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# Strategic interaction between inter vivos gifts and housing acquisition



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### ABSTRACT

**Yukutake, Norifumi, Iwata, Shinichiro, and Idee, Takako—**Strategic interaction between inter vivos gifts and housing acquisition

This paper models the interdependence of parental inter vivos gifts and children's home purchases when informal care affects decision making. We use data from Japanese households who purchased a detached house in an urban area to test this strategic interaction. Considering both censoring and endogeneity of inter vivos gifts, which are identified by information on formal care, our preferred results demonstrate that inter vivos gifts do not significantly increase the purchase price of housing. Theory suggests that this occurs when informal care tends to be a heavy burden for children. However, subsample analysis of young home buyers indicates that the empirical results are consistent with the literature: children who receive parental gifts tend to purchase a higher-priced dwelling. One potential explanation is that relatively young adult children are less likely to take charge of care obligations, and accordingly, parental gifts are only expected to relax their liquidity constraints. Subsample analysis appears to indicate that the underlying motivation of parental gifts is influenced by the timing of children's home purchase decisions. *J. Japanese Int. Economies* 35 (2015) 62–77. Housing Research & Advancement Foundation of Japan, 6-3 Nibancho, Chiyoda, Tokyo 102-0084, Japan; Faculty of Economics, University of Toyama, 3190 Gofuku, Toyama, Toyama

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## 1. Introduction

As a conventional mortgage requires approximately 20 percent down payment on a loan, home-buying households must build up substantial savings; therefore, down payment constraints may distort the optimal housing consumption (Artle and Varaiya, 1978). Parental gifts are expected to relax this borrowing constraint. Indeed, previous studies have demonstrated that inter vivos gifts by parents to their adult children play an important role in increasing down payments and raising the value of the acquired house (Engelhardt and Mayer, 1998; Guiso and Jappelli, 2002; Zhou, 2007; Luea, 2008; Spilerman and Wolff, 2012).

The claim that inter vivos gifts encourage housing demand seems to be induced from rational behavior. This can be true when parents have an altruistic preference: an increase in parental gifts only has an impact similar to an increase in income for home purchases. Parental gifts are simply used to increase the well-being of children from the children's point of view; therefore, children tend to purchase a higher-priced dwelling. The question is then whether or not parents freely provide inter vivos gifts even in the aging societies that most developed countries are facing. In such a society, parents may provide financial transfers in exchange for receiving informal care. That is, inter vivos gifts are not always available for children to finance dwelling purchases. Accordingly, the effect of inter vivos gifts on housing consumption becomes more complex.

Although substantial inter vivos gifts are implicitly associated with informal care and are frequently earmarked for home purchases, empirical evidence on this issue is limited to date. This may reflect the fact that even though researchers obtain information on the value of inter vivos gifts and housing consumption, they cannot obtain information on informal care. Our data set appears to face the same problem. To overcome this problem, we use publicly available information on formal care, which is a substitute for informal care to some extent (Van Houtven and Norton, 2004).

A theoretical model of strategic interaction between inter vivos gifts and the home purchase price leads to an empirical model where the home purchase price is a function of the value of inter vivos gifts, which depends on formal care. Our theory suggests that inter vivos gifts do not always increase the purchase value of an acquired house. To test this hypothesis, we use a repeated cross section of households who purchased a detached house in an urban area of Japan. Japanese evidence may provide interesting insights. In Japan, home ownership rates of younger generations have been declining substantially, potentially because economic stagnation has deteriorated the employment situation among young people. Inter vivos gifts thus seem to be particularly important for children in home purchases. On the other hand, older generations have accumulated a large portfolio of financial assets to fund their postretirement lives. Parents used to use a certain amount of these funds as rewards for informal care provided by children (Izuhara, 2004).<sup>1</sup> Therefore, exchange tends to be the traditional and primary motive for transfers from parents to children in Japan. Japan, however, faces the most rapid growth in the proportion of elderly in the population in the world. Reflecting the heavy burden of informal care, a social insurance scheme for long-term care has been designed to promote the formal care market (Izuhara, 2004; Abe, 2009). This indicates that parents can consider formal care, which may substitute for informal care, when they decide the value of inter vivos gifts.

<sup>1</sup> Japanese Civil Law may justify this. According to this Civil Law, a successor who has made substantial contributions to the maintenance, or to the increase in the value, of the predecessor's estate through medical treatment or nursing of the predecessor, or by other means, is entitled to receive a gift of greater value than his/her legal portion of an inheritance. This is called a contributory portion.

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