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Abstracts of Articles on Individual Financial Management

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CONSUMPTION-SAVINGS BEHAVIOR

Credit Cards and Household Demand for Monetary Assets: A Cross-Sectional Study, by John V. Duca (Federal Reserve Bank of Dallas) and William C. Whitesell (Board of Governors of the Federal Reserve System)

This study investigates credit card holdings and the household demands for several monetary assets in a simultaneous equations framework. It exploits the detailed data on household assets, as well as demographic and preference characteristics in the 1983 Survey of Consumer Finances. A key finding is that, consistent with theory, a higher probability of credit card ownership implies lower demand for transaction balances with no effect on small time deposit balances. *Journal of Money, Credit and Banking,* May 1995, 27(2): 604–623. (Reprinted with permission of the *Journal of Money, Credit and Banking.*)

Are Rising Earnings Profiles A Forced-Saving Mechanism? by David Neumark

This paper tests the hypothesis that rising earnings profiles are a mechanism by which individuals engage in forced saving. It does this by examining the cross-sectional relationship between overwithholding on income tax payments—behaviour that is consistent with a preference for forced saving—and the slopes of age-earnings profiles. The forced-saving hypothesis receives support from earnings regression estimates. Individuals who receive tax refunds are on earnings profiles that are significantly steeper and have significantly lower intercepts. *The Economic Journal,* January 1995, 105(428): 95–106. (Reprinted with permission of *The Economic Journal.*)

The Dynamics of Aggregate Consumption in an Open Economy Life Cycle Model, by J. Ermisch and P. Westaway

This paper examines the dynamic path of aggregate consumption resulting from the relaxation of borrowing constraints and changes in the age composition of the population.

Using simulation analysis, it indicates that, because of overlapping generations, the adjustment to a new steady-state aggregate consumption-income ratio following the relaxation of borrowing constraints is spread over a long time and it takes the form of a near linear fall following the immediate jump in the ratio. While potentially large, age composition changes have small effects on the aggregate consumption-income ratio when plausible parameter values are assumed. *Scottish Journal of Political Economy*, May 1994, 41(2): 113–127. (Reprinted with permission of the *Journal of Economic Literature*.)

INVESTMENTS AND INDIVIDUAL PORTFOLIO MANAGEMENT

Optimal Portfolio and Consumption Decisions in a Stochastic Environment with Precommitment, by Isaac Ehrlich and William A. Hamlen, Jr. (State University of New York, Buffalo)

In this paper we solve the stochastic portfolio-consumption control problem under the assumption that individuals follow precommitment strategies over finite intervals of time. This precommitment approach is an alternative to Merton's (1969) continuous-time stochastic dynamic control problem which assumes instantaneous feedback and costless revisions of choices all along the time path. Our solution to the problem is contrasted with that of Merton and several contributions to the subject. We show that under precommitment individuals will tend to hold portfolios that are a function of their expected risk and return parameters, but are independent of their wealth levels and risk preferences. We also show that the intertemporal consumption growth path would be a relatively smooth function of the risk-free rate of return, time preference, and the coefficient of relative risk aversion, and independent of the portfolio's risk parameters. The latter would influence only the initial consumption level. We derive a number of empirical implications of our analysis for both portfolio holding and consumption patterns. *Journal of Economic Dynamics and Control*, April 1995, 19(3): 457–480. (Reprinted with permission of the North-Holland Publishing Company.)

Individual Decision Making in an Investment Setting, by Carl A. Kogut (Northeast Louisiana University) and Owen R. Phillips (University of Wyoming, Laramie)

This paper examines individual decision making in an experimental investment setting. When individuals make payments sequentially in order to complete an investment project their decision to continue investing should, according to standard theory, be based on a comparison of the expected marginal costs and gains. Past payments are sunk and should be ignored. Our experimental subjects usually did not make the correct decision at the margin when positive returns were threatened. There was an overwhelming tendency to over-commit resources. *Journal of Economic Behavior and Organization*, December 1994, 25(3): 459–471. (Reprinted with permission of North-Holland Publishing Company.)

The Challenges of Investor Communication: The Case of CUC International, Inc., by Paul M. Healy (Sloan School of Management, Cambridge, MA) and Krishna G. Palepu (Harvard University)

We examine investor communication issues using the experience of CUC International. CUC had difficulty convincing investors that its marketing outlays were profitable investments, leading to stock misvaluation over an extended period. To resolve this problem, CUC adopted an accounting change and then underwent a leveraged recapitalization. Subsequently, it accelerated recap debt repayments and initiated a stock repurchase. CUC's experience suggests that accounting reports are not always effective in investor communication. While financial signals are more effective, their impact is not as immediate as predicted by prior research. The CUC case suggests that investor communications is a rich area for future research. *Journal of Financial Economics*, June 1995, 38(2): 111–140. (Reprinted with permission of North-Holland Publishing Company.)

Some Models of the International Capital Market, by B. Dumas

The original feature of international portfolio theory is that it considers investors of different countries who look at returns differently from each other because of deviations from purchasing power parity. Its purposes are to explain the different portfolio compositions of investors of different countries and to explain the structure of expected returns across securities worldwide. The author shows here that this theory fails on the first count (home equity bias) but may still have some potential on the second count. He also discusses some results of general-equilibrium models of the international economy that incorporate frictions. *European Economic Review*, April 1994, 38(3–4): 923–931. (Reprinted with permission of the *Journal of Economic Literature*.)

INVESTMENT PERFORMANCE

Signaling Theory and Risk Perception: An Experimental Study, by Haim Levy (Hebrew University) and Esther Lazarovich-Porat (University of Florida and Hebrew University)

Theoretical models provide unsatisfactory solutions to many issues in finance and economics. For some important issues, signaling theory bridges the gap between the theoretical solutions and the firm's actual behavior. However, many of the signaling theories are difficult, if not impossible, to test empirically.

In this paper, we provide experimental tests of one of the signaling theories. We test the hypothesis that the larger the proportion of entrepreneur participation in a project, the higher is its stock prices, as determined in an auction. The results strongly support the hypothesis. *Journal of Economics and Business*, February 1995, 47(1):39–56. (Reprinted with permission of North-Holland Publishing Company.)

The Impact of Calls of Preferred Stock on Common Shareholders' Wealth, by Archana Hingorani, Anil K. Makhija and Kuldeep Shastri (University of Pittsburgh)

This paper examines the behavior of common stock prices around the announcement dates of calls of straight and convertible preferred stock. Our results indicate that calls of in-the-money convertibles are associated with stock price increases. In addition, our results indicate that the negative price impact of in-the-money calls is related to the reduction in cash dividend payout induced by the conversion of preferred stock to common stock, and not related to whether the call is underwritten or not, and the "moneyness" of the convertible preferred. Finally, we find that calls of straight preferred that are financed with debt result in an increase in stock price, while all other straight preferred calls have no impact on stock price. *Journal of Banking and Finance*, December 1994, 18(6): 1095–1111. (Reprinted with permission of North-Holland Publishing Company.)

Forward Exchange Bias, Hedging and the Gains from International Diversification of Investment Portfolios, by H. Levy and K. C. Lim

The gains to the U.S. investor from international diversification of investment portfolios are examined for portfolio strategies that hedge and strategies that do not hedge exchange-rate risk via the interbank forward market. Using the Sharpe Performance Index and stochastic dominance as performance measures, almost all the unhedged strategies outperformed the hedged strategies for 1985–88; the opposite held for 1981–84. The results are explained by the biasedness of forward rates in predicting future spot rates. *Journal of International Money and Finance*, April 1994, 13(2): 159–170. (Reprinted with permission of the *Journal of Economic Literature*.)

INDIVIDUAL RISK MANAGEMENT AND INSURANCE DECISIONS

The Effects of Household Characteristics on Demand for Insurance: A Tobit Analysis, by Vince E. Showers and Joyce A. Shotick (Bradley University)

Tobit analysis is used to analyze the impact of household characteristics on demand for total insurance. This approach examines the marginal change in demand for insurance, as well as the change in the probability of purchasing insurance. Demand effects are dominated by the marginal impacts from existing purchasers of insurance. Although income and number of earners are both positively related to the demand for insurance, the marginal effect from an increase in income is greater for single-earner households than for multi-earner households. Also, as either family size or age increases, the marginal increase in insurance expenditure diminishes. *The Journal of Risk and Insurance*, September 1994, 61(3): 492–502. (Reprinted with permission of *The Journal of Risk and Insurance*.)

REAL ESTATE ISSUES

Apartment Rent, Concessions and Occupancy Rates, by G. Stacy Sirmans (The Florida State University), C. F. Sirmans (University of Connecticut) and John D. Benjamin (The American University)

This paper examines the effects of rental concessions on apartment rent and occupancy rates. Using limited-information maximum likelihood estimation, equations for rent, occupancy and concessions have a positive effect on both rent and occupancy rates. Rental concessions seem to provide the landlord a means to collect higher average rent and at the same time to increase occupancy rates. The results also indicate that a negative relationship exists between rent and occupancy rates and that certain amenities, services and occupancy restrictions influence rent. *The Journal of Real Estate Research*, Summer 1994, 9(3): 299–312. (Reprinted with permission of *The Journal of Real Estate Research.*)

The Thrift Crisis, Mortgage-Credit Intermediation, and Housing Activity, by Michael G. Bradley, Stuart A. Gabriel, and Mark E. Wohar

This paper evaluates the influence of periodic disruptions in the thrift industry on mortgage credit intermediation and housing activity. Results of the analysis indicate that disruptions in the thrift industry during the early 1980s imposed real costs on the economy by reducing the amount of mortgage credit intermediation. Estimation findings indicate a sizable mortgage interest rate premium stemming from the loss in thrift intermediation services during the early 1980s. Those higher mortgage rates served to dampen housing demand, in turn exacerbating the cyclical decline. In contrast, empirical findings for the post-recession period of the 1980s indicates a severing of the link between mortgage interest rates and thrift provision of mortgage credit. *Journal of Money, Credit and Banking*, May 1995, 27(2): 476–497. (Reprinted with permission of the *Journal of Money, Credit and Banking.*)

Differentiated Contracts, Heterogeneous Borrowers and the Mortgage Choice Decision, by J. Sa-Aadu (University of Iowa) and C. F. Sirmans (University of Connecticut)

Previous analyses of mortgage choice assume that ARMs are standard contracts and estimate bivariate models. We estimate a multinomial logit model that explicitly treats mortgages as differentiated contracts and provide insights on several important issues: the impact of price variables differs significantly across alternative mortgage contracts; borrower heterogeneity, particularly mobility, influences the type of contract chosen; and borrowers respond to market conditions as expected when choosing between alternative mortgage contracts. *Journal of Money, Credit and Banking*, May 1995, 27(2): 498–510. (Reprinted with permission of the *Journal of Money, Credit and Banking.*)

Dwellings for the Severely Mentally Disabled and Neighborhood Property Values: The Details Matter, by G. Galster and Y. Williams

This research investigates the effects of dwellings occupied exclusively by severely mentally disabled tenants on sale prices of nearby homes. Hedonic price models are estimated for an exhaustive sample of single-family home sales from 1989 to first quarter 1992 in Newark and Mt. Vernon, Ohio. Proximity within two blocks of rehabilitated dwellings occupied by severely mentally disabled tenants had no significant relationship with sales prices. Prices of homes proximate to two small, newly constructed apartment complexes were 40 percent lower after the complexes opened, although those near three other similar apartment complexes were not. *Land Economics*, November 1994, 70(4): 466–477. (Reprinted with permission of the *Journal of Economic Literature.*)

TAXATION

The Influence of Ethical Attitudes on Taxpayer Compliance, by Phillip M. J. Reckers (Arizona State University), Debra L. Sanders (Washington State University, Pullman) and Stephen J. Roark (Missouri Southern State College)

The development of tax decision-making models has focused on economic and behavioral factors affecting compliance. A possible explanatory factor that has been overlooked in these decision-making models is tax ethical beliefs. This study examines the influence of ethical beliefs on tax compliance decisions. Specifically, the research empirically tests whether an individual's ethical beliefs about tax compliance mediate withholding effects (overwithheld or tax due) and tax rate effects (low or high) in tax evasion decisions. The results indicate that tax ethics are highly significant in tax evasion decisions and may be a "missing variable" in decision making models. *National Tax Journal*, December 1994, XLVII (4): 825–836. (Reprinted with permission of the *National Tax Journal.*)