

The End of the American Dream? Inequality & Segregation in U.S. States

Discussion of Alessandra Fogli & Vernoica Guerrieri by Lee Ohanian

UCLA

50 Year Celebration of University of Minnesota & FRB Minneapolis
Partnership

Fascinating and Well-Crafted Paper!

- Equilibrium analysis of *increased housing segregation & wage inequality*
- Idea: return to H rises→altruistic parents invest more in kids' H
- Acquire H from education (private good) & local spillover
- 2 neighborhoods, housing rents capitalize value of spillover
- Higher return to H induces *income-based sorting*
- Rents, segregation, & inequality rise as rich benefit from spillover
- *Finding: Segregation accounts for 28% of post-1980 inequality rise*

Goal

- Equilibrium evaluation of *neighborhood effects*
- Model beautifully captures key evolution of U.S. neighborhoods:
- (1) Location choice depends on education opportunities
- (2) Equilibrium prices affected by education opportunities
- (3) Best education opportunities found in expensive locations
- (4) Rich economic feedback between opportunities & rents
- Quantitatively challenging, for reasons described below

Model

- Parents choose location (n), consumption (c), child education (e):

$$\begin{aligned} U(w_t, a_t) &= \max\{\ln(c_t) + E[g(w_{t+1})]\} \\ w_t &\geq c_t + R_{nt} + \tau e_t \\ n_t &\in \{A, B\} \end{aligned}$$

- Child's human capital:

$$w_{KID} = \varepsilon(b + ae\eta(\beta_0 + \beta_1 S_n^\xi))w_{PARENTS}^\alpha \quad (1)$$

Key Equation and How It Works

$$w_{KID} = \varepsilon(b + a\eta(\beta_0 + \beta_1 S_n^\xi))w_{PARENTS}^\alpha$$

- Focus on "inequality parameter" η and spillover S_n
- η changes permanently in 1980 - "inequality shock"
- Induces complex changes in S_n
- *Local spillover* is neighborhood child average human capital
- η increases *all* earnings - good for everyone
- No downward pressure on low ability wages

Challenges in Measuring Size of Spillover

- Key calibration target is Chetty-Hendren value of *exposure effect*
- Prominent in literature, but...
- Disentangling from selection/other effects is exceptionally hard
- Maintained assumption - effect independent of age
- Hard to reconcile with Keane-Wolpin (KW) 1995 JPE
- KW found male success determined by age 16, perhaps earlier

Challenges in Measuring Size of Spillover

- No evidence for persistence of effect, but this is needed for analysis
- Some neighborhood effect estimates are hard to buy into:
- San Jose one of the fastest growing areas - grew by 450%
- Yet Manchester, NH better than San Jose, but grew only 28%
- SF & Silicon Valley great for low income, but bad for high income
- Makes it challenging to quantify contribution of spillover

Modeling Choices That May Matter

- What is the neighborhood spillover?
- If high IQ kids, then this will be hard to scale up.
- Imagine importing 2,000 kids to Wayzata school district...

Modeling Choices That May Matter

- Schools in model identical, but...
- Awful learning outcomes in poor neighborhoods - reflect poor incentives
- Worst teachers are in these schools & no school choice
- Hoxby, Feyer, & others show *urban* charter schools have big effects
- Improved incentives & organization lead to large achievement gains
- This is scalable & very cost effective

Significant Racial Income Inequality Remains

- African American economic mobility is very low
- White child from top quintile 63% chance for top 2 quintiles
- Black child from top quintile 37% chance for top 2 quintiles
- 75% of Black kids in bottom will remain in bottom 2 quintiles
- Suggests a different narrative about post-1980 cities

A Different 1980s Narrative - "C17H21NO4"

- Crack cocaine began in U.S. in early 1980s
- Devastated many racially segregated neighborhoods
- Much higher incarceration, affects future employment
- Breakdown in family unit & social norms
- School quality deteriorates (absent from paper)

Conclusions

- Fascinating paper, with more exciting avenues for research
- *Capital markets*, will change some results, but allows analysis of student loans, etc.
- *Normative evaluations*, where specifying exact nature of spillovers will be important
- *School quality differences & reforms*
- Congrats to Alessandra & Veronica for a great paper!