Barriers to Entry and Regional Growth in China

Loren Brandt, Gueorgui Kambourov & Kjetil Storesletten

Discussion

ABFER 6th Annual Conference, 21 May 2018

Amanda Jakobsson

Singapore Management University

Contribution

- Analytical framework to identify distortions that affect economic growth
- Empirical: Local growth dynamics in China – drivers
- New facts: Convergence in wages, TFP and capital per worker since mid-1990s.
- Determinants of prefecture-specific barriers to entry: the role of state-owned enterprises (SOEs)
  - SOEs scaled back since mid-1990s $\Longrightarrow$ Entry barriers for non-SOEs were lowered $\Longrightarrow$ more (fast-growing) non-SOEs $\Longrightarrow$ Convergence
- Firm-level census data aggregated to prefecture-level
- Melitz-Hopenhayn model with
  - capital and labor
  - output wedges and capital wedges
  - Exogenous entry barrier (share of workers that are potential entrepreneurs i.e. given mass of potential entrants) instead of fixed entry cost

Closed labor market

- Model: closed economy of the prefecture. New version: the prefecture is a small open economy with a closed labor market
- Key mechanism: High entry wedge $\Longrightarrow$ Few firms will enter relative to available labor $\Longrightarrow$ Lower equilibrium wages $\Longrightarrow$ Lower productivity cutoff z^* $\Longrightarrow$ lower prefecture TFP and output per worker.
  - Closed labor market: Endogenous prefecture wage determines productivity cutoff and thereby entry, TFP, output per worker.
  - State-owned enterprises and private firms in some prefectures should have attracted large amounts of migration of (temporary) labor. Wage differences across prefectures?
  - Extension with inter-prefecture labor mobility (and prefecture-level labor frictions)?

Melitz (2003) model and inter-prefecture trade

- Model: Homogeneous good produced by heterogeneous firms with decreasing returns to scale. Incentive in the small open economy to buy from other prefectures?
- Melitz (2003) model: Heterogeneous firms + love for variety preferences (monopolistic competition)
  - With different varieties instead of the homogenous good, can inter-prefecture trade be abstracted from?
  - Widespread inter-prefecture trade in (across) some provinces? Systematically different trade linkages across prefectures with high (low) share of SOEs?
    - ★ Importance of entry barrier with inter-prefecture trade?
    - ★ Impact of capital and output wedges with inter-prefecture trade?
  - Export-oriented firms and entry barrier?

Political economy version

- Prefecture government can derive benefit from entry barrier but not from capital and output taxes
  - Revenue-generating taxes and labor market clearing condition (SOE hiring requirement)?
- Political benefit (promotion) from local economic growth – can be taken into account in the model? If so, what changes?
  - Reduce entry wedge and reduce SOE employment to benefit non-SOE sector?

Entry barrier

- Intuition of the entry barrier – Policy-relevant (beyond the scope of the paper)
  - Red tape
  - Taxes on entrepreneurs
  - Matching with workers
  - Scarce resources allocated by prefecture government – Land and electricity

Minor questions and comments

- Agents buy the homogenous good, earn wage as workers (no disutility of working) or profits as entrepreneurs
  - Rental rate of capital
- Possible to relax the assumption of $\tau_k \geq 0$ and $\tau_y \geq 0$, i.e. include subsidies? Subsidies to SOEs? (Hiring requirement)
  - In the firm-specific wedges extension, optimal subsidies? (Growth-promotion)