

## Comments on

### *The persistent institutional effect of liberal colonialism: evidence from China's financial policies*

The paper tries to explore the effect of liberal colonialism of the period 1896-1911 on the current (2004) efficiency of financial policies in China. The paper uses the firm level data from World Bank Investment Climate Survey for this purpose.

While the topic is interesting, I have some concerns about the assumptions and technical aspects of the analysis.

First, was China (except Hong Kong, Macau, Taiwan) colonized by the western powers during 1896-1911 in the usual sense? The western established 'zujie' (concessions) in many trading ports, and they had administration power in those concessions. The scale of the concessions were limited, and at most China in that period was 'semi-colonized'. The paper uses the sample of all those firms in the provinces, some of them may not be influenced by the colonialism at all.

In section 2.1, some references are cited in the context, but cannot be found at the References part of the paper.

In section 2.2, the paper claims that the colonialism affects the present development through economic institution. Institution quality is measured by the average percentage of cases in legal disputes in which a company's legal contracts or properties are protected. The paper first assumes that the colonialism effects persistent (with some regressions later). The simple justification in the paper is not convincing. Between 1911 and 2005, China changed so much politically, culturally and institutionally, and from the paper, 'The Cultural Revolution during 1966-1976 destroyed all foreign and traditional products (Walder, 2014)'. How can the institutions established by the colonialism still remain? In equation (4), the paper finds the relationship between IQ (the institution quality) and the liberal colonialism. This cannot justify the persistence of the colonialism. The relation found in the OLS can be caused by the endogeneity, which is not dealt properly in the paper. A simple reason of the relationship between efficiency (and IQ) with the colonialism could be that the westerners chose the places that were easy to do the trade, easy to access through Changjiang river or through the sea, and those regions have better allocative efficiency and better protection of property right in the modern time.

In section 4 about the colonialism and the allocative efficiency, the paper discussed the robustness caused by measurement errors, confounding factors, and the omitted variables. The problem of the omitted variables is only discussed by comparing two OLS with or without one variable. In the end of section 4, the paper claims "we use tests to justify the endogeneity concern due to the measurement errors, confounders or omitted variables is negligible". The real concern here is the endogeneity caused by the correlation of liberal colonialism with the error term, which may lead to a spurious outcome.

The endogeneity can be dealt with IV estimation if a valid IV can be found, as in Acemoglu et al. (2002). However, in section 5, the paper uses IV not to solve the endogeneity problem, but to claim that the colonialism takes effects through the institution. Equation (4) and (5) can justify the claim only if there is no problem of endogeneity. In the equation (1) and (2) of Acemoglu et al. (2002), it is pointed out that the key of that strategy is to find a good IV, and they used the mortality rate of the settlers as the IV. The current paper, as it appears now (especially from equation (6)), is running a 2SLS when IQ is endogenous, and LC is acted as an IV.

On summary, I believe that the paper needs more clarifications, more careful empirical analysis for the claim.