

Inequality in America: What Role for Human Capital Policies? By James J. Heckman and Alan B. Krueger. Cambridge, MA: MIT Press, 2003. Pp. xiv, 370. \$40.00. ISBN 0-262-08328-0.

The increase in wage and income inequality in the United States over the past three decades in large part reflects an increase in the market returns to skill, as measured for example by the college earnings premium. Human capital theory predicts that this rising premium should have encouraged greater investment in education, yet the record shows a rather weak response, particularly among the children of the poor. Thus the educational gap between high and low income youth has increased, and with it the potential for increased intergenerational persistence of income inequality.

The roots of this problem and how public policy might best address it are the subjects of this important and stimulating book. The core chapters are papers by Alan Krueger and by Pedro Carneiro and James Heckman, originally presented at the third Alvin Hansen Symposium on Public Policy in April 2002. These chapters are followed by comments from several other economists, responses by the authors, and rejoinders. The debate between the principals is sharp and lively and provides the reader with a clear understanding of the methodological and policy issues at stake.

Krueger's chapter begins with an overview of the evidence on inequality trends and a summary of why widening inequality is an appropriate policy concern. He then addresses the question of why the children of the poor get less education. In Krueger's view, the evidence of binding credit constraints is compelling. More important, he argues, the individual and social returns to investment in educating the poor are high, and at least as great as they are for higher income children, so increased public investment in educating the poor can be justified on both efficiency and equity grounds.

Krueger goes on to examine a number of specific policy interventions aimed at different age groups. The upshot is that well targeted increases in government spending on education and training for the disadvantaged could be effective in reducing inequality and pass a benefit-cost test. He cites the high social rate of return found in studies of preschool programs, notably the Perry Preschool experiment.

Summarizing his own work, Krueger argues that the evidence supports a significant impact of increased school resources devoted to class size reductions. He also takes a much less pessimistic view of job training programs than has been the norm in the profession. Finally, he acknowledges a point previously made by Heckman— namely, that using human capital policy to fully reverse the inequality trend of the last few decades could be hugely expensive. But a more modest human capital policy might still be coupled with other incomes policies to make a significant dent in inequality.

While Krueger’s contribution is informative, the chapter by Carneiro and Heckman is a tour de force. For readers in search of a concise and readable summary of Heckman’s voluminous work on human capital policy, this is the one-stop shop. Carneiro and Heckman begin with some general observations about human capital investment. First, they argue for the importance of early childhood investments in learning. Early investments are crucial because skills are much more malleable in the very young, and because of dynamic complementarities in human capital acquisition— i.e., “learning begets learning.” Second, they note that “families are just as important as, if not more important than, schools in promoting human capital” (p. 205). Third, they stress the importance of non-cognitive skills, such as attitudes and work habits, in both educational and labor market success.

Carneiro and Heckman dispute the significance of credit constraints in limiting the college attendance of low-income children. Their argument rests in part on technical econometric points, but perhaps the most compelling evidence is simply that the transitory component of family income has little or no marginal effect on college attendance once a student’s ability (as measured by AFQT score) is controlled for. Like Krueger, they view early childhood interventions as promising, with much of the estimated gain coming in the form of improved non-cognitive (behavioral) skills. But they are much more skeptical about the potential returns to job training for teenagers or adult workers. They also suggest that even using an optimistic estimate of the benefits of class-size reduction, devoting more resources in that direction does not pass a benefit-cost test.

Comments from several distinguished economists follow the essays. By and large there are no surprises here. George Borjas, for example, calls for greater attention to the impact of low-skilled immigration on inequality. Eric Hanushek challenges Krueger's take on the class-size question, although curiously he does not directly address Krueger's detailed critique (summarized in his chapter) of Hanushek's own meta-analysis of the class-size literature.

The comments are followed by a round of responses and rejoinders by the principals. These throw into sharp relief the basic methodological and interpretive differences between the authors. In their combative rejoinder, Carneiro and Heckman contrast their own "structural" approach to policy analysis with Krueger's "treatment effect" approach, arguing that the latter methodology is ill-suited to designing new policies. In terms of substantive views, perhaps the most important difference is over the effectiveness of human capital policies aimed at older children or adults. As Carneiro and Heckman put it, "How plastic are people?" (p. 338).

Interestingly, neither the Krueger nor the Carneiro/Heckman essay has much to say about some of the hottest current policy debates in education, such as the likely efficacy of school choice or voucher plans. Krueger expresses skepticism, but does advocate greater experimentation with choice (p. 306). Carneiro and Heckman (p. 161) offer a few encouraging words, but admit that the evidence on choice is very thin. Given their emphasis on the importance of early childhood education and the family environment, however, perhaps they think of the potential impact of school choice as second order.

Both Krueger and Carneiro/Heckman evaluate human capital policies using a net benefit-cost calculation or an implied rate of return comparison, although they differ on such details as the treatment of tax distortions. In a discussion of policies aimed at reducing inequality, however, the choice of conventional benefit-cost analysis seems questionable. From a social welfare standpoint, concern about inequality implies that the marginal welfare of a dollar to the poor exceeds that of a dollar to the rich. To the extent that human capital policies are targeted to the poor, then, a comparison of the gross benefits to

recipients with the gross costs to taxpayers would be more informative, allowing the reader to apply her own preferred weights. This quibble aside, the book constitutes a valuable contribution to the analysis of human capital policy, and deserves wide readership.

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