United States International Trade Commission

Bob Koopman’s comments on “Investment Rate and FDI – A Comparative Analysis of Return to Capital among China, US and Japan

By

Sun Wenkai, Yang Xiuke, Xiao Geng

Main findings

- First, kudos to the authors for a thoughtful and interesting paper.
- They look at an important topic, and use a conceptually sound and direct approach to provide important insights.
- The topic, understanding relative returns to capital, is particularly important given developments in modern day capital and technological mobility.

- Main findings
  - China top in FDI because of high return to K - but this is not empirically established and the comparison set of countries is too limited to draw this hueristically from the results.
  - No convergence of return to K across 3 countries – however high levels not sustained, see next bullet.
  - Return to K long term decreasing trend -
  - FDI mainly in manufacturing, and increasingly in high tech sectors

My comments will focus on two

- While there are a number of interesting elements in the paper, including data development I will focus on two areas for my comments.
- Comparative nature of paper – this is a very interesting effort, and would benefit from expanded set of comparator countries
- Question of treatment of risk or other returns that may be confounded with returns to K – returns to capital often reflect a risk vs. return payoff. This is not adequately addressed in the paper. Also when doing growth accounting one often considers other factors such as returns to human K and the role of intangible capital, such as brand value etc.

Comparison countries

- Urge the authors to expand set of comparison countries (dependent on data availability) to include other fast developing countries.
  - India, Korea, Malaysia, Indonesia, Singapore and perhaps Brazil and Russia come to mind. On p. 27 the authors assert that the return to capital in China is the highest in the world, but I don't see broad support for that assertion.
  - Why? Examining the pattern of returns to capital in countries more similar to China's development stage may provide interesting insights. Plus you would potentially covering countries with more diverse risk profiles.
    - Perhaps look at K/Q ratios for similarities. Note that in the current sample the US starts with a K/Q ration in 1930 that far exceeds China's or Japan's
    - It is also interesting to note that in Japan r was much higher than China's, but in 1974 -1975 it fell suddenly and never recovered to previous high levels.
    - However the US, at least in the sample examined here, never systematically approached those seen in Japan and China, even in the supposed "golden years" of US economic development just after WWII.
  - Examining those patterns across a broader set of countries, and looking for conceptually consistent findings might strengthen your conclusions re China, or provide alternative insights.

Treatment of risk and other factors

- A basic economic concept is that returns to investment should reflect risk. Thus riskier investments require higher rates of return. The results of this paper seem to align with what one might consider the risk profiles across the 3 countries and across time. But there is no explicit discussion of risk and its role in pricing capital.
- Other factors? The value of output reflects the contribution of many factors, not just K and L. In more complicated growth accounting exercises, often focused on estimating TFP, we often see human capital and explicit treatment of intangible capital, such as brand valuation. While your treatment of data is consistent across countries I wonder if one used a more complicated decomposition of output would you find interesting insights on what influences the return to K.
- Finally – the authors make a number of interesting assertions about policies affecting returns to K, particularly in reference to US returns rising after the oil shock years due to deregulation and market oriented policy reforms. Similar discussions of the influence of Chinese and Japanese policy environments would be informative. For instance Chinese policies in recent years have actively influenced FDI through favorable tax and tariff treatment, capital market policies that have kept the cost of capital low and that appear to favor large, perhaps inefficient, but also potentially monopolistic enterprises. How might these factors affect the returns to K over the historical period, and more importantly going forward.