Rules of Origin and the Use of NAFTA

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Overview

- The paper studies how Mexican exporters choose between **NAFTA** and **MFN** tariffs
- Using transaction-level customs data, the authors:
  - Document a set of novel stylized facts that highlight a trade-off between optimizing the supply chain and complying with Rules of Origin
  - Highlight the key role of firm size, inverted U-shape relationship with preference utilization
- Structural model of global sourcing (building on Antràs et al. 2017):
  - fixed costs of FTA utilization
  - RoOs act as a constraint on sourcing: using NAFTA requires a minimum share of NAFTA inputs
- Counterfactuals show that stricter RoOs reduce regional trade because of lower preference utilization

Discussion

- **Unique micro-data**: transaction-level export data featuring preference utilization
- **Novel stylized facts**: especially the inverted U-shape in FTA utilization
- **Elegant theoretical framework**: incorporates preference utilization in a global sourcing model

- A brief detour on the economic rationale for RoOs, followed by some comments

Comment #1: Why Do We Need RoOs?

- Free trade is globally efficient, but regional integration is often preferred (policy makers care about national welfare)
  - Rules of Origin are a **friction** that is introduced to prevent **trade deflection** (non-members exploiting preferential tariffs)
  - The implicit idea is that an increase in indirect imports would decrease welfare at the national level (difficult to appreciate in a partial equilibrium model)
- According to your counterfactuals, increasing RoO strictness entails substantial costs through lower NAFTA utilization
- **But** the rationale for RoO is not efficiency (otherwise countries would choose free trade), it's **increasing regional content**
  - which is **the opposite** of efficiency in any standard trade model
- **Practical suggestion**: stress more your results on regional content; would also be interesting to see what happens without RoOs ($\lambda = 0$)

Comment #2: Firm Heterogeneity and Model Calibration

- The fixed cost of using NAFTA $\hat{\zeta}_s$ is chosen so that the **simulated share of firms using NAFTA** in sector s matches the empirical one
- Suppose Sector A and Sector B face the **same fixed cost** of using NAFTA (ζ), but Sector A is mostly made of **medium-large firms** while Sector B mostly of **small firms**
- We know that small firms have a lower propensity to use NAFTA
- $\hat{\zeta}_B$ will be larger than $\hat{\zeta}_A$
- In other words, the estimated ζ_s **absorbs both** true fixed costs and sectoral size composition
- **How does this affect** the counterfactuals?

Other Comments

- **Elasticity of substitution.** The model calibration sets $\rho = 1.05$. How sensitive are counterfactuals to this parameter?
  - Stronger complementarity would likely amplify the cost of RoOs
- **Partial vs. general equilibrium.** Does the partial-equilibrium structure understate or overstate the effects of stricter RoOs?
  - For example, the effect on Mexican exporters could be attenuated by wage adjustment
- Similarly, **what if markups were endogenous**? How much of the additional cost following λ increase would be absorbed by markups vs passed through to U.S. buyers?
  - Of course these points cannot be easily included in the model, but a qualitative discussion would be useful
- **Ad-valorem tariff data.** The data cleaning drops HS codes without ad-valorem MFN tariffs. However, ad-valorem equivalents should be available through the **WTO IDB**, making it possible to retain more product lines.

Takeaways

- **A very interesting and well-executed paper!** I learned a great deal from reading it
- **Some refinements could make it stronger**
- **A valuable contribution to the preference-utilization literature.** The combination of unique data, novel facts, and a structural sourcing model advances our understanding of how RoOs shape regional trade