China Journal of Accounting Research 10 (2017) 189–230

Contents lists available at ScienceDirect

China Journal of Accounting Research

journal homepage: www.elsevier.com/locate/cjar

Five-year plans, China finance and their consequences

Donghua Chen [a,*], Oliver Zhen Li [b], Fu Xin [c]

[a] *Nanjing University, China*
[b] *National University of Singapore, Singapore*
[c] *Hohai University, China*

ARTICLE INFO

Article history:
Received 20 May 2016
Accepted 5 June 2017
Available online 23 August 2017

JEL classification:
G3
O2
P2
P3

Keywords:
Five-year plans
Government engineering
Industrial policies
Corporate finance
Economic growth
China

ABSTRACT

An important factor influencing corporate finance and economic growth in China lies in its government sponsored industrial policies. Examining China's five-year plans during 1991–2010, we find that state-owned firms in government supported industries enjoy faster growth in initial public offerings and higher offer prices. Further, they enjoy faster growth in loans granted by major national banks. However, this preferential access to capital by state-owned firms appears to be achieved at the expense of non-state-owned firms which are crowded out. Government support induces more investment but also brings more overinvestment, which mainly comes from the non-state sector. Finally, supported industries have higher stock market returns and cash flow growth that dampen when state ownership increases.

1. Introduction

While the first three decades after the establishment of the communist China in 1949 were marred by political turmoil, instabilities, ideological rigidness and natural and human-made disasters, China's economy has

* Corresponding author.
E-mail address: dhchen@nju.edu.cn (D. Chen).
☆ We thank workshop and conference participants at Fudan University, National Chengchi University, National University of Singapore, National University of Taiwan, Peking University, University of Hong Kong, University of International Business and Economics, China Accounting and Finance Review International Symposium 2010 and Journal of Contemporary Accounting and Economics Conference 2013 for comments and suggestions. This project has benefited from a generous Tier 2 grant from the Ministry of Education of Singapore, # R-521-000-024-112 and National Natural Science Foundation of China, # 71372032.

http://dx.doi.org/10.1016/j.cjar.2017.06.001
1755-3091/

been growing rapidly since the start of its economic reform in 1978. Its GDP reached about USD8.34 trillion (RMB51.93 trillion) in 2012 (National Bureau of Statistics of China, 2013), exceeding Japan to become the second largest economy in world in 2010. It currently has the largest foreign currency reserve in the world, reaching USD2.85 trillion in 2011, representing 30% of the global reserve (State Administration of Foreign Exchange, 2011). China's securities market was established just two decades ago. However, by the end of 2010, its total market capitalization reached USD4.01 trillion (RMB26.54 trillion), representing 66.69% of China's GDP (China Securities Regulatory Commission, 2011). By the end of 2012, its total capitalization was RMB22.97 trillion.

On the other end of the spectrum, China's rapid economic growth appears to contradict and defy mainstream economic and finance theories. China is a highly politically centralized country. Its government has the power to nominate provincial and ministerial level officials and owns a significant portion of the national economy. China's leaders have the authority to directly interfere with almost all aspects of China's economic, civil, and political affairs. China lacks the rule of law that is considered essential for the development of the capital markets (La Porta, Lopez-de-Silanes, Shleifer and Vishny, 1997, 1998, 2002a).

Therefore, it is high time for us to re-recognize the important role played the government in economic development. After many countries failed in their attempt to become developed countries in the 1970s, many economists conclude that government interventions are detrimental. This view appears to be going to one extreme of the pendulum (Lin, 2012). With the success of China's economic reform, its government's model of economic development has been receiving more and more attention, especially its ability for strategic economic planning (Sachs, 2011; Stern, 2011). We start from such a background and depict how the Chinese government, playing the role of a central planner, influences resource allocations in China's capital markets and the consequences of such an influence.

We study official documents of China's five-year plans and identify industries that the Chinese government emphasizes. We consider two financial markets, the equity market (initial and seasoned equity markets) and the bank loan market. If the government is effective in channeling resources to strategically important industries, then these industries should enjoy higher equity finance and bank loan growth. Further, corporate investment should be affected by the government's national strategies. We also examine consequences of this government engineering to determine if five-year plans are at least partially responsible for China's economic growth. If there is a positive association between the two, we conclude that government engineering is effective in spurring economic growth.[1]

A good knowledge of the heavy influence that China's political system exerts on corporate finance is important for us to understand the myriads of economic and social activities of China and its business entities. We try to comprehend China's corporate finance from the angle of its political superstructure and the interaction between the market mechanism and government control. This research can be useful in helping us understand the following issues: (1) Why can China, a country with such a severe degree of government interference, grow its economy consistently at a rapid pace over the last three decades? (2) What is the association between government engineering and corporate finance? (3) What are the consequences of government engineering?

Focusing on four of China's strategic five-year national plans during 1991–2010, we find that government supported industries enjoy faster IPO growth. However, supported state-owned firms appear to crowd out non-state-owned firms. As the government controls the IPO approval and review mechanism, IPO resources are scarce and the government can exert a powerful influence on initial equity offerings. In the SEO market, the government's control power is subdued due to an increase in market orientation. In the bank loan market, the government's power is further subdued due to a further increase in market orientation. We find that the government's influence exists mainly in loans granted by major national banks to state-owned firms. This pattern helps us understand the interactive effect of the government force and the market force in influencing resource allocations.

On the investment dimension, we find that supported industries invest more. This pattern is present in both the state and non-state sectors. However, non-state-owned firms appear to overinvest more in response to government support. This evidence is consistent with the fact that the Chinese economy is investment-driven and the momentum of investment mainly comes from the non-state sector (Barnett and Brooks, 2006).

[1] Of course, even if we fail to find a positive association, we still cannot dismiss government engineering as ineffective as external benefits that cannot be internalized within certain supported industries are often the basis of government policies.