

MESSAGE FROM THE PRESIDENT

Human Capital and the American Dream



Jeffrey M. Lacker
President

A 2006 documentary titled *The One Percent* chronicled the growing gap in wealth in the United States. Since that time, concerns about economic inequality have taken a prominent spot in public discourse. While rising inequality surely demands attention, perhaps an even more important issue is economic mobility.

Most measures of inequality compare income distributions from one point in time to another. In contrast, economic mobility, by definition, concerns the likelihood of moving up (or down) the income ladder. It is, in short, a more dynamic way to look at economic outcomes. It is also one that strikes a chord when we consider issues of social justice.

The widely shared ideal associated with the phrase “the American dream” is not, I would argue, the promise of prosperity, but the promise of opportunities to attain it. To the extent that such opportunities have disappeared or become vastly more difficult to seize, we fall short on this fundamental dimension of fairness.

Economists consider two distinct types of economic mobility: intragenerational and intergenerational. Intragenerational mobility refers to how a person’s economic status changes over the course of his lifetime. Intergenerational mobility is the degree to which a person’s economic status as an adult differs from his ancestors’ economic status.

As Kartik Athreya and Jessie Romero note in the feature essay of this year's *Annual Report*, both types of mobility seemed to decline in recent decades—particularly for people at the top and bottom of the income ladder. People in the middle remained more likely to experience significant changes in their fortunes, but people who were born to relatively rich or poor families tended to stay in those segments of the income distribution.

Why do we see such persistence at the extremes? There are a number of reasons—most notably the relative advantages and disadvantages that rich and poor parents convey to their children. But, as Athreya and Romero discuss, there can be little doubt that the returns to skill acquisition have risen over time. New technologies that have been developed and implemented over the past several decades have done more for the productivity of skilled workers than for less-skilled workers. As a result, the value of developing human capital has increased sharply. This is evident in the widening gap between the earnings of workers with and without college degrees.

The compensation gap seems to suggest continuing the various public policies that promote higher education. But research indicates that differences in educational attainment alone do not fully account for gaps in economic mobility, suggesting that human capital embodies other important factors as well. In fact, non-cognitive skills, such as work ethic, the ability to follow instructions, motivation, and patience may be just as important as cognitive skills in determining future success in the job market. And there is considerable evidence that the foundation for skill acquisition is laid very early in life. Long-term research projects have shown that high-quality early childhood education programs can deliver quantitatively significant social returns,

including higher lifetime earnings. Early mastery of some basic skills can make it easier to learn more complex skills throughout life, and children who fall behind early have difficulty catching up. This indicates that greater investment in early childhood education might be a more cost-effective way to increase equality of opportunity, in the long run, than increased subsidies for higher education.

Athreya and Romero are cautious, though, about the policy implications of the research they survey. That's appropriate, in my view, because more research is needed, and intuition alone is an insufficient and at times misleading guide to policy choice. Changes in economic opportunity are the result of a complex array of fundamental forces, and ideas about how to enhance opportunity have shifted over time. In decades past, we poured resources into traditional education—both K-12 and higher education—and yet improvements in fundamental measures of mobility have not been evident. This suggests to me that returns to such strategies are diminishing and that consideration of less-traditional strategies, such as greater investment in early childhood education, is warranted. New strategies should be grounded in well-vetted research, however, and implementation should be guided by careful evaluation of the effects on outcomes. Policy directions based on such research have the best chance to achieve sustained improvements in economic mobility. Such an outcome would be truly consistent with the American dream.



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