Section 301 and Politics: Analysis of Tariff Exemptions

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Abstract

Section 301 tariffs were imposed as a consequence of China's discriminatory business practices against American firms. However, domestic American firms who rely on Chinese imports are now faced with paying for these tariffs. In response, the Trump administration allowed the affected firms to apply for a tariff exemptions. Approximately 7% of these applications were approved. In this paper, we investigate the factors affecting the approval rates for these tariff exemptions. We find that an increase in county Republican vote share by 10 percentage points results in a 23% increase in probability of tariff exemption approval.

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1 Introduction

The Trump administration began imposing a series of Section 301 tariffs on China in 2017. Consequentially, US firms are experiencing the burden of these tariffs, on top of facing retaliation from the Chinese. To alleviate this tax burden, the Trump administration allowed American firms to appeal for a tariff exemption. The approval rate across the first three rounds of tariff exemptions are at 7.3%.

Since the Office of the United State Trade Representative (USTR) has authority over the appeals for tariff exemption and the USTR representative is appointed by the US President, there is reason to believe that partisan politics may matter. Our paper investigates the political party influence on approval decisions for tariff exemptions. We examine how the political party representation of a country can affect the approval rates for tariff exemption. Using the share of votes for Trump (the Republican candidate) in each county for the 2016 presidential election, we examine the approval outcomes to exempt certain Chinese imports from the Section 301 tariffs. We find that a 10-percentage point increase in county Republican vote share results in a 23% increase in the probability of tariff exemption approval.

The Trump administration has pursued a protectionist trade policy in order to increase employment in the manufacturing industry. In line with this platform, Trump has increased trade protection against China because manufacturing companies took advantage of its cheap labor and became a prominent exporter of manufacturing goods. As a result of Chinese import competition and firm relocation to China, the US manufacturing industry suffered significant job losses. Autor et al. (2013) analyzed the effect of rising Chinese import competition between 1990 and 2007 on US local labor markets. They find that these labor markets experienced increased unemployment, decreased labor force participation, and lower wages.

Targeting China, the Trump administration started an investigation regarding China's discriminatory business practices against US firms in 2017, imposing Section 301 tariffs as a result. However, US firms who rely on Chinese imports are then burdened by these tariffs. Recent literature estimates significant losses for US firms and consumers as a result of these tariffs on Chinese imports. For example, Amiti et al. (2019) claims that tariffs on Chinese imports are costing US consumers and firms an additional $3.2 billion per month in added tax costs, while Fajgelbaum et al. (2020) estimates that, accounting for tariff revenue and domestic producer gains, these tariffs resulted in an aggregate real income loss of $7.2 billion or 0.04% of US GDP in 2018. Carvalho et al. (2019) conducts a welfare analysis and finds that the tariff increases (during the $50 billion round) resulted in a welfare decrease from $19.3 to $23.6 billion for the US.

To alleviate this burden on US firms, the Trump administration has allowed US firms to appeal for tariff exemptions. These appeals are decided by the USTR. Since the USTR is appointed by the US President, we examine the potential political bias for increased approval rates in counties with higher Republican vote share.

Previous research has shown evidence on using bureaucratic connections through elected officials for favorable enforcement outcomes. Young et al. (2001) finds that there is a considerably lower fraction of audited tax return in IRS districts that house key representatives

on congressional committees. Correia (2014) claims that politically connected firms are less likely to be investigated by the SEC, and if they are prosecuted, these politically connected firms face lower penalties. Gulen and Myers (2017) documents significantly lower rates of violation of the Clean Water Act in battleground (swing) states. Heitz et al. (2019) finds evidence that firms that are more politically connected (defined as having donated to victors in elections) realize less regulatory enforcement and fines from the EPA Clean Air Act.

Our paper adds to this literature on favorable policy outcomes by showing the existence of a relationship between the 2016 voting patterns and the probability of a tariff exemption approval. We also contribute to the literature that evaluates the heterogenous regional impacts of the Section 301 tariffs in the United States. Fajgelbaum et al. (2020) finds that it was the politically mixed counties that received the most protection during the trade war. Robinson et al. (2019) provides evidence that the US-China trade was harmful not only to the involved countries but also created trade diversion in other markets. Amiti et al. (2019) finds that the impact of tariff spikes has been almost completely passed through to the prices on the imported goods that were affected by this conflict. However, it does not find any changes to the terms-of-trade. Similar results are found by Flaaen and Pierce (2019) for the manufacturing sector.

One may think of Section 301 tariffs as an example of rent-seeking behavior from the government. Krueger (1974) is one of the earliest papers to document the link between rent-seeking and quantitative restrictions to trade. However, the motivation for Section 301 is not purely rent-seeking. After the tariff has been imposed, tariff exemptions were implemented as a form of "trading in political markets." In other words, tariff exemptions could act as an exchange for past or future political support. Although, this does not imply that politics are irrelevant. That is, given that the administration wanted to impose a tariff on Chinese products, the political forces determine the details of the implementation.

However, for Section 301, a tariff is imposed, and then an exception is "traded in political markets" (in other words, an exception in exchange for past or future political support). Thus, the motivation for the policy is not purely rent-seeking. But this does not imply that politics is irrelevant. That is, given that the administration wanted to impose a tariff on Chinese products, the political forces determine the details of the implementation.

While some papers have evaluated the effect of the Section 301 tariffs either on trade flows or capital flows (Amiti et al. (2020)), to our knowledge we are the first paper to investigate this exemption process or any part of the procedure leading to the finalization of the tariff list.

The paper proceeds as follows. We describe the institutional background of the Section 301 and the exemption process. We further describe the data that we use in our analysis and introduce our empirical strategy.

2 Institutional Background

A USTR investigation in 2017 found China's trade practices unfair and harmful to the United States.[1]

1. China uses foreign ownership restrictions, such as joint venture requirements and foreign equity limitations, and various administrative review and licensing processes, to require or pressure technology transfer from U.S. companies.

2. China's regime of technology regulations forces U.S. companies seeking to license technologies to Chinese entities to do so on non-market based terms that favor Chinese recipients.

3. China directs and unfairly facilitates the systematic investment in, and acquisition of, U.S. companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property and generate the transfer of technology to Chinese companies.

4. China conducts and supports unauthorized intrusions into, and theft from, the computer networks of U.S. companies to access their sensitive commercial information and trade secrets.

The US thus implemented tariffs on $34 billion worth of Chinese exports in hope of pressuring China to change these practices. An escalation of tariffs both on the US and Chinese sides followed. US subsequently implemented an additional 3 rounds of tariffs on $16, $200, and $300 billion worth of goods.

After the imposition of round one of these tariffs, the USTR began a process to allow individuals or firms to file for specific products to be exempted from these tariffs for a certain time, in most cases a year. After a review period the USTR began to release exemptions on certain products varying in specificity, but usually defined at a level more descriptive than HS10. Some examples of these exclusions are:

> (9) Inflatable boats, other than kayaks and canoes, with over 20 gauge polyvinyl chloride (PVC), each valued at $500 or less and weighing not over 52 kg (described in statistical reporting number 8903.10.0060)[2]

> (33) Tuners designed to clip onto musical instruments and indicate whether the instrument is in tune (described in statistical reporting number 9031.80.8085)[3]

> (74) Battery-powered timers, with clock or watch movements, with opto-electronic display only, incorporating a 360-degree rotating timer control, a start/stop control, a reset control, and an audible alarm, with a maximum time count of 9

[1] See Federal Register Vol. 83, No. 67, pg 14907 for details.
[2] Federal Register August 7, 2019 pg 38718
[3] Federal Register March 25, 2019 pg 11157

hours, 59 minutes, and 59 seconds (described in statistical reporting number 9106.90.5510) [4]

This procedure was set in place after the second wave of tariffs was proposed. The USTR processes requests on a case by case basis, however the process leaves much to discretion. Some of the things that they look into are availability of the product from a non-Chinese source, previous attempts to source the product from another source, economic harm the tariff imposes on the specific importer, and how important the tariff is to China's industrial programs.

Fajgelbaum et al. (2020) found that districts in which the recent Presidential election was closer, "swing districts" enjoyed more protection than districts that voted either heavily Republican or Democrat. Given the lack of reasoning for decisions and the findings in Fajgelbaum et al. (2020) we find it worthwhile to investigate the potential link between approval probabilities and share of party specific votes in the county.

3 Data

The main data we utilize on tariff exemption requests and approvals is assembled by the open source group QuantGov, organized by the Mercatus Center at George Mason University. This data includes HS codes at the 10-digit level, BEC codes, company name, and the stage of the exemption process: granted, denied, or pending.

We used Orbis to gain information on firm location and other corresponding firm data. The matching procedure rates the potential matches[5] and allows the user to review variables specific to each firm including firm location.

Using the city and state names from the Orbis data, we implement a two-step procedure to map the firm locations into a county level Republican vote share for the 2016 presidential election. First, we used the United States Cities Database (from simplemaps.com) to map each firm's city and state locations to their corresponding counties. Next, we match the counties in our data set with the their corresponding 20120 and 2016 Presidential Election Returns (from the MIT Election Lab). We also include the unemployment rates and percentage of people with GED in our data in order to control for the socioeconomic status of each county. We believe that each company's policy is determined by the headquarters, which, in turn, file the exemption requests. Since there is substantial variation in voting patterns even within the state, we assume that county-level observations would capture this variation.

In order to provide analysis regarding import dependence from China, we calculated the share of Chinese imports in US total imports using Comtrade data. Accounting for this variable controls for any dependence on Chinese imports. Although, a drawback of using this data source is that the HS codes are aggregated to the 6-digit level, which limits our

[4] Federal Register Oct 28, 2019 pg 57807

[5] We take Orbis' best match on the firm name.

analysis. At the time of writing, we are unable to find access to a source that would provide a dis-aggregated data set.

In examining the data, we investigate the relationship between approval rates and the level of Republican vote share in each county. Approval rates are calculated by taking the proportion of products that were approved with tariff exemptions from the all of the petitions for tariff exemption in each county.

Pooling all of the waves together, we find that there is a positive relationship between the approval rates and share of Republican votes in each county as seen in Figure 1 in the appendix. We have also extended this analysis by accounting for the set of tariffs in each wave, and we find that this positive relationship is maintained. More notably, we find that there is a stronger correlation in Wave 3 as shown in Figure 2 in the appendix. Lastly, we examined the relationship between the approval rates and counties in swing states following Amiti et al. (2019) and Fajgelbaum et al. (2020).

4 Empirical Analysis

Our primary variable of interest is the share of voters in a county c, where firm f is located, who voted Republican during 2016 Presidential elections. We control for several other possible factors that can affect a firm's probability of receiving an approval for a tariff exemption on an imported product: 1) the number of firms petitioning for the same product; 2) the number of firms applying from the same county; 3) the dependence on Chinese imports; 4) firm's operating revenue turnover; and 5) county-level unemployment rate.

We consider the possible lobbying effect by including the number of firms that filed for the same product p on the HTS10 level or the number of firms that filed a petition from the same county c. More firms submitting petitions for the same product p or from the same county could result in an increase in the likelihood for that product to receive a tariff exemption. We cannot deny the possibility that larger firms may get some preferential treatment. To account for this channel, we use operating revenue turnover and number of employees as proxies for the size of a firm.

We also consider that the US might be highly dependent on certain imports which could increases the chances of getting a tariff exemption. We control for this possibility by including the average share of Chinese goods in US imports (from 2010 to 2017) since the approval could be based on the industry's dependence on intermediate goods from China.

Lastly, we account for the timing (wave) effects, SIC-industry variation effects, imported product differences, and state-specific factors by including τ_w, μ_n, η_p, and ν_s fixed effects, respectively. We control for economic conditions in the region c by adding county's unemployment rate in 2017.

In order to test the relationship between approval rates and share of Republican votes, we estimate a simple probability model:

(1)

$$1\{Approval_{ifpc}\} = \beta_0 + \beta_1 \text{Republican\_share}_c + \beta_2 log(\#\_firms) + \beta_3 log(firm\_size)_f \\ \beta_4 log(China\_Import\_share)_p + \beta_5 unemployment_c + \tau_w + \nu_s + \mu_n + \eta_p + \epsilon_{ifpc}$$

where the dependent variable is a binary indicator whether a petition i is approved by a firm f based in the county c for an HTS10 product p.

Table 1: Baseline results, dependent variable - approval decision (binary)

VARIABLES	(1) Approved	(2) Approved	(3) Approved	(4) Approved	(5) Approved
Republican share	0.0932*	0.0967**	0.181**	0.171**	0.169**
	(0.0525)	(0.0492)	(0.0744)	(0.0717)	(0.0719)
Unemployment rate			1.044*	1.139*	1.121*
			(0.626)	(0.647)	(0.646)
log(# firms in county c)			0.0121	0.0129	0.0129
			(0.0115)	(0.0118)	(0.0119)
log(# firms at HS6)			0.00262	0.00325	0.00107
			(0.00266)	(0.00276)	(0.00326)
log(# of employees)			-0.000633		
			(0.00301)		
log(Operating Revenue Turnover)				-0.000782	-0.000935
				(0.00248)	(0.00242)
log(Share of Imports from China)					0.0101
					(0.00790)
Constant	0.224***	0.222***	0.135	0.134	0.121
	(0.0658)	(0.0637)	(0.0876)	(0.0847)	(0.0839)
Observations	30,886	30,886	28,050	28,254	28,253
Number of SIC	261	261	249	249	249

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

We find that the likelihood of getting an approved tariff exemption positively depends on the share of Republican voters in the country. Table 1 reflects the results of our analysis. Specification (1) only has one explanatory variable, the Republican share, and it shows that the probability of approval is positively dependent on the support of the Republican party in the firm's home county.

We cannot rule out that our regressor, conditional on our controls, is not endogenous. This could potentially arise from either omitted variables being correlated with the 2016 vote share

or districts anticipation of future favors (tariff exemptions in our case) from the future Trump administration. To control for the possibility, we instrument the 2016 Republican vote share with the 2012 Republican vote share. The argument for the validity of our instrument rests upon a couple well known facts. One, that county's voting patterns are highly persistent over time. This means that 2012 voting share would be a good instrument for 2016 share, given high correlation between two variables. And two, President Donald Trump did not run in 2012, nor did a Republican win the 2012 election. This addresses possible biases, caused by the specifics of the Republican campaign prior to 2016 elections.

Specifications (2) through (5) show the results of our IV approach. We find that the magnitude of the coefficient remains the same while the significance of results improves. After adding other control variables (number of firms petitioning for the same HTS10 product, number of firms petitioning in the same county, firm size, and share of imports coming from China), our variable of interest (Republican share) remains positive and statistically significant, but the magnitude of its coefficient increases.

Across the five specifications, we find evidence that the likelihood of a firm receiving an approved tariff exemption is positively affected by the share of Republican voters in a county. We observe that a firm's probability of receiving approval increases by 1.7 percentage points when the share of Republican voters increase by 10 percentage points. Particularly, taking into account that the approval rate across the first three rounds of tariff exemptions stands at 7%, we find that a 10-percentage point increase in Republican share of votes results in a 23% increase in the probability of receiving an approval.

To further identify the effect of political party representation on tax exemption approval, we run our specification with only considering the products under the industry of boilers and machinery (HS2 code: 84). By isolating this industry, we are eliminating any possibilities of biased approval towards a particular industry. Also, all of the states have submitted product appeals that are part of this industry where 39 states have the largest share of product appeals in this industry.

Table 2 shows the results of running our specification but only focusing on appeals with products under the Boilers and Machinery industry. We find that the results remain consistent with our baseline findings. In additional robustness checks we account for county-level economic differences. We include the percentage of citizens with GED diplomas to proxy for skill-level as well as to control for the differences between rural and urban counties. The results were not significantly different from our main specification and are available upon request.

5 Discussion and Conclusion

The Trump administration has imposed Section 301 tariffs against Chinese imports, which harmed American firms. To alleviate the tariff burden on the affected firms, the Trump administration has allowed the firms to file an appeal for a tariff exemption through the USTR. However, the USTR president is appointed by the US President, which can result in

Table 2: Focusing on industry HS2 - Boilers and Machinery

VARIABLES	(1) Approved	(2) Approved	(3) Approved	(4) Approved	(5) Approved
Republican share	0.188	0.390**	0.185	0.454**	0.425**
	(0.158)	(0.180)	(0.156)	(0.221)	(0.210)
Unemployment rate	-1.528	-0.503	-1.298	-0.661	-0.344
	(2.167)	(2.190)	(2.126)	(1.744)	(1.727)
log(# firms in county c)		0.0456**		0.0529**	0.0524**
		(0.0223)		(0.0248)	(0.0243)
log(# firms at HS6)			0.0364***	0.0349***	0.0373***
			(0.0118)	(0.0133)	(0.0136)
log(# of employees)				-0.00528	
				(0.00627)	
log(Operating Revenue Turnover)					-0.00549
					(0.00600)
Constant	0.385*	0.169	0.281	0.0131	0.0316
	(0.200)	(0.217)	(0.201)	(0.230)	(0.221)
Observations	5,246	5,246	5,246	4,431	4,522
Number of SIC	156	156	156	144	145

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

favoring appeals for firms that are located in Republican-dominant counties. Our paper shows evidence that Republican representation positively affects the likelihood of receiving tariff exemption approval. Our research contributes to the literature that has shown evidence on using bureaucratic connection through elected officials for favorable enforcement outcomes.[6]

In this paper, we investigate the existence of possible bias in tariff exemption approvals under Section 301. We utilize the data on tariff exemption requests and approvals from QuantGov, and we cross-referenced each firm to the Orbis data set in order to gather information on firm location. Based on the 2016 Presidential Election Returns, we are able to approximate the political representation of each county. Particularly, we look at the share of voters who voted for the Republican in the 2016 Presidential Elections.

We examine the effect of Republican vote share to the probability of tariff exemption approval by implementing a probability model. We controlled for potential unobserved variations across products, industries, and states by accounting for multiple fixed effect. We find that a 10 percentage point increase in Republican vote share results in a 23% increase in probability of receiving an approved tariff exemption. Our results are robust when controlling for the number of firms and petitions in a county.

[6]See Young et al. (2001), Correia (2014),Gulen and Myers (2017)

This research will benefit from further empirical investigation that would consider other firm-specific factors, such as firm financial indicators. The specificity and level of detail in each petition could also influence the approval rates and should be addressed in future studies.

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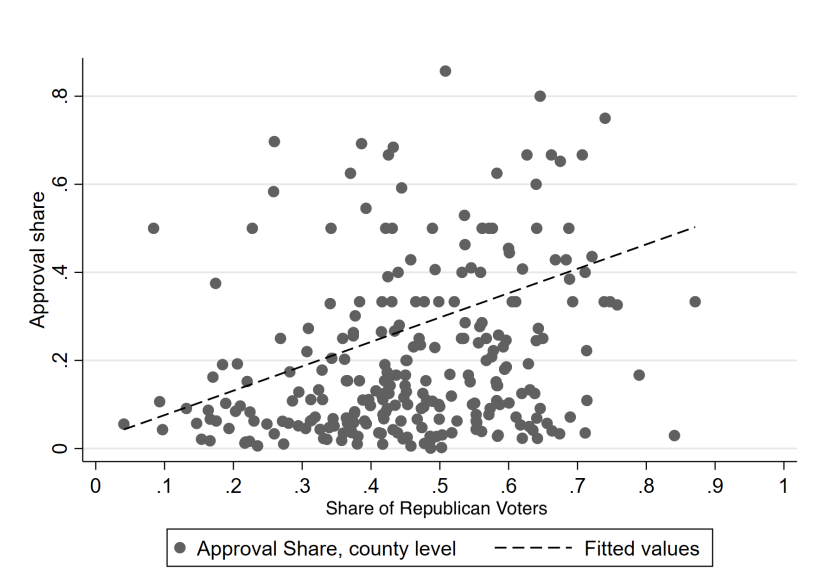
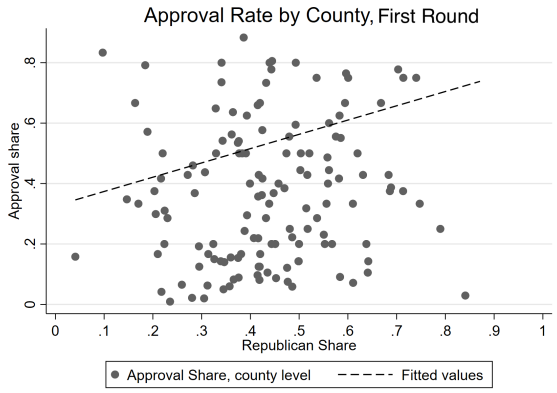
Appendix A Main Results

Figure 1





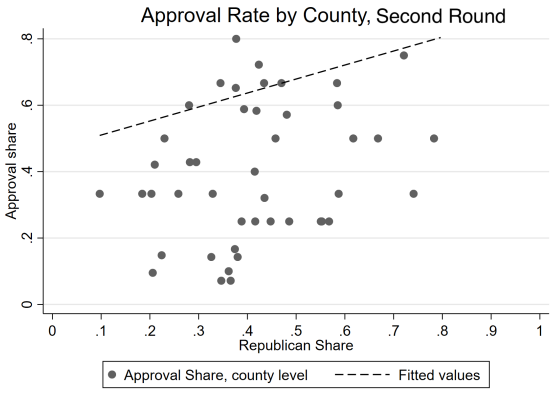


Figure 2