Asia: Challenges of Stability and Growth

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Discussion of

Chang-Tai Hsieh and Zheng (Michael) Song

"Grasp the Large, Let Go of the Small:
The Transformation of the State Sector in China"

by Carsten A. Holz
Hong Kong University of Science & Technology

Main results / arguments (in ppt and preliminary/incomplete paper)

1. China did not follow standard prescription to address SOE inefficiency/losses
   * Private firms dependent on CCP connections
   * Business environment no better than in Congo and Guatemala

2. 1998-2000 SOE reform program: improved performance of remaining SOEs

   抓大方小 "Grasp the large, let go of the small"

   Data 1998-2007, 5mio+ sales revenue industrial enterprises, balanced sample

   * SOE exit rate has become similar to private firms, higher for small SOEs
   * 1998-2007: compare corporatized SOEs – privatized SOEs – private firms

     Y/L becomes similar for all 3

     Y/K continued: private (top) – privatized SOEs – corporatized SOEs

     TFP continued: private (top) – privatized SOEs – corporatized SOEs

     but differences have narrowed (SOE TFP growth > private)

     The smaller 1998 firm size, the higher subsequent TFP growth

     Counterfactual experiments: 抓大方小 increased ind. output by 1/3

Paper does a lot, and does it very well.

Observations, thoughts, suggestions

1. The big question: why care?

Qualitative part:

“Marriage of Communist Party and Goldman Sachs” is well known(?)

Quantitative part:

TFP is not on policy makers’ horizon?

-> Is this paper concerned about TFP changes (etc.) for TFP’s sake?
May link up to efficiency *literature*,
but missing link to *real world relevance*?
Motivations of China’s SOE policy surely not increase in TFP.
But profitability (as authors mention), or physical measures of technology.
Not profitable -> go bankrupt (employment, “social stability,” promotion).

What (else) one could be interested in

Systematic (qualitative) documentation for, say, top 3 firms in each sector, or a random sample of large-medium-small enterprises: what are the connections between firm operations and CCP / government

China findings contradict WB/IMF "standard recommendations" (for privatization etc.)? Basis for such recommendations? Pure ideology?

If objective of the standard recommendations is growth: Does the Chinese model lead to faster growth?

What is the Chinese model? SASAC, budget management system, SOEs as source of gov. revenues // Fed, SOEs in natural monopoly sectors vs. national interest/pride vs. profitability, CCP Organization Dept.

Revisit theory of the firm?

Ownership is not crucial, incentives are?

What has more positive externalities, fewer negative externalities: "free" markets or CCP-controlled management?

-> Big issue of externalities that can't be easily quantified (Hirschmanian linkage effects, China's "New" Left)

What (else) one could be interested in (continued)

Privatization literature: impact of privatization on firm performance, employment, etc.

Historical comparison/precedents

- China centuries ago: transportation along Grand Canal: government-controlled, with special mechanisms for officials to benefit
- China 1950s: SOEs (formerly Japanese, KMT ent.) + private / joint ent. under CCP influence/control
- China 1980s – early 1990s: local state corporatism (TVE literature)
- Taiwan 1960-1980(?): KMT state enterprises, no large private ent.
- Korea 1970s, 1980s(?): 8 private Chaebols following Park's orders(?)
- Japan's MITI
- -> History in Asia of explicit government involvement and in practice how much different from the U.S.?

2. Does the Chinese system suggest to de-emphasize efficiency and ownership and emphasize politics? Different starting point?

Officials demand

private income

promotion (growth, employment)

possibly creation of public goods / public welfare

Enterprises supply these – ownership irrelevant as long as no political limitation on ownership. Size may matter.

-> Reduce economics to a political calculation of extraction?

Ex. coal mine industry

SU Fubing. "The Political Economy of Industrial Restructuring in China's Coal Industry, 1992-1999," Chapter 7 in Barry J. Naughton and Dali L. Yang (eds.), *Holding China Together: Diversity and National Integration in the Post-Deng Era*, Cambridge, UK: Cambridge University Press, 2004.

Purchasing cost of official positions in 2005 (Heilongjiang):

Deputy-provincial level position: 2mio yuan

Municipal department or county-level position: 200,000 yuan

County department position: 20,000 yuan

Three levels of evaluating state ownership

Political/economic system

- Extraction by officials as foundation of analysis
  - Issue of distribution – classical analysis
- Efficiency – neoclassical analysis
- Economic and political influences, all focusing on profitability
  - with implications, for example:
  - CCP Organization Dept. a more efficient allocator and controller of management talent than the "market economy?"

Structure of a given industry: monopolistic? competitive?

Firm level: management, operations, sustainability (corporate governance)

3. Data

<u>Importance of SOEs: for what?</u>

"60% of employment and investment" in 1998 (5m+ industry?)

but 1995 industrial census: employment total 147.4 mio

46.5 mio in SOEs (32%)

and 2008 econ. census: employment total 120.1 mio (88.4 mio in 5m+)

17.9 mio in SOSCEs (15%)

but 1998 capital construction: more than half in *utilities*

<u>Balanced sample – representativeness.</u>

The balanced sample captures

27% of 5m+ ent. in 1998, 12% in 2007

21% of SOEs in 1998, 37% in 2007

31% of non-SOEs in 1998, 9% in 2007 – is that an issue?

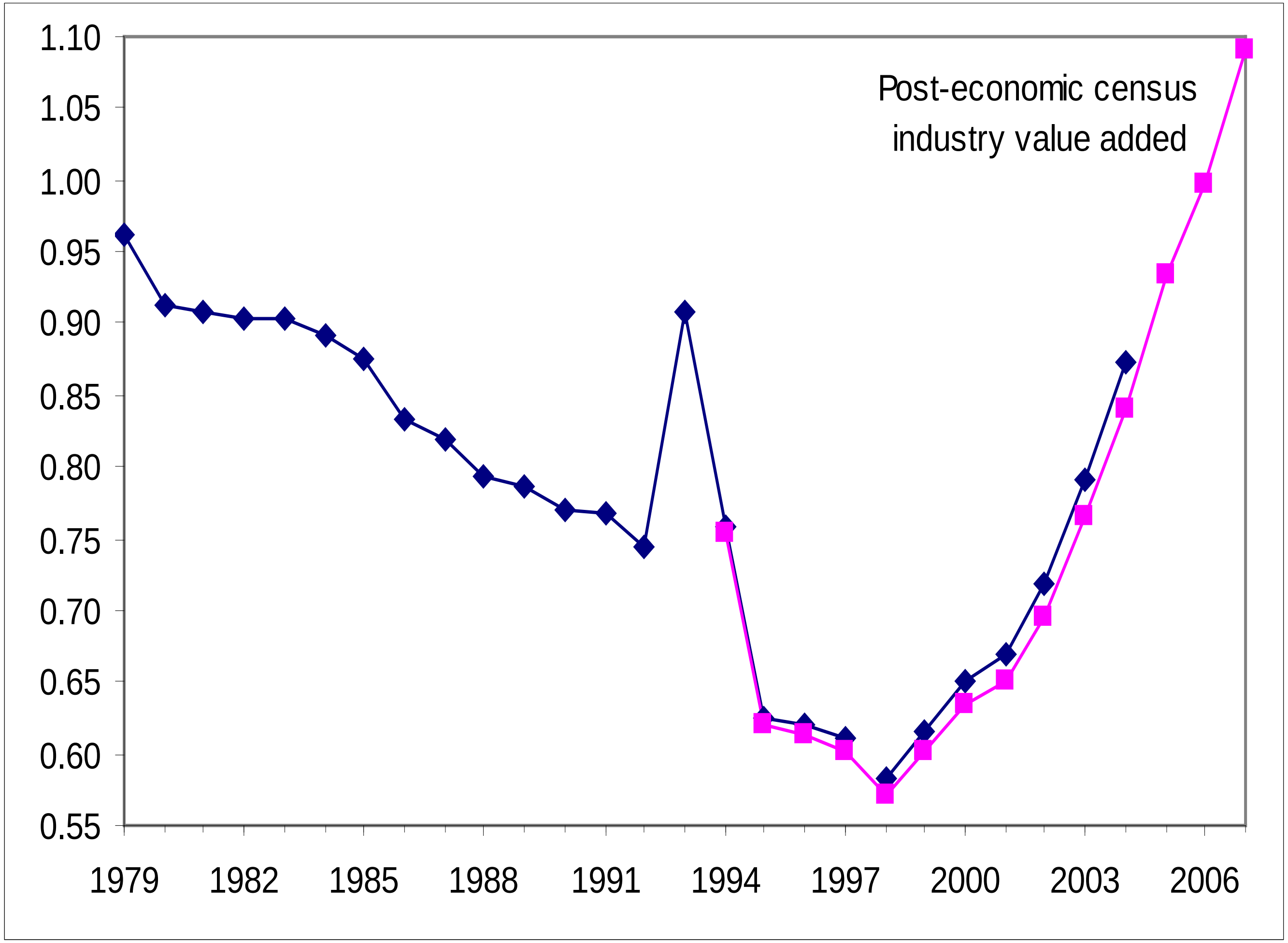
Missing out on many recent non-SOEs?

(alternative 2004-2007 analysis in paper welcome)

<u>Severe questions about quality of value-added data</u>

Share of 5m+ enterprises in total industry value-added

(Can logically not exceed 1.00.)



Do private enterprises exaggerate value-added more than SOEs?

4. Big issue?: Want sectoral rather than aggregate analysis

(Paper mentions but does not provide one table with sectoral results.)

Corporatized SOEs, privatized SOEs, private firms likely concentrated in very different sectors

Traditionally: SOEs in capital-intensive sectors

-> Not astonishing to find low Y/K in SOEs

-> Do different sectors have different TFP growth rates? Would affect all results in the paper.

5. Questions about (firm-specific) capital equation

$$K_t = (1-\delta)\, K_{t-1} + (BK_t - BK_{t-1})/P_t$$

where BK is the book value of capital
and $BK_{t0} = BK_{t1}$ / $(1+g)^{t1-t0}$

Assume δ=0.1
Assume firm maintains constant stock of 10 machines (investment=depreciation)
Assume constant price level P=1

Then
10 (constant stock) = (1 – 0.1) * 10 + (10-10)/1 = 0.9 * 10 + 0 = 9

->Something is not OK with this equation, either my reading of it, or its meaning.
-> In low-inflation period 1998-2007, firms with lower depreciation rates end up with lower capital values -> affects Y/K, TFP.