Journal of Empirical Finance 38 (2016) 103–119

Contents lists available at ScienceDirect

Journal of Empirical Finance

journal homepage: www.elsevier.com/locate/jempfin

Immigrant-native differences in stockholding – The role of cognitive and non-cognitive skills

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ARTICLE INFO

Article history:
Received 1 December 2015
Received in revised form 21 May 2016
Accepted 27 May 2016
Available online 1 June 2016

JEL classification:
D14
G02
G11
J61

Keywords:
Stockholding
Immigrants
Personality traits
Decomposition

ABSTRACT

This paper provides new evidence on immigrant-native differences in financial behavior. We use data from the Health and Retirement Study (HRS). Although looking at long-term immigrants, we find a substantial gap in stockholding between immigrant and native households. Estimates from a probit model suggest that cognitive and non-cognitive skills are important drivers and explain part of the difference between natives and immigrants. These findings are supported by results from a Blinder-Oaxaca decomposition analysis. Our paper delivers first evidence that differences in non-cognitive and cognitive skills contribute to the explanation of the financial market participation gap between natives and immigrants.

1. Introduction

Most OECD countries are experiencing ongoing immigration and a growing number of foreign-born inhabitants. The top destination country of international migration flows is still the U.S. which has reached a stock of almost 40 million foreign-born residents according to the latest census in 2010. The U.S. and other top immigration receiving countries have in common that immigrants often face adverse economic outcomes compared to the native-born population. This holds not only true for labor markets, health, housing, and education, but also for financial markets which are a crucial element for the socio-economic integration of immigrants.

Potential reasons for differences in financial market outcomes between immigrants and natives are manifold. First, immigrants are a self-selected group from the source country population. They tend to differ from those individuals who have decided not to emigrate in terms of observable and unobservable characteristics (Borjas, 1994). Most of these are cognitive and non-cognitive skills, like locus of control, which are likely to affect financial behavior in the host country. Second, immigrants often plan to return to their home country after a given time or revise their settlement intentions during their stay (Borjas and Bratsberg, 1996). Moreover, they often have relatives and friends in their home country whom they support through remittances (Amuedo-Dorantes and Pozo, 2002). All of these aspects matter for financial behavior in the host country. Third, at arrival immigrants earn on average less than

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http://dx.doi.org/10.1016/j.jempfin.2016.05.008
0927-5398/

natives due to their lack of host-country specific skills. As a result, they are less likely to participate in financial markets and to hold stocks. This might lead to participation inertia of immigrant households even in case of successful assimilation in earnings over time (Bilias et al., 2010). Finally, differences in financial behavior could be driven by factors and values which immigrants bring along from their home country (Haliassos et al., 2014).

While the study of labor market outcome differences between natives and immigrants has a long tradition in economics, the analysis of corresponding differences in financial outcomes has received less attention for many years. However, in recent years, the literature aiming to describe and explain differences in wealth accumulation between natives and foreign-born has been growing strongly (see among others (Amuedo-Dorantes and Pozo, 2002; Hao, 2004; Cobb-Clark and Hildebrand, 2006; Love and Schmidt, 2014). The studies have shown that differences in education, family composition, income, and time in the host country are the most important factors in explaining the wealth gap. Moreover, the studies suggest that differential patterns in asset holdings are an additional factor driving the differences in wealth accumulation between natives and immigrants.

As a reaction, a different strand of the literature developed and focused on participation in financial markets as a potential factor driving the differences in wealth accumulation. Among others, Osili and Paulson (2006) have highlighted a large gap in financial market participation between natives and immigrants in the U.S. Education, family composition, location and income have shown to be significant drivers of the gap (Osili and Paulson, 2006). Moreover, immigrants are less likely to hold risky assets than natives. This holds even after controlling for differences in net wealth, education, family size and time in the host country (Haliassos et al., 2014).

In recent years, triggered by the integration of psychological concepts into economics, several economists have started to analyze the role of non-cognitive skills for financial behavior. For example, Hong et al. (2004) showed that sociable people are more likely to hold stocks. Other works have shown that locus of control (Salamanca et al., 2013; Cobb-Clark et al., 2013), personality traits (Conlin et al., 2015) and optimism (Puri and Robinson, 2007) matter for financial behavior.

Our paper combines these two strands of the literature and provides first evidence on the role of cognitive and non-cognitive skills in explaining differences in stockholding between natives and immigrants. We make use of data from the Health and Retirement Study (HRS) which is a representative, longitudinal sample of the older U.S. population. Besides information about demographic characteristics and financial assets of the household it provides detailed data on a variety of personality traits. This allows us to construct a rich set of variables measuring cognitive and non-cognitive-skills, like locus of control and the Big Five.[1] We further include measures for risk and time preferences. In a first step, we document a substantial gap in stockholding between natives and immigrants at the extensive margin. This is in so far remarkable, as we compare older natives with older immigrants who spent most of their life in the U.S. Furthermore, we find not only educational disparities between natives and immigrants, but also significant differences in cognitive and non-cognitive skills. In a second step, we estimate a set of probit regressions and conduct a nonlinear Blinder-Oaxaca decomposition to analyze the determinants of the stockholding gap between natives and immigrants. Our estimates document that cognitive skills, like numeracy and memory, as well as personality traits, like locus of control, the Big Five and optimism, are important drivers of stockholding behavior. The same holds true for risk and time preferences. The decomposition results suggest that cognitive skills, personality traits and economic preferences also explain a significant part of the difference between natives and immigrants. Among others, we find differences in memory, numerical abilities, time preferences and conscientiousness to be factors driving the immigrant-native gap. Therefore, our analysis delivers new insights into the drivers of the immigrant-native wealth gap and contributes to the explanation of the stockholding puzzle (Haliassos and Bertaut, 1995).

The paper is organized as follows: Section 2 reviews the relevant literature. Section 3 describes the data used and provides first descriptive statistics, while Section 4 presents our empirical results. Section 5 concludes the paper.

2. Related literature

Our paper contributes to two strands of literature. The first analyzes the differences between natives and immigrants with respect to wealth accumulation and portfolio choices. The second strand investigates the role of cognitive and non-cognitive skills and their impact on financial behavior.

Thanks to the increased availability of micro data, there is a growing literature on immigrant-native differences in wealth accumulation. For example, Cobb-Clark and Hildebrand (2006) utilize household data from the Survey of Income and Program Participation (SIPP) to compare U.S. native and foreign-born wealth. Wealth is found to be strikingly higher for single and couple native households. Comparing wealthier households this gap increases. Moreover, immigrants' overall net wealth and its financial and housing components differ by country of origin and year of arrival, respectively. Hao (2004) also makes use of the SIPP to analyze differences in wealth accumulation between natives and immigrants. She finds that levels of net worth as well as its components are segregated by country of origin, ethnicity and nativity. Including adult time since immigration foreign-born are able to overtake natives after 22 years. Hao (2004) further highlights that spatial segregation affects wealth negatively for both natives and immigrants. Amuedo-Dorantes and Pozo (2002) instead use data from the 1979 Youth Cohort of the National Longitudinal Surveys to investigate the saving behavior of natives and immigrants. They find lower wealth accumulation among young

[1] The Big Five personality traits capture different facets of personality at the broadest level of abstraction. The traits are neuroticism, agreeableness, extraversion, conscientiousness and openness (to experience). For details, see Almlund et al. (2011).