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The Real Exchange Rate and U.S. Manufacturing Employment

In the early 1980s, until the first quarter of 1985, the U.S. dollar appreciated dramatically against foreign currencies. Those years of dollar strength, which made U.S. products relatively more expensive in other countries, led to the loss of about 1.1 million jobs in American manufacturing, according to NBER Research Associate **William Branson** and **James Love**. For the nation as a whole, the job loss represented nearly 6 percent of 1985 employment in the manufacturing sector. The individual states that lost the most jobs were: Texas, 112,000; Ohio, 101,000; Michigan, 98,000; and Illinois, 97,000.

In **The Real Exchange Rate and Employment in U.S. Manufacturing: State and Regional Results** (*NBER Working Paper No. 2435*), Branson and Love find that five largely rural states lost the most jobs as a percentage of their 1985 manufacturing work force: North Dakota, 25 percent; Nevada, 19 percent; Wyoming, Kansas, and West Virginia, 17 percent. The large "rust belt" industrial states also suffered sizable losses because of dollar appreciation. Michigan and Illinois lost 10 percent, Indiana and Ohio 9 percent, and Pennsylvania 7 percent of their 1985 manufacturing work force. At the same time, several industrial

states in the Northeast were less affected by exchange rates than the nation as a whole was. New Jersey actually gained 0.3 percent, and Massachusetts and New York lost only about 1 percent, of their 1985 manufacturing work force.

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In exploring why manufacturing employment is more sensitive to exchange rate movements in some states than in others, the authors find that a relatively high percentage of the population living outside of

metropolitan areas, a higher level of wages for production workers, and a larger amount of crude oil production are all related to greater sensitivity to exchange rates (more job losses). A higher percentage of the population with four years or more of college and larger per capita expenditures on public secondary schools are associated with less sensitivity to exchange rates.

In New York and Pennsylvania, industry mix, labor markets, and geographic characteristics also may account for the varying sensitivity of manufacturing jobs to exchange rate changes. For New York state in particular, Branson and Love find that 150,000 manufacturing jobs, or more than 10 percent of the 1980 manufacturing work force, were lost in the first half of the decade. That left 1,295,000 jobs in manufacturing in 1985. However, the impact of the exchange rate change was "negligible," they conclude. The decline in manufacturing jobs began well before the rise in the dollar.

Moreover, industries that have fared well under dollar appreciation, such as printing and publishing, are well represented in New York. In addition, New York state, and New York City in particular, might be expected to house a higher proportion of nonproduction management employees than other states do. These employees are hurt less by exchange rate appreciation than production workers are.

New York City and nearby areas apparently benefit from what Branson and Love term the "headquarters factor," since many large manufacturing firms' management offices and research centers are located there. Areas outside of New York City were hit harder by job losses than the city itself was.

Five southern states with large rural populations (Alabama, Arkansas, Mississippi, South Carolina, and West Virginia) had a different experience than New York did. There, manufacturing employment in the more rural areas was no more sensitive to exchange rate movements than manufacturing employment in the more urban areas was. DF

The Cost of Itemizing Deductions

Itemizing deductions on your federal income tax return may save you money, but it will cost you something, too. According to a new NBER study, the time that individuals spent itemizing deductions in 1982 was worth \$1.44 billion. On average, the time spent in keeping records and preparing returns was equivalent to \$43 per itemizing taxpayer.

In The Compliance Cost of Itemizing Deductions: Evidence from Individual Tax Returns (NBER Working Paper No. 2526), Mark Pitt and Joel Slemrod

estimate that nearly 700,000 taxpayers do not itemize deductions because of this implicit cost. As a result, these taxpayers pay \$196 million more in taxes than they would if they itemized.

"The time that individuals spent itemizing deductions in 1982 was worth \$1.44 billion."

Naturally, if the standard deduction were larger, even fewer households would itemize than now do. Pitt and Slemrod estimate that a \$1000 increase in the standard deduction would save taxpayers \$180 million (in the value of time spent itemizing). An across-the-board increase of \$2000 in the standard deduction would cut the compliance cost of itemizing by \$370 million, from \$1.44 billion to \$1.07 billion. Of course, increasing the standard deduction would result in lower revenues for the U.S. Treasury.

Pitt and Slemrod's results are based on the 1982 Treasury Tax File. They use 13,409 individual income tax returns for their study.

Performance, Management, and Corporate Control

How effective are boards of directors in disciplining top managers? According to a new NBER study, corporate boards *do* respond to poor performance by a firm within a healthy industry: their action tends to result in a complete turnover of top management. But in ailing industries in the 1980s—such as oil, steel, and airlines—boards tended not to discipline unresponsive managers. That role fell instead to hostile takeovers. Authors **Randall Mørck**, **Andrei Shleifer**, and **Robert Vishny** conclude that "internal turnover and hostile takeovers provide complementary means of enforcing maximization of shareholder value. Hostile takeovers become relevant precisely when the problems of the firm and the status of top management make the board's disciplinary role too difficult to perform effectively."

In **Alternative Mechanisms for Corporate Control (NBER Working Paper No. 2532)**, the three economists study 454 publicly traded firms on the *Fortune* 500 list during 1981–5. Forty of the firms experienced hostile takeovers, 34 were the object of friendly takeovers, and 93 firms underwent a complete turnover in top management without being acquired.

Using three performance measures (Tobin's *Q*, which measures the intangible assets of the firm; stock market abnormal returns, which capture the market's evaluation of recent news about the firm's

profitability; and employment growth, an indicator of firm performance and industry health) for 1978–80, the authors find that the firms whose management turned over had performed poorly relative to others in their industry. However, these firms were not disproportionately from ailing industries. On the other hand, the targets of hostile takeovers were concentrated in troubled industries, and they may or may not have underperformed their peers.

“Internal turnover and hostile takeovers provide complementary means of enforcing maximization of shareholder value.”

Mørck, Shleifer, and Vishny also observe that executives who are among the founders of the corporation, and those top executives alone at the top, seem relatively immune to internal discipline. The firms that experienced complete turnover in management were only 40 percent as likely to be run by a founder or a member of the founding family as the firms that neither changed management nor ownership, they estimate.

Similarly, targets of hostile takeovers were only 35 percent as likely to be run by a member of the founding family as firms that remained unchanged. The authors conclude that “founders are harder to force out in a hostile takeover but are more likely to sell their firms when they choose to retire or diversify.”

In contrast, Mørck, Shleifer, and Vishny find that firms with a single, relatively young top executive (age 60 or less in this study) are more likely to experience hostile takeovers than other firms are. Hostile takeovers may be one way to deal with these young “bosses” whom the board cannot control effectively, they conclude.

Why Do the Elderly Move?

As people get older, their incomes often fall and their family circumstances change. One might expect declining income and family size to precipitate a move to a smaller home. A recent NBER study by **Jonathan Feinstein** and **Daniel McFadden**, however, finds that financial considerations have relatively little effect on the mobility of the elderly.

In fact, the poor elderly are no more likely to move than the wealthy elderly are. Nor are elderly homeowners with few liquid assets (such as stocks, bonds, or bank deposits) more likely to move than those homeowners with large liquid assets are. Thus it ap-

pears that the elderly are not being forced to move and spend their housing equity.

However, declining family size is linked to mobility. Most moves by people over age 65 occur when a child leaves the home, the husband retires, or a spouse dies or enters a nursing home.

In **The Dynamics of Housing Demand by the Elderly: Wealth, Cash Flow, and Demographic Effects** (*NBER Working Paper No. 2471*), Feinstein and McFadden report that between 7 and 9 percent of people over age 55 move each year. The rate of mobility does not vary substantially as people age, and it has been relatively constant since the early 1970s.

Although wealth is not closely linked to mobility among the elderly, it is associated with homeownership, which in turn decreases mobility. Feinstein and McFadden estimate that fewer than 5 percent of elderly homeowners move in a typical year, compared with about 16 percent of elderly renters.

Among those over the age of 65 who do move, 81 percent of the renters move to other rental units and 63 percent of the owners buy another home. On the other hand, only 14 percent of the renters decide to buy homes and only 26 percent of the owners move to rental units. Of the remainder, both owners and renters tend to move in with other relatives.

“Financial considerations have relatively little effect on the mobility of the elderly.”

Feinstein and McFadden also find that a significant minority of older people live in relatively large homes (they define a large home as one that has three more rooms than occupants). By that standard, about 30 percent of households with heads aged 55 to 64 had large homes, while 37 percent of households with heads aged 65 to 74 and 39 percent of households with heads over age 75 had large homes. These percentages did not change very much between 1968 and 1982, the authors find.

Feinstein and McFadden also estimate that the typical elderly homeowner in their sample spent a little more than 20 percent of aftertax income on housing expenses from 1978–82, and the typical renter spent slightly less. However, well over 10 percent of the owners, and slightly fewer of the renters, spent more than 40 percent of their incomes on housing expenses. In addition, the percentage of elderly households devoting this much of their income to housing has been growing over time.

Feinstein and McFadden's analysis is based on a national sample of 1131 households headed by someone over age 50 in 1968. These households were interviewed each year from 1968 to 1982.

Recent NBER Book

Tax Policy and the Economy

Tax Policy and the Economy, edited by Lawrence H. Summers, is now available from The MIT Press for \$12.95. This is the second in an annual series of NBER paperback volumes based on a conference on tax policy held each November.

The papers in this volume cover: taxation and U.S. multinational investments; budget deficits and the balance of trade; tax neutrality and intangible capital; the taxation of capital income; how tax rates affect tax collection; and pensions, taxes, and the retirement decision.

This volume is nontechnical and should appeal not only to academic, government, and corporate economists, but also to tax attorneys, individuals in business, and anyone with an interest in the policy debate over taxes.

Summers is the Nathaniel Ropes Professor of Political Economy at Harvard University and an NBER research associate.

How to Order

This volume may be ordered directly from The MIT Press, 55 Hayward Street, Cambridge, MA 02142; the phone number is (617) 253-2884.



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