

IN THIS ISSUE

- Rising U.S. Imports in Eighties Raised Wages of Skilled Workers
- Why Investors Favor Home-Grown Stocks
- Racial Differences in Wages Reflect "Pre-market Factors"
- Problem Drinking Linked to Unemployment

Rising U.S. Imports in Eighties Raised Wages of Skilled Workers

During the 1980s, the wages of nonproduction workers rose relative to the wages of production workers. During that same time period, U.S. imports also increased sharply. A recent NBER study concludes that those two facts are related. In **Foreign Investment, Outsourcing, and Relative Wages** (NBER Working Paper No. 5121), **Robert Feenstra** and **Gordon Hanson** find that increasing imports between 1979 and 1987 account for 15 to 33 percent of the increase in the relative wage of nonproduction workers.

Feenstra and Hanson reach their conclusion by examining the effect of imports in 435 U.S. industries. Between 1979 and 1987, nonproduction workers' share of total wages paid in those industries rose annually by an average of 0.4 percent. During that same period, the average annual increase in imports as a fraction of total shipments plus imports rose by an average of nearly 0.7 percent. The researchers find that for every percentage point of increase in the share of imports, the nonproduction workers' share of wages in that industry rose by between 0.1 and 0.2 percent.

Feenstra and Hanson have an

explanation for this increase in nonproduction workers' relative wages. They show that when the amount of capital increases in less capital-intensive countries, such as Mexico—which happened in the 1980s—the relative demand for skilled labor should increase in both the United States and Mexico. Not just the U.S. data, but also the Mexican data, support their reasoning. Between 1984 and 1990, they note, hourly nonproduction wages

out that the value of imported materials excludes the cost of finished products. They note that Nike employs only 2500 people in the United States but that contractors employ 75,000 people in Asia who produce shoes that Nike buys. Because such shoes are products and not intermediate inputs, they are not counted as imported materials. Therefore they are not included in the usual economists' definition of outsourcing, even though most

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in Mexico went from being 93 percent higher than production wages to being 155 percent higher, similar to the increase in the United States.

To what extent was the increase in U.S. imports attributable to outsourcing by U.S. companies? Economists who previously studied the issue found outsourcing to be unimportant because foreign materials are only 8 percent of all materials purchased in U.S. manufacturing. But Feenstra and Hanson point

people reasonably would regard such shoes as outsourced. Many U.S. manufacturers in the footwear, textiles, and electronics industries, Feenstra and Hanson write, buy finished products, as do many manufacturers in other industries. They believe that outsourcing was an important contributor to the increase in imports in the 1980s, and in turn to the increase in relative wages of nonproduction workers.

DRH

Why Investors Favor Home-Grown Stocks

For at least 25 years, economists and finance specialists have known that investors can improve the performance of their portfolios by investing in foreign stocks, since the increased diversification makes the portfolio less prone to market gyrations. At the same time, barriers to foreign investment such as capital controls have been falling as part of the well-noted trend toward globalization. Nevertheless, researchers have found that investors overwhelmingly stick with local stocks, at least in large countries such as the United States and Japan.

Several theories have been put forth to explain this "home bias" in portfolios. One is that the remaining barriers to international invest-

ment may be more important than commonly believed. Another theory is that there are barriers to international investment that have not been identified and that play a large role in investors' decisions. Still other theories hold that investors are more optimistic about their

native countries, or that they typically know more about a certain security than foreigners. When these models make specific predictions about the stocks foreign investors hold in a country, they generally predict that these investors either buy the national market portfolios or buy portfolios tilted toward stocks with high expected returns.

Now a new NBER study by **Jun-Koo Kang** and **René Stulz** finds that foreign investors do *not* hold market portfolios and do not appear to choose a portfolio that would minimize risk for a given expected return. In **Why Is There a Home Bias? An Analysis of Foreign Portfolio Equity Ownership in Japan** (*NBER Working Paper*

the shares of large firms. On average, foreign investors hold almost 8 percent of the equity of the largest firms in this study, compared with less than 2 percent of the equity in the smallest firms. Surprisingly, however, there is a considerable home bias even for the largest firms whose stock trades in New York as well as in Tokyo.

Foreign investors also favor shares in firms in manufacturing industries, and in firms with good accounting performance, low leverage, and low systemic risk. Kang and Stulz also find that small firms that export more have greater foreign ownership than other firms of similar size.

The evidence in Kang and Stulz's paper suggests that investors pay more attention to firm characteristics than to modern portfolio theory. With modern portfolio theory, foreign investors would care only about the expected return of stocks, their variance, and their covariance. In contrast, Kang and Stulz show that foreign investors also care about firms' balance sheets, accounting income, and other characteristics. Since foreign investors are less informed about these firm-specific characteristics than local investors, a home bias is likely to result. RN

"[T]here is a considerable home bias even for the largest firms whose stock trades in New York as well as in Tokyo."

No. 5166), Kang and Stulz examine data on foreign stock ownership in Japan from 1975 to 1991 and confirm the existence of a substantial home bias.

As for investment strategy, the authors find that foreign investors tend to tilt their portfolios toward

Racial Differences in Wages Reflect "Premarket Factors"

In a recent NBER study, **Derek Neal** and **William Johnson** find that one test score explains all of the black-white wage gap for young women and much of that gap for young men. For today's

young adults, they find that the black-white wage gap primarily reflects a skill gap, which in turn can be traced, at least in part, to observable differences in the family backgrounds and school environ-

ments of black and white children.

In **The Role of Premarket Factors in Black-White Wage Differences** (*NBER Working Paper No. 5124*), Neal and Johnson use the National Longitudinal Survey of

Youth (NLSY) to examine the black-white wage gap among workers in their late twenties. The authors use a single measure of skill, the Armed Forces Qualification Test (AFQT). In 1980, over 90 percent of the members of the NLSY panel took the Armed Services Vocational Aptitude Battery, a series of 10 tests, four of which comprise the AFQT. Independent studies verify that the AFQT is a racially unbiased measure of basic skills that helps predict actual job performance. When the AFQT was administered in 1980, the NLSY panel, born between 1957 and 1964, ranged from 15 to 23 years old.

Neal and Johnson restrict their sample to those younger members of the survey group whose schooling choices by and large would be constrained by compulsory schooling laws, and who would not have entered the labor market full time by 1980. They analyze respondents born after 1961 who would have

been 18 or younger when they took the AFQT. Thus, neither discrimination in the labor market nor in post-secondary education could

labor market. Further, Neal and Johnson find that family background variables that affect the cost or difficulty parents face in investing in

“At least two-thirds of the gap can be attributed to a black-white gap in basic skills that exists prior to entry into the labor market.”

directly affect the test performance of blacks in this group of young people.

While most previous studies conclude that current labor market discrimination accounts for at least one-third to one-half of the overall racial wage gap, this study indicates that one-third is more likely a maximum estimate. At least two-thirds of the gap can be attributed to a black-white gap in basic skills that exists prior to entry into the la-

bor market. Further, Neal and Johnson find that family background variables that affect the cost or difficulty parents face in investing in their children's skills explain roughly one-third of the racial differential in test scores. Measures of school environment account for part of the remaining gap in test scores.

While the authors find some evidence of labor market discrimination, they conclude that the disadvantages young black workers now face in the labor market arise mostly from the obstacles they faced as children in acquiring productive human capital.

Problem Drinking Linked to Unemployment

If an individual is an alcoholic or a heavy drinker, he or she is more likely to have difficulty getting a job or keeping it. In fact, based on

percentage point increases in rates of unemployment.

Several recent studies have suggested that alcohol consumption, at

“[P]roblem drinking results in 10 to 15 percentage point reductions in employment rates and 4 to 10 percentage point increases in rates of unemployment.”

a large household survey, NBER Research Associates **John Mullahy** and **Jody Sindelar** estimate that problem drinking results in 10 to 15 percentage point reductions in employment rates and 4 to 10 per-

centage point increases in rates of unemployment. Several recent studies have suggested that alcohol consumption, at least at moderate levels, may be beneficial for productivity. But these studies looked only at working people. In **Employment, Unemployment, and Problem Drinking** (NBER Working Paper

No. 5123), Mullahy and Sindelar instead focus on some 15,000 problem drinkers, including those not working, who were selected from the 1988 Alcohol Survey of the National Health Interview Survey. The survey classified individuals as subject to alcohol dependence (involving withdrawal symptoms, a build-up of tolerance to large amounts of alcohol, and acceptance of the adverse consequences of their drinking); subject to alcohol abuse (continuing the use of alcohol for at least a month despite its adverse or hazardous effects); or heavy drinkers (within the top 5 to 10 percent of alcohol consumption). Mullahy and Sindelar pooled the categories of alcohol dependence and abuse; looked at males and females separately; and restricted their sample

to adults aged 25 to 59. They also incorporated state-level data on labor market conditions, alcoholic beverage excise taxes, and other relevant information.

The authors explain that alcohol is associated with a long list of physical, psychological, and cognitive impairments including liver

and heart damage, increased injuries from automobile accidents or other accidents, reduced hand-eye coordination, unusual or unstable behavior, and violence. All of these factors, Mullahy and Sindelar note, can reduce the productivity and reliability of a worker or potential worker. Thus, the link between

problem drinking and unemployment is not surprising. While some studies show that the stress of unemployment can cause increased and possibly excessive drinking, the authors do not find that short-term unemployment causes alcoholism, a disorder that takes a fair amount of time to develop. DRF

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