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.

\[ \text{Barrier}_{jt} = \sum_{s=1}^{n} FER_{st} \times w_{sj} \]  (2)

where \( \text{Barrier}_{jt} \) is the upstream foreign entry barrier for downstream manufacturing industry \( j \) at time \( t \); \( FER_{st} \) refers to the FER indicator (either \( FER_1 \) or \( FER_2 \)).

• 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.
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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