A Model of China's State Capitalism

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  - Two types of firms: entrepreneurs and SOEs
  - The entrepreneurs are more productive but financially constrained.
  - SOEs are less efficient but have better access to credit markets.

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  - Banks make most loans to SOEs.
  - SOEs shrink $\rightarrow$ excess domestic savings

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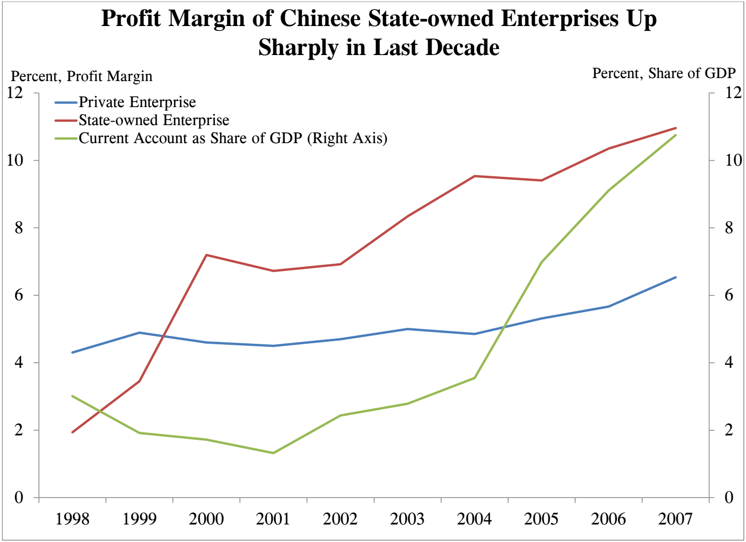
- What are missing in Song et al. (2011)
  - SOEs outperform private companies in China after 2001.
  - SOEs' profits comove with China's export and CA surplus after 2001 while their shares in exports decline significantly.


Profit Margin of Chinese State-owned Enterprises Up Sharply in Last Decade
Percent, Profit Margin
Percent, Share of GDP
Private Enterprise
State-owned Enterprise
Current Account as Share of GDP (Right Axis)
12
10
8
6
4
2
0
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007

Li, Liu, and Wang (2012)

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- Vertical structure in Chinese economy (after 2001)
  - SOEs have low productivity but monopolize upstream industries.
  - Private free competition exists in downstream industries.
- Trade liberalization (Accession to the WTO) $\rightarrow$ rapid expansion of downstream firms
- Profits of upstream SOEs increase, as a result.

Why is it an important issue?

- Complement Song et al. (2011) in understanding China's economic growth
- Different prescription for China's long-run economic growth
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- Different prescription for China's long-run economic growth
  - Eliminating financial frictions in Song et al. (2011)
  - Not enough in Li et al. (2012)
    - Remove entry barriers in upstream industries to sustain long-run economic growth.

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  - Are profits of upstream/downstream industries in other countries high/low?
  - Other reasons for rising profits in upstream industries, such as the run-up of energy prices?

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  - A result of financial frictions in Song et al. (2011)?
    - Financial frictions $\rightarrow$ SOEs specialize in capital intensive industries
    - Capital intensive industries coincide with upstream/high-profit industries
- In either case, financial market liberalization is good for China's long-run economic growth
  - Banking is one of the upstream industries that are dominated by SOEs.
  - Dallas Fed President Richard Fisher's RMB speech

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- Argument and model: China's economic growth after 2001 is mainly driven by trade liberalization
    - Data: Reallocation of resources may continue after 2001 (Figure 4)
    - How much trade liberalization contribute to China's economic growth?

Conclusion

- This paper proposes a different story to explain Chinese economy after 2001
  - SOEs outperformed private companies
  - SOEs' profitability comoved with trade though their shares in trade declined.
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- A sensible story on a very important issue
- More cross-checks of this story with the data are desirable.