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Discussion

Tao Zha began by acknowledging the comments from the discussion about the noisiness of the available data on China's macroeconomy. In particular, he noted that it is often difficult to gauge the reliability of the existing data provided by the National Bureau of Statistics in China. Therefore, one of the goals of the project was to collect more reliable and consistent data, which would ultimately be provided to the public through the Federal Reserve Bank of Atlanta.

Rick Mishkin then inquired about the implications of the preferential credit policy for long-term economic growth in China. He asked what the paper's theoretical framework has to say about the ability of China to balance the tension between maintaining high growth and the risk of a financial crisis arising from bad loans. He noted the problem of potential misallocation of capital arising from the preferential credit policy. However, Mishkin also acknowledged that a number of countries, including some countries in Asia, had used similar growth strategies to successfully break through "middle-income" status and become rich.

Tao Zha replied that the model does indeed highlight the serious credit risk associated with the preferential credit policy in China. Specifically, he noted that the policy has the risk of creating very large and unproductive factories in China. This can potentially lead to growth in the number of bad loans, because these factories and the associated buildings are commonly used as loan collateral. Zha gave the example of the construction of a financial center in the city of Tian Xian, despite the close proximity of an existing and popular financial center in Beijing. This resulted in a large number of empty high rises and buildings in Tian Xian. He also noted that the Chinese government has concerns about the credit risk in China and has begun to implement some financial reforms

to address these issues. Zha further noted that these financial issues are first order, and the issues of inequality in China are a by-product of the biased policies implemented by the Chinese government.

Kaiji Chen also replied to Mishkin's comment, arguing that capital allocation can be thought of along two dimensions: within sectors and across sectors. Previous papers, such as Song et al. (2011), focus on the within-sector allocation of capital from state-owned enterprises to privately owned enterprises. As these papers have shown, the reallocation within sectors boosted capital efficiency in China between 1998 and 2004/05. However, he argues that after 2007, the reallocation across sectors in China, which is the focus of the authors' paper, is the more important margin affecting capital efficiency. In particular, he spoke about the reallocation from the light to heavy sectors of the economy, which can result in idle capacity.

Daron Acemoglu spoke next, further comparing the current paper and the Song et al. (2011) paper. Specifically, he noted that the two papers share some similar qualitative facts (including the low and stable labor shares in the economy and the fact that labor is priced by the less efficient sector) but come to very different conclusions for the allocation of capital over time. In the Song et al. (2011) paper, capital allocation improves over time as the less efficient firms exit the market, which does not happen in the current paper. He asked whether there is anything in the data that can differentiate between the theories proposed in the two papers.

Tao Zha acknowledged the importance of using data to distinguish between the two papers and conveyed they were in the process of collecting more data to do so. He also referred to anecdotal evidence that supports the authors' conclusion that capital allocation is not likely to continue improving in China. Specifically, he argued that the within-sector reallocation from state-owned to privately owned enterprises is unlikely to result in large productivity improvements. This is because a large number of these privatized firms are reportedly functioning just like state-owned enterprises, despite being reclassified as private firms. He pointed out that these firms specialize in nonferrous metal products and heavy industries, which have low productivity. Kaiji Chen agreed that more detailed microdata will shed further light on the effects of capital reallocation.

Harald Uhlig spoke next, addressing the low consumption share and high savings rates in China. Specifically, he asked whether the consumption and savings patterns reflected private incentives or were a result of

government-imposed restrictions to household investment opportunities. He asked about the level of the social rate of return on capital that is needed to generate the observed high levels of household savings and how these rates compare to the interest rates in the data. He noted that one interpretation of the data is that the government is creating distortions by overinvesting in local sectors, using funds that they obtain by taxing households and keeping them from accessing the foreign market.

Tao Zha agreed with Harald Uhlig's interpretation of the distortions to savings created by the government's incentives. He argued that the growing foreign surplus in China is driven by the government surplus. One possible view of this growing surplus is that it is a tax on households, which then shows up in China's rising investment-to-consumption ratio. He pointed out that this also shows up in the authors' model as a by-product of the government's actions.

Kaiji Chen further added the data supports the model's predictions of a growing surplus being driven by rising government savings. Specifically, he noted that the data shows a 10% rise in the current account balance to GDP ratio from 1998 to 2010. This was driven by a 7% rise in government surplus to GDP over the same period. In contrast, the household savings rate did not increase much during that period.

Ricardo Reis spoke next. First, Reis questioned whether the paper's story about the Chinese government's preference for capital could instead be interpreted as favoritism toward exports. He referred to John Fernald's discussion and comments about further splitting the data by tradable versus nontradable sectors and examining the exports and capital intensity of those sectors. Reis hypothesized that the trends could be instead interpreted as the government pushing the tradable sectors. Second, Reis asked about the extent to which data on the current account, trade, and the closed economy can jointly explain the facts in the paper. Specifically, he referred to the fact that both investment- and consumption-to-GDP ratios stabilize somewhat after 2008. The stabilization of these two ratios occurred at the same time as the stabilization of the current account in China. Reis asked whether the trends in investment and consumption after 2008 can be used to distinguish between favoritism versus the alternative story about the supply of savings in China.

Tao Zha responded by noting that it would be difficult to replicate the facts in the data with a standard model with export and import sectors. In these models, the export sectors are more capital intensive than the import sectors. Therefore, opening up the economy leads to growth in the capital-intensive sectors and a decline in the labor share. However,

this has not been the case for China, where the exporting sectors consist of labor-intensive sectors, such as textiles. Therefore, growth in exports results in growth for the labor-intensive firms in China, rather than the capital-intensive firms.

Kaiji Chen gave an example that illustrated the growth in the exports of the labor-intensive sectors. Specifically, he referred to China's entry into the World Trade Organization (WTO). Around that time, China's comparative advantage was its labor-intensive technology. Following this event, the export share of labor-intensive firms rose relative to the capital-intensive firms from 1999 to 2007. Chen argues that this implies that the Chinese government has not been favoring the capital-intensive exporting sectors, as was suggested by Ricardo Reis.

Jonathan Parker spoke next, asking three questions. First, he asked to what extent the measured low labor share in China could be reflecting measurement issues related to taxes. In the United States, payroll taxes are added back to post-tax labor income to obtain a true measure of labor share. In contrast, the tax system in China is more informal. He wondered if these informal taxes, not included in the measured labor share, could be a significant issue.

Parker then asked a second question about whether it is possible to distinguish between two stories using data. The first story, which the paper pushes, is that distorted incentives result in high savings that are funneled into the housing market. The second story is that there is a vast supply of labor in nonindustrialized areas, which is now flowing and therefore pushing down wages and potentially the consumption share as well.

Lastly, Parker asked to what extent has credit in China been mismanaged, since there is a large credit boom that has arisen from capital outflows being essentially blocked rather than from a rise in capital inflows.

Tao Zha responded by acknowledging that the paper abstracts from housing and house prices, which could be the motivation behind the high household savings and low consumption ratios. Nonetheless, his view is that the heavy industrialization policies in China were still an important factor driving the trends in China. Specifically, he refers to the fact that in recent years, the consumption-to-income ratio has begun to rise in China, while the consumption-to-investment ratio has begun to decline. He argues that this coincided with various financial reforms in China, which implies that the preexisting policies also played an important role in driving the consumption and investment trends observed in the data.