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HOW RAISING OIL PRICES CAUSED HOME FORECLOSURES FROM 2005-2008

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ABSTRACT

Low-to-middle income mortgage borrowers, who took out variable interest rates between 2001 and 2004, were caught in interest rate increases, between 2005 to 2007. Home foreclosures were the result of interest rate increases that preceded the financial mortgage crisis of 2008. Study data and analysis demonstrates a moderate correlation between the rise in interest rates and the rise in the price of oil between 2004 and 2007. Dependence on unstable oil supply sources in conjunction with the overall increase in the demand resulted in the loss of home ownership for those who were using low interest rates to better their standard of living.

INTRODUCTION

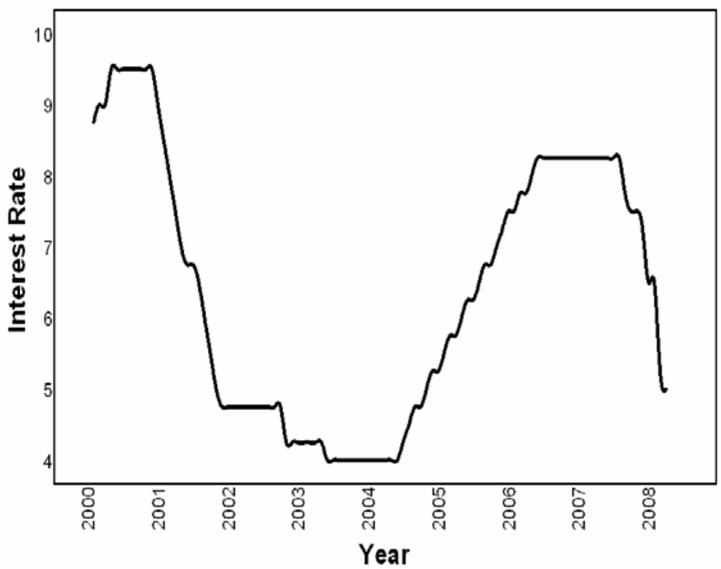
The current financial mortgage valuation problems and sub-prime mortgage foreclosures were initiated in 2004. The Federal Reserve System lowered interest rates from 9.5% in 2000, to 4% in 2003. An increasing number of borrowers were attracted to the low 4% interest rate. In 2004, the Federal Reserve reversed the direction of interest rates and raised interest rates from 4% culminating at 8.5% in 2007 (Board of Governors of the Federal Reserve System, 2008). The "housing bubble" was generated by lowering interest rates with the bubble "bursting" at the peak of rise of interest rates in 2007.

Another significant event contributed to the Federal Reserve interest rate manipulation, during 2000-2008, leading to the devaluation of home values in 2007-2008. This event was the spike in the price of oil from 2004 to 2008. The Federal Reserve raised interest rates, from 2004-2008, in a positive proportional manner which matched the raise in the price of oil (Energy Information Administration, 2008). Without the raise in the price of oil, one might assume that the Federal Reserve would not have raised interest rates subsequently, the crash in the value of homes would not have been so pronounced. It may also be stated that the financial mortgage lending institutions would not have experienced the current crisis in their holdings of loan portfolios. Many low-to-middle income homeowners, who obtained variable rate loans, during the low interest rate years of 2000-2003, entering the ranks of homeownership for the first time, would not have lost their homes through foreclosure.

STUDY DATA

The fluctuation of prime interest rate is shown in Chart 1.

Chart 1: Interest Rates



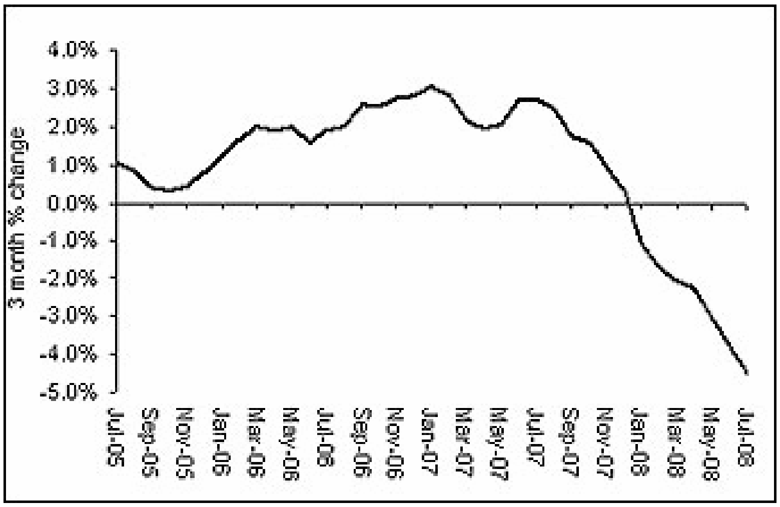
(Board of Governors of the Federal Reserve System, 2008)

The prime interest rate depicts low level of interest rates from 2002 to 2004. It was during this period that low income borrowers had the opportunity to enter the housing market. Naturally, the demand for houses followed the laws of supply and demand. Because the demand for houses was high due to the low interest rates, the price of houses increased. In 2005, Chairman Greenspan recognized, "…some regional housing markets were showing signs of unsustainable speculation and "froth" and that here were "a lot" of local housing bubbles (Haddad, 2005, p. 1)." Ackman (2004) noted, low interest rates and low energy prices were stimulating the economy but those trends reversed in 2004. He also commented that Federal Reserve Chairman Greenspan, in reference to the raise in home values, was "quelling concern…and…Wall Street analysts saw the rise as a spot phenomenon, nothing really to worry about (Ackman, 2004, p. 1).

It was during this period that initial variable rate loans dropped to a low of 3.5% (Mortgage X-Mortgage Information Services, 2008). However, initial variable rates were soon converted to indexed variable rates with an additional margin increase. Individuals, from 2002-2004, found their initial rates substantially increased when the initial variable rate changed to the variable indexed rate in 2005-2007. For example, individuals, who borrowed during the low interest rate trough, within the years 2001-2004, with an initial interest rate ARM of 4-5%, found themselves at the conversion rate, between 2005-2007, of 6-7% plus the 2.75% margin, using the CMT index. Thus, the new fully indexed rate became 8.75-9.75%. It can be assumed that the borrowers who were marginally qualified to obtain their loans found themselves experiencing increasing financial difficulty. It would also be valid to assume that these individuals, who could qualify for a loan at a higher fixed rate mortgage, could have avoided such financial trouble by choosing a fixed income mortgage loan.

It was during 2004-2007, that the Federal Reserve began the increasing interest rates. As a result, peak high housing starts were reduced. In 2007, home buyers factored in the purchase price of a home, the added cost of higher interest rates and the value of homes started to decline. Chart 2 (Butterworth, 2008) illustrates the decline in median home values.

Chart 2



The correlation is evident. The rise in interest rates precipitated the decrease in home values. This in turn devalued the after market value of home loans burdening the books of financial institutions.

CONCLUSIONS

The initial source of the 2008 financial mortgage crisis was not bad lending practices of financial institutions, nor was it the result of irresponsible borrowers. The 2008 financial mortgage crisis was a direct result of Federal Reserve interest rate manipulations beginning in 2000, and continuing through 2007.

The increase in interest rates, from 2004 to 2007, precipitated the collapse of home values in 2008. Individuals and financial institutions were encouraged to borrow and lend utilizing low interest rates not seen since 1958 (Board of Governors of the Federal Reserve System, 2008). Low and middle income borrowers were caught off guard by raising interest rates due to the rise in the price of oil.

To criticize borrowers or financial institutions appears, to the authors, to miss the root cause of the financial crisis. One key factor appears to be an excessive degree of interest rate manipulation by the Federal Reserve stimulated by the goals of fighting recessionary pressures in 2000 and an attempt to control inflation starting in 2004 (Wessel, 2008). The second, and no less important root cause, was the spike in oil prices from 2004 to 2008. Low-to-middle income mortgage borrowers appear to have paid the price for an unsteady and unreliable source of oil.

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ETHICS IN THE ECONOMICS CURRICULUM

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ABSTRACT

Ethics and ethical decision making are not new concepts or ideas in the economics field of study. Even in the earliest course in economics, students are asked to engage in differentiating between positive and normative economics followed shortly by examination of utilitarian and Rawlsian concepts of fairness and justice. Yet more and more in the world around us, the prominence of ethical decision making and corporate social responsibility has expanded beyond the realm of the academic world. This is evident through the extensive media coverage of corporate ethics crises, resulting reforms of standards and regulations, and in the expectations from accrediting bodies that explicit treatment of these subjects not only be incorporated but also assessed in curricula. The ability and willingness of some individuals and organizations to push the limits and even exceed them ethically and/or legally has led to demands that are changing the regulatory and legal environments of organizations and requiring universities to prepare students more rigorously in this regard.

Economics courses are particularly fertile grounds for the incorporation and examination of ethics. Not only do introductory courses set up the dichotomy between normative and positive economics so students are explicitly aware of what could be versus what ought to be, and also examine justice with respect to policy, but the nature of economics course is such that they are constantly examining the world around us which is rife with ethical dilemma and the subsequent weighing of decisions and outcomes. Incorporation of pedagogies targeted at ethics based learning objectives not only has the potential to increase reality-based elements in courses and hence foster learning thereby preparing students to function individually and as parts of different types of organizations in the inevitably ethical contexts and dilemma they will find themselves, but also serves the purpose of meeting broader school and university goals regarding ethics and corporate social responsibility increasingly required by accrediting organizations.

This explicit inquiry into ethical decision making in economics courses began in an upper division course, Global Economic Issues. The goal was to have students engage themselves in an ethical dilemma: that of the whistle blower, utilizing a speaker brought in by the Helzberg School of Management at Rockhurst University and subsequently expressed through reflective essays. This presentation outlines that assignment, and then assesses the effectiveness of the assignment in meeting learning objectives. Based on this assessment, the author has revised the approach to be taken in the next upper division course to be taught: The Developing World: Economics, Politics, and Culture to retain elements of the methodology as well as incorporate new ones. The result is a reproducible approach that can be adapted to any economics course.

EVALUATING SCIENTIFIC JOURNALS: PROPERTIES, LIMITS AND CONDITIONS OF EFFECTIVENESS OF CLASSIFICATION METHODOLOGY

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ABSTRACT

During last years a large debate was developed among academics about research evaluation procedure. Approaches proposed in literature considers quantitative and/or qualitative aspects of each journal but each methodology has limits and characteristics high heterogeneous. The meaning and implication of results achieved with a ranking procedure is strictly influenced by the approach selected for the journal evaluation.

The paper presents a literature review of the main qualitative and quantitative approaches proposed for journal ranking focusing the attention on the main differences of approaches. The study is completed with an empirical analysis on the database Thompson Scientific, one of the main provider of quantitative rankings. The analysis considers the characteristics of quantitative rankings proposed, look at the qualitative characteristics of best and worst ranked journals and compares results obtained with those achieved by an international qualitative survey (Harzing database). Results obtained demonstrate the low degree of coherence of ranking based on different approaches and point out some risks related to the use of these approaches to evaluate research.

INCOME AND EXPENSES OF LOW INCOME HOUSEHOLDS IN SMALL AND MID-SIZED CITIES OF THE U.S.

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INTRODUCTION AND METHODOLOGY

The US GDP growth climbed over $12 trillion in 2005, from over 1600 billion in 1975. This growth has been simply spectacular. Relentless hard work of the working population from the mid-sized cities contributed greatly to this growth. Unfortunately they received very little in return for their hard works. The startling fact is that the poverty pure and simple still engulfs millions of households in these cities. These households' economy belies the US economy. Another distressing feature of the US economy is the glaring disparity of income existing among different profession and regions, for decades. Our survey is designed to find the facts concerning the precarious economic existence of these households. This leads us to finding income, debt, and unavoidable expenses that these households incur.

Tax and interest payments on debts constitute obligatory expenses for a family. But what are the size of taxes and interest payments of these household? And these payments constitute what percentage of household income? Unfortunately, hardly there is a study reflecting on these facts. In this study we have tried to find out the average income, size of the debt, interest payment, and size of the taxes these households pay. Additionally, we also try to determine the interest and tax payments together constitute what percent of their income in mid sized cities in the US. A randomly selected sample size of 472 household's information on income, taxes and interest paid was collected and analyzed.

Our findings are as follows:

- **Average size of the income was $28,587.00.**
- **Average size of the interest paid was $886.00 (3% of income).**
- **Size of the tax paid was $941.00.**
- **Federal tax paid was $2,457.00 (9% of income).**
- **Household total expenses in the form of interest, state tax, and federal tax was$3,398.00 (12% of income).**

Disposable Income = Y - (Interest Paid + State Tax + Federal Tax)
$24,303 = 28,587 - $886 + $941 + $2,457

Per capita GDP [for all Americans stands at $43,000, per households] GDP stands at $86,000 (Assuming 2 persons living in one house). Per capita income in the mid sized cities stands at half of $14,294. It simply means that these households in midsized cities earn 82% less than what American households earn.

INCOME GROUP	
5 – 10,000	13 % of households belong to this group. Their total expense varied from a low of \$0 to a high of \$3221. The average total expenses of these households amounted to \$513. This amount constitutes 7% of the average income of this group.
10 – 20,000	29 % of households belong to this group. Their total expense varied from a low of \$0 to a high of \$5038. The average total expenses of these households amounted to \$997. This amount constitutes 7% of the average income of this group.
20 – 30,000	17 % of households belong to this group. Their total expense varied from a low of \$0 to a high of \$4718. The average total expenses of these households amounted to \$2444. This amount constitutes 10% of the average income of this group.
30 – 50,000	16 % of households belong to this group. Their total expense varied from a low of \$240 to a high of \$14323. The average total expenses of these households amounted to \$5001. This amount constitutes 3% of the average income of this group.

Expenses Regressed on Income

$$TE = \beta_0 + \beta_1 INCOME + \mu$$

where TE = Total Expenditure
μ = The residual term

Variable	Coefficient	Std Error	T-Statistic	Significance
CONSTANT	-1281.37	189.88	-6.75	0.00
INCOME	0.19	0.005	40.21	0.00

$$TE = -1281.37 + 0.19 * INCOME$$

(189.88) (0.005)

$$R^2 = 0.775$$

where the numbers in parentheses are the corresponding standard errors.

The equation shows that a low income households on average have to set aside 20 cents out of each dollar increase in income to meet taxes and interest payments. The surge in prices of some essential goods and services, such as gas, insurance premiums, and interest payments has increased the economic hardships of low income families in mid-sized US cities substantially.

Group analysis also shows that 52% of low income households earn less than \$15,000 in midsized cities and are living below poverty. Group analysis confirms that a little less than one third of income household (29%) spend about 8% of their income on unavoidable expenses such as (interest, state tax and federal tax). This also means that out of a dollar increase in income these households have to set aside 8 cents for these outlays.

Income group ($30,000-$50,000) spends about 13% of their income for interest and tax payment. Over $50,000 income group are requires to set aside over 16% of their income for interest and tax payments.

Against the back drop of the United States' over 10 trillion dollars GDP, a poor distribution of income has overshadowed and diminished the accomplishment of the economy. In small and mid-sized cities of the U.S., a large section of the population feels that it does not receive a legitimate share of the vast wealth of the U.S. economy in return for contributions they make to create it. Often these groups are forced to supplement their inadequate incomes by borrowing from costly sources and by bearing heavy debt burdens which often far exceed their incomes.

Inherent in the traditional distribution system lie forces that tend to widen disparities in income and help concentrate wealth in the hands of few. In the absence of the economic betterment of low and middle-income households, the richness of this nation may be misread as the prosperity of the few. With its current accumulation of capital, resources and vast infrastructure, the U.S. has the most powerful economy in the world. Against this richness of the economy, the financial woes of millions of households in small and mid-sized cities stand out like a sore thumb.

High debt-income ratios, low incomes, the inability to service debt, the agonies of living and dying in debt have become, over the years, a part of life for these poverty stricken households. This scenario contrasts with the abundant wealth and prosperity of the economy in which they live. This has been continuing for decades unnoticed and neglected. The time is ripe to address this issue once and for all. The woes, anxieties, pains, and anguish originating from low income, burdensome debt, and the man-made obstacles that the low income households surveyed in this study confront in everyday life are sorry spectacles. Traditional unfair distribution principles, abuses in credit markets and the callousness of society are at the root of their problems.

USING ITEM STATISTICS TO IMPROVE MULTIPLE-CHOICE ECONOMICS EXAMS

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ABSTRACT

In multiple-choice test construction, knowledge of item construction guidelines as well as analysis of output statistics can greatly improve the accuracy of assessment. Because scoring is often completed using computer software, a variety of output statistics are available for feedback and assessment purposes. Such statistics include those measuring option response frequency, item difficulty, and item discrimination. Analyzing the response frequency of item options can quickly identify questions violating construction guidelines as well as mistakes on an exam key. Item difficulty is reflected in the p-value, or the ratio of correct responses to total responses. Item discrimination, a measure of how each question discriminates among levels of student learning, is often measured by the point biserial statistic, which can aid instructors in establishing which test items should be removed, or alternatively, in modifying or "curving " test scores to reflect overall student performance.

In this study, five common errors of item construction are examined through actual examples from economics exams. Violation of item writing guidelines related to language usage, verbal clues, stem cues, longer correct options, all-inclusive distracters, and absolute terms in distracters are analyzed using output statistics from examples. Finally, suggestions for improvement in item construction and test writing strategies are presented.