

Magic Formula or Futile Effort: Lessons from China's Two-Tiered Government Guided Funds*

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April, 2024

Preliminary Draft. Please do not distribute.

Abstract

Governments worldwide have increasingly embraced industrial policies in recent years. Can these endeavours lead to sustainable growth and on what conditions? Learning from China's unique two-tiered Government Guided Funds, we demonstrate that the selection of targeted industries and the political and economic endowments of the government are pivotal factors influencing the success of industrial policies. Sustainable growth is observed only when targeted industries are under-invested by private investors and exhibit high externality, diffusing growth along the production network. In addition, governments must exhibit low corruption and high efficiency, while regions possess ample investment opportunities, sufficient talent pools, and high labor productivity.

*We would like to thank Mariassunta Giannetti, Bing Han, Abhiroop Mukherjee, Jun Pan, Neng Wang, Dong Yan, Alminas Zaldokas for helpful discussions. All errors are our own.

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