The proximity-concentration tradeoff in the presence of downside risk

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Abstract

This study analyzes the impact of downside risk on the joint pattern of exports and affiliate sales. The risk, in this study, relates to shocks to country and industry-level demand in the destination market. The downside risk is measured by the skewness of demand shocks. Using a panel of industry-level data on trade and affiliate sales for a large number of home and destination countries, I find that volatility and skewness of demand shocks affect the joint pattern of exports and affiliate sales. By focusing on downside risk, I expose several novel results regarding the effects of uncertainty on the proximity-concentration tradeoff. The results show that more exports, relative to affiliate sales, will flow to the destination market with less downside risk. In the second part of the study, I show that past realized volatility and skewness of demand shocks have predictive powers over downside risk in the future periods.

Keywords: Downside Risk, Proximity-Concentration Trade-off, Multinational firms, Foreign Direct Investment, International trade,

JEL Codes: F12, F23, E32, E37, D81

# Declarations of interest: none.

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