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Investment and Financing Constraints: Evidence from the Funding of Corporate Pension Plans

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ABSTRACT

I exploit sharply nonlinear funding rules for defined benefit pension plans in order to identify the dependence of corporate investment on internal financial resources in a large sample. Capital expenditures decline with mandatory contributions to DB pension plans, even when controlling for correlations between the pension funding status itself and the firm's unobserved investment opportunities. The effect is particularly evident among firms that face financing constraints based on observable variables such as credit ratings. Investment also displays strong negative correlations with the part of mandatory contributions resulting solely from unexpected asset market movements.

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