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The Pandemic Divide: How COVID Increased Inequality in America.

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The severe and prolonged economic consequences of the COVID-19 pandemic have stressed the earnings of tens of millions of households. The pandemic has also elevated concerns about further widening the racial disparities in economic outcomes for black and Latino families (for example, see figure 8.1). The unemployment rate surged at the start of the pandemic, with black and Latino workers experiencing higher rates of unemployment. And while the unprecedented fiscal support over the course of the pandemic helped stave off large increases in the poverty rate, the timing of this support still left uncertainty for households’ economic resources. Indeed, as figure 8.2 shows, the estimated poverty rate among black and Latino households fluctuated more during the pandemic, thanks to the outsized role of the social safety net and fiscal support for the adequacy of their economic resources relative to their needs. And on top of the many challenges with reduced or uncertain incomes, the pandemic has featured large racial disparities in health outcomes and access to education. Taken together, these shortfalls are likely to affect not just black and Latino households’ immediate needs but also, as research suggests, their long-term economic prospects (Hendren and Sprung-Keyser 2020).

Policymakers, philanthropists, nonprofits, and business leaders may wish to contemplate interventions that jointly address the immediate economic distress and lay the groundwork to help close economic gaps for black and Latino households. Given the persistence of earnings shocks and the challenges of re-employment after extended unemployment, black and Latino households may
be at heightened risk of falling even farther behind white households as a result of this protracted public-health and economic crisis.

In this chapter, we highlight evidence-based approaches—approaches based on empirical research—to reducing racial disparities in economic opportunity, particularly in light of the COVID-19 pandemic and economic downturn. Focusing on interventions with high private and social net benefits (or returns) leads us to emphasize strategies in three areas: (1) those related to children’s education and health; (2) those providing support for adults that typically have
spillovers to children; and (3) those focused on juvenile and criminal justice. We also briefly discuss interventions that have been evaluated and demonstrate low returns and interventions that have yet to be evaluated, including those targeting gaps in homeownership and wealth accumulation.

There are many possible policy interventions, so we limit our discussion in three ways. First, we focus on interventions that have been sufficiently evaluated, but there may be some that have not been evaluated and are still high-return. There may also be new interventions in development. In both cases, greater scrutiny would help broaden our understanding of the high-return interven-

tions that are available. Second, low-return interventions may be worth con-
sidering if they help achieve desirable noneconomic objectives, but this dis-
cussion is outside our scope. Third, often the purpose of interventions is to
help people with immediate needs, and such strategies are worth pursuing
without regard as to whether they lead to a large or permanent narrowing of
opportunity gaps.

Even though the interventions we review are wide-ranging, those with high
documented returns share some common characteristics. First, they tend to
have benefits that extend over a number of years. Second, they tend to have
benefits that spill over, such as to children or to the surrounding communities.
Third, they tend to provide direct material benefit or reinforce noncognitive
capabilities (soft skills) rather than giving beneficiaries complex information
or incentives. Finally, they have been evaluated empirically for both immediate
and long-term impacts.

**High-Return Interventions**

**Children’s Education and Health**

Absent intervention, economic disadvantage begins in utero and may com-
compound over time. Extensive research in economics, neuroscience, and psychol-
ogy points to large and durable economic impacts of early childhood programs
that narrow achievement gaps in older grades, boost earnings and strengthen
labor force attachment later in life, and reduce kids’ exposure to the criminal
justice system (Bartik, Gormley, and Adelstein 2012; Cascio and Schanzenbach
2013). The specific features of these programs can vary but they often involve
addressing the following: in utero nutrition and environmental exposure to
stress (Almond 2006; Royer 2009); work/life balance issues of parents/caregivers,
as well as their education and training; availability of educational materials;
parental habits and behaviors; lead abatement; and access to healthcare (Chay,
Guryan, and Mazumder 2009). Still, public investments in young children tend
to be lower than for older children, and parents of young kids tend to be at a
stage in their careers when they are least able to invest in their children using
their own income or savings.

The COVID-19 pandemic has disrupted investments in minority children
in at least two ways. First, day-care and school closures have limited educa-
tional opportunities, and early evidence points to widening achievement gaps
(Bacher-Hicks, Goodman, and Mulhern 2021; Dorn et al. 2020). Second, black
and Latino parents have lost earnings and are experiencing additional stress
and hardships, making the funding misalignment discussed in the previous
paragraph more serious. Both of these factors generate a critical need for more support to black and Latino families with young children. Indeed, Ryan et al. (2020) document disruptions in parents’ income stability, mental health, and support for children’s learning, particularly among low-income families. Moreover, the risks of being unable to reenter the workforce loom larger for black and Latino workers and working minority mothers in particular (Alon et al. 2020; Couch, Fairlie, and Xu 2020).

Many studies also underscore the high returns from increasing high school graduation rates, improving college readiness, and boosting college completion rates. Greater per-pupil spending in K-12 education not only increases low-income students’ educational attainment but also leads to higher wages and lower poverty for them when they grow up (Jackson, Johnson, and Persico 2016). High-performance charter schools also may have large effects on narrowing achievement gaps for low-income and minority students (Dobbie and Fryer 2011).

At the college level, high-return interventions include steering low-income students to selective institutions; providing “last dollar” scholarships to bridge the gap between financial aid and the all-in costs of college; high-touch support services, like comprehensive advising, career services, and tutoring; and even low-touch programs, like personalized text messages reminding students to renew financial aid applications. Today’s strained finances and uncertain job markets make student loans more burdensome, and college enrollment may even rise if high unemployment rates persist and typical recessionary patterns take hold. In the absence of job opportunities, more students may choose to continue their education until labor markets improve, often by financing college with student loan borrowing. Interventions to increase students’ odds of college completion and to lower their risk of being financially burdensed by student loan debt are particularly important for first-generation students, older students living independently from their parents, part-time students, and those attending nonselective institutions.

**SUPPORT FOR ADULTS**
The private and social returns on interventions targeting adults tend to be substantially smaller than for children, on balance. Among other reasons, the benefits from investing in adults accrue over a shorter horizon. However, there are some notable exceptions: select job training programs; work subsidies to encourage work among low-skilled workers (including add-ons to the earned-income tax credit like Paycheck Plus) (Miller et al. 2018); and interventions with large spillovers to children, such as subsidized moves to low-poverty
neighborhoods and health insurance for pregnant women (Miller and Wherry 2019). In these last two cases, the effects on children include higher educational attainment and earnings long after the interventions have taken place. The pandemic’s sharp employment losses among black and Latino workers, especially among black women and Latinas, mean that income support for adults is a critical component of economic recovery. Subsidies for affordable and high-quality childcare and eldercare may also be needed to allow workers to reenter the labor market.

In addition, job losses in the pandemic have not been even across geographies, as low-wage retail and service sector workers have lost their jobs at a higher rate. As such, the geographical concentration of workers without jobs will likely require new interventions to target the racially segregated and occupationally segregated neighborhoods that characterize many cities. This is especially the case because high-return neighborhood job creation strategies have been difficult to develop, as we discuss below.

**Juvenile and Criminal Justice**

Disadvantaged youths are at high risk of becoming victims or perpetrators of crime. When juvenile and criminal justice interventions have high returns, two mechanisms are usually present: teens build human capital and become less likely to be exposed to the criminal justice system, expanding their future job opportunities, and safety and quality of life improve in disadvantaged neighborhoods where violent crimes disproportionately occur. As one example of a high-return intervention, the Becoming a Man (BAM) program prevents automatic escalation into violent crimes through cognitive behavioral therapy (CBT) group sessions that help youths reevaluate their automatic responses (Heller et al. 2017). Another set of interventions creates summer jobs and transitional employment for teens, which in turn lowers their risk of arrest for violent crime (Heller 2014). These latest interventions have been evaluated through randomized controlled trials and distinguish themselves from older interventions in that they require lower costs to implement. While research is ongoing to determine the exact mechanism, both interventions point to the role of soft-skill development, either in CBT sessions or on the job. This theme is consistent with the large and growing evidence on the importance of soft skills—autonomy, self-control, etc.—on market and nonmarket outcomes. The effects also persist beyond the program duration, pointing to a durable impact on the youths’ human capital. At a time when COVID-19 has disproportionately challenged low-income neighborhoods and our society is reexamining the appropriate role of police, interventions to reduce teens’ and young adults’ exposure to...
the juvenile and criminal justice system can have important long-run payoffs for black and Latino youth.

SUMMARY

To date, the strongest evidence for high-return interventions apply to human capital formation. We believe this occurs for at least two reasons. First, market incompleteness may apply more to human capital investments than other areas, leaving considerable scope for policies to make a difference. Second, using the methods of causal identification, microeconomists have looked the hardest at human capital interventions.

Interventions with Less Evidence of High Returns

We now turn to important areas where interventions are necessary but where there is less evidence of their efficacy. Across these areas, some interventions have been evaluated and demonstrate low returns, while other interventions have yet to be evaluated. Considering the former, low-return interventions targeting opportunity gaps typically have some or all of the following distinguishing features: (1) the evidence suggests the economic gains are small or not widespread enough; (2) the intervention is not well targeted; (3) the intervention is very costly or resource intensive; and (4) unintended consequences undermine the intent of the intervention and may even lead to harm.

Closing racial gaps in nonhuman capital aspects of wealth requires targeting tangible and intangible aspects of household balance sheets. At the risk of oversimplifying, many existing interventions related to gaps in homeownership, financial wealth accumulation (by way of financial literacy programs and savings policies), and place-based economic opportunities possess some or all of these distinguishing features.

These interventions are partly motivated by the strong correlations that wealth displays with each component: high-wealth households are more likely to own their homes as well as own investment real estate; they have disproportionately more financial assets and invest them more in risky assets that earn premiums; they are more likely to be self-employed and own disproportionate shares of private business; and they live in neighborhoods that are characterized by better amenities, other high-wealth peers, and higher house prices.

However, the evidence we have on various interventions is not as robust and often shows mixed results. While it is difficult to generalize over such heterogeneous policies and aspects of household finance, it is possible to point out two likely causes. First, unlike in human capital, where market incompleteness is
more likely to be a feature, there is greater scope for private-sector intermediaries to respond to market incompleteness. The ability to make and capture profit is higher when the assets are more tangible or if they can be traded or collateralized, neither of which applies to human capital. Second, while interventions targeting the household balance sheet have been researched considerably, less research employs the causal identification methods typically used by applied microeconomists, whose topics of study overlap the most with human capital.

To narrow racial disparities in areas beyond human capital, new interventions may be needed to achieve high returns. For each of these areas, we provide our interpretation of why the evidence may be more limited and point to new possibilities where there may be more scope to close racial opportunity and wealth gaps. We caution that such new interventions would need to be rigorously evaluated and compared against those that offer more certainty of high returns.

**Homeownership**

Homeownership is often considered a pathway to wealth accumulation, possibly because of the robust correlation between homeownership and wealth or because of the long history of policy interventions to encourage it. Research evidence is limited, however, on whether homeownership itself actually causes faster wealth accumulation, suggesting that interventions to increase homeownership may not have the intended effect of increasing wealth unless other factors are also addressed.

One reason why homeownership may not increase wealth is that buying a home exposes households to a volatile and leveraged risky asset with high transaction costs. Financial gains through homeownership substantially depend on what happens to housing markets following the home purchase (Wainer and Zabel 2020). Weaker housing demand in minority neighborhoods, as well as lower provision of amenities and schools, may weigh down home price growth and housing returns. Moreover, if subsidies to homeownership are structured to subsidize greater leverage, this policy design can leave households exposed to more risk.

An important consideration is whether the nonfinancial benefits of homeownership can offset the aforementioned risk. There is a stronger evidence base that the nonfinancial benefits are positive, including tax exemptions on mortgage and imputed rent, access to neighborhoods with limited rental options, greater attachment to the community, and the automatic savings feature of amortized mortgage payments (Laibson 1997). However, research is lacking on
whether these nonfinancial benefits and expected financial returns outweigh the aforementioned risk.

Economic research suggests there may be more scope for interventions that keep struggling homeowners from losing their homes, such as by providing loan relief during periods of falling or stagnant house prices. This is consistent with three evidence-based findings in the literature. First, there is robust evidence that the main drawback to homeownership is the downside risk. Second, liquidity is important for keeping homeowners in their homes. Third, liquidity-driven defaults negatively affect future wealth building. As such, an intervention that acts as an insurance scheme, rather than a price subsidy, may be more effective at helping homeowners build wealth. For example, mortgage products can mimic equity by making the repayment amount contingent on local house price indices (Mian and Sufi 2015). Another potential intervention might support new mortgage loan products that help homeowners build equity (liquidity) faster than the amortization schedule of a traditional thirty-year fixed-rate mortgage (Oliner, Peter, and Pinto 2020).

**Wealth Accumulation Process**

To date, the most promising interventions on personal financial decisions have been along behavioral dimensions, including nudges and intelligent defaults. These interventions engage noncognitive aspects of behavior and can simplify choices without adding to the cognitive burdens of households (Madrian and Shea 2001; Thaler and Benartzi 2004). For example, default options into savings in retirement accounts have been successful in increasing 401(k) participation and allocations that include risky-asset exposure (Beshears et al. 2009). Such nudges have shown to be effective across various domains, including personal finance. Some evidence suggests that limited cognitive slack may be exacerbated for low-wealth households who face more tough choices throughout the day (Mani et al. 2013; Mullainathan and Shafir 2013). This explanation contrasts with the stereotypes that associate minorities with low savings and spendthrift behavior.

A shift of focus in interventions to effective yet safe nudges would be useful, aided by more evidence from field experiments. We believe this shift would entail less emphasis on interventions that aim to improve financial literacy, which have, on balance, produced nonrobust results (Hastings, Madrian, and Skimmyhorn 2013). This result may frustrate policymakers as higher-wealth households make decisions that contribute more to wealth accumulation over time, such as investing in risky assets with higher average returns and avoiding costly behavior (Campbell 2006). Moreover, in surveys, financial literacy—
measured as knowledge about financial concepts—is also greater for higher-wealth respondents (Lusardi and Mitchell 2014).

Across the range of wealth accumulation interventions, there are important risks to consider. Because it is difficult to affect how individuals make decisions consistently, successful nudges often change the environment or choice set in which decisions are made, for example, by changing the default options in 401(k) automatic enrollment or target-date fund selection. Inertia from households then makes them stick with these options instead of opting out. When nudges and defaults are designed well, they benefit households even without their paying too much attention, but the same inertia means that poorly designed nudges and defaults can have lasting welfare costs. Many behavioral interventions with robust evidence have been and are being adopted. Research in this area has been fruitful as field experiments have been easier to roll out with the collaboration of employers and benefit providers (Harrison and List 2004).

Entrepreneurship and Small-Business Ownership

Research suggests that interventions to create wealth through business ownership may be challenged. Despite the archetype of the successful innovator entrepreneur along the path to wealth, whether there are high-return interventions that yield this outcome remains an open question. Importantly, when comparing the same individuals before and after their transition into self-employment, small-business owners earn less on average, and few report desires of expanding their businesses. Autonomy, flexibility, and leisure may be prevalent benefits of small businesses and may offset lower earnings to some extent (Hurst and Pugsley 2011). The vast majority do not hire more than one employee, leaving little room for employment spillovers to boost hiring. This is especially a concern among minority-owned small businesses and their scope to hire minority employees. Lastly, average productivity tends to be low, and given that, on average, higher-income individuals enter self-employment, subsidies may be regressive.

An emerging literature recognizing the heterogeneity in small businesses may one day support the development of high-return interventions. After all, business owners have higher incomes (Evans and Jovanovic 1989) and private-business equity takes up disproportionately large shares of balance sheets among high-wealth households (Campbell 2006). Small businesses are not a monolith, and recent research is beginning to understand which small businesses contribute to growth, employment, and wealth. For example, young businesses are on average faster growing, whereas older small businesses more
likely provide leisure (Haltiwanger, Jarmin, and Miranda 2013). Research on venture capital and deterrents to access venture capital is also progressing.

A stronger safety net for business owners who want to transition out of self-employment may be a promising policy response. While older small firms do not grow and are not productive, the business owners themselves made fixed investments that make it difficult to transition out. Furthermore, successful ventures are risky, so stronger safety net protection in cases of failure can encourage risky innovation (Hombert et al. 2020).

PLACE-BASED ECONOMIC OPPORTUNITIES

Federal, state, and local governments spend about $95 billion per year on place-based policies that seek to strengthen and move the location of economic activity, thereby reducing inequality and opportunity gaps (Kline and Moretti 2014b). But recent research on place-based policies, such as state enterprise zones and federal empowerment zones, casts doubt on their effectiveness. Nevertheless, there may be a large need for such place-based policies (Austin, Glaeser, and Summers 2018). Most obviously there is a large geographical component to the wealth distribution, and places of residence are often segregated by wealth. In addition, place-based policies have several theoretical benefits, ranging from synergy among beneficiaries in geographically concentrated areas and localized market failures to improved public services (Bartik 2020).

Place-based policies may be challenged for several reasons. First, such policies may target too large a geography, as often the wealth distribution is still substantial within the targeted areas. Furthermore, place-based policies are often intermediated through employers or other suppliers, who also capture some of the benefit themselves.

Another fundamental issue is that of information. Neighborhoods and cities are constantly rising and falling in their economic prosperity. It is difficult for policymakers to gauge whether an area is temporarily distressed or whether a fundamental and secular decline is taking hold. While places are important, policies seek to improve outcomes for the people in those places, with improvements to the physical infrastructure of places providing an input to that process. In this light, place-based policies can also be contrasted against policies that support moves to growing areas or areas with more opportunities. While there have been fewer interventions of this kind, research evidence has demonstrated their effectiveness in improving economic outcomes of the targeted households (Ludwig et al. 2013; Chetty, Hendren, and Katz 2016; Bergman et al. 2019). Moving is costly, of course, not just in economic costs but also
in lost social connections and the costs to rebuild them. A silver lining from the COVID-19 pandemic may be that many more Americans have become more familiar with online communications, which can help retain value from long-distance social connections and thus improve the net welfare gains from moves to pursue opportunities.

One final challenge with today’s place-based policies may be their small scale. Massive Great Depression-era programs were effective, most notably the Tennessee Valley Authority (Kline and Moretti 2014a); select, large-scale interventions have also been effective, a primary example being the Rosenwald rural schools’ initiative in the early twentieth century (Aaronson and Mazumder 2011).

Discussion
Taking an even broader view of the recent evidence on interventions to close racial opportunity gaps, we outline and discuss four overarching themes. Our perspective is that new policies to close economic opportunity gaps may achieve a more effective design, should policymakers take these themes into consideration.

Human capital development requires both economic and noneconomic inputs. The many randomized controlled trials and quasi-experimental studies in recent years point to the importance of both economic and noneconomic inputs for human capital development, including better outcomes for employment and earnings. Importantly, interventions that increase noneconomic resources, like reducing exposure to lead or improving women’s access to health insurance during pregnancy, have large effects on human capital outcomes (education, earnings, and employment). Conversely, economic inputs, such as participation in summer youth employment programs, improve noneconomic outcomes (e.g., violent crime arrests). A more holistic view of human capital development emphasizes the vast range of policies that must work together to reduce racial opportunity gaps.

The intergenerational economic benefits of social safety net programs deserve greater emphasis in policy debates. As discussed above, in the last two decades, many studies have identified robust causal effects of social safety net policies for strengthening the long-run economic prospects of low-income and minority children. For example, social safety net programs providing supports
like healthcare (Medicaid), food (Supplemental Nutrition Assistance Program and wic), earnings (earned income tax credit), cash assistance (welfare), and education (Head Start) have causally improved many economic and health outcomes for low-income children (see Brown, Kowalski, and Lurie 2019; Ludwig and Miller 2007; Hoynes, Schanzenbach, and Almond 2016; Bailey et al. 2020). Policymakers would be well served to balance this evidence against complaints—which are often based on insufficient evidence—about the social safety net exacerbating cycles of economic dependency, idleness, and individuals’ moralfailings. The positive evidence also diverges from the negative and racially charged stereotypes that tend to accompany such gripes.

**Focusing housing and financial wealth-building interventions on behavioral nudges and defaults can have larger effects over price subsidies or individual incentives, especially in the short run.** The more limited evidence base for nonhuman capital interventions suggests there may be opportunities for new policies to help narrow racial disparities in wealth. Our earlier discussion emphasizes how behavioral nudges and defaults have large effects on retirement savings, college attendance, and health insurance plans (Chetty 2015). Research shows great promise for adding these new policy tools to existing efforts seeking to improve financial outcomes for low-wealth, minority households. Importantly, behavioral nudges and defaults are often cheaper to implement than price subsidies (Benartzi et al. 2017). The private sector can also play a role.

**For closing large wealth gaps, deliberating about incremental policy changes with large important impacts and larger-scale policy changes will likely prove challenging.** To date, the most convincing and policy-relevant research evidence stems from either actual randomized controlled trials in real-life settings (field experiments) or natural experiments. Such methods have been widely used across subfields and interventions, but still a large bulk of such evidence is limited to topics studied by applied microeconomists. The use of natural and field experiments has been spreading into macroeconomics and finance as well, and accumulating more convincing evidence will delineate the most effective interventions in those areas for reducing racial opportunity gaps.

However, in experimental settings, the majority of interventions or policy changes studied are incremental. Costs, ethical concerns, and disruptions to people’s lives limit the applicability of large-scale field experiments to many
important settings, while large changes threaten the validity of the study design in natural experiments. But theory suggests that even interventions that are effective in small doses will experience decreasing returns as they are scaled up, both in terms of returns for a given recipient as well as in terms of returns for the broader economy. While making educated assessments may be possible using models disciplined by empirical estimates from more incremental experiments, the research has less to say about larger-scale policy changes. This limitation could be ameliorated through more small-scale field experiments of larger-scale policy changes, as well as through policy experiments and data from around the world.

**Conclusions**

In this chapter, we reviewed three categories of high-return interventions that can help address the immediate needs of families and close economic opportunity gaps. These interventions include those related to children's health and education, income supports for adults that spill over onto children, and youth crime prevention. All of these interventions affect the human capital of young individuals, who have many years over which the benefits can accrue. Relative to adults, they may be more malleable and likely to be receptive to behavioral “nudges,” as well as material support.

However, of the wide inequality in wealth and especially of the wealth gap between racial groups, only about half can be accounted for by differences in earnings, the main byproduct of human capital. This incomplete answer motivates researchers to understand better how those earnings accumulate into wealth, such as through homeownership and financial-market participation—and especially how that process varies across people. More work is needed to develop and validate interventions in this area; we highlight a few nonhuman capital interventions that seem to show promise, but these still need to be evaluated. Lastly, we must consider important trade-offs in dedicating limited resources to new interventions over proven ones; it is a topic that warrants robust debate.

**Notes**

The views in this chapter are those of the authors and do not reflect those of the Federal Reserve Bank of Chicago, the Federal Reserve Board, or their staffs.

1. The evidence on the returns for inputs beyond traditional resource-based ones and community programs that are often bundled with charter schools suggests more muted effects.

REFERENCES


