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Tax Reform and Housing

Under current tax law, the advantages of owning one's home increase as household income rises. What would happen to such advantages if a "flat tax" proposal, such as the Treasury's tax reform plan, were enacted? According to a recent NBER study (*Working Paper No. 1524*), homeownership would become more expensive for those with higher incomes and less expensive for those with lower incomes. At the same time, renting would become relatively more expensive at all income levels.

The coauthors of the study, **Patric H. Hendershott** and **David C. Ling**, analyze the homeownership choice in the context of three tax proposals that move toward flat rates: Kemp-Kasten (KK), Bradley-Gephardt (BG), and Hall-Rabushka (HR). The authors ask how these plans will affect the costs of housing services from owned versus rental housing, thus affecting the demand for housing and the rate of homeownership.

Under current law, "the prices or costs of owner-occupied housing decline with income . . . because the deductions are worth more as incomes rise. . . ." This is not true under the reform proposals; all households would deduct at the same tax rate—zero under HR, 0.14 with BG, and about 0.25 with KK. Hendershott and Ling find that all three reforms would lower the price of obtaining housing services from owner-occupied housing for households with lower incomes and raise the price for higher-income households. The breakeven income, at which the price of housing services would be unchanged, is about $50,000 for KK and HR and $10,000 to $25,000 less for BG.

The relatively favorable result under HR, in spite of the zero deductibility of housing expenses, occurs because of an assumed decline in interest rates of 4 percentage points. The logic of that assumption is that the current full deductibility of interest expense and taxation of interest income forces rates to be higher than they would be if interest were neither taxed nor deducted.

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Finally, Hendershott and Ling estimate that the price of rental housing would rise under all three reforms. According to their calculations, the KK and BG plans would raise the cost of renting by 5 to 15 percent, while HR would hardly affect it. At the same time, "all reforms lower the cost of owning relatively for households with incomes below about $40,000 (about $70,000 for KK)." Thus, the homeownership rate should rise for middle-income households and fall (by a minor amount) for the upper-income households.

All of these calculations are based on a set of standard assumptions: Households have an average (1981) level of deductions, file jointly, and claim four exemptions. The middle- and lower-income households that own homes finance 90 percent of the value

with a 12.65 percent fixed-rate mortgage. Mortgage payments represent 28 percent of income, and property taxes are 1.2 percent of the value of the house. The higher-income households pay 30 percent of income for housing. The household incomes considered in this study range from $17,500 to $70,000.

In recently completed work (not reported in this Working Paper), the authors have extended their analysis to the Treasury proposal. That proposal is found to be more favorable to owner-cccupied housing than any of the plans previously discussed—the costs should decline for households with incomes up to $90,000. However, it is less favorable to rental housing—rents are expected to rise by 20 percent. Thus, the shift toward homeownership would be even more pronounced than under the other proposals. The provision of the Treasury proposal responsible for this exaggerated result is the indexation of all interest (that is, only the after-inflation component of interest will be deductible) except home mortgage interest.

Imports as a Cause of Injury: The Case of the U.S. Steel Industry

Under U.S. law, domestic industries may seek temporary government protection from imports if they are the most significant cause of injury to the industry. In July 1984, the International Trade Commission (ITC) ruled that imports in fact were the most significant cause of injury to the steel industry, and last September the administration agreed to persuade foreign suppliers of steel to restrict their exports to the United States. However, NBER Research Associate **Gene M. Grossman** has recently shown that the long-term decline in the demand for steel was more important than increased competition from imports as a source of declining employment in the U.S. steel industry.

In *NBER Working Paper No. 1494,* Grossman uses a model of the U.S. steel industry to attribute changes in domestic employment to a number of causes. Among the potential contributors to the industry's employment decline are: competition from imported steel; a long-term decline in the demand for steel (caused, for example, by reduced use of steel by U.S. automobile manufacturers and by substituting aluminum, plastics, and other materials for steel in construction); the cyclical drop in the demand for steel caused by the recent recession; an upward trend in the wages paid to steel workers; and increases in the price of energy—an important input into steel production.

Grossman estimates that long-term decline in the industry eliminated approximately 209,000 jobs in steel between January 1976 and October 1983. By contrast, increased import competition, as measured by the decrease in the real dollar price of foreign steel, accounted for only 37,000 lost jobs during this period. Grossman also reports that the U.S. steel industry would have employed about 27,000 more workers in October 1983 if economic growth had proceeded at a steady 4 percent annual rate throughout the period, thereby averting the recession of 1981 to 1983. Finally, Grossman estimates that wages in the steel industry, by rising faster than in the manufacturing sector at large, accounted for slightly more than 5000 lost jobs. The increase in the real cost of energy during 1976 to 1983 was responsible for nearly 4000 additional jobs lost.

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In another set of estimates, Grossman considers the period from January 1979 to October 1983. For this shorter period, long-term decline again was the most significant cause of injury, responsible for approximately 110,000 lost jobs. Import competition is next on the list (81,000 jobs), followed by the recession (49,000 jobs) and the rise in real energy prices (3000 jobs). By comparing the figures for the two periods, it becomes clear that competition from abroad for U.S. steel producers actually abated from January 1976 through January 1979 but intensified dramatically thereafter. In an effort to explain this finding, Grossman breaks into three components the decline in employment attributable to the fall in the real dollar price of imported steel: the recent appreciation in the value of the dollar; changes in supply and competitive conditions in foreign steel sectors (including any changes in alleged unfair pricing practices); and reductions in U.S. tariff rates on steel imports. He concludes that increasingly severe competition from imports in this industry is entirely the result of the dollar's appreciation.

Thus, industrial competition is an important cause of the decrease in employment. However, contrary to the conclusion reached by the ITC, it appears that industrial competition is not the most significant cause of injury to the steel industry.

Women in the Labor Force

Not only in the United States are more and more women taking paying jobs outside of their homes. According to a study by NBER Research Associate **Jacob A. Mincer** (*Working Paper No. 1438*), the proportion of women who worked for pay also grew in 10 other industrialized nations between 1960 and 1980. (It dropped somewhat in the Netherlands, an exception.)

In **Intercountry Comparisons of Labor Force Trends and of Related Developments: An Overview,** Mincer finds that this growth was most rapid among married women: their participation grew, on average, at 2.84 percent per year during that period, about twice as fast as the growth in labor force participation for all women. In contrast, the proportion of *single* women working for pay declined, if women of school age are included; it grew slightly for those beyond school age.

Mincer looks at 12 industrialized countries for his analysis of women in the labor force: Australia, Britain, France, West Germany, Israel, Italy, Japan, the Netherlands, Spain, Sweden, the United States, and the Soviet Union. Earlier in this century, he notes, married women usually dropped out of the labor force permanently after marriage or at their first pregnancy. That is no longer the case: increasing proportions of married women go back to paid work after the childbearing and childrearing period.

Married women are also more likely now to stay in the labor force continuously, even when they have children. ". . . In the most recent decade, the fastest labor force growth is observable among mothers of small children."

However, only in the Soviet Union is the labor force participation rate of women nearly equal to that of men. That rate peaked at 89.4 percent in 1970 and has slipped a little to 88.2 percent. In the other countries surveyed, the labor force participation rate for married women grew (on average) from 30 percent to 48 percent between 1960 and 1980. "At this pace," Mincer writes, "it will take another half-century to reach 90 percent participation rates."

The participation rate of Swedish married women had surpassed 75 percent by 1980, but most of the growth there was in part-time work. In the Soviet Union, in contrast, few women work part time.

In Australia, Britain, France, Germany, and the United States, the participation rate of married women in the labor force surpassed 50 percent by 1980. "It is perhaps not coincidental that feminist movements in these countries spread just about when the 50 percent 'tipping point' was reached in the 1970s," notes Mincer. In Japan, Spain, the Netherlands, and Italy, however, the proportion of married women working is still quite low, despite recent rapid increases.

Japan is somewhat an exception among industrial countries, because it has a relatively large proportion of women working at home, on the farm, in cottage industries, or in family businesses. Such work may not fit the definition of labor force participation as paid work outside the home. However, the proportion of married women who work outside their homes is growing rapidly in Japan as elsewhere.

While the labor force participation rates of married women grew in all countries, the rates of growth differed. Mincer's analysis indicates that growth in the labor force responded positively to growth in real wages and/or to growth in women's education, but the responses differed among countries.

Women's move into the labor market was also related to declines in fertility. This relationship is apparently mutual: in part, declining fertility is a consequence of women's growing participation in the labor market; at the same time, smaller families and fewer family obligations facilitated labor market commitments.

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Mincer reports that fertility rates declined in every country in his survey. Moreover, this decline accelerated during the 1970s. At the same time, divorce and separation rates rose in an unprecedented fashion, while marriage rates declined and the average age at first marriage rose.

The smallest declines in fertility occurred in Spain and Japan, where growth of female participation in the labor force was small and wage growth was steep. In Sweden, where both female labor force growth and wage growth were moderate, declines in fertility were also modest. Growth in child-care facilities and generous provisions for parental leave for childbirth may have slowed the fertility decline there, Mincer suggests.

Divorce, which tripled in frequency (on average) in the 1970s, increased more slowly in Japan and Israel. The movement of women into the labor force in those countries was relatively slow or average, respectively. The divorce rate climbed fastest in the Netherlands, Australia, Britain, and the United States, where married women's labor force participation also grew at an above-average pace. Causality is likely to run in both directions in the relationship between divorce and labor force growth, just as it does in the relationship between fertility and labor force participation.

In all of the 12 countries surveyed, wages of women are lower than wages of men. The ratio ranges from .54 in Japan to .90 in Sweden in 1980. However, this variation is in part overstated by differences across countries in definition of wages and in survey coverage.

The existence of the wage gap by itself does not prove the existence or extent of discrimination against women, Mincer says. When wages are standardized by marital status, age, education, work experience and its continuity, job training, hours of work, and other distinguishing characteristics of workers, the gross wage gap is reduced substantially. Some analysts, Mincer notes, see the residual gap as a measure of discrimination. Others say it only measures ignorance, since many of the relevant characteristics mentioned above are not available in the data.

In the Soviet Union, there remains a sizable (30 percent) gross wage gap despite the fact that few women work part time and about the same proportion of women and men work. Also, there is less occupational segregation than in other industrial countries, primarily because more women are employed at manual work and in the professions. Nevertheless, in all 12 countries, including the USSR, occupational segregation remains pronounced and changing slowly, if at all.

Over the 1960–80 period, wages of working women, on average, did grow faster than wages of men in most of the 12 countries surveyed. The average wage ratio rose from .62 to .71 between 1960 and 1980. This narrowing of the wage gap was caused both by a longer-term catching up of women's educational attainment in the population and by a positive educational selectivity of women's labor force growth during this period. Neither of these factors was present in the United States, though, where the wage gap barely moved.

Some of the narrowing of the wage gap, as well as some acceleration in the growth of women's participation in the labor force, can be attributed to changes in public policy. Such changes include shifts from family-based (income-splitting) to individual taxation and generous provisions for parental leave and child-care subsidies. The introduction of equal pay laws also apparently contributed to the narrowing of the wage gap in Australia and in Britain (although not in the United States). However, by making women's labor more expensive, these laws may have slowed growth in female employment in the 1970s in the private sector of those countries.

The observed narrowing of the wage gap is not easily extrapolated into the future, though. This is because most of the changes that have affected the wage/gender ratio are self-limiting: educational catch-up, tax changes, and other legal changes, for example.

Mincer thus concludes: "Ultimately, without labor market discrimination and with equal educational attainment, the wage gap can be eliminated only when sex differences in lifetime work experience vanish, provided differences in investments in job market skills and work effort also disappear. Whether this will happen, and to what extent the wage gap will narrow, is a question of economic and technological change as it affects work hours, location, and flexibility of both, as much as it is a question of how the same forces will affect the family institution."

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