



School of Public Policy
Economics, Political Science, Sociology

“Exporting Under Trade Policy Uncertainty: Theory and Evidence”

by

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Abstract: Policy commitment and credibility are important for inducing agents to make costly, irreversible investments. Policy uncertainty can delay investment and reduce the response to policy change. I provide theoretical and novel quantitative evidence for these effects by focusing on trade policy, a ubiquitous but often overlooked source of uncertainty, when a firm’s cost of export market entry is sunk. While an explicit purpose of the World Trade Organization (WTO) and preferential trade agreements (PTAs) is to secure long term market access, little theoretical and empirical work analyzes the value of reducing uncertainty in these arrangements to prospective exporters. Within a dynamic model of heterogeneous firms, I show that trade policy uncertainty will delay the entry of exporters into new markets and make them less responsive to applied tariff reductions. Policy instruments that reduce or eliminate uncertainty such as PTAs or binding trade policy commitments at the WTO can increase entry even when applied protection is unchanged. I test the model using a disaggregated and detailed dataset of product level Australian imports for 2002-2006. I use the variation in tariffs and PTA implementation across countries, products and time, to construct model-consistent measures of uncertainty. The estimates indicate that PTAs reduce the probability of policy reversals and that lower WTO commitments increase entry. Reducing trade policy uncertainty is up to four times more important than tariff reductions alone. These results illuminate and quantify an important new channel for trade creation in the world trade system.

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