

УДК 327

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THE IMPACT OF INTERNATIONAL ECONOMIC RELATIONS ON THE COUNTRIES' SHARE OF INTERNATIONAL BUSINESS.THE US VS CHINA TRADE WAR*Abstract:*

Current trade war between U.S. and China, strongly affects international business and investment flows among them. The article aims to contribute to the understanding of investment flows and business investment behavior during the trade war. The study includes comparative analysis of two-way FDI flows between the US and China. The case analysis was used to understand the behavior of Tesla as an example of MNC. The key findings suggest that U.S. suffer more from this war than China and business make solution about investments to avoid governmental trade restrictions. China has a vital role in sustainability of GVCs and this country become primary destination for investments. Research findings can be useful in analysing investment flows during the trade war.

Keywords:

Trade war, Global value chain, Foreign direct investments, Tesla inc.

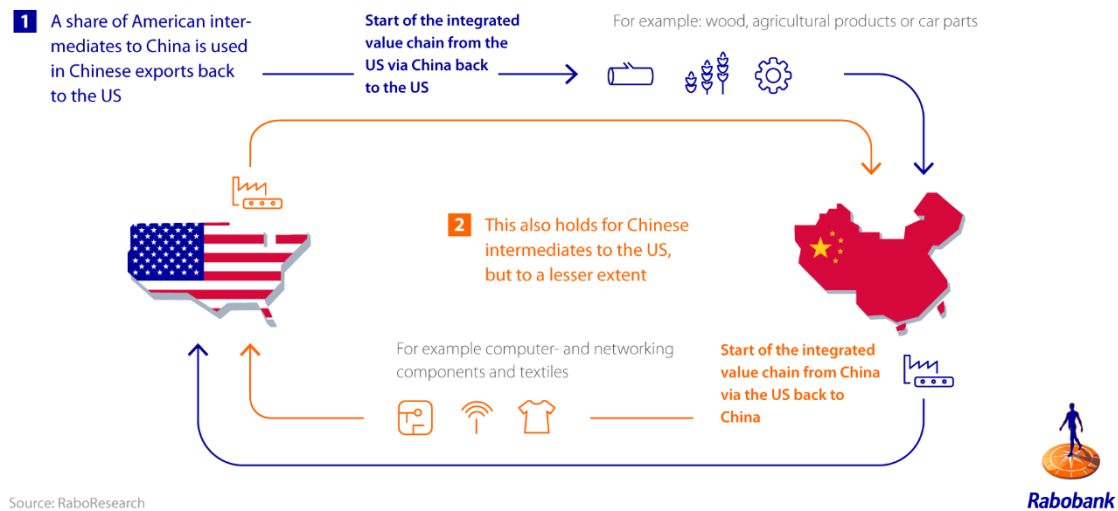
Governmental interests may not coincide with the global trends that is why we need to consider international economic relations when we are talking about international business. Governments of strong countries can limit trade by using many instruments, for example, trade tariffs and economic sanctions. In my work I want to analyze the case of the trade war between the US and China, which started in 2018. I want to see the impact of that conflict on the share of international business in these countries. In addition, I want to find out how Tesla behave under such conditions.

The current trends in international business are deglobalization[1]. Analysis from the perspective of a networked system, ranging from the social to the economic, supports this trend[2]. From this point, the crisis of globalism appears and new tendencies as regionalization, glocalization and fragmentation are formed. Such tendencies lead to formation of countries clusters [3]. Certain trends can explain why after the years of free trade, countries start to promote protectionism policies, even if it leads to a diminishing in import and export [4]. A similar idea of restructuring of global equilibrium and the formation of “new globalization”, based on innovation development, supported by Charis Vlados[5]

While free trade gives a variety of goods to consumers, decreases cost by specialization process and increases overall productivity, it makes the competing process with foreign competitors very harsh for local producers. The issue with a local force seems more complicated as low-skilled workers gain in case of protectionism and high-skilled lose[6]

According to Kimberly Amadeo near half of the Chinese import to the U.S. is cheaply assembled parts for the U.S. manufacturers[7]. The scheme here is quite simple, the US sends resources to China which counts as export on the U.S. trade balance. Then these resources transform into parts on Chinese factories and send back to the U.S. At this stage, such an operation counts as an import on the U.S. trade balance.

Indirect and intermediate trade war risks



Picture 1 – Trade flows between the US and China [8]

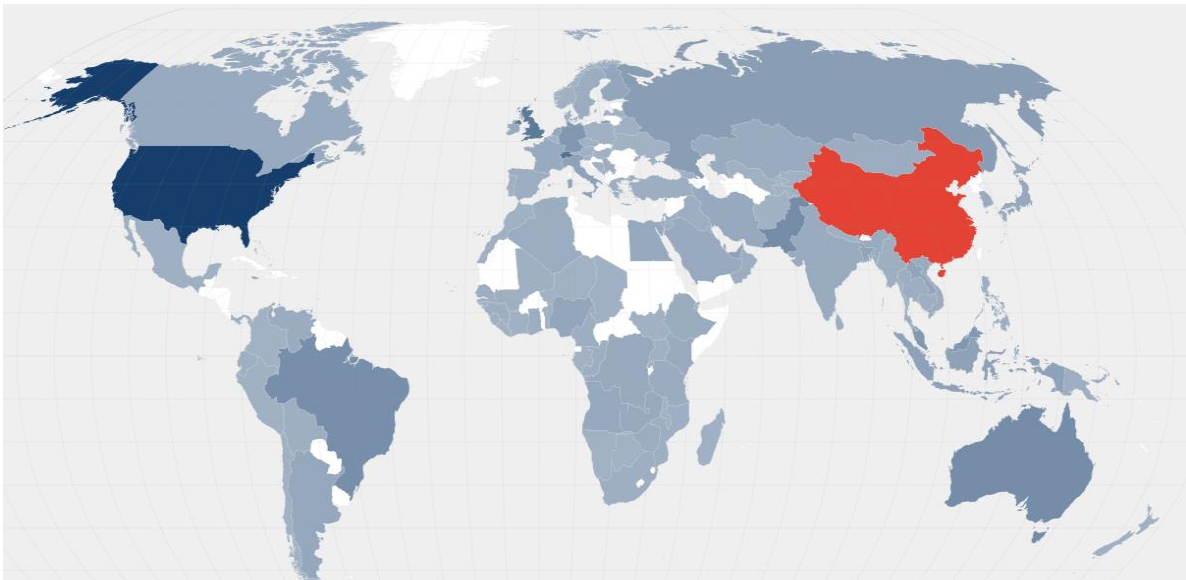
Previous researches analyse the economic impact via different prisms: changes in the overall welfare of the US and China, where China lose approximately 1,7% and the US 0,2[9], GDP decrease of China and the US by 1.41% and 1.35%, sequentially, ecological effect of barriers on the economical development[10]. The FDI aspect was not disclosed.

According to Mark J. Perry “Many large US firms sell, hire and invest more overseas than in the US and they have to think globally, not domestically, to survive”. He concludes that many MNCs of the US have more than 60% income outside the US. Also, he underlines that many companies have near and more than 50% of assets outside the US. The main conclusion here is that 80 out of 100 top MNCs are located outside the US and create enormous competitiveness in the markets. To have the competitive ability, companies should decrease their cost of production. To do that they need to search for lower labour costs, lower taxes and more favourable regulations around the world[11].

The next factor is the Foreign Direct Investments. FDI provides fundings for companies, promotes the development of the economy and international trade, shares technological progress between countries, and provides economic modernization[12]. As FDI is mainly processed by MNCs, it can show the current interest in the country. If MNCs see the possible opportunities on that market of a special country, they will buy the share or create the new entity. Understanding the FDI will show the differences caused by the trade war.

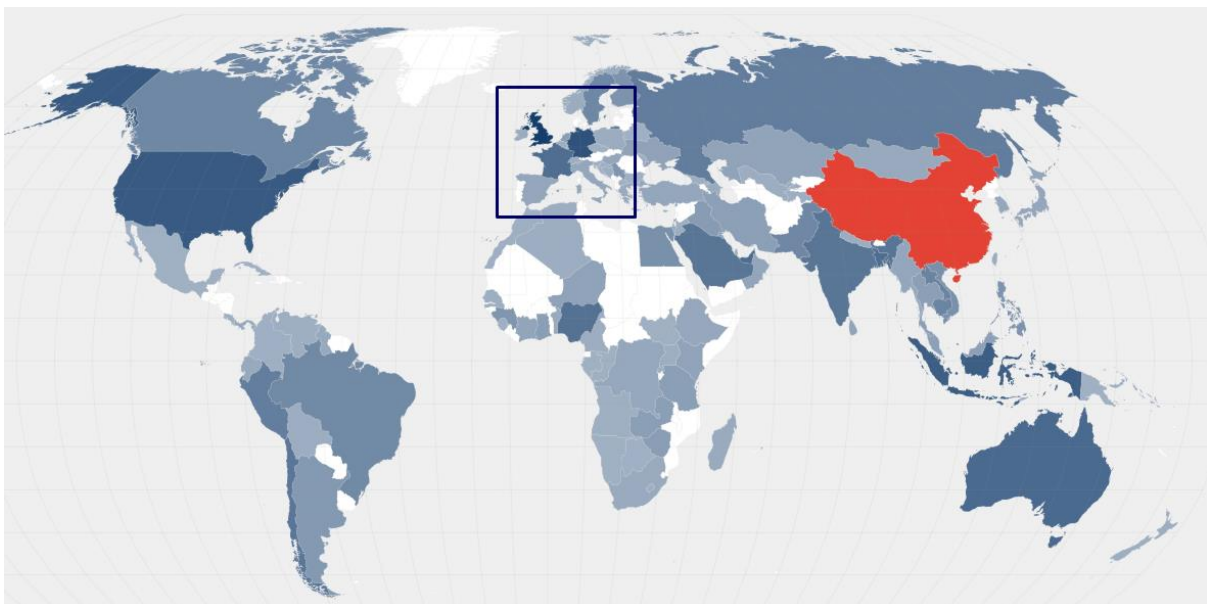
China investment and construction

China is one of the biggest investors in the world. Since 2005 its investment value has exceeded 2 trillion dollars. If we consider the period before the trade war, we can see that the US was the biggest recipient of Chinese investments with a total amount of \$94.58B. Investments were quite diversified and cover almost every sphere of the US economy: Transport(\$17,49B), Tourism (\$17,41B), Real estate (\$15,25B), Technology(\$14,54B) and Entertainment(\$10,80B). The total amount of deals reached 133.



Picture 3 – Chinese Investments & Contracts in USA (2015 - 2017) source: AEI

During the next three years, the total amount of investment worldwide decreases. There are two main reasons for that: trade war, which causes uncertainty and decreases the desire to invest, and COVID-19 recession. During that period China invested 60% less in comparison with the previous period(\$417.22). Secondly, investments in the US dropped to \$17.14B (4,1%). The total amount of deals was only 42. The US ceased to be the number one destination. Picture 3 shows that the main investment partners become Indonesia, France, Germany and Great Britain with an average of \$17.94B.



Picture 4 – Chinese Investments & Contracts in USA (2018 - 2020) source: AEI

The US investment

The dynamics of US-China investment is different. For the period from 2015 to 2017, US companies invested \$37.27B in China's economy. The predominant part of \$24.3B(65%) was greenfield investments and \$12.93B(35%) Acquisitions. For the trade war period (2018-2020) the total amount invested in China was \$28.3B. The decrease was 24%, however, I connect this with the pandemic situation mostly as the invested amount in 2018 and 2019 was an average of \$12.1B, which is on the level with previous years. The structure of entry type has not changed much. By the comparison of two-way investments, the US investment into China was not affected negatively by

the trade war, and China totally changed its attitude to the US by cutting its investments more than 5 times[13].

Such an imbalanced situation I will consider via the prism of case analysis of the most valuable Greenfield investment during the period of trade war: Tesla's gigafactory in China. Tesla is the US company that is accelerating the world's transition to sustainable energy with electric cars, solar and integrated renewable energy solutions for homes and businesses[14]. The main products of the company are electric vehicles: Model S/X/3.

Table 1 – Based on the official Tesla reports data[15]

	FY, 2017	FY, 2018	FY, 2019	FY, 2020
Vehicles Produced	101.41k	254.53k	365.23k	509.74k
Vehicles Delivered	103.18k	245.51k	367.66k	499.55k

The CAGR for produced vehicles is 49,73%, and 48,34% for delivered ones, according to table 1. Such values show that during that period, Tesla grew faster than the industry, if we compare it with the forecasted mean CAGR, which is equal to 18.4%[16].

In 2015 Tesla built only 55000 cars at its factory in Fremont, California. The ambitions of co-founder and CEO Elon Musk were enormous, Tesla plans to build 500,000 units annually by 2018[17]. Such colossal goals were supported by the demand of Tesla's Model 3; Tesla has received almost 400,000 orders in 2016 [18]. From these points, the problems appeared for Tesla. Productive capacity is restricted by around 100,000 according to Anjan Hemanth Kumar, programme manager for powertrain and electric vehicles at Frost & Sullivan[19] the reason for this is the vertically integrated supply chain. This leads to the bottleneck problem. The most important bottleneck causing delays for manufacturing was battery production, however, Tesla solved it by constructing Gigafactory 1 in partnership with Panasonic in Nevada state[20].

By that moment interest in Tesla worldwide increased and the company needs to find the solution to increase its production. The fast growth of China's economy and the fact that China is the largest auto market in the world[21], make this country very attractive for Tesla. However, in 2016 Tesla cannot fulfil that destination and even a small target of 10000 units was reduced by half to 5000[22]. One of the reasons for that is High transportation cost due to high import duties. Firstly, Elon Musk made a guess about building the factory in China, but the protection of Tesla's technologies was the issue at this question[23].

Finally, Tesla start's the construction of gigafactory 3 in Shanghai in January 2019. The approximate cost of this investment equals \$2B[24]. This factory was fully financed by Tesla. The purpose of the building was a production of affordable versions of Model 3/Model Y for the greater China region, as the trade war and its increased tariffs and possible deterioration of the conflict made competing with local producers very harsh for Tesla.

Installed Annual Capacity		Current	Status
Fremont	Model S / Model X	90,000	Production
	Model 3 / Model Y	400,000	Production
Shanghai	Model 3	150,000	Production
	Model Y	-	Construction

Picture 5 –Tesla vehicle capacity by region Source: Shareholder Deck 2019

By Q4 2019 Tesla capability in producing Model 3 increased by 150000, according to the picture 5. The gigafactory 3 helps Tesla to achieve growth in production by 43,5 % and delivery by 49,8% in comparison with the previous year.

Installed Annual Capacity		Current	Status
Fremont	Model S / Model X	100,000	Production
	Model 3 / Model Y	500,000	Production
Shanghai	Model 3 / Model Y	450,000	Production

Picture 6 – Tesla vehicle capacity by region Source: Shareholder Deck 2020

The production capacity increased by 39.6% and delivery by 35.9%. The factory not only fulfilled China's demand, but also vehicles started to be exported from China to Europe. Such fast recovery shows China's vital role in the stability of the global supply chain[25]

Barriers that are built by the government seem to affect the companies in a way to develop local production. However, for innovative companies like Tesla, these barriers do not restrict its aspiration to growth. No matter what, businesses make the final decision, not the government.

China's companies lost interest in the US. In 2020, China had \$163B in inflows, compared to \$134B attracted by the US. The US stopped to be the most attractive place for investments[26].

Policy implementation

International economic relationships always affect the business sphere. The barriers force companies to find new suppliers and make their supply chains more sustainable. The government can implement tariffs, quotas etc., but in the end, the business will decide in which direction it will move. Protectionism policy seems to be outdated. The case of the US shows that it prevents the development of international business inside the country, slows down economy and makes other destinations more attractive. To gain from globalization, governments should not control international business share with restriction policies. They need new understanding of GVCs and international trade. It should consider the welfare increase, not the trade balance. The interconnections between the companies increases and GVCs become more developed. Governments should avoid trade wars, if they want to develop international business.

For companies, a destination to the consumer market, is more effective. Such globalization with focusing on a local production, allows avoiding risks connected with local crises (by diversification), and protecting business from the losses. If other companies follow the experience of Tesla, it will help them to develop even in such difficult conditions.

During this research, I found that Trade war in terms of FDI was not the best solution. Foreign investments from China decreased by 5 times due to this conflict and such decline moved the US from the top destination for investments. Development of GVCs lead companies to focus more on local markets and produce their goods at place and not to deliver it. China did not suffer from this war in terms of FDI and become the number one destination for investments in 2020.

China's ability to fast recovery helped to support world demand in Tesla cars during the pandemic situation. This result can support the idea that China has a vital role in the stability of GVCs. The case of Tesla shows that the business is a key driver of investments and even the government cannot stop the company's demand to grow.

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