FINANCIAL SERVICES REVIEW, 2(2): 157–168
ISSN: 1057-0810
Copyright © 1993 by JAI Press Inc.
All rights of reproduction in any form reserved.

Abstracts of Articles on Individual Financial Management

Edited by Phyllis Schiller Myers
Virginia Commonwealth University

CONSUMPTION-SAVINGS BEHAVIOR

The Timing of Intergenerational Transfers, Tax Policy, and Aggregate Savings, by David Altig (Federal Reserve Bank of Cleveland) and Steven J. Davis (University of Chicago).

We analyze an overlapping-generations framework that accommodates two observations: (i) the interest rate on consumption loans exceeds the rate of return to savings, and (ii) private intergenerational transfers primarily occur early in the life cycle. Assuming altruistically motivated transfers in at least some family lines and other plausible conditions, we prove the invariance of capital's steady-state marginal product to government debt, government expenditures, and the tax rates on labor and capital income. We show that the tax treatment of household interest payments has powerful effects on capital intensity and aggregate savings in life-cycle and, especially, altruistic linkage models. *The American Economic Review*, December 1992, 82(5): 1199–1220. (Reprinted with permission of *The American Economic Review.*)

The Impact of the Demographic Transition on Capital Formation, by A. J. Auerbach and L. J. Kotlikoff.

The population of the United States is aging. The authors review a variety of the implications this has for U.S. national saving rates and discuss the policy issues that they raise. After reviewing what different models would predict for household saving over the next several decades, they consider how the demographic transition may also affect national saving through changes in government behavior. Ways in which the composition of household saving might change as individuals age are also analyzed along with the implications of changes in government fiscal policy for asset composition. *Scandinavian Journal of Economics*, 1992, 94(2): 281–195. (Reprinted with permission of the *Journal of Economic Literature.*)

Time Constraints in Consumption and Savings Behavior, by Vito Tanzi and Howell H. Zee (International Monetary Fund, Washington, DC).

This paper investigates the implications for savings behavior of time constraints in consumption in a simple life-cycle model, and finds that some standard results in the literature on savings and taxation need to be modified. *Journal of Public Economics*, February 1993, 50(2): 253–259. (Reprinted with permission of North-Holland Publishing Company.)

Earnings Uncertainty and Precautionary Saving, by Luigi Guiso (Bank of Italy, Rome, Italy), Tullio Jappelli (Istituto Universitario Navale, Naples, Italy), and Daniele Terlizzese (Bank of Italy, Rome, Italy).

We test for the presence of precautionary saving using a self-reported measure of earnings uncertainty drawn from the 1989 Italian Survey of Household Income and Wealth. The effect of uncertainty on wealth accumulation is consistent with the theory of precautionary saving and with decreasing prudence, but explains only a small fraction of saving. The results cast doubts on the empirical relevance of precautionary saving in response to earnings uncertainty, but are not in contrast with the importance of the precautionary motive *per se*. Beside earnings uncertainty, other risks, such as health and mortality, may be important determinants of wealth accumulation. *Journal of Monetary Economics*, November 1992, 30(2): 307–337. (Reprinted with permission of North-Holland Publishing Company.)

Wealth Seeking Reconsidered, by Kai A. Konrad (University of Munich).

If individuals are interested in their *relative* wealth position, they engage in contests for wealth. This leads to a steady state with overaccumulation. In a simple growth model it is shown that, if some individuals are engaged in wealth seeking activity, but others are not, the latter might benefit. However, wealth seeking is not welfare enhancing under usual assumptions concerning production technology. The steady-state equilibrium is characterized by a marginal productivity of capital that is below the steady-state rate of time preference and by emergence of a class structure. *Journal of Economic Behavior and Organization*, July 1992, 18(2): 215–227. (Reprinted with permission of North-Holland Publishing Company.)

ESTATE PLANNING AND WEALTH TRANSFER

Saving, Wealth, and the Exchange-Bequest Motive, by W. A. Lord.

A model of exchange-motivated bequests based upon childrens' "attentions" to parents, provided when the children are young adults, is joined to a standard

life-cycle specification to examine the consequences for wealth and savings. The results of general equilibrium simulations show contribution to be far below some recent estimates. Exchange-motivated bequests produce offsets to life-cycle savings that limit their ability to increase total savings. *Canadian Journal of Economics*, August 1992, 25(3): 743–753. (Reprinted with permission of the *Journal of Economic Literature*.)

Patterns of Intergenerational Mobility in Income and Earnings,
by H. Elizabeth Peters (University of Colorado).

This paper characterizes the patterns of intergenerational mobility in the United States using data for matched parent/child pairs from the National Longitudinal Surveys. In general, what is found is far from the extremes of either perfect mobility or perfect immobility. Parents' log income explains only about 9% to 11% of the variation in children's log incomes. Earnings exhibit more mobility than does total income, and the difference is most striking for daughters. The paper also identifies the influence of family background characteristics on mobility. The addition of these background variables adds another three to five percentage points to the R^2 in the intergenerational earnings and income regressions. *The Review of Economics and Statistics*, August 1992, 74(3): 456–466. (Reprinted with permission of Elsevier Science Publishers B.V., North-Holland.)

INDIVIDUAL FINANCIAL MANAGEMENT

The Effect of Borrowing Constraints on Consumer Liabilities,
by Donald Cox (Boston College) and Tullio Jappelli (Instituto di Studi Economici, I.U.N., Naples).

This paper explores the effects of liquidity constraints on consumer liabilities. While much empirical evidence attests to the importance of liquidity constraints in the U.S. economy, evidence about the effects of borrowing constraints on consumer balance sheets is scarce. Using the 1983 Survey of Consumer Finances data we estimate desired borrowing for unconstrained households. We then evaluate the gap between predicted and observed debt for the sample of liquidity constrained consumers. Predicted debt is 75 percent higher than actual debt in the liquidity constrained sample. Thus, the effect of removing borrowing constraints has quantitatively important implications for the allocation of debt in the household portfolio. The removal of borrowing constraints would raise aggregate household liabilities by 9 percent. *Journal of Money, Credit, and Banking*, May 1993, 25(2): 197–213. (Reprinted with permission of *Journal of Money, Credit, and Banking*.)

Tax Timing with Liquidity Constraints: A Heterogeneous Agent Model, by Betty C. Daniel (State University of New York, Albany).

This paper considers the Ricardian Equivalence Hypothesis in a model in which some families face binding liquidity constraints and others do not. The source of heterogeneity which generates binding constraints in some families, but not in others, is shown to be the rate of intergenerational discount. In an economy populated by these two types of families, a change in tax timing has non-Ricardian short-run effects, but many Ricardian long-run effects. This implies that heterogeneous agent models can reconcile some of the conflicting empirical evidence on Ricardian Equivalence. *Journal of Money, Credit, and Banking*, May 1993, 25(2): 176–196. (Reprinted with permission of *Journal of Money, Credit, and Banking.*)

Aging and the Income Value of Housing Wealth, by Steven F. Venti and David A. Wise (National Bureau of Economic Research, Harvard University, Cambridge, MA).

The potential of reverse annuity mortgages to increase the current income of the elderly is analyzed. We conclude that most low-income elderly also have little housing equity. In general, a reverse annuity mortgage would substantially affect the income only of the single elderly who are very old—whose life expectancy is short. On the other hand, if the transfer were in the form of a lump-sum payment, rather than an annuity, the payment would increase the liquid wealth of most elderly families by a large fraction. Thus legislation that would facilitate the market for reverse mortgages could improve substantially the financial status of a small proportion of the elderly. *Journal of Public Economics*, April 1991, 44(3): 371–397. (Reprinted with permission of North-Holland Publishing Company.)

Predicting Personal Debt and Debt Repayment: Psychological, Social, and Economic Determinants, by Sonia M. Livingstone (London School of Economics and Political Science) and Peter K. Lunt (University College London, UK).

While personal debt has grown rapidly in the United Kingdom in recent years, posing problems for individuals, families and society, little empirical research has been conducted to date on everyday experiences of debt. The present paper reports on the findings of an in-depth survey of the social, economic and psychological factors related to debt. Discriminant function analysis and multiple regression analysis were used to address three questions: what discriminates debtors from nondebtors; what determines how far people get into debt; and what determines how much of their debts people repay? Sociodemographic factors were found to play a relatively minor role in personal debt and debt repayment. Disposable income did not differ between those in debt and not in debt, although it predicted how far people

were in debt and was most important in determining debt repayment. Attitudinal factors (being pro-credit rather than anti-debt, or seeing credit as useful but problematic) were found to be important predictors of debt and debt repayments. Further psychological factors, focusing on economic attributions, locus of control, coping strategies and consumer pleasure were found to be important, and a range of specific economic practices were also related to experiences of debt. *Journal of Economic Psychology*, 1992, 13: 111–134. (Reprinted with permission of North-Holland Publishing Company).

INTERNATIONAL FINANCIAL INVESTMENT ISSUES

Deviations from Purchasing Power Parity and Capital Flows,
by R. Uppal.

This article examines the implications of deviations from purchasing power parity for an investor's portfolio decision and the consequent capital flows in a two-country, intertemporal model with complete financial markets. In the presence of deviations from purchasing power parity, investors from different nations hold disparate portfolios and the equilibrium that results is not a pooling one. The author solves explicitly for asset demands and derives the relationship between the direction of capital flows and deviations from purchasing power parity. In contrast to the small country assumption in the existing literature, the world interest rate in this model is determined endogenously. *Journal of International Money and Finance*, April 1992, 11(2): 126–144. (Reprinted with permission of the *Journal of Economic Literature*.)

Portfolio Preference Uncertainty and Gains from Policy Coordination, by P. R. Masson.

International policy coordination is generally considered to be made less likely—and less profitable—by uncertainty about how the economy works. This paper offers a counter example in which investors' increased uncertainty about portfolio preference makes coordination more beneficial. Without such coordination, monetary authorities may respond to financial market uncertainty by not fully accommodating demands for increased liquidity for fear of inducing exchange rate depreciation. Coordinated monetary expansion would minimize this danger. This result is formalized in a model incorporating an equity market; then, the stock market crash of October 1987 and its implications for monetary policy coordination are discussed. *International Monetary Fund Staff Papers*, March 1992, 39(1): 101–120. (Reprinted with permission of the *Journal of Economic Literature*.)

Determinants of International Financial Services, by Fariborz Moshirian (The University of New South Wales, Sydney, Australia).

This paper analyzes the determinants of international financial services. It argues that the main difficulty in obtaining data about international financial services is the consequence of the current treatment of financial services in the System of National Accounts (SNA) of the United Nations which treats the imputed service charge as 'intermediate consumption of industries.' The empirical results of import and export demands for financial services indicate that disposable income, domestic and foreign price of financial services are the important determinants of international financial services flows. *Journal of Banking and Finance*, February 1993, 17(1): 7–18. (Reprinted with permission of North-Holland Publishing Company.)

INVESTMENT SELECTION AND INDIVIDUAL PORTFOLIO MANAGEMENT

Optimal Portfolio Selection Without Short Sales Under the Full-Information Covariance Structure: A Pedagogic Consideration, by Clarence C. Y. Kwan and Yufei Yuan (McMaster University, Hamilton, Canada).

This study considers a portfolio optimization problem without short sales under the full-information covariance structure of security returns from a pedagogic perspective. By applying Markowitz's (1956, 1959, 1987) critical line algorithm to Lintner (1965) tangency portfolios, it offers a solution method which is algebraically simpler than Markowitz's original formulation. It also illustrates that the use of spreadsheets is a convenient alternative to traditional forms of computer programming in the implementation of a small-scale analysis on microcomputers. Doing so makes the Markowitz analysis more accessible to finance students and practitioners in portfolio management. *Journal of Economics and Business*, February 1993, 45(1): 91–98. (Reprinted with permission of the *Journal of Economics and Business.*)

Stock Prices and Bond Yields: Can their Comovements be Explained in Terms of Present Value Models?, by Robert J. Shiller (Yale University) and Andrea E. Beltratti (University of Turin, Italy).

Real stock prices do not show the relation to long-term interest rates that a simple rational expectations present value model would imply. Real stock prices drop when long-term interest rates rise (and rise when they fall) more than would be implied by this vector autoregression model. In contrast, over the last century changes in real stock prices have shown little correlation with changes in inflation

rates, and according to the present value model they should show little correlation. These conclusions were reached from an analysis of annual data in the United States, 1871–1989, and the United Kingdom, 1918–1989. *Journal of Monetary Economics*, October 1992, 30(1): 25–46. (Reprinted with permission of North-Holland Publishing Company.)

Macroeconometrics of Stock Price Fluctuations, by Dewan A. Abdullah and Steven C. Hayworth (Eastern Michigan University).

This paper employs Granger causality tests and Sims' innovation accounting to explain fluctuations in monthly stock returns within a vector autoregressive framework. The results show that past money growth, budget deficits, inflation, and both short-and long-term interest rates are Granger causal prior to stock returns. These variables also explain a substantial proportion of the forecast error variance of stock returns. It is found that stock returns are related positively to inflation and money growth and negatively to budget deficits, trade deficits, and both short- and long-term interest rates, as economic theory would predict. *Quarterly Journal of Business and Economics*, Winter 1993, 32(1): 50–67. (Reprinted with permission of *Quarterly Journal of Business and Economics*.)

Did Regulatory Actions Discourage Consumer Demand for Treasury Bills?, by Harold A. Black (University of Tennessee) and Robert L. Schweitzer (University of Delaware).

This paper studies the demand for Treasury bills by consumers during each period of significant regulatory change intended to discourage such demand. The results show that there were significant changes in the structure of the public's demand, although the changes were not always in the direction intended by the regulatory authorities. *Journal of Banking and Finance*, February 1993, 17(1): 19–26. (Reprinted with permission of North-Holland Publishing Company.)

Initial Public Offerings of Equity Securities: Anomalous Evidence Using REITs, by Ko Wang and Su Han Chan (California State University, Fullerton) and George W. Gau (University of Texas).

In contrast with numerous studies that find significant underpricing for initial public offerings of industrial firms, we document a statistically significant average return of –2.82% on the first trading day for a sample of 87 initial public offerings of real estate investment trusts during the 1971–1988 period. Our overpricing result is invariant to offer price, issue size, distribution method, offer period, and underwriter reputation. Newly issued REITs, on average, substantially underperform a matching sample of seasoned REITs during the first 190 trading days. Interestingly,

buyers of overpriced REITs are predominantly individual or non-13(f) institutional investors. *Journal of Financial Economics*, June 1992, 31(3): 381–410. (Reprinted with permission of North-Holland Publishing Company.)

Introducing Risky Housing and Endogenous Tenure Choice into a Portfolio-Based General Equilibrium Model, by Patric H. Hendershott and Yunhi Won (Ohio State University).

Portfolio-based general equilibrium models are useful for analyzing the interaction between the structure of individual tax rates and the way particular assets are taxed, for considering the role of differential tax rules and risk in determining household portfolio choices, and for addressing distributional questions. Unfortunately, current versions of these models give housing short shrift; owner housing is assumed to be riskless, rental housing is not a separately identifiable asset, and tenure choice is of necessity exogenously determined. This paper extends one of these models to incorporate a full housing subsector and uses the model to analyze the impact of the U.S. 1986 Tax Reform Act. *Journal of Public Economics*, August 1992, 48(3): 293–316. (Reprinted with permission of North-Holland Publishing Company.)

Portfolio Rebalancing and the Effective Taxation of Dividends and Capital Gains Following the Tax Reform Act of 1986, by Mark Fedenia (University of Wisconsin-Madison) and Theoharry Grammatikos (European Investment Bank, Luxembourg).

The Tax Reform Act (TRA) of 1986, among other things, equalized the nominal taxation of dividend and capital gains income. The evidence is consistent with the hypothesis that ordinary investors rebalanced their portfolio holdings in response to the new taxes. Such rebalancing appears to have concentrated on liquid stocks indicating that transaction costs are an important consideration for ordinary investors involved in restructuring their portfolio holdings. The tax clientele relationships that existed prior to the new Act were distorted temporarily but have reappeared by 1988. Interestingly, investors' post-reform effective tax rates still give a preference to capital gains as they did prior to the tax reform. *Journal of Banking and Finance*, June 1991, 15(3): 501–519. (Reprinted with permission of North-Holland Publishing Company.)

Towards an Equilibrium Model of the Mutual Funds Industry, by Jean Dermine, Damien Neven (INSEAD Fontainebleau, France), and Jacques F. Thisse (CORE, Louvain-La-Neuve, Belgium).

We 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, we model competition between mutual funds as a non-cooperative game in which funds select their

portfolios. We show that a small number of funds suffices to ensure a Pareto superior equilibrium. *Journal of Banking and Finance*, June 1991, 15(3): 485–499. (Reprinted with permission of North-Holland Publishing Company.)

Bayesian and CAPM Estimators of the Means: Implications for Portfolio Selection, by Philippe Jorion (Columbia University).

This paper compares active investment policies under three alternative models for estimating expected stock returns: the historical sample mean, a shrinkage or Bayesian estimator and a CAPM-based estimator. The out-of-sample performance of actively managed U.S. industry portfolios is analyzed for these three estimators over the period 1931 to 1987.

It is found that the classical method, based on historical means and covariances, leads to the worst forecasts and out-of-sample performance, and is generally outperformed by shrinkage estimators. An active portfolio with expected returns based on the CAPM produced the best results among all actively managed portfolios; this strategy, as we show, closely matches a simple buy-and-hold the market rule. *Journal of Banking and Finance*, June 1991, 15(3): 717–727. (Reprinted with permission of North-Holland Publishing Company.)

The Dividend-Clientele Controversy and the Tax Reform Act of 1986, by Douglas Hearth and James N. Rimbey (University of Arkansas).

Several recent studies employ the Tax Reform Act of 1986 (TRA) to reexamine the dividend tax clientele hypothesis. Because TRA effectively equalized the rate of taxation between dividends and capital gains, its implementation should provide a platform for resolving this controversy. Instead, reported results remain sharply divergent. This study attempts to shed new light on the dividend-clientele question through use of a method that carefully matches pre- and post-TRA dividend activity and avoids problems associated with the distribution of data. No significant or systematic changes in the ex-dividend price behavior of common stocks as a result of the Tax Reform Act of 1986 are reported. *Quarterly Journal of Business and Economics*, Winter 1993, 32(1): 68–81. (Reprinted with permission of *Quarterly Journal of Business and Economics*.)

Why Don't Individuals Speculate in the Forward Foreign Exchange Market? by C. A. E. Goodhart and M. P. Taylor.

It is shown, using institutional evidence, economic theory, and empirical evidence, that, given reasonable estimates of individuals' coefficients of relative risk aversion, the combination of riskiness, minimal size of contract, and transactions costs will deter all but the wealthiest individuals from seeking to speculate in the forward foreign exchange market. *Scottish Journal of Political Economy*,

February 1992, 39(1): 1–13. (Reprinted with permission of the *Journal of Economic Literature.*)

MUTUAL FUND PERFORMANCE

Hot Hands in Mutual Funds: Short-Run Persistence of Relative Performance, 1974–1988, by Darryll Hendricks, Jayendu Patel, and Richard Zeckhauser (Harvard University).

The relative performance of no-load, growth-oriented mutual funds persists in the near term, with the strongest evidence for a one-year evaluation horizon. Portfolios of recent poor performers do significantly worse than standard benchmarks; those of recent top performers do better, though not significantly so. The difference in risk-adjusted performance between the top and bottom octile portfolios is six to eight percent per year. These results are not attributable to known anomalies or survivorship bias. Investigations with a different (previously used) data set and with some post-1988 data confirm the find of persistence. *The Journal of Finance,* March 1993, 48(1): 93–130. (Reprinted with permission of *The Journal of Finance.*)

REAL ESTATE INVESTMENT

Reducing Taxes on the Disposition of a Personal Residence With Acreage, by Michael M. Megaard (Lukins and Annis, Spokane, WA) and Susan L. Megaard (Eastern Washington University).

After the rules for deferring gain under Section 1034 and excluding gain under Section 121 on dispositions of a personal residence are explained, the focus is on how to use these sections in combination to minimize taxes where a home is sold with acreage in one transaction or in separate parcels. *The Journal of Real Estate Taxation,* Spring 1993, 20(3): 269–284. (Reprinted with permission of *The Journal of Real Estate Taxation.*)

Planning for the "Temporary Rental" of a Principal Residence, by Cynthia E. Bird (California State University, San Bernardino).

The tax consequences of a rental of a personal residence are discussed and suggestions are made with regard to structuring the rental to maximize the tax benefits during the rental period and preserve the opportunity for deferral of gain on disposition. *The Journal of Real Estate Taxation,* Winter, 1993, 20(2): 135–148. (Reprinted with permission of *The Journal of Real Estate Taxation.*)

An Empirical Analysis of Housing Price Appreciation in a Market Stratified by Size and Value of the Housing Stock, by J. Allen Seward, Charles J. Delaney (Baylor University) and Marc T. Smith (University of Florida).

This paper examines the relationship between house size and appreciation, and house value and appreciation evidenced in the date collected from a single geographic region. The analysis of the data suggests that high price housing appreciates at a more rapid rate than low and medium price housing during expansionary periods, and there is no statistical difference in the rates of price change in contractionary periods. Further, the rate of price change for larger homes exhibits no consistent difference from the rate of change for small and medium size housing for the time period studied. *The Journal of Real Estate Research,* Spring 1992, 7(2): 195–205. (Reprinted with permission of *The Journal of Real Estate Research.*)

TAXATION

Is the Child Care Credit Progressive? by A. Dunbar and S. Nordhauser.

The child care credit has been widely perceived as regressive because critics claim that more credit is claimed by high-income taxpayers than low-income taxpayers. The credit was changed in 1981 in an effort to make it more progressive. Nevertheless, the perception that the credit is regressive persists. This paper applies three measures of tax progressivity to a sample of taxpayer data to determine whether the child care credit was regressive during 1979–86 and whether changes made in 1981 made it more progressive. The conclusion is that the credit was progressive over the entire period, becoming more progressive after 1981. *National Tax Journal,* Part 2, December 1991, 44(4): 519–528. (Reprinted with permission of the *National Tax Journal.*)

Capital Gains Tax and Equity Values: Empirical Test of Stock Price Reaction to the Introduction and Reduction of Capital Gains Tax Exemption, by Ben Amoako-Adu (Wilfrid Laurier University, Waterloo, Canada), M. Rashid (University of New Brunswick, Canada) and M. Stebbins (Mount Saint Vincent University, Halifax, Canada).

This paper evaluates the differential effect on stock prices of the introduction in Canada of $500,000 capital gains tax exemption and the reduction of this limit to $100,000 two years later. Using the seemingly unrelated regression methodology and controlling for thin-trading and heteroscedasticity, the empirical evidence indicates that the changes in capital gains tax laws has a differential effect on

low-dividend yield and high-dividend yield stocks on both occasions. While the evidence indicates that the stock market anticipated the 1985 capital gains tax law changes, the significant market reaction to the 1987 reduction of the exemption occurred a day before and after the reading of the tax reform proposals in Parliament. Thus, it can be inferred from the results that, despite the presence of tax-sheltering opportunities in Canada, changes in capital gains tax laws affect equity values. *Journal of Banking and Finance*, April 1992, 16(2): 275–287. (Reprinted with permission of North-Holland Publishing Company).