

The Economic Policy Uncertainty on Firm's Behavior

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Abstract: The study examines how economic policy uncertainty could affect firm behavior. It discusses how changes in economic policies can affect investment decisions, capital expenditure, innovation, and green behavior of firms. This topic focuses on analyzing the relationship between corporate financial decisions and consumer spending under policy uncertainty. It also explores the relationship between policy uncertainty and firms' overseas investments, environmental performance, governance practices, tax avoidance strategies, and cash-effective tax rates. The findings reveal the importance of cash holdings in alleviating the effects of policy uncertainty on firm activities and highlight the relationship between policy uncertainty and firms' carbon emission intensity. Overall, the study provides insights into the various aspects of corporate decision-making affected by economic policy uncertainty.

Keywords: investments, emission, strategies, economic, consumer.

1. Introduction

Rising global trade protectionism has challenged international economic and trade rules.

Global trade protectionism has risen, and the United States has adopted unilateral trade protection measures. Affected by this, trade frictions between the USA, EU, Canada, Mexico, and many other countries have intensified. At the same time, the United States and the European Union are at odds over the climate issue, and the trade dispute has triggered a new round of negotiations between the two sides on global climate issues. All of these issues create uncertainty for the global economy. Affected by Britain's "Brexit", the British stock market fell sharply, and the yield of British government bonds fell sharply; At the same time, due to the tax cuts introduced by the Trump administration, US corporate profits have increased sharply, the US dollar has strengthened, the international financial market is volatile, and the stock and bond markets are depressed. The turbulence in the international financial market has exacerbated the uncertainties in the economic and social development of various countries. The current tight supply situation in the global energy market has not been fundamentally eased. Oil and gas production in the United States has increased sharply as a result of the "shale gas revolution" in the United States. However, due to the influence of global geopolitical and economic factors, the imbalance between global oil and gas supply and demand will exist for a long time. At the same time, affected by the conflict between Russia and Ukraine, international oil prices are still running at a high level. High international commodity prices will have a profound impact on national economies.

With regard to global macroeconomic uncertainties, the first is that international economic and trade rules are being challenged by growing global protectionism, which is on the rise, and the United

States is taking unilateral measures to protect trade. Because of this, the United States, the European Union, Canada, Mexico, and other trade friction intensified. Meanwhile, the United States and the European Union are at odds over climate change, triggering a new round of global climate talks. All of this is a source of global economic uncertainty. Second, as a result of the turmoil in international financial markets, stock markets, and bond markets, the UK's "Brexit" has sent stock markets tumbling and UK government bond yields plunging; and, thanks to the Trump administration's tax cuts, US corporate profits have risen, the dollar has strengthened, international financial markets have been in turmoil, and equity and bond markets have been depressed. The turmoil in the international financial market has exacerbated the economic and social uncertainty. Finally, because of high energy and commodity prices, the current tight supply situation in the world energy market has not been substantially eased. Oil and gas production in the United States has increased dramatically, driven by the "shale gas revolution." However, due to global geopolitical and economic factors, the world's supply and demand will be long-term imbalanced. Meanwhile, affected by the Russia-Ukraine conflict, international oil prices remain high. High international commodity prices will have a profound impact on the country's economy.

From the study examines how economic policy uncertainty affects firm behavior. In today's constantly changing economic conditions, governments frequently change policies on economics to face the challenges. The uncertainty of economic policy could affect the firm's behavior to a large extent.

Having done sufficient paper searching and empirical studies, we conclude that economic policy uncertainty could partly determine the firm behavior in negative or positive ways, including investment decisions, capital expenditure, innovation, and green behavior.

From this point, we discuss the influence of macroeconomic uncertainty directly and indirectly on corporate behavior. In today's changing economy, countries are also adapting their economic policies to cope with the challenges. Uncertainty in economic policy can have a significant impact on business behavior.

This paper discusses the impact of different factors on corporate performance, including return on assets, return on net assets, net return, and Tobin's problem. The systematic GMM method is used to overcome problems such as heterogeneity and autoregression in OLS and the fixed effect model.

2. Negative effect on firm's behavior

2.1. Firms' investment behavior in the face of economic policy uncertainty

2.1.1. Changes in different investment types

In today's rapidly changing society, uncertainties about economic decisions are becoming increasingly important. This paper summarizes the related research on the enterprise and economic effects of EPU globally to provide evidence for the existing research. Overall, the uncertainty of monetary policy has a significant impact on corporate financial decisions and consumer spending. In particular, companies are more cautious in times of economic uncertainty, thus reducing investment in products and jobs. After controlling the characteristics of enterprises, the author finds that there is a significant negative correlation between enterprises' overseas investment and EPU. It shows a greater negative impact in companies with limited funds, companies that rely on government subsidies, as well as companies with lower overseas income and national companies. Wang and Song believe that changes in the macro environment will have a significant impact on the investment decisions of enterprises, which will lead to external demand will be segmented. Among them, the demand for working capital and long-term capital financing also significantly impact [1].

2.1.2. Impact on specific companies

It is found that due to the uncertainty of national macro-control measures, the real investment of private enterprises is obviously restrained, which leads to a decline in net debt issuance by private companies. However, in state-owned enterprises, this effect is not obvious. The EPU has no obvious effect on the cash holdings of enterprises. Through the analysis of the sample data, it is found that the investment effect of government procurement on companies will only have an effect when the proportion of capital investment is low. Due to increased funding constraints, EPU will invest more in conventional energy companies, although it will play a more significant role in new energy companies.

2.1.3. The result of the irreversibility of investment

This paper uses a series of data to study the equity investment behavior of Australian companies. Similarly, empirical analysis shows that due to the irreversibility of investment, the limiting effect of EPU on investment timing also exists. On this basis, through the construction of the enterprise asset allocation model, it is found that the internal capital investment will significantly change the uncertainty of the overall decision-making and regulation effect of the company. This study found that PU will hinder the investment behavior of companies, resulting in prevention delays, which is irreversible

2.1.4. The cost of debt financing will also increase

He Yiming points out that with the increase in macroeconomic uncertainty, the scale of debt financing of private enterprises will be significantly reduced, and the cost of debt financing will also increase. In addition, the more financing constraints private enterprises face, the regional marketing will be higher, the heavier the inhibition effect of macroeconomic uncertainty on the scale of financing of private enterprises, and the more obvious the positive impact on the debt financing cost of private companies [2].

2.2. Firms' strategy making in the face of economic policy uncertainty.

2.2.1. The changing of the firm's innovation situation when facing economic policy uncertainty

This paper examines the changes in the technological innovation capability of Chinese enterprises from 2000 to 2017. This project studies the relationship between EPU and the company's technological innovation. In addition, when the EPU investment is insufficient, technological innovation plays a significant positive role in the value of the company. On this basis, this paper examines the action mechanism of national macro-control factors on enterprise technological innovation and reveals the transmission mechanism of capital cost. We found that EPU increased the cost of capital, leading to decreased innovation. The empirical results show that the effect of EPU on corporate technological innovation is mainly reflected in the company's cash holdings and the growth rate of operating profits. The company's reform and development are affected by the company's internal and external environmental factors. The study found that the increased policy uncertainty will have a negative effect on the company's technological innovation. Yang Luping believes that the government has a significant promoting effect on the scientific and technological innovation of enterprises, and when the financing restrictions of enterprises are reduced, their level of independent research and development will also be improved [3].

2.2.2. Changes in capital structure decisions of firms responding to economic policy uncertainty

Based on China's data from 2003 to 2013, this paper empirically examines the effects of different factors on the capital structure of Chinese enterprises at macro and micro levels. The results show that companies tend to reduce their financial leverage when they face more uncertainty [4]. Therefore, this project intends to empirically test the economic policy uncertainty (EPU) on U.S. public companies. The influence of EPU on the corporate debt ratio is different. The reason lies in the difference in EPU, some companies are positive, and some companies are negative. However, overall, an increase in EPU results in a significant reduction in the company's debt ratio. Nonfinancial companies now invest huge sums in financial assets, raising questions about their traditional boundaries [5]. The results show that the allocation of non-monetary financial assets will be adversely affected when financing constraints are relatively loose. Lu and Zhu point out that by controlling the latest resource allocation of commercial banks, the state can reduce the risk of market economy fluctuations borne by enterprises, thereby reducing the adverse impact of macroeconomic uncertainty on the allocation of credit resources [6]. Zhao Jinrong points out that when the economy is uncertain, the company's operation is unstable, the profit is not guaranteed, the accuracy of cash flow is reduced, and the cash holding of management's transaction motivation is increased [7]. At the same time, the external financing channels are reduced, the financing cost is increased, and the prevention enthusiasm of the company's management is enhanced. Therefore, the relevant government departments should improve the level of macro research and decision-making, perfect the capital market, and broaden the financing channels of Chinese enterprises.

2.3. How economic policy uncertainty affects a firm's social behavior

The study found that, in the near term, EPU contributes significantly to carbon emissions not through its role in technological progress, but through the proportion of fossil fuels in total energy consumption and energy intensity. The results show that manufacturing companies tend to use low-quality fossil fuels at low prices to meet the challenges of rising EPUs. Taking Chinese companies as the research object, this study examines the indirect effects of foreign direct investment (FDI) on the productivity of "green insurance". The results show that foreign direct investment plays a positive role in green technology transfer.

3. Positive effect on firm's behavior

3.1. The social responsibility is reinforced when EPU is high

According to the study, when the economy is unstable, high intangible strength industries and R&D enterprises are most affected by restrictive governance policies. However, when the economic environment is unstable, those companies benefit more from previous socially responsible investments. The accumulated social capital can offset the negative effects of these factors on the financial performance of the company through the investment of social responsibility. In addition, this paper also studies that the positive role of corporate social responsibility is stronger when the economic environment is unstable [8]. Finally, during periods of greater uncertainty, companies improve their overall environmental, social, and ESG, corporate environmental and governance performance. This relationship applies to ESG, subdimensions of emissions, resource utilization, labor, management, and corporate social responsibility (CSR) strategies. Take a more aggressive approach to tax avoidance to invest.

Our results show that companies will reduce their actual cash income when they face greater uncertainty. Holding cash can ease uncertainty about monetary policy, especially for cash-strapped businesses. Cash tax savings will be used for secondary investments rather than dividends. Wang Ke

points out that there are risk transmission channels for monetary policy transmission in China's banking industry, and macroeconomic uncertainties will be reduced [9].

4. Conclusion

The findings consistently show that economic policy uncertainty has a significant and negative effect on firm performance across all proxies. It is positively correlated with corporate cash holdings, especially for companies' dependent on government spending. It hinders firm innovation, reduces leverage ratios, and decreases capital investment. It also affects firms' investment-financing decisions, tax avoidance strategies, and cash-effective tax rates. This study highlights the important role of cash reserves in alleviating the policy uncertainty of corporate business behavior. At the same time, the study also shows that there is a significant positive correlation between enterprises' carbon emissions and the level of national macro-control. This study reveals the impact of economic policy uncertainty on corporate behavior at different levels.

The effects of macroeconomic uncertainty on firm behavior can be further analyzed through several studies. First, a direct consequence is that companies operating in unstable conditions will be impacted when the economy is uncertain, as profits and cash flow accuracy will decrease and transaction motivation will increase.

Then, an indirect consequence is that external financing may broaden Chinese enterprises' financing channels, making it more difficult for them to take advantage of opportunities in a competitive market environment.

Last, direct consequence also includes a potential effect on investment behavior due to excessive cost stickiness or inadequate investment due to increasing costs related to cost stickiness or inadequate investment due to reduced profitability or lack thereof.

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