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Intra-firm Trade and Swedish Multinationals

6.1 Introduction

International trade has always been an important aspect of economic development and there has been an increasing emphasis on trade as a mechanism for promoting economic growth. In almost every year since the end of the 1940s, the volume of international trade has grown faster than the volume of world production and, as a result, the degree of interdependence of the world economy has increased markedly. A large share of this rapid growth of international trade has been accomplished under the control of multinational corporations, and a good proportion of the MNCs’ exports and imports consist of intra-firm or intra-corporate trade.

The present study deals with the determinants of intra-firm trade, or more precisely with the identification of the determinants of Swedish foreign affiliates’ imports from their parents. Several observers have pointed out that such trade behaves differently from arm’s-length trade. For example, Lall (1973) emphasizes that trade between related parties sustains transfer pricing which, if manipulated, can result in an unfair distribution of the gains of trade.1 Helleiner (1979), while stressing the importance of transfer pricing, also claims that intra-firm trade is characterized by relatively low short-run price elasticities, which, in turn, lead to inflexible trade flows and reduce the effectiveness of exchange rate policies.

The shortcomings of traditional trade theory in dealing with intra-firm trade have been noted in the literature for a long time, and Lall (1973, p. 128), for example, stated that ‘a strong attack may be mounted on both the positive and normative aspects of trade theory for that part of trade which is intra-firm’.

Although intra-firm trade is important when studying monopolistic trade practices, for example, vast gaps remain in our knowledge of it. As indicated above, we shall attempt to fill some of these gaps regarding affiliates’ imports from their parents. For example, how do the dif-
ifferent characteristics of multinational corporations influence their affiliates’ propensity to import from their parents? Are these kinds of transactions more intense among affiliates in less developed countries (LDCs) than among those in the developed countries (DCs)? This chapter aims to answer these questions.

Earlier empirical investigations of intra-firm trade suffer from a high degree of aggregation. Most studies are based on industry-level data, and are therefore unable to incorporate attributes of the parent companies. In this study we use firm-level data. This allows us to test a wide range of hypotheses regarding the determinants of the affiliates’ internalized imports which have not been tested before, and to shed some more light on the determinants of intra-firm trade. By concentrating on affiliate imports from parents, our study differs somewhat from what is normally dealt with in the literature on intra-firm trade. We can, however, make use of this literature in formulating our hypotheses.

In Section 2 we discuss the determinants of the affiliates’ internalized imports and offer a brief summary of previous studies in this area. Section 3 presents the data and the specification of the model used. Section 4 reports the empirical results, and Section 5 gives a summary and conclusions.

### 6.2 Intra-firm trade and affiliate imports

Firms are expected to react to various factors that promote internalization of their transactions. Earlier work has emphasized the role of market imperfections, which affect the transactions of information and other firm-specific assets, and induce multinationals to replace market transactions with internal operations (Buckley and Casson, 1976; and Casson, 1979). For example, technological know-how developed within a firm is not a free good, but can be used as an asset for the firm. The markets for such intangible assets are usually characterized by imperfections, or may simply not exist. The costs related to the establishment of contracts when markets are incomplete and imperfect will be so high that firms have incentives to avoid market contracts, resorting to internal transactions (Casson, 1979). Not only information in more or less intangible forms (experience, know-how, blueprints, catalogues and so on), but also goods embodying information such as managerial and marketing know-how or specific technological innovations will be internally transacted (Lall, 1978a).