

**Winter School on Inequality and Welfare Theory IT 5
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Lecture: Social Interactions and Segregation in Skill Accumulation

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A large theoretical literature explains persistent inter-household inequality in earnings and human capital on the basis of capital market imperfections (CMI), indivisibilities and historical wealth differences. One can view economic segregation as a result of such inequality and a tendency for agents with similar wealth to cluster geographically; inequality between, e.g., urban vs. rural areas or inner cities vs. suburbs is then just a symptom of individual inequality. This lecture, in contrast, will explore how such geographical patterns can themselves be a primary determinant of human capital incentives and economic inequality in the presence of localized social interactions – in the absence of CMI and agent movements.

We will first look at the possible co-existence of equilibria with and without segregation for given economic fundamentals, and investigate how different geographical patterns imply different output per capita. We will then study how distinct changes in the ‘localness’ of agents’ interaction – caused, for instance, by government-initiated desegregation efforts, lower transportation costs or new means of communication – affect welfare.

Useful references are given below. The lecture will pay particular attention to the readings marked with (*).

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