

IN THIS ISSUE

- Recessions and the Cost of Job Loss
- For-Profit Postsecondary Schools
- Fiduciary Duties and Equity-Debt-holder Conflicts
- Family Proximity, Childcare, and Women's Labor Force Attachment
- CEO Preferences and Acquisitions
- Saving Rates in Developing Asia

Recessions and the Cost of Job Loss

Economic downturns bring increases in permanent layoffs, even among workers with high prior tenure on the job. Using Social Security records for U.S. workers covering more than 30 years (1974–2005), researchers **Steven J. Davis** and **Till von Wachter** explore the cumulative earnings losses associated with what they call “job displacement.” They are particularly interested in the role of labor market conditions at the time of job displacement in determining the magnitude of these losses.

In **Recessions and the Cost of Job Loss** (NBER Working Paper No. 17638), they find that for men under the age of 50 with three or more years of job tenure, job loss reduces the present value of earnings by an esti-

mated \$77,557 (2000 dollars). This amount is estimated over a 20-year period using a 5 percent annual discount rate. The estimated losses are

average earnings loss equals 2.8 years of pre-displacement earnings.

The evidence suggests that tight labor market conditions at the time

“If the unemployment rate is above 8 percent, the average earnings loss [for men under the age of 50 who lose their jobs, with at least three years of job tenure] equals 2.8 years of pre-displacement earnings.”

even larger for men with more job tenure, but are smaller for women.

The researchers further find that earnings losses rise steeply with the unemployment rate at the time of displacement. If the unemployment rate at the time of displacement is less than 6 percent, then the average earnings loss equals 1.4 years of pre-displacement earnings. If the unemployment rate is above 8 percent, the

of displacement strongly improve the medium- and long-term future earnings prospects of displaced workers. Because job-finding rates among the unemployed are highly pro-cyclical, tight labor market conditions also strengthen near-term re-employment and earnings prospects.

— Lester Picker

For-Profit Postsecondary Schools

Between 2000 and 2009, enrollment in private, for-profit, postsecondary degree granting institutions grew from 4.3 to 10.7 percent of all postsecondary enrollments among institutions eligible for Department of Education student financial aid under Title IV. In **The For-Profit Postsecondary School Sector:**

Nimble Critters or Agile Predators? (NBER Working Paper 17710),

for-profit sector and then compare the outcomes for first-time for-profit

“Students at the for-profit schools leave school with considerably higher debt, and they default on their loans at a higher rate.”

David Deming, Claudia Goldin, and **Lawrence Katz** study the schools, students, and programs in the private

students to those of first-time students who attended community colleges or other non-profit institutions.

Using data on a sample of first-time students who are in their first, third, and sixth years since entering an undergraduate institution in the fall of 2003–4, the researchers find that the for-profit students have a higher probability of finishing the first year of a program. This early persistence, and the fact that for-profit students are less likely to report taking remedial courses in their first year, appears to translate into a one-or-two-year certificate program completion rate that is 9 percent higher than that of similar commu-

nity college students. However, the for-profit students are 5 percent less likely to complete longer undergraduate programs than students at non-selective non-profit schools.

Students at the for-profit schools also have “higher sticker-price tuition and pay higher net tuition than comparable students at other institutions.” They leave school with considerably higher debt, and they default on their loans at a higher rate, even after controlling for a detailed set of student characteristics and their pre-enrollment academic

record. By 2009, the default rate for students with \$5,001 to \$10,000 in cumulative federal student loans was 26 percent for students enrolling at for-profits, 10 percent for those enrolling in community colleges, and 7 percent for those enrolling in 4-year public and nonprofit schools. Students at for-profit schools also had modestly lower earnings, and were less likely to be working or to still be enrolled in school six years after starting college.

—Linda Gorman

Fiduciary Duties and Equity-Debt-holder Conflicts

One of the cornerstones of U.S. corporate governance is that directors and officers have a duty to manage their firms to maximize shareholder value. However, decisions that increase shareholder value may impose costs on other stakeholders, such as creditors and employees. To ensure that firms are run in shareholders’ interest, directors and officers may be assigned fiduciary duties, requiring that they take certain actions that are in the interest of owners. Historically, the position of U.S. courts has been that for solvent firms, such fiduciary duties were owed to the firm as a whole and to its owners, but not to other firm stakeholders, such as creditors. If a firm became insolvent, however, then fiduciary duties were owed to all interested parties (including creditors).

This changed with a Delaware court’s ruling in the 1991 *Credit Lyonnais v. Pathe Communications* bankruptcy case. The ruling argued that when a firm is not insolvent but is in the “zone of insolvency”, duties already are owed to creditors. The case was widely understood to have created a new obligation for direc-

tors of Delaware-incorporated firms. Because this ruling did not affect firms incorporated outside Delaware, it provides a “natural experiment” for

examining whether and how equity-debt conflict affects firm behavior.

In **Fiduciary Duties and Equity-Debt-holder Conflicts** (NBER Working Paper No. 17661), authors **Bo Becker** and **Per Strömberg** compare Delaware-incorporated firms to non-Delaware firms before and after the 1991 change. They find that firms affected by the court ruling increased equity issues and investment and reduced operational and financial risk. They also find that in this same group of firms, leverage increased and the use of covenants—contractual features that are often understood as control mechanisms for creditors—declined after 1991.

There appears to have been little impact of this court ruling on firms with low leverage, or firms unlikely to default—firms far from the “zone of insolvency.” Instead, the effects of the new ruling were iso-

lated to the subset of firms in which financial distress was more likely.

In the absence of rules like those associated with this court case, firms

“The Credit Lyonnais ruling was followed by slight increases in leverage and a modest increase in average firm values.”

in distress may have an incentive to undertake actions that are unfavorable to creditors but valuable for equity holders. These behaviors lead to indirect costs of financial distress, discouraging leverage and reducing overall firm value. Indeed, the authors find that the Credit Lyonnais ruling was followed by slight increases in leverage and a modest increase in average firm values around the time of announcement. Thus, firms appear to have reaped immediate benefits of lower agency costs in the form of higher investment, lower operational risk, higher equity issues, and better access to debt. In addition, stock prices responded positively to the ruling, especially for firms with moderate levels of debt.

—Lester Picker

Family Proximity, Childcare, and Women's Labor Force Attachment

Married women with children under age 12 are 4-to-10 percent more likely to work if they live within 25 miles of their mothers or mothers-in-law. In **Family Proximity, Childcare, and Women's Labor Force Attachment** (NBER Working Paper No. 17678), **Janice Compton** and **Robert A. Pollak** suggest that this higher employment rate is the result of better access to both regularly scheduled childcare and to "insurance" care, care that can be provided on an irregular basis or on short notice.

The data for this study come from the U.S. Census and from the National Survey of Families and

Households, which sampled 13,007 households in 1987–8 and followed up five years later. The authors focus on women aged 25 to 60 whose

About 4 percent of women living more than 25 miles away from their mothers or mothers-in-law receive work-related childcare from them.

"Roughly 25 percent of women living within 25 miles of their mothers receive work-related childcare from them, [compared with] only 4.2 percent of women living more than 25 miles away."

mothers (or mothers-in-law) were alive and living in the United States. They find that roughly 25 percent of women living within 25 miles of their mothers receive work-related childcare from them. Almost 20 percent of women within the same proximity of their mothers-in-law receive work-related childcare from them.

Close proximity is also strongly correlated with education. Among couples in which neither spouse had a college degree, 46 percent lived within 25 miles of both mothers, while only 17 percent of couples where both spouses were college graduates lived in such proximity.

—Linda Gorman

CEO Preferences and Acquisitions

The careers of most target firms' CEOs suffer after an acquisition. Mergers frequently force target CEOs to retire early, and the older the CEO, the more likely the merger is to end a career entirely. For CEOs, the private merger costs are the forgone benefits of staying employed until their planned retirement date.

In **CEO Preferences and Acquisitions** (NBER Working Paper No. 17663), **Dirk Jenter** and **Katharina Lewellen** find that target CEO preferences affect merger patterns. Using acquisition data on 5,537 public U.S. firms from 1992 to 2008, the researchers determine that the likelihood of a takeover bid increases sharply when the target CEO reaches age 65. Controlling for CEO and firm characteristics, the implied probability that a firm receives a takeover bid is close to 4 percent per year for CEOs between the ages of 56 and 65, but it increases

to 6 percent for those over the age of 65. This corresponds to a 50 percent increase in the odds of receiving a bid. Bidders thus are more

implies that a CEO with lower private costs will require a smaller gain for shareholders to approve a merger deal. Thus, if retirement-

"CEOs' retirement preferences have a significant impact on firms' takeover decisions and on shareholder value."

likely to target firms with retirement-age CEOs, possibly because of these CEOs' reduced resistance to takeovers. The increase in takeover activity appears precisely at the age-65 threshold, with no gradual increase as CEOs approach retirement age, ruling out many alternative explanations.

Jenter and Lewellen also examine the effect of target CEOs' retirement preferences on takeover premiums. CEOs are concerned about shareholder value because they themselves hold equity in their firms and because of pressure from boards to maximize shareholder wealth. This

age CEOs face lower private costs, they allow more mergers to proceed, and the incremental deals generate lower shareholder gains on average. Consistent with this prediction, observed takeover premiums and target announcement returns are significantly lower when target CEOs are above 65. Controlling for firm, CEO, and deal characteristics, the takeover premium measured from one month before the first bid announcement to the final offer price is 10 percentage points lower when the target firm has a retirement-age CEO. This is a large reduction relative to the average takeover premium of 32 percent.

Overall, Jenter and Lewellen's findings suggest that CEOs' retirement

preferences have a significant impact on both bidders' and targets' take-

over decisions and, ultimately, on shareholder value.

— Matt Nesvisky

Saving Rates in Developing Asia

In **The Determinants and Long-Term Projections of Saving Rates in Developing Asia** (NBER Working Paper No. 17581), co-authors **Charles Yuji Horioka** and **Akiko Terada-Hagiwara** present and analyze trends between 1966 and 2007 in domestic saving rates in twelve developing Asian economies. They find that domestic saving rates in general have been high and rising but that there are substantial differences among countries. For example, the average nominal domestic saving rate was 11.2 percent in Pakistan and 39.8 percent in Singapore during this period. Moreover, for the entire group of countries, nominal domestic saving rates increased from 19.8 percent in 1966–70 to 37.5 percent in 2001–7.

The main determinants of these trends appear to have been the age structure of the population, income levels, and, to a lesser extent, the level of financial sector development. A high ratio of aged-to-working-age populations has a significant

negative impact on the saving rate because the aged typically finance their living expenses from previously

“The domestic saving rate in developing Asia as a whole will remain roughly constant over the next twenty years.”

accumulated savings. Income levels initially have a negative impact on domestic saving rates but their impact becomes more and more positive as income levels rise.

The impact of financial development on saving depends on the stage of development. In half of the countries in this sample, financial development was in the early stages and had a positive impact on saving rates. For the other half of the sample, financial sector development had progressed enough for the availability of private credit to be having a negative impact on the domestic saving rate.

The authors project that the domestic saving rate in developing Asia as a whole will remain roughly constant over the next twenty years.

However, there will continue to be substantial variation from economy to economy. The rapidly aging econ-

omies will show a sharp downturn in their domestic saving rates by 2030 because the negative impact of population aging will dominate the positive impact of higher income levels. The less rapidly aging economies will show rising domestic saving rates, at least until 2020, because the positive impact of higher income levels will dominate the negative impact of population aging. The primary exception is China, where the domestic saving rate is projected to remain roughly constant for the next two decades, as the substantial downward pressure caused by the rapid population aging will be roughly offset by the substantial upward pressure caused by higher income levels.

— Claire Brunel

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