

Political Cleavages over Supply Chains: Rules of Origin and Preferential Liberalization

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- Two trends in international trade in recent decades
 - Proliferation of preferential trade agreements (PTAs)
 - Globalization of supply chains

- Existing literature ignores inherent tension between these trends
 - PTAs must distinguish between member and non-member goods
 - Global supply chains make it difficult to identify a good's origin

- PTAs use rules of origin (RoO) to determine the origin of a good
 - Define the requirements for goods to obtain preferential treatment
 - Condition preferential access on satisfying certain sourcing constraints



- Automotive RoO were a key issue in NAFTA negotiations
 - *“The success of NAFTA would be judged by what each country got in autos. And in autos, we knew it would be judged by the rule itself and the regional value content, the number”* (NAFTA Negotiator)
- Political divisions emerge within industries between global firms
 - General Motors, Ford, and Chrysler supported high content requirement
 - Toyota, Honda, and others lobbied for more permissive rule
- Similar divisions emerge during USMCA negotiations



- Sourcing restrictions imposed by RoO raise input prices (Grossman, 1981)
 - Why do vehicle manufacturers support policies that raise costs?

- Global firms should support liberalization (Kim and Osgood, 2019)
 - Why do firms with global connections support sourcing restrictions?

- Trade should pit global firms against domestic firms (Gulotty, 2020)
 - Why do core political cleavages over RoO emerge between global firms?



- Develop a supply network theory for the politics of RoO
 - Location of firm networks
 - Input customization

- Input customization & heterogeneity in firm networks cause restrictive RoO to impose asymmetric costs on global firms
 - Differences in adjustment costs shift market share toward low-cost firms
 - Induces support for restrictive RoO

- Some global firms support restrictive RoO because they provide a competitive advantage in the PTA market by imposing larger adjustment costs on rival firms



- Customization raises the cost to establish/alter supply chains
 - Search frictions & relationship-specific investments
- Increases the costs imposed by restrictive RoO when supply chains extend beyond the PTA market
- Minimizes incentives for upstream protection
- **Prediction 1:** a firm with a greater amount of production linkages outside the PTA market should be more likely to favor permissive RoO, especially when inputs are customized.



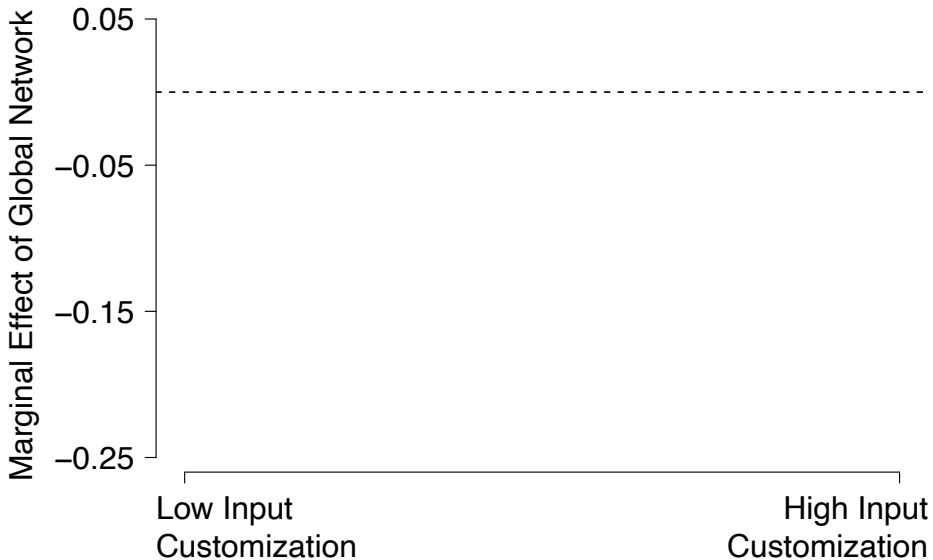
- Input customization also activates heterogeneity in firm networks
 - Creates intraindustry differences in global sourcing strategies
- Restrictive RoO impose asymmetric costs on global firms when inputs are customized and global sourcing strategies differ
 - Shifts market share toward low-cost firms
 - Induces support for restrictive RoO
- **Prediction 2:** a firm with a comparative sourcing advantage within the PTA market, relative to competitors, should be more likely to support restrictive RoO, especially when inputs are customized



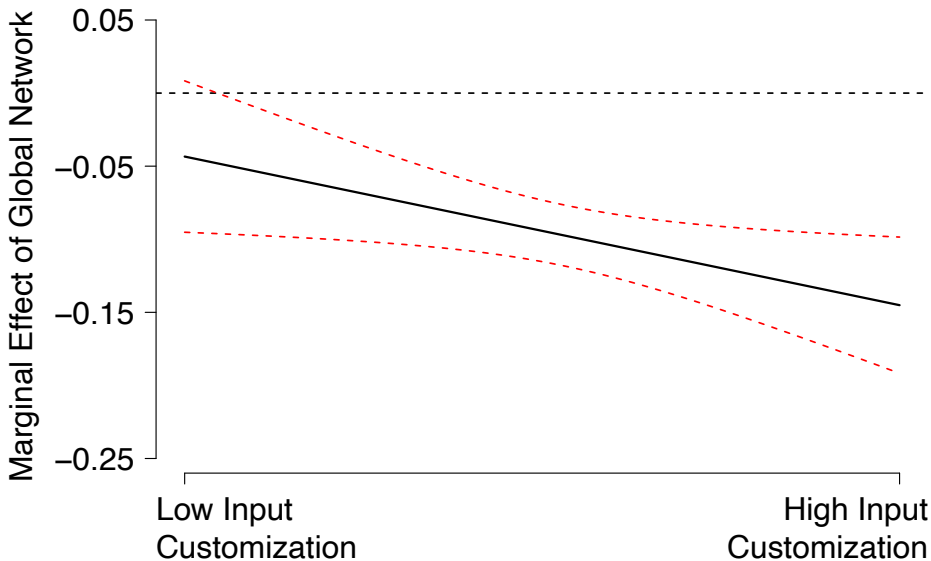
- Construct dataset on firm position-taking over RoO in 11 US PTAs
 - $\approx 1,000$ instances where firms publicly state position
- Match with firm-level characteristics using Orbis
 - Create sample of non-position-taking firms
- Unit of Analysis: firm-agreement
- DV: Permissive RoO = -1; No position = 0; Restrictive RoO = 1
- $N \approx 3,000,000$ observations



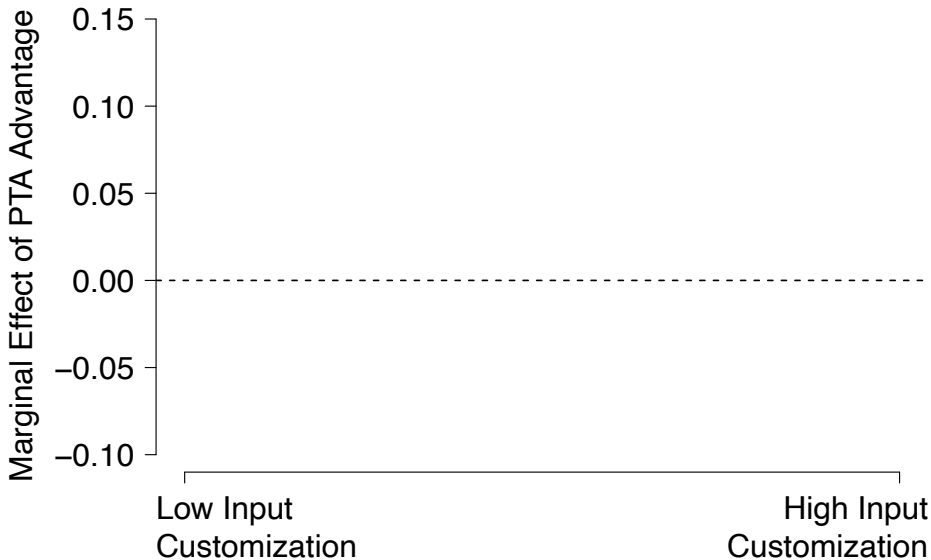
- Input customization: Nunn (2007)
 - Uses Rauch (1999) product classification and input-output tables
 - Ranges from 0 to 1
 - Measured at 6-digit NAICS level
- Global Network: # of subsidiaries located outside PTA market
- PTA Advantage: # of subsidiaries inside PTA market - median of large firms in same industry
 - Captures relative competitiveness compared to top rivals
- Controls: vertical integration, firm size, MFN tariffs, capital intensity, upstreamness, industry (NAICS 3-digit) and agreement fixed effects
- Weighted least squares regressions (Osgood, 2021)



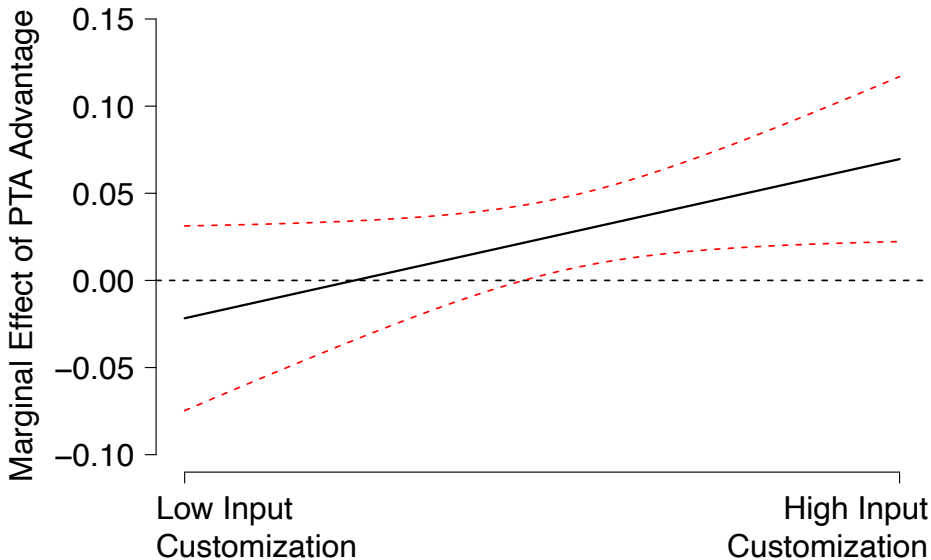
Results: Global Networks & Input Customization



Results: PTA Advantage & Input Customization



Results: PTA Advantage & Input Customization





- RoO are critical to understanding the political economy of modern trade policy!
- Global firms strategically use restrictive RoO and exploit differences in supply chains to gain a competitive advantage in the PTA market
- Political cleavages emerge over the structure of supply chains between global firms

Thank you!

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