Asia: Challenges of Stability and Growth
BOK, IMF, *IMF Economic Review*
September 26-27, 2013, Seoul, Korea

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
     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


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

Importance of SOEs: for what?
“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

Balanced sample – representativeness.
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)

Severe questions about quality of value-added data
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

\[ K_t = (1 - \delta) K_{t-1} + \frac{(B K_t - B K_{t-1})}{P_t} \]

where \( B K \) is the book value of capital

and \( B K_{t0} = B K_{t1} / (1 + g)^{t_1 - t_0} \)

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

Then

10 (constant stock) = \((1 - 0.1) \times 10 + (10-10)/1 = 0.9 \times 10 + 0 = 9 \)

-> 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.