FINANCIAL SERVICES REVIEW, 2(1): 63–71
ISSN: 1057-0810
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Abstracts of Articles on Individual Financial Management

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CHARITABLE GIVING

Voluntary Contributions to United Charities, by Marc Bilodeau (Département d' Économique, Université de Sherbrooke, Quebec, Canada).

If individuals are free to direct their gifts to any charity, why would they contribute instead to an institution like the United Way that may not disburse their donations as they would have themselves? It is shown that 'contributing only to the United Fund' can be a Subgame Perfect Equilibrium, if the Fund plays after everyone else and is able to offset direct contributions. However, donations to a United Fund may be lower than direct contributions would have been, so that an optimal grants policy for the United Fund would involve trading off a less desirable mix of services for higher total contributions. *Journal of Public Economics*, June 1992, 48(1): 199–233. (Reprinted with permission of North-Holland Publishing Company).

CONSUMPTION-SAVINGS DECISION

The Decline in Saving: Evidence from Household Surveys, by B. Bosworth, G. Burless and J. Sabelhaus.

Using the microeconomic survey data covering 1962–89, this paper examines the recent decline of private saving in three countries — the United States, Canada, and Japan. There is no evidence that shifts in the demographic composition of the population between high- and low-saving groups has contributed to the recent decline. The most interesting result is that saving has fallen within nearly all groups examined, although in the United States it fell most among those over forty-five.

Nor can capital gains explain the pattern of saving decline. Saving fell among families with limited assets as well as among households enjoying large capital gains. *Brookings Papers on Economic Activity*, 1992, No. 1, pp. 183–241. (Reprinted with permission of the *Journal of Economic Literature*).

The Consumption of Stockholders and Nonstockholders, by N.G. Mankiw (Harvard University) and S.P. Zeldes (University of Pennsylvania).

Only one-fourth of U.S. families own stock. This paper examines whether the consumption of stockholders differs from the consumption of nonstockholders and, if so, whether these differences help explain the empirical failures of the consumption-based CAPM. Household panel data are used to construct time series on the consumption of each group. The results indicate that the consumption of stockholders is more volatile and more highly correlated with the excess return on the stock market. These differences help explain the size of the equity premium, although they do not fully resolve the equity premium puzzle. *Journal of Financial Economics*, March 1991, 17(1): 97–112. (Reprinted with permission of North-Holland Publishing Company).

Saving and Liquidity Constraints, by A. Deaton.

This paper is concerned with the theory of saving when consumers are not permitted to borrow, and with the ability of such a theory to account for some of the stylized facts of saving behavior. The models presented in the paper seem to account for important aspects of reality that are not explained by traditional life-cycle models. *Econometrica*, September 1991, 59(5): 1221–1248. (Reprinted with permission of the *Journal of Economic Literature*).

Do Individuals Optimize in Intertemporal Consumption/Savings Decisions? A Liberal Method to Encourage Savings, by Y.K. Ng.

Rational consumption/saving choice requires rough knowledge regarding how much a dollar saved now could be compounded to become after various numbers of years. An indicative questionnaire reveals that most people grossly underestimate the significance of compound interest. When told of the right figures, they indicate their willingness to save much more. A simple model of intertemporal optimization under plausible parameters (4–5 percent real rate of return) prescribe many times higher consumption at older ages than at younger ages, implying very high rates of savings when young. *Journal of Economic Behavior and Organization*, January 1992, 17(1): 101–114. (Reprinted with permission of North Holland Publishing Company).

ESTATE PLANNING

How Strong Are Bequest Motives? Evidence Based on Estimates of the Demand for Life Insurance and Annuities, by B. Douglas Bernheim (Princeton University).

This paper presents new empirical evidence in support of the view that a significant fraction of total savings is motivated by the desire to leave bequests. Specifically, I find that social security annuity benefits significantly raise life insurance holdings and depress private annuity holdings among elderly individuals. These patterns indicate that the typical household would choose to maintain a positive fraction of its resources in bequeathable forms, even if insurance markets were perfect. Evidence on the relationship between insurance purchases and total resources reinforces this conclusion. *Journal of Political Economy*, October 1991, 99(5): 899–927. (Reprinted with permission of the University of Chicago Press).

INSURANCE DECISIONS AND INDIVIDUAL RISK MANAGEMENT

Income Tax Deductions for Losses as Insurance, by Louis Kaplow (Harvard University).

The federal income tax allows deductions for some categories of personal losses, notably for casualty losses (such as destruction of one's home or car) and medical expenses above a threshold. The latter, even with lower marginal rates and further restrictions brought about by the 1986 tax reform, involves more than a $3 billion annual revenue loss (Office of Management and Budget, 1990).

Deductions like these act as partial insurance: individuals receive a tax benefit equal to their marginal rate multiplied by the magnitude of their loss. However, this form of insurance is unnecessary when private insurance is available. Moreover, as will be emphasized here, these deductions have a perverse effect because they are allowed only for the uninsured portion of losses. This induces individuals to be less protected against risk in the aggregate than if the implicit insurance provided by the tax system were unavailable; if the tax rate is sufficiently high, individuals would forgo insurance coverage altogether. It will be demonstrated that a tax system with no deductions for personal losses Pareto dominates the current system.

These conclusions are demonstrated in Section I using a simple model in which risk-averse individuals may purchase actuarially fair insurance against loss and individual behavior does not affect the risk of loss (no moral hazard). Section II considers the applicability of the results when one allows for moral hazard, administrative costs, and other imperfections. It also discusses the applicability of tradi-

tional notions of tax equity. *American Economic Review*, September 1992, 82(4): 1013–1017. (Reprinted with permission of the *American Economic Review*).

INVESTMENT SELECTION AND INDIVIDUAL PORTFOLIO MANAGEMENT

Stock Prices and the Dissemination of Analysts' Recommendations, by M.D. Beneish (Duke University).

This article investigates alternative explanations for the significant stock-price reaction to analysts' information reported in the "Heard on the Street" column of the Wall Street Journal. The observed market reaction persists after eliminating firms with confounding releases and firms for which analysts' reports are issued immediately prior to publication. The evidence indicates that the column is not usually a secondary dissemination. First, stock prices adjust prior to publication when recommendations are reported on a single firm. Second, analysts have incentives to release information to the column before disseminating it to their clients. Overall, the evidence suggests that the "Heard on the Street" column gathers information, forms a consensus, and provides it to investors. *Journal of Business*, 64(3): 393–416. (Reprinted with permission of the University of Chicago Press).

Makroökonomisches Umfeld und optimaler Anlagemix. Eine Analyse für die Schweiz unter spezieller Berücksichtigung von Immobilienanlagen (with English Summary), by W. Burger and P. Meier.

In this paper, the stability of an optimal asset mix of bonds, shares, and real estate is analyzed using different time frames and indicators for real estate returns. Diverging portfolio structures are discussed in light of different macroeconomic environments. An attempt is made to evaluate efficiency losses caused by asset allocation strategies based on nominal returns if-as is often argued-the investor's prime concern lies with the preservation of purchasing power. *Schweizerische Zeitschrift für Volkswirtschaft und Statistik/Swiss Journal of Economics and Statistics*, June 1991, 127(3): 511–523. (Reprinted with permission of the *Journal of Economic Literature*).

Towards an Equilibrium Model of the Mutual Funds Industry, by J. Dermine, D.J. Neven and J.F. Thisse.

The authors consider an industry in which mutual funds can form portfolios at lower cost than individual investors. Investors can gather their own portfolio from

primary securities and/or shares of mutual funds. In this context, the authors model competition between mutual funds as a noncooperative game in which funds select their portfolios. They show that a small number of funds suffices to ensure a Pareto superior equilibrium. *Journal of Banking Finance*, June 1991, 15(3): 485–499. (Reprinted with permission of the *Journal of Economic Literature*).

Portfolio Choice and Risk, by J. Encarnación, Jr.

Risk and risk aversion are interpreted in terms of a lexicographic model of portfolio choice where the Telser criterion of expected value is maximized if the Cramér-Roy safety first criterion is satisfied, whence less risk aversion or more wealth implies a riskier portfolio and a higher return per dollar, and the asset demand for money-if held in the portfolio- is less at a higher rate of interest. *Journal of Economic Behavior and Organization*, December 1991, 16(3): 347–353. (Reprinted with permission of the *Journal of Economic Literature*).

Die Kommunikationsfunktion der Finanzmärkte (with English summary), by M. Hellwig.

This paper compares different approaches to modeling communication in financial markets with asymmetric information. It appears that market outcomes do not depend on whether outsiders infer the insiders' information directly from their behavior or indirectly from prices. The difference between self- selection models à la Leland-Pyle (1977) and market models à la Grossman-Stiglitz (1980) hinges on whether "insiders" behave as oligopolists or as price takers. Price taking cannot be justified strategically unless communication is perturbed by "noise." There is, thus, an inherent conflict between the requirements of information efficiency and allocation efficiency of the market. *Schweizerische Zeitschrift für Volkswirtschaft und Statistik/Swiss Journal of Economics and Statistics*, September 1991, 127(3): 351–364. (Reprinted with permission of the *Journal of Economic Literature*).

Tests of Inflation and Industry Portfolio Stock Returns, by K. C. John Wei (Indiana University) and K. Matthew Wong (St. John's University).

This study examines the relationship between stock returns and inflation across 19 industry sectors during the pre- and post-World War II periods. The results in the postwar period suggest that the proxy hypothesis can explain the spurious negative relationship between stock returns and expected inflation in all industries, but not the negative relationship between stock returns and unexpected inflation in non-natural-resource industries. We find little evidence supporting the nominal

contracting hypothesis. Also, the expected inflation/returns sensitivity appears to be positively related to the level of real assets, but negatively related to debt ratio during the postwar period. *Journal of Economics and Business*, February 1992, 44(1): 77–94. (Reprinted with permission of North-Holland Publishing Company).

Ein internationales Kapitalmarktmodell mit unterschiedlich informierten Anlegern (With English summary), by T. Gehrig.

International portfolio diversification seems rather limited. While there may be a long list of potential mutually compatible explanations, this paper provides another often neglected but important factor: investors' information structure. It is argued that, in general, the asymmetry of information renders foreign stock holdings relatively more risky than domestic equity. Accordingly, investors' portfolio exhibit a bias toward domestic stock. *Schweizerische Zeitschrift für Volkswirtschaft und Statistik/Swiss Journal of Economics and Statistics*, September 1991, 127(3): 617–629. (Reprinted with permission of the *Journal of Economic Literature*).

International Asset Pricing and Equity Market Risk, by T.C. Chiang.

This paper presents a model to examine the behavioral relationship between the excess returns of foreign exchange and the variables that measure risk factor. The test results of four major currencies support the hypothesis that the excess exchange returns are related to the relative risks of the two national equity markets. The evidence validates the existence of a risk premium in foreign exchange markets. *Journal of International Money and Finance*, September 1992, 10(3): 349–364. (Reprinted with permission of the *Journal of Economic Literature*).

Evolution in Dynamic Linkages Across Daily National Stock Indexes, by P.D. Koch and T.W. Koch.

This article investigates how dynamic linkages among the daily rates of return of eight national stock indexes that evolved since 1972. A dynamic simultaneous equations model is estimated to describe the contemporaneous and lead/lag relationships across national equity markets over three different years: 1972, 1980, and 1987. Results reveal growing market interdependence within the same geographical region over time. While there are many significant intermarket relationships within the same twenty-four-hour period, there are few significant lagged responses across markets beyond twenty-four hours. This suggests a high degree of international market efficiency. Furthermore, Japan's market influence has been growing to rival that of the United States. *Journal of International Money and*

Finance, June 1991, 10(2): 231–251. (Reprinted with permission of the *Journal of Economic Literature*).

REAL ESTATE FINANCING AND INVESTING

Prix et rendements immobiliers: Construction d'indices pour les années 1980 (with English summary), by C. Zimmermann.

An index of real estate prices based on the observation of the stock prices of estate mutual funds is computed for the years 1980 to 1989. With 1.9 percent a year, the prices have not risen as much as many thought. This index is compared to the price of land and to the costs of residential construction, allowing to confirm that the rent market is constrained. The average earning from real estate (6.5 percent) is slightly higher than the theoretical earning from CAPM (5.05 percent), which may augur future price decreases. *Schweizerische Zeitschrift für Volkswirtschaft und Statistik/Swiss Journal of Economics and Statistics*, December 1991, 127(4): 735–753. (Reprinted with permission of the *Journal of Economic Literature*).

Fixed versus Variable Rate Financing: The Influence of Borrower, Lender, and Market Characteristics, by Lawrence G. Goldberg and Andrea J. Heuson (University of Miami).

Previous research has analyzed the problem faced by borrowers who must choose between fixed rate and variable rate loans when each loan carries different cost and risk characteristics and the borrowers face various income and employment prospects. In addition, the existing literature contains theoretical and empirical studies of how lenders react when given the ability to offer both fixed and variable rate financing. This article unifies the two strands of research to develop and test a model of the equilibrium proportion of variable rate lending. Results indicate that factors related to borrower, lender, and market characteristics are significant determinants of the equilibrium proportion of variable rate credit originated. *Journal of Financial Services Research*, May 1992, 1: 49–60. (Reprinted with permission of Kluwer Academic Publishers).

The Relationship Between the Demand and Supply of Home Financing and Neighborhood Characteristics: An Empirical Study of Mortgage Redlining, by George J. Benston (Emory University) and Dan Horsky (University of Rochester).

In this study the hypothesis that central cities are "redlined" was tested with data gathered from three separate central city and matching city-suburban areas. Potentially unmet mortgage demand was estimated from interviews of people who tried unsuccessfully to sell their homes. A hedonic price function revealed that these owners did not "overprice" their homes. However, they did not attribute their inability to sell to potential buyers' problems with financial institutions. A logit analysis of data provided by home buyers showed that individuals bought in the areas they preferred. We also found that central city and city-suburban home buyers got the type of mortgage they wanted at market terms and home owners in both areas had no difficulty in financing home repairs. *Journal of Financial Services Research*, February 1992, 5(3): 235–260. (Reprinted with permission of Kluwer Academic Publishers).

A General Equilibrium Model of Housing, Taxes, and Portfolio Choice, by James Berkovec (Federal Reserve Board) and Don Fullerton (University of Virginia and Carnegie Mellon University).

We describe a model in which rental and owner housing are risky assets, tenure choice is endogenous, and each household is constrained to consume the same amount of owner housing that it has in its investment portfolio. At each iteration in the search for an equilibrium, we determine the new taxable income for each of 3,578 households (from the Survey of Consumer Finances), and we use statutory schedules to find the marginal rate and tax paid. Equilibrium net rates of return are major determinants of the amount of owner housing, but a logit model indicates that demographic factors are the main determinants of ownership rates. In our simulation, taxes on owner housing would raise welfare not only by reallocating capital but also by the government's taking part of the risk from individual properties and diversifying it away. Measures to disallow property tax or mortgage interest deductions do not help share this risk. Simulations of the 1986 tax reform indicate a small shift from rental to owner housing and welfare gains from reallocating risk. *Journal of Political Economy*, April 1992, 100(2): 390–429. (Reprinted with permission of the University of Chicago Press).

STATISTICAL METHODOLOGY

Generalized Bankruptcy Models Applied to Predicting Consumer Credit Behavior, by Darral G. Clarke and James B. McDonald (Brigham Young University).

Although it is well known that many financial variables do not behave according to the assumptions of commonly used statistical methodologies, it has

been generally assumed that the robustness of these methodologies assures adequately accurate results. Recent work in the econometrics literature has explored the use of estimation methodologies that are appropriate for variables that do not have symmetric or normal distributions. This article explores the application of the EGB2 family of distributions to the problem of predicting bankruptcy and offering consumer credit. The distributions of the forecasts of good and bankrupt accounts violate many of the assumptions of the multiple discriminant analysis methodology used in most commercial bankruptcy forecasting models.

The importance of the criterion used to classify good and bankrupt accounts is also considered. Since there is a positive payoff to the correct classification of good accounts, minimizing the number or expected costs of misclassifications does not maximize the expected economic return.

The theoretical development is demonstrated on a data base of more than 16,000 observations of demographic and credit variables of bankrupt and solvent households. The performance of the various classification models is tested on a holdout sample of more than 11,000 observations. Although the generalized distribution is found to be statistically superior to discriminant analysis, the managerial importance of this superiority is seen to vary with the characteristics of the bankruptcy forecasting problem. *Journal of Economics and Business*, February 1992, 44(1): 47–62. (Reprinted with permission of North Holland Publishing Company).