

# The Causes and Costs of Misallocation

Diego Restuccia and Richard Rogerson (2017)  
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**Introduction to Macroeconomics I**  
(6<sup>th</sup> Paper Reading Session)

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- 1 Introduction
- 2 Findings
  - Using *Indirect* Approach
  - Using *Direct* Approach
- 3 Future Path of Research
- 4 Research Ideas

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- Motivation behind this literature:
  - Why do poor countries produce much less output per worker than rich countries?
  - Why do living standards differ so much across countries?
- This paper raises 3 important questions that must be answered:
  - ① How important is misallocation? (Very!)
  - ② What are the causes of misallocation? (Many causes)
  - ③ What additional costs are associated with misallocation?  
(endogenous responses. Impact on: investment decisions, culture, discrimination, etc.)

- The paper argues about sources of misallocation:
  - The sources are wide ranging
  - Each source is very narrow in scope
  - Many of them are hard to measure
- This paper discusses how scholars have approached answering the questions and challenges they face in doing so.

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Two approaches have been used to measure misallocation:

① *Indirect Approach:*

- Measurement of aggregate effect of multiple reasons.
- A shallow structural model suffices.
- Limitations:
  - Heterogeneity among producers
  - Adjustment costs
  - Measurement error

② *Direct Approach:*

- Measures the specific reason's contribution to productivity.
- Usually quasi-natural experiments are used.
- A detailed structural model is required to run counterfactual analysis.

# The Indirect Approach Findings

- Helps to identify the extent of inefficiency due to misallocation.
- Differences in manufacturing productivity across countries are quite large.
- Misallocation in agriculture and service sectors is even larger.



# The Direct Approach Findings

- Helps to identify the causes of misallocation.
- No source is solely accountable for the observed large differences in productivity among countries.
- Several reasons contribute to misallocation:
  - Regulations (distort operation as a wedge in FOCs of the model.)
  - Property Rights
  - Trade and Competition
  - Financial and Informational Frictions

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# Future Path of Research

For further understanding of these questions:

- 1 How important is misallocation?
- 2 What are the causes of misallocation?
- 3 What additional costs are associated with misallocation?

The literature:

- Should explore possible sources and their extent of their effect on misallocation more accurately.
- Is encouraged to use panel micro datasets more.
- Should focus on the dynamic models of heterogeneous producers and its impact of dynamic decision making of agents.

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# Some Research Ideas

- Effect of “zombie-lending” (extension of credits to avoid writing bad loans) in Iran.
- Effect of extensive production market regulations on misallocation and thus productivity in Iran.
- Efficiency of state-owned and private firms that operate in the same market. The correlation of productivity and size can be studied.
- Misallocation versus growth and business cycles.

## Some Research Ideas - Continued

- Unemployment insurance and its productivity distortions via selection.
- Misallocation in the agriculture sector in Iran (numerous small family-owned lands).
- Distortions caused by tariff policies impact exporters and importers differently. One can compare each to their competitors in their markets. (Dr. Kowsar Yousefi is an expert in Iran's trade.)
- [Theory] — Writing a model that studies multiple sources of misallocation and their contemporaneous effects on aggregate misallocation.

Thanks for your attention!