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The Effect of Dividends on Consumption

by Malcolm Baker, Stefan Nagel and Jeffrey Wurgler

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Abstract

Classical models predict that the division of stock returns into dividends and capital appreciation does not affect investor consumption patterns, while mental accounting and other economic frictions predict that investors have a higher propensity to consume from stock returns in the form of dividends. Using two micro data sets, we show that investors are indeed far more likely to consume from dividends than capital gains. In the Consumer Expenditure Survey, household consumption increases with dividend income, controlling for total wealth, total portfolio returns, and other sources of income. In a sample of household investment accounts data from a brokerage, net withdrawals from the accounts increase one-for-one with ordinary dividends of moderate size, controlling for total portfolio returns, and also increase with mutual fund and special dividends. We comment on several potential explanations for the results.

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