Investment, Tobin's Q, and Vintage Capital: Theory and Evidence

Speaker:
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Content:
This paper extends the Q-theory of investment to capital goods with arbitrary efficiency profiles. Under the assumption of geometric economic depreciation employed by the traditional Q-theory, a firm's replacement cost of assets-in-place is independent of their vintage composition and can be directly measured by the firm's current productive capacity, i.e., its capital stock. When the economic depreciation is non-geometric, the firm's current capital stock and the replacement cost of its assets are fundamentally different aggregates of its investment history. We construct empirical proxies for these two quantities and show that, consistent with our theoretical predictions, vintage capital effects significantly improve the explanatory power of investment regressions. We further find that the effect of vintage capital in investment regressions is at least as strong as that of cash flow.

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All Interested are Welcome