

Escape from tariffs: The political economies of protection and classification

Michael-David Mangini 💿

Princeton School of Public and International Affairs, Princeton University, Princeton, New Jersey, USA

Correspondence

Michael-David Mangini, Princeton School of Public and International Affairs, Princeton University, Princeton, NJ, USA. Email: mangini@g.harvard.edu

Abstract

The literature on the political economy of trade protection has focused on how firms lobby for their preferred tariffs, but opportunities to change the tariff schedule in the United States by legislation are relatively uncommon. How can importers lobbying in their private capacity escape from tariffs without relying on Congress? In the United States, products must be sorted into tariff categories by the customs office before the appropriate duty can be determined. This article documents how firms seek to lower their tariffs by strategically requesting product classifications from customs. Firms hire lawyers to make legal arguments to customs officials promoting an interpretation of the tariff schedule which lowers their costs. Lobbying for favorable classification is most important to the firm when similar categories have very different tariffs. The language of product descriptions is political because legal arguments for a particular classification are more persuasive when the descriptions are worded flexibly. Using a data set of over 200,000 classification rulings between 1990 and 2020, I find evidence that firms request classifications in response to certain quotas and the China tariffs. The findings characterize the tariff schedule as a living document and describe

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how the distribution of tariffs and the language of product descriptions affect the structure of protection.

KEYWORDS

domestic political economy, international political economy, lobbying/interest groups, quotas, regional specialization, regulation, tariffs, trade, US political economy

1 | INTRODUCTION

Schattschneider (1935) described how members of the United States Congress exchanged support for tariffs protecting important industries in their districts and ultimately logrolled their way to the highly protective Tariff Act of 1930. It has been a long time since that specific scenario where interest groups vie directly for Congressional support was last repeated—the United States last significantly reduced its tariffs as part of a multilateral negotiation in 1994, and its most recent preferential trade agreements were signed in 2006. How can importers lobbying in their private capacity escape from tariffs without relying on Congress? A brief discussion of two cases suggests how diligent importers can effectively and continuously bend the tariff schedule in their favor even when there are no trade negotiations in the headlines.

In October of 1926, the pioneering early modernist Constantin Brancusi shipped 20 sculptures from Paris to New York City for an exhibition, including his masterpiece titled *Bird in Space*. Modern art and its tendency towards abstraction was not widely known or appreciated at the time. The customs officials who processed the sculptures refused to exempt *Bird in Space* from tariffs as a work of art because they were unable to discern the bird. Instead, they classified it as a "manufactured object of metal" and applied a 40% tariff. Brancusi and the artwork's buyer, having been offended by the decision, sued the US government for reclassification of the good and reimbursement of the duties. The consequent legal proceedings quite literally put the concept of modern art on trial: would Brancusi's revolutionary approach be accepted by society as art?¹ Ultimately, Brancusi prevailed in court, the duties were returned, and finally, in 2005 *Bird in Space* was purchased at auction for almost \$30 million as a major work of modernism (Cleary, 2014; Giry, 2002).

Close to a century later, another dissatisfied importer found itself involved in litigation over tariffs. Apple Inc. imports iPad Smart Covers from China which are classified by customs officials as "other articles of plastic" and subject to a 5.3% tariff. Apple's lawyers argued that the product would correctly be classified as "an accessory to a machine," a category that was conveniently duty free. Unfortunately for Apple, the duty free category's description explicitly excludes "covers" as accessories. Apple argued in court that the iPad Smart Cover was not a cover at all—instead, it was an article of furniture because it could be configured as a stand for the iPad. Ultimately, they lost the case (Friedman, 2019; Kelly, 2019).

These two cases, though separated by a wide expanse of time, echo each other strongly. In both cases, an importer was displeased with a tariff and they challenged it through the judicial rather than legislative process. Also in both cases the importer targeted the ex post enforcement

¹The tariff classification of artwork has encountered somewhat frequent difficulties. In a separate incident, Customs classified a mosaic by Pablo Picasso as "an article of glass," a decision which was also reversed by the courts (New York Times, 1960).

of the tariff rather than its ex ante determination. The purpose of this study is to theorize what the mostly hidden political economy of classification means for the better-studied political economy of protection. The argument is that certain bureaucratic institutions are designed to afford importers—and only importers, except in rare circumstances—the opportunity to obtain favorable but narrow legal rulings to reduce their tariffs. The narrowness of these rulings raises the firms' private benefits from lobbying and therefore encourages firms to lobby for classification individually rather than as part of an industry group.

WILEY-

3

This article documents how firms can attempt to escape tariffs by directly lobbying the bureaucratic classification process using a novel data set of over 200, 000 advance classification rulings issued by the customs authorities since 1990. The customs authorities in many countries, including the United States, issue legally binding rulings on the classification of particular goods at the request of an importer. The US's rulings are available from the Customs Rulings Online Search System (CROSS) (https://rulings.cbp.gov/home). An analysis of the data provides evidence consistent with the contention that firms use the system not only to responsibly comply with regulations but also to escape unfavorable trade barriers. There is evidence that the number of classification requests increases with the mean and variance of the tariff rates within a heading of the tariff schedule. Also, firms appear to request classifications when quotas are adjusted (particularly in textiles) and when former President Donald Trump imposed tariffs during the trade war with China. The general conclusion is that the assignment of products to categories of the tariff schedule is itself a political consequence which cannot be taken for granted.

Additionally, the findings portray the political economy of classification as an intertemporal and interinstitutional conflict. The institutions of the classification bureaucracy encourage importers to lobby in their private capacity. Because classification rulings apply narrowly to individual products, importers have little incentive to lobby as an industry. The ability of importers to escape from tariffs using the classification system is limited by the overall distribution of tariffs and the specificity of the legal language describing product categories. Protectionists, despite having limited opportunities to directly affect the classification process, can participate indirectly by influencing these two variables through the traditional legislative channels.

The tariff schedule has had a prominent role in previous studies of the clash between free traders and protectionists. Rogowski (1989) argues that trade politics, and in particular average tariffs, are a proxy for class conflict because the distributional consequences of trade liberalization depend on whether a worker owns labor or capital. Hiscox (2001) also emphasizes tariffs in his study of how changes in factor mobility caused by advancements in technology can shift the political competition from class-cleavages to sector-cleavages. Related work has emphasized how populations delineated by either class or sector are affected by the global economy and how they use the political system to raise or lower tariffs accordingly (Irwin, 2017; Milner, 1988; Milner & Kubota, 2005; Rodrik, 1995; Schattschneider, 1935; Scheve & Slaughter, 2004). As an example, the large literature on the political economy of populism describes how those who have been harmed by globalization have voted against incumbents and in favor or politicians who promised to raise tariffs (Autor et al., 2013, 2020; Colantone & Stanig, 2018a, 2018b; Goldstein & Gulotty, 2019; Jensen et al., 2017). The economics literature has similarly focused on tariffs to measure trade openness.²

²Particularly the theoretical approach of Grossman and Helpman (1994) and the work it inspired (including Gawande & Bandyopadhyay, 2000; Goldberg & Maggi, 1999; Mitra, 1999, among others). In these models a central regulator that chooses a tariff schedule favorable to the groups that earned the highest political weights by making "campaign contributions" (generically, lobbying investments). Ludema et al. (2018) study the process of temporary tariff suspensions.

WILEY- ECONOMICS

The tariff schedule also plays a role in the processes that determine nontariff barriers outside the legislature. Among the most important nontariff barriers studied by scholars are antidumping duties.³ Because the US antidumping duties are determined by the International Trade Commission (ITC) and the Department of Commerce (DOC) these two bureaucracies have attracted some scholarly attention (Hansen, 1990; Hansen & Prusa, 1997). Antidumping duties originated as a way to temporarily buttress domestic industry against malicious anticompetitive behavior from foreign monopolists. The study of antidumping duties has shown how domestic industries have been able to transform the system into a tool for semipermanently raising protective tariffs on foreign goods (Blonigen, 2002; Blonigen & Bown, 2003; for an excellent review, see Blonigen & Prusa, 2008). However, the ITC and the DOC conduct their investigations on the basis of the categories defined in the tariff schedule. Therefore, the classification of products into categories has a direct effect on the data that determine whether the ITC and DOC will find that dumping occurred. The classification process is important for understanding the reach and significance of antidumping duties because, just like tariffs, the duties are applied to product categories rather than to individual products. Importers can still attempt to escape the antidumping duties by seeking favorable classifications.⁴

Recent work in political science has highlighted how politics does not cease after the determination of law or policy—it continues at the enforcement stage. You (2017) documents how most lobbying in the United States occurs after the law in question has been passed. She develops a framework for the study of ex post lobbying, or the direct lobbying of bureaucratic agencies for favorable enforcement. Her work concludes that the difficulty of collective action and whether the benefits are particularistic determine the intensity of ex post lobbying. In a very different setting, Holland (2016) also demonstrates how the enforcement of law can become a political instrument.⁵ She studies how politicians selectively choose not to enforce laws to maximize votes from specific populations. The present article applies these principles to the political economy of protection. The study discusses the role of classification as a process that selects which tariffs will be enforced and which will not. Furthermore, importers are privileged by the institutional structure because they have more opportunities to lobby the bureaucracy for favorable outcomes.

A new approach in the literature has approached lobbying as a private good. Recent literature has sought to understand when firms lobby for protection individually or as part of an industry group (Baccini et al., 2017; Bombardini & Trebbi, 2012; Gilligan, 1997; Kim, 2017; Madeira, 2016; Osgood, 2017; Rho & Tomz, 2017).⁶ The literature has found that firms producing highly differentiated products tend to lobby individually. Firms tend to lobby in cooperation with their industry when the tariff would benefit all firms relatively equally. Particularistic rewards, however, incentivize firms to lobby alone. These recent studies explain when import-competing firms are able to overcome obstacles to collective action, but relatively

⁵See also Holland (2015) and Holland (2017).

³Other approaches to nontariff barriers study how regulations, subsidies, and quotas are used to protect domestic industry (Büthe & Mattli, 2013; Deardorff & Stern, 1998; Egger et al., 2015; Goldstein, 1986; Kono, 2006; Lawrence, 2000; Mansfield & Busch, 1995, among many others). Like antidumping duties, these instruments are also implemented using the categories specified in the tariff code. Therefore, it is possible that firms might seek preferred classifications to escape from unfavorable nontariff barriers.

⁴Institutionalists have studied when and why the legislature could decide to delegate its tariff-setting authority to the executive Goldstein and Gulotty (2014). Congress has historically chosen to strategically delegate tariff-setting authority when doing so is expected to the the hands of a future Congress that would reverse current policy.

⁶The recent literature draws on advances in the economics literature on the study of global firms including Krugman (1980), Helpman and Krugman (1985), Bernard and Jensen (1999), Bernard et al. (2003), and Melitz (2003) among many others.

-WILEY-

little attention has been paid to importers. In addition, these studies also take the tariff schedule as given. The present article will expand the literature on lobbying as a private good to cover these issues.

The classification process has attracted some previous scholarly attention. Fisman and Wei (2004) study tax evasion by comparing Hong Kong's reported exports to China with China's reported imports from Hong Kong at the category level. They find that the gap in reported trade is higher for categories where the tax rates are higher, which they interpret as evidence of tariff evasion.⁷ Fisman and Wei's approach detects only illegal misclassifications because their measures compare reported trade in two locales. Similarly, Betz (2019) studies the relationship between the complexity of the tariff code, measured by the variance of tariffs, and tariff compliance.⁸ His approach also focuses on illegal means to evade tariffs. Other work that discusses the details of the tariff code, including Goldstein and Gulotty (2014), studies how tariff lines are redefined by the legislature. This article focuses exclusively on explaining how firms legally use the institutions of the classification process to evade tariffs, which is a bureaucratic process that exists independently of illegal misclassifications and the standard legislative channel.

2 | INSTITUTIONAL CONTEXT

The key characteristic of the political economy of classification is the institutional context of the conflict between free traders and protectionists. Because institutions are central to the theory it is necessary to explicate some of the details of the classification process in the United States. Since the Customs Modernization Act was passed in 1993 importers have been responsible for self-reporting their products and their correct classification on entry into the United States. The port authorities and customs officials conduct regular audits of the declarations to deter importers from dodging tariffs by intentionally reporting incorrect classification and underpaying tariffs. If the port authority disagrees with a classification they can demand that a higher tariff be paid. The possible financial penalties for deliberate misclassification are very steep but fines are relatively uncommon (US Customs and Border Protection, 2004a).

Importers might be concerned about the possibility of mistakenly declaring an incorrect classification and facing a costly penalty after an audit.⁹ Alternatively, importers may wish to declare a low tariff classification that would stretch the category definitions and risk being challenged during an audit. Regardless of the motivation, firms can eliminate the risk of penalties by requesting a legally binding ruling on the classification of their product before importation (US Customs and Border Protection, 2004b, p. 37). These advance rulings are issued by the United States Customs Office (USCS) and its successor agency, Customs and Border Protection (CBP) following the Department of Homeland Security Reorganization. Firms request a ruling by submitting a letter to the agency detailing relevant information about

⁷The authors continue their research program in Fisman, Moustakerski, and Wei (2008) and Fisman and Wei (2009). Their program is also explored in Javorcik and Narciso (2008), Javorcik and Wei (2009), and Buehn and Eichler (2011).

⁸See also Tavares (2006).

⁹The tariff code is formally called the Harmonized Tariff Schedule of the United States (HTSUS) and is available at https://hts.usitc.gov/. The first six digits of the hierarchically organized codes are standardized internationally by the World Customs Organization. Each member state can define higher precision categories using up to four additional digits. In the United States tariffs are set at the eightdigit level, which is also known as a tariff line.

the product, often including photographs and sometimes even including a sample item. Firms can either prepare the letter themselves or retain legal counsel to do it on their behalf. The letters are permitted to request a particular classification for the product and to provide a legal rationale for the request referencing the category descriptions, their associated notes of interpretation, and precedent. A firm that disagrees with a ruling can appeal the decision. If the appeal is denied, the firm can sue the United States in the Court of International Trade for reimbursement of the duties and reclassification of the product.

The classification rulings are legally binding but they are not laws so they can be revoked by the customs office.¹⁰ Generally, these revocations occur when the office determines the ruling to be in error. Revocations and modifications are relatively rare events, but they can be very meaningful for importers when they do occur. Rulings are periodically reviewed by customs lawyers for consistency with current practice and are sometimes unilaterally modified or revoked. Additionally, there is a process which permits protectionists to petition for a ruling to be revoked (19 C.F.R. §175), but the process is only very rarely used. Since 1994 fewer than 30 petitions have been recorded in the Federal Register, while there have been around 200,000 classification rulings issued over that same interval.

3 | INTRODUCING THE CROSS DATA SET

The CROSS database contains all classification rulings issued by CBP since 1990.¹¹ The metadata contains, for every ruling, information on which tariff lines were identified by CBP, which rulings are related, whether the ruling has been revoked by subsequent rulings, and the date on which the ruling was issued. Figure 1 shows the count of rulings issued on a monthly basis since 1990. Rulings are very frequent in most years; there are months in which Customs issues more than 1000 rulings. The large decline in the number of rulings issued in September, October, and November of 2001 occurred because the Customs office responsible for the rulings was located in Building Six of the World Trade Center until it was destroyed during the terror attacks on September 11 (US Customs and Border Protection, 2016). The decline in January 2019 coincides with the government shutdown of that month. More information about the distribution of rulings by category is available in Supporting Information: Appendix 12.

The history of significant developments in US trade policy can be read directly off of Figure 2, which shows the number of classification rulings by country of origin and product type. The inverted U pattern is particularly prominent in textile products.¹² The peak of the hump in textiles coincides with the termination of the Multifiber Arrangement, a global system of quotas in textile manufacturing that was gradually phased out between 1995 and 2005 (Khandelwal et al., 2013). It is possible that the number of classifications rises as the importing firms attempt to determine when their products will no longer be subject to quotas, or perhaps to convince Customs to classify their products in categories newly without quotas.

As China became more integrated into the global economy more firms it quickly became a preferred location for the production of consumer goods and textiles. The rising demand for Chinese imports appeared to drive an increase in the number of classification requests. Previous scholarship

¹⁰The precise legal deference given to Customs' rulings was decided by the Supreme Court in United States v. Mead Corp., 533 U.S. 218, 121 S. Ct. 2164, 150 L. Ed. 2d 292 (2001).

¹¹In addition to rulings on tariff classification, CROSS also contains around 50,000 rulings on topics including country of origin, coastwise transportation, and other issues. All non-classification rulings are excluded from the present analysis.

¹²Here, textile products are roughly defined as HTS chapters 50–63 following the definition used in Khandelwal et al. (2013).



FIGURE 1 Count of advance classification rulings by month available in the CROSS data set.

has shown that China's entry into the WTO greatly increased trade, potentially by reducing trade policy uncertainty (Autor et al., 2013; Handley & Limão, 2017). China's low wages made it a particularly profitable location to produce textiles (Khandelwal et al., 2013). The end of the textile quota system, combined with the entry of China onto world markets, was anticipated to cause a huge spike in textile imports that could put textile producers in the US out of business. The United States, under pressure from domestic textile producers, retained the ability to temporarily reimpose quotas on Chinese textiles during China's negotiations to enter the WTO. The Chinese government and US textile importers balked at the piecemeal reimposition of these quotas between 2003 and 2005. In particular, they found it difficult to plan business decisions while being unsure about which textile products would be subject to quotas in the future. The United States and China negotiated an agreement in late 2005 that would provide some degree of import protection for US textile producers while clarifying policy for the US retailers and Chinese producers. The US would reimpose quotas on certain prespecified textile product categories (with some products individually exempt) and would completely remove quotas on all textile goods after 3 years. The huge spike in classifications related to textile goods from China occurs after the new agreement was implemented on January 1, 2006 (Jones, 2005). I will show some evidence that the spike represents attempts by firms to convince Customs to classify their products into the quota-exempt categories.

The pattern of classification requests unrelated to textiles and China follows a quite different pattern which appears to be driven by an episode of institutional change. While classification requests related to China or textile products experience a hump shape pattern, the other goods experience a slow rise in classifications followed by a dramatic and persistent decline. The decline occurs immediately after March 2003, the month in which the US Customs Service was absorbed into Customs and Border Patrol as part of the Department of Homeland Security Reorganization (shown by the gray bar on the plot). Examining the other panels, it appears that they also began to decline after the reorganization (or, in the case of non-Chinese textiles, a pre-existing decline began to intensify). The pattern suggests that the reorganization



FIGURE 2 Number of CBP rulings by product's country of origin and textile status. The country of origin is indicated by the applicant and the HTS chapter is decided by CBP. The light bar indicates March 2003 when the US Customs Service was reorganized into the CBP. CBP, Customs and Border Protection; HTS, harmonized tariff schedule.

of Customs inside the new Customs and Border Patrol agency, an example of institutional change, affected its effectiveness as an organization. These trends are explored in a separate paper.

4 | THEORY: THE POLITICAL ECONOMY OF CLASSIFICATION

4.1 Decision to lobby for classification

Firms choose whether to lobby the classification process by weighing the costs of switching categories against the benefits. The primary benefit is achieving a lower tariff rate, but due to

the widespread use of the classification system in trade policy, sometimes firms may wish to escape a category for other reasons. Firms might also be motivated to escape a category that is a frequent target in antidumping cases. Firms may also wish to take advantage of the rules of origin and other eligibility requirements in a trade deal. Finally, there are benefits of lobbying the classification system relative to lobbying through other channels. Firms can achieve lower tariffs through classification without needing to wait for the next tariff bill to come through the legislature. Also, due to the narrow scope of each ruling, firms can lower their own tariffs through classification without necessarily also lowering the tariffs on their competitors' products. The narrowness of the rulings emphasizes how these benefits are more easily accessible to firms lobbying in their private capacity.

The primary cost of requesting a classification ruling with the intent to switch categories are the costs of retaining legal counsel.¹³ These costs can become significant if firms must appeal the ruling. Even with effective legal representation, firms do not have perfect control over the rulings made by Customs and the courts. Rulings are difficult to reverse. Unfavorable rulings can be appealed first to Customs, then to the Court of International Trade, and finally to the Supreme Court. Finally, there is an additional risk from future antidumping tariffs and other changes to the tariff schedule. Firms may wish to avoid classification into categories at risk of being included in future antidumping cases even if they currently carry a lower tariff rate.

Both the costs and benefits of lobbying for classification depend not only on the tariff assigned to individual categories but also on the tariffs assigned to similar categories. The benefits of switching categories depend on the difference in tariffs between them. The costs also depend on the structure of the tariff schedule—the consequences of an unfavorable ruling are higher if similar categories have high tariff rates. The primary implication of the theory is that the distribution of tariff rates among similar product categories will determine the propensity of firms to lobby for classification. Events that change the distribution of tariff rates will also change the pattern of classification rulings.

These insights translate naturally into two empirical predictions. First, there are greater rewards possible for moving categories when the variance in tariffs among similar categories is high. If all similar products have the same tariff rate there are fewer incentives to move categories. Second, there are more incentives to moving categories when the average tariff among similar products is higher. Few firms will seek to reduce their tariffs when tariffs are very low in all similar products.

Firms cannot simply choose any low tariff category for their product's classification—they are constrained by the plausibility of their legal arguments. The plausibility is controlled by the wording of the category descriptions. The wording of the category descriptions has previously been considered an anodyne feature of the tariff code.¹⁴ However, the precise wording of the category descriptions and the associated interpretation notes are crucial to determining how easily firms can target their preferred classification. In the *Apple Inc. v. United States* case it was clear that the exemption of "covers" from their targeted category's description required their lawyers to make a more tenuous legal argument.

S-WILEY

¹³See Section 6.2 for an empirical assessment of these costs.

¹⁴The arguments in this section address the specificity of description wording at the eight-digit level, also known as the tariff line level. A direct consequence of the tariff code's hierarchical design is that the description wording is always more precise for more disaggregated levels. These differences in precision are unimportant to firms because tariffs are set at the line level. The specificity of the category wording is only important for the classification process when comparing descriptions at the line level within a group of similar products (which is taken as the four digit or tariff heading level).

WILEY- ECONOMICS & POLITICS

10

Aspects of the tariff schedule other than the tariff rate itself can become political at the classification stage. Flexible description wording facilitates the ability of importers to argue for their preferred categories during the classification stage. Importers may also prefer that the tariff code includes a large number of categories because a higher number of categories provides more opportunities to achieve a favorable classification. Precisely worded category descriptions have a double-edged effect. Firms may find it very difficult to escape to a target category which is precisely defined, but a higher number of precisely defined categories can increase the number of categories, which creates opportunities to target other categories. Regardless, the wording of the category descriptions is a political object because it determines the ease with which different categories can be targeted by the firm. The consequences of a particular category wording can be very high because of the high degree of persistence in tariff rates (Acosta & Cox, 2022).

The literature has sometimes used the specificity of a category wording as a proxy for the degree of differentiation of the products in the category (Broda & Weinstein, 2006). The often unstated assumption is that highly differentiated products require highly specific wording for identification. However, it is not necessarily true that highly specific category wording must be an indication of a highly differentiated product. Because the category wording has implications for the possibility of tariff classification, it is possible that the wording itself is subject to political influence.¹⁵ The specificity of the category wording may reflect more than the purely economic characteristics of the products at issue.

Not all firms that interact with the classification process intend to move their products into favorable categories. Some are simply trying to ensure compliance with the Customs Modernization Act's requirement that importers correctly report their goods to Customs. Disclosures are audited, and firms might need to pay penalties if they are found to be out of compliance. It is not clear that changes in the tariff schedule would induce firms to seek classification rulings—changes in the tariff rate would not generally call the classification of goods into question. Thus, if firms request more classification rulings after an increase in tariff rates it is likely that they are attempting to escape the new tariffs.

4.2 | Classification and the political economy of protection

Figure 3 represents the classic approach to the study of the political economy of protection using dashed arrows and is loosely inspired by Grossman and Helpman (1994). Importers and protectionists lobby the legislature to promote their interests. There is substantial evidence suggesting that protectionist interests are more effective because they tend to be geographically concentrated, enabling them to punish any firms that under-contribute to the lobbying effort (Busch & Reinhardt, 1999, 2000).¹⁶ The struggle for control over the tariff schedule normally occurs in the legislature while conflict over nontariff barriers usually occurs in bureaucratic institutions. The political process results in a tariff schedule which assigns tariff rates to categories of products.

¹⁵See also Acosta and Cox (2022) for case studies of the political history of tariffs on specific products.

¹⁶An alternative mechanism explaining the success of protectionists focuses on information about the distributional consequences of liberalization. If workers are unsure about whether their wages will be benefited or harmed by trade liberalization (perhaps because they cannot discern the degree of factor mobility) then a majority may oppose liberalization even if it generates aggregate gains (Fernandez & Rodrik, 1991).



Structure of Protection

FIGURE 3 Schematic diagram of the classic approach as modified by the theory of this paper. The dashed lines represent the classic theory whereby a legislature and a bureaucratic apparatus balance the interests of firms and consumers. The legislature takes account of consumer interests because they need votes, and they take note of industry interests because they need industry buy-in for their policies and campaign contributions (De Figueiredo & Richter, 2014; Grossman & Helpman, 1994; Mitra, 1999). The legislature determines a tariff schedule assigning tariffs to product categories. The solid lines depict the additional components related to tariff classification. Importers can lobby Customs for favorable classifications. Their ability to shop for tariff rates is constrained by the tariff schedule-the wording of category descriptions and the variance of the tariff rates across similar categories. Together, the classifications decided by Customs and the tariff schedule decided by the legislature determine the actual structure of protection. Boxes represent actors, ellipses represent institutions, and octagons represent outcomes. Arrows are labeled with the mechanism of the interaction.

Figure 3 shows how the classic approach is supplemented by the political economy of classification using solid arrows. In the United States the classification process is administered by executive branch agencies (the United States Custom Service and the Customs and Border Protection agency since 2003) as overseen by the judiciary. The agencies are staffed by civil servants who are motivated to implement the laws as passed by Congress. They require information from importers about their products to do that work. Thus, importers have an opportunity to make the best legal case possible that their products should be placed into favorable categories. Importers lobby, not by meeting with policymakers in smoke-filled rooms, WILEY & POLITICS

12

but by providing information about their products in a relatively transparent institutionalized system. But the system is not politically neutral—it gives importers the opportunity to make their case to the bureaucracy with limited interference from protectionists.

The diagram illustrates how the political economy of protection is both an intertemporal and interinstitutional process. While import-competing industries emphasize the traditional channels of lobbying the legislature or the regulatory bureaucracy, importers can escape these barriers by focusing their attention on Customs. Importers can still lobby the legislature or try to oppose antidumping initiatives. But they must decide where to direct their limited resources for lobbying—towards Customs or the traditional arenas of protection. Choosing Customs means that they might secure a favorable classification within a relatively short timeframe. Choosing the legislature gives them an ability to reduce tariffs directly but they must wait for an opportunity in the form of a trade deal negotiation or another legislative initiative. Importers that choose to prioritze the classification channel can lobby in their private capacity but they need to coordinate with other firms when lobbying in other channels.

The political economy of classification theorizes how firms are using the classification system to escape from tariffs. It describes how importing firms spread their lobbying efforts across both legislative and bureaucratic channels while import-competing firms are constrained to focus their efforts to directly affect the tariff schedule on legislative lobbying.¹⁷ The implication is that the importers which choose to allocate scarce resources towards legislative lobbying are choosing not to put those resources towards bureaucratic lobbying. Therefore, classic studies of the political economy of protection that focus only on legislative lobbying could be studying a highly nonrandom subset of the lobbying for free trade. In particular, firms that produce highly differentiated products should be more inclined to lobby the classification process because of how narrowly the classification rulings are applied. Importers choosing to emphasize bureaucratic lobbying over legislative lobbying might be invisible to studies that only consider how firms spend resources on legislative lobbying.

5 | HYPOTHESES AND RESEARCH DESIGN

The primary empirical prediction from the theory is that more firms will attempt to shop around for favorable tariff rates when tariffs are steeper. The prediction can be operationalized in at least a few ways. First, importers should be more likely to request a classification ruling if tariffs in a group of similar products are relatively high. Second, importers should be more likely to request a classification ruling when there are plausible alternative categories with low tariffs. Third, importers should be more likely to request classification rulings for categories whose descriptions are flexibly worded because it is easier for firms to make a plausible legal argument for classification in the category. Fourth, changes in the tariff code such as new quotas or tariffs should cause spikes in classification requests for those products. Each of these predictions will be assessed empirically in Sections 6.3, 6.4, 6.5, and 6.6. The combination of intertemporal, inter-sectoral, and case study analyzes robustly assess the relationship between tariffs and classification rulings. To aid the interpretation of the results, some descriptive statistics on the key variables are provided in Supporting Information: Appendix Table 5.

¹⁷As discussed previously, there are avenues for import-competing firms to pursue nontariff barriers such as antidumping duties. But they have relatively few available paths if they wish to change the tariff schedule.

Unfortunately, the available data are somewhat limited in their ability to evaluate these predictions from the theory unless certain assumptions are made. The most significant limitation is that the rulings indicate only Customs' decision on the product's classification and contain very limited information about whichever alternative possible classifications were considered. Without knowledge of the set of plausible classifications for each product it is not possible to directly evaluate whether the firm was able to successfully achieve a low tariff classification.¹⁸ For the same reason, it is difficult to obtain a good sense of the consequences of the political economy of classification for tariff revenue. To make progress, some weak assumptions must be made when interpreting the CROSS data. First, the analysis will assume that attempts to escape from a particular category are not always successful. Therefore, an increase in the frequency of rulings that classify a product into a category could represent either an increase in unsuccessful attempts to escape the category or an increase in successful attempts to reach the category. It is still necessary to define a set of comparable product categories to evaluate how successfully firms are avoiding tariffs. Second, the analysis will assume that the set of plausible alternative classifications is some subset of the tariff heading.¹⁹

To study the relationship between classification rulings and lobbying, data on the firms that requested classification rulings were collected from over 100,000 rulings.²⁰ Because most rulings are issued in the form of a letter to the applicant, it is normally possible to extract the name of the firm that submitted the request from the ruling's text. These names were then approximately matched to the names of firms appearing in the firm-level LobbyView database (https://www.lobbyview.org/) (Kim, 2018). The LobbyView database contains information from thousands of digitized lobbying reports filed under the Lobbying Disclosure Act of 1995. The merged data set was then supplemented with firm and industry level control variables (Bown, 2005; Feenstra et al., 2002).²¹ To separate importing firms from import competing firms, the data set also includes sector-level information about dependence on foreign inputs from the World Input-Output Database (Timmer et al., 2015, 2012). These data are deployed in Section 6.7.

6 | **RESULTS AND ANALYSIS**

6.1 Do firms use classifications strategically? The case of Heartland By-Products

Perhaps the most crucial question about the political economy of classification is the extent to which it is actually about importers using the system to escape from tariffs. It is true that some

S-WILEY-

¹⁸Some rulings do indicate the alternative categories considered by Customs. However, Customs appears to have a lot of discretion to choose the discussion's level of detail. Sometimes many categories are discussed, sometimes just a few, and typically none at all. There appears to be no systematic information available from the rulings on the alternative categories under consideration.

¹⁹The heading level corresponds to the four-digit codes of the hierarchical tariff classification scheme. While there are clearly products which could be sorted into categories under multiple headings, industry experts have validated the use of headings as a heuristic for comparability in interviews with the author.

²⁰Although the main data set contains 200, 000 rulings, firm names could only be reliably extracted from rulings after 2000. Therefore the firm level data set covers the 100, 000 rulings issued since 2000.

²¹Because of the presence of privately owned firms I relied on Bureau van Dijk's *Orbis* data set for firm-level control variables. Feenstra, Romalis, and Schott's trade database was most recently updated by Schott in 2018. I also use tariff data from the International Trade Commission and data on antidumping cases from Bown (2005). When industry-level variables need to be connected to the classifications I use the concordance provided by Pierce and Schott (2012). Finally, to ascertain whether a given product category consists of mostly differentiated products the elasticities of substitution from Fontagne et al. (2019) were merged to the final data set.

WILEY- ECONOMICS & POLITICS

14

importers request classification rulings without targeting a low tariff category simply to ensure their compliance with customs law. At least some requests for rulings are motivated by a desire to limiting transactions costs associated with international trade—to create certainty about the tariff that will be charged and to guard against future litigation. Is there any evidence that firms treat classification politically? To demonstrate that the political aspects of the classification process have not escaped the interest of firms this section briefly discusses the case of a firm whose use of the classification system fell afoul of some politically powerful groups.²²

For the sake of transparency, it should be noted upfront that the case of Heartland By-Products is atypical in two major ways. First and most importantly, a classification ruling was directly challenged by domestic industry in this case. As discussed above, this mechanism has only been invoked fewer than 30 times since 1994. Second, members of Congress became directly involved in the ruling process. Congress rarely intervenes in the classification process, appearing to choose the fire-alarm method of oversight in this instance (McCubbins & Schwartz, 1984). The purpose of studying the case is to demonstrate how classification can matter to firms and how a seemingly innocuous technical process can create distributional consequences that determine the structure of protection.²³

6.1.1 | SCT, LLC and the Livewire Flash Drive

In light of the atypical nature of the Heartland case, it is useful to first describe a more typical case of how firms lobby the classification system which can be used for comparison. In August 2010 Customs issued a ruling on the classification of the "Livewire Flash Device" imported by SCT, LLC, a manufacturer of aftermarket automobile parts. This product connects to Ford motor vehicles and enables users to "diagnose potential problems, adjust certain performance settings, and record performance data." Customs is considering two possible classifications for the product: (1) an apparatus for transmitting data (duty free) or (2) a device for measuring or checking instruments (1.7% ad valorem tariff).²⁴

The text of the ruling letter reveals prolonged contact between Customs and counsel representing the firm. The ruling refers to a phone conference between counsel and Customs in June 2010. The ruling also references at least two written communications occurring before July 2010. Initially, counsel proposed that the product be classified as an "automatic data processing" device, but later withdrew that contention after discussions with Customs. Their second communication argued for classification as an apparatus for data transmission citing precedent from previous rulings. Although the exact nature of these communications remains unknown, it is notable that lawyers for SCT were in contact with Customs officials for several months.

²²The section draws on the contemporary journalistic accounts of the incident by Rabson (2000), Palmer (2000), Morgan and Sarasohn (2000), Staff (2000), Salant (2000), and particularly Tirschwell (1999).

²³Of course, even if classifications are mostly motivated by circumspect firms seeking to avoid surprising litigation and tariffs the process may yet play a political role. As discussed extensively by Williamson (1979), transactions costs can greatly affect the structure of economic relations. If the bureaucracy is designed to help importers reduce transactions costs then it is also harming the interests of protectionists who would prefer that the act of importing be a risky endeavor (see also Williamson, 1999).

²⁴Specifically, Customs was choosing between a classification within heading 8517: "Telephone sets, including telephones for cellular networks or for other wireless networks; other apparatus for the transmission or reception of voice, images or other data, including apparatus for communication in a wired or wireless network (such as a local or wide area network), other than transmission or reception apparatus of heading 8443, 8525, 8527 or 8528; parts thereof:" and heading 9031: "Measuring or checking instruments, appliances and machines, not specified or included elsewhere in this chapter; profile projectors; parts and accessories thereof."

On August 2, 2010, Customs ruled against SCT and classified the device as a device for measuring or checking instruments.²⁵ However, SCT was able to protest the ruling. Counsel had filed their appeal by September 2010. A meeting was held at the Customs office on May 26, 2011, where counsel presented additional arguments. They also submitted an additional written communication in June 2011. It appears that the primary objective of the SCT lawyers was to persuade Customs that the primary use of their device was "to improve such aspects as fuel mileage and other vehicle functions," not merely to monitor data from the vehicle's engine. Evidently, Customs found these additional arguments to be persuasive. On August 9, 2012, Customs issued a new ruling that simultaneously revoked their 2010 ruling and reclassified the Livewire device as an apparatus for transmitting data.²⁶

The case of SCT's Livewire is a typical example of how firms work to escape from tariffs. The firm sought its preferred classification by retaining counsel and submitting legal arguments to Customs. In this case, they needed to appeal the initial ruling, which probably resulted in additional legal costs. The communication by private correspondence and meetings behind closed doors illustrate the semi-transparent nature of these proceedings. The ultimate legal justification of the classification is available to the public in the form of the ruling. Notably, at no point do any of SCT's domestic competitors participate in the process. Any firms that compete with SCT's imports have no direct role in the process. The Heartland By-Products case shows what import competing firms must do to directly influence the classification process.

6.1.2 | Heartland By-Products, Inc.

The US sugar market is protected by a type of quota called a tariff rate quota. The sugar products subject to the tariff rate quotas are enumerated by their categories in the tariff schedule. In mid-1995 the firm Heartland By-Products developed a strategy to import sugar without it being subject to the quotas. First, they received an advance classification ruling indicating that their imported syrup from Canada would not be subject to the sugar import quotas. Next, Heartland promptly invested \$7 million in a processing plant that could transform the imported syrup into sugar which could then be sold on American markets.

The strategy had two effects on the US domestic sugar market. First, the supply of sugar was increased by an amount which may have had a small effect on prices. At its peak Heartland's single processing plant represented 0.5% of the entire US sugar market. Second and perhaps more importantly, Heartland's strategy actually decreased US sugar imports despite the fact that Heartland was now importing syrup from Canada. Because the syrup had a tariff classification which was not subject to the sugar quotas it was not counted in the trade statistics on sugar imports. The syrup was transformed into sugar in the United States, which meant that Heartland's sugar was produced inside the United States and did not count as an import. The sugar industry had a previous arrangement with the government where loans from the Department of Agriculture would be forgiven if the total sugar imports were estimated above 1.5 million tons at the beginning of the fiscal year. The estimates were threatening to dip below the threshold because of how Heartland's scheme reduced sugar imports. There was a possibility that Heartland could inadvertently cause a significant increase in the financial liabilities of sugar producers.

15

MICS -WILEY-

²⁵Ruling H097095 is available in full at https://rulings.cbp.gov/ruling/H097095.

²⁶Ruling H126020 is available in full at https://rulings.cbp.gov/ruling/H126020.

WILEY- ECONOMIC & POLITIC

16

In December 1997, the sugar industry met with Customs officials, the Deputy Assistant Secretary of the Treasury, and staff of the co-chairmen of the Senate Sweetener Caucus. They soon filed a formal petition for the revocation of Heartland's ruling. In January 1998, Heartland learned that their ruling was under review, but they were unable to obtain the petition until March through the Freedom of Information Act. They contacted their Congressman, John Dingell (D-MI), who contacted the Department of Treasury and Customs on their behalf. According to an internal sugar industry memo reviewed by journalists, sugar industry executives were told that "political muscle" would help their cause. The sugar executives then asked senators to send a letter to the Secretary of the Treasury requesting that the ruling be revoked. The letter, signed by 22 senators, was sent in September 1998. It took another several months but in June 1999 Customs recommended that Heartland's ruling be revoked.

Heartland then sued to prevent Customs from following through on the revocation. Due to highly complex litigation, Heartland only ceased importing the syrup in 2001. The last legal disputes were finally settled in 2009, more than 14 years after the initial classification ruling was issued. The litigation in the Heartland case is a reminder that the Customs bureaucracy also does not exist in an institutional vacuum—the courts are ultimately the entity that determines classification in the event of a dispute. The threat of litigation and the disposition of the judges to free trade must play a role in classification decisions. The key judicial institution to the classification process is the degree of judicial deference afforded to Customs, or the degree to which the courts are willing to yield to Customs' legal reasoning. The degree of judicial deference to Customs impacts the difficulty of overturning a classification decision on appeal. The difficulty of an appeal in turn affects the willingness of firms to use the classification system to lower their tariffs because firms always risk receiving an unfavorable ruling. The degree of judicial deference has varied over time with somewhat regular input from the Supreme Court.²⁷

The case of Heartland By-Products highlights how classification can become political. Heartland may have initially sought a ruling with the intent to circumvent the quotas or simply to better understand their import costs. Regardless of whether their motivation was technical or strategic, the ruling had a significant impact on the profits of the domestic sugar industry. In many cases the story ends here—the importer achieves a better outcome by virtue of having more access to the bureaucratic institutions responsible for enforcing the customs law. In this case, the sugar industry was able to overcome barriers to collective action and leverage its existing political connections to reverse the ruling.

6.2 What are the magnitudes of the costs and benefits of requesting a classification?

The benefits to obtaining favorable classification are substantial enough that firms sometimes manipulate the manufacturing process to bolster their claim to a particular category. This phenomenon is called "tariff engineering" and dates to at least the late 19th century in the United States. For a modern example, some imported sneakers are given a layer of textile on the

²⁷The most important case on judicial deference is United States v. Mead Corp., 533 U.S. 218, 121 S. Ct. 2164, 150 L. Ed. 2d 292 (2001) which directly addresses the Customs advance classification rulings. Other cases frequently referenced include Chevron USA Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 104 S. Ct. 2778, 81 L. Ed. 2d 694 (1984) and Skidmore v. Swift & Co., 323 U.S. 134, 65 S. Ct. 161, 89 L. Ed. 124 (1944).

sole so that they can be legally imported at a far lower duty as slippers. In two rulings from 2001, Customs indicated its willingness to interpret any fabric on the bottom of the shoe as the soling material for the purpose of classification (rulings G89205 and G89960). Firms explored how they could design soles that could qualify for the lower duty. One patent for a method of adding felt to soles described the invention's purpose with illuminating clarity: "Depending upon the material which is used to manufacture the upper and the sole, the rate of the duty may vary significantly. For example, the rate of duty may range from 37.5% ad valorem for many common types of footwear to 3% ad valorem for certain types of sandals and similar footwear ... a classification may be based on the type of material that is present on 50% or more of the bottom surface of the shoe (outer sole) that contacts the ground" (Safdeye, Wu, and Stein U.S. Patent 6 571 491, Mar., 2001). The shoe manufacturer Converse added fabric to many versions of its popular "Chuck Taylor All Star" sneakers to achieve a more favorable classification, a practice which continues to the present.

The decision to permit sneakers to be classified as slippers had economically significant consequences. Between 1996 and 2001 there was a 217% increase in importation of "textiled soled house slippers" paired with a 45% decrease in importation of "rubber soled slippers" from 2000 to 2001 when Customs issued the first rulings on the subject. As can be seen in Figure 4, imports of footwear classified in the low tariff category 6405.20.9015 soared while imports in the high tariff category 6404.19.3515 languished. Had the imports of footwear with textile soles been charged the tariff applied to footwear with rubber soles, importers would have paid more than \$191 million in tariffs from 2001 to 2005. Switching to the low tariff category saved the industry approximately \$127 million over that period. The economic consequences were significant enough that protectionist interests lobbied to reverse the trend. In 2002 a consortium of domestic shoe producers argued that the practice of adding felt and other fabrics to the soles of shoes constituted "disguise or artifice" and should be under the Supreme Court case United States v. Citroen, 223 U.S. 407 (1912). Customs found that, because the shoes were sold with the fabric still attached to the soles, the products could be classified as slippers. They further argued that if the product were not properly classified as slippers then it would be incumbent on the US Congress to change the tariff code (ruling 965751). As of 2018, around 98% of sneakers sold in the US were manufactured abroad (Bhattarai, 2018). The significance of a handful of rulings for the shoe industry is indicative of the importance of classification to the global economy.

The costs of lobbying the classification process are not easily ascertained but there is sufficient evidence to show they can be substantial. The primary financial consideration is the cost of legal counsel, but law firms have few incentives to be transparent about their bill rates. Nonetheless, there are times when lawyers are forced to disclose their fees. When firms disagree with a classification ruling they can sue the government for it to be overturned in the Court of International Trade. Firms that are successful in court and request that the government cover their attorney's fees under the Equal Access to Justice Act (EAJA). Only firms that are successful in court and have a sufficiently small size are eligible to receive relief under the Act and the court has the ability to partially grant requests. But when they do apply for relief, firms are forced to disclose information about their costs of litigation. A review of cases where relief under the EAJA was sought reveals that the costs of litigation have risen over time. In the 1990s lawyers were charging between \$150 and \$250 per hour for work on classification-related matters, but in 2014 the court decided that rates had risen to between \$300 and \$450 per hour. As part of their EAJA applications firms disclosed total fees ranging from around \$10,000 to \$300,000 for a

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Classification — Rubber Sole (HTS 6404.19.3515) — Textile Sole (HTS 6405.20.9015)

FIGURE 4 Following the classification rulings NY G89205 and NY G89960, imports of footwear with textile soles soared while imports of footwear with rubber soles declined. These two rulings, both issued on April 19, 2001, established that the material of the sole could be classified in the low tariff category 6405.20.9015.

given case.²⁸ For context, these values would be between the 30th and 95th percentile of all EAJA awards reported by the Department of Homeland Security in 2020–2021, which is consistently the department reporting the highest EAJA awards in the entire government. Costs are almost certainly higher for firms that are too large to be eligible for relief under the EAJA. Costs for firms that initially receive favorable classifications from Customs are almost certainly lower. Nonetheless, these costs are indicative of the possible investment firms must make to contest a ruling.

²⁸ Cases substantiating these numbers include: Consol. Fibers, Inc. v. United States, 39 Int'l Trade Rep. (BNA) 2430, 2017 Ct. Intl. Trade LEXIS 156, SLIP OP. 2017-157 (United States Court of International Trade November 27, 2017, Decided); Am. Bayridge Corp. v. United States, 24 C.I.T. 9, 86 F. Supp. 2d 1284, 22 Int'l Trade Rep. (BNA) 1006, 2000 Ct. Intl. Trade LEXIS 1, SLIP OP. 2000-3 (United States Court of International Trade January 5, 2000, Decided); Inner Secrets/Secretly Yours v. United States, 20 C.I.T. 210, 916 F. Supp. 1258, 18 Int'l Trade Rep. (BNA) 1289, 1996 Ct. Intl. Trade LEXIS 44, SLIP OP. 96-33 (United States Court of International Trade February 7, 1996, Dated); Automatic Plastic Molding, Inc. v. United States, 27 C.I.T. 1095, 276 F. Supp. 2d 1362, 25 Int'l Trade Rep. (BNA) 1968, 2003 Ct. Intl. Trade LEXIS 94, SLIP OP. 2003-94 (United States Court of International Trade July 28, 2003, Decided); Shah Bros. v. United States, 38 C.I.T. 1314, 9 F. Supp. 3d 1402, 36 Int'l Trade Rep. (BNA) 940, 2014 Ct. Intl. Trade LEXIS 110, SLIP OP. 2014-109 (United States Court of International Trade September 18, 2014, Decided); United States v. Hi-Temp Specialty Metals, 22 C.I.T. 51, 20 Int'l Trade Rep. (BNA) 1139, 1998 Ct. Intl. Trade LEXIS 1, SLIP OP. 98-12 (United States Court of International Trade February 6, 1998, Dated); United States v. Pressman-Gutman Co., 34 C.I.T. 1200, 721 F. Supp. 2d 1333, 32 Int'l Trade Rep. (BNA) 1925, 2010 Ct. Intl. Trade LEXIS 109, SLIP OP. 2010-105 (United States Court of International Trade September 16, 2010, Decided); Libas, Ltd. v. United States, 27 C.I.T. 1193, 283 F. Supp. 2d 1327, 25 Int'l Trade Rep. (BNA) 2020, 2003 Ct. Intl. Trade LEXIS 102, SLIP OP. 2003-103 (United States Court of International Trade August 13, 2003, Dated); Universal Percussion v. United States, 19 C.I.T. 546, 17 Int'l Trade Rep. (BNA) 1412, 1995 Ct. Intl. Trade LEXIS 99, SLIP OP. 95-64 (United States Court of International Trade April 13, 1995, Decided); Nat'l Bonded Warehouse Ass'n v. United States, 14 C.I.T. 856, 754 F. Supp. 874, 1990 Ct. Intl. Trade LEXIS 597, SLIP OP. 90-134 (United States Court of International Trade December 21, 1990, Decided).

6.3 | Are there more tariff classification rulings in headings with higher or more varied tariff rates?

Higher average tariffs within a tariff heading raise the stakes for classification and high tariff variance ensures that there are low tariff lines within a heading that can serve as target destinations. High average tariffs have two effects: (1) firms are more likely to spend resources to reduce a higher tariff and (2) higher tariffs can also reduce the quantity demanded in addition to raising the firm's costs. High tariff variance means that any products initially given an unfavorable classification have more plausible alternative classifications with lower tariffs. If importers are attempting to escape from tariffs then there should be more requests for advance classification rulings in headings with higher average tariffs and higher tariff variance. These two hypotheses are supported in Figure 5. As shown by the lines of best fit, the number of rulings is increasing in both the mean and variance of the tariffs within a heading (Figure 6).

6.4 | Are there more rulings requests in categories with flexibly worded descriptions?

The theory predicts that flexibly worded categories should attract requests for classification rulings. Category descriptions which are flexible are both easier to escape from if its tariffs are high or to enter if its tariffs are low. The concept of a "flexibly worded" category can be



FIGURE 5 The number of rulings within a tariff heading increases in both the mean and the variance of the tariffs in that heading. Due to the presence of a small number of extreme outliers, the heading level variances are top-coded at a threshold of 2%. Both figures show a bin scatter plot and a line of best fit.

19

WILEY



FIGURE 6 The number of rulings associated with a six-digit tariff code is decreasing in its elasticity of substitution. Two-dimensional binning is used to avoid overplotting. The count of six-digit tariff codes inside each box is shown by the box's color. All categories with zero elasticities of substitution or fewer than five classification rulings have been excluded. The black line is a cubic polynomial spline.

operationalized using the mean string distance between category descriptions among similar products. The distance between two sentences, or strings, is the minimal number of insertions, deletions, and substitutions required to transform one string into another.²⁹ For example, the distance from apple to orange is 5 because there are 1 insertions, 0 deletions, and 4 substitutions necessary to make the transformation.³⁰ "Flexible" categories have low average string distance because there are fewer distinctions between them; "rigid" categories have high average string distance because the descriptions are very specific.

I calculate the mean distance between any two product descriptions within a tariff heading.³¹ Category descriptions which are very similar to the other descriptions in their heading will have a low average string distance. These values were standardized by heading to account for idiosyncratic differences in the language used to describe different types of

account under the terms of additional U.S. note 5 to this chapter, which is tariffed at a 12.5%. The string distance between these descriptions is 28, which contributes to the average string distance applied to tariff heading 6404.

²⁹These techniques are commonly used in the literature on natural language processing. See, for example, Cohen et al. (2003). ³⁰For another example, consider tariffs 6404.19.52: With uppers of vegetable fibers and having outer soles with textile materials having the greatest surface area in contact with the ground, but not taken into account under the terms of additional U.S. note 5 to this chapter which is tariffed at 7.5%, and 6404.19.57: With uppers of textile material other than vegetable fibers and having outer soles with textile materials having the greatest surface area in contact with the ground, but not taken into

³¹Tariff headings are defined as four-digit level categories of the tariff schedule and tariff lines are defined as the eight-digit level of the tariff schedule.

products. The theory would predict that categories with smaller average string distance would have more classification requests and rulings.

Table 1 shows ordinary least square regressions on the determinants of theoretical interest. When a tariff line is worded more precisely (meaning that its description is less similar to the descriptions of other tariff lines within the same heading) there are fewer classification rulings associated with the line. The relationship is stable across several specifications.

Also, the regressions in Table 1 show that product lines associated with a higher elasticity of substitution have fewer classification rulings. The elasticity of substitution is an indicator of the degree of product differentiation. A product which is highly differentiated cannot be easily substituted for another and so would have a low elasticity of substitution. The regressions show that higher elasticities of substitution are associated with fewer classification rulings. This result confirms the earlier conjecture that the benefits of lobbying for favorable classifications are largely private. Classification rulings apply narrowly to a particular firm's product, so there are few advantages to coordinating lobbying activity across firms. As a consequence, most rulings occur in highly differentiated product categories.

6.5 | Do temporary quotas cause an increase in the number of classification requests?

The following two sections introduce case studies designed to examine how changes in trade barriers affect demand for classification rulings in finer detail than was possible so far. The first section studies the termination of the Multifiber Arrangement (MFA), which was a multinational system of quotas in the textile industry. During the Uruguay Round in 1995 members of the newly created World Trade Organization agreed to replace the quota system with tariffs. The MFA would be phased out in four waves the last of which was implemented in 2005. China was allowed to become a member of the WTO in 2001 which meant that it would also benefit from the end of the MFA. But during negotiations, it agreed to delay its access to the full benefits of membership at the behest of the US and other states. One concession was that states were permitted to implement a special safeguard applicable only to China which would allow the reimposition of quotas for certain textile products. At the urging of textile producers, the US slowly reimposed quotas on a number of textile products using this mechanism between 2003 and 2005 which greatly frustrated Chinese exporters and US retail firms. To resolve their dispute over the US's adherence to WTO rules, China and the US initiated negotiations.

On January 1, 2006, the United States and China implemented a memorandum of understanding that permitted the full reimposition of quotas on most Chinese textile products, but only for a maximum of 3 years. US textile producers were somewhat satisfied, but the US importers and Chinese exporters were disappointed that they had longer to wait before they could access the Chinese market. Some textile products were exempt from the quotas, and these products were identified by their classification. There is some evidence that Chinese exporters attempted to evade the quotas by deliberately misclassifying their products into nonquota categories without having an official classification ruling (Leonard, 2006). To what extent did importers attempt to legally evade the quotas by seeking a classification ruling into a non-quota category?

Figure 7 plots the cumulative count of rulings over time by Chinese origin and the relevance of the classification identified in the ruling to textiles. The vertical line indicates the date on which the new temporary quotas were implemented. Each product is placed into one of four categories: either

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TABLE I ariff line.	Regression analysis of the key determinants of the number of rulings associated with a given
	Dependent variable
	log(Count of rulings + 1)

(1)	(2)	(3)	(4)	
-0.014***	-0.014***	-0.015***	-0.015***	
(0.001)	(0.001)	(0.001)	(0.001)	
-0.004***	-0.004***	-0.004***	-0.004***	
(0.0001)	(0.0001)	(0.0001)	(0.0001)	
		23.924***	24.713***	
		(0.850)	(0.841)	
		0.171***	0.086***	
		(0.031)	(0.030)	
		0.005	0.004	
		(0.011)	(0.009)	
0.240***	197.124	0.191***	-621.325***	
(0.002)	(125.337)	(0.002)	(124.350)	
No	Yes	No	Yes	
209,804	209,804	205,714	205,714	
0.004	0.017	0.019	0.033	
	-0.014*** (0.001) -0.004*** (0.0001) (0.0001) 0.240*** (0.002) No 209,804 0.004	••••••••••••••••••••••••••••••••••••	Image: contract of the second get table(1)(2)(3) -0.014^{***} -0.015^{***} (0.001)(0.001)(0.001) -0.004^{***} -0.004^{***} -0.004^{***} (0.0001)(0.0001)(0.0001)(0.0001)(0.0001)(0.0001) -0.004^{***} -0.004^{***} (0.0001)(0.001)(0.0001)(0.0001) -0.004^{***} 0.0001 (0.005)(0.011)0.005(0.011) 0.240^{***} 197.1240.191^{***}(0.002)(125.337)(0.002)NoYesNo209,804209,804205,7140.0040.0170.019	

Note: The mean string distance has been standardized by heading. The elasticity of substitution applies to the six digit level of the tariff code (Fontagne et al., 2019). The distance from median is the difference between the tariff associated with that line and the median tariff within its heading. The standard errors are heteroskedasticity and autocorrelation robust. Poisson and Zero Inflated Poisson specifications are available in Supporting Information: Appendix 9.

it is not a textile product and not affected by the reimposition of quotas (Not a Textile), it is clearly subject to the new quotas (Quota Applied), it is a textile product but not subject to the new quotas (Textile (No Quota)), or it is explicitly made exempt from the quotas in the agreement (Quota Exempt). Most products that were explicitly exempted were "knit to shape." There are also dashed lines showing linear predictions of the trend for each series from before the imposition of the quotas. The graph shows that immediately after the quotas were implemented there was an increase of rulings concerning textile products from China. The cumulative count for the Quota Exempt category departs from trend especially dramatically. These increases do not appear in textile products of non-Chinese origin and they also do not appear in nontextile products.

The data suggest that some firms were successful at securing favorable classifications once the quotas were implemented. Increases in the "Quota Applied" category suggest that some firms were not successful. The case illustrates how firms can use the institutions of classifications to obtain preferable outcomes. The results are corroborated using various specifications from a regression framework reported in Table 2. These regressions take the

p < 0.1.**p < 0.05.***p < 0.01.



FIGURE 7 Effect of temporary quotas on tariff classifications. The plot shows a bin scatter of daily data by tariff line with a loess curve included. The vertical ine indicates the date that the quota system from the United States-China Memorandum of Understanding was implemented. Quota Applied means that the listed product was subject to a quota as part of the United States-China Memorandum of Understanding. Quota Exempt means that the listed product is either one of the HS codes created to identify articles that are knit to shape and exempt from the China quota or one of the antecedant codes.

shifted log count of rulings as the dependent variable and include controls for factors that could also affect rulings.

Do the 2018 China tariffs cause an increase in the number of 6.6 classification requests?

President Donald J. Trump imposed tariffs on products from China under Section 301 of the Trade Act of 1974 during an extended confrontation over trade policy. As of the time of writing, the China tariffs have been implemented in three waves mostly during the summer of 2018. The first China tariffs came into effect on June 20, 2018, a second wave of products was added on August 16, 2018, and a massive number of additional products was added on September 24, 2018. These tariffs are very steep at 25% ad valorem. Would firms undercut the effectiveness of the tariffs by using the classification system to escape them?

Careful consideration of the importers' incentives to use the classification system to escape the China tariffs reveals its limits. Importers face additional risks when relying on the classification system to escape tariffs that do not apply in other contexts because the China tariffs could be removed in the future. There are at least three consequences of the tariffs' impermanence and their targeted scope. First, in the event of a reclassification that successfully avoids the China tariffs, the new MFN

4	ECONOMICS
	& POLITICS

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	Dependent variable					
	log(Count of rulings + 1)					
	(1)	(2)	(3)			
Treatment	0.018***	0.017***	0.015***			
	(0.001)	(0.001)	(0.001)			
Quota Applied	-0.002**	-0.003***	-0.004***			
	(0.001)	(0.001)	(0.001)			
Quota Exempt	0.072***	0.070***	0.079***			
	(0.004)	(0.004)	(0.005)			
Textile (No Quota)	0.004***	0.003***	0.001			
	(0.001)	(0.001)	(0.001)			
Treatment × Quota Applied	-0.021***	-0.022***	-0.017***			
	(0.002)	(0.002)	(0.003)			
Treatment × Quota Exempt	0.096***	0.092***	0.086***			
	(0.016)	(0.016)	(0.016)			
Treatment * Textile (No Quota)	-0.023***	-0.025***	-0.018***			
	(0.002)	(0.002)	(0.002)			
Month Dummies and Quadratic Trends	No	Yes	Yes			
Controls	No	No	Yes			
Observations	221,304	221,304	169,555			

TABLE 2	Models studying	the effect of	temporary	textile quotas	on classification rulings.
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Note: Under all specifications there are large increases in the number of classification rulings that sort a product into an exempt category after the imposition of the quotas. "Treatment" refers to the period in which the quotas were active. Control variables include the MFN tariff rate of the product, the heading level variance and mean, and whether the product's tariff is above the heading level mean. Poisson specifications are included in Supporting Information: Appendix 10.

****p* < 0.01.

tariff rate could be higher than previously. While the firm avoids the additional China tariffs, their product would continue to be charged the higher rate if the China tariffs are removed. Also, Customs would apply the new higher rate retroactively, so the firm would need to pay additional taxes on previous imports. Second, the China tariffs are specific to China but tariff classifications apply to all imports. A firm that imports from multiple countries may not benefit from reclassification if it means paying higher duties on imports from other sources. Third, firms can apply for specific exemptions from China tariffs through the United States Trade Representative, which would not involve reclassification. Nonetheless, firms facing hardship because of the tariffs may resort to the use of the classification system to escape the China tariffs.

Figure 8 shows how firms reacted to the imposition of the tariffs. It illustrates the cumulative count of tariff classification rulings as the China tariffs were being implemented. The gray bar indicates the period during which tariffs were raised on three lists of products. The dashed lines show linear trends from before the first tariffs were raised. Interestingly, there is a

^{*}p < 0.1. **p < 0.05.



FIGURE 8 Tariff classification rulings related to the China tariffs by country of origin. The plot shows the cumulative count of daily data by tariff list and Chinese origin. The vertical bar indicates the dates where the tariffs were being raised. Trend lines projected from before the tariffs system are included.

clear increase in the number of classifications recorded for all products of Chinese origin regardless of whether they were on any list. There is evidence that some firms were successful at securing favorable classifications while others were not. Regardless, firms utilized the classification system far more once the tariffs were implemented.

What was the effect of tariffs on the frequency of classification rulings for affected products relative to unaffected products? The relative differences can be analyzed in a regression framework, which is illustrated in Table 3. The first regression shows the simple ordinary least squares specification where treatment is defined as both being (1) a product on one of the three China tariffs lists and (2) a date following the list's implementation. The result is actually a negative effect which suggests that other confounding trends are overwhelming the effect of the China tariffs. Adjustment for these confounding trends occurs in the second regression which adds control variables, month dummy variables to deseasonalize the data, and quadratic trends to detrend the data. The addition of the controls turns the effect of the China tariffs on rulings requests positive. The effect is similar for an analysis conducted at the heading level, where the product is considered treated if its heading appears on a China tariff list and the list has been implemented. This regression is designed to identify cases where firms were successful at avoiding the China tariffs-the products were classified within a heading but not into a category subject to the tariffs. Finally, the same regression is run where treatment is again redefined to only examine products originating from China after the first list was implemented, which is another way of identifying the successful cases of firms escaping the China tariffs. This regression again finds a higher number of classification rulings for affected products following the implementation of the China tariffs.

WILEY- & POLITICS

26

	Dependent variable				
	log(Count o	of rulings + 1)			
	(1)	(2)	(3)	(4)	
Treatment (affected lines after tariffs)	-0.027***	0.007*			
	(0.003)	(0.004)			
Treatment (affected headings after tariffs)			0.008**		
			(0.003)		
Treatment (Chinese origin after tariffs)				0.016***	
				(0.003)	
MFN rate		0.077***	0.077***	0.077***	
		(0.009)	(0.009)	(0.009)	
MFN Rate Heading Mean		-0.002***	-0.002***	-0.002***	
		(0.001)	(0.001)	(0.001)	
MFN tariff (mean by heading)		0.098***	0.098***	0.099***	
		(0.011)	(0.011)	(0.011)	
MFN tariff (variance by heading)		-0.091***	-0.091***	-0.092***	
		(0.011)	(0.011)	(0.011)	
Constant	0.751***	-635.738***	-646.334***	-706.937***	
	(0.0004)	(52.641)	(53.785)	(55.535)	
Month dummies	No	Yes	Yes	Yes	
Quadratic trends	No	Yes	Yes	Yes	
Observations	212,831	158,863	158,863	158,863	

TABLE 3 Regressions illustrating the relationship between the imposition of the China tariffs and the frequency of classification rulings.

Note: Heteroskedasticity and autocorrelation robust standard errors are reported. Poisson and quasi-Poisson specifications are available in Supporting Information: Appendix 11.

*p < 0.1.

**p < 0.05.

***p < 0.01.

6.7 | Do the same firms that heavily lobby the legislature also heavily use the classification system?

Table 4 demonstrates how firms rely on the legislative and classification processes at an extensive margin. It shows the fraction of firms that accumulate significant lobbying expenditure and/or significant numbers of classification rulings between 2000 and 2020.³² Consistent with existing findings on lobbying in the literature, the vast majority of firms do not spend significant amounts on lobbying (Huneeus & Kim, 2018; Kim, 2017; Osgood, 2017). This pattern is also observed in the realm

³²Total lobbying expenditure between 2000 and 2020 was deemed significant if it exceeded \$1 million. Three or more total classification rulings over the same period was considered significant.

Insignificant lobbying

Significant lobbying

		In	significant 1	rulings			Significar	nt ruling	s
classification	rulings.								
TABLE 4	Count of firms	having significant	spending on	lobbying	Congress	and/or a	significant	number	01

3155 (80.81%)

448 (11.48%)

f

Note: Lobbying was deemed significant if it amounted to at least \$1 million between 2000 and 2020. The number of classification rulings was deemed significant if there were at least three rulings associated with the firm over the same interval. Only 92 firms (3%) had significant amounts of both lobbying and classification rulings. An exact test rejects the sharp null hypothesis of independence between the distributions (95% confidence interval (2.35, 4.06) excludes 1). See Supporting Information: Appendix G.4 for robustness to other thresholds.

of lobbying the classification process-only around 10% of firms in the data set requested three or more rulings. Crucially, the firms that spend heavily on lobbying are not the same as the firms that regularly request classification rulings. Only around 3% of all firms in the data set lobbied both Congress and the bureaucracy in significant amounts. These differences suggest that the type of firm which chooses to lobby Congress is quite different from the type of firm that chooses to lobby the bureaucracy, which is consistent with the theory.

Table 4 suggests that different types of firms prefer different lobbying strategies but provides little insight into how those groups differ. While the theory suggests that the groups should be differentiated by their orientation towards trade and the type of products they import, it may be that another factor such as firm size is driving the differences in the table. Previous literature has found that only large firms are able to pay the fixed costs of legislative lobbying (Kim, 2017; Osgood, 2017). One way to bolster confidence that the groups in Table 4 reflect the theory would be to observe substitution at the intensive margin among the few firms that do lobby in both channels. If the firms that rely relatively heavily on one channel eschew the other channel, even among the rarefied group of firms that use both, then it suggests that firms treat lobbying for classification and lobbying the legislature as substitutable activities.

Figure 9 provides two perspectives on the intensive margin of ex ante and ex post lobbying. The left panel depicts the actual lobbying expenditure and ruling frequency for the roughly 3% of firms that lobbied significantly in both channels.³³ The panel shows that the firms which lobbied Congress relatively heavily tended not to lobby the classification bureaucracy heavily and vice versa. This negative relationship at the intensive margin supports the theory. Even among the firms with enough resources to properly invest in lobbying, firms tend to choose one channel or the other.

The right panel of Figure 9 shows, among the firms that significantly lobbied either Congress or the bureaucracy, whether both channels were regularly employed in the same year. If the two channels are complements, then firms would benefit from employing them at the same time because investment in one channel would enhance the efficacy of the other. If the two channels are substitutes then the firm would prefer to use one or the other depending on their relative favorability at that time. The plot shows the proportion of years in which a given firm lobbied Congress, requested a classification ruling, or both. Very few firms regularly chose to both lobby Congress and request classification rulings in the same year. The plot provides evidence that firms are treating these channels as substitutes in the way proposed by the theory.

27

209 (5.35%)

92 (2.36%)

³³Regression of log(Lobbying Amount) on log(Number of Rulings) among firms that have nonzero lobbying and associated with nonzero rulings produces a coefficient of -0.31 with a robust standard error of 0.09. Thus, the results are robust to more permissive definitions of "significant" rulings and lobbying.



FIGURE 9 The left panel shows the 92 firms with significant amounts of both lobbying and classification rulings. Even among the group of firms that employ both strategies, few firms utilize both equally intensely. The depicted clusters (from the Hartigan & Wong, 1979, K-Means algorithm with three centers) are identifiable as one group that focuses on lobbying Congress, one group that focuses on filing classification rulings, and a final group that uses both methods relatively less intensely. The right panel depicts, among firms that significantly use either channel, how frequently firms have nonzero lobbying and nonzero classification rulings in any given year. Few firms regularly lobby Congress and pursue classification rulings in the same year.

7 | CONCLUSION

The extensive literature on the political economy of protection has illuminated how firms and industries use the apparatus of the state to promote their own narrow economic interests. In the classic approach, firms lobby a central regulator who sets a tariff schedule by balancing the interests of producers and consumers. This literature is important to political economists because it demonstrates how concentrated interests can subvert the social good (in this context, higher consumer welfare) through the political process.

The classical political economy of protection literature underemphasizes the role of enforcement institutions in the lobbying process. Tariffs are changed rarely, but firms have opportunities to continue advancing their interests between rounds of trade negotiation through the process of tariff classification. These bureaucratic institutions favor importers. The paper presents a theory of the political economy of classification where importers divide their lobbying efforts across lobbying channels. By contrast, import competing firms must concentrate their lobbying efforts on the processes that determine tariffs rather than the process that classifies products. Empirical evidence suggests that firms really do treat lobbying the legislature and lobbying the classification bureaucracy as strategic substitutes. It also shows support for the assertion that firms are more likely to engage in classification lobbying as tariffs change.

The political economy of classification changes how scholars should interpret congressional lobbying on trade-related issues and the tariff schedule itself. First, the firms that lobby Congress have chosen not to spend those resources on lobbying the bureaucracy through the classification system. Second, the tariff schedule as determined by Congress should be considered something of an upper bound on the protection available to import-competing firms because importers have the opportunity to escape the tariffs through the classification system. Third, the design of the tariff schedule should be considered a component of the political economy of protection because importers benefit when the category descriptions are flexible.

Future work should study how the opportunity to escape from tariffs by lobbying for favorable classifications changes how the tariff code should be interpreted. Previous studies such as Broda and Weinstein (2006) have often used the categories of the tariff schedule to estimate welfare gains from increased product variety due to trade. An often unstated assumption of this approach is that the addition of new categories to the tariff code represents the introduction of new product varieties for consumers. The political economy of classification suggests that free traders have an incentive to expand the number of categories when lobbying the legislature because more categories provide more opportunities to target a favorable tariff rate. Therefore, some product categories could be added to the tariff schedule for strategic reasons which do not reflect increased innovation associated with international trade. For example, it is possible that the categories have been defined by protectionists who wanted to limit the ability of firms to jump their products to lower tariff lines. In addition, many nontariff barriers also depend on classification. For example, the ITC and DOC investigate antidumping cases using trade data defined by the tariff code. If antidumping duties are added to a particular category firms may have incentives to use the classification system to escape that category. Ultimately, the classification of products into the tariff schedule needs to be considered as a political process, not merely technical, which shapes the trade data that we observe.

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DATA AVAILABILITY STATEMENT

The data that support the findings of this study are available from the corresponding author upon reasonable request.

ORCID

Michael-David Mangini D http://orcid.org/0000-0003-0802-3912

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SUPPORTING INFORMATION

Additional supporting information can be found online in the Supporting Information section at the end of this article.

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