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Better Friends, Better Trade?

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Abstract

Using a unique dataset on political relations between China and its key trading partners and a nonlinear model, we explore how improvements in bilateral political relationships influence trade outcomes under varying economic states. Our findings reveal that while stronger political ties (“better friends”) generally improve trade flows, this effect is not universal. During periods of weak domestic demand, better political relations do not significantly enhance trade performance. The results also exhibit heterogeneity across countries, indicating that the impact of political relations on trade flows differs depending on the specific economic condition and political context.

JEL-codes: F14,F50, C32, E32,

Keywords: China, political relations, non-linear models, trade flows.

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1 Introduction

The dynamics between political relations and trade have long been an area of interest in international economics. Strong diplomatic relationships may lead to increased trade agreements, while conflicts or sanctions can reduce or block trade. While prior research has explored the effects of bilateral political ties on trade outcomes, there is limited understanding of how these effects vary across different economic conditions. Trade between major trading blocs and countries is heavily influenced by the state of political relations between nations. Additionally, trade dynamics are influenced by whether a country is experiencing an expansionary phase or a recessionary phase in its economic cycle, as economic conditions significantly shape trade policies, demand patterns, and resource availability. Against the backdrop of deglobalization and rising trade protectionism, international political relations have become increasingly influential on trade, particularly during periods of economic instability. Changes in political relationships often exacerbate fluctuations in international trade under such conditions. However, the mechanisms through which political relations between nations influence trade dynamics, and whether these effects vary with changes in economic conditions, remain complex issues requiring further exploration.

China's accession to the World Trade Organization (WTO) in 2001 marked a significant milestone in its integration into the global economic system. This event catalyzed China's transformation into a major player in international trade, accelerating its economic growth and enhancing its connectivity within global supply chains (Rumbaugh and Blancher, 2004). Building on this foundation, in recent years, China has further strengthened economic cooperation with countries along the Belt and Road Initiative (BRI), promoting infrastructure development and resource sharing, and gradually forming an extensive network of trade and economic linkages. The BRI not only supports economic growth in participating countries but also enhances China's significance in the global economy through supply chain integration, production networks, and market connectivity (Chen, 2023; Kwok, 2019).

Although prior studies have examined the impact of inter-state political relations on trade interactions, the mechanisms by which these effects evolve under varying economic conditions remain unclear. This study seeks to address the following questions: Does the positive influence of political relations on trade adjust when a country's domestic economic environment is in an expansionary or recessionary phase? Furthermore, are there differences in these effects between BRI and non-BRI countries?

This paper examines China's evolving economic and strategic partnerships with nine key global economies, assessing the varying levels of engagement with the BRI and bilateral cooperation outside its framework. These nations include (i) Australia, a major resource supplier and key trade partner where the government has not formally joined the

BRI, though Australian businesses actively seek opportunities in BRI-related markets, particularly in infrastructure and energy, with certain regions participating in cooperative projects; (ii) Indonesia, a leading BRI participant in Southeast Asia; (iii) South Korea, a critical partner in technology and trade within Asia; (iv) France, a prominent EU collaborator in trade and climate governance; (v) Germany, China’s largest European trading partner; (vi) India, a complex partner balancing cooperation and competition; (vii) Japan, a high-tech and manufacturing partner with historical challenges; (viii) the United Kingdom, a significant European investment destination and early BRI supporter; and (ix) the United States, a multifaceted partner marked by both collaboration and strategic rivalry.

Existing literature has established a close relationship between political ties and trade flows. For instance, [Whitten, Dai, Fan, and Pang \(2020\)](#) provide evidence that positive political shocks generally lead to increased trade flows between China and many of its partners, though there are exceptions. Similarly, [Yilmazkuday \(2024\)](#) demonstrates that geopolitical risks can significantly increase shipping costs, affecting global trade flows. For example, relations with countries like India and Vietnam show trade decreases after positive political shifts. [Du, Ju, Ramirez, and Yao \(2017\)](#) find that political shocks, while affecting trade, tend to have a temporary effect. Exports to China from partner countries typically decline for about two months after a political shock, but these effects dissipate quickly, with no long-term consequences.

While the existing body of research highlights the importance of political events in shaping trade flows, most studies overlook the potential variations that may emerge under different economic conditions. Trade flows between countries are influenced by multiple factors, including economic fundamentals, trade policies, and the broader political context. This complexity suggests that the relationship between political ties and trade flows is not uniform but highly context-dependent, with its impact potentially fluctuating across varying stages of the economic cycle. Understanding these nuances is crucial, as the interplay between political relationships and economic forces can yield markedly different outcomes depending on the prevailing economic environment. This paper addresses this gap by offering a nuanced analysis that captures the dynamic and multifaceted nature of these interactions. Studies on the impact of existing political relations on trade mainly focus on the following aspects: First, many studies show that close political relations not only reduce the policy uncertainty between countries, but also support the steady growth of economic and trade activities by reducing transaction costs ([Dixon and Moon, 1993](#); [Gowa and Mansfield, 1993](#); [Morrow, Siverson, and Tabares, 1998](#)). Similarly, [Yilmazkuday \(2024\)](#) shows that geopolitical risks can significantly increase shipping costs and thus affect global trade flows. [Du, Ju, Ramirez, and Yao \(2017\)](#) found that although political shocks affect trade, their impact is often temporary. A partner country’s exports to China usually fall for about two months after a political shock, but the impact

quickly fades with no long-term consequences. However, some studies suggest that even in the case of conflict, the importance of trade makes the impact of conflict on trade not lasting. [Davis and Meunier \(2011\)](#) believe that the “sunk cost” of economic and trade relations between some countries is high, which makes consumers and enterprises relatively insensitive to changes in political relations, and makes it difficult to maintain boycott activities for a long time. This indicates that although political relations have an impact on trade surplus, under certain conditions, close economic and trade relations can offset the negative impact of conflicts to some extent ([Davis and Meunier, 2011](#); [Martin, Mayer, and Thoenig, 2008](#)). Finally, while good political relations can promote bilateral trade cooperation, there is heterogeneity among different countries. For example, [Whitten, Dai, Fan, and Pang \(2020\)](#) provides evidence that positive political shocks usually lead to increased trade flows between China and many countries, but there are some exceptions.

The BRI, as China’s innovative plan to promote the common prosperity of the global economy, has attracted wide attention from scholars at home and abroad due to its unique geographical spatial layout and new regional cooperation model. Existing studies have discussed the economic impact of the BRI from the aspects of Sino-foreign trade relations and foreign direct investment ([Bird, Lebrand, and Venables, 2020](#); [Lee, 2018](#)). At the same time, as a new model of international and regional economic cooperation, the BRI not only focuses on foreign trade, but also seeks to enhance the vitality of global cooperation through regional economic integration. Research in the context of globalization further shows that regional cooperation agreements tend to have a significant and long-lasting positive effect on trade flows. [Magee \(2008\)](#) found that the trade-boosting effects of regional agreements can last up to 11 years. With the deepening of international and regional economic cooperation, it is increasingly necessary to establish a stable political mutual trust mechanism. In this context, the BRI conforms to the trend of global governance reform. [Zhou and Esteban \(2018\)](#) pointed out that as a grand strategy for Eurasia, it has the potential to reshape the international system and promote the reform of the global governance system.

The existing literature underscores the significant role political relations play in shaping international trade flows. However, there remain critical gaps in understanding the dynamics of these relationships, particularly under varying economic conditions. While trade flows are influenced by an interplay of factors such as economic fundamentals, trade policies, and political context, most studies have focused narrowly on short-term political events or single economic states, overlooking potential variations across economic cycles. This paper seeks to address these gaps by providing a comprehensive analysis of the relationship between political relations and trade, with a focus on the moderating effects of economic cycles.

This study contributes to the existing body of research in three key ways. First,

it employs a Smooth Transition Vector Autoregressive (STVAR) model to analyze the influence of political relations on trade surplus across different phases of the economic cycle. The STVAR model is uniquely suited to capturing dynamic changes between periods of economic expansion and slowdown, thereby revealing the nonlinear impact of economic cycles on the relationship between political ties and trade. By applying this model, the study offers a more nuanced understanding of how political relations function as a regulatory mechanism in different economic environments, addressing the limitations of traditional static models that fail to account for such dynamics.

Second, this paper introduces an inter-state political relations index to overcome the constraints of existing research, which often focuses on isolated political events or short-term fluctuations. This index provides a systematic measure of the long-term stability and evolution of political ties, offering a broader and more comprehensive perspective on their impact. Unlike studies that focus solely on specific events or time points, this approach enables the analysis to capture both the gradual changes in political relations and their sustained effects on trade surplus over time.

Third, the paper incorporates the BRI as a contextual framework to examine the relationship between political relations and trade. Rather than focusing solely on BRI participants, the analysis includes nine countries with varying degrees of involvement—some fully engaged in the BRI, some partially involved, and others not participating at all. By comparing these countries' trade relations with China, the study captures a broader spectrum of political and economic dynamics. This cross-country approach reveals heterogeneities in how political relations influence trade outcomes, highlighting the roles of factors such as economic development, geographical proximity, and industrial structures.

In sum, this paper offers a multifaceted contribution to the literature by systematically analyzing the complex interactions between political relations, trade flows, and economic cycles. The insights derived from this study not only fill gaps in the existing research but also provide actionable policy recommendations for leveraging political ties to enhance trade, particularly in the context of initiatives such as the Belt and Road. By adopting a dynamic and comprehensive approach, this research advances our understanding of how political and economic factors interact to shape trade outcomes in a globalized economy.

Section 2 presents empirical methodology and data sources. In Section 3, we discuss the results, including country-specific variations in the trade flow response to political relations shocks. Finally, Section 4 concludes.

2 Empirical Methodology

To analyze the responses of trade flow to a favorable political relations shock, we employ two models: a linear VAR model and a non-linear VAR model. The linear VAR serves as the baseline, while the non-linear VAR explores whether the responses vary depending on

the prevailing economic conditions. The results are obtained by running the two models for each trading partner with China.

2.1 Linear model

The baseline model includes six variables: the political relations index (*pri*) between China and the trading partner, China's real GDP growth (*y*), the partner's real GDP growth (*y**), the real exchange rate (*rer*) the two countries' currency, real exports (*ex*) to the partner and real imports from the partner (*im*). While our primary focus is on examining the responses of exports and imports to political shocks, we include additional macroeconomic variables to control for domestic demand and a key determinant of trade flows: the exchange rate.

Let $\mathbf{z}_t = (pri_t, y_t, y_t^*, rer_t, ex_t, im_t)'$. The structural representation of our benchmark VAR(*p*) model is given by:

$$\mathbf{B}\mathbf{z}_t = \boldsymbol{\gamma} + \sum_{i=1}^p \boldsymbol{\Gamma}_i \mathbf{z}_{t-i} + \boldsymbol{\varepsilon}_t, \quad (1)$$

where $\boldsymbol{\varepsilon}_t$ is assumed to independently follow a standard multivariate normal distribution.

We assume a recursive structure on $\mathbf{B}$, which is a lower-triangular matrix with 1s along the diagonal. The reduced form of the VAR can be expressed as:

$$\mathbf{z}_t = \boldsymbol{\alpha} + \sum_{i=1}^p \mathbf{A}_i \mathbf{z}_{t-i} + \mathbf{e}_t, \quad (2)$$

where $\boldsymbol{\alpha} = \mathbf{B}^{-1}\boldsymbol{\gamma}$, $\mathbf{A}_i = \mathbf{B}^{-1}\boldsymbol{\Gamma}_i$, and $\mathbf{e}_t = \mathbf{B}^{-1}\boldsymbol{\varepsilon}_t$.

2.2 Non-linear model

In addition to the linear analysis, we also estimate a non-linear model to examine the possible regime dependent reactions of trade flows to political relation shocks. Following [Weise \(1999\)](#) and [Gefang and Strachan \(2010\)](#), we accommodate the smooth transition into the reduced form equation (2) as

$$\mathbf{z}_t = (1 - F(s_{t-1})) \left(\boldsymbol{\alpha}^{(1)} + \sum_{i=1}^p \mathbf{A}_i^{(1)} \mathbf{z}_{t-i} \right) + F(s_{t-1}) \left(\boldsymbol{\alpha}^{(2)} + \sum_{i=1}^p \mathbf{A}_i^{(2)} \mathbf{z}_{t-i} \right) + \mathbf{e}_t, \quad (3)$$

where $\boldsymbol{\alpha}^{(j)}$ and $\mathbf{A}_i^{(j)}$ are reduced form parameters for regime *j*, a transition function, $F(\cdot)$ is given by

$$F(s_{t-1}; c, \gamma) = \frac{1}{1 + \exp(-\gamma(s_{t-1} - c))}, \quad \gamma > 0, \quad (4)$$

taking values between 0 and 1 with a transition variable s_t . The transition function and transition variable are determined according to the purpose of the analysis. In this paper, to detect the economic condition regimes, we use the average growth rate of China's GDP over the last p -months as a transition variable s_t .

Adopting the convention, we date the index s by $t - 1$ to avoid contemporaneous feedbacks. With this choice of transition function and variable, we can interpret regime 1, characterized by $\alpha^{(1)}$ and $\mathbf{A}_i^{(1)}$, as the expansion regime with $F(s_{t-1}) \approx 0$ and regime 2, characterized by $\alpha^{(2)}$ and $\mathbf{A}_i^{(2)}$, as the slowdown regime with $F(s_{t-1}) \approx 1$. The location parameter c determines the threshold between the recession and expansion. The smoothness parameter γ determines the speed of the transition from regime 1 to regime 2 as the past p -month economic growth rate increases. Following the approach in [Nguyen and Okimoto \(2019\)](#) and [Nguyen, Okimoto, and Tran \(2022\)](#), we estimate both c and γ using a grid search method, incorporating a lag length of up to 6 months.

2.3 Identification

To recover the structural shock, we rely on a recursive identification scheme, using the Cholesky decomposition to obtain a lower triangular matrix. By placing the Political Relations Index (PRI) first in the system, we allow political relations shocks—unexpected increases in the relationship between China and its trading partner—to have an immediate, contemporaneous effect on all remaining variables. However, shocks from the other variables, such as domestic demand, foreign demand, and the real exchange rate, only impact the PRI with a one-quarter lag. This approach enables us to identify and disentangle the response of exports and imports to political relations shocks, isolating them from other economic disturbances.

2.4 Data

Given the availability of data, we employ quarterly observations, spanning from 1984Q1 to 2022Q4, for China and its nine key trading partners: Australia, France, Germany, India, Indonesia, Korea, Japan, the UK and US. As mentioned earlier, the Political Relations Index (PRI) is constructed by the Institute of International Relations at Tsinghua University to measure political relationships between China and its major trading partners (see [Yan, Zhuo, and Haixia \(2010\)](#) and [Cai, Saadaoui, and Wu \(2024\)](#) for further discussion).¹ The PRI is primarily derived from reports on bilateral political events pub-

¹The data can be accessed here: <http://www.tuiir.tsinghua.edu.cn/imiren/info/1091/1320.htm>

lished in The People’s Daily and on the official website of the Ministry of Foreign Affairs of the *People’s Republic of China*. The index ranges from -9 to 9, reflecting the nature of the relationship between countries: scores from -9 to -6 indicate rivalry, -6 to -3 reflect a tense relationship, -3 to 0 represent a poor relationship, 0 to 3 indicate a neutral or normal relationship, 3 to 6 suggest a good relationship, and 6 to 9 denote a strong friendship. As in Cai, Saadaoui, and Wu (2024) and Mignon and Saadaoui (2024), the PRI series is linearly standardized as $pri_t + \sqrt{1 + pri_t^2}$.

We utilize export and import data from the International Monetary Fund’s (IMF) Direction of Trade Statistics. The nominal values of exports and imports, expressed in US dollars, are adjusted for inflation using the US Consumer Price Index (CPI) to obtain real values. Real exports and real imports are expressed in logarithmic form.

For macroeconomic variables, we rely on data from the Global VAR (GVAR) database (Mohaddes and Raissi, 2024). While the database provides GDP in log levels, we calculate the growth rate by taking the first differences. The real exchange rate in the GVAR database represents the rate between each country and the US dollar. To derive the real exchange rate between China and its trading partners, we compute the difference between their respective exchange rates with the US dollar. Thus, an increase in the real exchange rate indicates a depreciation of the Chinese yuan relative to its trading partners.

3 Results

In this section, we examine the impulse responses of real exports and imports to a favorable political shocks, which is defined as a sudden improvement in the relationship between China and the trading partner, under the traditional linear model as well as the non-linear model. The main findings of the responses are presented in Figure 2 and 3, for exports and imports receptively.²

3.1 Benchmark: linear VAR results

As a benchmark, we initially focus on the non-regime results, where the responses are not conditioned on the state of the Chinese economy. These responses are represented by black dotted lines in the figure. Regarding exports, in three out of nine cases, a positive political shock leads to a sustained positive impact on China’s exports (Australia, UK, France). For France, the response gradually increases over time, reflecting a deepening trade relationship, while Australia’s response stabilizes around the fourth quarter. By contrast, the UK’s response initially strengthens but then weakens over time. Germany and India exhibit a similar delayed response, with export levels remaining close to zero

²The responses of China’s GDP and its partners’ GDP to political shocks can be found in the online appendix.

until the fifth quarter before turning positive. A similar pattern holds for Indonesia and Korea, where the initial response is negative but quickly shifts to positive, peaking around the fifth quarter before declining. Japan’s response starts negatively, turns positive shortly afterwards, and stabilizes after a four-quarter lag. The US shows a general upward trend in response. However, it remains almost equally negligible.

Turning to imports, in three out of nine cases, a positive political shock leads to a similar import response pattern (India, Korea, Japan). Initially negative, these responses quickly shift to positive and remain so, with India and Japan peaking around the fifth to sixth quarters and maintaining that level, while Korea’s response declines after reaching its peak. France and Indonesia show a consistently positive response throughout. Australia and the UK exhibit a rapid decline, reaching their lowest point around a two-to three-quarter lag, then gradually rising and approaching zero around the tenth quarter. Germany and the United States follow a similar trend, both being almost equally negligible.

A key overall finding is that political shocks tend to produce a sustained positive impact on China’s trade with certain countries, notably Australia, the UK, and France in terms of exports, and Indonesia and France in terms of imports. In contrast, responses in Germany and the United States are consistently minimal and largely negligible for both exports and imports. This indicates that while political relations can significantly enhance trade with some economies, their effects remain limited with others, especially in established Western markets like Germany and the US.

3.2 Regime dependent VAR results

The impulse responses derived from the linear VAR model provide a general overview of how trade flows respond to political shocks. However, as highlighted earlier, these results fail to fully capture the nuanced interplay between political relationships and the economic stages of the countries involved. The STVAR model addresses this limitation by offering deeper insights, emphasizing the regime-dependent nature of trade dynamics. We use fluctuations in China’s GDP growth to identify potential regime shifts throughout the sample period. Figure 1 illustrates that, while China experienced no full-scale recessions, there were brief economic slowdowns, reflected in the GDP growth patterns. In the 1980s, economic reforms spurred changes, while fluctuations in the late 1990s coincided with the Asian Financial Crisis. The 2008 Global Financial Crisis marked a significant slowdown and signaled a pivot toward a consumption-based economy. The most pronounced contraction occurred in 2020 due to the COVID-19 pandemic, with values of $F(s_t)$ approaching 1 during these slowdowns. Estimation results from transition function (4) indicate that the dynamic relationship between political relations and trade outcomes may vary according to the business cycle phase. This variation can be more formally

assessed by comparing impulse response functions across different regimes.

Overall, a positive shock to bilateral relations between China and its trading partners demonstrates notable variations in trade flow responses across economic regimes, reflecting the interplay of economic cycles and the adaptability of trade relationships. During expansionary periods, trade flows tend to stabilize after initial fluctuations, often aligning closely with non-regime trends. Exports generally exhibit smoother responses, while imports display more pronounced oscillations, often stabilizing in the mid to long term. In contrast, during slowdowns, trade flows show heightened sensitivity, with exports and imports frequently deviating more significantly from non-regime patterns. Import responses in slowdowns often start negatively but tend to recover or turn positive after several quarters, whereas export responses may lag initially before aligning with or surpassing non-regime levels. These patterns indicate that slowdowns amplify the impact of shocks on trade flows, particularly in terms of timing and magnitude. Furthermore, highly integrated trade relationships, such as those between China and advanced economies, often exhibit more consistent and less volatile adjustments compared to less integrated partners. Next, we examine the responses of real exports and imports for each country.

Australia: A positive shock to Chinese-Australian relations leads to an increase in Chinese exports to Australia and a decrease in imports from Australia during non-regime periods. During expansions, the export trend remains consistent with non-regime patterns, stabilizing after 4-5 quarters but with a weaker response compared to non-regime periods. For imports, the response during expansions follows non-regime trends but with stronger negative effects. In slowdowns, the export response is insignificant in the first five quarters but eventually aligns with non-regime patterns, while the import response turns positive after the fifth quarter. This highlights how trade flows adapt to economic regimes and bilateral relations.

France: A positive shock to Chinese-French relations leads to a positive response in Chinese exports to France during both expansions and slowdowns, with the response during slowdowns being significantly larger than in non-regime periods. For imports, the trend during expansions mirrors that of non-regime periods but exhibits more pronounced fluctuations. During slowdowns, the import response oscillates between negative and slightly above zero.

Germany

A positive shock to Chinese-German relations leads to distinct patterns in trade flows. For exports, during expansionary periods, the response initially follows non-regime trends until the fifth quarter, after which it shifts to a more subdued trajectory, settling slightly below zero. During recessionary periods, the export response becomes positive after one quarter and remains so thereafter. For imports, during expansions, the response stabilizes after the third quarter and remains consistently negative. In recessions, the import response turns positive after one quarter and stabilizes thereafter, reflecting changes in

trade flows under different economic conditions.

India: A positive shock to Chinese-Indian relations leads to varying trade flows across regimes. Under the expansive regime, the response of exports is slightly lower compared to the non-regime scenario. In the slowdown regime, the export response turns positive after one quarter, peaking between the third and fifth quarters. For imports, under the expansive regime, the trend is similar to the non-regime scenario but remains slightly lower. In the slowdown regime, the import response becomes negative after one quarter, reaching its lowest point around the third quarter.

Indonesia

Under the expansive regime, the response of China's exports to Indonesia is slightly lower compared to the non-regime model. In the slowdown regime, the export response from China to Indonesia becomes higher than in the non-regime model after the first quarter. For China's imports from Indonesia, under the expansive regime, the trend aligns with the non-regime model but peaks around the second quarter. In the slowdown regime, the import response from Indonesia to China turns negative during the first two quarters, reaching its lowest point, and becomes positive by the fourth quarter.

Japan: Under the expansive regime, the response of China's exports to Japan follows a trend similar to that of the non-regime model but is slightly higher. In the slowdown regime, the export response from China to Japan is lower than in the non-regime model before the seventh quarter but becomes higher after the ninth or tenth quarter. For China's imports from Japan, under the expansive regime, the response is slightly higher than in the non-regime model, with a positive effect observed after the first quarter, peaking around the second quarter. In the slowdown regime, the import response from Japan to China becomes higher than in the non-regime model after the fourth quarter and continues to rise in subsequent periods.

UK: Under the expansive regime, the response of China's exports to the UK follows a trend similar to that of the non-regime model but is slightly higher. In the slowdown regime, the export response from China to the UK drops below zero after the second quarter. For China's imports from the UK, under the expansive regime, the trend aligns with the non-regime model. In the slowdown regime, the import response from the UK to China falls below zero during the first two quarters, reaching its lowest point in the second quarter.

US: Under the expansive regime, the response of China's exports to the U.S. follows a trend similar to that of the non-regime model but is slightly higher. In the slowdown regime, the export response from China to the U.S. drops below zero after the second quarter. For China's imports from the U.S., under the expansive regime, the trend aligns with the non-regime model but remains closer to zero. In the slowdown regime, the import response from the U.S. to China falls below zero after the second quarter. The trade relationship between China and the U.S. has long been a focal point for researchers

due to its global economic significance. For instance, in the fourth quarter of 2022, China’s exports to the U.S. constituted approximately 15% of its total exports, while imports from the U.S. accounted for 7% of its total imports. This substantial trade volume creates what [Davis and Meunier \(2011\)](#) describe as high “sunk costs” in trade relations between certain countries, making consumers and businesses relatively insensitive to shifts in political relations. Consequently, this could explain why the effect of China-U.S. relations on bilateral trade is not significant under the non-regime model, as these high sunk costs discourage any lasting consumer-led boycott movements or disruptions in trade.

3.3 Discussion of results

The overall results of this paper can be summarized as follows. First, the impulse responses under the linear VAR model suggest that the influence of political relations on trade varies significantly across countries, being more pronounced in certain bilateral relationships while remaining limited in well-established Western markets like Germany and the US. Second, the findings obtained by the non-linear VAR highlight the importance of the stage of China’s economy. More precisely, during expansionary periods, trade flows tend to stabilize and align with non-regime trends, with exports showing smoother responses and imports more oscillatory. However, during economic slowdowns, trade flows become more sensitive, with exports and imports deviating significantly from non-regime patterns. Imports often experience a negative initial response but recover over time, while export responses may be delayed.

There are several potential explanations for our findings. Geographical proximity reduces transport costs for countries like Japan, Korea, and Indonesia, making their trade flows more sensitive to China’s economic cycles. However, previous studies suggest that reductions in tariffs or transportation costs alone are not sufficient to significantly boost trade ([Hou, Wang, and Yilmazkuday, 2023](#)). Variations in economic structures and trade profiles also contribute to differing outcomes. Japan and Korea, for example, primarily export high-tech goods, which are more closely tied to China’s domestic production cycles. In contrast, countries like Australia, Germany, and France experience more stable trade growth in sectors where China remains heavily reliant on imports, such as energy and high-end industrial goods.

The heterogeneity in trade responses among Asian countries reflects the complex interplay of economic, political, and historical factors. Improved political relations with Japan and Indonesia have a more significant positive impact on imports and exports during China’s economic downturns. This is due to the high economic complementarity between these countries and China, reduced transportation costs from geographical proximity, lowered trade barriers through regional trade agreements, and China’s possible inclination to strengthen ties with key trading partners during economic slowdowns. In

contrast, improved political relations with India and South Korea have a limited impact on trade, especially during expansion periods. This may be attributed to differences in economic structures, historical and border issues, a lack of deep trade agreements, and industrial competition. Notably, during China’s economic slowdown, enhancing relations with India actually led to a reduction in China’s imports from India, possibly because China adjusted its import priorities or adopted trade protectionist measures. These differences underscore the importance of historical relationships, geographical distance, trade costs, trade preferences, and bilateral and regional trade agreements in determining how political relations affect trade flows.

4 Conclusion

Previous studies have shown that positive political shocks generally increase trade flows between China and its partners, though their effects may be temporary and vary depending on specific conditions (Whitten, Dai, Fan, and Pang, 2020; Du, Ju, Ramirez, and Yao, 2017). However, most research does not account for regime-dependent variations. In this paper, we have addressed this limitation by utilising a non-linear model and offering deeper insights, emphasizing the regime-dependent nature of trade dynamics. We used fluctuations in China’s GDP growth to identify potential regime changes throughout the sample period.

The heterogeneity observed in trade responses among Asian countries underscores the intricate relationship between political dynamics, economic structures, and historical contexts in shaping international trade flows. Improved political relations with countries like Japan and Indonesia have been shown to significantly boost trade with China, especially during periods of economic slowdown.

In contrast, enhanced political relations with India and South Korea exhibit a limited impact on trade, particularly during economic expansions. Factors such as differing economic structures, historical tensions, lack of comprehensive trade agreements, and industrial competition may play a role in dampening the potential positive effects of improved political ties. Notably, during China’s economic downturns, improved relations with India have even correlated with reduced Chinese imports from India, possibly due to shifts in import priorities or protective trade measures by China.

The critical importance of aligning economic interests, resolving historical and political issues, and fostering deep trade partnerships to maximize the benefits of positive political relations is underscored by these findings. Countries aiming to enhance trade with China should focus on developing economic complementarities, reducing trade barriers through bilateral and regional agreements, and building trust to overcome historical and geopolitical challenges.

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Figures

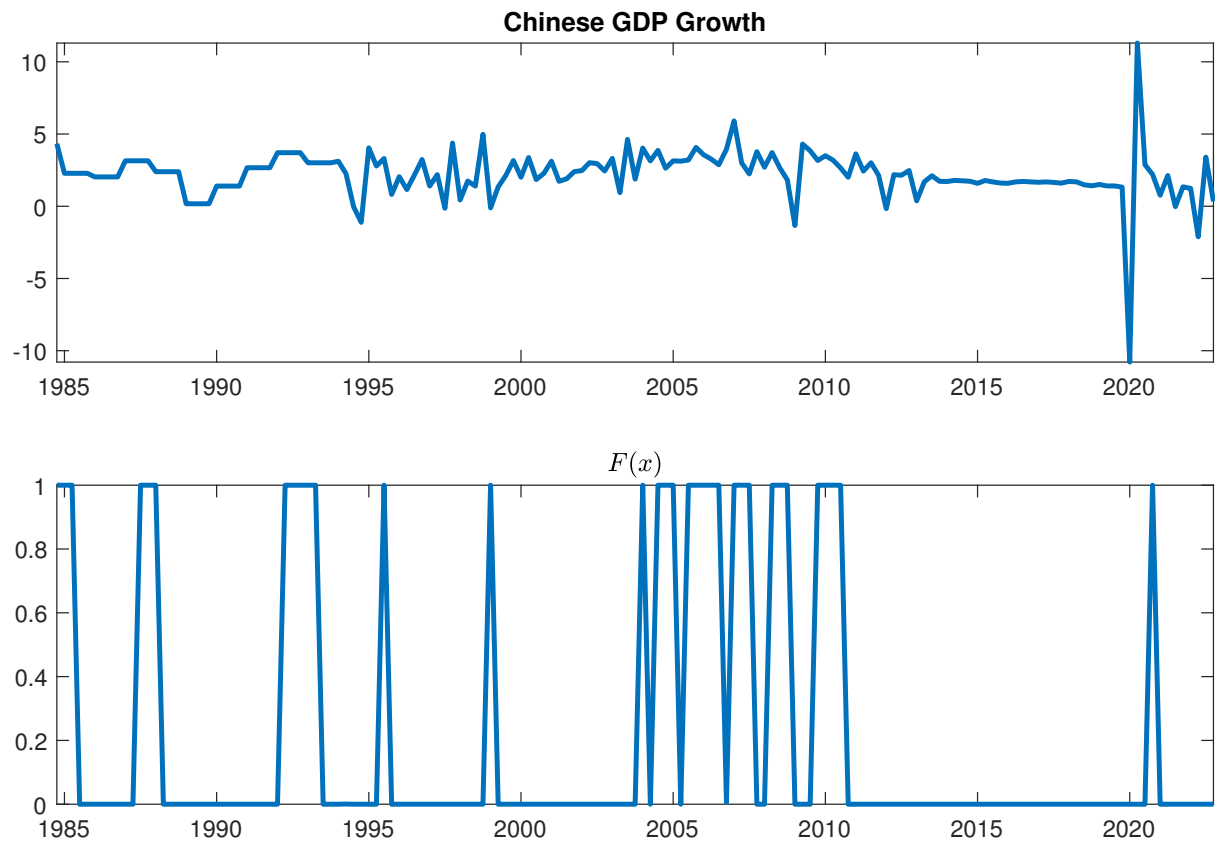


Figure 1: Chinese GDP growth and weight on slowdown regime $F(s_t)$.

Notes: The slowdown regime with $F(s_t) \approx 1$

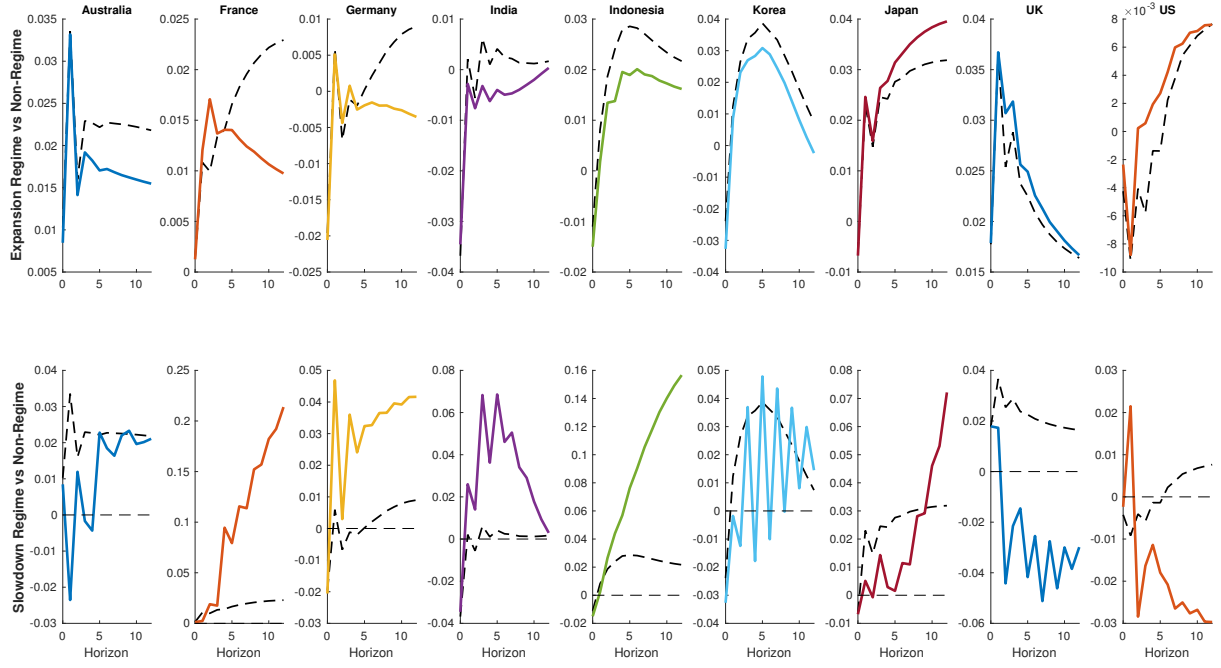


Figure 2: Export responses to a favourite political shock by country across regimes

Notes: The first row displays the comparison of impulse responses estimated using the non-linear VAR (black dotted-lines) and STVAR model under expansion regime (solid lines). The second shows the comparison of responses under the non-linear VAR (black dotted lines) and the responses under the slowdown regime (solid lines). The lines represent the point estimates. The corresponding one-standard-error bands, which are constructed using a recursive-design wild bootstrap, are shown in the online appendix.

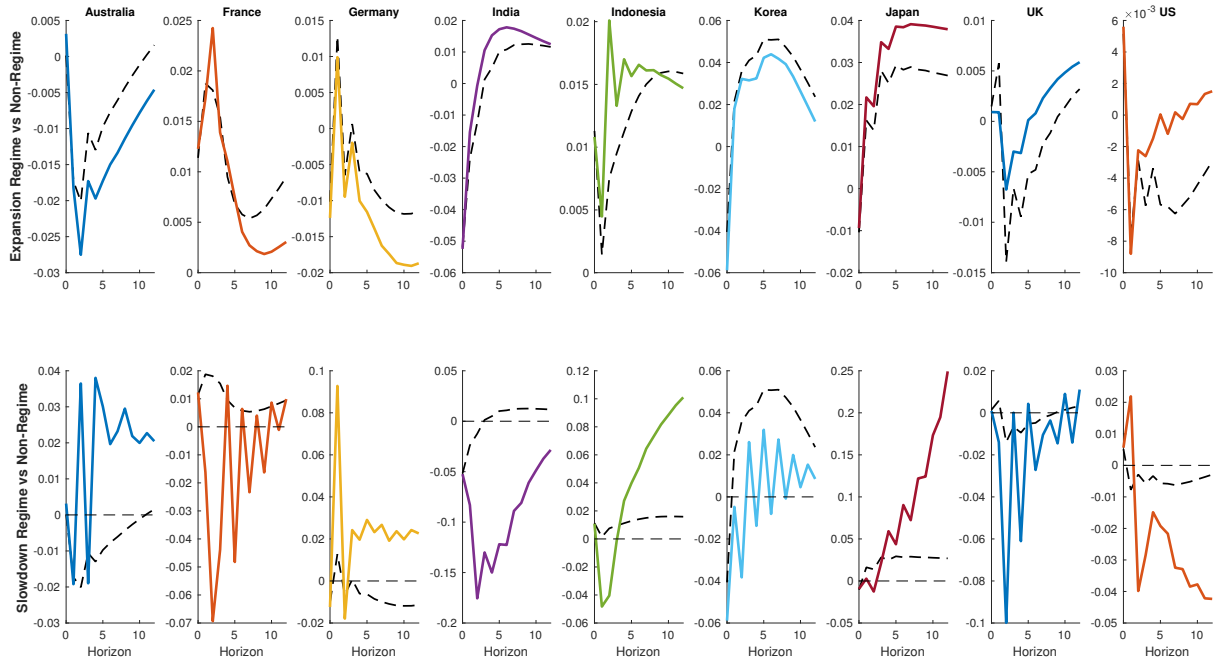


Figure 3: Import responses to a favourite political shock by country across regimes

Notes: See Figure 2