Graduate School of Economics, WASEDA University

Overview for Doctoral Dissertation

Research Subject

Essays on Financial Development in China: Political Connection, Fiscal Effect and Openness

Doctoral Program Economic Policy · Money and Banking

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Abstract

The economic reforms and liberalization that started in 1978 transformed the Chinese economy from a centrally planned economy to a market-oriented one. Key aspects of the economic reform were the reduction of trade barriers, the adoption of foreign direct investment (FDI) and the establishment of stock exchanges. Economic reforms brought the rapid economic growth and the financial development, which also entailed the serious distortions in the capital allocation, the poor operating performance of post-initial public offering (IPO) firms, and the fast-growing government spending. This dissertation is devoted to statistically examining the role of financial and trade openness as factors behind the divergent pattern of the financial deepening process, the effect of regulation changes on operating performance of IPO firms and the response of Chinese economy to fiscal stimulus. It should have importance implications for China's and other transition economies' reform.

Structure of Dissertations

Chapter 1: Introduction

Chapter 1 provides a detailed description of the general background information and motivation of the study. Main results and contributions of each chapter and organization of the dissertation are presented.

Chapter 2: The role of financial and trade openness in local financial development in post-reform China: Evidence from panel data

Chapter 2 explores whether financial and trade openness improves the distortions apparent in Chinese banking system. The adoption of FDI and the sum of imports and exports are used to be indicator of financial and trade openness. Controlling for other factors, we find that both trade openness and financial openness has a positive and significant effect to the total bank credit. We also find that FDI inflows have a positive and significant influence on the local financial development by improving the access of firms in the private sector to formal bank finance and by facilitating deposit mobilization in recipient provinces. These results suggest that it is important to ensure financial openness to improve the efficiency of capital allocation and, consequently, to address the widening regional disparities in China.

Chapter 3: Political connections, regulation changes and operating performance of Chinese IPOs

Chapter 3 examines whether the regulatory incentives induce the opportunistic reporting practices and forecasting behaviors by the issuer during the IPO processing, and poor post-IPO operating performance of Chinese companies. We find that IPO firms with political connections engage in earnings management by using 627 A-share IPOs in the years from 2000 to 2007. Our results also suggest that politically connected IPO firms experience a poor operating and financial performance than those without political connections after going public. Moreover, we find that the IPOs that went public during the book-building system experience a better post-IPO operating performance than those went public under the issuance-quota system and the restricted-channel system. This chapter is based on the following published article:

- Liu, Jianlei, Konari Uchida, and Ruidong Gao. (2012). "Earnings management of initial public offering firms: evidence from regulation changes in China." Forthcoming*, Accounting & Finance* (DOI: 10.1111/acfi.12006).

Chapter 4: Does government expenditure affect Chinese long-term stock performance?

Previous studies illustrate ambiguous evidences about the influence of political connections on IPO processing. Some researchers argued that political connections are likely to provide preferential benefits to IPO firms on IPO processing, such as higher offering price, lower underpricing, and preferential access to bank loans. In contrast, some other studies argued that the government intervention may reduce the efficiency of politically connected firms, and thus bring a worse post-IPO performance. Chapter 4 examines whether the government expenditure could potentially affect the long-term stock performance of IPOs to test the hypothesis that the government subsidies and contracts are given to politically connected firms prior to non-connected ones. We find that the government expenditure positively affects the long-term stock performance of politically connected firms by using 627 A-share IPOs in the years from 2000 to 2007. This chapter is based on the following published article:

- Liu, Jianlei, Konari Uchida, and Ruidong Gao. (2012). "Political connections and the long-term stock performance of Chinese IPOs." *Journal of International Financial Markets, Institutions and Money* 22(4): 814-833.

Chapter 5: Using SOEs stock returns to identify Chinese government spending shocks

All of the Neo-Classical and new open economy macroeconomics (NOEM) models predict a negative response of the private consumption against a positive government spending shocks. However, the existing empirical studies find only the opposite; a positive response of the private consumption. We attribute the inconsistency to the defect of the traditional recursive identification strategy, which lacks the ability to capture the unobservable information about the expected change in the government spending in a more precise and timely manner. Chapter 5 proposes a new identification strategy, which makes use of the typical feature of a transition economy, i.e., the government preferential treatment for state-owned enterprises (SOEs). By applying our novel identification method, we find that the response of Chinese economy to fiscal stimulus under the crawling-peg exchange rate regime is consistent with the view of the Neo-Classical and NOEM models; namely the output increases, the private consumption decreases and the real exchange rate appreciates in response to a positive government spending shock.

Chapter 6: Conclusion

Chapter 6 summarizes the dissertation.