The Effect of Trade Wars on Foreign Direct Investment: Evidence from the U.S.–China Economic Conflict

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Abstract

With a particular focus on the U.S.-China trade battle from 2016 to 2024, this article investigates the impact of trade wars on foreign direct investment (FDI). We evaluate how trade policy volatility and geopolitical rivalry influence global capital movements by looking at bilateral trade indicators, foreign direct investment flows, and global spillover effects. Through the use of empirical data and comparative analysis, the study concludes that third-party countries frequently benefit from trade diversion and increased foreign direct investment (FDI), whereas direct participants in trade conflicts suffer from decreased trade volumes and disturbed investment flows. The results highlight the need for governments to consider both immediate losses and long-term changes in global investment patterns when economic conflicts arise.

INTRODUCTION

In the twenty-first century, trade wars have become defining markers of geopolitical tension. Formally starting in 2018 with tariffs imposed by the Trump administration, the economic rivalry between the United States and China has grown into one of the biggest trade disruptions in modern history. This trade war has affected global investment patterns, particularly in developing economies, in addition to its immediate effects on bilateral commerce. This paper explores the effects of such economic conflicts on foreign direct investment flows, looking at both the bilateral and wider ramifications for third-party countries and the world economy.

LITERATURE REVIEW

The negative economic effects of trade wars, such as trade diversion, decreased investor confidence, and price inflation, are highlighted by academics like Bown & Irwin (2019) and Freund et al. (2020). According to FDI literature (e.g., Blonigen & Piger, 2014), protectionism and political instability discourage capital inflows since they raise risk and uncertainty. The policy-sensitive aspect of foreign direct investment (FDI) is highlighted by papers by UNCTAD (2019) and Brookings (2020) that demonstrate diminishing Chinese investment in the U.S. and vice versa in the context of the U.S.–China dispute.

RESEARCH OBJECTIVE

This study aims to:

- Analyze the effect of U.S.–China trade tensions on bilateral and global FDI patterns.
- Investigate how third-party countries (ASEAN, EU, Africa) are impacted through trade and investment redirection.
- Assess whether trade wars lead to long-term structural shifts in global investment geography.

METHODOLOGY

We adopt a mixed-methods approach:

- **Quantitative Analysis**: Using trade and FDI data from U.S. Census Bureau, Statista, and Trading Economics (2015–2024), we examine bilateral investment trends.
- **Comparative Analysis**: Trade and FDI flows are compared across affected regions (China, U.S., ASEAN, EU, Africa).
- **Policy Review**: Key political decisions, including tariff rounds and policy declarations, are analyzed for contextual relevance.

RESULT AND ANALISIS

- **U.S.–China Trade and FDI Patterns**

From 2015 to 2023, U.S. FDI in China increased by 37.7% while Chinese FDI in the U.S. declined by 27.7%. Despite fluctuations in trade (notably a 20.4% drop in U.S. imports from China in 2023), American investment in China remained resilient—likely due to China's strong consumer market and production infrastructure.

- **Impact on Other Economies**

The trade war benefited third-party nations:

- **Vietnam**: +$2.6B in exports to the U.S.
- **Mexico**: +$3.5B
- **EU**: +$2.7B
- **Taiwan**: +$4.2B
  China expanded its trade with ASEAN and African countries, reaching a record $282B with Africa in 2023. This reflects successful trade diversification in response to U.S. tariffs.

- **Sectoral Effects**

Sectors like telecommunications, electronics, and agriculture were most affected. The U.S. agricultural exports dropped 53% in 2019, while Chinese tech exports faced steep tariffs.

DISCUSSION

Although trade disputes have asymmetrical worldwide impacts, they create uncertainty that discourages foreign direct investment. Strategically placed third-party countries can draw cash and divert commerce, while direct participants suffer short-term setbacks. This realignment implies that trade wars alter international economic alliances rather than just redistributing trade.
Since China expanded its reach through the Belt and Road Initiative, fortifying economic links with more than 150 nations, the United States' attempt to stop China's rise through tariffs has not been very successful.

CONCLUSION

Trade wars can drastically disrupt foreign direct investment (FDI) flows and change the global investment environment, particularly when they are fought between economic giants like the United States and China. Redirected trade and

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investment may benefit others while causing economic losses for current participants. Long-term economic expenses and short-term political objectives must be balanced by policymakers.

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