



Religious beliefs and local government financing, investment, and cash holding decisions☆



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ABSTRACT

This paper is the first to examine the association between religious beliefs and the local government financing, investment and cash holding decisions. Using a sample of 15,204 county-year observations for census years between 1992 and 2012, we show that the degree of religiosity is negatively associated with the level of local government debt and investments while it is positively associated with accumulated cash holdings. Our results indicate that local governments in counties with a higher degree of religiosity are more conservatively managed. To validate the main findings we conduct a range of robustness tests and demonstrate that our main results hold.

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1. Introduction

Chen and Hungerman (2014) observe that interactions between culture, religion and economics are being increasingly studied by financial economists and that improved understanding of the interaction between religious beliefs and economic outcomes are a fruitful ground for further research. Our paper is motivated by two strands of literature. Prior studies in the first strand examine the impact of local religious beliefs on economic attitudes (Guiso et al., 2003), corporate decisions (Hilary and Hui, 2009), investor portfolio choices (Kumar et al., 2011), employee stock option based compensation (Spalt, 2013), earnings management (Grullon et al., 2010), mutual fund risk-taking (Shu et al., 2012), and corporate information disclosure (McGuire et al., 2012; Callen and Fang, 2015).

Studies in the second strand focus on agency problems in nonprofit organizations (Core et al., 2006) and in the municipal government sector (Gore et al., 2012), GAAP requirements and municipal borrowing costs (Baber and Gore, 2008), nature and extent of municipal cash holdings (Gore, 2009), financial restatements in municipal debt markets (Baber et al., 2013), and the effect of quality of local government on the level of corporate cash holdings (Chen et al., 2014). Nevertheless, none of the prior studies have explored the behavioral and religious aspects in local government decision making. We make the first attempt to fill the

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void by investigating the association between religious beliefs and local government financing, investment, and cash holding decisions in the United States.¹

Examining core managerial decisions in local governments is important as they are an integral part of the overall economy and are different from the corporate sector. We are interested in the local government setting for the following reasons. First, in the seven years to December 2015, debt levels for the state and local governments have increased by 18.9% and 22.8% respectively (USDebtClock.org). Furthermore, 51 municipalities filed for Chapter 9 bankruptcy protection between January 2010 and August 2015 and the U.S. Government Accountability Office (GAO) forecasts that state and local governments face growing operating deficits each fiscal year over the next several decades.² Since the start of the financial crisis in 2008, the most prevalent reason for a local government bankruptcy was the inability to continue servicing debts, often as a result of declining tax intakes and increasing expenses.

Second, local governments represent an important part of the overall U.S. economy. For example, the total size of the local government revenue was approximately 40% of the size of the Federal Government revenue in 2007.³ Furthermore, local government spending was approximately \$1.5 trillion in 2007, being roughly 10.6% of the GDP. Local governments also hold substantial liquidity reserves. For example, holdings of cash and liquid securities by local governments were at \$1.54 trillion in total in 2007, with the average cash holdings representing 46.6% of revenue ([U.S. Census Bureau, 2007](http://www.census.gov)).

Third, the governmental setting is different from the corporate sector in that local governments are non-profit organizations but also have the ability to raise revenue from their citizens directly through taxes ([Gore, 2009](http://www.gore.gov)). Furthermore, local governments issuing debt securities are given a preferential tax treatment due to the interest on municipal bonds received by investors generally being exempt from federal taxes ([Gore, 2009](http://www.gore.gov); [Sammartino, 2012](http://www.sammartino.com)). Therefore, it is important to know whether the findings from the corporate setting apply to the government setting. Prior literature shows that religious beliefs have significant influence on governmental organizations. For example, [Stulz and Williamson \(2003\)](http://www.stulz.com) document that religion is an important predictor of how countries enforce investor and creditor rights by focusing on cross-country comparisons rather than government management. Our paper is the first to investigate the effect of the level of religiosity within a local government area on investments, financing and cash holdings decisions by that local government. We demonstrate that religiosity matters in the financial decisions made by local governments.

Recent research indicates that religion influences risk attitudes of individuals and that religious individuals tend to be more risk-averse ([Renneboog and Spaenjers, 2012](http://www.renneboog.com); [Noussair et al., 2013](http://www.noussair.com)). A number of recent studies also find that religion has significant influence on corporate risk-taking, in that higher degree of religiosity is associated with more risk-aversion in corporate decision making ([Hilary and Hui, 2009](http://www.hilaryandhui.com); [Shu et al., 2012](http://www.shu.com)).

Our hypotheses are grounded in the argument that increased religiosity should manifest in risk-averse behavior at local government level, which results in more conservative government decision making. More specifically, we ask the following research question: how does the degree of religiosity affect local government debt financing, capital expenditure, and cash holdings decisions?

Using a sample of 15,204 county-year observations for census years 1992, 1997, 2002, 2007 and 2012, we demonstrate that the degree of religiosity is negatively associated with local government debt financing and investment decisions. We also find that local governments with a higher degree of religiosity have greater cash holdings. We conduct an extensive range of robustness tests, including year-by-year regression, subsample regressions, tests for the omitted variable problem and reverse causality, and tests on alternative samples. Our main findings hold.

Our paper contributes to the religion and local government entities literature. In particular, two previous studies ([Gore, 2009](http://www.gore.gov); [Hilary and Hui, 2009](http://www.hilaryandhui.com)) are related to ours. [Gore \(2009\)](http://www.gore.gov) examines the determinants of municipal cash holdings and the implications for holding high levels of cash. In particular, she documents that governments with relatively high variation in revenues, fewer sources of revenues and higher growth are more likely to accumulate cash. [Hilary and Hui \(2009\)](http://www.hilaryandhui.com) examine the influence of religiosity on corporate decision making and show that firms located in counties with high levels of religiosity exhibit lower risk exposure. Our study differs from the above studies in the following aspects. The focus of [Gore \(2009\)](http://www.gore.gov) is on examining the determinants of municipal cash holdings, whilst we investigate the association between religious beliefs and local government financing, investment and cash holding decisions. Our study not only examines a broader set of government decisions but also focuses on the cultural factors in government decision making. [Hilary and Hui \(2009\)](http://www.hilaryandhui.com) examine if the level of religiosity in a firms' environment affects its corporate behavior and investment decisions, whilst we investigate the effect of local religious beliefs on decision making at the local government level.

Our findings suggest that the risk aversion induced by religious beliefs affects decision making at the government level. Therefore, our findings should be of interest not only to local government decision makers and other local government stakeholders, but also to a broader investment community including, but not limited to, municipal bond buyers and possibly credit ratings agencies.

¹ We define degree of religiosity as the number of religious adherents divided by the total population of the county. Religious adherents are defined as "All full members, their children, and others who regularly attend services or participate in the congregation" (source: Association of Religion Data Archives). We acknowledge that our definition of religiosity potentially exclude individuals who nominally proclaim religiosity but do not regularly attend religious services or participate in the congregation.

² "Governing the states and localities data" (article date 12/03/2013), which is available at: <http://www.governing.com/gov-data/municipal-cities-counties-bankruptcies-and-defaults.html>.

³ "Government Revenue Details", available at: http://www.usgovernmentrevenue.com/yearrev2007_0.html (information accessed November 18, 2014).

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