Choice of Invoicing Currency in International Trade: Evidence from Turkish Firms

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Abstract

The purpose of this paper is to examines the choice of invoicing currency of Turkish exports and imports in 2013. The role of the various type of driving forces resulting from macro level considerations, micro and industry features and transaction level considerations of the choice of invoicing currency is investigated through a multinomial logit analysis. We present stylized facts, mapping practices in invoicing and analyzing the main determinants of invoicing currency choice in international trade.

JEL Classification: F1, F3, F4, E31

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Extended Abstract

The currency in which exporters set the price of their goods - the so-called “invoicing” currency - is a central feature of international economics. Exporter’s price setting and choice of invoicing currency have important role on inflation, the international transmission of shocks and the optimal monetary policy design. Specifically, the choice of invoicing currency determines who among the exporter or the customer and to what extent gets exposed to exchange rate risk. This paper develops the theoretical model of the international linkages from imported inputs to the optimal export currency pricing of firms. Understanding firms’ choice of invoicing currency is one of the essential component to explain exchange rate pass-through effects. Assuming that the currency of invoicing serves as a good proxy for the currency in which prices preset with endogenous pass-through, this is the principal motivation for the theoretical approach of the model in this paper.

Exporters can choose from among the home currency, the foreign currency and a vehicle currency for the invoice currency. If exporters prefer to invoice in their own currency (producer currency pricing-PCP), then exchange rate pass through to consumes prices will be complete. However, there is zero pass-through to consumer if the exporters prefer to invoice in local currency pricing (LCP). The US Dollar is historically dominant international currency in world trade. The dominance of US Dollar invoicing in trade flows offers an additional mechanism which US monetary conditions are transmitted internationally.

The reduction in the trade barrier leads to increase in exports associated with an even bigger rise in imports. When the production function with three factors (labour, capital and intermediate goods) is estimated for industries, the biggest share of the total cost of production is spent for intermediate goods. Recent finding shows that the share of intermediate goods in total production costs is between 60% and 70% for almost all manufacturing sectors. The choice of invoicing currency might be sensitive to the import content of the production. Therefore, this study examines whether exporters’ dependence on imported inputs have an effects on their decision of invoicing currency.

There are three possible ways for a producer to state the price of the traded product: prefer to follow producer currency pricing (PCP) or local currency pricing (LCP) or vehicle currency pricing (VCP). This study examines the choice of invoicing currency of Turkish exports and imports during 2013 using unique and highly disaggregated data on the Turkish firms. The role of the various driving forces of the choice of invoicing currency is investigated through a multinomial logit analysis, with the dependent variables being dummy variables which show whether a transaction is invoiced in the producer’s currency (PCP), the customer’s currency (LCP), or a third vehicle currency, mainly US Dollar or Euro, (VCP).