

The NBER Digest

NATIONAL BUREAU OF
ECONOMIC RESEARCH, INC.

October 1991

Young Blacks Lost Ground in the 1980s

During the late 1970s and 1980s, the disparity between earnings of young black men and their white counterparts widened. According to a new NBER study by **John Bound** and **Richard Freeman**, no single race-related factor explains the pattern of erosion. They estimate that the location of many young black men in declining inner cities, the loss of manufacturing jobs in the United States, and a shift in occupations of blacks together account for about 40 percent of the erosion of their relative earnings.

From the mid-1960s to the mid-1970s, the racial earnings gap among young men fell, until it effectively disappeared for those with the same years of schooling. But in the late 1970s and early 1980s, the environment for black advancement worsened. Economic growth slackened. The manufacturing share of jobs plummeted. Wage inequality grew. And drugs and crime pervaded many inner city neighborhoods.

In **What Went Wrong? The Erosion of Relative Earnings and Employment Among Young Black Men in the 1990s** (*NBER Working Paper No. 3778*), Bound and Freeman note that in 1973, black male wage and salary workers out of school less than ten years earned 89 percent of what white males with similar education and experience did. By 1976, relative earnings had increased to 94 percent. But by 1989, relative earnings had slipped to 82 percent.

The gap widened especially among workers with

no more than a high school diploma living in the Midwest and among college graduates. In the Midwest, young black men were earning only about 79 percent of the wages of their white counterparts at the end of the 1980s: a greater differential than in the South (82 percent) where blacks historically have fared worst.

“From the mid-1960s to the mid-1970s, the racial earnings gap among young men fell, until it effectively disappeared for those with the same years of schooling. . . . But by 1989, [black/white] relative earnings had slipped to 82 percent.”

Black male college graduates earned more than otherwise comparable white college graduates in the mid-1970s, and were as likely as whites to be managers or professionals. Then the supply of black graduates relative to white graduates increased rapidly. Further, the disparity in incomes among all college graduates widened during the 1980s, depending on the type of work they did, the quality of their schools, and so on. Apparently black male college graduates were hit by both elements. By 1989, they were earning about 17 percent less than white graduates; and, they

The Changing System of Housing Finance

were 13 percent less likely to be managers or professionals. Bound and Freeman also note that various statistics show that government pressures to increase minority employment lessened in the 1980s. This change, they conclude, was especially hard on young black college graduates.

In the 1970s, young black males with a high school education were underrepresented as craftworkers (for example, carpenters and plumbers) but overrepresented as operatives (such as assembly line workers). By 1988-9 they were no more likely to be operatives, but also had fallen further behind whites as craftworkers.

Black men were 6 percent more likely to be union members than whites in the mid-1970s, but have been hard hit by the decline in unionism since then. By now, they are no more likely to be unionized than whites. This partially explains why the wage gap has widened, especially in the industrial Midwest.

Another factor hurting these young black men has been the increase in the proportion of them with criminal records. In 1989, 20 percent of black male high school dropouts aged 18 to 29 were in jail, Bound and Freeman estimate. That compares with 7 percent in 1980.

Some black dropouts are on probation: the proportion of young dropouts with criminal records but not in prison is estimated to be about one and a half times the proportion in jail, Bound and Freeman calculate. Youths with criminal records have a harder time finding a job. Therefore, the increased proportion of young black dropouts with criminal records could account for as much as 70 percent of the decline in their employment rate, from 62 percent in 1979 to 55 percent in 1989.

From 1973-89, employment rates dropped 15 percentage points. However, there was no rise in incarceration rates of young blacks in the 1970s. So, over the longer 1973-89 period, the growth of the population with a criminal record may explain only one-third of their long-run erosion of employment. Still, not everyone involved in crime is caught, so these statistics may underestimate the full reduction in employment potentially caused by crime.

Bound and Freeman use data from the Current Population Survey and other sources to examine the relative economic position of young black men. They focus on young men because their wages and employment are more sensitive to current market realities than those of older workers with specific skills and seniority that may buffer them from market developments.

However, **Francine Blau** and **Andrea Beller** uncover similar trends for black women in their NBER study. In **Black-White Earnings over the 1970s and 1980s: Gender Differences in Trends** (*NBER Working Paper No. 3736*), they find that "while earnings and wages relative to whites of the same sex rose during the 1970s, they stagnated or declined during the 1980s." Younger blacks fared particularly poorly. DRF

Perhaps no major financial market has changed as thoroughly and as quickly as the U.S. single-family housing finance system did in the past decade. Through the 1960s and 1970s, the system was highly specialized and under close government control. Regulations spelled out everything from what kind of investments housing lenders could make to what interest rates they could pay for deposits. All that changed abruptly in the 1980s. A recent NBER study by **Patric Hendershott** finds that, as a result, the housing sector is now more stable and less sensitive to rising or falling interest rates than it was prior to the changes.

In **An Altered U.S. Housing Finance System: Implications for Housing** (*NBER Working Paper No. 3770*), Hendershott shows that the web of government regulation that surrounded the housing finance industry in the 1960s and 1970s kept mortgage rates artificially low but made the housing sector vulnerable to interest rate changes. Hendershott identifies four notable characteristics: first, federally chartered depository institutions were prohibited from offering adjustable-rate mortgages (ARMs), so that virtually all home buyers committed to 20-to-30-year fixed-rate mortgages (FRMs). Second, government regulations and tax inducements favored savings and loan associations' (S&Ls') and savings banks' investments in home mortgages. As a result, these institutions supplied two-thirds of all home mortgage funds and home mortgage rates were roughly half a percentage point lower than they otherwise would have been. Third, because depository institutions were funding long-term FRMs with short-term deposits, the government imposed rate ceilings on deposits when interest rates rose significantly. Fourth, because the capital markets could not compete with the "cheap" deposit money of the savings institutions, few mortgages were pooled into pass-through securities, with the exception of government-guaranteed mortgages. "As a result of these four characteristics," Hendershott says, "the U.S. housing sector was extremely vulnerable to increases in interest rates that caused deposits to flow out of the depository institutions, thereby restricting credit availability."

Hendershott examines two major changes that followed the regulatory loosening. One was the increase in the securitization of FRMs by such quasi-governmental agencies as the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. These agencies securitized less than 4 percent of newly originated FRMs between 1977 and 1981, but had upped their share to 69 percent by 1989.

The second major change was the rise of the ARM, first made practical on a large scale by regulators in 1981. S&Ls had only 10 percent of their portfolios in ARMs in mid-1982. By early 1989, the proportion was nearly half. Only a small portion (about a tenth) of newly originated ARMs are being securitized.

“... the widespread introduction of ARMs, and the securitization of FRMs have reduced the sensitivity of housing production to fluctuations in interest rates.”

As these changes were transforming the home mortgage market, the relative importance of S&Ls was dwindling. Beginning in 1961 with 42 percent of the holdings of the home mortgage market, the S&Ls increased their market share to 51 percent in 1977, but since then it was halved, with most of the decline following the passage of the Financial Institutions Reform, Recovery, and Enforcement Act in 1989.

Hendershott finds that securitization has tied home mortgage rates more closely to capital market rates. He also compares the level of actual rates with a hypothetical “perfect market” rate, and concludes that home mortgage rates were below the perfect rate throughout the 1970s, because of regulatory restrictions, and higher than the perfect rate in the early 1980s, because of the impact of the S&L crisis. Since mid-1986, Hendershott finds, the actual rate and the perfect rate have been very close. The variations in interest rate levels also affected real house prices and rates of homeownership, according to the study.

Finally, Hendershott concludes that the removal of interest rate ceilings on deposits, the widespread introduction of ARMs, and the securitization of FRMs have reduced the sensitivity of housing production to fluctuations in interest rates. While this should make the housing industry less volatile in the future, it also will force monetary policymakers to make greater contracyclical shifts in interest rates to obtain a given degree of monetary tightness or ease.

Hendershott sees two uncertainties clouding the U.S. housing finance market today: first, a possibility that the collapse of the thrift industry could lead to major disruptions in the nonsecuritized portions of the home mortgage markets, which “could lead to reduced housing demand, real prices, and homeownership.” The second uncertainty lies in the market for government-insured mortgages, in which the unsoundness of the Federal Housing Authority’s (FHA’s) basic single-family insurance fund led to legislation that will increase the cost of federal mortgage insurance substantially and will require higher down payments. This could lead to a decline in the share of FRMs underwritten by the FHA, and to a decline in the homeownership rates of younger households, who have been disproportionately heavy users of the FHA program.

RN

Price Differences Increase As Airlines Compete

According to a new NBER study by **Severin Borenstein** and **Nancy Rose**, the dispersion of prices that an airline charges different passengers on the same route depends on the amount of competition on that route. Perhaps surprisingly, as the number of competitors increases, an airline actually will increase the dispersion of its prices.

In **Competition and Price Dispersion in the U.S. Airline Industry** (*NBER Working Paper No. 3785*), Borenstein and Rose find significant differences in the prices an airline charges different customers on the same route. They calculate that the average difference in fares between two passengers flying the same route on the same airline is 36 percent of the mean ticket price on that route.

Borenstein and Rose explain that increased competition tends to drive down all ticket prices. However, its effects are greatest on the types of tickets bought by tourists: advance purchase tickets requiring a Saturday night stay. Competition has a smaller effect on the unrestricted tickets that business travelers usually purchase. Thus, price dispersion increases along with competition, even as all ticket prices decline.

“The average difference in fares between two passengers flying the same route on the same airline is 36 percent of the mean ticket price on that route.”

The authors also find that there was more dispersion in the price of tickets sold by airlines that operated a computerized reservation system (CRS) in 1986 (the time period studied) than in ticket prices of other airlines. Borenstein and Rose suggest that ownership of a CRS indicates a greater sophistication in the process of adjusting the mix of discount and full-fare seats in order to maximize revenue on each flight. Less sophisticated airlines tended to use simpler pricing strategies that resulted in less price dispersion.

The data in this study come from a Department of Transportation sample of coach class tickets on 521 routes during the second quarter of 1986. First class tickets and tickets requiring a change of plane were excluded from the sample in order to maintain comparability of the prices. The largest route in this sample was Boston-La Guardia (New York), with 58,607 direct-service coach passengers during the quarter. The smallest was Seattle-Ketchikan, Alaska with 235 such passengers.

The Financial Status of Widows

About one-third of new widows experience a substantial reduction—25 percent or more—in their living standards when their husbands die. The cut in living standards is more severe for younger widows and for widows with higher incomes prior to their husbands' deaths.

In **Life Insurance Inadequacy—Evidence from a Sample of Older Widows** (NBER Working Paper No. 3765), Research Associates **Alan Auerbach** and **Laurence Kotlikoff** analyze data from the Retirement History Survey of household heads aged 58 to 63 in 1969. These individuals or their widows were interviewed again in 1971, 1973, 1975, 1977, and 1979. By measuring the income of wives prior to the death of their husbands as one-half of the couples' combined incomes, the authors find that 35 percent of older wives (over age 65) suffer at least a 25 percent decline in their incomes when their husbands die.

Looking at average income for a number of years

before and after widowhood, Auerbach and Kotlikoff find that 44 percent of widows under age 55, and 37 percent of those aged 55 to 65, lost more than 25 percent of income. In fact, among widows under age 55 (most of whom are at least in their late 40s in this dataset), nearly one in four suffers a drop in income of more than 50 percent.

“Thirty-five percent of older wives (over age 65) suffer at least a 25 percent decline in their incomes when their husbands die.”

Auerbach and Kotlikoff also observe that 26 percent of widows from families with incomes before the husband's death of below \$10,000 lose more than 25 percent of their income. For those whose incomes had been between \$10,000 and \$25,000, 44 percent lose more than a quarter of their incomes. But nearly 60 percent of widows from higher-income families suffer a drop of 25 percent or more in their incomes, and 43 percent of them lose more than half of their incomes.

DRF

NBER

The National Bureau of Economic Research is a private, non-profit research organization founded in 1920 and devoted to objective quantitative analysis of the American economy. Its officers are:

Chairman—George T. Conklin, Jr.
Vice Chairman—Paul W. McCracken
Treasurer—Charles A. Walworth
President and Chief Executive Officer—Martin Feldstein
Executive Director—Geoffrey Carliner
Director of Finance and Administration—Sam Parker

Contributions to the National Bureau are tax deductible. Inquiries concerning contributions may be addressed to Martin Feldstein, President, NBER, 1050 Massachusetts Avenue, Cambridge, MA 02138.

The NBER Digest summarizes selected Working Papers recently produced as part of the Bureau's program of research. Working Papers are intended to make preliminary research results available to economists in the hope of encouraging discussion and suggestions for revision. The Digest is issued for similar informational purposes and to stimulate discussion of Working Papers before their final publication. Neither the Working Papers nor the Digest has been reviewed by the Board of Directors of the NBER.

The Digest is not copyrighted and may be reproduced freely with appropriate attribution of source. Please provide the NBER's Public Information Department with copies of anything reproduced.

Preparation of the Digest is under the supervision of Donna Zerwitz. The articles indicated by DRF and RN were prepared with the assistance of David R. Francis and Rob Norton, respectively.

Abstracts of all current NBER Working Papers appear in the NBER Reporter. Individual copies of the NBER Working Papers summarized here (and others) are available free of charge to Corporate Associates. For all others, there is a charge of \$3.00 (\$4.00 outside of the U.S.) per paper requested. Advance payment is required on orders. Please do not send cash. For further information, please contact: Working Papers, NBER, 1050 Massachusetts Avenue, Cambridge, MA 02138; (617) 868-3900.

Requests for Digest subscriptions, changes of address, and cancellations should be sent to Digest, NBER, 1050 Massachusetts Avenue, Cambridge, MA 02138. Please include the current mailing label.