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

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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 $\rightarrow$ 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 \((e)\):

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

- Child’s human capital:

\[
w_{KID} = \varepsilon(b + a\eta(\beta_0 + \beta_1 S_n^\xi))w_{PARENTS}^\alpha
\]  \quad (1)
Key Equation and How It Works

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

- Focus on "inequality parameter" \( \eta \) and spillover \( S_n \)
- \( \eta \) changes permanently in 1980 - "inequality shock"
- Induces complex changes in \( S_n \)
- Local spillover is neighborhood child average human capital
- \( \eta \) 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!