The Reallocation Myth

Discussant: Gita Gopinath
Harvard

1. Measurement?
2. Lack of Ideas?
3. Lack of Dynamism?

Driven by IT intensive sectors
Dynamism: Good? Bad? Irrelevant?

1. **Fact**: Decline in reallocation
   - Lower rates of firm entry & exit; job creation & destruction

2. **Myth**: Reallocation important driver of growth
   - Myth 1: Lower reallocation $\rightarrow$ lower allocative efficiency
   - Myth 2: Lower reallocation $\rightarrow$ lower innovation

3. **Chang-Tai & Pete**: Reallocation not a major driver of growth
   - No evidence of improving allocative efficiency at any point
   - Most innovation by slow growing incumbents, not entrants or ‘gazelles’
   - LBD: Average growth over 5 years: Reallocation explains at most 25%
Myth 1: Lower reallocation $\rightarrow$ lower allocative efficiency

1. Beyond dispute: Wrong to infer that resources moving from low to high productivity firms is a sign of better allocation


3. Retail Sector Vs. Information Sector
Myth 2: Lower reallocation → lower innovation

- Major contribution: Provide decomposition for all non-farm private businesses

Table 5: Sources of Growth, 1976–1986

<table>
<thead>
<tr>
<th></th>
<th>Entrants</th>
<th>Incumbents</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creative destruction</td>
<td>19.1%</td>
<td>8.2%</td>
<td>27.3%</td>
</tr>
<tr>
<td>New varieties</td>
<td>0.0%</td>
<td>7.6%</td>
<td>7.6%</td>
</tr>
<tr>
<td>Own-variety improvements</td>
<td>-</td>
<td>65.1%</td>
<td>65.1%</td>
</tr>
<tr>
<td></td>
<td>19.1%</td>
<td>80.9%</td>
<td></td>
</tr>
</tbody>
</table>

Table 6: Sources of Growth, 2003–2013

<table>
<thead>
<tr>
<th></th>
<th>Entrants</th>
<th>Incumbents</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creative destruction</td>
<td>12.5%</td>
<td>6.4%</td>
<td>18.9%</td>
</tr>
<tr>
<td>New varieties</td>
<td>0.3%</td>
<td>4.1%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Own-variety improvements</td>
<td>-</td>
<td>76.7%</td>
<td>76.7%</td>
</tr>
<tr>
<td></td>
<td>12.8%</td>
<td>87.2%</td>
<td></td>
</tr>
</tbody>
</table>

This is the model’s proximate answer to the question of how much the decline in job creation matters for aggregate TFP growth. Recall that the growth rate of aggregate TFP actually increased from 1.03% a year during 1976–1986 to 1.44% a year during the 2003–2013 period. How could the growth rate of aggregate TFP increase when innovation by entrants and creative destruction by incumbents fell? The model’s answer is that own innovation by incumbents must have increased and more than offset lower innovation by entrants and less creative destruction by incumbents. The arrival rate of quality improvement via own innovation by incumbent firms increased from 71% to 81%, and the share of TFP growth due to this channel increased from 65% to 77%.
Comment # 1: What about the years when TFP growth was high?

• Analysis covers 1976-1986 and 2003-2013

<table>
<thead>
<tr>
<th></th>
<th>TFP Growth</th>
<th>Job Destruction</th>
<th>Job Creation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976-1986</td>
<td>1.03%</td>
<td>32%</td>
<td>45%</td>
</tr>
<tr>
<td>2003-2013</td>
<td>1.44%</td>
<td>28%</td>
<td>33%</td>
</tr>
</tbody>
</table>

• 1996-2003 & 2003-2013: TFP declines and reallocation declines
• Sector specific analysis: IT producing and using sectors
Comment # 2: Is it the right model?

- Decomposition based on indirect inference using model + job flow data
  - CD: lumpy distribution with thick tails
  - Own innovation: continuous distribution

- Model assumptions
  - Step size of innovation independent of firm size and firm age
  - No interaction between CD and own innovation

Comment # 3: About symptoms, not about cause

- Accounting model: exogenous innovation
- Limits to policy analysis: Hard to do counterfactuals
  - Higher costs on firm entry dampens innovation
- Independent measures of rising frictions associated with business dynamism?
  - De Loecker & Eeckhout: Rising market power (publicly held firms)
    - Starting 1980, average markups rise from 18% above marginal cost to 67% now
- What explains the slow down in TFP?