

Discussion of “Growing Like China”

by Song, Storesletten and Zilibotti

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December 2008

This paper

- Tries to explain features of the Chinese transition
 - High growth and high return on capital (decreasing returns?)
 - Growing foreign surplus
- Main idea
 - Public firms and private firms
 - Private firms: higher TFP and TFP growth, but financially constrained
 - Private firms grow through internal savings/investment and crowd-out public firms (labor market tight)
 - Private firms cannot absorb excess savings: where does it go? \Rightarrow abroad
- “Extra” predictions:
 - Increase in inequality (entrepreneurs need to become wealthier)
 - Higher correlation of S and I in regions with higher shares of private firms
 - Pattern of specialization: private firms should enter relatively labor-intensive sectors

General Assessment

- Ambitious paper: serious attempt to look at financial frictions as the origin of high return / large surplus economies
 - Gourinchas and Jeanne (2008)
- Story is not new, follows:
 - Theory: Boyd and Smith (1997), Matsuyama (2004), Broner and Ventura (2008)
 - Recent work on global imbalances: Caballero, Fahri and Gourinchas (2008)
- Takes it one step further: how well does this story map out in the data?
- Main contribution
 - Greater understanding of Chinese transition
 - More importantly: how plausible is the financial frictions story

Sketch of Model

- OLG economy with no population growth
- In each generation:
 - Young: either workers or entrepreneurs (in fixed proportion)
 - Young workers supply labor inelastically and get wage w
 - Young entrepreneurs are managers and get rents (fraction of output)
 - All income is saved: workers save in banks, entrepreneurs start their firm
 - Old consume
- One good produced either by

- Public firms:

$$y_{Ft} = A_F^{1-\alpha} (k_{Ft})^\alpha (l_{Ft})^{1-\alpha}$$

- Private firms:

$$y_{Et} = A_E^{1-\alpha} (k_{Et})^\alpha (l_{Et})^{1-\alpha}$$

Sketch of Model

- Difference between private and public firms
 - Private more productive: $A_E > A_F$
 - Private cannot borrow: only entrepreneurial savings (rents) used for k_E
 - Public firms: no borrowing frictions
- Public sector in equilibrium:
 - Capital-labor share pinned down by international interest rate r^*

$$\frac{k_{Ft}}{l_{Ft}} = A_F \left(\frac{\alpha}{r^*} \right)$$

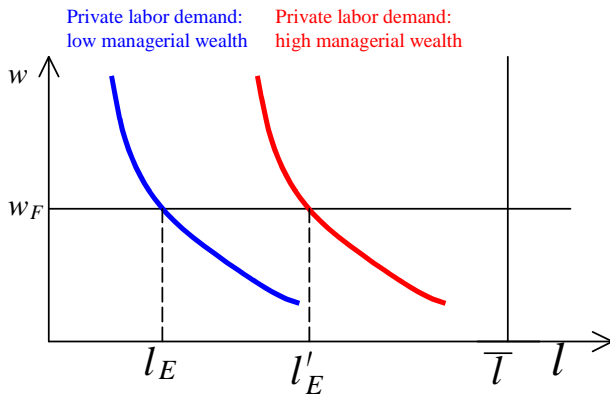
- Labor demand is fully elastic at wage

$$w_F = (1 - \alpha) A_F \left(\frac{\alpha}{r^*} \right)^{\frac{\alpha}{1-\alpha}}$$

- Private firms face same w but cannot borrow: hence, more labor-intensive

Main Mechanism

- Initially, private sector is constrained: through entrepreneurial savings, though, k_E expands
- Increases demand of labor by private sector: public sector contracts



Main Results

- As private sector expands:
 - Not all of the savings can be invested (it is more labor-intensive) ✓
 - Foreign surplus increases ✓
 - Investment rate falls X
 - GDP increases (private sector more productive) ✓
 - Average return on capital increases (i.e., more capital in private sector) ✓
 - Increasing inequality: managers become richer relative to workers ✓
- Extensions:
 - Improvement in domestic financial market: higher investment rate
 - Higher correlation of S and I in regions with more entrepreneurship ✓
 - Share of public firms has decreased the most in labor intensive sector ✓

General Comments

- In my view:
 - Idea that financial frictions can generate high growth / high surplus economy: not new
 - This paper adds a nice twist in terms of sectorial predictions
 - Its main contribution is to provide a real test of the role played by financial frictions
- Does it live up to this?
 - It provides different strands of evidence consistent with the model (quite persuasive)
 - How well could such a model perform quantitatively among all the dimensions that you want to match?
 - Example:
 - In the paper: try to match increase in investment through improvement on domestic financial markets
 - How does this affect foreign surplus?

- It would be nice to have a calibrated / estimated version of the model to see how well it could perform on:
 - GDP growth, return to capital, investment rate, foreign surplus
- Privatizations:
 - What role do they play in all of this?
 - In the paper, evolution of private vs. public companies is “market driven”
 - How directed is this process in terms of
 - Companies / Sectors open to private sector
 - Regulation of private companies

More Specific Comments

- Some more discussion on the composition of savings / current account surplus
 - Model has implications for the contribution of household, government, and private sector companies to the current account surplus
 - Seems consistent with data (Kuijs 2005)
- Detour: optimality of current account surplus?
 - There is a hint of this in the paper
 - Suppose private sector can only commit to repay up to a fraction of output
 - If capital outflows are forbidden, domestic interest rate falls:
 - Public sector will expand (COST)
 - Private sector as well, and distortion will decrease (BENEFIT)