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Saadaoui, Jamel

Université Paris 8 Vincennes-St Denis, Saint-Denis, France

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US-China Tensions, US Partisan Conflict and Global Oil Prices: Scapegoating or Following the Flag or both?

Jamel Saadaoui¹

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Abstract

I explore the relationship between US-China tensions, US partisan conflict and global oil prices over the last 20 years. Using lag-augmented local projections, I find empirical support for both the scapegoating hypothesis and the “following the flag” hypothesis. For the scapegoating hypothesis, a rise of US partisan conflict lead to an increase in US-China tension and a reduction of the global prices of oil in the medium run. For the “following the flag” hypothesis, a rise in US-China tension lead to a reduction of US partisan conflict and a reduction of the global prices of oil in the short run. Overall, I underline a new channel through which the domestic economy can be influenced by geopolitical tensions.

Keywords:

US-China Tensions; US Partisan Conflict; Global Oil Prices

JEL: F4, F5, F6.

¹ *Université Paris 8 Vincennes-St Denis, Saint-Denis, France. Email: jamelsaadaoui@gmail.com.*

1. Introduction

After the 2016 US presidential election and the start of the trade war at the end of 2017, it became clear that the geopolitical relations between the US and China were at the center of the stage of the world economy. Since then, how the US-China tension impacts the world trade and the oil markets has been the focus of several studies (Du et al., 2017; Afonso et al., 2024; Cai et al., 2022; Mignon and Saadaoui, 2024). These studies show US-China tensions may impact the trade relationships of China. In particular, Afonso et al. (2024) show that the trade between China and its main trading partners “follows the flag” in the sense that good geopolitical relationships were a prerequisite to favorable trade evolutions. Du et al. (2017) found something similar. Political relations shocks have a short-lived effect on trade ties between China and its main trade partners. In addition to trade considerations, the literature has also looked at the impact of these tensions on the oil markets. Cai et al. (2022) show that geopolitical tensions between the US and China may threaten world economic growth, pulling down oil demand and prices. Mignon and Saadaoui (2024) go beyond this last study by examining the impact of political tensions between the US and China and geopolitical risks specific to China on the oil market dynamics. They show that a deterioration in the US-China relationships may result in lower oil prices, due to lower growth prospects.

In a more recent study, Cai et al. (2024) explore the impact of political tension between the US and China on the US partisan conflict in the context of the oil market dynamics. They introduce a new possible channel through which geopolitical tensions may influence the oil markets, namely the partisan conflict. In Political Science, two causal relationships are plausible between US-China tension and US partisan conflict. The first runs from the US partisan conflict to the US-China tension and is described in Borg (2024). I call this first causality: “scapegoating”, as the rise of the partisan conflict in the US can increase China-US tensions to win the elections. This view is well illustrated by the rhetoric of Donald Trump about the rise of China. The second runs from the US-China tensions to US partisan conflict and is shown in Schwartz and Tierney (2024). This second causality can be called: “following the flag”, as the increase in the US China tensions can produce a “rally around the flag” effect and reduce the US partisan conflict.

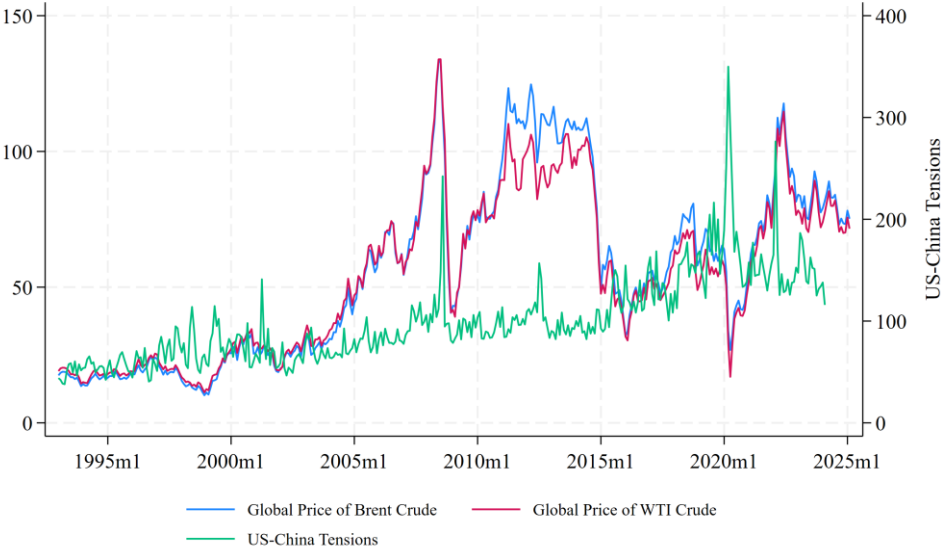
Using a geopolitically augmented oil model based on Kilian (2009), and estimated with lag-augmented local projections over the period January 1993 to December 2024, I found empirical evidence for both causalities. I use the two different global crude prices to consider the spread between the Brent and WTI crude oil prices. Besides, I also use three different proxies for the global economic conditions (Baumeister and Hamilton, 2019; Kilian and Zhou, 2018; Baumeister et al., 2022). First, for the scapegoating hypothesis, a 1 point rise in US partisan conflict produces an increase of US-China tension by around about 0.3 point. It also decreases in the global crude oil prices of 0.2 U.S. Dollars per barrel in the medium run. Second, for the following the flag hypothesis, a 1 point rise in US-China tension generates a reduction in the US partisan conflict of about 0.1 point. It also decreases in the global crude oil prices of 0.1 U.S. Dollars per barrel in the short run.

In the following Section, I will describe the data and the empirical framework. In particular, I will discuss the US-China tension index and the US partisan conflict index. In the Section 3, I will present the empirical results supporting the scapegoating hypothesis and the following the flag hypothesis. I will conclude in a last section.

2. Data and Empirical framework

From January 1993 to December 2024, I use the main variables that influence the global oil markets, together with the US-China tension variable and the Partisan Conflict variable. In Figure 1, we can see that the global price of oil know three sharp reductions during after the start of the GFC in 2008, during the commodity crash in 2015 and after the start of the COVID-19 crisis in 2020. These sharp reductions are associated with an increase in US-China tensions. Besides, we can also see that the Brent-WTI spread started to increase after 2010. In Figure 1 and 2, I plot the US-China tension index (Rodgers et al., 2024) and the US partisan conflict index (Azzimonti, 2018). The US-China index (UCT) follows the construction of the Economic Policy Uncertainty (EPU) index (Bloom, 2016) and is focused on contentious issues in the bilateral relationship between China and the US. The US partisan conflict (PCI) index is also based on a search-based approach on frequency of newspaper articles reporting political disagreement about government policy.

Figure 1. Global Oil Prices and US-China Tensions.



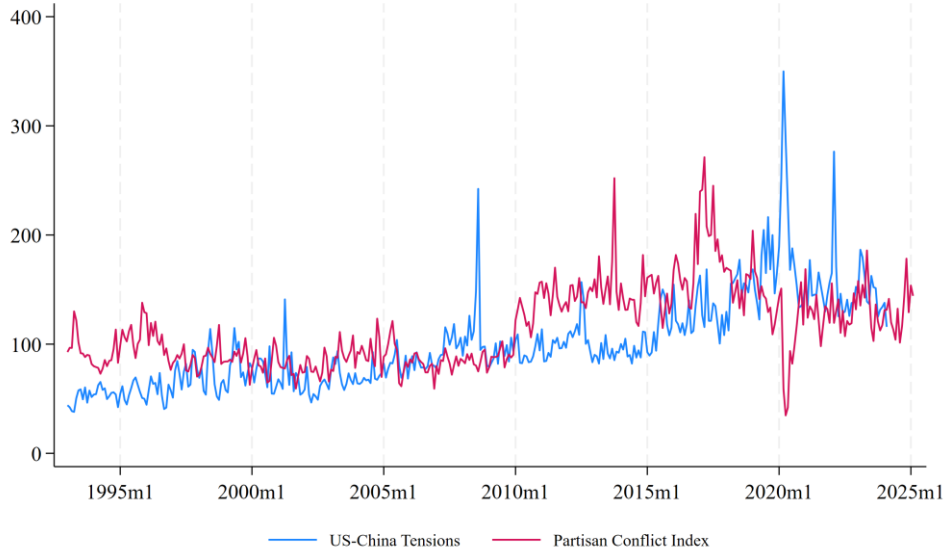
Source: IMF and Rodgers et al. (2024).

In Figure 2, we can see that the UCT spikes during episodes of heightened tensions like the Belgrade Embassy Bombing in 1999, the Hainan Island incident in 2001, the Beijing Olympics in 2008 and after the start of the COVID-19 crisis in 2020. The PCI spikes during episodes of large disagreements on US government policy, like the 2013 US government shutdown, the 2016 Trump election. However, this index known a large reduction after the start of the COVID-19 crisis. This reduction was accompanied by a large increase of the UCT lending some support to the “following the flag” behavior. Blaming China for COVID-19 may have acted as a unifying force that reduced the partisan conflict in the US.

In Figure 3, we have 3 measures of global economic activity and the global oil production. The first is an index that averages of world industrial production in the main OECD countries and 6 non-OECD countries (WIP) created by Baumeister and Hamilton (2019). The second is a proxy for the volume of shipping in global industrial commodity markets (IGREA) introduced in the literature by Kilian and Zhou (2018). The third is the global economic condition index (GECON) computed by Baumeister and al. (2022). GECON includes more dimensions than in

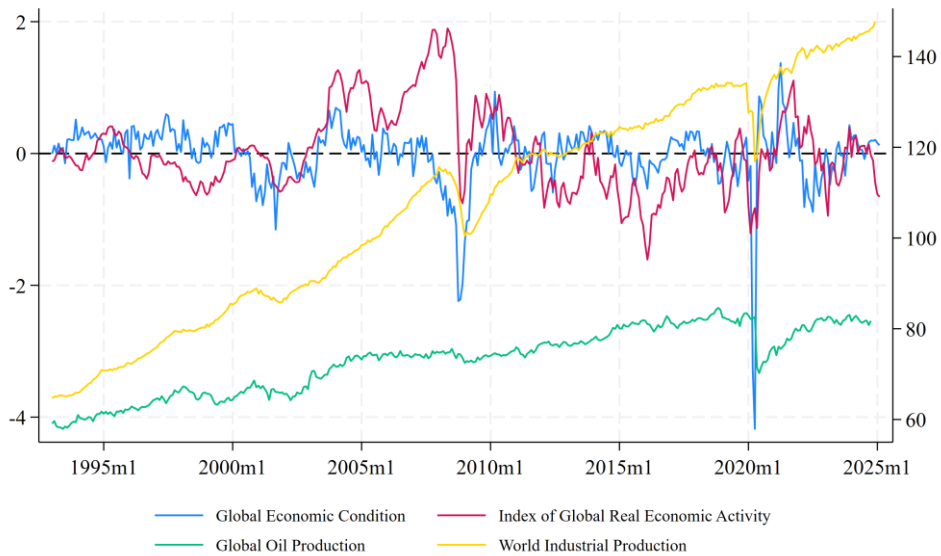
WIP and IGREA and performs better in capturing the deterioration of global economic conditions during the COVID-19. Global oil production has known a sharp reduction during the COVID-19.

Figure 2. US-China Tensions and Partisan Conflict Index.



Source: Rodgers et al. (2024) and Azzimonti (2018).

Figure 3. Global Economic Condition and Oil production.



Source: Baumeister and Hamilton (2019), Kilian and Zhou (2018) and US Energy Information Agency.

I use the following lag-augmented local projection model, following Jordà and Taylor (2024):

$$GOP_{t+h} = a_h + \beta_h s_t + \lambda_h s_{t-1} + \sum_{j=1}^2 \gamma'_h \mathbf{x}_{t-j} + v_{t+h}; \quad h = 0, 1, \dots, H; \quad (1)$$

$$IRF(h) = \beta_h.$$

The target variables, GOP for global price of oil, are alternatively the Brent and WTI global crude oil prices in U.S. Dollars per barrel computed by the IMF². The vector of control variables \mathbf{x} is the following: UCT is the US-China tension index of Rodgers et al. (2024), an increase in the index measure a deterioration of the relation between the US and China; PCI is the Partisan Conflict index from Azzimonti (2018), an increase in the index means that degree of political disagreement among U.S. politicians at the federal level increases; PROD is the oil production measured in millions of barrels from the US EIA³; GECON is the Global Economic Condition index from Baumeister et al. (2022), a negative value indicates bad economic conditions.

The vector changes whether we test the *scapegoating* hypothesis (shock on PCI) or the *following the flag* hypothesis (shock on UCT). The impulse variable is alternatively the PCI or the UCT:

$$\mathbf{x} = (\text{UCT}, \text{PROD}, \text{GECON}, \text{GOP})' \text{ if } s = \text{PCI}; \quad (2)$$

$$\mathbf{x} = (\text{PCI}, \text{PROD}, \text{GECON}, \text{GOP})' \text{ if } s = \text{UCT}.$$

In the appendix A and B, the Global Economic Condition variable, GECON, is replaced by the world industrial production (WIP, Baumeister and Hamilton, 2019), and the Index of Global Real Activity (IGREA, Kilian and Zhou, 2018). The Table 1 provides summary statistics for all the variables involved in the analysis.

Table 1. Summary Statistics.

Variables	Acronym	Observations	Mean	SD	Min	Max
US-China Tensions	UCT	374	100.00	42.55	37.98	349.9
Partisan Conflict Index	PCI	386	114.70	36.52	34.74	271.30
Global Price of Brent Crude	BRENT	386	56.20	32.50	10.16	133.60
Global Price of WTI Crude	WTI	386	53.92	29.14	11.27	134.00
Global Oil Production	PROD	382	73.04	7.22	57.93	84.59
Global Economic Condition	GECON	386	-0.01	0.48	-4.18	1.37
Index of Global Real Economic Activity	IGREA	386	0.04	0.62	-1.61	1.90
World Industrial Production	WIP	384	107.30	23.79	64.61	147.70

Source: author's calculations.

3. Results and discussion

In Figure 4 and 5, I find empirical evidence supporting the scapegoating hypothesis. A rise of 1 point in the political disagreement in the US implies a rise in US-China tensions of about 0.3 point and a decrease in the global crude oil prices of 0.2 U.S. Dollars per barrel in the medium run. This late reaction may be due to the nature of the relationship. The US partisan disagreements take time to translate into US-China tension. These results are confirmed in the Figure A.1 to A.3 in the Appendix A using different proxies for Global Economic conditions, namely WIP and IGREA.

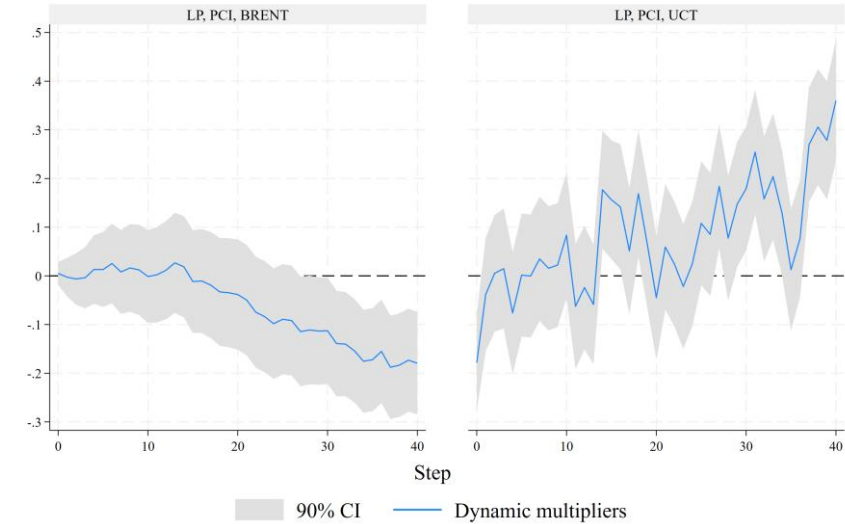
In Figures 6 and 7, I find empirical evidence supporting the “following the flag” hypothesis. A Rise in US-China tensions of 1 point implies a reduction in Political disagreement in the US of about 0.1 point and a decrease in the global crude oil prices of 0.1 U.S. Dollars per barrel in the

² I use the following series from the FRED website, POILBREUSD and POILWTIUSD for the Brent and WTI global crude oil prices, respectively.

³ I use this specific series available on the website of the US EIA: INTL.57-1-WORL-TBPD.M.

short run. These results are confirmed in the Figure B.1 to B.3 in the Appendix B using different proxies for Global Economic conditions, namely WIP and IGERA.

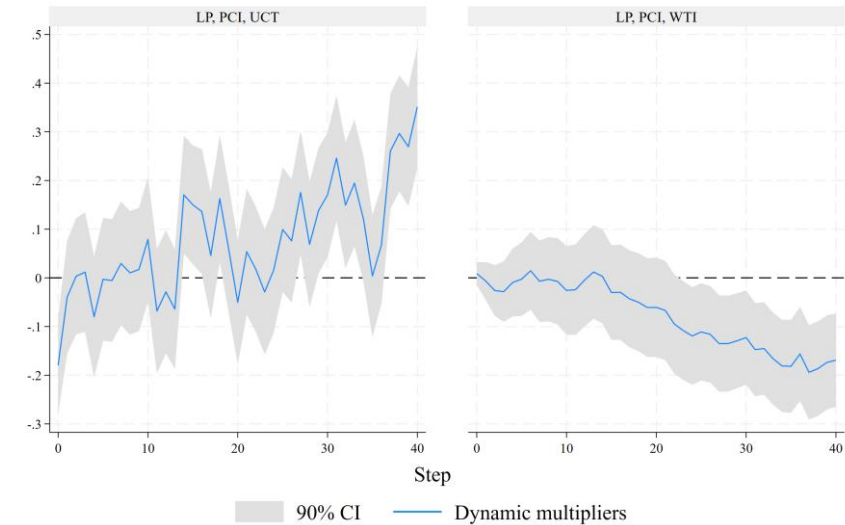
Figure 4. Global Brent price and US-China tension reaction to a rise in US Political disagreement.



Graphs by irfname, impulse variable, and response variable

Source: author calculations.

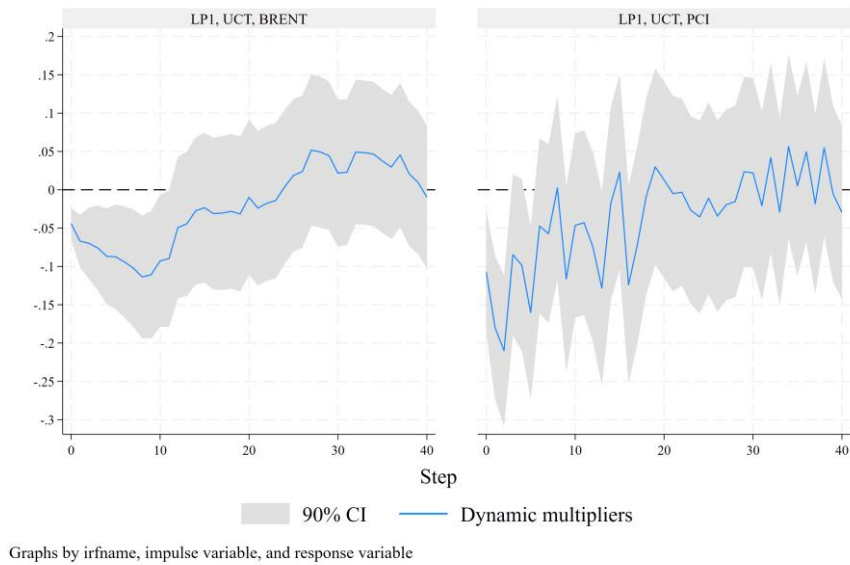
Figure 5. Global WTI price and US-China tension reaction to a rise in US Political disagreement.



Graphs by irfname, impulse variable, and response variable

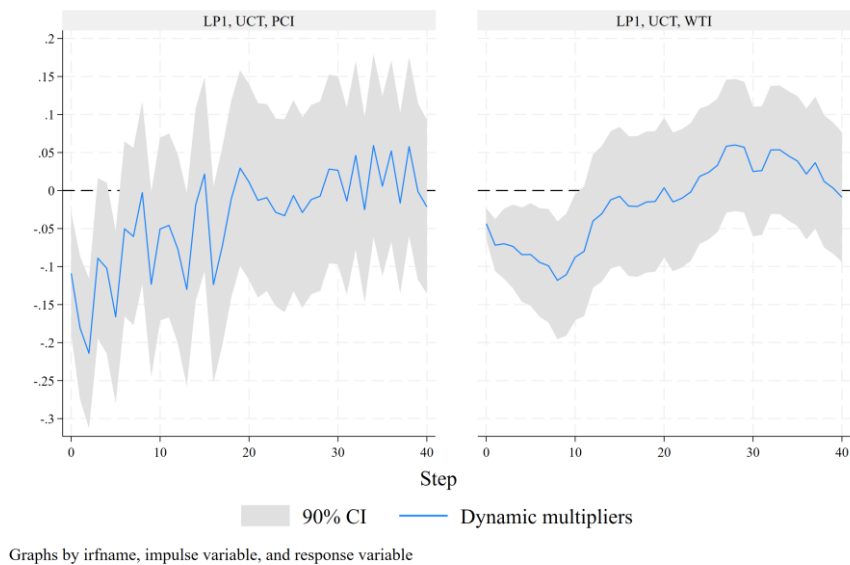
Source: author calculations.

Figure 6. Global Brent price and US Political disagreement reaction to a rise in US-China tension.



Source: author calculations.

Figure 6. Global WTI price and US Political disagreement reaction to a rise in US-China tensions.



Source: author calculations.

4. Conclusion

This research provides new evidence on the relation between US-China tensions, US partisan conflict and the global price of oil. I find support for the scapegoating hypothesis. A rise in the US partisan conflict produces an increase of US-China tensions and a reduction of the global price of oil in the medium run. I also find support for the “following the flag” hypothesis. A rise in the US-China tensions reduce the US partisan conflict and the global price of oil in the short run. These pieces of evidence underline a new channel through which the geopolitical tensions influence the domestic economy. Subsequent studies may explore the effect on US private investment of US-China tensions. I left that for further research.

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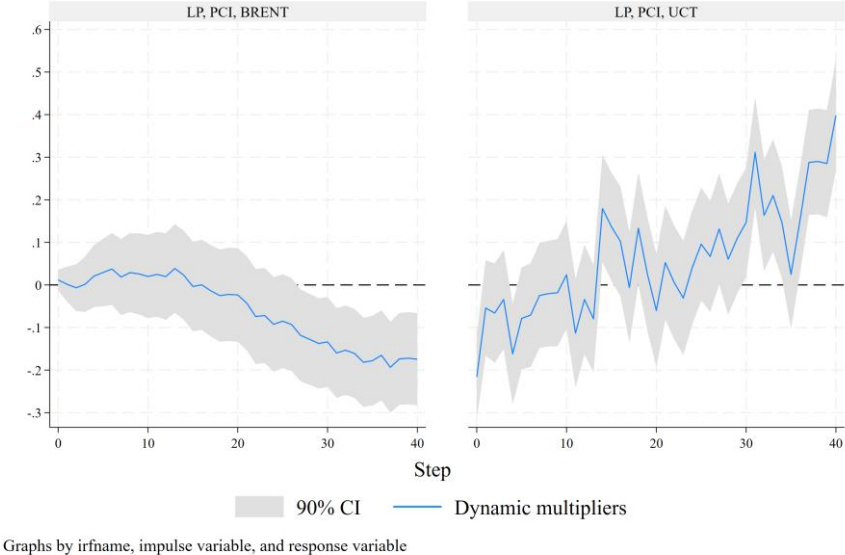
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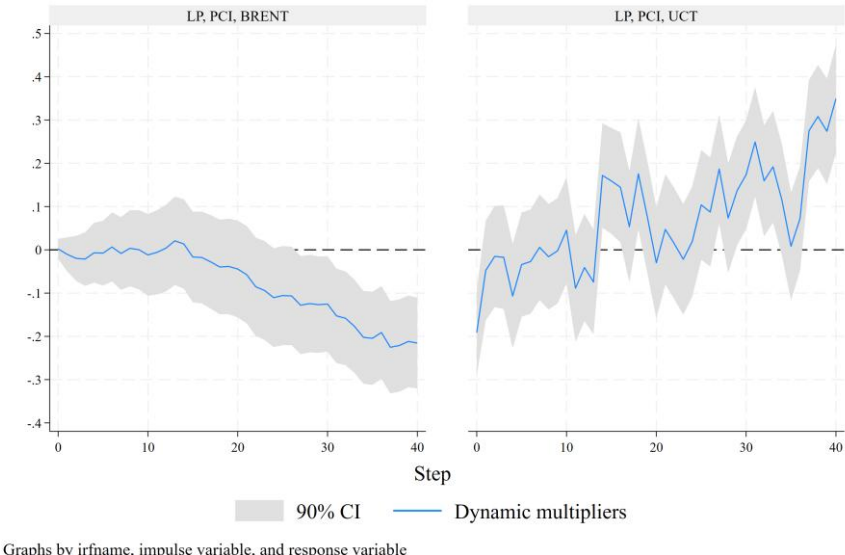
Appendix A. Robustness check for the scapegoating hypothesis

Figure A1. Global Brent price and US-China tension reaction to a rise in US Political disagreement (extended lags for the controls to 12 months)



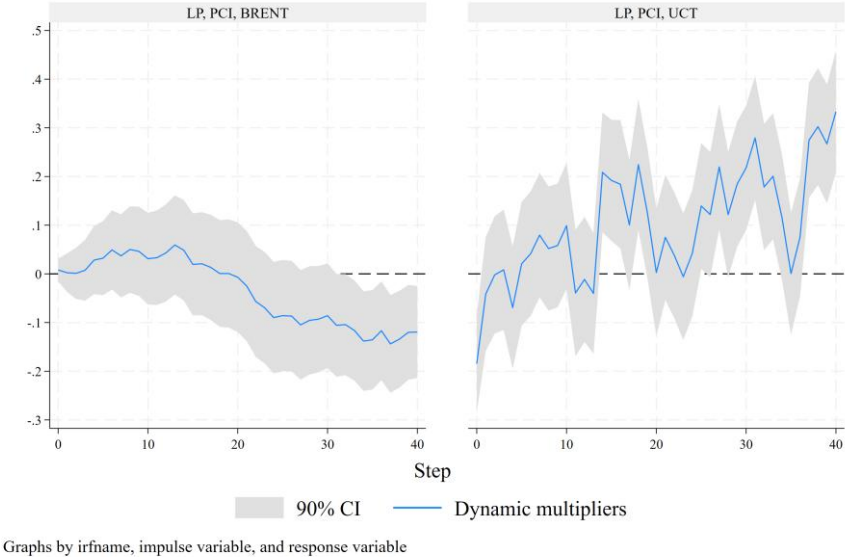
Source: author calculations.

Figure A2. Global Brent price and US-China tension reaction to a rise in US Political disagreement (World Industrial Production).



Source: author calculations.

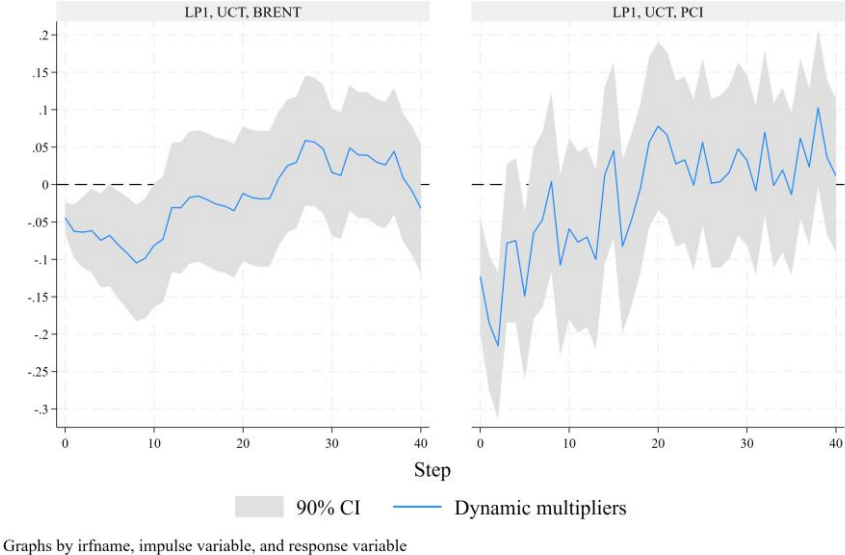
Figure A3. Global Brent price and US-China tension reaction to a rise in US Political disagreement (Index of Global Real Activity).



Source: author calculations.

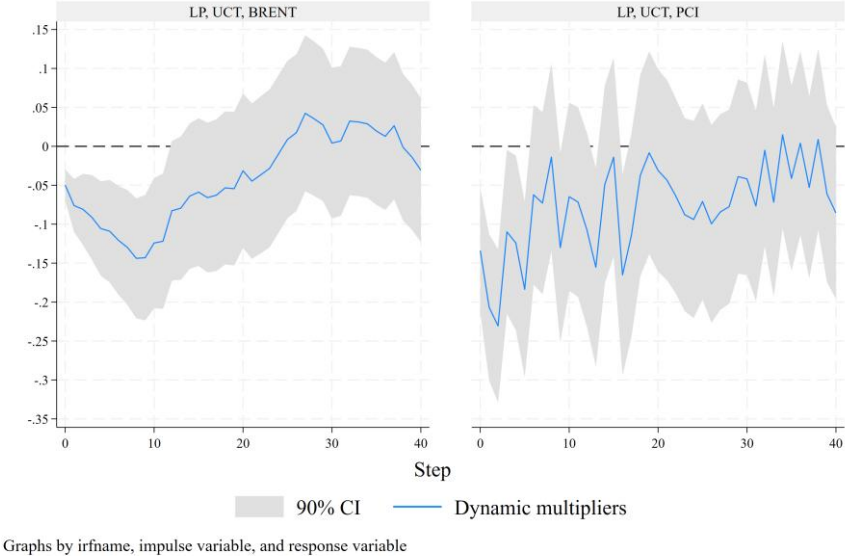
Appendix B. Robustness check for the “following the flag” hypothesis

Figure B1. Global Brent price and US Political disagreement to a rise in US-China tension reaction (extended lags for the controls to 12 months).



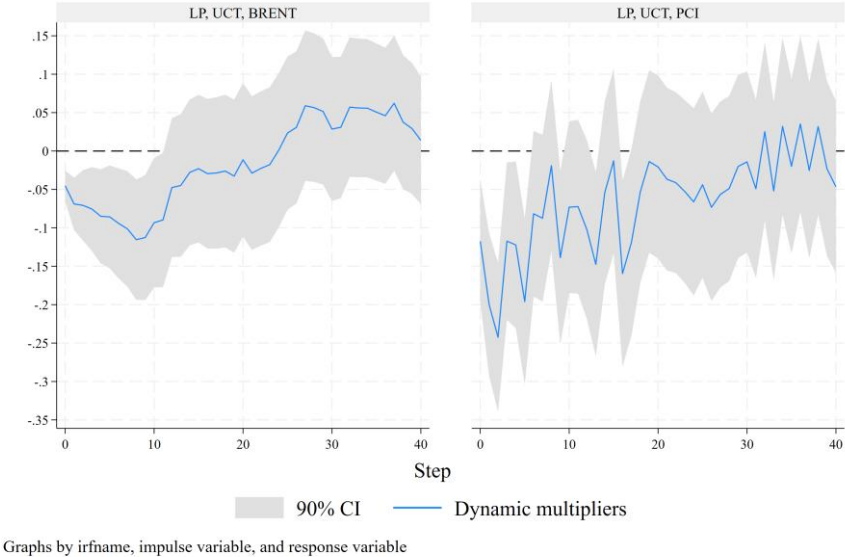
Source: author calculations.

Figure B2. Global Brent price and US Political disagreement reaction to a rise in US-China tension (World Industrial Production).



Source: author calculations.

Figure B3. Global Brent price and US-China tension reaction to a rise in US Political disagreement (Index of Global Real Activity).



Source: author calculations.