ELSEVIER

Journal of International Economics 54 (2001) 309–331

Journal of
INTERNATIONAL
ECONOMICS

www.elsevier.nl/locate/econbase

The human capital of stockholders and the international diversification puzzle

Ignacio Palacios-Huerta*

Brown University, Department of Economics, Box B., Providence, RI 02912, USA

Received 22 October 1999; received in revised form 27 November 2000; accepted 29 November 2000

Abstract

This paper evaluates the extent of the international diversification puzzle when human capital is considered part of the wealth of nations. The analysis examines whether (i) the inclusion of human capital in the wealth of portfolio of individuals, (ii) the different human capital assets held by stockholders and non-stockholders, and (iii) frictions in human capital markets, can help explain the puzzle. The methodology consists of comparing Hansen–Jagannathan bounds on the stochastic discount factor (IMRS) implied by human capital and financial returns across different countries. The results suggest that the information contained in the human capital of stockholders can greatly contribute towards explaining the international diversification puzzle. © 2001 Elsevier Science B.V. All rights reserved.

Keywords: International diversification; Human capital; Stockholders; Asset returns, Discount factors

JEL classification: F39; G12; G15; J24

1. Introduction

The ‘‘international diversification puzzle’’ observes that investors hold too little of their financial wealth in foreign securities and that potential benefits from diversification exist. U.S. investors hold more than 90 percent of their financial assets in the form of domestic securities. In the United Kingdom, Germany, and Japan, for instance, the share of domestic financial assets in investors’ financial

*Tel.: +1-401-863-2691; fax: 1-401-863-1970.
E-mail address: ipalacios@brown.edu (I. Palacios-Huerta).

0022-1996/01/$ – see front matter © 2001 Elsevier Science B.V. All rights reserved.
PII: S0022-1996(01)00104-0

wealth portfolios exceeds 85 percent. Similar numbers are also observed for a variety of other countries. Using existing models of investment and portfolio diversification, the evidence reported in several studies indicates the existence of a significant ''home bias'' in international financial markets. Although these markets have experienced a very significant growth and a substantial increase in their levels of integration during the last few decades, the low existing levels of international diversification of financial wealth are still considered to be one of the most intriguing and elusive puzzles in international economics and finance.

Different classes of potential explanations have been discussed in the literature. Among these are institutional barriers, transaction costs and explicit limits on cross-border investments.[1] However, as French and Poterba (1991) discuss, all of these ''are unlikely to explain the low levels of cross-border equity investment today'' and the ''apparent tendency for portfolio *investors* to overweight *their* own equity market'' appears to be ''the result of *investors* choices, rather than constraints'' (italics added). Two recent papers by Baxter and Jermann (1997) and Bottazzi et al. (1996) suggest that one potentially crucial piece of this puzzle that has been consistently ignored in the literature is the role of human capital, an asset which is the largest component of the wealth portfolio of individuals and countries.[2] Given the dominant position of this asset in individual and aggregate wealth, it is important to evaluate how human capital affects the international diversification puzzle. The initial results that these authors obtain, however, are inconclusive and divergent for the role of human capital assets in this puzzle.[3]

A common procedure in the literature is to examine the home bias puzzle at the aggregate level. Interestingly enough, most individuals hold few or no stocks and, as French and Poterba (1991) remark, the puzzle appears to be the result of *investors'* choices. Given this heterogeneity in the population, this paper focuses on the analysis of the puzzle with human and financial assets at a basic disaggregated level. More precisely, the analysis evaluates whether the human capital of stockholders, rather than aggregate human capital, may help us understand the weak extent of international financial diversification of equity investments. The analysis initially examines the extent to which two aspects of the puzzle are important: the measurement of human capital returns and the asset

[1] See Lewis (1999) for a comprehensive review and assessment of the literature.

[2] Human capital assets account for more than two-thirds of the wealth of the United States and other developed countries. Indeed, only the share of labor in the compensation of the typical firm and in GNP already accounts for about 70 percent (see Becker (1993) and Jorgenson and Fraumeni(1989)).

[3] The first paper examines the extent of the puzzle in the United States, the United Kingdom, Germany and Japan considering human capital, as a nontradable asset, part of the wealth portfolio of these countries. They use fundamentals-based *physical* capital returns and find that the puzzle is *deepened*. The reason is that their measure of human capital returns are highly correlated with their physical capital returns and, hence, hedging human capital risk involves a short position in domestic physical capital. Bottazzi et al. (1996) obtain similar results using fundamentals-based returns but find that human capital *helps* to explain the home bias when using security market returns.

متن کامل مقاله ← دریافت فوری

ISIArticles
مرجع مقالات تخصصی ایران

- ✓ امکان دانلود نسخه تمام متن مقالات انگلیسی
- ✓ امکان دانلود نسخه ترجمه شده مقالات
- ✓ پذیرش سفارش ترجمه تخصصی
- ✓ امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
- ✓ امکان دانلود رایگان ۲ صفحه اول هر مقاله
- ✓ امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
- ✓ دانلود فوری مقاله پس از پرداخت آنلاین
- ✓ پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات