Chinese government's corporate subsidies have had little effect on firms' productivity

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Over the past 15 years, the Chinese government has made significant efforts to promote innovation-driven growth through industrial policy and corporate subsidies. In a new study, researchers examined government subsidies to businesses in China to determine whether they are making firms more productive. The study found that China's rising wave of subsidizing businesses has had limited effect on promoting the firms' productivity.

The study, by researchers at Carnegie Mellon University (CMU) and ShanghaiTech University, appears in the *Journal of Comparative Economics.*

"Many countries have criticized China for playing favorites with indigenous Chinese firms when handing out subsidies, suggesting that these firms are given an unfair advantage over foreign firms, as well as small and mid-size enterprises, in the race to dominate technological business," says Lee G. Branstetter, professor of economics and public policy at CMU's Heinz College, who co-authored the study. "Yet many of these claims have not been studied."

In their study, researchers used firm-level data that has not before been fully analyzed: Since 2007, companies listed on any of China's stock exchanges have been required to disclose all direct government subsidies received, along with a brief description of the nature of these subsidies. Based on these disclosures, the study found that the total amount of direct government subsidies to Chinese-listed companies increased more than seven-fold from 2007 to 2018, from $4 billion to $29 billion.

The study found little evidence that Chinese government subsidies boost firms' productivity; if anything, the evidence suggested that direct subsidies tended to flow to less productive firms rather than more productive firms. In addition, overall, the receipt of direct government subsidies negatively correlated with subsequent growth in firms' productivity from 2007 to 2018.

Even subsidies given by the government in the name of promoting research and development or innovation, or upgrading industrial equipment did not show any statistically significant effects on firms' subsequent productivity growth.

"While the Chinese government has articulated a clear ambition to promote innovation-driven growth through the use of industrial policy and corporate subsidies, our research suggests that there is little evidence that it has been able to consistently pick or create winners," notes Guangwei Li, assistant professor at Shanghai Tech University's School of Entrepreneurship and Management, who coauthored the study.

"Subsidies seemed to be allocated to less productive firms, and the relative productivity of firms' receiving these subsidies appeared to decline further after disbursement."

The study did find that government subsidies supported slightly higher levels of employment, at least temporarily. The authors suggest that this is consistent with the view that political and social considerations might outweigh efficiency considerations in the government's allocation of direct subsidies.

Among the study's limitations, the authors note that their data on subsidies are limited, reflecting only one of the many policy instruments the Chinese government is using to shape the nation's industrial evolution. In addition, they characterize their analysis as largely descriptive.

More information: Lee G. Branstetter et al, Picking winners? Government subsidies and firm productivity in China, *Journal of Comparative Economics* (2023). DOI: 10.1016/j.jce.2023.06.004

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