

Discussion: “Firm Entry and Regional Growth Disparities: the Effect of SOEs in China”

by Brandt, Kambourov and Storesletten

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What does this paper do? (I)

- ▶ What explains large regional disparity in economic performance in China?
 - SOE vs. NSOE
- ▶ Even among NSOE sectors, Y/N , W , TFP, K/L are highly heterogeneous across prefectures in China.
- ▶ In prefectures where SOEs are dominant (by share of output):
 - (a) NSOE entry is lower
 - (b) NSOE firms/entrants pay lower W , have lower Y/L , K , TFP
 - (c) NSOE firms/entrants have higher capital wedge, significantly higher output wedge, both implies higher TFP in the model equilibrium \Rightarrow need something else!

What does this paper do? (II)

▶ Main idea

- Base on observation (a), assume SOE dominance leads to a smaller size of NSOE potential entrants (lower $1 - \psi$)
- Less entrants \Rightarrow lower demand on labor and lower $W \Rightarrow$ the cutoff-level TFP is lower (as low productive entrants can also “make ends meet”)
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- ▶ Over time, observe signs of convergence in W , Y/N , TFP across prefectures. Based on extracted wedges for 1995, 2004, 2008, analyze (a) the contribution of three wedges (b) the role of SOE reforms (e.g. lower share of SOE employment).

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- ▶ Over time, observe signs of convergence in W , Y/N , TFP across prefectures. Based on extracted wedges for 1995, 2004, 2008, analyze (a) the contribution of three wedges (b) the role of SOE reforms (e.g. lower share of SOE employment).
- ▶ Policy implication: layoffs of SOE workers (higher share of NSOE employment) still lead to lower TFP. Removing entry wedge is the key!

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- ▶ Traditional explanations for regional disparities in China (based on aggregate data): Differences in exposure to trade liberalization, industry agglomeration, regional development policies/governance
- ▶ Contribution:
 - Takes the role of firm dynamics seriously
 - Uses more disaggregated level data to understand source of growth; particularly, entry. (Importance of entry and exit, Brandt et al. 2012)
 - Contribute to the literature on distortions (output wedge and capital/labor wedge) and resource allocations between SOE and POE (Song, Storesletten and Zilibotti, AER, 2011; Hsieh and Klenow, QJE, 2009)
 - Investigates a new wedge related to entry.
 - Develops a framework, through the lens of wedges, to assess potential impact of structural reforms (SOE reforms, labor market reforms).

Comments—Motivating Facts

- ▶ What about regional specialization of production (especially when looking at 334 prefectures)?
 - Different regions in China specializes in different industries.
- ▶ Cross-regional comparison of NSOEs would be cleaner if controlling for industry-specific characters.
 - *In the same industry*, do we still observe NSOE's W , Y/L , TFP decrease with SOE shares?
- ▶ SOEs specialize in more capital-intensive sectors, upstream industries, heavy industries. So prefectures with low SOE share specialize more in labor-intensive, light industries.
 - For example, we observe low SOE shares in Wenzhou, a lot of NSOEs manufactures shoes, and low W , TFP, Y/L . But its a characteristics of the industry/production function, may not be related to entry wedge.
- ▶ Industries also differ substantially in their exit and entry pattern.

Comments—Estimating wedges

- ▶ Assume prefectures only differ in the three wedges: $1 - \tau_i^y, 1 + \tau_i^k, 1 - \psi_i$.
- ▶ Assume exactly the same production function (α), degree of decreasing return to scale (η), firm productivity heterogeneity (ξ), fixed costs of operation (v)
- ▶ Different prefectures specialize in different technologies; thus different firm heterogeneity and fixed costs
- ▶ Affects interpretation of “wedges”.
- ▶ Data are available to estimate some parameters, such as α_i and ξ_i .

Comments — Model (I): SOE and NSOE interaction

- ▶ Interaction between SOE and NSOE is not explicitly modeled;
- ▶ Assumes a relationship between SOE share and $(1 - \psi)$;
- ▶ It would be interesting to have this observation as an equilibrium outcome
- ▶ This requires first digging deeper into the data to understand why it is the case, and then model it accordingly. For example,
 - ▶ SOEs absorb labor supply (wage premium), leaving less people to become entrepreneur
 - ▶ SOEs absorb more credit (preferable credit conditions/interest rates), leaving less financing opportunities to startups
 - ▶ Incumbent SOEs collude with local government and demand higher license/registration fees.
 - ▶ lower \underline{z}
 - Different stories can be empirically tested and distinguished

Comments — Model (II): labor market reform

- ▶ The paper assumes no/imperfect labor mobility across prefectures— w_i is prefecture-specific
- ▶ The framework has a good setup to study labor market reforms—withdrawal of the household registration system (“*Hukou*”).
- ▶ It would be nice to investigate also “labor mobility wedge” (e.g. $w_i = \bar{w}(1 + \tau_i^l)$)
- ▶ Then the share of NSOE employment (n_i) can be modeled endogenously, as labor mobility wedge is an exogenous policy variable.
- ▶ Can also think about extending the model to a dynamic model where labor can move across prefecture over time, but with an adjustment cost.

What else can we use this framework for?

- ▶ The current paper is descriptive: providing decomposition of contribution of wedges to observed changes in regional disparity
- ▶ It would be interesting to run counterfactual experiments.
- ▶ However, requires a richer setup and solving the full model, endogenizing w_i, n_i for example.
- ▶ Could be informative to policies
 - answer questions such as the impact of individual policies vs. coordinated policies that remove wedges sequentially or simultaneously, and their quantitative impacts.

Minor Comments—Measurement of TFP

- ▶ Measurement of TFP: Solow residuals at the aggregate level.
- ▶ Distortions affect TFP measures
- ▶ Endogeneity issue.
- ▶ Given its importance in motivation, for robustness, it would be nice to show results with alternative measures of TFP. Average firm's TFP? Firm-level estimates based on Olley and Pakes (1996) or Akerberg, Caves and Frazer (2006) method?

Conclusion

- ▶ A promising paper.
- ▶ Very interesting investigation on the role of firm's entry on regional disparity in China
- ▶ So far, a simple framework highlights an important wedge
- ▶ A lot of interesting followup work can be done in the future.