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 ⇒ 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 ($1 - \psi$).
- 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”)
- Entry wedge dominates $\Rightarrow$ lower aggregate TFP in that prefecture.
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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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▸ Policy implication: layoffs of SOE workers (higher share of NSOE employment) still lead to lower TFP. Removing entry wedge is the key!
Overall Assessment

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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).
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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.
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 ($\alpha$), degree of decreasing return to scale ($\eta$), firm productivity heterogeneity ($\xi$), 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 $\alpha_i$ and $\xi_i$. 
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 $z$
  — 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. $w_i = \bar{w}(1 + \tau^l_i)$)

▶ 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 Ackerberg, 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.