Micro, Macro, and Strategic Forces in International Trade Invoicing

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Summary

The use of various currencies in the invoicing of international trade plays a major role in the transmission of economic fluctuations across borders. If exporters set the price of their goods in their own currency, the price paid by the importer in her currency then fluctuates with the exchange rate. If however the price is set in the importer's currency, the exporter bears the exchange rate risk. Finally, if the price is set in a third currency, both the importer and the exporter are exposed to exchange rate risk. This third possibility – referred to as invoicing in a vehicle currency – is particularly relevant given the prominent role of some currencies in international trade, such as the U.S. dollar.

Our paper assesses the determinants of international invoicing both from an empirical and a theoretical perspective. The empirical analysis uses a new highly detailed dataset of Canadian imports, which allows for a finer analysis compared to earlier studies that rely on aggregated data. We find evidence in support of structural factor, macroeconomic factors, and strategic consideration. In industries where there is little differentiation between individual goods of various, producers cannot afford to let their price vary too much relative to their competitors'. We then observe a "coalescing effect" where invoicing is concentrated on one currency. Invoicing is also used to bring income fluctuations in line with costs. Exporters that make a large use of commodities, which tend to be priced in U.S. dollar, show a relatively large propensity to use the U.S. dollar themselves. Macroeconomic volatility also matters, as we find that exporters from a country with volatile macroeconomic conditions make relatively little use of their own currency.

We finally document a linkage between the size of individual transactions and the invoicing, which represents a new feature in the literature. Specifically, large transactions make relatively more use of the importer's currency than smaller ones. This pattern is robust across all industries.

Our paper presents a theoretical model that accounts for the linkage between transaction size and invoicing. In departure to most of the existing literature, we analyze the invoicing decision as resulting from a bargaining between the exporter and the importer. Both exporters and importers have a preference for invoicing in their own currency. In a bargaining setting, the exporter has more too lose by failing to reach an agreement with a large customer than with a smaller one, and is then more inclined to accept invoicing in the importer's currency.

Understanding how importers and exporters interact in setting the invoicing of international trade is a promising area for future research. While the literature has mostly abstracted from bargaining, our results point to this as a serious limitation. This is confirmed by survey evidence that invoicing is set through negotiations between the parties.

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