

# Selling Indulgences: The Political Economy Of Tariff Exemption Grants



**Veljko Fotak**

University at Buffalo

**Hye Seung (Grace) Lee**

Fordham University



**FORDHAM UNIVERSITY**  
THE JESUIT UNIVERSITY OF NEW YORK



**Bill Megginson**

University of Oklahoma

**Visiting Professor, UIBE (Beijing)**

**Jesus Salas**

Lehigh University



# The Main Questions We Address

- **Do Political Connections (PC) Distort The Allocation Of Trade Tariff Exemptions?**
  - We document PC are highly influential in exemption grants
- **Do Politicians Reward Supporters With Exemptions?**
  - We show that companies that contributed to Republican Party were much more likely to receive exemptions
- **Do Politicians Punish Supporters Of The Opposition By Withholding Exemptions?**
  - We show that companies that contributed to Democratic Party were much less likely to receive exemptions
- **Are Tariff Exemptions Financially Valuable?**
  - Each exemption grant increases firm mkt cap by \$55 Mn

# Trump Administration Imposed Tariffs On Chinese Imports Beginning In 2018

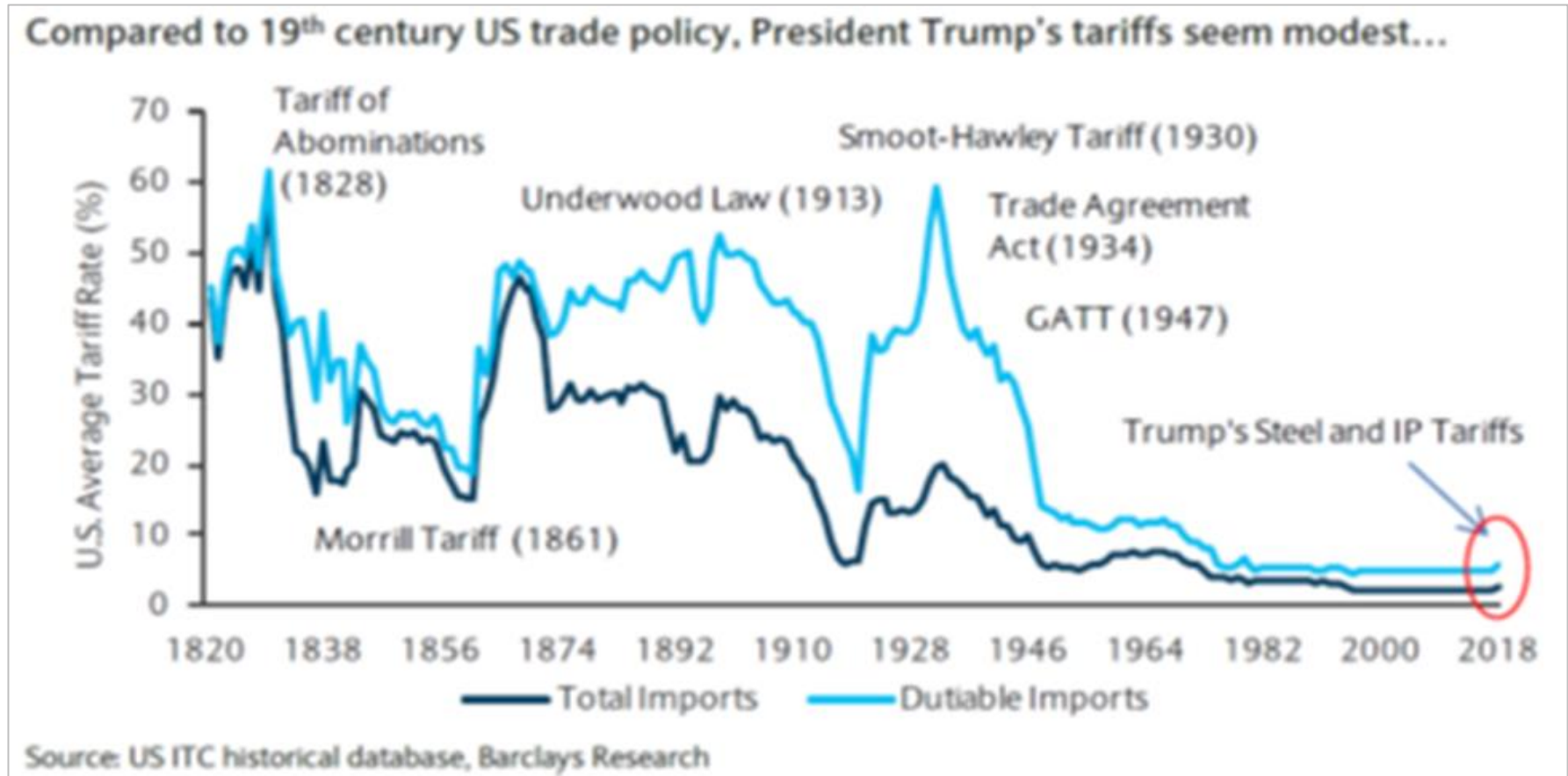
**Stated Aim Of Tariffs “To Prevent Harm To  
American Interests”. Was This The Only Aim?**



# The Chinese Import Tariff Regime

- **Trump Administration Unilaterally Imposed Tariffs Averaging 20% On \$550 Bn Chinese Imports In Four Phases, 2018-19**
  - Set up historically unique review and enforcement regime in executive branch department, USTR
  - Adopted under authority of Trade Expansion Act of 1972, Trade Act of 1974, others for “national security” reasons
  - Average 20% tariff rate implies total tariffs of ~\$110 Bn
- **Stated Purpose To Punish China For Predatory Trade Practices And Shield US Producers From Dumping**
  - Trump foreshadowed plans to “hit China” in 2016 campaign
  - Initially popular, but became more controversial over time
- **System Differs Fundamentally From Past US Tariff Regimes**

# Tariffs Have Been Important In American History, But Not Since WWII



- American industry developed behind high tariff wall during 1800s
- Until early 1900s, tariffs were single largest source of federal government revenue
- After WWII, US led prolonged and dramatic global reductions of tariffs: GATT, WTO

# Why This Tariff Regime Is Novel

- **Unlike Previous “Temporary Duty Suspension” Regimes, This Novel Review Process In Executive Branch, Highly Opaque**
  - Firms could apply for exemptions on individual products
  - If exemptions granted for one applicant, granted for all
- **USTR Guidelines Called For Exemptions To Be Adjudicated On Three Criteria**
  1. Availability of product outside of China
  2. Likelihood of severe harm to firm or other US interests
  3. Whether product “strategically important” To China (covered by Made in China 2025 policy)
- **We Check Whether Politics, PC Also Play Significant Roles**
  - Anecdotes suggest PC important; we document empirically



# Very Novel Review Process Set Up Compared To Previous TDS Regimes

- **Temporary Duty Suspension Framework**
- Managed by the judiciary.
- Firms apply for exemptions; exemptions are grouped into bills; bills are voted on in Congress.
- The legislative process is, largely, transparent.
- **Adjudication by Office of US Trade Representative**
- Managed by the executive.
- Firms apply for exemptions; exemptions are individually adjudicated by the USTR.
- Very little information is available – adjudication decisions are either “Approved” or “Rejected for failure to show harm to US interests.”

# How the U.S.-China Trade War Escalated

Cumulative tariffs between the U.S. and China in 2018/19

■ U.S. tariff action ■ Chinese tariff action ● Tariff rate



## Evolution Of Trump Tariffs, 2018-2019

- People and (mostly) companies allowed to apply for renewable one-year exemptions
- Total of 52,747 exemption applications filed over four phases
- Application success rate only 14.7% in our sample of 7,578 applications by publicly traded companies
- Unsurprisingly, China retaliated with tariffs on US imports



# We Draw On And Contribute To Four Key Literatures In Financial Economics

- **Most Basically, The Economics Literature On The Political Determinants of Trade Protectionism**
  - Ray (*JPE* 81); Marvel & Ray (*AER* 83); Lee & Swagel (*REStat* 97); Grossman & Helpman (*AER* 94); Gokeekus & Barth (*PC* 07)
- **The Financial Economics Literature on Whether Political Connections Enhance Private Firm Value**
  - Fisman (*AER* 01); Khwaja & Mian (*QJE* 05); Faccio, Masulis, McConnell (*JF* 06); Goldman, Rocholl, So (*RFS* 09)
- **The Finance Literature On The Value Of Political Spending, Either In the Form of Contributions Or Lobbying**
  - Claessens, Feijen, Laeven (*JFE* 08); Jayachandran (*JPE* 06); Cooper, Gulen, Ovtchinnikov (*JF* 10); Yu & Yu (*JFQA* 11)

# We Draw On And Contribute To Four Key Literatures In Financial Economics (Cont.)

- **Literature Examining Whether PC Act Through “Information Channel” (Beneficial) Or “Quid Pro Quo” (Welfare Reducing)**
  - Crawford & Sobel (*Econometrica* 82); Austen-Smith (*APSR* 95)  
Chakraborty & Harbaugh (*AER* 10)
  - Borisov (*RFS* 06); Yu & Yu (*JFQA* 11); Bradley, Pantzalis, Yuan (*JFE* 16)
- **Our Principal Contributions**
  - We document that political connections significantly impact the likelihood of receiving tariff exemptions
  - We show that investors correctly predict, on average, which companies will receive exemptions and react significantly to surprises
  - We are uniquely able to disentangle information vs favors channel and show that politicians use exemption grants to reward supporters and punish supporters of the opposing party

# Why Do We Entitle Our Paper “Selling Indulgences”?

**Because It Resembles Middle-Ages Catholic Church Practice Of Establishing A Crime/Sin, Then Selling Forgiveness For That Crime/Sin**





# **Indulgences Have Been Very Important For Western History—Three Pivotal Events**

- **Gutenberg Invented The Printing Press in 1450 To Reproduce Blank Indulgence Forms (And Eventually Publish Bibles)**
- **Martin Luther Explicitly Denounced Indulgences In His Ninety-Five Theses (Nailed to Church Door in Wittenberg 1517)**
  - Led to Luther's excommunication Protestant Reformation
- **Indulgences Partly Financed The Construction Of (The New) St. Peters Basilica in Vatican City, 1506-1615.**
- **Hopefully Trump Tariffs Will Not Prove As Historically Impactful**



# Data And Methodology

**Required Very Intense Collection Of Data  
On Tariff Rules, Individual Applications,  
And Outcome Announcements**



# Data

- **52,747 Total Tariff Exemption Applications**
  - Details about each application (substitute, final product) extracted from separate file (one for each application)
- **Manually Merge To Compustat Firms By Firm Name**
  - Many are small companies. Checked whether the firm applying is subsidiary of a firm on Compustat
  - 7,631 applications merged with Compustat
- **Separately, Manually Identify Political Action Committees (PACs) For Companies With Applications**
  - Data from [opensecrets.org](https://www.opensecrets.org).
  - 2,996 of 7,631 firms in Compustat have a PAC
  - Larger firms are more likely to have a PAC



# Table 1: Summary Statistics

Variable	N. Obs	Mean	Median	Std. Dev
Approved	7097	0.147	0	0.354
Rep contributions / AT	7576	2.145	0	6.119
Dem contributions / AT	7576	0.458	0	1.558
Total contributions / AT	7576	2.603	0	6.976
Lobbying / AT	7578	19.765	0	59.027
Final product	7578	0.382	0	0.486
Substitute	7258	0.203	0	0.402
China 2025	7578	0.382	0	0.486
Size (natural log of AT)	7576	8.930	9.077	2.097
ROA	7561	0.049	0.053	0.079
R&D/AT	7576	0.026	0.016	0.035
Capex/AT	7560	0.036	0.025	0.029

- Only 14.7% of applications for exemptions are accepted
- Republican-connected firms contribute \$2 per \$ Mn total assets
- Democratic-connected firms contribute \$0.46 per \$ Mn total assets
- All firms contribute \$2.60 and \$19.77 per \$ Mn total assets, respectively on political contributions and lobbying, respectively

	(1)	(2)	(3)
VARIABLES	Approved	Approved	Approved
Total contributions / AT	0.0209		0.0048
	(1.88)*		(0.29)
Lobbying / AT		0.0039	0.0036
		(8.66)***	(2.45)**
Size	-0.0245	-0.0312	-0.0298
	(-1.20)	(-1.68)*	(-1.90)*
ROA	-1.7841	-1.5638	-1.5844
	(-1.23)	(-1.00)	(-1.08)
R&D/AT	-1.7697	-1.7902	-1.8483
	(-1.08)	(-1.10)	(-1.13)
Capex/AT	-3.6434	-4.6140	-4.6035
	(-1.30)	(-1.28)	(-1.32)
Constant	-1.9594	-1.8334	-1.8495
	(-3.25)***	(-3.13)***	(-3.21)***
List fixed effects	YES	YES	YES
Product code fixed effects	YES	YES	YES
Industry fixed effects	YES	YES	YES
Observations	7,064	7,064	7,064
Pseudo R2	0.210	0.217	0.217

**Table 3: Total Lobbying Expenditures And Total Campaign Contributions: Likelihood Of Approval**

- Higher Total contributions per \$MN total assets and Lobbying per \$ Mn total assets both increase likelihood of exemption approval

# **Empirical Results: The Impact Of Contributions & Lobbying On Approval**

**Did Political Connections Impact Likelihood Of Exemption Grants? Were Republican Donors Favored And Democratic Donors Punished?**



	(1)	(2)	(3)
Variable	Approved	Approved	Approved
Republican contributions / AT	0.0245		0.0407
	(1.86)*		(4.65)***
Democratic contributions / AT		-0.1102	-0.1487
		(-2.49)**	(-3.65)***
Lobbying / AT	0.0031	0.0056	0.0035
	(2.64)***	(6.58)***	(2.45)**
Substitute	-0.3125	-0.2078	-0.2940
	(-3.38)***	(-2.47)**	(-3.85)***
Final product	-0.1336	-0.0835	-0.1060
	(-1.48)	(-1.06)	(-1.28)
China 2025	-4.5860	-4.6951	-4.4827
	(-15.21)***	(-15.68)***	(-15.59)***
Size	-0.0309	-0.0346	-0.0222
	(-1.25)	(-1.58)	(-1.04)
ROA	-1.6270	-1.5765	-1.6551
	(-0.92)	(-0.83)	(-0.86)
R&D/AT	-2.0280	-1.9800	-2.3546
	(-1.12)	(-1.08)	(-1.30)
Capex/AT	-5.0061	-5.8118	-7.0444
	(-1.70)*	(-1.29)	(-1.86)*
Constant	-1.5643	-1.4872	-1.5624
	(-2.44)**	(-2.32)**	(-2.54)**
Observations	6,755	6,755	6,755
Pseudo R2	0.231	0.233	0.241

**Table 5: Campaign Contributions By Party And USTR-Provided Criteria, Likelihood Of Approval**

- Lobbying positively related to exemption grants
- Republican-connected more likely to receive exemption grants
- Democratic-connected less likely to receive exemption grants
- Exemption grants less likely for MC 2025 products & those with substitutes available

# **Empirical Results: Valuation Effects And Abnormal Returns**

**Were The Exemption Grant Announcements  
Value Enhancing? Were The “Winners” Correctly  
Predicted By Investors?**



# Table 7: Event Study Results

## Panel A: CAR Around Announcement Event Date (Both Positive & Negative)

Window	N Obs	Mean	Median	St Dev
(0,+1)	5854	-0.114%	-0.074%	1.968%
(0,+2)	5854	0.013%	0.219%	2.403%
(-1,+1)	5854	-0.203%	0.040%	2.543%
(-2,+2)	5854	-0.014%	0.253%	3.311%

## Panel B: Categorized by Approved Or Rejected

Approved				Rejected				Difference		p-value
Window	N Obs	Mean	St Dev	Window	N Obs	Mean	St Dev			
(0,+1)	910	0.27%#	1.89%	(0,+1)	4512	-0.19%#	1.99%	0.45%	***	<0.001
(0,+2)	910	0.68%#	2.20%	(0,+2)	4512	-0.06%#	2.40%	0.74%	***	<0.001
(-1,+1)	910	0.06%	2.47%	(-1,+1)	4512	-0.22%#	2.53%	0.28%	***	<0.001
(-2,+2)	910	0.55%#	2.94%	(-2,+2)	4512	-0.07%#	3.31%	0.62%	***	<0.001

# Denotes significance at least at the 5% level.



# Table 8 Panel A: Event Study Regressions—All Applications

	(1)	(2)	(3)	(4)
Variable	CAR (0,+1)	CAR (0,+2)	CAR(-1,+1)	(CAR-2,+2)
Approved	0.0046	0.0073	0.0035	0.0073
	(2.02)**	(2.51)**	(1.66)*	(1.75)*
Predicted approval	-0.0193	-0.0380	-0.0401	-0.0459
	(-3.89)***	(-6.82)***	(-2.50)**	(-1.48)
Size	-0.0003	-0.0010	0.0008	0.0006
	(-0.46)	(-0.96)	(1.62)	(0.43)
ROA	-0.0130	-0.0184	-0.0133	-0.0018
	(-0.65)	(-0.61)	(-0.51)	(-0.04)
R&D/TA	-0.0397	-0.0517	-0.1071	-0.0938
	(-0.88)	(-0.77)	(-5.09)***	(-1.86)*
Capex/TA	-0.0324	-0.0817	-0.0798	-0.0748
	(-2.68)***	(-2.20)**	(-1.75)*	(-1.87)*
Constant	0.0104	0.0283	0.0003	0.0128
	(1.29)	(2.83)***	(.)	(1.01)
Observations	5,104	5,104	5,104	5,104
R-squared	0.094	0.112	0.149	0.118

- CARs significantly positive when exemption approval announced
- CARs significantly less positive if exemption approval expected
- CARs significantly less positive for high R&D, high Capex firms

**Table 8 Panel B.**  
**Event Study**  
**Regressions:**  
**Successful**  
**Applicants Only**

• CARs significantly positive when democratic connected firm receives exemption; for firms that lobbied heavily; for products with substitutes; and for MC 2025 products

• CARs significantly less positive for republican connected firm; final products; large firms and high R&D

	(1)	(2)	(3)	(4)
Variable	CAR (0,+1)	CAR (0,+2)	CAR(-1,+1)	(CAR-2,+2)
Republican contributions / AT	<b>-0.0011</b>	-0.0006	<b>-0.0016</b>	<b>-0.0011</b>
	<b>(-6.43)***</b>	(-1.09)	<b>(-7.16)***</b>	<b>(-1.66)*</b>
Democratic contributns / AT	0.0002	0.0004	0.0016	<b>0.0025</b>
	(0.26)	(0.46)	(1.23)	<b>(2.74)***</b>
Lobbying / AT	<b>0.0001</b>	0.0000	<b>0.0001</b>	-0.0000
	<b>(3.33)***</b>	(0.14)	<b>(2.53)**</b>	(-0.87)
Substitute	<b>0.0074</b>	<b>0.0079</b>	0.0111	<b>0.0096</b>
	<b>(3.09)***</b>	<b>(16.60)***</b>	(1.42)	<b>(1.98)**</b>
Final product	<b>-0.0076</b>	<b>-0.0098</b>	<b>-0.0112</b>	<b>-0.0203</b>
	<b>(-2.44)**</b>	<b>(-1.97)*</b>	<b>(-2.85)***</b>	<b>(-3.94)***</b>
China 2025	<b>0.0078</b>	<b>0.0148</b>	-0.0011	0.0051
	<b>(2.02)**</b>	<b>(5.16)***</b>	(-0.12)	(.)
Size	<b>-0.0012</b>	<b>-0.0018</b>	-0.0005	0.0002
	<b>(-3.91)***</b>	<b>(-2.59)**</b>	(-0.31)	(0.18)
ROA	0.0366	0.0304	0.0857	0.0758
	(0.62)	(0.42)	(1.00)	(0.76)
R&D/AT	<b>-0.0299</b>	-0.0267	-0.0355	0.0098
	<b>(-3.07)***</b>	(-0.80)	(-0.72)	(0.25)
Capex/AT	0.1123	0.0739	0.0637	0.0737
	(1.06)	(0.49)	(0.38)	(0.26)
Constant	-0.0055	-0.0009	-0.0140	-0.0189
	(-0.73)	(-0.08)	(-1.21)	<b>(-2.91)***</b>
Observations	853	853	853	853
R-squared	0.286	0.262	0.264	0.337

# **Empirical Results: Which Political Connections Mattered Most?**

**Were Links To The Trump Administration More Valuable Than Links To Republican Party, Or Vice Versa?**



**Table 9: Inaugural Committee And Lobbyists Connected To Trump Administration—Likelihood Of Approval**

- Exemption approval significantly more likely for Republican connected firms and high lobbying firms
- Exemption approval significantly less likely for Democratic connected firms; for substitute products and high lobbying firms; for MC 2025 products; and, surprisingly, for firms that contributed to Trump's inaugural.

	(1)	(2)	(3)
Variable	Approved	Approved	Approved
Inaugural/AT	<b>-0.4271</b>		<b>-0.4542</b>
	<b>(-3.59)***</b>		<b>(-3.42)***</b>
Lobby connection		0.0172	0.0888
		(0.13)	(0.63)
Republican contributions/AT	<b>0.0396</b>	<b>0.0411</b>	<b>0.0418</b>
	<b>(4.42)***</b>	<b>(4.49)***</b>	<b>(4.64)***</b>
Democratic contributions/AT	<b>-0.1432</b>	<b>-0.1500</b>	<b>-0.1495</b>
	<b>(-3.72)***</b>	<b>(-3.56)***</b>	<b>(-3.78)***</b>
Lobbying/AT	<b>0.0036</b>	<b>0.0035</b>	<b>0.0034</b>
	<b>(2.55)**</b>	<b>(2.31)**</b>	<b>(2.40)**</b>
Substitute	<b>-0.2860</b>	<b>-0.2946</b>	<b>-0.2873</b>
	<b>(-3.67)***</b>	<b>(-3.94)***</b>	<b>(-3.71)***</b>
Final product	-0.0915	-0.1056	-0.0877
	(-1.08)	(-1.27)	(-1.01)
China 2025	<b>-4.4898</b>	<b>-4.4814</b>	<b>-4.4839</b>
	<b>(-16.58)***</b>	<b>(-16.05)***</b>	<b>(-16.73)***</b>
Size	-0.0177	<b>-0.0236</b>	<b>-0.0243</b>
	(-0.88)	<b>(-1.87)*</b>	<b>(-2.76)***</b>
ROA	-1.6649	-1.6512	-1.6513
	(-0.85)	(-0.86)	(-0.85)
R&D/AT	-2.3344	-2.3659	-2.3943
	(-1.29)	(-1.35)	(-1.39)
Capex/AT	<b>-6.5192</b>	<b>-7.0311</b>	<b>-6.3900</b>
	<b>(-1.73)*</b>	<b>(-1.86)*</b>	<b>(-1.71)*</b>
Constant	-1.6165	-1.5545	-1.5793
	<b>(-2.60)***</b>	<b>(-2.68)***</b>	<b>(-2.68)***</b>
Pseudo R2	0.244	0.241	0.244

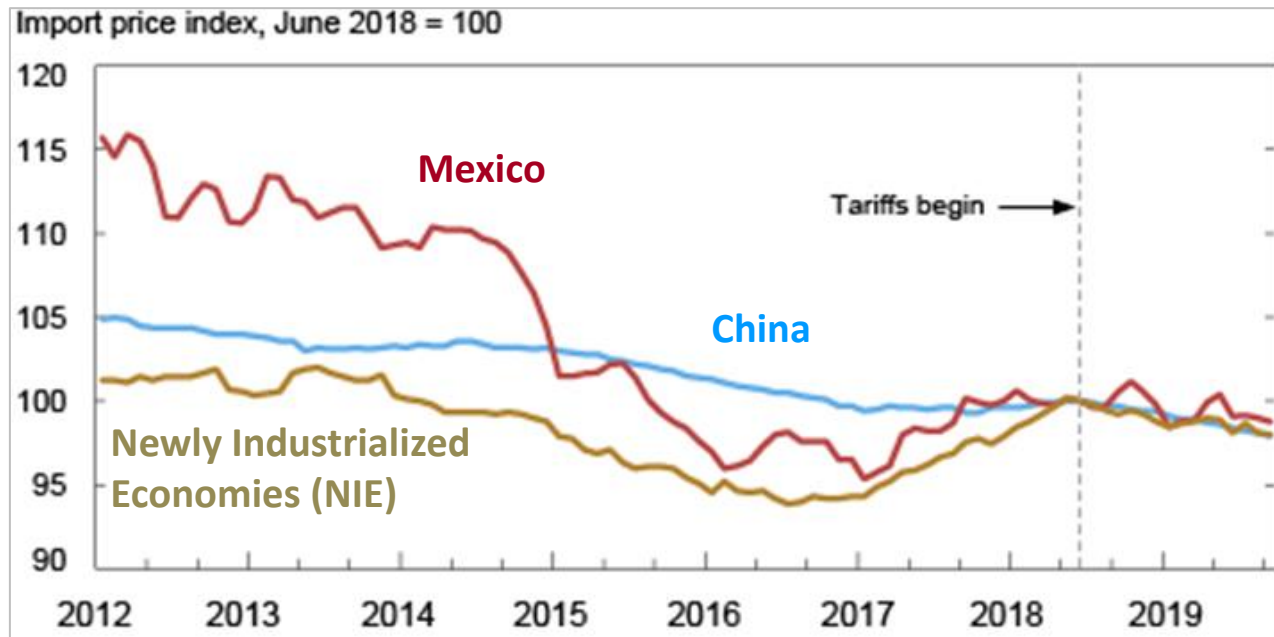
# Summary And Conclusions

- **What Have We Learned? What Is Still A Puzzle?**



# Limitations And Extensions

- **Tariffs Imposed By One Administration, At One Point In Time**
  - Do our results generalize?
- **We Cannot Observe All forms Of Political Connections**
  - Contributions, lobbying may proxy for broader connections
- **Do Not Examine Distributional Issues: Who Pays For Tariffs?**
  - Circumstantial evidence suggests primarily US consumers



**Import Prices For  
Chinese Goods  
Seem Unaffected By  
Tariffs**

NIEs comprise Singapore, South Korea, Taiwan, and Hong Kong

Source: U.S. Bureau of Economic Analysis



# Conclusions

- **We Document Evidence Of Political Connections Affecting A Supposedly “Arm’s Length” Process**
  - Both lobbying and campaign contributions have an impact
- **Politicians Rewarding Supporters Could Be Due Either To Information Effects Or A Sign Of Quid-Pro-Quo Arrangements**
  - But politicians harming opposition supporters cannot be explained with information
- **The Picture This Paints Is Ugly. Politicians Effectively Create Roadblocks With Tariffs, Then Obtain Campaign Contributions To Selectively Remove Them**
  - They also use them to hurt opposition supporters
- **We Estimate Value Of A Granted Proposal As Approximately \$55 Million**

# Thank You

**William L. Megginson**

**wmegginson@ou.edu**

<http://www.ou.edu/content/price/finance/faculty/billmegginson.html>

