Do Major Government Customers Help U.S. Firms Escape Foreign Competition?
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Abstract
This paper studies whether government-dependent firms are more resilient to foreign competition. Using the United States granting Permanent Normal Trade Relations to China as an exogenous shock, we show that government contractors have better operating performance than their peers when their industries are more exposed to the import shock. The results are robust to the inclusion of a broad set of controls, instrumental variable analysis, matching analysis, and alternative proxies of government dependence and import competition. The beneficial effect is found to be stronger among firms with greater financial constraints or less corporate diversification. Further analysis shows that government procurements allow firms to maintain a higher level of investment and investment efficiency and enjoy a lower demand uncertainty when import competition intensifies. Overall, this study provides further evidence of the effect of government participation in product market.

Permanent Normal Trade Relations (PNTR)
U.S. imports from China were subject to relatively high tariff rates imposed by the Smoot-Hawley Tariff Act of 1930, known as the “Normal Trade Relations (non-NTR) tariff rates”. Starting in 1980, the U.S. president granted a waiver to China on an annually renewable basis and allowed imports from China to enjoy the relatively low “Normal Trade Relations” (NTR) tariff rates that the United States offered World Trade Organization (WTO) members. However, the annual waiver was subject to Congress approval and was politically contentious. This created high uncertainty about China’s NTR status and deterred U.S. firms from sourcing goods from China (Pierce and Schott, 2016). In October 2000, PNTR was passed by U.S. Congress and went into effect in December 2001 upon China’s accession to the WTO. The passage of PNTR effectively eliminated the uncertainty associated with China’s NTR status, leading to a substantial reduction in expected U.S. import tariffs on Chinese goods. The impact of PNTR also varies across industries. Pierce and Schott (2016) show that industries more exposed to the policy change experienced a greater increase in Chinese imports after the passage of PNTR than do other industries.

Government as a Major Customer
Governments are important customers of public and private firms around the world. Many public U.S. firms report government departments and agencies as their significant customers in their regulatory filings. Our data show that government procurements are more than 35% of their total revenues generated from the government. Prior studies show that, relative to private investment, U.S. government purchases are very stable over time, with a low correlation between GDP and total government procurement expenditures (Bachmann and Bai, 2013; Goldman, 2020). Since government customers often offer long-term procurement contracts, government purchases are likely to be stable at the firm level. As a result, having a major government customer can provide suppliers firms with distinct benefits. In particular, government contractors would face lower default risk and lower risk of being replaced by their government customers (Dhaliwal et al., 2016; Cohen and Li, 2020).

Contributions
First, our paper adds to the international business literature on the impact of import competition on firms. Very few studies explore factors that can help firms in developed countries better cope with intensified foreign competition. Second, this paper contributes to the emerging line of studies that investigates the impact of government spending on firm behavior. Though macroeconomic studies have examined how government purchases affect the overall economy, the role of government entities as major customers to private sector firms is understudied. Third, our paper adds to the literature that investigates how a firm’s customer affects corporate outcomes. We focus on firms with government purchase. Finally, our paper also contributes to the literature that examines how different trade policies affect corporate performance. This study sheds some additional light on the real consequences of PNTR and the resulting increased Chinese imports on U.S. firms.

4. Mechanism: Demand Uncertainty and Investment Efficiency

Main References