

Suspiciously timed trade disputes[☆]Paola Conconi^{a, b, *}, David R. DeRemer^c, Georg Kirchsteiger^{a, b, d, e}, Lorenzo Trimarchi^a, Maurizio Zanardi^f^aECARES, Université Libre de Bruxelles, Belgium^bCEPR, United Kingdom^cInstitute of Economics, Hungarian Academy of Sciences, Hungary^dCESifo, Germany^eVCEE, Austria^fLancaster University Management School, United Kingdom

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ABSTRACT

This paper shows that electoral incentives crucially affect the initiation of trade disputes. Focusing on WTO disputes filed by the United States during the 1995–2014 period, we find that U.S. presidents are more likely to initiate a dispute in the year preceding their re-election. Moreover, U.S. trade disputes are more likely to involve industries that are important in swing states. To explain these regularities, we develop a theoretical model in which re-election motives can lead an incumbent politician to file trade disputes to appeal to voters motivated by reciprocity.

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1. Introduction

Media coverage of the 2012 United States presidential election suggests that trade disputes mattered in the re-election campaign

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of Barack Obama. An article in *The Economist* noted a “suspiciously timed dispute” filed against China in the World Trade Organization (WTO) less than two months before Obama’s re-election.¹ Not only the timing of the disputes was suspicious, but also the fact that it involved the automobile industry, a large employer in Ohio, a crucial “swing state” in the U.S. presidential election:

There was nothing subtle about the American government’s lodging of a trade complaint on September 17th, alleging that China unfairly subsidises car-part exports on the same day that Barack Obama was campaigning in the crucial swing state of Ohio—home to many car-part suppliers. But then subtlety does not win many elections.

Later media coverage observed that Obama “frequently touted a series of cases” against China which were “occasionally timed to campaign stops in industrial swing states in the Midwest” (“US in trade dispute with Indonesia,” *Financial Times*, January 10, 2013).

¹ “Chasing the anti-China vote: a suspiciously timed dispute,” *The Economist*, September 22, 2012.

Obama has not been unique among U.S. presidents in filing disputes that figured prominently during a re-election campaign. Less than a month before his re-election date, George W. Bush filed a dispute at the WTO against the European Union for allegedly subsidizing Airbus. During the third presidential debate between Bush and John Kerry, Kerry commented: “This president didn’t stand up for Boeing when Airbus was violating international rules and subsidies. He discovered Boeing during the course of this campaign after I’d been talking about it for months” (“October 13, 2004 Debate Transcript,” Commission on Presidential Debates).

Our paper provides systematic empirical evidence that electoral incentives affect the filing of trade disputes. We study WTO disputes initiated by the United States. There are three main reasons to focus on the U.S. First, it is the country that has filed the most WTO disputes. Second, the existence of executive term limits creates variation in electoral incentives both within and across U.S. presidents, who have direct control over the decision to initiate WTO disputes. Finally, we can observe variation over time in the electoral importance of different U.S. states and industries.

We construct a database of all WTO disputes initiated by the United States during the 1995–2014 period. To verify whether U.S. trade disputes are “suspiciously timed” close to the president’s re-election, we collect each dispute’s initiation date. We also match each dispute to one or more NAICS 3-digit codes. This allows us to study industry determinants of U.S. trade disputes. In particular, we can verify whether U.S. presidents are more likely to initiate disputes to support important industries in swing states (e.g. the automotive industry in Ohio). We identify swing states based on the margin of victory in the most recent presidential election. To capture the importance of an industry in these battleground states, we calculate the percentage share of workers over all swing states that are employed in the industry. To capture the importance of an industry in these battleground states, we calculate the industry’s employment summed across swing states over total employment in swing states. Crucially, these employment shares vary over time, due both to changes in the identity of the swing states and changes in the employment structure across industries within states.

A first descriptive look at the U.S. dispute history in Fig. 1 already suggests that re-election motives affect the initiation of trade disputes. Each bar represents the number of disputes filed by the U.S. in each year between 1995 and 2014.² The dashed lines show an increase in disputes during the first term of the three presidents, when they could still be re-elected. There is no clear pattern in the disputes during the second terms, when the presidents faced term limits and thus had no re-election motive.

Our industry-year panel data analysis of the determinants of U.S. trade disputes provides more systematic evidence of the importance of electoral incentives. Our results confirm that U.S. presidents are more likely to initiate WTO disputes during the last year of their first term (re-election year effect). With respect to sectoral composition, we find that U.S. trade disputes are more likely to involve industries that are important in swing states (swing industry effect). We show that these results are robust to including broad industry fixed effects, different time fixed effects (President or President-term), as well as many different controls accounting for other possible determinants of trade disputes, both at the sectoral level (e.g. the size of the industry in the U.S. at large, its degree of concentration, and the growth rate of imports and exports) and aggregate level (e.g. changes in unemployment and the exchange rate). They also continue to hold when we use alternative econometric methodologies to study the determinants of trade disputes (linear probability model, probit, or negative binomial). In terms of magnitude, the estimates of our

baseline regressions indicate that the re-election year effect and the swing industry effect are sizeable. Trade disputes are between 13.5 and 21.7 percentage points more likely to be initiated in re-election years; and a marginal increase in importance of an industry in swing states raises the probability that the U.S. initiates a dispute involving that industry by between 18.3 and 30.8 percentage points.

To interpret our empirical findings, we develop a tractable political economy model of trade disputes. There are three main actors in the model: the incumbent politician, a challenger, and the median voter. Politicians serve one-period terms and can only be re-elected once. In the first period, the incumbent decides whether to file a dispute. At the end of this period, the voter decides whether to elect the incumbent or the challenger. In the second period, the elected politician decides whether to file a dispute, if it was not filed prior to the election. Politicians are office motivated and, all else equal, prefer not to file the trade dispute.

The key assumption of our theoretical model is that voters have reciprocal preferences, i.e. they like to act kindly to politicians who have helped them and unkindly to politicians who have harmed them. We build on a vast theoretical literature, which emphasizes the importance of reciprocity and fairness (e.g. Rabin, 1993; Fehr and Schmidt, 1999; Dufwenberg and Kirchsteiger, 2004; Falk and Fischbacher, 2006).³ In recent years, experimental economists have gathered overwhelming evidence that individuals reward kind actions and punish unkind ones (e.g. Fehr et al., 1997; Charness and Dufwenberg, 2006; Kube et al., 2012). Models of reciprocity have also been applied to political economy (e.g. Hahn, 2009), and recent influential work by Finan and Schechter (2012) provides strong empirical and experimental evidence that voters like to help politicians who have been kind to them, and to punish politicians who have been unkind to them.

We first show that, if voters have standard preferences (no reciprocity), they will choose between the incumbent and the challenger based on their ideological preferences. In this case, politicians will never file a trade dispute, even if they are office motivated and know that voters would like a dispute to be filed. This is because, if voters are fully rational, their decisions are unaffected by whether or not a politician has filed a dispute. We then show that, if voters have reciprocal preferences, the unique equilibrium involves the incumbent filing the dispute prior to the election and increasing his chance of re-election, provided that the voter’s ideological preference for either candidate is sufficiently small relative to the voter’s preference for the trade dispute. When the voter narrowly prefers the challenger, the incumbent’s ability to file a dispute provides an advantage over the challenger who cannot commit to file the dispute after the election. The voter’s motivation to reciprocally reward the incumbent for filing the dispute dominates the voter’s ideological preference for the challenger, so the voter chooses the incumbent. When the voter narrowly prefers the incumbent, the incumbent will still file the dispute, because otherwise the voter’s desire to be unkind to the incumbent would dominate the voter’s ideological preference for the incumbent.

Our theoretical model provides a simple explanation for our empirical findings concerning the timing of U.S. trade disputes (the re-election effect) and their composition (the swing industry effect). An alternative rationale for our findings could be provided by a model in which the incumbent politician initiates disputes to signal his trade policy preferences to voters. Our model shows that, even if voters have full information about politicians’ preferences, electoral

² As we detail in Section 2, our definition of year accounts for differences in the electoral, inaugural, and conventional calendars.

³ We focus on intrinsic reciprocity instead of the “instrumental” reciprocity that can result from optimizing behavior of selfish agents (Sobel, 2005). Models of instrumental reciprocity include vote-buying (e.g. Dekel et al., 2008) and clientelism, i.e. the literal exchange of favors or policies for political support (e.g. Kitschelt and Wilkinson, 2007; and Robinson and Verdier, 2013).

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