

COLLEGE OF HUMANITIES,
ARTS, AND SOCIAL SCIENCES

Research Highlights 'Interview'



Self-Introduction

- Briefly introduce yourself, the department and school that you are in.

I'm **Laura Wu** from the Economics Programme of the **School of Social Sciences**.

Elaboration

- Share with us what is your research project.

My recent research project aims to understand the miracle of China's economic development through a perspective of capital misallocation. Resource misallocation across heterogeneous firms in an economy lowers its aggregate total factor productivity. McKinsey Global Institute country and sector studies found large differences across firms within the same sector in many developing countries. In fact, the most productive firms within most sectors have productivity levels comparable to those in Western Europe or the United States, but there is a long tail of very low productivity firms. If the resources could be reallocated from the low productive firms to high productive firms within a country, the aggregate output would increase even with the same amount of production factors, which leads to an increase in the measured aggregate total factor productivity. Among various production factors, capital misallocation has been documented as a prevailing empirical phenomenon in China in particular.

- What inspired you to embark on this research project?

At the macro-level, why the real GDP per capita in China was only one-fortieth of that in the United States back to forty years ago but has been one-seventh in this year? At the micro-level, why the Chinese banks, which are mostly state owned tend to offer easier credit to state-owned enterprises – less screening, higher line of credit, lower interest rate and less collateral requirement? Why the Chinese stock market is disproportionately dominated by the state-owned enterprises? Why many successful non-state-owned enterprises do not use any channel of formal financing at all during various stages of development? Does this cause large dispersion in the marginal product of capital across heterogeneous firms in China? Can the decline in the dispersion explain China's economic development in the past four decades?

- **What is/are the most interesting finding(s) of this project?**

I find that evidences on capital misallocation in China take many forms, which could be caused by both financial frictions and policy distortions. A full correction of capital misallocation would increase China's total output by 20 percent. About one-third of the misallocation arises from financial frictions, which are due to capital market imperfections that exist in any country but are more pronounced in China as a result of financial underdevelopment. About two-third of the misallocation is due to policy distortions, which are the consequences of some specific industrial policies, trade-off between growth and stability and political connection.

- **How do you think your research can impact society?**

In recognizing that both financial frictions and policy distortions have caused the capital misallocation and aggregate total factor productivity loss in China, my research provides an important perspective to understand China's economic development in the past four decades, thanks to both the development of the financial environment and the economic reform correcting policy distortions at large. To the extent that large and persistent capital misallocation still exists after forty years of reform, the factors identified in my research can be interpreted as directions for further reforms.

These findings have been published as Chapter 2 in [The Chinese Economic Transformation: Views from Young Economists](#) by ANU Press in July 2019.

An essence of the chapter has been published in the East Asia Forum under the title [Tackling capital misallocation in China](#) in August 2019.

Future Plans

- **Tell us about your future research plans and if you are looking for any research collaborators!**

My future research plan is to study capital misallocation not only within the country but also across the country, not only from firm's perspective but also from household's perspective. For example, how capital control in China has caused a dispersion in the rate of return of investment and saving within China and outside of China, and what are the implications of such misallocation to household portfolio choice, assets bubble, exchange rate and financial stability?