Discussion of "Entry vs. Rents: Aggregation with Economies of Scale" by David Baqaee and Emmanuel Farhi (2021)

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An Aggregation Exercise

- How changes in productivities and markups of disaggregated producers shape aggregate outcomes?

- To my knowledge, first such paper that allows for a general treatment of the extensive margin

- The characterization results are then applied to ...
  - explore how product entry and exit determine allocative efficiency
  - social costs of distortions (distance to frontier)
  - second-best policy interventions (markup regulations & entry subsidies)

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Main Result

- decomposition of the macro impact of shocks in terms of changes in
  (a) technical efficiency
  (b) pure rents
  (c) quasi rents
  (d) markups

Theorem

$$\begin{aligned}
\mathrm{d}\log Y = &\sum_i \lambda_i^F \underbrace{\mathrm{d}\log A_i}_{\Delta \text{ technology}} - \sum_{i:DRS} \lambda_i^F \underbrace{(1-\epsilon_i)}_{DRS} \underbrace{(\mathrm{d}\log \lambda_{\pi,i} - \widehat{\mathrm{d}\log \lambda_{\pi}},i)}_{\Delta \text{ pure rents}} \\
&+ \sum_{i:IRS} \lambda_i^F \underbrace{(\gamma_i - 1)}_{IRS} \underbrace{\widehat{\mathrm{d}\log \lambda_{\pi,i}}}_{\Delta \text{ quasi-rents}} \\
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- Two more theorems expressing changes in rents and quasi-rents in terms of model primitives

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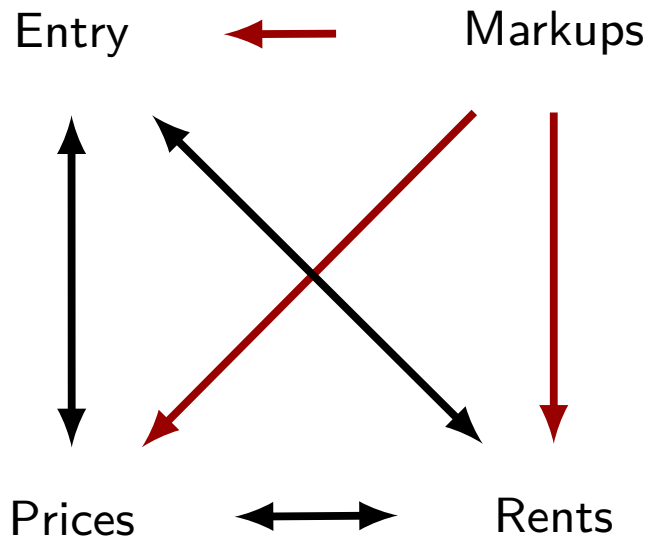
How General Is the Result?

- Very General!
  - input-output linkages
  - non-trivial markups
  - various degrees of returns to scale
  - general treatment of entry (directed, undirected, and anything in between)

What is Not Captured by the Results?



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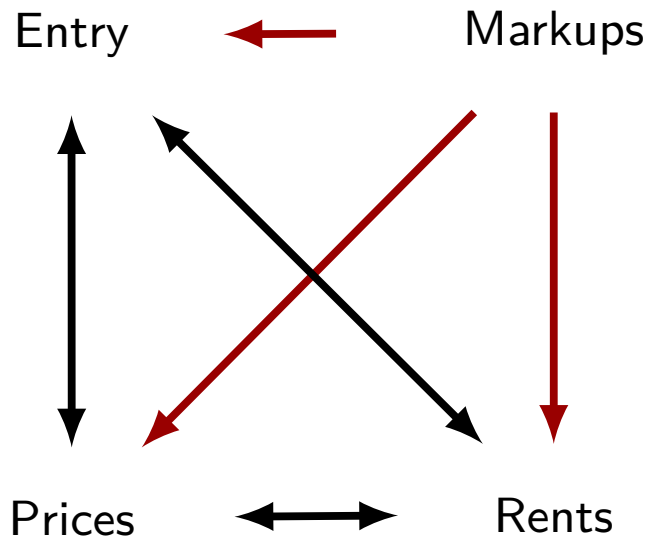

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Aggregation Results with Entry

- Paper makes a convincing case that one cannot sidestep modeling the extent and nature of entry.

- Simple economy with no input-output linkages and a single factor of production:

DRS + directed entry: $\mathrm{d}\log Y = \sum_{i=1}^{n} \lambda_i \, \mathrm{d}\log A_i$

DRS + undirected entry: $\mathrm{d}\log Y = \sum_{i=1}^{n} \lambda_i \, \mathrm{d}\log A_i - \frac{\epsilon}{\lambda_E} \mathrm{Cov}_\lambda (1/\mu_k, \mathrm{d}\log A_k)$

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- What should one do with such an observation?

  Next time take the extensive margin seriously!

- But what if one cannot (or does not want to) take an exact, detailed position about what type of firm can enter into each market? Is one out of luck?

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