The Strategic Use of Tariff Phaseouts in US Free Trade Agreement

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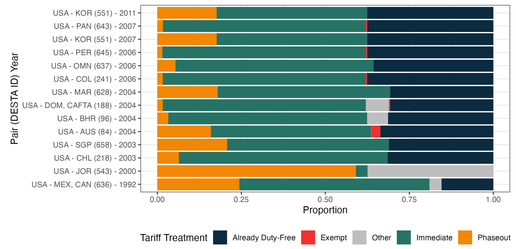
Paper Link

Abstract

Motivation: Rules regarding the duration of tariff elimination are common in modern free trade agreements (FTAs) and are assigned differentially and selectively to sensitive products, as their extensive use incurs opportunity costs for more exporters. *How does the executive determine which products are politically sensitive?*
Argument: Beyond mitigating import competition, I argue that the sources of political sensitivities stem from the executive's interests in either insulating themselves electorally or facilitating FTA ratification.
Empirical Results: I test my argument using a novel dataset on tariff treatment at the tariff line level across all 13 FTAs ratified by the United States. I find that, on average, longer tariff durations are allocated to products in industries concentrated in more electorally competitive states, especially for highly import-sensitive products. While the political motivations differ by agreement, the executive cannot address both concerns simultaneously. These findings demonstrate that the executive's particularistic preferences partly shape the structure of FTA tariff schedules.

Tariff Phaseouts



Model of Trade Negotiation

Premises:

1. Sequential bargaining, product by product
2. Negotiators go down the list of products to protect
3. Prioritization
4. Reciprocity

Implications:

⇒ Exclusion begets exclusion
⇒ Reciprocity necessitates tariff phaseout to reach mutual free-trade commitment
⇒ Reciprocity moderates tariff phaseouts to balance import-competing and exporting interests
⇒ Require a *targeting strategy*

How does the executive determine which products are politically sensitive?

Sources of Political Sensitivities

Electoral Insulation: Products made by industries concentrating in electorally competitive states are phased out longer.

- Executive's desire to *maintain or improve margins* in electorally competitive states (high vote-electoral college vote elasticity in majoritarian system)
- Political sensitivity arise from historical concentration in swing state ⇒ *policy path dependency*

Ratification Promotion: Products made by industries concentrating in median legislators' districts are phased out longer.

- Strategically target phaseout duration to flip votes
- Median legislator(s) are more credible with their ratification threats and promises
- Staunchly pro and anti-trade legislators' preferences are shaped by the underlying interests of their districts

Trade Committee: Products made by industries concentrating in districts of legislators in trade-related committees are phased out longer.

- Although Trade Promotion Authority (TPA) or Fast Track Authority allows for the automatic discharge of FTA implementation bills from committees...
- It is critical that negotiators gain the approval of members from the House Ways and Means and Senate Finance committees.

Empirical Strategy

$$P_{pj}^{HS8d} = \gamma_j + \delta_k^{HTSSector} + \beta_1 X_{kt}^{NAICS6d} + \beta_2 X_{kt}^{NAICS6d} + \beta_3 X_{pt}^{HS6d} + \varepsilon_{pt} \quad (1)$$

- P_{pj}^{HS8d}: Phaseout Duration (8-digits HTS)
- γ_j: FTA fixed effects
- $\delta_k^{HTSSector}$: HTS Sector fixed effects
- $\beta_1 X_{kt}^{NAICS6d}$: Main variables
- $\beta_2 X_{kt}^{NAICS6d}$: Industry-level controls
- $\beta_3 X_{pt}^{HS6d}$: Product-level controls

Results are robust with:

1. FTA-sector fixed effects
2. Inclusion of rust and sun belt states
3. Poisson regression
4. Alternative measures of median legislator using DW-NOMINATE
5. Alternative measures of competitive margins
6. Binary measure of phaseout usage
7. Omitting US-Jordan FTA

Measurement

1. Industry Concentration in Electorally Competitive States

$$CompetitiveMargins_{kt} = \sum_{s=1}^{S} \left(\frac{E_{sk\tau}}{E_{k\tau}} \times \psi_{st} \right) \quad (2)$$

$$\psi_{st} = 0.50 - (|V_{st} - 0.50|) \quad (3)$$

V_{st} = the average two-party vote share over three previous elections.

2. Industry Concentration in Median Legislators' Districts

$$MedianTPA_{kt} = \sum_{d=1}^{D} \left(\frac{E_{dk\tau}}{E_{k\tau}} \times \gamma_{dt} \right) \quad (4)$$

γ_{dt} = binary indicator if the district is represented by a legislator whose average TPA-approval rate is within the middle one-third among legislators in the Congressional term. $\gamma_{dt} = 1$ also if the legislator has not voted on any TPA extension bills.

3. Industry Concentration in Districts of Legislators in Trade-Related Committees

$$Committee_{kt} = \sum_{d=1}^{D} \left(\frac{E_{dk\tau}}{E_{k\tau}} \times \theta_{dt} \right) \quad (5)$$

θ_{dt} = binary indicator if the district is represented by a legislator in either House Ways and Means or Senate Finance Committee.

4. Import Threat

$$ImportThreat_{jpt}^{HS6d} = \log(Export_{jip\tau,i\neq USA}^{HS4d} \times (1 - (1 + BaseRate_{ipt}^{HS6d})^{-\sigma_{ip}^{HS2d}})) \quad (6)$$

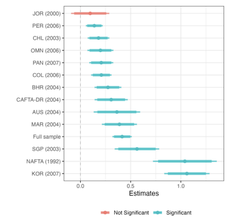
$Export_{jip\tau,i\neq USA}^{HS4d}$ = partner's j export of product p to rest of the world aside from the US $i \neq USA$

$1 - (1 + BaseRate_{ipt}^{HS6d})^{-\sigma_{ip}^{HS2d}})$ = change in demand level once tariff is eliminated.

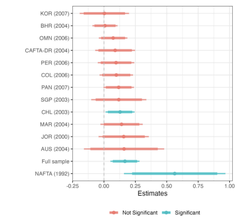
Controls

Union PAC (HoR), Union PAC (Senate), Base Rate, Industry Size, Capital Mobility, Intermediate Product, Agricultural Product, Capital Product, Consumer Product, Upstream Product, Differentiated Product, Intra-industry Trade, Union Membership Rate (district and state).

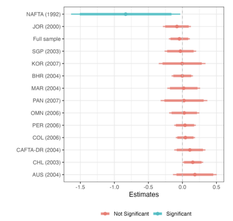
Main Results (and by FTA)



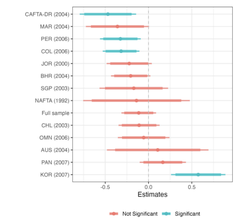
(a) Import Threat



(b) Competitive Margins



(c) Median TPA (HoR)



(d) Median TPA (Senator)

Marginal Effects