Industrial Policy and Asset Prices: Evidence from the Made in China 2025 Policy

Xia (Summer) Liu*, William Megginson*, and Junjie Xia†
*University of Oklahoma, †Peking University

What We Do?

Using the Made in China 2025 (MC2025) policy as an experiment, we examine
1. How financial market investors assess government industrial policy announcements.
2. How industrial policy announcements and evolutions impact targeted industries, both the presumed domestic industrial beneficiaries and their international competitors.

What is the MC2025?

It is the most important industrial policy initiative of recent decades.
• Time: It is proposed in October 2014 and officially announced on May 08, 2015.
• Policy: The policy targets ten mostly high-tech industries with promised subsidies, tax benefits, protection from competition, and other preferences.
• Goal: To achieve Chinese industrial prominence by 2025 and dominance by 2040.
• Sector-based: 10 high-tech industries
• Placed-based: Key regions/cities: 30 cities in 14 provinces

Empirical Design

1. We investigate market investors’ responses to the policy announcement in China and the US, both the immediate market reaction and long-term stock performance.
2. We explain the long-term performance of Chinese firms by investigating
   1) City-based policy outcomes
   2) The DID results of Chinese firms’
      - External support (government subsidies, external financing)
      - Business expansion (R&D, capex, employment)
      - Operating performance (ROA, ROE)

Sample

The sample contains public listed firms in MC2025 targeted industries in China and the US.
• China: 169 firms
  - Listed on the Shanghai or Shenzhen stock exchanges
• US: 24 firms
  - Listed on the NYSE, Nasdaq, or Amex stock exchange
  - Headquartered in the United States
  - Have at least 20% of average annual revenues from China over 2012-2018
  - Disclose average research and development expenses exceeding $100 million over 2012-2018

Event Study Results

Daily Analysis: around 8 May 2015

Long-term Analysis: May 2015-Dec 2018
- [0,17]: May 2015 to Oct. 2016 (before Trump’s election);
- [18,33]: Nov. 2016 to Feb. 2018 (before the start of the US-China trade war);

Why Chinese firms perform so badly?

Our empirical analyses show that
1. Treated firms headquartered in key-cities do not have better performance.
2. Treated firms do not actually receive better external government support or financing support as promised.
3. Treated firms do not actively respond to the MC2025 announcement by expanding their R&D, CapEx, or employment.
4. Treated firms experience a significant decrease in their operating performance measured by ROA and ROE.

Conclusions

• Chinese treated-industry firms benefit during the first few months, but then lose heavily in the long-term; US high-tech companies emerge as the biggest long-term financial winners.
• There is no increased government subsidy or external financing available, and, therefore, treated firms do not have incentives to expand their R&D investment, capital expenditures, or employment. The poor long-term stock performance is associated with the declined profitability of treated firms after 2015.