STEG-PEDL Virtual Course on 'Private Enterprises, Productivity and Economic Growth'

Session 3: Friday 20th February 2026

[Dave Donaldson](#)

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Q: Where can we find the Handbook of Development Economics?

A: It's online here, but behind massive paywalls: https://www.sciencedirect.com/handbook/handbook-of-development-economics . But most chapters can be found ungated online, if you look for them.

The 6th edition is not out yet. The papers are still being finalized. Drafts are floating around, but the new version won't be published until later in the year

Q: Can failure of a State/planning also account for market failure?

A: Yes, very much so. A state planning exercise might allocate inputs in a way that achieves some other outcome, but there would be no reason to expect it to equalize marginal products across firms/activities.

Q: Is there theory and evidence on how the delivery of public goods and services (by the state) impacts firms, productivity and growth? A lot of production is a composite of private and public inputs, like infrastructure, electricity (often state provided), digital services, etc.

A: We tend to treat public goods and services as a distinct category from wedges, in a theoretical sense. But there are some similarities. What's true is that the presence or absence of these public goods and services will affect the marginal conditions facing firms. But firm-level efficiency could still hold in an economy where the allocation of public goods and services is not at an efficient level.

There is a separability, in other words, between the optimization of public goods and the firm-level allocation decision.

Q: What are some good reference papers on public goods and services? Also, how different is public expenditure to public goods? Theoretically I guess they differ significantly as public expenditure is modelled more as a demand for firm good while in the data, it would include expenditure on public goods?

> **A:** Public expenditure is very different from public goods... Public goods have a formal definition related to non-rivalrousness and non-excludability. But governments typically provide (and are expected to provide) goods and services that are not strictly public goods (e.g., some elements of health provision). Any good textbook on public economics will cover both of these topics. I would maybe take a look at the CORE Econ website for some links: https://www.core-econ.org/

Q: Are these wedges thought of as resources or returns to factors of production?

> **A:** You might think of them as distortions in the prices of factors of productions (or outputs).
>
> I think they are probably best understood as market distortions that affect the returns to different factors of production or output choices. So one simple version might be a tax on an input or output. But for instance, a firm might purchase inputs from a seller who has market power. That would create a distortion in the choices faced by the downstream firm.
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> The wedges might vary across firms. Different firms in the same industry might face different wedges because they buy from different suppliers or face different market distortions.

Q: I have also realised that in developing countries issues like congestion whereby employees/ workers take 2-3 hours to go to work and then knock off early to skip congestion can be another distortion for a country to reach its optimum utility levels in terms of production. Do you agree?

> **A:** Yes, although if this is just a country-specific norm, shared by all firms and all sectors, then it's not so much a source of firm-level misallocation as a reduction in the effective endowment, in a macro sense. It still means that there is scope to increase aggregate production (and utility) by changing the norm... But you couldn't reallocate labor across firms, under the existing norm, to improve things.

Q: Does having a taste parameter for each good change anything? For example, if consumers have a preference for good A over good B, do we see it as a wedge? How about trust? Good A and B have the same quality but consumers trust A's quality more than B's. Do we see this as a wedge?

> **A:** I would say that if the goods are really different and the consumers have different utility from them, then this is in the utility function and not a wedge. If consumers are misinformed about the quality / utility value of the goods, then we might think of this as a wedge because it will affect output prices.

Follow-up Q: But if we measure TFPR (as Hsieh and Klenow did), we see taste differences show up as a wedge?

> **A:** In the HK framework, tastes will show up in demand functions (utility in Dave's formulation) and so not as wedges.

Taste differences would mean that firms face different prices and marginal value products, so they should allocate inputs according to those prices. That's not misallocation, and it's not a wedge. Would these taste differences look like wedges in the data: perhaps, if we didn't have a way to identify separately the prices from the quantities. So this ties back to Chad's lecture from last week.

Q: The data from this graph - what year was it from?

A: Don't know. You could probably track down the original presentation, which might provide more context.

The paper was published pre-2010, so the data is probably 2000s? I think they used three rounds of surveys.

Q: I am wondering if the instrument Z can satisfy relevance and exclusion restriction at the same time? Z need to correlate with delta x to be relevant, but we said that delta x also correlated with epsilon since epsilon can contain some higher order of x. Does it mean that Z will always correlate with epsilon?

A: Hopefully this is clearer after what Dave just discussed. If the relevant shock is random, it can satisfy both relevance and exclusion.

Q: How can insights from fields like Public Finance or Labor Economics improve development policy decisions?

A: We increasingly see these fields merging with development economics. There aren't really any well-defined distinctions across these fields. How well economic research feeds into development policy -- that's a different and bigger question. Going from research to policy is not a simple thing, even in richer countries!!

Q: Please submit questions that you'd like to put to Dave! Ideally keep them in this thread!

Q1: If markups reflect residual elasticities and wedges - and residual elasticities may reflect quality and productivity - should wedges and markups pose different implications for policy?

Q2: Can some practical takeaway be given for a developing economy? Such as how to potentially estimate this wedge using the market failure approach.

Q3: In your Ecuador case, could you talk a little bit more about what the implications of finding such low level of misallocation are? What "within-firm" factors might explain the large variance in revenue/costs that you showed?

Q4: To what extent might gender-based barriers — such as unequal access to capital, networks, or managerial authority — contribute to within-firm misallocation of talent or resources, and how might these gendered inefficiencies generate negative externalities?

Q5: What about in a context where the firm is also a household (small agricultural good production)?

Links to papers referred to in talk:

- **Wedges: A Microeconomic Perspective on Misallocation** (Bergquist et al.) - https://www.nber.org/papers/w34756 or http://www.columbia.edu/~ev2124/research/BergquistLashkari&VerhoogenHoDEforthcoming.pdf
- **Misallocation in Firm Production: A Nonparametric Analysis Using Procurement Lotteries** (Carillo et al.) - https://dave-donaldson.com/wp-content/uploads/CDPS_Misallocation.pdf