Capital Misallocation: Frictions or Distortions?

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Abstract

We study a model of investment in which both technological and informational frictions as well as institutional/policy distortions lead to capital misallocation, i.e., static marginal products are not equalized. We devise an empirical strategy to disentangle these forces using readily observable moments in firm-level data. Applying this methodology to manufacturing firms in China reveals that adjustment costs and uncertainty have significant aggregate consequences but account for only a modest share of the observed dispersion in the marginal product of capital. A substantial fraction of misallocation stems from firm-specific distortions, both productivity/size-dependent as well as permanent. For large US firms, adjustment costs are relatively more salient, though permanent firm-level factors remain important.

Speaker Profile

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