

EFFECTS OF TRADE TENSIONS AND PUNITIVE TARIFFS ON THE CROSS-BORDER M&A DEALS IN CHINA, THE US, AND BEYOND

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Abstract. The implementation of the initial tariff hikes on imports from China to the USA had a profound impact on the global economy. In early 2018, the two largest economies in the world engaged in a series of retaliatory tariffs against each other, leading to instability in international trade. A quantitative approach was adopted to assess the effects of this trade dispute on M&A (merger and acquisition) activities. The data utilized for the analysis was sourced from "Mergermarket," a reputable secondary data provider. The results obtained from this analysis were conclusive, highlighting the significant influence of the trade dispute on both countries' M&A behaviors. It became evident that the M&A behavior of China underwent a permanent transformation due to the trade dispute. The value and the number of transactions from China into the USA experienced substantial changes following the imposition of the initial punitive tariffs. This shift in M&A dynamics reflects the broader impact of the trade conflict on the economic relationships between the two nations.

Keywords: Mergers & Acquisitions, M&A, Trade War, Trade Tensions, Trade Dispute, China, USA, FDI.

ВЛИЯНИЕ ТОРГОВОЙ НАПРЯЖЕННОСТИ И ШТРАФНЫХ ТАРИФОВ НА ТРАНСГРАНИЧНЫЕ СДЕЛКИ СЛИЯНИЙ И ПОГЛОЩЕНИЙ В КИТАЕ, США И ЗА ИХ ПРЕДЕЛАМИ

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Аннотация. Осуществление первоначального повышения тарифов на импорт из Китая в США оказало глубокое влияние на мировую экономику. В начале 2018 года две крупнейшие экономики мира ввели серию ответных пошлин друг против друга, что привело к нестабильности в международной торговле. Для оценки последствий этого торгового спора для деятельности по слияниям и поглощениям был применен количественный подход. Данные, использованные для анализа, были получены от "Mergermarket", авторитетного поставщика вторичных данных. Результаты, полученные в результате этого анализа, были убедительными, подчеркивая значительное влияние торгового спора на поведение обеих стран в области слияний и поглощений. Стало очевидно, что поведение Китая в области слияний и поглощений претерпело необратимую трансформацию из-за торгового спора. Стоимость и количество транзакций из Китая в США претерпели существенные изменения после введения первоначальных штрафных тарифов. Этот сдвиг в динамике слияний и поглощений отражает более широкое влияние торгового конфликта на экономические отношения между двумя странами.

Ключевые слова: слияния и поглощения, M&A, торговая война, торговая напряженность, торговый спор, Китай, США, прямые иностранные инвестиции.

Introduction

Mergers and Acquisitions (M&A) refer to consolidating companies or assets through various financial transactions to generate growth (Roberts et al., 2016, p. 2). These transactions can occur within a single country or involve cross-border deals to achieve business expansion. In recent decades, cross-border M&A activities have gained significance due to the opportunities presented by global interconnectedness, tax advantages, and other benefits (Junni & Teerikangas, 2019, p. 13).

On the other hand, a trade dispute, also known as a trade war or trade conflict, arises when two countries engage in an economic conflict by imposing punitive tariffs on each other's imported goods (Evans, 2019, p. 47). These punitive tariffs, which are in addition to regular tariffs, are intended to regulate trade and protect domestic economies (Evans, 2019, p. 48). The effects of trade disputes and protectionism are subject to debate, with some arguing it creates job opportunities and competitive advantages through coordinated policies, while others contend it hinders domestic economic growth and raises prices of domestically produced goods (Arnaud, 2009, p. 1012; Abboushi, 2010).

Interestingly, both M&A activities and trade disputes involve aspects related to taxes, labor, and the influence of political power. Although the countries' sanctions may not have been directly targeted at cross-border M&A, significant changes could result from such actions. This study explores the interplay between these two topics and their potential implications for businesses and economies.

Theoretical background

The trade dispute between China and the USA had been brewing before the official imposition of punitive tariffs (Wong & Koty, 2020). Donald Trump's "America First" policy sought to reduce China's influence in the US, increasing tensions during his presidency (Berend & Klipper, 2022, p.44). The first significant event in this dispute was the imposition of the first official punitive tariffs on Chinese goods imported into the US on July 6, 2018 (Wong & Koty, 2020). The US government cited China's alleged market distortion through state-owned enterprises, subsidies, forced technology transfer, and inadequate intellectual property protection as justifications for these tariffs.

Subsequently, both countries engaged in a period of tariff escalations. The USA imposed punitive tariffs worth US\$651 billion on imports, while China retaliated with tariffs worth US\$207.5 billion on imports (Wong & Koty, 2020; Berend & Klipper, 2022; Mullen, 2022).

The next milestone in this trade dispute was the signing of the "Phase One" deal, which led to suspending some threatened tariffs and reducing others. As part of the deal, China committed to purchasing US products over the following two years while enhancing the protection of US companies intellectual property and easing market entry for US financial services providers. In return, the USA reduced some of its punitive tariffs, although a significant portion, up to 70%, remained in place (Berend & Klipper, 2022).

The commitments in the Phase One trade agreement have sparked controversy in the literature. Some argue that the deal contravenes current multilateral trade law (Van Dyken & Diekmann, 2020, p. 40; Chowdhry & Felbermayr, 2020; Berend & Klipper, 2022). Moreover, critical issues such as market distortion by state-owned enterprises and subsidization still need to be solved.

FDI into China

For a considerable period, China's domestic political situation posed significant challenges for foreign investors looking to enter the country. However, in 1978, China took a momentous step by opening up its domestic economy (Tianyu, 2021). The initial years until 1991 saw modest FDI (Foreign Direct Investment) activity, with an average incoming FDI of US\$1.7 billion annually. Subsequently, FDI inflows

experienced remarkable growth, reaching an average of US\$37 billion between 1991 and 2001 (Macrotrends, 2022a).

China's accession to the World Trade Organization (WTO) in 2001 further bolstered its attractiveness to foreign investors, leading to a substantial surge in FDI activity. From 2001 to 2013, FDI inflows peaked, with an annual average value of US\$160 billion. Although growth stagnated after this period, FDI remained at a relatively high average of US\$218 billion until 2020 (Macrotrends, China Foreign Direct Investment 1979-2022, 2022; Hanemann et al., 2021). Notably, a typical M&A wave pattern was absent in this scenario.

When examining FDI from the United States into China, a similar pattern emerged as that of global FDI into China, with no significant differences observed until 2000. The discussion then focused on the period between 2000 and 2020, with a differentiation between acquisition and greenfield investment.

Following the global trend, China's WTO accession triggered a rapid increase in FDI from the US between 2001 and 2004, with a substantial surge in 2005. Notably, greenfield investments experienced a remarkable 408% jump, while acquisitions increased by 37%, resulting in a 97% overall increase in FDI value compared to the previous year. Subsequently, the balance between greenfield and acquisitions remained consistent. Over the selected period, 100% of the investments originated from POEs (Partially Owned Enterprises). An enterprise is considered an SOP (State-Owned Enterprise) if the state's share exceeds 20 percent (TUCIH, 2022).

FDI into the United States

Global FDI into the USA exhibits a pattern consistent with the observed global M&A waves. The percentage of FDI relative to GDP provides insight into the scale of investments flowing into a country relative to its economic performance. When the relative FDI aligns with the FDI pattern, it indicates that FDI has evolved in sync with the country's economic performance. Conversely, if the relative FDI deviates from the FDI pattern, it suggests that the FDI sector has either outperformed or underperformed. Upon comparing the relative FDI with the absolute FDI of the United States, it becomes apparent that FDI activities have developed in line with the country's economic performance.

Similarities exist up to the year 2000, prompting the discussion of FDI from China into the USA to focus on the period between 2000 and 2020. A distinction is made between two types of FDI: acquisitions and greenfield investments. Until 2010, FDI activities from China to the United States were limited. However, from 2010 onwards, FDI activities followed the seventh global M&A wave, leading to a significant increase. Notably, most of the FDI from China to the USA comprises

M&A transactions, making up 90% of the total value, a consistent ratio over the observed period.

Regarding ownership structure, enterprises are considered state-owned enterprises (SOEs) if the state holds 20% or more ownership. Between 2000 and 2020, the FDI ownership structure comprised 71% partially owned enterprises (POEs) and 29% SOEs. Notably, the proportion of SOEs has shown a decreasing trend over time. The average share of SOEs was 81% between 2000 and 2006, 61% between 2006 and 2012, and decreased to 24% from 2013 onwards (TUCIH, 2022). The prevalence of SOEs in China's outgoing FDI is a unique and crucial aspect of its FDI characteristics.

Research question, methods of work, and research approach

As the two most significant economic powers, the USA and China greatly influence global, national, and local economies. The emergence of the trade dispute between them has had far-reaching consequences for various stakeholders. This research aims to investigate the impact of the China-US trade dispute on M&A activity, explicitly focusing on both countries involved. It also seeks to identify any potential effects on M&A activities in other countries, particularly in Europe.

The main research question centers on understanding how trade tensions and punitive tariffs have affected cross-border M&A deals in China, the USA, and beyond. The question is formulated broadly to encompass the overall impact without delving into the underlying reasons (the "why"). The study will primarily concentrate on the participants of the trade dispute, with a more in-depth examination of the effects in the USA and China. Nevertheless, it also considers potential global effects, mainly limited to Europe, to a lesser extent.

Given that M&A behavior can be accurately described by the value and number of transactions, a quantitative approach is deemed most appropriate. The topic has yet to be extensively covered in quantitative studies, with primarily descriptive articles from news sites available. A quantitative research method will be employed to achieve a more valid and independent outcome.

The choice between primary and secondary data analysis led to the selection of secondary data due to the complexity and availability of FDI and M&A data. Specialized institutions with global networks are better equipped for data collection. The data source chosen is "Mergermarket," used by "White & Case." Mergermarket is a reputable private company specializing in M&A data monitoring, and its data is deemed highly valid and accurate.

The quantitative evaluation will be performed using R-Studio and Microsoft Excel. The analysis comprises three parts:

- **Market Dynamic Comparison:** Examining countries' investment behavior relative to global trends.
- **Comparison with regression lines:** Analyzing absolute trends and their alignment with trade dispute milestones.
- **Differences in Mean:** Comparing averages to understand M&A transaction behavior.

By utilizing these quantitative methods and examining M&A data, this research sheds light on the impact of the China-US trade dispute on cross-border M&A activities and its potential ramifications on the global economy.

Table 1 – Results of the analysis

	Variant of Investigation	Result before	Result after	Change in behavior detected
	China->USA & China-> Global Unit: Value Sector: Overall	p-value = 0.003247	p-value = 0.09402	Yes
	China->USA & China-> Global Unit: Number Sector: Overall	p-value = 3.396e-07	p-value = 0.3682	Yes
	China->USA & China-> Global Unit: Value Sector: TMT	p-value = 0.01955	p-value = 0.7036	Yes
	China->USA & China-> Global Unit: Number Sector: TMT	p-value = 0.002021	p-value = 0.1686	Yes
	China->USA & China-> Global Unit: Value Sector: Industrials & Chemicals	p-value = 1.419e-11	p-value = 0.5712	Yes
	China->USA & China-> Global Unit: Number Sector: Industrials & Chemicals	p-value = 0.002127	p-value = 0.1919	Yes
	USA->China & USA-> Global Unit: Value Sector: Overall	p-value = 0.5203	p-value = 0.6334	No
	USA->China & USA-> Global Unit: Number Sector: Overall	p-value = 0.6312	p-value = 0.07967	No
	USA->China & USA-> Global Unit: Value Sector: Industrials & Chemicals	p-value = 0.3983	p-value = 0.3633	No
0	USA->China & USA-> Global Unit: Number Sector: Industrials & Chemicals	p-value = 0.8523	p-value = 0.002931	Yes
1	USA->China & USA-> Global Unit: Value	p-value = 0.3711	p-value = 0.5061	No

	Sector: Pharma			
2	USA->China & USA-> Global Unit: Number Sector: Pharma	p-value 0.4261	=	p-value 0.7324
3	USA->China & USA-> Global Unit: Value Sector: TMT	p-value 0.7349	=	p-value 0.9345
4	USA->China & USA-> Global Unit: Number Sector: TMT	p-value 0.06003	=	p-value 0.0893

Source: Own calculations.

Discussion

As the world's two largest economic powers, the USA and China wield significant influence over the global, national, and local economies. The trade dispute between them has had widespread implications for various stakeholders. This research investigates how the China-US trade dispute has affected M&A activity, explicitly focusing on both countries directly involved. Additionally, it seeks to explore any potential impacts on M&A activities in other countries, with particular attention to Europe.

The central research question revolves around understanding the influence of trade tensions and punitive tariffs on cross-border M&A deals in China, the USA, and beyond. The question is formulated broadly to capture the overall impact without delving into its underlying reasons.

The study primarily concentrates on the participants of the trade dispute, conducting a detailed examination of the effects in the USA and China. However, it also considers potential global effects, with a secondary emphasis on Europe.

A quantitative approach is deemed the most appropriate since M&A behavior can be accurately described by analyzing the value and number of transactions. Previous quantitative studies on this topic are limited, with primarily descriptive articles from news sources available. Therefore, quantitative research methods will provide a more valid and independent outcome.

Considering the complexity and availability of FDI and M&A data, secondary data analysis was chosen over primary data collection. Specialized institutions with extensive global networks are better suited for comprehensive data gathering. The data source "Mergermarket," used by "White & Case," was selected for this research. Mergermarket is a reputable private company specializing in M&A data monitoring, ensuring the data's high validity and accuracy.

The quantitative evaluation will be conducted using R-Studio and Microsoft Excel, comprising three key aspects:

- **Market Dynamic Comparison:** Analyzing countries' investment behavior relative to global trends.
- **Comparison with regression lines:** Examining absolute trends and their alignment with significant trade dispute milestones.
- **Differences in Mean:** Comparing averages to gain insights into M&A transaction behavior.

Through these quantitative methods and a thorough examination of M&A data, this research aims to shed light on the impact of the China-US trade dispute on cross-border M&A activities and its potential implications for the global economy.

Conclusion

In conclusion, the trade dispute between the USA and China significantly affected both countries' M&A behavior. China's M&A behavior has undergone permanent changes, with noticeable shifts in the value and number of transactions since the imposition of the initial punitive tariffs. On the other hand, the USA experienced only a short-term negative impact on its M&A behavior, which later returned to its previous levels, even showing an increase in certain M&A activities after the Phase One agreement.

Moreover, the investment behavior regarding deal size distribution has also changed. Post-trade dispute, the USA has increasingly engaged in "Large" M&A deals, while China has witnessed a decline in "Large" sized deals and a preference for smaller M&A transactions.

Some recommendations have emerged for further research in this area throughout this intensive study. To conduct in-depth investigations, it is crucial to ensure access to trustworthy data sources with suitable data frequency. Additionally, given the unique prevalence of State-Owned Enterprises (SOEs) in the Chinese economy, further studies should differentiate between Chinese POEs and SOEs in their cross-border M&A activities to assess their impact on other sectors and economies.

After imposition of punitive tariffs, the high increase in M&A transactions in the Chinese "Pharma" sector warrants further investigation to understand this anomaly. Furthermore, examining the possible influence of the Committee on Foreign Investment in the United States (CFIUS) on the course of M&A transactions between the two countries would provide valuable insights.

Lastly, for a comprehensive understanding of the trade dispute's impact, future studies should explore the hypothetical scenario of how M&A transactions might have differed in the absence of the trade dispute. By addressing these recommendations, researchers can delve deeper into the complexities and nuances of

the China-US trade dispute's impact on M&A activities, shedding more light on this critical study area.

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