Institute of Policy Studies

Changing Wage Structure, Financial Distress and Asset Dynamics in the US

By Varian Lim
IPS Research Analyst

As Singapore pushes forward with its productivity drive, lessons from the US can help inform about pertinent safeguards that could be put in place for workers and families. The Institute of Policy Studies (IPS) invited University of Michigan economics professor, Frank P. Stafford to give a lecture titled "Changing Wage Structure, Financial Distress and Asset Dynamics in the US" on 18 March 2015 at the Lee Kuan Yew School of Public Policy. Prof Stafford is also Research Consultant for IPS Social Lab's flagship project, the Singapore Panel Study on Social Dynamics (PSSD). Several PSSD survey respondents, civil servants and academics were among the 47 individuals who attended Prof Stafford's talk.

Prof Frank P. Stafford addressing the audience

Changing Wage Structures and the Fallout from the Recession

Prof Stafford focused on the factors that have contributed to financial distress in the US and have caused the poor to get poorer. First, there have been no wage improvements for the lower- and middle-income groups, where new jobs did not benefit those who would be

middle-income and hence middle-skilled workers. This is a worldwide phenomenon called "the disappearing middle".

Technology has also eroded the income of the less skilled, as their jobs can now be performed by more skilled workers. This has broadened the income gap between the skilled and less skilled workers. Prof Stafford also cited a finding from the Panel Study of Income Dynamics (PSID), a longitudinal survey of individuals and households in the US for which he is a co-investigator. He highlighted how food expenditure decreased as a result of decreasing incomes, but housing expenditure including mortgage payments remained constant. This is consistent with the theory of consumption commitment, where individuals adjust their expenditure based on what they have committed themselves to paying, such as loans and mortgage payments.

Second, the fallout from the sub-prime mortgage crisis in end-2007 and the subsequent recession in 2008–2009 have hit certain groups of Americans hard.

African-Americans, who had experienced a rise in their temporary income before the crisis, were the most affected by the recession. Many had to sell their assets and stocks at lower prices, and some lost their homes when they could not meet housing loan payments due to higher loan interest rates. Individuals who took on cheap second mortgages when refinancing was popular were also likely to have ended up in financial trouble.

The sub-prime mortgage crisis was caused by easy access to mortgages and fuelled by rising home prices in the 1990s and early 2000s. Banks did not properly screen the ability of loan applicants to repay housing loans in the 1990s; these mortgages were securitised and in turn sold to third parties, such as Lehman Brothers, which eventually went bankrupt. In the 2000s, banks introduced 125% loan-to-value mortgages at low floating interest rates; this resulted in families with temporary high incomes taking up these mortgages. Thus, when interest rates began to rise between mid-2004 and 2006, and home prices stopped increasing, mortgagees found they were not able to pay their loans and chose to default or wait for the bank to foreclose on their property.

Prof Stafford also addressed perceptions that housing prices would always remain buoyant. The true picture, he said, is often quite volatile and dependent on geography, consumption patterns and other financial factors. He compared two American cities, Dallas and San Francisco. San Francisco has limited land unlike Dallas, where less than 10% of available land has been developed. It is thus easier to get a housing permit in Dallas than in San Francisco and demand for housing in San Francisco would always be less elastic than in Dallas.

Research showed that Americans who took up mortgages that formed 90% of the value of their home were most likely to go bankrupt. While there had been a strong stigma attached to declaring bankruptcy in the 1990s, it became more socially acceptable in the 2000s. As a result, the US government introduced bankruptcy reform laws in 2005 to make it more difficult for borrowers to declare bankruptcy.

The non-recourse law in the US also gave rise to individuals borrowing money and putting themselves at financial risk. Lenders (the banks) are only allowed to seize the collateral (e.g., housing) and not the other assets of the borrower. This has resulted in individuals refinancing their homes and then having an additional line of credit, thus increasing their propensity for debt.

Prof Stafford highlighted data from the PSID which showed that wealthier families benefited from the financial turmoil of recent years. With better education, jobs and financial portfolios, they were able to swoop in on the low-priced stocks and assets of recent times. Conversely, the smaller stakeholders who pulled out of the stock market after getting burnt did not re-enter, having lost confidence in the market. They were not able to profit from the subsequent stock market recovery, unlike those who had gone in when prices had bottomed out.

Question and Answer Session

Deputy Head of the IPS Social Lab and IPS Senior Research Fellow Dr Leong Chan-Hoong asked about the risk-taking behaviour of individuals, and whether that would contribute to a growing social class divide. Prof Stafford's response was that calculated risks need to be taken by individuals in order to improve their lives. Unfortunately, the lack of confidence in the economy and the economic downturn are two main reasons why the lower and middle classes take less calculated risks. The upper class however will continue to take calculated risks and reap benefits from the stock market, contributing to a growing class divide.

The next question posed by the audience was whether the PSID revealed any impact of the minimum wage policy in the US. Prof Stafford said that studies showed that the minimum wage did reduce poverty for some groups. However, the minimum wage may discourage companies from employing young adults, depriving them of early job experience and affecting their future prospects. In addition, even if legislation increases the minimum wage, companies may cut back on fringe benefits to recover the costs incurred.

Another participant asked if there was evidence of good learning in the PSID, whereby individuals who experienced positive reinforcement from their choices were more likely to repeat the same behaviour. Prof Stafford explained that good and bad learning experiences depend on context and psychological states. He gave the example of the rich who exited the stock market during the recession and financial crisis and were found more likely to reopen their trading accounts and re-enter the stock market compared to poorer investors.

Dr Leong posed another question with regard to the relationship between family formation and the ease of home ownership. Prof Stafford quipped that the PSID data showed that marriage and family formation was delayed for individuals who moved back to stay with their parents during the recession. The increased uncertainty during the recession had an effect on all sorts of individual commitments as well and not just on family formation.

(From left to right) Dr Leong Chan-Hoong, Prof Frank P. Stafford and Assoc Prof Tan Ern Ser

In concluding the session, Prof Stafford opined that although the findings are based on the US context, they are still highly relevant and applicable to Singapore. The PSID as a national panel study has allowed for the study of the global financial crisis among other topics such as the mortgage crisis, bankruptcy and occupations affected by the recession. Similarly, the PSSD as a Singapore panel study has the potential to be used in the investigation of a wide range of topics in the local context.

Varian Lim is a Research Analyst at IPS Social Lab, an independent centre for social indicators research.

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