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American multinational corporations in China adjust to trade war risks, analysis shows

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The U.S.-China trade war has pitted the world's two biggest economies against each other. Many American multinational corporations (MNCs) find themselves stuck in between.

"China is not an easy market for multinationals, and it has become more challenging as a result of the trade war," said Jack Zhang, assistant professor of political science at the University of Kansas.

His new article titled "In the Middle: American Multinationals in China and Trade War Politics" addresses the question: Which factors make some MNCs take political action in response to the U.S.-China trade war and cause others to stay on the sidelines? This analysis reveals that business models, ownership structure, experience in China and size of capital investments each shape how embedded firms perceive political risk. It appears in *Business and Politics*.

The article, co-written with KU doctoral student Rigao Liu and Samantha Vortherms, assistant professor at the University of California-Irvine, is part of a series the team is working on that attempts to explain the determinants of firm exit or divestment out of China.

"This paper asks if you're an American company, and you have operations in China, how do you choose among a menu of options to respond to the trade war?" Zhang said. "Do you follow that decoupling logic and say, 'China is getting riskier. Let's go somewhere else.' Or do you try to influence policy in the U.S. and say, 'These tariffs are not working for us.'"

Surprisingly, his research found that companies avoid either of these drastic actions. They neither voice dissatisfaction with this policy, nor do they decouple their supply chains or unravel operations. Primarily, the company embraces a third category that Zhang terms "loyalty." They stay in China but also try other tactics to potentially mitigate tariffs.

Zhang based his research on two key datasets. The first is the annual registration filed with the Chinese Ministry of Commerce to identify foreign-invested enterprises from 2014 to 2019. The second consists of the observed political behaviors of U.S. firms that responded to Section 301 tariffs by submitting a comment, testifying in a hearing, filing a tariff exclusion request or lobbying the Office of the United States Trade Representative in 2018 and 2019.

According to his article, tariffs have "done more harm than good."

"We've understood in economics for a really long time that tariffs generate deadweight losses. They act as a tax on consumers, essentially," he said. "The reality is that American companies are paying tariffs when they import goods, and those costs are passed on to American consumers."

Despite these costs, tariffs have not generated the leverage to alter MNC behavior.

Zhang said, "The Trump administration very much stated, 'We're making the environment in China riskier. We're highlighting these risks to U.S. multinationals. And the way to not have to deal with that is to just move back to the U.S.' But very few multinationals engaged in that."

Yet from the Chinese perspective—based on past instances when MNCs prior to China's World Trade Organization accession in the late 1990s were strong advocates of economic relations with their country—leaders assumed multinationals would be in China's corner and voice dissatisfaction with U.S. policy.

"They hoped multinationals would help put a quick kibosh on the trade war," Zhang said. "That has not happened either."

He wrote that larger, more experienced MNCs are resilient to both tariffs and to political pressure to decouple from China "due to privileged access to various regulatory loopholes as well as greater market power."

Is there an example of a major multinational pulling out of China recently?

"A large one that pulled out entirely? I can't think of anyone directly that would be related to tariffs," Zhang said. "Some have unraveled trade operations in the tech side for security reasons or due to local competition—American tech companies have been notoriously unsuccessful there. But Uber in 2016 is probably the last big exit."

A professor at KU since 2019, Zhang is also the founder and director of the KU Trade War Lab. His research explores the political economy of trade and conflict in East Asia with a focus on explaining why interdependent countries use military versus economic coercion in foreign policy disputes.

Zhang said the biggest takeaway from this paper is that MNCs will take care of their own interests and reliably put profits first. They are reluctant to serve the interests of politicians.

"There is always the risk of misalignment when we think about multinational investments as extensions of national policy," he said. "Even policies that are well-intentioned from a national foreign policy perspective, when you filter that through the prism of how companies need to operate to satisfy shareholders, it will produce perverse outcomes for both sets of governments in ways they did not anticipate."

More information: Rigao Liu et al, In the Middle: American Multinationals in China and Trade War Politics, *Business and Politics* (2022). DOI: 10.1017/bap.2022.14

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