ECONOMIC FINDING

The End of the American Dream?

Alessandra Fogli, Monetary Advisor, Federal Reserve Bank of Minneapolis; Veronica Guerrieri, Ronald E. Tarrson Professor of Economics, Chicago Booth

Residential segregation significantly amplifies the increase in inequality in an economy where technological progress increases the skill premium.

The promise of the American dream is about the possibility of upward mobility; namely, that anyone, regardless of where they were born and what class they were born into, can achieve success on their own terms. Together with the recent dramatic rise of income inequality, US cities have experienced a steady increase in residential segregation by income that challenges this ideal.

This research focuses on the interconnection between inequality and residential segregation and the work of Raj Chetty and Nathaniel Hendren, who have estimated the effects of exposures to better neighborhoods on children's future earnings. Fogli and Guerrieri use these micro estimates to study the macroeconomic implications of these neighborhood effects. They show that residential segregation significantly amplifies the increase in inequality in an economy where technological progress increases the skill premium.

To determine this result, the authors calibrate their model using salient features of the US economy in 1980 and the micro estimates of neighborhood exposure effects. Then they study the response of the economy to a "skill-biased technical change shock," that is, a change in technology that increases the productivity of high-skilled jobs, and, hence, increases the earnings of the more and better educated workers. This is what happened in the US economy during the 1980s, and is considered one of the primary reasons for the widening income gap in following decades.

The main contribution of this research is to quantify how much of the subsequent increase in inequality is due to the presence of neighborhood effects and the resulting residential segregation. To this end, the authors compare the response of the benchmark model to the response that would arise if families

Figure 1 · Inequality and Segregation across US Metros

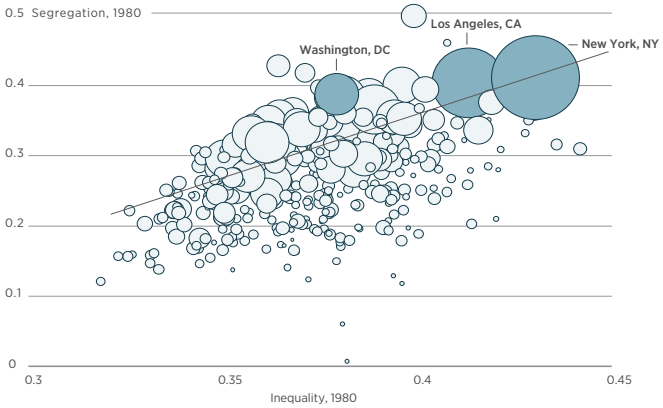
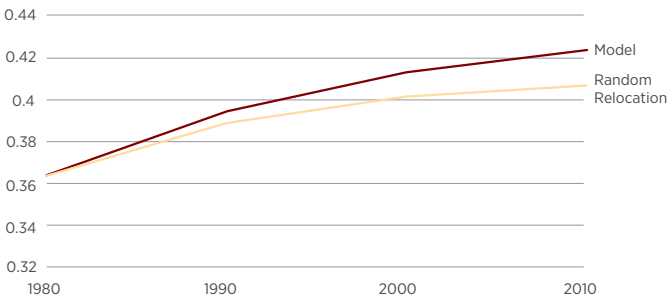


Figure 2 · Paid Employment Changes by 2-Digit Industry



Notes: This figure compares the response of inequality to the skill premium shock in the baseline model (yellow) to the response of the economy when families are randomly re-located between the two neighborhoods every period after the shock (light yellow). The figure shows that segregation contributes to 18% of the increase in inequality one period after the shock, that is, between 1980 and 1990, and to 28% of the increase in inequality over the whole period between 1980 and 2010.

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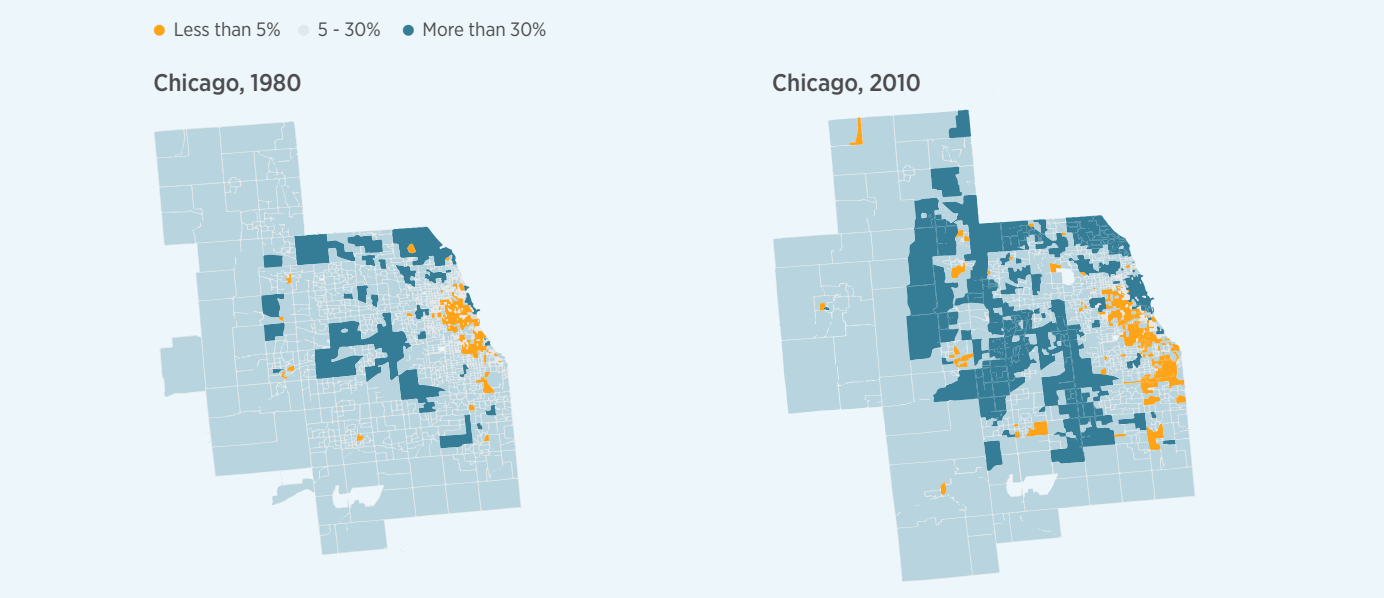
Figure 3 · Share of Rich Households in Chicagoland (those in the top 20th percentile) in 1980 and 2010



were randomly re-located across neighborhoods and the segregation channel was muted. The authors show sizeable results: segregation contributed to 28 percent of the increase in inequality in response to skill-biased technical changes between 1980 and 2010. The more that skill premia drive disparity in wages, the more certain neighborhoods will continue to gain an advantage, as children in those neighborhoods are better positioned to learn, adapt, and earn more than children in poorer neighborhoods. Skill premia act like a widening wedge, driving future generations of rich and poor children further apart.