Reckless Research
An Unpublished Review of *Reckless Endangerment* by Morgenson and Rosner

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If the material in this book on mortgage discrimination is any indication, the “reckless endangerment” in the title must refer to the authors’ own research methods. This material contains numerous errors and the authors completely ignore the large volume of research in the last two decades that undermines their conclusions.

Morgenson and Rosner focus on a 1992 study by scholars at the Federal Reserve Bank of Boston. This study, the so-called Boston Fed Study, found that in 1990 Blacks and Hispanics in Boston were 82 percent more likely to be turned down for a loan than whites with equivalent credit characteristics. (Morgenson and Rosner can’t even state this finding correctly; according to them, the Boston Fed Study claimed that “The rejection ratio for minorities was 2.8 to 1 compared with white applicants” (p. 33). This is a description of the raw data, not the Boston Fed Study’s conclusion.) Morgenson and Rosner dismiss the Boston Fed’s principal finding with the claim that “The methods used by the Boston Fed researchers to prepare their report were flawed, according to a throng of critics in and out of academia” (p. 35). This claim is simply not correct. Many people raised questions about the study, but all the rigorous investigations of the study’s data and methods, and there were several, found that the study’s results were remarkably robust. Indeed qualitatively similar results emerged from a wide range of alternative variable definitions and statistical methods. Moreover, the paper was published in 1996, after peer review, in the *American Economic Review*, which is one of the most rigorous and prestigious journals in economics.

According to Morgenson and Rosner, researchers evaluating the Boston Fed Study concluded that the Boston Fed "analysts did not consider whether an applicant met a lender's credit guidelines" and that "the type of model used by the Boston Fed oversimplified the complex mortgage lending process" (p. 35). I do not know who Morgenson and Rosner interviewed, but the scholars who have published rigorous evaluations of the Boston Fed Study emphatically disagree with these conclusions. Indeed, the whole point of the Boston Fed Study was to account for the many factors that lenders consider in making an underwriting decision and then to determine of Blacks and Hispanics are treated differently after all these factors are taken into account. They interviewed a large number of lenders in Boston to determine the factors they considered, they collected data on all those factors, and they estimated numerous sophisticated models of lenders' underwriting decisions. Moreover, as indicated above, many alternative models estimated by other scholars yield qualitatively similar answers. Contrary to the claims of Morgenson and Rosner, it was possible to conclude that banks decisions were driven by something "other than sound lending decisions" (p. 35).

Finally, Morgenson and Rosner push an erroneous argument from an article in *Forbes* magazine based on loan default rates. "[I]f bias were at work in minority neighborhoods," they say, "default rates in those areas would have been lower than among white areas, indicating that bankers were refusing loans to legitimate minority borrowers" (p. 36). The fact that default rates were not lower in minority neighborhoods, "should have been a signal to the researchers that their discrimination findings were off base" (p. 36). Although this line of argument has received support from Nobel Laureate Gary Becker, both in a *Business Week* column and in his Nobel

Lecture, it is simply not correct. Indeed, the flaws of this argument have been well known in the academic literature for at least 30 years, and are even clearly laid out by one of the Boston Fed critics cited by Morgenson and Rosner, namely, Stanley Longhofer.

The most fundamental problem with this argument is that it confuses averages and margins. The default rate for a group of borrowers is an average that reflects the entire distribution of credit characteristics for those borrowers—not just the characteristics of the least creditworthy borrowers in that group. Consider two groups, one of which (say whites) has many more borrowers with impeccable credit (and many fewer borrowers with questionable credit) than another group (say members of a minority group). Then with no discrimination, the average default rate for whites will be much lower than for minorities. Now add discrimination that takes the form of a higher credit standard for minority than for white borrowers. In this case, minority applicants with creditworthiness equal to that of the white borrowers with the poorest credit will no longer receive loans. As a result the default rate observed among minority borrowers will go down. However, there is absolutely no reason to believe that this decline in the default rate for minorities will be sufficient push the average black default rate below the average white default rate. Indeed, given the high concentration of white borrowers at the highest level of creditworthiness, this outcome is highly unlikely.

Perhaps the terrible research on mortgage discrimination in *Reckless Endangerment* is just an aberration, but I doubt it. Reporters who are this sloppy on such a central issue are unlikely to careful on everything else. Readers should be very skeptical about all the claims in this book.

Further reading:

Morgenson-Rosner:

Morgenson, Gretchen, and Joshua Rosner. 2011. *Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon.* New York: Times Books.

The Boston Fed Study:

Munnell, Alicia H., Lynn E. Browne, James McEneaney, and Geoffrey Tootell. 1996. "Mortgage Lending in Boston: Interpreting the HMDA Data." *American Economic Review* 86 (1) (March), pp. 25-53.

Rigorous evaluations of the Boston Fed Study:

Carr, James H., and Isaac F. Megbolugbe. 1993. "The Federal Reserve Bank of Boston Study on Mortgage Lending Revisited." *Journal of Housing Research* 4 (2), pp. 277-313.

Glennon, Dennis, and Mitchell Stengel. 1994. "An Evaluation of the Federal Reserve of Boston's Study of Racial Discrimination in Mortgage Lending." Economic and Policy Analysis Working Paper no 94-2. Office of the Comptroller of the Currency, Washington, D.C.

Ross, Stephen L., and John Yinger. 2002. *The Color of Credit: Mortgage Discrimination, Research Methodology, and Fair-Lending Enforcement* (Cambridge, MA: The MIT Press), Chapter 5, "Evaluating Criticisms of the Boston Fed Study."

A response to the critics by the Boston Fed Researchers:

Browne, Lynn E., and Gregory M. Tootell. 1995. "Mortgage Lending in Boston: A Response to the Critics." *New England Economic Review* (September/October), pp. 53-78.

Proponents of the so-called default approach:

Becker, Gary S. 1993. “The Evidence against Banks Doesn’t Prove Bias.” *Business Week*, April 19, p. 18.

Becker, Gary S. 1993. “Nobel Lecture: The Economic Way of Looking at Behavior,” *Journal of Political Economy* 101 (3), pp. 385-409.

Brimelow, Peter and Leslie Spencer. 1993. “Mortgage Lending Surprise! The Evidence Suggests that Banks are Color Blind When It Comes to Mortgage Lending.” *Forbes* 151 (1), January 4, p. 48.

Analysis of the so-called default approach:

Galster, George C. 1996. “Comparing Loan Performance between Races as a Test for Discrimination,” *Cityscape: A Journal of Policy Development and Research* 2 (1), pp. 33-39.

Longhofer, Stanley D., and Stephen R. Peters, “Beneath the Rhetoric: Clarifying the Debate on Mortgage Lending Discrimination.” *Economic Review*, Federal Reserve Bank of Cleveland, 4th Quarter 1998, vol. 34, no. 4, pp. 2-13.

Peterson, Richard L. 1981. “An Investigation of Sex Discrimination in Commercial Banks’ Direct Consumer Lending,” *The Bell Journal of Economics* 12 (2): 547-561.

Ross, Stephen L., and John Yinger. 2002. *The Color of Credit: Mortgage Discrimination, Research Methodology, and Fair-Lending Enforcement* (Cambridge, MA: The MIT Press), Chapter 8, “Using Performance Data to Study Discrimination: Evaluating the Default Approach.”