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Blacks' Gains: Permanent or Transitory?

Measured by earnings and occupational attainment, the gains made by blacks in the labor market after 1964 continued through the 1970s, according to a recent study by NBER Research Associate **Richard B. Freeman**. In *Working Paper No. 751, Have Black Labor Market Gains Post-1964 Been Permanent or Transitory?*, Freeman focuses on young black males and finds that the preponderance of evidence suggests that the post-1964 advances were neither transitory nor illusory.

Freeman analyzes data on specific age groups, termed cohorts. In the 1950s, the black-to-white income ratio declined among 14-24 year olds as the cohort aged. In the 1960s, the same ratio for that age group showed greater stability. Freeman's analysis of the published data for the 1970s shows that young blacks (aged 18-24) and those with little job experience (from zero to five years) slipped over time in their labor market position relative to similar whites. Among 25-29 year olds, though, there was no change over time in the relative position of blacks and whites, and, for those aged 30-34, or with 6-10 years of experience, there was some improvement in the blacks' relative position over time.

Moreover, based on surveys of occupational change conducted in 1962 and 1975, the progress of black cohorts accelerated in the post-1964 period. The picture of the 1970s is thus somewhat mixed: it seems

that in cases where only a slight initial differential existed between blacks and whites in the labor market, the differential grew as the cohort aged; in cases of a strong initial differential, blacks tended to catch up with whites over time.

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While Freeman rejects the claim that the post-1964 gains of blacks disappeared in the sluggish economy of the 1970s, he notes that blacks still had problems in the labor market. For example, black family income did not rise relative to white family income: it was 64 percent in 1968 and in 1978. This is because the proportion of homes with male heads of household declined more rapidly for blacks than whites in that period. Young blacks also experienced an employment crisis during the 1970s, and the earnings of some black workers did not increase as rapidly as those of whites. Finally, black male employment relative to population was 73 percent in 1964 and 1969 and slipped to 64 percent in 1979; the comparable figures for white males were 78 percent, 78 percent, and 75 percent.

The Holding Period and Capital Gains

Under current U.S. tax law, all sales of capital assets such as corporate stocks are not equal; the law distinguishes between short-term and long-term transactions. **Steven Kaplan**, in *NBER Working Paper No. 762, The Holding Period Distinction of the Capital Gains Tax*, argues that this distinction: (1) makes the capital markets less efficient; (2) does not discourage speculation; and, most important, (3) may cost the federal government revenues. Kaplan calculates that the system may have cost the government at least \$40 million in 1977.

Currently, net short-term gains involving sales of assets held less than a year are taxed as ordinary income while net long-term gains are taxed at only 40 percent of the ordinary rate. Similarly, net short-term losses may be deducted from income while only 50 percent of net long-term losses may be deducted, with a limit of a total \$3,000 deduction.

This differential tax treatment creates incentives for investors not to realize short-term gains. However, it encourages the taxpayer to take short-term losses. By looking at Internal Revenue Service data on individual corporate stock transactions for 1973, when the holding period was six months, Kaplan offers additional evidence of the tendency for the tax law to lock investors into short-term gains until they become long-term. Investors held onto stocks longer than they would have otherwise. The amount of capital gains realized on all tax returns decreased steadily for holding periods from under one month to five–six months. Then it increased dramatically at six–seven and seven–eight months when, presumably, investors sold their stocks to realize long-term—rather than short-term—gains. This behavior was most pronounced for taxpayers with gross and adjusted incomes greater than \$100,000 who, because of their high income tax bracket, stood to benefit most.

Two opposing forces affect the size of the average short-term gain realized. One is the price variance over time: this causes the size of the average outstanding gain to increase with time. The other is the tax disadvantage of short-term gains: this tends to make it less worthwhile to realize large short-term gains as the six-month period approaches. Examining a 3,000-taxpayer sample from the 30,000 taxpayers in the 1973 IRS data, Kaplan finds that the average gain realized, after increasing for a time, begins to decrease after a 3½-month holding period.

Theoretically, by taxing short-term gains at a high rate, speculators who turn their assets over quickly

will be taxed more heavily. In reality, however, speculators with their tendency to make many transactions might tend to hold onto investments with gains long enough to get long-term treatment and dump losing stocks to get short-term losses that can offset any short-term gains. So, “the holding period distinction is less of a deterrent to the speculator than it is to other investors.”

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The 1973 tax data, Kaplan finds, tends to confirm the tendency of some wealthy speculators to take advantage of the tax treatment of short-term losses as offsets to short-term gains and thus they are not fundamentally deterred from speculation. Large gains are likely to be held until they become long-term. Over 80 percent of the taxpayers with more than 20 corporate stock transactions in 1973—those taxpayers most likely to be speculators—paid no tax on short-term capital gains.

Another argument made in favor of a holding period distinction is that by taxing short-term gains at a higher rate, Treasury revenues are increased. Kaplan shows, however, that, at the same time, the distinction decreases Treasury revenues through its favorable treatment of short-term losses.

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Are Income and Wealth Passed On?

Some people believe that the American economic system creates an aristocracy of wealth: rich parents bequeathing money and business contacts to their heirs. Actually, economic success can be passed on to children in a number of ways: through genetic or cultural traits, education, gifts, and inheritance. Few social scientists have actually measured intergenerational correlations of income and wealth, though. In *NBER Working Paper No. 754, Intergenerational Effects on the Distribution of Income and Wealth: The Utah Experience, 1850-1900*, that is what Research Associates **J. R. Kearl** and **Clayne L. Pope** do. While they find a persistent relationship between the economic status of parents and their children, they observe enough averaging out over time that an economic elite was “unlikely to be based upon intergenerational transmission of success.”

The authors choose Utah in the 19th century as their sample for a number of reasons. First, the Mormon Church kept extensive family records including information on income and wealth that could be merged with data from the U.S. censuses of 1850, 1860, and 1870 containing questions regarding wealth. Second, Utah during this period was characterized by rising inequality, economic mobility, and individual (or family) positions substantially influenced by such factors as birthplace, sex of household head, and decisions made in past years.

Using this data, Kearl and Pope estimate a series of measures of the relationship between fathers' wealth and sons' wealth or income. In 1870 fathers were about 30 years older than their sons and held about 2/3 more wealth than their sons. Taking account of no individual characteristics except age, Kearl and Pope find that a group of fathers with 100 percent more wealth than a second group had sons who averaged only 30 percent wealthier than the second group's sons. This is termed an elasticity of .30. If the father had already died in 1870, there was a higher correlation between his wealth prior to his death and his sons' wealth than was found among living fathers and sons.

Kearl and Pope then go on to consider other factors. They find, for example, that “foreign birth reduces an individual's wealth-holdings by 29 percent relative to U.S. born individuals with otherwise comparable characteristics.” But when the authors allow for son's age, place of birth, portfolio decisions (wealth held as land or other assets), county of residence, and occupation, the elasticity between fathers' and sons' wealth falls only from .302 to .22. This implies that the fathers' eco-

nomical position exerts some pull on the sons above and beyond these other factors.

Next Kearl and Pope consider the relationship between fathers' wealth in 1860 and sons' wealth ten years later. Those data show only a slight relationship (an elasticity of .10), but if the father died during that decade, the relationship is stronger (elasticity rises to .34). Obviously, then, there is an inheritance effect, but it is smaller than previous studies have indicated.

If one considers sons' income, rather than wealth, and looks at fathers' wealth in 1870 and sons' wealth 15 years later, there is again only a slight relationship (elasticity for all sons in the sample is .135, for sons of deceased fathers, .212).

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The number of siblings in the family with a deceased father affects the sons' income, too. “For example, a farmer in Salt Lake County who is U.S. born, whose father was average in age and wealth in 1870, would have a 13 percent lower income in 1885 if he had ten siblings instead of five,” the authors note.

Kearl and Pope summarize their findings by noting that the persistent relationship between fathers' and sons' wealth exists prior to the fathers' death and therefore must reflect genetic or cultural inheritances. While parents' economic position emerges as one influence on the level and distribution of wealth, it is not an extremely large influence, and “regression toward the mean [that is, the rich getting poorer and the poor getting richer] appears to be a dominating tendency within the intergenerational economic process.”

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