Bai, Hsieh and Song - “Special Deals with Chinese Characteristics”

General Discussion

Thomas Philippon opened the general discussion by commenting on the benefits of competition among localities in China. He referred to the findings of Mokyr (2018) on the link between political fragmentation and growth in Europe. Focusing on the period 1500-1700, Mokyr found that political fragmentation prevented monarchs from impeding innovation, Philippon reminded. Political fragmentation is particularly beneficial when combined with cultural unity, free trade and absence of war, he pointed out. Philippon noted that China shares these three characteristics, and that competition among localities seems to foster innovation, just like political fragmentation did in Europe a few centuries ago.

Frederic Mishkin spoke next. He noted that China experienced an important rural exodus. This reallocation of labor potentially increased productivity, he argued, by reassigning it from unproductive activities in the countryside to productive, capital-intensive ones in cities. Mishkin asked the authors to which extent reallocation could explain China’s growth over the past decades. The authors argued that the evidence suggests that labor reallocation played a minor role, at least over the past two decades. In particular, they pointed out that real wages grew at 6%-7% on average over an extended period of time, which does not fit the labor reallocation narrative. The authors emphasized the role of capital misallocation instead, referring to existing work of theirs. In Bai et al. (2016), they found that capital misallocation has increased over the past 10 years. Part of this misallocation is imputable to the response to the Great Recession, they argued. Local governments circumvented institutional constraints on borrowing by setting up special purpose vehicles. These entities proved hard to wind down, the authors explained, and ended up offering special deals to local firms, which contributed to credit misallocations. The evidence on the subject is not definitive though, they pointed out.

Daron Acemoglu placed the question of special deals in a broader conceptual framework. Special deals can fuel two types of growth, he argued. They can foster investment, facilitate the adoption of technology at the world frontier and encourage innovation, i.e. the type of growth emphasized by Gerschenkron (1962). Or they can encourage insider deals and channel credit to connected, but inefficient firms. China's growth falls into the first category, he argued. The success of special deals in China stands in sharp contrast with the experience of other developing countries. This raises two questions, according to Acemoglu. What factors provide discipline on special deals? And what are the limits of special deals to generate long-term growth? Acemoglu provided tentative answers. On the first question, he emphasized the role of state capacity and export-orientation. He noted that industrial policies that proved successful in China, South Korea and Taiwan failed in some African countries. Part of the reason lies in the fact that these countries couldn't control local officials, and lacked the bureaucratic capacity to implement these policies, he argued. Export-orientation also provides some discipline on special deals, Acemoglu argued. He contrasted the case of China with that of Turkey: the
two countries experienced similar growth since 2009, but the former is much more export-oriented than the latter. Inefficiency built up much faster in Turkey due to the lack of export discipline, according to Acemoglu. In particular, special deals encouraged credit to connected firms and contributed to a real estate boom. On the limits of special deals to generate long-term growth, Acemoglu pointed out that China's approach constitutes a unique experiment. Industrial policies that ultimately generated sustained innovation have been typically accompanied by political and institutional changes, he noted. The future of the Chinese economy will tell whether industrial policies can foster innovation without broader transformations, he suggested. The authors seconded Acemoglu on the role of state capacity in China. They were also in agreement with the importance of export-orientation, but put forth another mechanism. Exports offer an escape valve for companies facing local protections, they argued.

The rest of the discussion focused on the nature of incentives for local officials, echoing a point raised by one of the discussants, Antoinette Schoar.

Erik Hurst inquired about the role of growth targets imposed by the central government, and the potential political tournaments they induce across regions or municipalities. The authors emphasized the role of financial incentives over career concerns. They identified three potential drivers that could explain the officials’ actions and performance. First, they could be intrinsically motivated and benevolent. Second, they could act in their self-interest, and seek power and influence. Or third, they could respond to implicit equity stakes. Financial incentives are the most plausible explanation in the case of special deals, according to the authors. Rents can only be extracted after wealth has been created, which disciplines the local officials’ decisions, they argued.

The authors concluded the discussion by providing further details about the institutional context in which local officials operate. A common misconception is that the Chinese government is a homogeneous, unified entity, they argued. In reality, decisions are decentralized, and uncoordinated at times. Regulations at the central and local levels might even conflict. Local officials sometimes have to violate regulations issued by the central authority to proceed with local projects, which entails career risks, the authors suggested.

References

