}} \sum_{k \in \mathcal{K}} w_k \ell_{k,i}(\nu) \\ \text{s.t. } & F_i(\{q_i(\nu)\}_{\nu \in \mathcal{V}}) = 1 && \text{(bundle of products)} \\ \text{s.t. } & q_i(\nu) = F_i^\nu(\{\ell_{k,i}(\nu)\}_{k \in \mathcal{K}}) && \text{(production technology)} \end{aligned}$$

We shall say that assembly locations are (local) substitutes if  $\frac{\partial^2 \pi^o}{\partial w_k \partial w_l} < 0$  and (local) complements if  $\frac{\partial^2 \pi^o}{\partial w_k \partial w_l} > 0$  for  $k \neq l$ .<sup>4</sup> To compute these expressions, we calculate

$$\begin{aligned} \frac{\partial^2 c_i^{1-\sigma}}{\partial w_k \partial w_l} &= \frac{\partial}{\partial w_l} \left[ (1-\sigma) c_i^{-\sigma} \cdot \frac{\partial c_i}{\partial w_k} \right] = \frac{\partial}{\partial w_l} \left[ (1-\sigma) c_i^{-\sigma} \cdot \ell_{k,i} \right] = \\ &= (1-\sigma) \cdot \left[ c_i^{-\sigma} \frac{\partial \ell_{k,i}}{\partial w_l} - \sigma \cdot c_i^{-\sigma-1} \ell_{l,i} \cdot \ell_{k,i} \right] \end{aligned}$$

where we use Shephard's lemma to derive the total demand for labor from location  $k$ ,  $\frac{\partial c_i}{\partial w_k} = \sum_{\nu \in \mathcal{V}} \ell_{k,i}(\nu) \equiv \ell_{k,i}$ , and location  $l$ ,  $\frac{\partial c_i}{\partial w_l} = \sum_{\nu \in \mathcal{V}} \ell_{l,i}(\nu) \equiv \ell_{l,i}$ .

<sup>4</sup>We assume that wages are firm-specific, so the aggregate demand  $P_i^{\sigma-1} E_i$  is constant.

It thus follows that assembly locations are (local) substitutes or complements, respectively, if

$$\min_{i,l,k} \left\{ \frac{\mathcal{E}_{k,l}^i}{S_l^i} \right\} > \sigma \text{ or } \max_{i,l,k} \left\{ \frac{\mathcal{E}_{k,l}^i}{S_l^i} \right\} < \sigma, \quad (22)$$

where  $\mathcal{E}_{k,l}^i$  is the elasticity of substitution of conditional demand for labor in location  $k$  with respect to the price of labor in location  $l$ , and  $S_l^i$  is share of spending on labor from  $l$  in total spending on labor from different countries to serve market  $i$ :

$$\mathcal{E}_{k,l}^i = \frac{\partial \ell_{k,i}}{\partial w_l} \frac{w_l}{\ell_{k,i}} \text{ and } S_l^i = \frac{w_l \ell_{l,i}}{c_i} = \frac{w_l \ell_{l,i}}{\sum_{k \in \mathcal{K}} w_k \ell_{k,i}}.$$

In sum, we have that assembly locations are (local) substitutes or complements, respectively, if

$$\min_{i,l,k} \left\{ \varepsilon_{k,l}^i \right\} > \sigma \text{ or } \max_{i,l,k} \left\{ \varepsilon_{k,l}^i \right\} < \sigma,$$

where  $\varepsilon_{k,l}^i$  is the (Allen) partial elasticity of substitution of labor across locations  $k$  and  $l$ , when producing goods for sale in market  $i$ .

**Special Cases.** The Armington setting in the main text corresponds to the following assumptions

$$\begin{aligned} \mathcal{V} &= \mathcal{K} \\ F_i(\{q_i(\nu)\}) &= \left( \sum_{\nu \in \mathcal{K}} q_i(\nu)^{\frac{\varepsilon-1}{\varepsilon}} \right)^{\frac{\varepsilon}{\varepsilon-1}} \\ q_i(\nu) &= Z_{k,i}^a \cdot \ell_{k,i}(\nu) \text{ for } \nu = k \text{ and } Z_{k,i}^a = \frac{Z_k^a}{\tau_{k,i}^a} > 0 \\ q_i(\nu) &= 0 \text{ for } \nu \neq k, \end{aligned}$$

while the setting in [Tintelnot \(2017\)](#) (extended to nested CES preferences) corresponds to<sup>5</sup>

$$\begin{aligned} \mathcal{V} &= [0, 1] \\ F_i(\{q_i(\nu)\}) &= \left( \int_0^1 q_i(\nu)^{\frac{\varepsilon-1}{\varepsilon}} \right)^{\frac{\varepsilon}{\varepsilon-1}} \\ q_i(\nu) &= \sum_{k \in \mathcal{K}} Z_{k,i}^a(\nu) \cdot \ell_{k,i}(\nu). \end{aligned}$$

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<sup>5</sup>We replaced the sum with an integral.



## A.5 Proofs of Propositions 1-3

### Notation

Consider the general problem with firm- and plant-level fixed costs. Denote by  $\mathcal{I}_i^x = 1$  if a firm paid firm-level fixed costs of marketing to destination  $i$ ,  $w_i f_i^x$ , and  $\mathcal{I}_i^x = 0$  otherwise; by  $\mathcal{I}_j^s = 1$  if a firm paid firm-level fixed costs of importing from sourcing location  $j$ ,  $w_j f_j^s$ , and  $\mathcal{I}_j^s = 0$  otherwise; by  $\mathcal{I}_k^a = 1$  if a firm paid firm-level fixed costs of assembly in location  $k$ ,  $w_k f_k^a$ , and  $\mathcal{I}_k^a = 0$  otherwise; by  $\mathcal{I}_{ki}^x = 1$  if a firm paid plant-destination specific fixed costs of exporting from plant  $k$  to destination  $i$ ,  $w_i f_{ki}^x$ , and  $\mathcal{I}_{ki}^x = 0$  otherwise; by  $\mathcal{I}_{jk}^s = 1$  if a firm paid sourcing-assembly specific fixed costs of importing from sourcing location  $j$  to assembly plant  $k$ ,  $w_j f_{jk}^s$ , and  $\mathcal{I}_{jk}^s = 0$  otherwise.

We denote by  $\mathcal{I}^a = (\mathcal{I}_1^a, \dots, \mathcal{I}_J^a)$  the vector of optimal decisions for assembly locations under  $\xi^a$ , and by  $\hat{\mathcal{I}}^a = (\hat{\mathcal{I}}_1^a, \dots, \hat{\mathcal{I}}_J^a)$  the optimal solution under  $\hat{\xi}^a$ . In a similar way, we denote by  $\mathcal{I}^x$ ,  $\mathcal{I}^s$ ,  $\hat{\mathcal{I}}^x$ ,  $\hat{\mathcal{I}}^s$  the vectors of optimal decisions for exporting and sourcing. We also denote by  $\mathcal{I}_{-k}^a$  and  $\hat{\mathcal{I}}_{-k}^a$  the vectors  $\mathcal{I}^a$  and  $\hat{\mathcal{I}}^a$  without elements  $\mathcal{I}_k^a$  and  $\hat{\mathcal{I}}_k^a$ , respectively. For vectors  $X$  and  $Y$ , we say that  $X \geq Y$  if  $X_i \geq Y_i$  for all  $i$ , and  $X > Y$  if  $X \geq Y$  and  $X_j > Y_j$  for some  $j$ .

In all propositions, we assume that  $\xi_k^a > 0$  and  $\xi_j^s > 0$  for all  $k \in J$  and  $j \in J$ .

### General Profit Function

Consider the general profit function with firm- and plant-level fixed costs:

$$\begin{aligned} \pi = & \kappa_\pi \varphi^{\sigma-1} \cdot \overbrace{\sum_{i \in J} \mathcal{I}_i^x \cdot E_i P_i^{\sigma-1}}^{\text{Destinations}} \left[ \overbrace{\sum_{k \in J} \mathcal{I}_{k,i}^x \mathcal{I}_k^a \cdot \xi_k^a (\tau_{ki}^a)^{1-\varepsilon}}^{\text{Assembly}} \left( \overbrace{\sum_{j \in J} \mathcal{I}_{j,k}^s \mathcal{I}_j^s \xi_j^s (\tau_{jk}^s)^{1-\rho}}^{\text{Sourcing}} \right)^\mu \right]^\theta - \\ & \underbrace{\sum_{i \in J} \sum_{k \in J} \mathcal{I}_{k,i}^x \cdot w_i f_{k,i}^x - \sum_{k \in J} \sum_{j \in J} \mathcal{I}_{j,k}^s \cdot w_j f_{j,k}^x}_{\text{Plant-Level FC}} - \underbrace{\sum_{i \in J} \mathcal{I}_i^x \cdot w_i f_i^x - \sum_{k \in J} \mathcal{I}_k^a \cdot w_k f_k^a - \sum_{j \in J} \mathcal{I}_j^s \cdot w_j f_j^s}_{\text{Firm-Level FC}}, \end{aligned} \quad (23)$$

where

$$\theta = \frac{\sigma - 1}{\varepsilon - 1} \text{ and } \mu = \frac{\alpha(\varepsilon - 1)}{\rho - 1}.$$

If  $\sigma \geq \varepsilon$  and  $\alpha(\varepsilon - 1) \geq \rho - 1$ , then the profit function in (23) is supermodular in  $(\mathcal{I}', \mathcal{I}'')$  and has increasing differences in  $(\mathcal{I}, \xi_k^a)$ , where  $\mathcal{I}'$  and  $\mathcal{I}''$  are two any indicator variables in (23). Therefore, by Topkis' Theorem

$$\text{If } \hat{\xi}_k^a \geq \xi_k^a, \text{ then } \hat{\mathcal{I}} \geq \mathcal{I}.$$

As shown below, this result will suffice to prove all Propositions for the case of  $\sigma \geq \varepsilon$  and  $\alpha(\varepsilon - 1) \geq \rho - 1$ .

### A.5.1 Proposition 1

In our baseline model without fixed costs of exporting or intermediate inputs, a firm solves the following problem:

$$\max_{\mathcal{I}^a} \pi(\mathcal{I}^a; \xi^a) = \kappa_\pi \varphi^{\sigma-1} \cdot \sum_{i \in J} E_i P_i^{\sigma-1} \left[ \sum_{k \in J} \mathcal{I}_k^a \cdot \xi_k^a (\tau_{ki}^a)^{1-\varepsilon} \right]^{\frac{\sigma-1}{\varepsilon-1}} - \sum_{k \in J} \mathcal{I}_k^a \cdot w_k f_k^a, \quad (24)$$

which is a special case of (23) under  $\mu = 0$  and all fixed costs equal to zero except for the assembly ones,  $f_k^a > 0$ . We prove the following proposition:

**Proposition 1.** Consider the problem in (24) and an increase in the assembly potential of plant  $k$ ,  $\hat{\xi}_k^a > \xi_k^a$ , holding other parameters and  $P_i^{\sigma-1} E_i$  fixed. If  $\varepsilon \leq \sigma$ , then  $\hat{\mathcal{I}}^a \geq \mathcal{I}^a$ . If  $\varepsilon > \sigma$  and  $\mathcal{I}^a$  is a unique solution, then  $\hat{\mathcal{I}}_k^a \geq \mathcal{I}_k^a$ , and it is **not** possible that  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$ .

*Proof.* For the case  $\varepsilon \leq \sigma$ , we can apply Topkis' theorem.

Consider the case  $\varepsilon > \sigma$ . If  $\mathcal{I}^a$  is an optimal solution under  $\xi^a = (\xi_1^a, \dots, \xi_k^a, \dots, \xi_J^a)$ , then

$$\pi(\mathcal{I}^a; \xi^a) \geq \pi(\tilde{\mathcal{I}}^a; \xi^a) \text{ for all } \tilde{\mathcal{I}}^a \in 2^J.$$

To prove that  $\hat{\mathcal{I}}_k^a \geq \mathcal{I}_k^a$ , assume, by contradiction, that  $\hat{\mathcal{I}}_k^a = 0 < \mathcal{I}_k^a = 1$ . Notice that  $\pi(\mathcal{I}_k^a = 1, \mathcal{I}_{-k}^a; \xi^a)$  is increasing in  $\xi_k^a$  while  $\pi(\mathcal{I}_k^a = 0, \tilde{\mathcal{I}}_{-k}^a; \xi^a)$  is independent of  $\xi_k^a$  for all  $\tilde{\mathcal{I}}_{-k}^a$  and  $\xi_{-k}^a$ , where  $\xi_{-k}^a$  is vector  $\xi^a$  without an element  $\xi_k^a$ . Therefore,

$$\pi(\mathcal{I}_k^a = 1, \mathcal{I}_{-k}^a; \hat{\xi}^a) > \pi(\mathcal{I}_k^a = 1, \mathcal{I}_{-k}^a; \xi^a) \geq \pi(\hat{\mathcal{I}}_k^a = 0, \hat{\mathcal{I}}_{-k}^a; \xi^a) = \pi(\hat{\mathcal{I}}_k^a = 0, \hat{\mathcal{I}}_{-k}^a; \hat{\xi}^a),$$

which is a contradiction. Therefore,  $\hat{\mathcal{I}}_k^a \geq \mathcal{I}_k^a$ .

For the second part, suppose, by contradiction, that  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$ . Consider three cases. First, suppose that  $\mathcal{I}_k^a = 1$ . Then,  $\hat{\mathcal{I}}_k^a = 1$ , and

$$\pi(\hat{\mathcal{I}}_k^a = 1, \hat{\mathcal{I}}_{-k}^a; \hat{\xi}^a) - \pi(\mathcal{I}_k^a = 1, \mathcal{I}_{-k}^a; \hat{\xi}^a) < \pi(\hat{\mathcal{I}}_k^a = 1, \hat{\mathcal{I}}_{-k}^a; \xi^a) - \pi(\mathcal{I}_k^a = 1, \mathcal{I}_{-k}^a; \xi^a) \leq 0, \quad (25)$$

where the first inequality comes from  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$  and  $\varepsilon > \sigma$ , and the second inequality comes from the optimality of  $\mathcal{I}^a$  under  $\xi^a$ . This inequality contradicts the optimality of  $\hat{\mathcal{I}}^a$  under  $\hat{\xi}^a$ .

Second, suppose that  $\hat{\mathcal{I}}_k^a = 0$ . Then,  $\mathcal{I}_k^a = 0$ , and  $\hat{\mathcal{I}}^a$  should be the optimal solution under both  $\xi^a$  and  $\hat{\xi}^a$ . This result contradicts the uniqueness of the solution.

Finally, suppose that  $\mathcal{I}_k^a = 0$  and  $\hat{\mathcal{I}}_k^a = 1$ . The optimality of  $\mathcal{I}^a$  under  $\xi^a$  implies

$$\pi\left(\hat{\mathcal{I}}_k^a = 1, \hat{\mathcal{I}}_{-k}^a; \xi^a\right) - \pi\left(\mathcal{I}_k^a = 1, \mathcal{I}_{-k}^a; \xi^a\right) \leq \pi\left(\hat{\mathcal{I}}_k^a = 1, \hat{\mathcal{I}}_{-k}^a; \xi^a\right) - \pi\left(\mathcal{I}_k^a = 0, \mathcal{I}_{-k}^a; \xi^a\right) \leq 0.$$

Combining this inequality with (25), we get a contradiction for the optimality of  $\hat{\mathcal{I}}^a$ :  $\pi\left(\hat{\mathcal{I}}_k^a = 1, \hat{\mathcal{I}}_{-k}^a; \hat{\xi}^a\right) < \pi\left(\mathcal{I}_k^a = 1, \mathcal{I}_{-k}^a; \hat{\xi}^a\right)$ .  $\square$

**Note:** If parameters in (23) are randomly drawn from continuous distributions, the solution is generically unique. To see the problem with multiple solutions, consider the following example. There are two plant decisions and one market with  $\kappa_\pi \varphi^{\sigma-1} E_i P_i^{\sigma-1} = 1$ . Suppose that  $w_1 f_1^a = 100$ ,  $w_2 f_2^a = 1$ ,  $\xi_2^a = 1$ ,  $\tau_{1i}^a = \tau_{2i}^a = 1$ , and we consider a change from  $\xi_1^a = 1$  to  $\hat{\xi}_2^a = 2$ . The firm chooses  $\mathcal{I}_1^a = \hat{\mathcal{I}}_1^a = 0$ , it is indifferent between  $\mathcal{I}_2^a = 1$  and  $\mathcal{I}_2^a = 0$  under  $\xi_1^a$ , and between  $\hat{\mathcal{I}}_2^a = 1$  and  $\hat{\mathcal{I}}_2^a = 0$  under  $\hat{\xi}_1^a$ . Therefore, we might have  $\mathcal{I}_2^a = 0$  and  $\hat{\mathcal{I}}_2^a = 1$  due to multiplicity, leading to  $\hat{\mathcal{I}}_{-1}^a > \mathcal{I}_{-1}^a$  for  $\hat{\xi}_1^a > \xi_1^a$ . If we specify a solution selection, the proposition can be refined for the case with multiple solutions, for instance, by always choosing the solution with the largest number of active plants.

### A.5.2 Proposition 2

We add firm-level exporting fixed costs. A firm solves the following problem:

$$\max_{\mathcal{I}^a, \mathcal{I}^x} \kappa_\pi \varphi^{\sigma-1} \cdot \sum_{i \in J} \mathcal{I}_i^x \cdot E_i P_i^{\sigma-1} \left[ \sum_{k \in J} \mathcal{I}_k^a \cdot \xi_k^a (\tau_{ki}^a)^{1-\varepsilon} \right]^{\frac{\sigma-1}{\varepsilon-1}} - \sum_{i \in J} \mathcal{I}_i^x \cdot w_i f_i^x - \sum_{k \in J} \mathcal{I}_k^a \cdot w_k f_k^a, \quad (26)$$

which is a special case of (23) under  $\mu = 0$  and all fixed costs equal to zero except assembly and firm-level exporting ones,  $f_k^a > 0$  and  $f_i^x > 0$ . We prove the following proposition:

**Proposition 2.** Consider the problem with firm-level fixed costs of exporting (26) and an increase in the assembly potential of plant  $k$ ,  $\hat{\xi}_k^a > \xi_k^a$ , holding other parameters and  $P_i^{\sigma-1} E_i$  fixed. If  $\varepsilon \leq \sigma$ , then  $\hat{\mathcal{I}}^a \geq \mathcal{I}^a$ . If  $\varepsilon > \sigma$ , then it is possible that  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$ .

*Proof.* For the case  $\varepsilon \leq \sigma$ , we can apply Topkis' theorem.

Consider the case  $\varepsilon > \sigma$ , it is sufficient to construct an example in which a rise in  $\xi_k^a$  leads to an opening of assembly plants in  $l \neq k$ . For simplicity, we assume that there is only one feasible destination market  $i$ , with  $\tau_{ki'}^a = \infty$  for  $i' \neq i$ . Suppose that all assembly fixed costs are very

small and equal to  $\delta > 0$ . The firm-level fixed cost of exporting to  $i$  is such that

$$\begin{aligned} \kappa_\pi \varphi^{\sigma-1} \cdot E_i P_i^{\sigma-1} \cdot \left( \xi_k^a (\tau_{ki})^{1-\varepsilon} + \sum_{l \neq k} \xi_l^a (\tau_{li}^a)^{1-\varepsilon} \right)^{\frac{\sigma-1}{\varepsilon-1}} &< w_i f_i^x \\ \kappa_\pi \varphi^{\sigma-1} \cdot E_i P_i^{\sigma-1} \cdot \left( \hat{\xi}_k^a (\tau_{ki})^{1-\varepsilon} + \sum_{l \neq k} \xi_l^a (\tau_{li}^a)^{1-\varepsilon} \right)^{\frac{\sigma-1}{\varepsilon-1}} &> w_i f_i^x. \end{aligned}$$

For sufficiently small  $\delta$ , an increase in  $\xi_k^a$  leads from an optimum with no assembly plants to the optimum in which all plants are activated.  $\square$

### A.5.3 Proposition 3

We add firm-level importing fixed costs. A firm solves the following problem:

$$\begin{aligned} \max_{\mathcal{I}^a, \mathcal{I}^s} \quad & \kappa_\pi \varphi^{\sigma-1} \cdot \sum_{i \in J} E_i P_i^{\sigma-1} \left[ \sum_{k \in J} \mathcal{I}_k^a \cdot \xi_k^a (\tau_{ki})^{1-\varepsilon} \cdot \left( \sum_{j \in J} \mathcal{I}_j^s \cdot \xi_j^s (\tau_{jk}^s)^{1-\rho} \right)^{\frac{\alpha(\varepsilon-1)}{\rho-1}} \right]^{\frac{\sigma-1}{\varepsilon-1}} - \\ & - \sum_{j \in J} \mathcal{I}_j^x \cdot w_j f_j^s - \sum_{k \in J} \mathcal{I}_k^a \cdot w_k f_k^a, \end{aligned} \quad (27)$$

which is a special case of (23) under  $\mu > 0$  and all fixed costs equal to zero except assembly and firm-level importing ones,  $f_k^a > 0$  and  $f_j^s > 0$ . We prove the following proposition:

**Proposition 3.** Consider the problem with firm-level fixed costs of importing (27) and an increase in the assembly potential of plant  $k$ ,  $\hat{\xi}_k^a > \xi_k^a$ , holding other parameters and  $P_i^{\sigma-1} E_i$  fixed. If  $\varepsilon \leq \sigma$ , then  $\hat{\mathcal{I}}^a \geq \mathcal{I}^a$ . Assume that  $\alpha(\varepsilon - 1) \geq \rho - 1$ . If  $\varepsilon > \sigma$ , then it is possible that  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$ .

*Proof.* Consider the following example. Assume that there is only one feasible destination market  $i$ , with  $\tau_{ki'}^a = \infty$  for  $i' \neq i$ , and one sourcing location  $j$ , with  $\tau_{j'k}^s = \infty$  for  $j' \neq j$ . Assume also that  $\tau_{jk}^s = 1$  for all  $k$ . Suppose that all assembly fixed costs are very small and equal to  $\delta > 0$ . The firm-level fixed cost of sourcing from  $j$  is such that

$$\begin{aligned} \kappa_\pi \varphi^{\sigma-1} E_i P_i^{\sigma-1} \cdot (\xi_j^s)^{\frac{\alpha(\sigma-1)}{\rho-1}} \cdot \left( \xi_k^a (\tau_{ki})^{1-\varepsilon} + \sum_{l \neq k} \xi_l^a (\tau_{li}^a)^{1-\varepsilon} \right)^{\frac{\sigma-1}{\varepsilon-1}} &< w_j f_j^s \\ \kappa_\pi \varphi^{\sigma-1} E_i P_i^{\sigma-1} \cdot (\xi_j^s)^{\frac{\alpha(\sigma-1)}{\rho-1}} \cdot \left( \hat{\xi}_k^a (\tau_{ki})^{1-\varepsilon} + \sum_{l \neq k} \xi_l^a (\tau_{li}^a)^{1-\varepsilon} \right)^{\frac{\sigma-1}{\varepsilon-1}} &> w_j f_j^s. \end{aligned}$$

For sufficiently small  $\delta$ , an increase in  $\xi_k^a$  leads from an optimum with no assembly plants to the optimum in which all plants are activated.  $\square$

#### A.5.4 Plant-Level Fixed Costs

Consider the problem with plant-level fixed costs of exporting. A firm solves the following problem:

$$\begin{aligned} \max_{\mathcal{I}^x, \mathcal{I}^a} \quad & \kappa_\pi \varphi^{\sigma-1} \cdot \sum_{i \in J} E_i P_i^{\sigma-1} \left[ \sum_{k \in J} \mathcal{I}_{k,i}^x \mathcal{I}_k^a \cdot \xi_k^a (\tau_{ki}^a)^{1-\varepsilon} \right]^{\frac{\sigma-1}{\varepsilon-1}} - \\ & - \underbrace{\sum_{i \in J} \sum_{k \in J} \mathcal{I}_{k,i}^x \cdot w_i f_{k,i}^x}_{\text{Plant-Level FC}} - \underbrace{\sum_{k \in J} \mathcal{I}_k^a \cdot w_k f_k^a}_{\text{Firm-Level FC}}. \end{aligned} \quad (28)$$

We can then prove that:

**Proposition 4.** Consider the problem in (28) and an increase in the assembly potential of plant  $k$ ,  $\hat{\xi}_k^a > \xi_k^a$ , holding other parameters and  $P_i^{\sigma-1} E_i$  fixed. If  $\varepsilon \leq \sigma$ , then  $\hat{\mathcal{I}}^a \geq \mathcal{I}^a$  and  $\hat{\mathcal{I}}^x \geq \mathcal{I}^x$ . If  $\varepsilon > \sigma$  and the solution is unique, then  $\hat{\mathcal{I}}_k^a \geq \mathcal{I}_k^a$ , and it is **not** possible that  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$  and  $\hat{\mathcal{I}}^x > \mathcal{I}^x$ .

*Proof.* For the case  $\varepsilon \leq \sigma$ , we can apply Topkis' theorem. Consider the case  $\varepsilon > \sigma$ . The proof follows the same steps as the proof of Proposition 1. Under  $\varepsilon > \sigma$ , the assumption  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$  and  $\hat{\mathcal{I}}^x > \mathcal{I}^x$  contradicts the optimality (or uniqueness) of the solution.  $\square$

Now consider the problem with plant-level fixed costs of importing. A firm solves the following problem:

$$\begin{aligned} \max_{\mathcal{I}^s, \mathcal{I}^a} \quad & \kappa_\pi \varphi^{\sigma-1} \cdot \sum_{i \in J} E_i P_i^{\sigma-1} \left[ \sum_{k \in J} \mathcal{I}_k^a \cdot \xi_k^a (\tau_{ki}^a)^{1-\varepsilon} \cdot \left( \sum_{j \in J} \mathcal{I}_{j,k}^s \xi_j^s (\tau_{jk}^s)^{1-\rho} \right)^{\frac{\alpha(\varepsilon-1)}{\rho-1}} \right]^{\frac{\sigma-1}{\varepsilon-1}} - \\ & - \underbrace{\sum_{k \in J} \sum_{j \in J} \mathcal{I}_{j,k}^s \cdot w_j f_{j,k}^x}_{\text{Plant-Level FC}} - \underbrace{\sum_{k \in J} \mathcal{I}_k^a \cdot w_k f_k^a}_{\text{Firm-Level FC}}. \end{aligned} \quad (29)$$

We can then prove that:

**Proposition 5.** Consider the problem in (29) and an increase in the assembly potential of plant  $k$ ,  $\hat{\xi}_k^a > \xi_k^a$ , holding other parameters and  $P_i^{\sigma-1} E_i$  fixed. Assume that  $\alpha(\varepsilon - 1) \geq \rho - 1$ . If  $\varepsilon \leq \sigma$ , then  $\hat{\mathcal{I}}^a \geq \mathcal{I}^a$  and  $\hat{\mathcal{I}}^s \geq \mathcal{I}^s$ . If  $\varepsilon > \sigma$  and the solution is unique, then  $\hat{\mathcal{I}}_k^a \geq \mathcal{I}_k^a$ , and it is **not** possible that  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$  and  $\hat{\mathcal{I}}^s > \mathcal{I}^s$ .

*Proof.* For the case  $\varepsilon \leq \sigma$ , we can apply Topkis' theorem. Consider the case  $\varepsilon > \sigma$ . The proof follows the same steps as the proof of Proposition 1. Under  $\varepsilon > \sigma$ , the assumption  $\hat{\mathcal{I}}_{-k}^a > \mathcal{I}_{-k}^a$  and  $\hat{\mathcal{I}}^s > \mathcal{I}^s$  contradicts the optimality (or uniqueness) of the solution.  $\square$