Using SOEs Stock Returns to Identify Chinese Government Spending Shocks

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Until now, there are a great many theoretical and empirical papers studied the effects of government spending shocks. However, their consequences are surprisingly little consensus derives from choosing different competing macroeconomic models and exchange rate regimes that make diverse predictions. The empirical evidences in different exchange rate regimes are also completely different.

The literatures devote themselves to modify theoretical models so that making consistent with empirical evidence in OECD countries, but less concerned about circumstances of the other sample countries. With the following questions, this paper turns our attention to the developing country China. Does the China under crawling peg exchange rate regime have the similar results with EU? Whether or not the evidences in transitional economy China are consistent with some theoretical model predictions? We hope the results provided by this paper can offer some inspiration and information for these questions and bridge that gap by investigating the effects of government spending shocks in China from empirical perspective.

Meanwhile, this paper attempt to propose a new identification strategy only against to China that can avoid the shortcomings that the anticipated problems are existed in structural and narrative identification approaches. We make a hypothesis that the stock returns of State-Owed-Enterprises (SOEs) can be used to identify government spending shocks within the VAR framework.

The results of our estimation and verification are unexpected. The effects of government spending on output, consumption and the real exchange rate are arbitrary and no rules, although the "Granger Causality test" provide support for their causal relationship among these variable. The hypothesis that using SOEs stock returns to identify fiscal shocks is rejected since this indicator does not have enough explanatory power for government spending, output, private consumption and real exchange rate variables.