

Stock Market Investing Is a Family Affair

BY DANIEL BROOKS

“Information Sharing and Stock Market Participation: Evidence from Extended Families.” Geng Li, Federal Reserve Board Finance and Economics Discussion Series 2009-47, September 2009.

In this paper, Geng Li of the Federal Reserve Board of Governors suggests that sharing of information about the stock market between members of a family plays a large role in influencing each family member’s stock market participation. Existing literature along these lines tends to focus on the transmission of knowledge from parents to children. Li suggests that the relevant transmission mechanism is a two-way street and parents can learn from the stock market experiences of their children.

Li concludes that whether a parent or child had entered the stock market during the previous five years increases by 30 percent the chances that a member of that same family will enter the stock market within the next five to six years. Additionally, even investors older than 65 years of age — a group often found to have lower stock ownership generally — are significantly influenced by their children’s past stock investment. Information sharing among siblings, however, doesn’t seem to influence stock market entry in a statistically significant way. To show that the phenomenon observed isn’t just a coincidence — or that it’s simply a reflection of members of a family having similar preferences — Li studied the sequence of stock market entry among family members. If the entry was simply a matter of upbringing, he argues, you might see each member of the family enter the stock market at similar stages of their respective life cycles. Instead, Li’s analysis implies that the entry of one family member will positively influence the entry decision of another member who is at a very different stage in his life cycle.

Li concludes his analysis with a discussion of whether any of this can be explained by simple “herd” behavior. He looks at stock market exits by the same family members. As it turns out, exit of one family member does not necessarily precipitate the exit of others, suggesting that herd behavior does not dominate and lends credence to the idea that information sharing between family members is a more potent motivator of stock market investment decisions.

“Boomerang Kids: Labor Market Dynamics and Moving Back Home.” Greg Kaplan, Federal Reserve Bank of Minneapolis Working Paper No. 675, October 2009.

Stories in the popular press have provided anecdotal accounts of “boomerang kids.” These are young adults

who have moved back in with their parents after having initially moved out of the home. Greg Kaplan of the Minneapolis Fed looks at not only the empirical prevalence of this phenomenon but also how economic activity may affect such choices.

Kaplan examined the National Longitudinal Survey of Youth 1997. This survey provides information on labor market behavior and educational outcomes, as well as detailed information on the youths’ family and community background. Kaplan’s paper examines a sample of young adults who completed high school but did not attend college. Among that group, about 51 percent of males and 49 percent of females returned home for at least one month by age 23.

The intensity of the boomerang effect was strongly related to trends in the labor market. Males who moved out, became employed, and then unemployed were 64 percent more likely to return home than those who remain employed. For females in the same situation, the figure was 72 percent. Kaplan suggests that a careful examination of the movement characteristics of the college educated would be a useful addition to his paper and to the anecdotal reports that have largely focused on this group.

“The Long Run Effects of Changes in Tax Progressivity.” Daniel R. Carroll and Eric R. Young, Federal Reserve Bank of Cleveland Working Paper 09-13, December 2009.

Previous studies often lend support to the notion that flattening the tax code — in essence, making the income tax less progressive — would result in gains for the economy. These gains tend to be a result of more efficient allocations of capital.

Daniel Carroll of the Cleveland Fed and Eric Young of the University of Virginia have constructed a model in which households can more fully insure against economic risk, a feature missing from many previous models. (An example of such insurance might be the ability to borrow in the present based on expected future income.) They find that in such a world more progressive, though revenue-neutral, tax schedules can actually lead to steady states with as much as 47 percent and 40 percent *greater* capital and labor input, respectively. Progressivity increases labor output in simulations of their model because it reallocates labor from less productive to more productive agents — and this is true despite a decrease in the total number of hours worked. Carroll and Young also find that increased progressivity generally lessens income inequality but raises wealth inequality. **RF**