Discussion on:

The Effect of the China Connect

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Main takeaways

Firms after being included in the Connect program

Negative

Became more vulnerable to the U.S. monetary policy shocks

= spillover to real economy, contractionary U.S. MP results in reduced domestic investments
(~2.8% drop following a unit increase in the shock)

- Firms relying more on external financing and with higher covariance with the global market returns are the most affected

Positive

Spend more on capital expenditures, more profitably, and enjoy positive abnormal return after being included in the program relative to firms outside the Connect

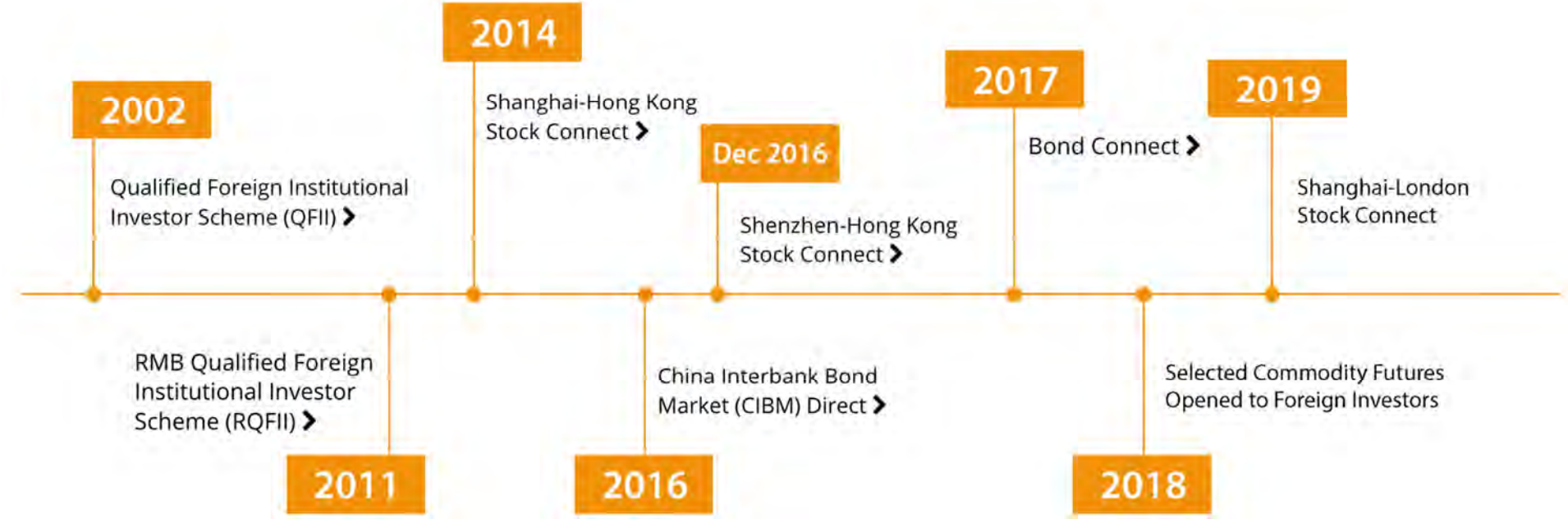
- Since the Connect program is still in place, the benefits seem to outweigh the costs

= positive tradeoff

Compliments

- Extremely timely topic on costs and benefits of capital account liberalization in China
  - On-going concern for Chinese policymakers
- Examines the issue at the micro-level
  - Finally some evidence on the effect at the firm-level
- Solid empirical framework with a battery of robustness tests
  - Yet there are some things remain unclear or left wondering about

The Connect Program



1. Sample period

- The sample spans from 2002 to 2017
  - Almost 13 years before the actual Connect
    - Include many other periods of market frictions, the GFC, QFII and other liberalization attempts
  - and just 3 years within the Connect program
    - With tight restrictions on daily and aggregate quotas – aggregate quotas in place until 2016 and daily quotas were increased four-fold in 2018
    - Do some of the firms from 2002 even make it to 2014?
- Is there any rationale in looking at the long historic data and only sneak peek at the post-Connect?
  - The responses of the Chinese economy to conventional (2002-08) and unconventional (2009-17) U.S. MP shocks exhibit different dynamics (Wei Ho et al., 2018 JMCB)
- Is the observed effect persistent after 2 years?
  - If yes, what's the source of superior profitability of connected firms?
- Does the magnitude of the effect increase with other Connect programs or at least with quotas relaxation?

2. Connected firms

- Two waves of connection – 2014Q4 and 2016Q4
  - Do both of these waves have similar effects?
    - Or is it driven mostly by the first one? Subsampling first?
  - Shanghai-connect firms are mixed with Shenzhen-connect firms although the firms on these two markets are rather different ("old" economy vs. "new" economy)
    - Firms FE probably catch this difference, so the average results shouldn't be affected but wouldn't it be important from the policy perspective to see if "new" firms are more/less vulnerable?

- Firms are added and dropped from the Connect approx. twice a year based
  - Subject to index inclusion or min. capitalization
- In the baseline analysis, firms dropped from the Connect are treated as not connected but we don't know how many of such firms are being excluded and whether they are financially stable
  - One of the robustness tests (S.4) actually excludes periodic adjustments and the results appear to be much weaker

Table S.4 Corporate Investment, U.S. Monetary Policy Shocks, and the China Connect: Eliminate Periodic Adjustment to Indexes

	Investment					
	(1)	(2)	(3)	(4)	(5)	(6)
Connect	0.002*	0.003**	0.004**	0.002	0.002*	0.004**
	(0.001)	(0.001)	(0.002)	(0.002)	(0.001)	(0.002)
MPS^{US}*Connect				-0.015*	-0.017*	-0.017*
				(0.009)	(0.010)	(0.009)
MPS^{US}				-0.009*	-0.011***	-0.011***
				(0.004)	(0.004)	(0.004)

3. Other sensitivity tests

- Cov with the global returns, foreign sales exposure, risk premium, and external financing intensity are all good channels
  - But does the effect change with the fraction actually being traded through the Connect (intensive and extensive margin)?

Stock Code	Stock Name	Shareholding in CCASS	% of the total number of A shares listed and traded on the SSE
90000	SHANGHAI PUDONG DEVELOPMENT BANK CO., LTD. (A #600000)	476,862,402	1.62%
90004	GUANGZHOU BAIYUN INTERNATIONAL AIRPORT CO.,LTD. (A #600004)	176,924,471	8.54%
90006	DONGFENG AUTOMOBILE CO.,LTD (A #600006)	533,538	0.02%
90007	CHINA WORLD TRADE CENTER COMPANY LTD. (A #600007)	10,532,385	1.04%
90008	BEIJING CAPITAL CO.,LTD (A #600008)	114,055,609	1.55%
90009	SHANGHAI INTERNATIONAL AIRPORT CO., LTD. (A #600009)	244,220,405	22.33%
90010	INNER MONGOLIA BAOTOU STEEL UNION CO.,LTD. (A #600010)	660,309,647	2.08%
90011	HUANENG POWER INTERNATIONAL, INC. (A #600011)	170,571,355	1.55%
90012	ANHUI EXPRESSWAY COMPANY LIMITED (A #600012)	21,873,198	1.87%
90015	HUA XIA BANK CO., LIMITED (A #600015)	242,840,630	1.89%
90016	CHINA MINSHENG BANKING CORP., LTD. (A #600016)	645,066,555	1.81%
90017	RIZHAO PORT CO.,LTD. (A #600017)	2,860,004	0.09%
90018	SHANGHAI INTERNATIONAL PORT (GROUP) CO., LTD (A #600018)	141,878,674	0.61%
90019	BAOSHAN IRON & STEEL CO., LTD. (A #600019)	1,203,998,660	5.43%

State ownership

1. Let's talk about the elephant in the room: Chinese government and its exposure to ownership stakes in many firms
   - Presumably, firm within the Connect but with a higher share of state ownership should be able to neglect the negative effect from the foreign MP shock
2. Foreign investors in the connected firms as a signal can also help the government to reduce information asymmetry
   - There's evidence that firms in the SSE stock connect receive more R&D subsidies from the government (Chen et al., 2020)

Shareholders

Name	Equities	%
Shanghai State-Owned Assets Supervision & Administration	192,695,844	17.6%
China Securities Finance Corp. Ltd.	57,616,668	5.27%
China Universal Asset Management Co., Ltd.	41,888,989	3.83%
Capital Research & Management Co. (World Investors)	37,769,120	3.45%
E Fund Management Co., Ltd.	37,592,998	3.44%

Other suggestions

1. MP shocks may alter firms financing costs
   - Given that banks are the primary source of external financing in China:
     - Have you considered looking at banks (if there are enough of them in the Connect program)?
       - The result may be stronger if looking at the bank lending rates, for instance
     - Would “connected” banks charge different interest rates or cut on lending?
2. Another type of placebo test would be artificially shifting the connect dummy for a few quarters

Other concerns

1. From the abstract: “We also find that firms in the Connect enjoy lower financing costs”
   - Footnote 29: “The coefficient on Connect is negative but not significant in the cost of debt regression. This may occur because we have an aggregate measure for cost of debt, rather than firm-specific”
2. In the text, there’s literally one sentence for Table 7 and Table 8 each
   - A bit more elaboration would be useful

Thank you!

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