# *DISCUSSIONS ON* THE EFFECT OF FOREIGN ENTRY REGULATION ON DOWNSTREAM PRODUCTIVITY: MICROECONOMIC EVIDENCE FROM CHINA

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# Summary

- Q : Impact of FDI entry regulation on downstream firm productivity in China
- FDI entry regulation is constructed from the Catalogue for the Guidance of Foreign Investment from NDRC
- Finding 1 : in general there is decline of FDI entry barrier, according to the author's measure of regulation, but there exist sizable differences across sectors ( mean -2.3 with std. 0.77 )
- Finding 2 : Reductions in FDI entry barriers in upstream sectors lead to increases in downstream firm TFP
- Finding 3: finding 2 is robust to IV (India's deregulation)
- Finding 4 : finding 2 is strongest in sectors which (a) are closer to world technology frontier (b) have higher TS and LS with the upstream sector, and firms with (a) positive R&D (b) higher intermediate input shares

# Comment 1 /
# VA relative to studies on vertical FDI spill-overs

- This literature often focuses on the “backward” or “forward” linkages of FDI spillovers, with “foreign presence” of upstream/downstream industries at the RHS
- A number of papers focus on China (c.f. Hale and Long 2007 for a survey), with inclusive/mixed results, but drivers of the “foreign presence” variable remain a black-box

- Contribution of this paper ? Focus on a unique form of FDI policy of China – NDRC guidance of FDI
- Distinctive feature of this measure of FDI policy – (a) sizable variation across time and sectors (b) different categories – encourage, restricted, prohibited (c) NDRC policy potentially should have big impact on FDI
- These may help open this black-box and solve the endogeneity issues

# Comment 1(contd.)

- Note that this paper only focuses on “prohibited”/”restricted” and label them as FDI entry barriers

$$Barrier_{jt} = \sum_{s=1}^{n} FER_{st} * w_{sj} \qquad (2)$$

where $Barrier_{jt}$ is the upstream foreign entry barrier for downstream manufacturing industry $j$ at time $t$; $FER_{st}$ refers to the FER indicator (either $\text{FER}_1$ or $\text{FER}_2$)

- But note that China’s FDI policy is two hands : “restricting” &“promoting”
- The “encouraged” category is ignored , which could be very interesting to explore further , and see how it differs from the “restriction” measures

- Suggestion:

  construct a “promotion” measure based on the encourage category as a separate variable at the RHS

| | 1997 | | | 2002 | | | 2004 | | | 2007 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | E | R | P | E | R | P | E | R | P | E | R | P |
| Agriculture | 6 | 4 | 3 | 11 | 2 | 3 | 11 | 2 | 3 | 12 | 3 | 3 |
| Manufacturing | 176 | 73 | 14 | 216 | 41 | 14 | 209 | 41 | 14 | 298 | 48 | 15 |
| Services | 3 | 25 | 14 | 35 | 32 | 18 | 36 | 35 | 17 | 41 | 36 | 21 |
| Total | 185 | 102 | 31 | 262 | 75 | 35 | 256 | 78 | 34 | 351 | 87 | 39 |

Notes: 'E' refers to the 'encouraged' items; 'R' refers to the 'restricted' items, and 'P' refers to the 'prohibited' items.

# Comment 2/
## Understanding NDRC's FDI regulation

- NDRC's FDI regulation is surely not random
- What are the economic determinants ? Mark vs Resource protection? Evolution over time?
- Political economics of FDI regulation ? SOE presence? environmental issues ? Structural reform ?

- Suggestion
- Transition matrix between categories
- Descriptive regressions with FDI restriction/promotion at LFS, and industry characteristics at RHS , e.g. SOE share , pollution, etc.

# Comment 3

- Horizontal effect might be first order importance
- What is the direct effect of FDI regulation within the same industry ?
- Increase/decrease competition ? Spillovers ?
- Does the form of Foreign entry matter ? M&A vs Greenfield ? Export oriented vs Market seeking ?

- Suggestion
- Same specification/IV but with firm/industry performances at the LHS. (firm/industry productivity , concentration, etc. )

# Other comments

- Endogeneity
  - Reverse causality. High barriers due to low upstream productivity
  - Omitted variables. Other measures of FDI incentives/disincentive, etc. preferential tax treatment ?
- Validity of IV and DID ? Section 7.1 should be expanded.
- Channels.
  - Need robustness checks to control for interactions with other industry or firm characteristics, e.g. firm size, K or L intensity of the industry
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