

SORTING TO EXPENSIVE CITIES*

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Abstract

We propose an elementary spatial equilibrium theory with heterogeneous households holding general non-homothetic preferences. Cities are endowed with heterogeneous consumption and production amenities. In equilibrium, desirable and productive locations command high housing prices. So long as housing is a necessity, these locations are disproportionately inhabited by high-income earners who are relatively less affected by high housing prices. We clarify how this source of sorting complements other potential sorting forces in spatial equilibrium models, namely, comparative advantage in production and heterogeneous preferences for locations. We show how to measure changes in welfare inequality across income groups in a theoretically-consistent way when housing is a necessity, extending the approach popular in models with homothetic preferences. We use our framework to track the evolution of welfare inequality between college and non-college graduates in the United States between 1980 and 2020. We find that, accounting for change in prices, it has risen by more than nominal wage inequality, even as college graduates increasingly sort into cities with expensive housing over this time period.

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1 Introduction

Cities differ dramatically in size, productivity, and cost of living. They also vary in composition: larger, more productive, and more expensive cities typically attract a disproportionate share of high-skill workers and high-income earners—a pattern of spatial sorting (Diamond and Gaubert, 2022). A growing literature relies on quantitative spatial models to study the uneven distribution of economic activity in space. These models typically assume homogeneous agents with homothetic preferences over housing and consumption (Redding and Rossi-Hansberg, 2017). While these assumptions facilitate tractability and welfare analysis, they cannot, by construction, explain why cities differ in composition.

In this paper, we introduce a general class of non-homothetic preferences for housing in an elementary spatial model and characterize the model properties. This framework makes consumption patterns—and thus location choices— income-dependent. Higher-ability and higher-income workers, who allocate a smaller share of their income to housing, are more willing to pay the premium to live in attractive, high-cost cities, leading to endogenous spatial sorting. The advantage of this setup is threefold. First, the assumption of non-homotheticity is realistic. Second, it provides a microfounded driver of sorting, in contrast to a common alternative in the quantitative spatial literature which is to rely on a standard homothetic model but assume exogenous differences in preferences for urban amenities across fixed groups of workers. While useful for capturing observed patterns, such models assume preference heterogeneity rather than deriving it from fundamental economic behavior. Third, this microfoundation allows all agents to share the same preferences, making welfare comparisons meaningful. We show to use the model to track welfare inequality between skill groups using simple sufficient statistics.

If non-homothetic preferences shape, in part, spatial sorting, what are the broader implications? We use the framework to quantify the evolution of welfare inequality between college and high-school graduates in the United States from 1980 to 2020, accounting for changes in spatial sorting. Moretti (2013), using a framework with homothetic preferences, finds that real wages grew less unequal than nominal wages because college graduates increasingly clustered in expensive cities. In contrast, when we incorporate income-dependent housing expenditure shares, we find that welfare inequality rose by more than nominal wage differences suggest, a reflection of the housing affordability crisis that generates a disproportionate burden on lower wage workers in expensive cities.

Our framework is motivated by four established stylized facts:

1. **Housing is more expensive in large cities.** For instance, dwelling rent increase with respect to urban population density with an elasticity of about 0.15 - as reported in the meta-analysis of Ahlfeldt and Pietrostefani (2019).
2. **Housing demand is income-inelastic.** The expenditure share of housing falls with household income¹ while housing is the largest single component of consumer’s baskets, making it

¹see e.g. Aguiar and Bils (2015); Albouy, Ehrlich, and Liu (2016); Finlay and Williams (2022); Ganong and Shoag (2017); Glaeser, Kahn, and Rappaport (2008).

determinant in location choices. Specifically, housing costs represent a median of 28% of a household’s expenditures and up to 62% for the bottom decile of renters by income based on French data (Combes, Duranton, and Gobillon, 2019).

3. **The urban wage premium**, whereby wages increase with city size, **is increases with workers’ skill.**² Davis and Dingel (2020) report that the elasticity of the urban skill premium with respect to city population size is 0.3 in the United States.
4. **Higher incomes and highly educated workers are over-represented in larger cities** in the U.S. (Glaeser and Mare, 2001; Baum-Snow and Pavan, 2013) and beyond.³ This patterns holds within narrowly defined skilled groups: the elasticity of PhD graduates to city population is 1.14 in the United States (Davis and Dingel, 2020).

Fact 2 is the foundation for our core assumption: we take household preferences to be non-homothetic, with housing as a necessity. Combined with Fact 1, this will generate a natural mechanism for sorting: high-income households self-select into larger, more expensive cities. Alone, however, Facts 1 and 2 alone would imply that the urban wage premium should *decrease* with city size (Black, Kolesnikova, and Taylor, 2009). In spatial equilibrium, differences in the burden of housing costs should offset differences in skill returns across locations. Since housing costs affect a smaller share of the expenditure of high-income households than that of low-income households, standard compensating differential logic suggests that skill premia should be lower in expensive cities. Therefore, Fact 3 suggests an additional force at play: high-ability workers have a comparative advantage in productive cities. This comparative advantage together with cost-of-living effects drive spatial sorting (Fact 4).⁴

We first lay out our spatial sorting model and establish conditions for equilibrium existence and uniqueness (Section 2). Cities differ in exogenous amenities and productivity. Workers are endowed with heterogeneous ability, which may be relatively more valuable in some cities than others, and have general, potentially non-homothetic preferences over a freely traded consumption good and housing. They also have idiosyncratic preferences for locations, generating imperfect sorting within skill. We do not impose specific functional forms on preferences or technology. We establish that the equilibrium exists under general technical conditions. Moreover, we show that the equilibrium is unique if there is a single type of workers, whether preferences are homothetic or not, or if utility is homogeneous in income, whether workers have homogeneous ability or not. In contrast, the interaction between non-homothetic preferences and heterogeneity in worker types

²See e.g. Baum-Snow and Pavan (2013); Baum-Snow, Freedman, and Pavan (2018); Davis and Dingel (2019); Card, Rothstein, and Yi (2023).

³The fact was established in particular for France (Combes, Duranton, and Gobillon, 2008), Britain (D’Costa and Overman, 2014), as well as in the developing world (Dingel, Miscio, and Davis, 2021). In contrast to this evidence of sorting on observed individual characteristics, the evidence of sorting on unobserved ability is more mixed (Baum-Snow and Pavan, 2012; Combes, Duranton, and Gobillon, 2008; Dauth, Findeisen, Moretti, and Suedekum, 2022; De La Roca and Puga, 2017).

⁴A third driver of sorting may be taste-based, driven by heterogeneous preferences for local amenities or local public goods (Kuminoff, Smith, and Timmins, 2013; Diamond, 2016; Fajgelbaum and Gaubert, 2020; Diamond and Gaubert, 2022). We discuss this source of sorting briefly in Section 3.1.

may generate multiple equilibria. In this case, we provide sufficient conditions for uniqueness that can be evaluated in quantitative applications.

We then characterize theoretical conditions under which spatial sorting emerges (Section 3). We highlight how these conditions relate to existing frameworks in the literature. A key insight is that seemingly innocuous functional form choices can strongly influence sorting outcomes. We clarify that both the sub-utility of consumption and the distribution of locational preference shocks affect sorting. In fact, it is the combination of these two that drive theoretical results, rather than each of them separately. As a result, the a priori uncontroversial choice of the distribution of idiosyncratic shocks for locations can be as consequential for spatial sorting as choosing between a homothetic and a non-homothetic utility function. We next examine how city fundamentals impact worker composition. In equilibrium, cities with better consumption or production amenities exhibit higher housing rents, consistent with classic urban theory (Rosen, 1979; Roback, 1982). We establish conditions under which higher-ability workers sort into these cities. Non-homothetic preferences alone yield such sorting, since even in the absence of comparative advantage and even if household agree on the quality of local amenities, higher income workers can more easily afford the higher cost of living in attractive places. In addition, sorting also arises if high-type workers have what we define as a “strong comparative advantage” in productive cities. In this case, the two sorting mechanisms reinforce each other.

Third, we study the normative implications of the model (Section 4). In quantitative spatial models with homogeneous agents, welfare changes are often measured using a “sufficient statistics” approach, which computes representative welfare effects of economic shocks based on model elasticities and a small set of key statistics from the data. We extend this approach to our model with heterogeneous agents and non-homothetic preferences to measure the *distributional* consequences of shocks. We show that relative welfare changes across any pair of skill types in the economy can be expressed as a function of three statistics that are usually readily available in the data: (i) relative change in nominal incomes, (ii) relative changes in location choices, and (iii) relative change in housing expenditure shares. The first two elements are standard in models with homothetic preferences, but the third component is novel to our framework. It captures how local housing price changes affect workers differently based on income, reflecting the unequal burden of housing costs. Intuitively, measuring changes in expenditure share on a necessity reveals information on welfare change (Atkin, Faber, Fally, and Gonzalez-Navarro, 2023). Finally, to enable meaningful interpersonal welfare comparisons in the context of non-homothetic preferences, we convert utility changes into money-metric terms.

We apply this framework to measure how welfare inequality between college and high-school graduates evolved in the United States between 1980 and 2020 (Section 5).. Our approach differs from Moretti (2013)’s original contribution on this question in two ways. First, we account for endogenous sorting as an equilibrium outcome. While Moretti adjusts for differential location choices, we incorporate the fact that sorting is not random—workers have idiosyncratic location preferences, meaning newcomers to expensive cities are a selected group that may have lower

amenity valuations than incumbent residents. Second, we account for heterogeneous housing expenditure shares. Unlike in homothetic models, college graduates spend a substantially smaller share of income on housing than high-school graduates, which alters the welfare effects of housing price changes. The first correction pulls in the same direction as Moretti’s correction: if nominal income inequality has increased by 27% between 1980 and 2020, the inequality gap has widened by less accounting for sorting (25%). However, the second correction goes in the opposite direction, and by a larger amount. Accounting for the heterogeneous effect of prices on workers with different incomes increases measured inequality to between 30% and 35%, depending on the specification. Adding changes in endogenous amenities that favor high-skill households relative to low-skill ones, as reported by [Diamond \(2016\)](#), would reinforce this result further. In the context of the housing affordability crisis, taking into account the disproportionate burden that housing cost place on lower-income households – even though they sort less into expensive cities than high-income ones – sheds a strikingly different light on welfare inequality.

This paper contributes to the Economic Geography literature by studying the properties of spatial models with non-homothetic preferences, thereby enriching the quantitative spatial toolbox pioneered by [Ahlfeldt, Redding, Sturm, and Wolf \(2015\)](#) and [Allen and Arkolakis \(2014\)](#). Within quantitative spatial frameworks, a literature posits different homothetic preferences for different groups to generate sorting across cities ([Diamond, 2016](#); [Giannone, 2019](#); [Fajgelbaum and Gaubert, 2020](#)) or sorting within cities across neighborhoods ([Tsivanidis, 2019](#); [Almagro and Domínguez-Iino, 2020](#)), different from our approach. In contrast, a series of recent applied quantitative work has incorporated income-based sorting in their analysis of sorting across regions or cities ([Finlay and Williams, 2022](#); [Fretz, Parchet, and Robert-Nicoud, 2021](#); [Takeda, 2022](#)) or within cities ([Couture, Gaubert, Handbury, and Hurst, 2023](#); [Hoelzlein, 2023](#); [Gaigné, Koster, Moizeau, and Thisse, 2022](#); [Tsivanidis, 2019](#)). [Handbury \(2021\)](#) measures the prevalence and welfare incidence of heterogeneous prices over space. Our work complements these papers by deriving general positive and normative theoretical results. Our research also connects with earlier (non-quantitative) theories of systems of cities, specifically those featuring heterogeneous agents making heterogeneous location choices in equilibrium ([Behrens, Duranton, and Robert-Nicoud, 2014](#); [Davis and Dingel, 2019](#)). In these papers, sorting follows from the popular assumption of unit housing consumption, an extreme form of non-homotheticity, which we relax. Finally our welfare analysis relates to the recent work of [Baqaee and Burstein \(2022\)](#), [Jaravel \(2021\)](#), [Jaravel and Lashkari \(2022\)](#) and [Oberfield \(2023\)](#) that study the measurement of welfare inequality with income-dependent preferences in non-spatial contexts.

2 An Elementary Spatial Sorting Model With Non-Homothetic Preferences

2.1 Setup

Consider an economy populated by a continuum of workers of heterogeneous skills $t, s \in \mathcal{T}$. The set of skills is discrete, and there is a fixed aggregate supply L^t of workers of skill t . Workers make a discrete choice of where to live among $n, m \in \mathcal{C} \equiv \{1, \dots, N\}$ locations. A worker of type t supplies one unit of labor where they live, facing wage w_n^t in location n and a rental cost of housing r_n .

Preferences Preferences are the same for all workers. They consume a freely traded good c (taken as the numeraire), housing h , and directly derive utility from the amenities A_n of the city where they live. Worker ω has idiosyncratic preferences for locations $\{\varepsilon_n^\omega\}_{n \in \mathcal{C}}$, iid across workers. In line with extant work, we assume that utility is separable in its idiosyncratic component, ε_n^i , and its common component, $\tilde{U}(c, h, A_n)$ and restrict the analysis to distributions of idiosyncratic shocks that result in Luce aggregation. That is, there exists an increasing function $g(\cdot)$ such that we can write the fraction of workers of type t choosing to live and work in location n as:

$$\lambda_n^t = \frac{V_n^t}{\sum_{m \in \mathcal{C}} V_m^t},$$

where $V_n^t \equiv g(\tilde{V}_n^t)$ in a monotonic transform of the common component of indirect utility in location n :

$$\tilde{V}_n^t = \max_{c, h} \tilde{U}(c, h, A_n)$$

$$\text{such that } c + r_n h = w_n^t.$$

In particular, under the assumption popular in the quantitative spatial literature that utility is $\tilde{U}\varepsilon$, i.e. multiplicative and separable in idiosyncratic shocks, and that idiosyncratic shocks are distributed Frechet with shape parameter $\kappa > 1$, we have $g(\tilde{V}_n^t) = (\tilde{V}_n^t)^\kappa$. Location choice probabilities become:

$$\lambda_n^t = \left(\frac{\tilde{V}_n^t}{\mathbb{V}^t} \right)^\kappa, \quad \mathbb{V}^t \equiv \left[\sum_{m \in \mathcal{C}} (\tilde{V}_m^t)^\kappa \right]^{\frac{1}{\kappa}}. \quad (1)$$

If instead utility is $\tilde{U} + \varepsilon$ and idiosyncratic shocks follow the standard Gumbel distribution, an assumption popular in IO that is also used in the urban economics literature (see e.g., [Almagro and Domínguez-Iino 2020](#); [Diamond 2016](#); [Giannone 2019](#)), then $g(\tilde{V}_n^t) = \exp \tilde{V}_n^t$ and choice probabilities are:

$$\lambda_n^t = \frac{\exp \tilde{V}_n^t}{\exp \mathbb{V}^t}, \quad \mathbb{V}^t \equiv \ln \left(\sum_{m \in \mathcal{C}} \exp \tilde{V}_m^t \right). \quad (2)$$

With some abuse of terminology, we henceforth refer to V_n^t as the (common component of) indirect utility of type t in city n , even though it is a combination of the indirect utility proper, \tilde{V}_n^t , and of the functional form chosen for the distribution of the idiosyncratic preferences shocks.

The Marshallian demand for housing in city n for skill t is denoted h_n^t :

$$h_n^t \equiv h(w_n^t, r_n, A_n).$$

We assume it is continuously differentiable in all its arguments. Furthermore, we take housing to be a normal good so that h_n^t is increasing in its first argument and decreasing in the second. Our object of interest in this paper is the case where preferences are non-homothetic in (c, h) . Specifically, we will focus on the case where housing is a necessity, so that the expenditure share on housing is non-decreasing in income, consistent with empirical evidence.⁵ Denoting

$$s_n^t = \frac{r_n h_n^t}{w_n^t} \tag{3}$$

the housing expenditure shares, we assume in what follows that

$$\frac{\partial s_n^t}{\partial w_n^t} \leq 0. \tag{4}$$

Popular functional forms Though we work with minimalist assumptions throughout, and most of our results do not depend on parametric assumptions, applied work requires using specific functional forms. It is therefore useful to summarize how popular functional forms for preferences fit in our framework.

Table 1 does so. The first column lists Stone-Geary and the acronyms of five other classes of non-homothetic preferences, several of which are well-known (see the Table caption for the meaning of acronyms and for references). The second column reports the indirect utility function V as a function of the vector of prices (p, r, w) and amenities A . We choose V to be multiplicatively separable in amenities as we discuss in Section 3.1. Parameter $\nu \in \{0, 1\}$ governs the (non-)homotheticity of each class of preferences. In all cases, preferences are homothetic if $\nu = 0$ and non-homothetic if $\nu = 1$. Under the assumption $\nu = 1$, the third column imposes restrictions on the structural parameters that ensure that the inequality in equation (4) holds (housing is a necessity). Appendix C provides the details.

Most applications in urban economics use either of the following polar preferences over housing and the consumption good: homothetic Cobb-Douglas (in which case the price- and income-

⁵In contrast, the Economic Geography literature usually models housing consumption assuming Cobb-Douglas utility, so that expenditure share on housing is constant across households and cities ($\frac{\partial s_n^t}{\partial w_n^t} = 0$). This latter assumption is convenient, together with the assumption of homogeneous workers, to reflect the aggregate patterns reported by Davis and Ortalo-Magné (2011): the median of the distribution of expenditure share on housing is stable across cities. However, this aggregate empirical pattern masks heterogeneity in consumption patterns of housing across incomes within cities – poorer households spend more on housing as a share of their income – as well as heterogeneity in income distribution across cities. These cannot be rationalized with Cobb-Douglas preferences and instead call for non-homothetic preferences, motivating the current study.

Table 1: Non-homothetic preferences: Functional forms

Preferences	Indirect utility V	Structural parameters
Stone-Geary	$V = A \frac{w-\nu hr}{p^{1-\psi} r^\psi}$	$\psi \in (0, 1), \underline{h} > 0$
PIGL	$V = A \left[\left(\frac{w}{p^{1-\psi} r^\psi} \right)^\nu - \frac{\nu}{\gamma} \left(\frac{r}{p} \right)^{\gamma \nu} \right]^{1/\nu}$	$\nu, \psi \in (0, 1), \gamma \geq 1$
PIGLOG	$V = A \left(\frac{r}{p} \right)^\nu \ln \left(\frac{w}{p^{1-\psi} r^\psi} \right)$	$\psi \in (0, 1)$
CRIE	$V = A \left[\left(\frac{w}{r} \right)^{-\psi} + \left(\frac{w}{p} \right)^{-\psi + \nu(\psi - \mu)} \right]^{-1}$	$\psi > \mu$
NH-CES	$w^{1-\sigma} = \left(\frac{V}{A} \right)^{1-\sigma} \left[\left(\frac{V}{A} \right)^{\nu(\mu-\psi)} r^{1-\sigma} + p^{1-\sigma} \right]$	$\sigma \in (0, 1), \psi > \mu > \sigma - 1$
HCD	$0 = \left(\frac{V}{A} \right)^\mu \ln \left(\frac{r}{w} \right) + \left(\frac{V}{A} \right)^{\mu + \nu(\psi - \mu)} \ln \left(\frac{p}{w} \right)$	$\psi > \mu$

Notes: PIGL stands for "Price Independent Generalized Linearity" (Muellbauer, 1975), PIGLOG stands for "Price Invariant Generalized Logarithmic" (Deaton and Muellbauer, 1980), CRIE stands for "Constant Relative Income Elasticity" (Caron, Fally, and Markusen, 2014; Eeckhout, Pinheiro, and Schmidheiny, 2014; Fieler, 2011; Hanoch, 1975), NH-CES stands for "Non Homothetic Constant Elasticity of Substitution" (Albouy, Ehrlich, and Liu, 2016; Comin, Lashkari, and Mestieri, 2021; Hanoch, 1975; Matsuyama, 2019; Sato, 1977), and HCD stands for "Heterothetic Cobb-Douglas" (Bohr, Mestieri, and Robert-Nicoud, 2024). HCD preferences are a limiting case of NH-CES preferences. The indicator variable $\nu \in \{0, 1\}$ governs the (non-)homotheticity of each class of preferences. In all cases, preferences are homothetic if $\nu = 0$ and non-homothetic if $\nu = 1$.

elasticity of housing demand are unitary), or unit housing consumption (in which households consume exactly one unit of housing).⁶ Recent exceptions include Albouy, Ehrlich, and Liu (2016) and Finlay and Williams (2022), who use NH-CES, Eckert and Peters (2022) and Fan, Peters, and Zilibotti (2023), who use PIGL, and Fretz, Parchet, and Robert-Nicoud (2021) and Tsivanidis (2019), who use Stone-Geary.

Production The traded good is produced in each city by perfectly competitive producers using labor under constant returns to scale. Worker skills are perfect substitutes in production, but they may differ in their complementarity with city productivity T_n . Workers of type t who work in city n provide $\ell_n^t \equiv \ell(T_n, t)$ effective units of labor, with

$$\frac{\partial \ell(T_n, t)}{\partial T_n} \geq 0, \quad \frac{\partial \ell(T_n, t)}{\partial t} \geq 0.$$

Higher- t workers are more productive everywhere, and all worker types are more productive in high- T cities. We leave $\ell(T_n, t)$ general for now, but will explore assumptions on the complementarity between T_n and t later on. For simplicity, we model here vertical differentiation of worker skills (ability) without modeling their horizontal differentiation (between different sectors or occupation

⁶These polar cases are limiting cases of some of the functional forms listed in Table 2. Homothetic Cobb-Douglas preferences correspond to limit case $\nu = 0$ in all cases of Table 2, with the exception of CRIE and NH-CES. The case of unit housing consumption corresponds to the limiting case $\psi \rightarrow 0$ and the normalization $\underline{h} = 1$ if preferences are Stone-Geary, and to the limiting case $\psi \rightarrow 0, \nu \rightarrow 1$ if preferences are PIGL.

for instance). Results have to be understood as characterizing spatial sorting on ability within a given sector or occupation. Traded output is simply:

$$Y_n = \sum_{t \in \mathcal{T}} L^t \lambda_n^t \ell_n^t.$$

Housing Housing is produced by perfect competitors in each market combining land and the traded good under constant returns to scale. We parameterize the aggregate supply function for housing in city n so that both the level of housing supply and the elasticity of housing supply can vary across markets (Saiz, 2010). They are captured respectively by parameters H_n and η_n in the following production function:

$$\mathcal{H}_n = H_n k \left(\frac{r_n}{p}; \eta_n \right), \quad (5)$$

where we assume:

$$\frac{\partial k}{\partial r} > 0, \quad \frac{\partial k}{\partial \eta} > 0, \quad \frac{\partial^2 \ln k}{\partial \eta \partial \ln r} \geq 0, \quad (6)$$

This latter assumption insures that the elasticity of housing supply is increasing in η , and we may refer to η as the housing supply elasticity for short when we compare two locations with different η 's.

Taking stock, cities are differentiated in four dimensions: productivity T_n , amenities A_n , land endowment H_n , and housing supply elasticity η_n . We now analyze an equilibrium of this economy, with the goal of understanding how these city primitives impact the *sorting* of heterogeneous skills across locations.

2.2 Equilibrium

An equilibrium of this economy is a set of prices $(\{r_n\}_n, \{w_n^t\}_{n,t})$, a distribution of types across space $\{\lambda_n^t\}_{n,t}$, and consumption profiles by type and city $\{c_n^t, h_n^t\}_{n,t}$ such that the following conditions hold:

- (i) Workers are paid their marginal product, so that $\forall n, t$:

$$w_n^t = \ell(T_n, t). \quad (7)$$

- (ii) Workers choose location n , and consumption c and h to maximize utility under their budget constraint, given prices. In particular, $\forall n, t$:

$$\lambda_n^t = \frac{V_n^t}{\sum_{m \in \mathcal{C}} V_m^t}, \quad (8)$$

$$\text{where } V_n^t = V(w_n^t, r_n; A_n). \quad (9)$$

(iii) The housing market clears in each city n :

$$H_n k \left(\frac{r_n}{p}; \eta_n \right) = \sum_{t \in \mathcal{T}} L^t \lambda_n^t h_n^t. \quad (10)$$

The consumption good market then clears by Walras' law. Note that after substitution of equations 7-9 into equation 10, the set of N equations (10) pins down the N unknown $\{r_n\}_n$ that fully summarize equilibrium conditions. All other endogenous variables are explicit functions of the vector $\{r_n\}_n$.

Our first result concerns the existence of such an equilibrium:

Proposition 1. *Existence.* *An equilibrium of the economy always exists.*

Proof. The proof relies on Brouwer's fixed point theorem, and is provided in Appendix A. □

The next result establishes sufficient conditions for the equilibrium to be unique. Throughout the paper, it will be convenient to use the city n -type t elasticity notation:

$$\mathcal{E}_n^t(x, y) \equiv \frac{\partial \ln x_n^t}{\partial \ln y_n^t}.$$

We also denote by $\mathcal{E}_n(x, y)$ elasticities of variables that are independent from worker-type.

Proposition 2. *Uniqueness.* *The spatial equilibrium is unique if either of the following conditions holds:*

- (i) *there is only one type of workers;*
- (ii) *preferences are homothetic and multiplicatively separable in amenities;*
- (iii) *preferences and the production function for housing jointly satisfy:*

$$\inf_n \mathcal{E}_n(k, r) + \inf_{n,t} |\mathcal{E}_n^t(h, r)| > \sup_{n,t} \left| \mathcal{E}_n^t(V, r) - \overline{\mathcal{E}^t(V, r)} \right|, \quad (11)$$

where we have defined $\overline{\mathcal{E}^t(V, r)} \equiv \sum_{i=1}^N \lambda_i^t \mathcal{E}_i^t(V, r)$.

Proof. See Appendix A. □

To understand the threat to equilibrium uniqueness when preferences are non-homothetic and workers are of heterogeneous type, start from a reference equilibrium and consider the impact of an increase in the price of the traded good on the housing markets of all locations. Relative housing prices decrease everywhere and, holding constant the distribution of workers across locations, this equilibrium perturbation increases demand for housing in all locations. However, what then happens to the distribution of population across cities is ambiguous. The relative attractiveness of cities changes following a housing price decrease everywhere, and these relative changes in attractiveness may lead some types to migrate out of some cities, given income effects in location choice. If out-migration is large enough to decrease total demand for housing in some city n , then

the possibility of multiple equilibria arises. In particular, the demand system does not exhibit the gross substitutes property in this case, as an increase in the price of the traded good leads to a *decrease* in excess demand for housing in n . Several equilibria may therefore coexist in principle: for instance, a reference equilibrium alongside an equilibrium with higher traded-good price and higher housing costs everywhere except in n , where they are lower.

Interestingly, the threat to uniqueness comes from the *interaction* between non-homothetic preferences and type heterogeneity. Taken in isolation, neither is sufficient to lead to multiple equilibria, as conditions (i) and (ii) highlight. When the economy features several workers types, a sufficient condition for uniqueness is given by equation (11). Consider first the left-hand side of this inequality. When the housing supply elasticity $\mathcal{E}_n(k, r)$ is high, a pervasive decrease in housing rents yields strong reductions in housing supply. Similarly, a high price-elasticity of housing demand also leads to a large increase in excess demand when housing prices decrease. Both channels lead to large responses in the excess demand for housing, which makes the gross substitutes property more likely to hold. Consider next the right-hand side of the inequality, which captures the equilibrium location choice response of workers. If the elasticity of indirect utility with respect to housing prices is heterogeneous across locations, a proportional decrease in housing costs everywhere leads to net out-migrations in some locations. If this effect is strong enough, it can lead to a net decrease in housing demand in some locations, violating the gross substitutes property. Overall, uniqueness is all the more guaranteed as supply and demand for housing respond strongly to prices, or as the relative attractiveness of cities does not change too much when housing prices change in the same proportion everywhere.⁷ In quantitative applications, the sufficient condition in equation (11) can be checked to hold or fail.

We assume from now on that model parameters are such that the equilibrium is unique, and turn to studying how heterogeneous skill types sort into different locations.

3 Sorting in Spatial Equilibrium

In this section, we first give conditions under which the equilibrium exhibit sorting – i.e., location choices are heterogeneous across skills (Section 3.1). We then characterize the sorting equilibrium. We establish in particular that spatial sorting is shaped by the distribution of equilibrium housing prices. We characterize these equilibrium prices in Section 3.2, before establishing in Section 3.3 which skills sort into which type of cities.

3.1 Conditions for Spatial Sorting

An equilibrium with sorting is defined as follows:

⁷We show in Appendix C.8 that Condition (11) is akin to a single-crossing condition in the space of housing prices in the two-city case.

Definition 1. Sorting. Sorting occurs when equilibrium location choices differ by skill type:

$$\exists n \in \{1, \dots, N\}, \quad \exists s \neq t \in \mathcal{T}, \quad \text{such that } \lambda_n^t \neq \lambda_n^s.$$

In contrast, a no-sorting equilibrium is characterized by:

$$\forall m, n \in \mathcal{C}, \quad \forall s, t \in \mathcal{T}: \quad \left(\frac{\lambda_n^t}{\lambda_n^s} \right) \left(\frac{\lambda_m^t}{\lambda_m^s} \right)^{-1} = 1. \quad (12)$$

We lay out and discuss two conditions, which jointly imply a no-sorting equilibrium.

Condition 1. The productivity advantage of cities is skill-neutral. That is, for all $n \in \{1, \dots, N\}$ and all $t \in \mathcal{T}$, $\frac{\partial^2 \ln \ell_n^t}{\partial T_n \partial t} = 0$.

Note that in this case, we can re-normalize t and T without loss of generality and write $w_n^t = T_n t$. This condition shuts down the possibility of a given skill enjoying comparative advantage in production in some location.

Condition 2. The indirect utility V is homogeneous in income. That is, there exists a function P , common across types, and a real number $\kappa > 0$ such that $V_n^t = \left[\frac{w_n^t}{P(r_n, A_n)} \right]^\kappa$ for all $n \in \mathcal{C}$ and all $t \in \mathcal{T}$.⁸

This condition crucially requires that the common component of preferences be *homothetic* as all types face the same price index $P(r_n, A_n)$. However, the condition is more stringent, as it is in effect a joint condition on the *representation* chosen for these homothetic preferences, \tilde{U} , and on the distribution of idiosyncratic shocks $\{\varepsilon_n\}$. Specifically, Condition 2 can fail when the common component of preferences \tilde{U} is homothetic. Assume for instance that utility is $\tilde{U}(c, h; A_n) \varepsilon_n^\omega$ where $\tilde{U} = 1 + c^\alpha h^{1-\alpha}$ and shocks are distributed Frechet, with shape parameter κ . \tilde{U} represents homothetic preferences, but condition 2 fails, as $\left(1 + \frac{w_n^t}{r_n^{1-\alpha}}\right)^\kappa$ is not homogeneous in income. What matters ultimately is not the separate properties of \tilde{U} and of the distribution of $\{\varepsilon_n\}$, but only the properties of the resulting probability choice λ . Specifically, the property of location choices that matter for sorting is that, under Condition 2, location choices are given by:

$$\forall m, n \in \mathcal{C}, \quad \forall s, t \in \mathcal{T}: \quad \lambda_n^t = \frac{\left[\frac{w_n^t}{P(r_n, A_n)} \right]^\kappa}{\sum_{m \in \mathcal{C}} \left[\frac{w_m^t}{P(r_m, A_m)} \right]^\kappa}, \quad (13)$$

so that location choice are homogeneous of degree zero in wages.

We are now ready to establish necessary conditions under which spatial equilibria exhibit sorting, generically (that is, for arbitrary distributions of city primitives):

Proposition 3. Sorting.

⁸If $V(w, r, A)$ is homogeneous in income, then $\forall x > 0$, $V(xw, r, A) = x^\kappa V(w, r, A)$ and, in particular, $V(w, r, A) = w^\kappa V(1, r, A)$. Denoting $P(r_n, A_n) = V(1, r, A)^{-\frac{1}{\kappa}}$, we get $V_n^t = \left[\frac{w_n^t}{P(r_n, A_n)} \right]^\kappa$.

(i) (Necessary condition) If there is sorting, then either or both Conditions 1 and 2 fail.

(ii) (Sufficient condition) If exactly one of the two Conditions 1 or 2 fails, then sorting generically obtains.

Proof. See Appendix B. □

A few comments are in order. First, Proposition 3 characterizes a necessary condition for sorting, as well as a more stringent sufficient condition. To see why the necessary condition is not sufficient, consider the following case, which shows Conditions 1 and 2 can both fail, and yet there is no sorting. Assume that $\ell_n^t = w_n^t = t + T_n$, so the productivity advantage of cities is unskilled-biased ($\frac{\partial^2 \ln \ell_n^t}{\partial T_n \partial t} < 0$) and Condition 1 fails. In addition, assume that utility is $\exp(c) \varepsilon_n^\omega$ with unit housing consumption, so that $c = w - r$ (which generates housing expenditure shares $s_n^t = \frac{r_n}{w_n^t}$ that are decreasing with income). Assume that ε_n^ω are distributed Frechet with shape parameter κ , so that $V_n^t = \left[\frac{\exp(w_n^t)}{\exp(r_n)} \right]^\kappa$. Under these assumptions, Condition 2 fails. However, it is easy to see that $\lambda_n^t = \frac{[\exp(T_n - r_n)]^\kappa}{\sum_{m \in \mathcal{C}} \exp(T_m - r_m)^\kappa}$ does not depend on t , hence the spatial equilibrium features no sorting. In this example, the comparative advantage in production that the unskilled enjoy in high-productivity cities is exactly offset by the differential burden that housing prices places on them, so that location choices are ultimately independent from skill. In knife-edge cases where the failures of Conditions 1 and 2 are such that they exactly offset each other, the absence of sorting can still arise in equilibrium.

Second, the representations commonly used in quantitative spatial equilibrium models feature a single type of agents, with Cobb-Douglas preferences between traded good and housing, multiplicative amenities and Frechet idiosyncratic shocks (see Redding and Rossi-Hansberg, 2017). Once extended to several agent types, these baseline assumptions allow for sorting across locations to be driven by comparative advantage only (i.e., heterogeneous nominal wage premium of groups across locations). To allow for sources of sorting other than these nominal wage effects, the most popular approach in the literature has been to keep this general Cobb-Douglas multiplicative structure within groups, but allow the parameters that govern preferences to vary by group. The alternative we explore in this paper is to maintain the assumption of preferences that are common across all groups, but to allow for non-homotheticity in these preferences. Doing so offers a microfounded model where groups with different incomes make systematically different choices.

Before studying the consequences of our alternative approach, we discuss here how various papers in the literature have generated the failure of Condition 2 to model sorting. In what follows, we assume for simplicity that Condition 1 holds.

First, some papers assume that different groups have different common components of utility. In order to illustrate the consequences of this assumption in a simple way, assume that preferences are Cobb-Douglas, but with different housing shares $\mu^t \neq \mu^s$ for some types $s \neq t$. In this case, Condition 2 is violated, and households types that spend a higher share of income on housing are

disproportionately drawn into cheaper cities:

$$\forall m, n \in \mathcal{C} \quad \forall s, t \in \mathcal{T} : \quad \left(\frac{\lambda_n^t}{\lambda_n^s} \right) \left(\frac{\lambda_m^t}{\lambda_m^s} \right)^{-1} = \left(\frac{r_n}{r_m} \right)^{-\kappa(\mu^t - \mu^s)}.$$

It is also often assumed that different types have ex-ante heterogeneous preferences for amenities (as in [Almagro and Domínguez-Iino, 2020](#); [Diamond, 2016](#); [Fajgelbaum and Gaubert, 2020](#)). To illustrate this channel, assume that $V_n^t = A_n^t \frac{w_n^t}{r_n^t}$, where the notation A_n^t highlights that the valuation of amenities differ across groups. Then, households types are disproportionately drawn into cities with amenities that they disproportionately care about:

$$\forall m, n \in \mathcal{C} \quad \forall s, t \in \mathcal{T} : \quad \left(\frac{\lambda_n^t}{\lambda_n^s} \right) \left(\frac{\lambda_m^t}{\lambda_m^s} \right)^{-1} = \left(\frac{A_n^t}{A_n^s} \right) \left(\frac{A_m^t}{A_m^s} \right)^{-1}.$$

Alternatively, some authors assume that the common component of utility is homothetic and identical for all skills, but sorting is obtained through the distribution of shocks. For instance, if shocks are distributed Frechet, but the distribution of shocks differ by skill with a Frechet parameter $\kappa^t \neq \kappa^s$ for some types $s \neq t$ (as in e.g. [Tsivanidis, 2019](#)), then Condition 2 is violated. It then follows that:

$$\forall m, n \in \mathcal{C} \quad \forall s, t \in \mathcal{T} : \quad \left(\frac{\lambda_n^t}{\lambda_n^s} \right) \left(\frac{\lambda_m^t}{\lambda_m^s} \right)^{-1} = \left(\frac{\frac{T_n}{P(r_n, A_n)}}{\frac{T_m}{P(r_m, A_m)}} \right)^{\kappa^t - \kappa^s},$$

and high- κ types disproportionately sort into cities displaying high productivity, desirable amenities, and cheap housing, as their sensitivity to these differences in local attractiveness is higher. Relatedly, assume that the common component of utility is a homothetic function, but consider additive logit shocks as in equation 2. In this case, Condition 2 also fails. Specifically, so long as Condition 1 holds, relative choice probabilities are given by:

$$\left(\frac{\lambda_n^t}{\lambda_n^s} \right) \left(\frac{\lambda_m^t}{\lambda_m^s} \right)^{-1} = \exp \left[\left(\frac{T_n}{P(r_n, A_n)} - \frac{T_m}{P(r_m, A_m)} \right) (t - s) \right],$$

which generically differs from unity. The reason why this seemingly innocuous change of functional forms has a direct impact on sorting is that, as discussed above, what matters for the properties of sorting is the combined feature of the representation of preferences and the distribution of shocks. With additive logit shocks, the migration elasticity $\mathcal{E}_n^t \left(\frac{\lambda}{1-\lambda}, \tilde{V} \right)$ is city- and type-specific and equal to V_n^t , and thus is increasing in type t , given n . Through this mechanism, more mobile types (that is, higher utility/higher- t type in this case) are disproportionately represented in more attractive cities.

In complement to this literature, we focus our analysis in this paper on the role of identical but non-homothetic preferences in generating sorting. A common definition of preferences is particularly desirable in that it allows for transparent welfare comparison across individuals, as well as for welfare

accounting in the context of changing groups composition – e.g., the context of the stark rise in college education in developed economies.

We now move on to our model with income-inelastic preferences for housing, and characterize the sorting equilibrium, i.e. which skills sort to which type of cities. To that end, we first make a detour through housing rents and establish that, under quite general conditions, desirable and productive cities command relatively high housing prices in spatial equilibrium.

3.2 Equilibrium Housing Prices

We show in this section that desirable and productive cities command relatively high housing prices in spatial equilibrium under quite general conditions. This result may not hold, however, if the quality of some local amenities directly reduce housing consumption. The following assumption rules out this case:

Assumption 1. *Housing and amenities are q-complements in the sense that*

$$\forall n \in \mathcal{C}, \quad \forall t \in \mathcal{T} : \quad \frac{\partial h_n^t}{\partial A_n} \geq 0.$$

Note that Assumption 1 is warranted in particular in the case that is ubiquitous in the literature where $U(c, h, A_n) = U(u(c, h), A_n)$ for some function u , i.e., when consumption and amenities are separable. In this case, $\partial h_n^t / \partial A_n = 0$.⁹

The following proposition summarizes how equilibrium housing rents reflect city characteristics:

Proposition 4. "Rosen-Roback." *Consider two cities $m, n \in \mathcal{C}$. If $T_n > T_m$, $H_n < H_m$ or $\eta_n < \eta_m$, all else equal, then city n is more expensive than city m in equilibrium ($r_n > r_m$). In addition, under A1, if $A_n > A_m$ all else equal, then city n is more expensive than city m in equilibrium ($r_n > r_m$).*

Proof. See Appendix B. □

Note that the effect of a higher amenity A_n on the equilibrium housing price r_n is ambiguous if Assumption 1 is violated. Indeed, when housing and amenities are q-substitutes, higher amenities reduce housing demand of locals. This force pushes housing prices down. At the same time, higher amenities attract more households to the city, pushing prices up, so that the net effect of amenities on housing prices is ambiguous. Note also that Assumption 1 is strong for our purposes: Proposition 4 holds so long as local *aggregate* demand for housing in the city, $\sum_t L^t \lambda_n^t h_n^t$, is non-decreasing in A_n , a condition that may hold even if Assumption 1 (that pertains to individual housing demand h_n^t) is violated.

⁹The case $\frac{\partial h_n^t}{\partial A_n} > 0$ corresponds to a situation in which natural amenities are a complement to housing services – e.g., a soft climate that makes a large garden more enjoyable, or nice views that make a spacious living room with large windows more desirable. The case $\frac{\partial h_n^t}{\partial A_n} < 0$ corresponds to cultural or natural amenities that make hanging out outside more attractive than staying home watching Netflix, or if the variety and quality of local restaurants makes you use your kitchen less frequently.

3.3 City Primitives and Sorting

We now characterize spatial sorting, that is, we establish the effects of cities primitives $\{A_n, T_n, H_n, \eta_n\}$ on the *composition* of their labor force. We restrict the analysis to a demand system separable in amenities and consumption, in line with the literature.¹⁰ Specifically, we assume from now on that:

Assumption 2. *Preferences are separable in amenities and consumption. Location choices are given by:*

$$\lambda_n^t = \frac{[v(w_n^t, r_n) A_n]^\kappa}{\sum_{m \in \mathcal{C}} [v(w_m^t, r_m) A_m]^\kappa}. \quad (14)$$

In particular, Assumption 1 holds under Assumption 2, as in this case $\frac{\partial h_n^t}{\partial A_n} = 0$. This formulation allows for two distinct drivers of sorting: comparative advantage (Condition 1 may fail), and income effects (Condition 2 may fail). The assumption that preferences are separable in amenities and real wages v conveniently emphasizes the role of non-homothetic preferences (embedded in v) on sorting: heterogeneous amenities do drive sorting in equilibrium, but only indirectly – through their capitalization in housing prices.

As is intuitive, the direction of sorting depends on which worker type gets a higher benefit from city productivity and/or is more burdened by local cost of living. We detail here assumptions on primitives that drive these two forces, before characterizing sorting under these assumptions. First, we assume that high-skill workers have a comparative advantage in cities with high productivity, as it is the more empirically relevant case. :

$$\frac{\partial \mathcal{E}_n^t(\ell, T)}{\partial t} > 0. \quad (15)$$

We will see below that a stronger form of comparative advantage may sometimes be required. We say that high-skill workers have a *strong comparative advantage* in cities with high productivity when:

$$\frac{\partial \mathcal{E}_n^t(v, T)}{\partial t} > 0. \quad (16)$$

Strong comparative advantage means a high-skill worker is comparatively more productive than a low-skill in a high productivity city, not just in income terms, as in expression (15), but also in utility terms, as in expression (16). Second, income-based sorting is driven by how concave is utility. This is because concavity in utility makes differences in real income across locations more salient for low-skill workers than for high-skill workers. To fix ideas, we derive results under the following assumption:

¹⁰Arntz, Brull, and Lipowski (2023) use a stated-preference experiment to elicit preferences for urban amenities. They do not find any significant differences among skill groups. We are unaware of other empirical results measuring substitution patterns between local amenities and consumption. We therefore make the assumption, pervasive in the literature, that preferences are separable in these two terms. Relaxing this assumption would lead to a typology of cases that are ancillary to the main point of the paper.

Assumption 3. *The elasticity of indirect utility with respect to income is non-increasing in income and therefore in worker type by $\partial w_n^t / \partial t > 0$:*

$$\frac{\partial^2 (\ln v_n^t)}{\partial (\ln w_n^t)^2} \leq 0 \quad \Rightarrow \quad \frac{\partial \mathcal{E}_n^t(v, w)}{\partial t} \leq 0. \quad (17)$$

Note that under Assumption 3, strong comparative advantage (16) implies comparative advantage (15). Importantly, we show in Appendix C that the functional forms for utility listed in Table 2 satisfy Assumption 3.¹¹

We are now ready to characterize sorting patterns in this economy.

Proposition 5. *Sorting Patterns.* *Consider two cities $m, n \in \mathcal{C}$, and two worker types $s, t \in \mathcal{T}$ with $s < t$. In equilibrium, city n disproportionately attracts high- t workers relative to city m ($\frac{\lambda_n^t}{\lambda_n^s} > \frac{\lambda_m^t}{\lambda_m^s}$):*

(i) *If $H_n < H_m$ or $\eta_n < \eta_m$, all else equal.*

(ii) *Under A1, if $A_n > A_m$, all else equal.*

(ii) *Under A3, if high-ability workers have a strong comparative advantage in productive cities and if $T_n > T_m$, all else equal.*

Proof. See Appendix B. □

Two comments are in order. The first part of the proof shows that any city characteristic that increases local housing prices, all else equal, increases the relative supply of high-skill workers there. In that sense, *high-skill workers sort into expensive cities*. In particular, this mechanism leads high-skill workers to sort into productive cities (which pay high wages and tend to be more expensive in equilibrium). In addition, their comparative advantage in production also leads high-skill workers to sort to high-productivity places. Though seemingly intuitive, this result is more subtle, as the decreasing marginal utility of income dampens the effect of comparative advantage on the relative attractiveness of cities. As the proposition shows, this type of comparative advantage has to be stronger than the effect of decreasing marginal utility of income to generate this sorting. Condition (16) provides a sufficient condition for the comparative advantage effect to dominate decreasing marginal utility of income, and drive sorting of high-skill workers to high-productivity locations. With this correction, non-homothetic preferences and comparative advantage do reinforce each other in shaping the sorting of high skill into high productivity cities. The role played by the concavity of preferences does not arise in quantitative models that use preferences that are unit-elastic in income (typically Cobb-Douglas).

¹¹We show in Appendix C.9 that the first inequality in equation (17) holds if the Arrow-Pratt measure of relative risk aversion, $-w \frac{\partial^2 v / \partial w^2}{\partial v / \partial w}$, is larger than 1.

4 Welfare Inequality

We have focused so far on positive questions, and have discussed in particular how city characteristics shape the spatial sorting of heterogeneous types of workers. Another class of questions urban economists are interested in is normative in nature. What are the distributional consequences of spatial shocks? To make progress on these issues, we propose results on the measurement of welfare and welfare inequality between types, in our spatial model with heterogeneous agents and non-homothetic preferences.

4.1 Welfare Changes: Sufficient Statistics Approach

Models with homogeneous agents typically rely on a “sufficient statistics” approach for welfare, which allows to compute representative welfare changes following an economic shock, given available statistics. We extend this approach to our model with heterogeneous agents and non-homothetic preferences, to measure the distributional consequences, across heterogeneous groups, of given economic shocks. We use the hat notation to compute relative changes in variables, $\hat{x} \equiv x'/x$, where x' denotes the value of x after an economic shock or a policy change. We maintain Assumption 2. In particular, expected utility of type t is equal to $\Gamma(1 - \frac{1}{\kappa})$ times \mathbb{V}^t , where Γ is the gamma function and:

$$\mathbb{V}^t = \left[\sum_{m \in \mathcal{C}} [v(w_m^t, r_m) A_m]^\kappa \right]^{\frac{1}{\kappa}}. \quad (18)$$

Compared to the literature, we relax the assumption that $v(\cdot)$ is Cobb-Douglas, and consider instead functions that exhibit income effects.

We first look into how expected utility changes for different types following a shock. Given the properties of the Frechet distribution, expected utility of type t changes as follows:

$$\hat{\mathbb{V}}^t = \hat{A}_n \frac{\hat{w}_n^t}{\hat{P}_n^t} \left(\hat{\lambda}_n^t \right)^{-\frac{1}{\kappa}}, \quad (19)$$

where $P_n^t \equiv w_n^t/v_n^t = P(w_n^t, r_n; \Theta)$ is a price index for type t in city n . It depends on wages and prices (which can a priori be observed) and on the vector Θ that summarizes the parameters of the demand function (which can a priori be estimated). This price index is generically both city-specific, because housing prices differ across space, and type-specific, because of non-homothetic preferences.

In turn, change in expected utility inequality between types s and t is given by:

$$\frac{\hat{\mathbb{V}}^t}{\hat{\mathbb{V}}^s} = \frac{\hat{w}_n^t}{\hat{w}_n^s} \left(\frac{\hat{P}_n^t}{\hat{P}_n^s} \right)^{-1} \left(\frac{\hat{\lambda}_n^t}{\hat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}. \quad (20)$$

Expression (20) makes clear that simple measures of changes in relative real income in a given city, such as $\frac{\hat{w}_n^t}{\hat{w}_n^s} \left(\frac{\hat{P}_n^t}{\hat{P}_n^s} \right)^{-1}$, do not deliver a theoretically consistent measure of change in expected

utility between types. This is because, in spatial equilibrium, the economy responds to shocks in two ways: through a change in prices, captured by this real income measure, but also through a reallocation of population, moving out of (relatively) adversely affected locations. By a revealed preference argument, changes in sorting patterns reveals relative preferences for places. In addition to real income changes, one must account for a selection effect in how population responds to shock: those attracted to a location with a positive shock have typically lower idiosyncratic preference for that location than incumbents. This is controlled for through the term $\left(\frac{\hat{\lambda}_n^t}{\hat{\lambda}_n^s}\right)^{-\frac{1}{\kappa}}$, to obtain a theoretically grounded measure of the change in utility inequality.

Note that if the first and last terms in the right hand side of equation (20), $\frac{\hat{w}_n^t}{\hat{w}_n^s}$ and $\frac{\hat{\lambda}_n^t}{\hat{\lambda}_n^s}$, are readily observable empirically, changes in type-specific price indices $\frac{P_n^t}{P_n^s}$ are model-based constructs and are not directly observable. In order to make progress, then, one has to impose a functional form for utility and hence for price indices, as in [Handbury \(2021\)](#). We consider several popular classes of non-homothetic preferences, and we propose below a new convenient result for distributional analysis in these classes of models: in each case, the change in expected utility inequality in equation (20) depends on a small set of simple statistics, including – crucially – changes in the expenditure shares on housing, s_n^t . These housing expenditure shares are key statistics that measure the distributional effect of a shock, as they are directly informative about relative welfare changes when preferences are non-homothetic. The key insight here is that these statistics exploit the mapping between Engel curves and welfare, as in ([Aguiar and Bils, 2015](#)) and [Atkin, Faber, Fally, and Gonzalez-Navarro \(2023\)](#). Specifically, it turns out that in all functional forms we consider, the type-specific price index can be written as

$$P_n^t = P_n S_n^t, \tag{21}$$

i.e. as the product of component common to all incomes (P_n) and a correction for income effects (S_n^t) which only depends on the expenditure share on housing. Consider the following Stone-Geary preferences as an example:

$$v(w_n^t, r_n) = \frac{w_n^t - \underline{h}r_n}{p^{1-\psi} (r_n)^\psi}, \tag{22}$$

where \underline{h} can be interpreted as the subsistence level of housing if it is positive (in which case housing is a necessity) and $\psi \in (0, 1)$. This expression encompasses Cobb-Douglas as a special case when $\underline{h} = 0$. This attractive feature and its simplicity make this functional form a popular one – see e.g. [Tsivanidis \(2019\)](#) and [Gagné, Koster, Moizeau, and Thisse \(2022\)](#) for applications in spatial contexts; however, it is not without caveats ([Matsuyama, 2023](#)).¹² Using Roy’s identity, the expenditure share of housing is $s_n^t = \psi + (1 - \psi) \frac{\underline{h}r_n}{w_n^t}$, so that in this case, we get:

$$v(w_n^t, r_n) = \frac{w_n^t}{P_n S_n^t}, \text{ with } P_n = p^{1-\psi} (r_n)^\psi \text{ and } S_n^t = \frac{1 - \psi}{1 - s_n^t}.$$

¹²For instance, Stone-Geary preferences embed the strong assumption that preferences satisfy Pigou’s Law, they are asymptotically homothetic, and their Engel curves are linear.

Therefore, *relative* changes in indirect utility V only depend on prices via the housing expenditure share term S_n^t .

The relative change in expected utility between types s and t is thus:

$$\frac{\widehat{V}^t}{\widehat{V}^s} = \frac{\widehat{w}_n^t \widehat{1 - s}_n^t}{\widehat{w}_n^s \widehat{1 - s}_n^s} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}, \quad (23)$$

where n is any arbitrary city. That is, changes in nominal incomes, housing expenditure shares and skill composition of any arbitrary municipality n , as well as an estimate of the migration elasticity κ , are sufficient to compute changes in expected utility inequality between any pair of types. Thus, any change in expected utility inequality can be decomposed into changes in nominal earnings (which are equal to changes in real earning inequality if preferences are homothetic), a correction for non-homothetic preferences, as captured by heterogeneous changes in expenditure shares, and a correction for (revealed preferred) location changes.

In Table 2 we generalize this result to the six alternative functional forms for utility that are listed in Table 1. We establish the following results. Let $\alpha, \beta, \delta, a, b > 0$ define a set of reduced form parameters that fully characterize pairwise relative welfare changes as per equations (24) and (25) below. Columns 3 to 7 of Table 2 provide the relationship between the structural parameters of each functional form and the reduced form parameters $(a, b, \alpha, \beta, \delta)$.

Table 2: Non-homothetic preferences: Reduced form parameters from equations (24) and (25).

Preferences	Indirect utility V	Reduced form parameters				
		α	β	δ	a	b
Stone-Geary	$V = A \frac{w - \nu hr}{p^{1-\psi} r^\psi}$	1	0	1	0	1
PIGL	$V = A \left[\left(\frac{w}{p^{1-\psi} r^\psi} \right)^\iota - \frac{\nu}{\gamma} \left(\frac{r}{p} \right)^{\gamma \iota} \right]^{1/\iota}$	1	0	$\frac{1}{\iota}$	ψ	$\frac{1}{\gamma}$
PIGLOG	$V = A \left(\frac{r}{p} \right)^\nu \ln \left(\frac{w}{p^{1-\psi} r^\psi} \right)$	0	0	1	0	$\frac{1}{\psi}$
CRIE	$V = A \left[\left(\frac{w}{r} \right)^{-\psi} + \left(\frac{w}{p} \right)^{-\psi + \nu(\psi - \mu)} \right]^{-1}$	1	$\frac{1}{\mu}$	$\frac{1}{\mu}$	$\frac{\psi}{\psi - \mu}$	$-\frac{\psi - \mu}{\mu}$
NH-CES	$w^{1-\sigma} = \left(\frac{V}{A} \right)^{1-\sigma} \left[\left(\frac{V}{A} \right)^{\nu(\mu - \psi)} r^{1-\sigma} + p^{1-\sigma} \right]$	1	0	$\frac{1}{1-\sigma}$	0	1
HCD	$0 = \left(\frac{V}{A} \right)^{\psi + \nu(\mu - \psi)} \ln \left(\frac{r}{w} \right) + \left(\frac{V}{A} \right)^\psi \ln \left(\frac{p}{w} \right)$	0	$\frac{1}{\psi - \mu}$	$\frac{1}{\psi - \mu}$	0	1

Notes: PIGL stands for "Price Independent Generalized Linearity" (Muellbauer, 1975), PIGLOG stands for "Price Invariant Generalized Logarithmic" (Deaton and Muellbauer, 1980), CRIE stands for "Constant Relative Income Elasticity" (Caron, Fally, and Markusen, 2014; Eeckhout, Pinheiro, and Schmidheiny, 2014; Fieler, 2011; Hanoch, 1975), NH-CES stands for "Non Homothetic Constant Elasticity of Substitution" (Albouy, Ehrlich, and Liu, 2016; Comin, Lashkari, and Mestieri, 2021; Hanoch, 1975; Matsuyama, 2019; Sato, 1977), and HCD stands for "Heterothetic Cobb-Douglas" (Bohr, Mestieri, and Robert-Nicoud, 2024). HCD preferences are a limiting case of NH-CES preferences. The indicator variable $\nu \in \{0, 1\}$ governs the (non-)homotheticity of each class of preferences. In all cases, preferences are homothetic if $\nu = 0$ and non-homothetic if $\nu = 1$.

Let

$$S_n^t \equiv \frac{(s_n^t - a)^\beta}{[1 - b(s_n^t - a)]^\delta} \quad (24)$$

define a monotonically increasing transformation of the housing expenditure share s_n^t , for $s_n^t \in [\max\{0, a\}, \min\{a, 1\}]$. The following result obtains:

Proposition 6. *Relative Welfare Changes.* *Under any of the functional forms for V considered in Table 2, the relative change in expected utility between any pair of types can simply be expressed as:*

$$\frac{\hat{V}^t}{\hat{V}^s} = \left(\frac{\widehat{w}_n^t}{\widehat{w}_n^s} \right)^\alpha \left(\frac{\widehat{S}_n^t}{\widehat{S}_n^s} \right)^{-1} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}. \quad (25)$$

Proof. Appendix C derives this result for each class of non-homothetic preferences. \square

Proposition 6 establishes that changes in nominal incomes and populations by skill in any location n , pre- and post-housing expenditure shares, and relative migration changes, together with knowledge of some structural parameters of the model, are sufficient to compute changes in expected utility inequality between any pair of types. Note that the formula does not necessarily require estimates of all structural parameters of the utility function, in line with the “hat algebra” approach more generally. Consider the NH-CES case as an example. The formula requires an estimate for the elasticity of substitution σ between housing and other goods, but not of the parameters governing the income elasticity of demand μ, ψ . Similarly, the approach does not require estimating any of the structural parameters of the Stone-Geary utility function. In either case, the effect of the superfluous parameters on equilibrium outcomes are subsumed in the (potentially observable) expenditure shares.

Finally, we note that one can augment the model to allow for type-specific local amenities, as in Diamond (2016) and Fajgelbaum and Gaubert (2020). In this case maintaining the assumption of multiplicatively separable amenities, equation (25) becomes

$$\frac{\hat{V}^t}{\hat{V}^s} = \frac{\widehat{A}_n^t}{\widehat{A}_n^s} \left(\frac{\widehat{w}_n^t}{\widehat{w}_n^s} \right)^\alpha \left(\frac{\widehat{S}_n^t}{\widehat{S}_n^s} \right)^{-1} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}. \quad (26)$$

We return to that case in the application of Section 5 below.

4.2 Money-Metric Welfare Changes

Proposition 6 takes a first step to extend the “exact hat algebra” approach to welfare analysis, common in trade, economic geography, and other fields, to a setting with general non-homothetic preferences. In the context of non-homothetic preferences, however, changes in utility are not money-metric changes. An additional step is thus required to convert changes in utility into interpretable money-metric changes. We now show how to map these changes in utils into an equivalent variation-type measure. As will become clear, $\mathcal{E}_n^t(v, w)$ is an important variable for our analysis,

and we henceforth refer to this object as the “log-log marginal utility of income.” It is equivalent to the marginal utility of income, expressed in elasticity terms.

Specifically, we interpret the expected utility function (18) as the utility function of a representative type- t agent. We measure the impact of a shock on welfare of type t by asking what should be her proportional increase in income in the period prior to the shock to reach the well-being of the period posterior to the shock? This offers a natural money-metric measure of welfare change between the two periods, which we write \hat{y}^t . It is an equivalent variation concept, expressed in percentage terms. Formally, \hat{y}^t is implicitly defined as:

$$\left[\sum_{m \in \mathcal{C}} v(w_m^t \hat{y}^t, r_m)^\kappa (A_m)^\kappa \right]^{\frac{1}{\kappa}} = \left[\sum_{m \in \mathcal{C}} v(w_m', r_m')^\kappa (A_m')^\kappa \right]^{\frac{1}{\kappa}}. \quad (27)$$

We consider small shocks to the economy. Using a first order approximation, we establish the following result.¹³

Proposition 7. *Equivalent Variation.* *The equivalent variation (in proportional terms) is related to the relative change in expected utility as follows:*

$$\hat{y}^t = \left(\hat{V}^t \right)^{1/\bar{\varepsilon}^t}, \quad (28)$$

where $\bar{\varepsilon}^t \equiv \sum_n \lambda_n^t \mathcal{E}_n^t(v, w)$ is the average log-log marginal utility of income across all cities.

Proof. See Appendix C.7. □

That is, the change in income that is equivalent to the change in the economic environment caused by a given shock is given by the corresponding proportional change in utility, converted in money-metric unit (converting 1% util increase into 1% dollar increase) by the term $\bar{\varepsilon}^t$. When utility is homothetic and unit-elastic in income, it is clear that $\bar{\varepsilon}^t = 1$, so that $\hat{y}^t = \hat{V}^t$. Hence, expected utility can be used directly in this case to measure welfare change in an appropriate metric. Here, in contrast, the log-log marginal utility of income is not constant, and varies across individuals and choices. McFadden (1999) and Karlstrom (2000) discuss how to compute equivalent variation in discrete choice models with income effects, which is generally intractable and computationally intensive. The Frechet formulation, combined with a generic non-homothetic common utility, strikes a balance between allowing for realistic income effects and preserving some tractability for welfare computations.

We use $\frac{\hat{y}^t}{\hat{y}^s}$ as a money metric measure of change in welfare inequality. It measures the difference in the proportional income growth equivalent to a given shock for type t versus type s . Using equation (28) and considering two arbitrary types t, s , we find that this change in welfare inequality

¹³We note that Proposition 7 does not require Assumption 2 (that is, V does not have to be multiplicatively separable in v and A). The equivalent variation term captures both change in prices and changes in amenities.

following a small shock can be expressed as follows:

$$\frac{\hat{y}^t}{\hat{y}^s} = \frac{(\hat{\mathbb{V}}^t)^{1/\bar{\varepsilon}^t}}{(\hat{\mathbb{V}}^s)^{1/\bar{\varepsilon}^s}}. \quad (29)$$

Expression (29) tells us that the measure of change in expected utility inequality using sufficient statistics, $\frac{\hat{\mathbb{V}}^t}{\hat{\mathbb{V}}^s}$, in equation (25) has to be corrected in two ways to deliver a meaningful measure of change in inequality between types. First, it has to be corrected by the average log-log marginal utility of income, $\bar{\varepsilon}^t$ to convert a change in utils into a change in income. The second correction accounts for the fact that the average log-log marginal utility of income differs across types. That is, using only expected utility inequality $\frac{\hat{\mathbb{V}}^t}{\hat{\mathbb{V}}^s}$ generally leads to a biased measure of change in welfare because $\bar{\varepsilon}^t, \bar{\varepsilon}^s \neq 1$, and because $\bar{\varepsilon}^t \neq \bar{\varepsilon}^s$.

This additional correction can have important implications for the welfare consequences of changes in amenities in particular. To see this point, use equations (19) and (21) to rewrite equation (29) as follows:

$$\frac{\hat{y}^t}{\hat{y}^s} = \frac{\left[(\widehat{w}_n^t)^\alpha (\widehat{S}_n^t)^{-1} (\widehat{\lambda}_n^t)^{-\frac{1}{\kappa}} \right]^{1/\bar{\varepsilon}^t}}{\left[(\widehat{w}_n^s)^\alpha (\widehat{S}_n^s)^{-1} (\widehat{\lambda}_n^s)^{-\frac{1}{\kappa}} \right]^{1/\bar{\varepsilon}^s}} \left(\frac{\widehat{A}_n}{\widehat{P}_n} \right)^{\frac{1}{\bar{\varepsilon}^t} - \frac{1}{\bar{\varepsilon}^s}}. \quad (30)$$

The first term in the right-hand side of the expression above is a simple correction to relative utility changes in equation (25) that accounts for the fact that utility \mathbb{V} is generically not log-linear in income. The caveat is that the correction in both the numerator and the denominator of this first correction is type-specific. As a matter of fact, the second term accounts for the fact that the log-log marginal utility of income differs across types. As a result, changes in the homothetic components of utility also have an impact on the relative change in money-metric inequality.

5 Measuring Changes In Welfare Inequality: USA 1980-2020

In this section, we evaluate the model-consistent money-metric change in welfare inequality between high- and low-skill workers in the U.S., in the last four decades, using the results from Section 4. In doing so we revisit results from a literature that has measured these changes taking into account the heterogeneous spatial sorting of high- and low-skill workers (Moretti, 2013; Diamond, 2016). We show that accounting for income effects in housing consumption changes these measures significantly.

We maintain Assumption 2 throughout this section, so that we can write $V_n^t = (v_n^t A_n)^\kappa$, where $v_n^t = v(w_n^t, r_n)$ and $\kappa > 1$ governs the elasticity of the spatial labor supply.

5.1 Data

To operationalize the formulas of Section 4, we need data on nominal wages, location choices of high- vs low-skill workers, and – crucially – expenditure on housing over time. We describe these here in turn and refer the reader to Appendix D for more details.

Raw data Our data collection and definitions follow Moretti (2013) as closely as possible. Data for our key variables come from the Decennial Census for 1980 to 2000 and the 5-year American Community Survey (ACS) sample for 2010 and 2020 (Ruggles et al., 2024). A location in the analysis is one of 303 Metropolitan Statistical Areas (MSAs) and “rest-of-state” regions. The sample includes US-born, full-time workers aged 25 to 59 who live in private households. We define individuals with 4+ years of higher education as “high skill” and individuals with a high school degree as “low skill.”

Sufficient statistics First, from the dataset above, we directly read the share $\lambda_{n,y}^t$ of workers of type t living in location n in year y . Second, we use an adjusted measure of wages to control for demographic changes among worker types over time. To that end, we use the same controls as in Moretti (2013): sex, dummies for race, and a cubic in work experience. The adjustment is performed separately for 1980-2000 and 2010-2020 periods to maintain consistency with Moretti (2013), who analyzes the earlier period. For each period, we regress wages on these demographic controls and use the residuals, holding demographic characteristics constant at their period-specific means. We compute $\{w_{n,y}^t\}_{t,n,y}$ as the median adjusted wage for each city-year-skill. We compute housing expenditure shares $\{s_{n,y}^t\}_{t,n,y}$ in two different ways. Our main measure considers only renters and divides their total housing costs (including utilities) by their household income from wages and salaries, retaining the median value. We consider in addition a measure that also includes homeowners (whose expenses include mortgage payments, property taxes, and utilities). We again use the median within a city-year-skill group as our preferred measure of $\{s_{n,y}^t\}_{t,n,y}$. Our main measure shows that in 2020 the median share of income spent on housing was 20% for high-skill individuals and 24% for low-skill individuals. These shares vary across cities from 13% to 24% for high-skill households, and from 16% to 29% for low-skill ones. Moreover, from 1980 to 2020, housing expenditure shares rose relatively more for low-skill individuals, increasing by 5 percentage points against 2 percentage point increase for high-skill individuals. Much of the increase in spending shares occurred after 2000. Summary statistics for these housing shares are detailed in Appendix Table 6.

5.2 Model Parameters

In addition to this data, implementing the formulas of Section 4 requires estimates of the elasticity of population to wages κ and estimates of the average log-log marginal utility of income by group, $\{\bar{\varepsilon}^L, \bar{\varepsilon}^H\}$.

Non-homotheticity and marginal utility of income We apply equation (25) considering two alternative specifications of non-homothetic demand: Stone-Geary and Non-Homothetic CES. In each case, we review here how we calibrate the average log-log marginal utility of income for each group, $\{\bar{\varepsilon}^L, \bar{\varepsilon}^H\}$.

In the Stone-Geary case, recall from equation (22) that two parameters, $\psi \in (0, 1)$ and $\underline{h} \geq 0$, characterize the indirect sub-utility function: $v_n^t = \frac{w_n^t - \underline{h}r_n}{r_n^\psi}$. We show in Appendix C.1 that the log-log marginal utility of income for type t in location n is given by:

$$\mathcal{E}_{n,SG}^t(v, w) = \frac{1 - \psi}{1 - s_n^t},$$

which is larger than one given that $s_n^t \geq \psi$ (here we add the subscript ‘‘SG’’ to emphasize that the computation of this elasticity is specific to the choice of functional form for preferences, and to avoid confusion with the computation of $\mathcal{E}_{n,NHCES}^t$ below). We calibrate parameter ψ noting that this parameter relates to the expenditure share on housing as follows: $s_n^t = \psi + (1 - \psi) \frac{\underline{h}r_n}{w_n^t}$. In particular, ψ corresponds to the housing expenditure share for infinitely high incomes. We calibrate ψ to match the 10th percentile of the expenditure share distribution of high skills as the actual minimum of the housing expenditure share $\min_{n,t} s_n^t$ is very prone to measurement error. This yields $\psi = 0.1$. We then compute the distribution of $\{\mathcal{E}_{n,SG}^t(v, w)\}_{n,t}$ given that of $\{s_n^t\}_{n,t}$ (we use the median housing expenditure share for each combination of city and type), and finally compute the mean $\bar{\varepsilon}_{SG}^t \equiv \sum_n \lambda_n^t \mathcal{E}_{n,SG}^t(v, w)$. We report the results in Table 3 for renters only, as well as for homeowners and renters. We also report the median rather than the mean value to assess the stability of the results. Finally, we emphasize that these elasticities are unitary in the homothetic and nominal cases.

In the Non-Homothetic CES case, v_n^t is implicitly defined by

$$(w_n^t)^{1-\sigma} = (v_n^t)^{1-\sigma} \left[(v_n^t)^{\mu-\psi} (r_n)^{1-\sigma} + p^{1-\sigma} \right].$$

Housing demand is price-inelastic if $\sigma \in (0, 1)$ and income-inelastic if $\sigma - 1 \leq \mu - \psi < 0$. Appendix C.5 provides details. There, we also show that the log-log marginal utility of income for type t in location n is given by:

$$\mathcal{E}_{n,NHCES}^t(v, w) = \frac{1 - \sigma}{1 - \sigma - (\psi - \mu) s_n^t},$$

which is strictly larger than one if $\mu < \psi$. We set $\sigma = 0.53$ and $\mu - \psi = -0.306$ based on Finlay and Williams (2022). As for the Stone-Geary case, we then compute the distribution of $\{\mathcal{E}_{n,NHCES}^t(v, w)\}_{n,t}$ using the median housing expenditure share for each combination of city and type, and report $\bar{\varepsilon}_{NHCES}^t \equiv \sum_n \lambda_n^t \mathcal{E}_{n,NHCES}^t(v, w)$ (and the median of $\mathcal{E}_{n,NHCES}^t(v, w)$) in Table 3.

Two intermediate results are worth emphasizing. First, the computed values of the log-log marginal utility of income are very stable whether we restrict the analysis to renters or we also include homeowners in the computations (a comparisons across panels of the table), or if we use

Table 3: Log-log marginal utility of a dollar (1980)

	Mean		Median	
	Low Skill	High Skill	Low Skill	High Skill
Homothetic	1.000	1.000	1.000	1.000
Nominal	1.000	1.000	1.000	1.000
Renters Only:				
Stone-Geary	1.103	1.093	1.095	1.093
NH-CES	1.098	1.093	1.094	1.093
Renters & Owners:				
Stone-Geary	1.066	1.087	1.062	1.087
NH-CES	1.070	1.078	1.069	1.078

the median value of \mathcal{E}_n^t instead of the weighted average (a comparison across column pairs). Second, these computed values are remarkably similar across types and across functional forms: they differ at the second decimal only, ranging around 1.1 for both high-skill and low-skill renters. By inspection of equation (30), an immediate, quantitative implication of this finding is that the impact of changes in the *levels* of local amenities (and the common component of price indices) on money-metric welfare inequality is almost fifty times smaller than the impact of relative changes in wages, expenditure shares, or migration patterns, hence can be neglected.¹⁴

Migration elasticity Implementing the formulas of Section 4 also requires an estimate of the migration elasticity, κ . Taking logs of equation (14) and differentiating the equation between types and over time by decade (as symbolized by the operator Δ) yields our estimating equation for κ :

$$\Delta \ln \lambda_{n,y}^H - \Delta \ln \lambda_{n,y}^L = \alpha + \kappa \left(\Delta \ln \frac{w_{n,y}^H}{P_{n,y}^H} - \Delta \ln \frac{w_{n,y}^L}{P_{n,y}^L} \right) + \underbrace{\kappa (\Delta \ln A_{n,y}^H - \Delta \ln A_{n,y}^L)}_{\text{unobserved}} + \epsilon_{n,y}, \quad (31)$$

where $\lambda_{n,y}^t$ is the population share of type t in MSA n and year y , $w_{n,y}^t$ is the nominal wage, $P_{n,y}^t$ is the type-specific price index, $A_{n,y}^t$ is type-specific amenities and the term $\epsilon_{n,y}$ captures measurement error. We denote high-skill households with H and low-skill households with L .

One may worry that OLS estimates of κ using equation (31) are biased due to reverse causality (due e.g. to housing prices responding to population changes) or omitted variables (amenity

¹⁴To see this point, note from equation (30) that the elasticity of the change in money-metric inequality (the left hand side of this expression) with respect to the change in utility inequality (the first term in its right hand side) is at least equal to $\min \left\{ \frac{1}{\bar{\epsilon}^L}, \frac{1}{\bar{\epsilon}^H} \right\}$, whereas its elasticity with respect to the change in amenities or price level (the second term in its right hand side) is equal to $\frac{\bar{\epsilon}^L - \bar{\epsilon}^H}{\bar{\epsilon}^L \bar{\epsilon}^H}$. The ratio of these elasticities is thus bounded above in absolute value by $\frac{|\bar{\epsilon}^L - \bar{\epsilon}^H|}{\min \{ \bar{\epsilon}^H, \bar{\epsilon}^L \}}$. Using the mean values in Table 3 computed for renters only, we obtain an upper bound for this ratio of 0.02. Since, in addition, P_n and A_n are likely to move in the same direction, as amenities are capitalized in prices, this leads to limited changes in $\frac{A_n}{P_n}$ itself.

changes). In addition to double differencing our estimating equation to control for city-level shocks that are common to both types and for city-level characteristics that are constant over time, we follow common practice in the literature and instrument for relative real wage changes using a shift-share instrument differenced between types and over time. Our instrument predicts local changes in real wages by fixing type- and city-specific employment shares by industries to their 1980 levels and using national leave-one-out wage growth by industry. The identifying assumption is that relative 1980 employment shares in a city are uncorrelated with future changes in relative amenities (Goldsmith-Pinkham, Sorkin, and Swift, 2020).

We estimate κ for the homothetic case (in which case both types face the same price index, $P_{n,y}^H = P_{n,y}^L$) as well as for Stone-Geary and NH-CES specifications of non-homothetic preferences. In these latter cases, we use the decomposition in equation (21) and the result in Proposition 6 to replace relative changes in city-type-specific price indices (which we do not observe) by relative changes in city-type-specific expenditure shares (which we do).¹⁵ Results are presented in Table 4. Our preferred specifications using the IV estimator yield an estimate of the migration elasticity of 3.93 in the homothetic case, 3.80 in the non-homothetic Stone Geary case, and 3.66 in the non-homothetic CES case. Our estimates of decadal migration elasticities are in line with extant results in the literature, which vary between 0.6 and 4 (Albouy and Stuart, 2020; Diamond, 2016; Notowidigdo, 2020; Suarez Serrato and Zidar, 2016).¹⁶

One can interpret the IV coefficient in the second column as the labor supply elasticity with respect to nominal wages, and the IV coefficient in the fourth and sixth columns as the labor supply elasticity with respect to real wages when preferences are non-homothetic (Stone-Geary or NHCES). The fact that the difference between the two coefficient is positive means that omitting skill-specific prices from the regression (as we do under the homothetic assumption) yields an upward bias in the elasticity. This suggests that, in the cities where nominal wage ratios w_n^H/w_n^L have gone up the most and hence attracted the largest fractions of high-skill households, real wage ratios v_n^H/v_n^L have increased by even more, i.e. relative prices for high skill have increased *less* than for low skill. This

¹⁵Specifically, building on the derivations in Appendix C.1 for Stone-Geary preferences, we use:

$$\frac{\hat{P}_n^H}{\hat{P}_n^L} = \left(\frac{\widehat{1 - s_n^H}}{\widehat{1 - s_n^L}} \right)^{-1}.$$

By the same token, building on the derivations in Appendix C.5 for NH-CES preferences, we use:

$$\frac{\hat{P}_n^H}{\hat{P}_n^L} = \left(\frac{\widehat{1 - s_n^H}}{\widehat{1 - s_n^L}} \right)^{-1/(1-\sigma)},$$

where we use the estimates from Finlay and Williams (2022) to set $\sigma = 0.53$.

¹⁶Our estimates in the homothetic case are close to the upper bound of those of Albouy and Stuart (2020), Diamond (2016), Notowidigdo (2020), and Suarez Serrato and Zidar (2016), which vary between 2 and 4, and above those in Goldsmith-Pinkham, Sorkin, and Swift (2020) and Autor, Dorn, and Hanson (2013). Goldsmith-Pinkham, Sorkin, and Swift (2020) report an inverse labor elasticity in the range [1.28, 1.76] (and hence an elasticity in the range [0.6, 0.8]). We take the ratio of the wage and employment effects from one thousand dollar-increase in imports in Autor, Dorn, and Hanson (2013) to get a commuting zone (CZ) labor supply elasticity of 1.36 without CZ trends or controls, 0.47 (statistically insignificant at conventional levels) with CZ trends but no controls, and 0.07 (insignificant) with CZ trends and controls.

Table 4: Estimation of Migration Elasticity κ

	Homothetic preferences		Stone-Geary		NH-CES	
	OLS	IV	OLS	IV	OLS	IV
$\Delta \left(\ln \frac{w_n^H}{P_n^H} - \ln \frac{w_n^L}{P_n^L} \right)$	1.14*** (0.16)	3.93*** (0.62)	1.34*** (0.16)	3.80*** (0.62)	1.22*** (0.14)	3.66*** (0.62)
Constant	-0.12*** (0.01)		-0.15*** (0.01)		-0.16*** (0.01)	
Observations	724	724	724	724	724	724
F -Stat		540.73		437.90		272.12

Dependent variable: $\Delta \ln \lambda_n^H - \Delta \ln \lambda_n^L$ (relative labor supply changes). IVs are shift-shares.

Standard errors clustered at the MSA level in parenthesis. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Regressions are weighted using 1980 MSA population.

is consistent with housing being a necessity: when house price rise in these skill-intensive cities, lower-skill are more sensitive to the corresponding price change. ¹⁷

5.3 Welfare Inequality 1980-2020

With this data at hand, we are ready to compute the model-consistent change in welfare inequality from 1980 to 2000 and 2000 to 2020 between high- and low-skill households, revisiting the seminal work of Moretti (2013). Our approach differs from that in Moretti (2013) in two ways. First, our framework allows us to go from real wages to expected utility by taking into account the revealed preferences of households across locations, as we demonstrate in Section 4. Second, our non-homothetic preferences allow for price indices to be income specific, while Moretti (2013) imposes homothetic preferences. As a result, we need to convert changes in utility (which are not readily interpretable) into money-metric, equivalent variation changes.

We start by computing changes in nominal inequality as a benchmark. We report the findings in the first row of the left panel of Table 5. We find that the skill premium has risen by 19.1% between 1980 and 2000 (the time period covered by Moretti, 2013), by 7.1% between 2000 and 2020, and overall by 27.9% between 1980 and 2020. For the sake of comparison, we also report the relative increase in nominal hourly wage inequality of 20% that Moretti (2013) reports for the time period 1980-2000.

Our first modification is to correct for idiosyncratic location preferences and differential sorting patterns. Results are reported in the third row of Table 5. We find a relative increase in inequality of 30.9% between 1980 and 2020, which is slightly higher than the 27.9%-increase in nominal inequality. We report in the fourth row of the table the model-consistent welfare changes in equation (25) under the assumption that preferences are homothetic. In this case, high- and low-skill households face the same changes in local prices, and hence measured changes in inequality are identical to those

¹⁷Let $v_n^t = w_n^t/P_n^t$. Then, by Roy's identity, the housing expenditure share is equal to $s_n^t = \mathcal{E}_n^t(P, r)$, hence the local price index of high-skill households is less sensitive to housing prices than the price index of low-skill households if and only if housing is a necessity.

Table 5: Welfare Results

		Relative Welfare Change			Relative Equivalent Variation		
		1980–2000	2000–2020	1980–2020	1980–2000	2000–2020	1980–2020
Moretti (2013)	$\frac{\widehat{w}^H}{\widehat{w}^L}$	1.20					
Nominal	$\frac{\widehat{w}^H}{\widehat{w}^L}$	1.191	1.071	1.279	1.191	1.071	1.279
Nominal + sorting	$\frac{\widehat{w}^H}{\widehat{w}^L} \left(\frac{\widehat{\lambda}^H}{\widehat{\lambda}^L} \right)^{-\frac{1}{\kappa}}$	1.172	1.109	1.309	1.172	1.109	1.309
Homothetic + sorting	$\frac{\widehat{w}^H}{\widehat{w}^L} \frac{\widehat{P}}{\widehat{P}} \left(\frac{\widehat{\lambda}^H}{\widehat{\lambda}^L} \right)^{-\frac{1}{\kappa}}$	1.172	1.109	1.309	1.172	1.109	1.309
Stone-Geary + sorting	$\frac{\widehat{w}^H}{\widehat{w}^L} \frac{1-s^H}{1-s^L} \left(\frac{\widehat{\lambda}^H}{\widehat{\lambda}^L} \right)^{-\frac{1}{\kappa}}$	1.192	1.136	1.365	1.182	1.135	1.342
NH-CES + sorting	$\frac{\widehat{w}_n^t}{\widehat{w}_n^s} \left(\frac{1-s_n^H}{1-s_n^L} \right)^{1/(1-\sigma)} \left(\frac{\widehat{\lambda}_n^H}{\widehat{\lambda}_n^L} \right)^{-\frac{1}{\kappa}}$	1.216	1.167	1.431	1.199	1.153	1.393
Real (Moretti, 2013)	$\frac{\widehat{W}^H}{\widehat{W}^L}$ in eq. (33)	1.16					

of the previous specification (in the row above).

Our second modification is to allow for non-homothetic housing demand. We compute the change in utility inequality from equation (25) in the Stone-Geary and NH-CES cases, which we recall here for convenience:

$$\frac{\widehat{V}_{SG}^t}{\widehat{V}_{SG}^s} = \frac{\widehat{w}_n^t}{\widehat{w}_n^s} \frac{1-s_n^t}{1-s_n^s} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}, \quad \frac{\widehat{V}_{NHCES}^t}{\widehat{V}_{NHCES}^s} = \frac{\widehat{w}_n^t}{\widehat{w}_n^s} \left(\frac{1-s_n^t}{1-s_n^s} \right)^{\frac{1}{1-\sigma}} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}. \quad (32)$$

Using $\sigma = 0.53$ from Finlay and Williams (2022), it follows that changes in welfare inequality put a geometric weight on changes in expenditure shares that is about twice as large if preferences are NH-CES than if preferences are Stone-Geary (i.e., $\frac{1}{1-0.53} \approx 2$). These computations rely on the maintained assumption that location-specific amenities change in the same way for both skills (an implication of Assumption 2). We return to the consequences of this assumption below. In the model, the formulas in equation (32) hold exactly across all locations; in the data, the resulting measure differs by location. We therefore compute this formula for each city and report the geometric average as our main estimate of $\frac{\widehat{V}^H}{\widehat{V}^L}$, weighted by 1980 population shares.¹⁸ We report the results in the fifth and sixth rows of Table 5.¹⁹ The main takeaway from this exercise is that welfare inequality between high- and low-skill households has risen by *more* than nominal inequality once we account for non-homothetic preferences. Rather than increasing by 30.9% under homothetic preferences, inequality has risen by 36.5% between 1980 and 2020 if we assume that preferences are Stone-Geary, and by 43.1% if preferences are NH-CES.

For completeness and comparison, we report in the last two rows of Table 5 changes in real-wage inequality computed using the methodology in Moretti (2013). It computes the difference between the average change in real wage for high-skill and low-skill, weighted by their respective populations across cities. Real wages are measured by skill-specific nominal wages deflated by a common price

¹⁸Results are almost identical when they are non-weighted or weighted by low-skill or high-skill population instead.

¹⁹We also plot the distribution of the inequality measures in equation (32) across cities in Figure 2 of Appendix E. There we find that inequality increases everywhere.

index for low- and high-skill workers:

$$\ln \frac{\hat{W}^H}{\hat{W}^L} = \left[\sum_{n \in \mathcal{C}} \omega_{n,y'}^H \ln \left(\frac{w_{n,y'}^H}{P_{n,y'}} \right) - \sum_{n \in \mathcal{C}} \omega_{n,y}^H \ln \left(\frac{w_{n,y}^H}{P_{n,y}} \right) \right] - \left[\sum_{n \in \mathcal{C}} \omega_{n,y'}^L \ln \left(\frac{w_{n,y'}^L}{P_{n,y'}} \right) - \sum_{n \in \mathcal{C}} \omega_{n,y}^L \ln \left(\frac{w_{n,y}^L}{P_{n,y}} \right) \right]. \quad (33)$$

According to this measure, as emphasized by [Moretti \(2013\)](#), real wage inequality has increased by 16% in the period 1980-2000, less than the 19.1%-increase in nominal wage inequality. This measure controls for sorting but assumes homothetic preferences. When we take into account non-homothetic preferences, we find instead that welfare inequality has risen by more than nominal inequality. These findings emphasize the importance to correct for revealed location preferences and for non-homothetic housing demand.

Our third and final modification is to convert these changes in “utils” into money-metric changes (changes in utils are economically meaningful only in the homothetic case where $\bar{\varepsilon}^L = \bar{\varepsilon}^H = 1$) using the average log-log marginal utility of income for each worker type. Specifically, we use equation (30) for high- and low-skill households, treating the contribution of the final term in the expression as negligible (i.e., $\simeq 1$) as discussed above. This yields for each specification of preferences $\zeta = SG, NHCES$:

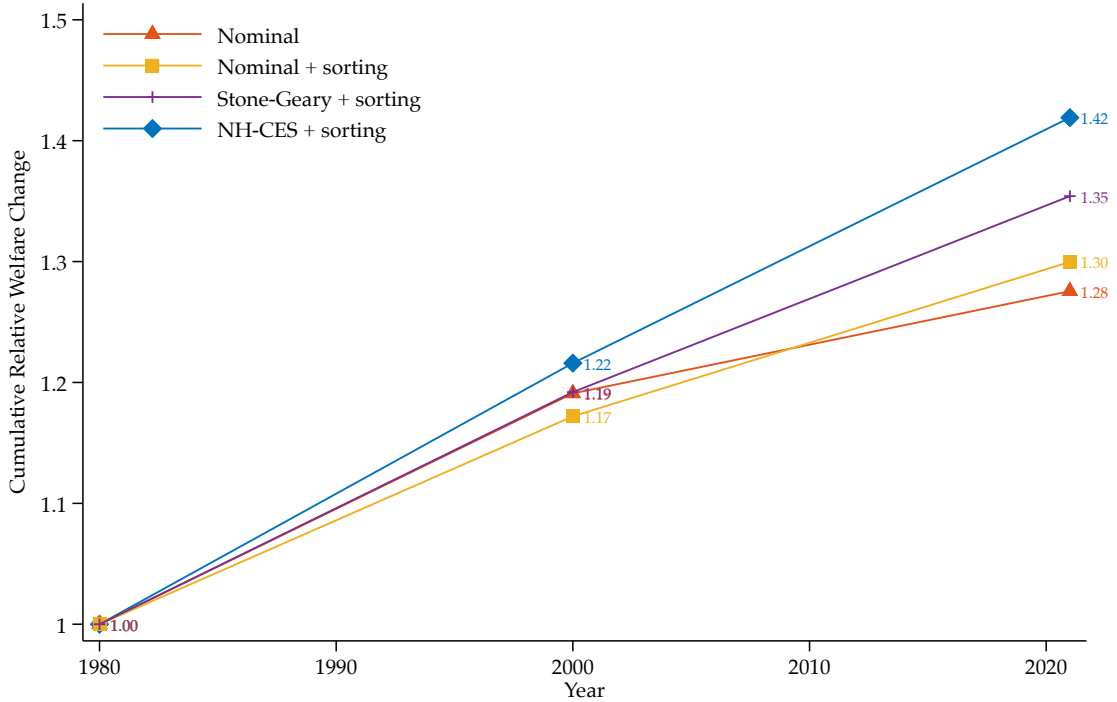
$$\ln \frac{\hat{y}_\zeta^H}{\hat{y}_\zeta^L} = \frac{1}{\bar{\varepsilon}_\zeta^H} \ln \hat{V}_\zeta^H - \frac{1}{\bar{\varepsilon}_\zeta^L} \ln \hat{V}_\zeta^L, \quad \zeta = SG, NHCES. \quad (34)$$

The rightmost panel of [Table 5](#) applies this measure on the relative welfare changes in the left panel using the estimates of the log-log marginal utility of incomes for renters that we report in [Table 3](#). Since these estimates are close to unity (and similar across types), this final modification is quantitatively small and the results are very similar to those in the left panel. We find that money-metric welfare inequality has increased by 34.2% if we assume that preferences are Stone-Geary, and by 39.3% if preferences are NH-CES.

[Figure 1](#) illustrates our findings. Since 1980, the gap between average high-skill and low-skill wages has increased by 28% (red line). Accounting for the fact that sorting is a choice in spatial equilibrium amplifies this increase to 30% (yellow line). Also accounting for the fact that housing is a necessity, and hence that rising housing prices hurts high-skill households less than low-skill ones, increases measured inequality to between 35% and 42%, depending on the specification (purple and blue lines). Adding changes in endogenous amenities that favor high-skill households relative to low-skill ones, as reported by [Diamond \(2016\)](#), would reinforce this result.

Finally, we return to the case of type-specific (but still multiplicatively separable) local amenities, as in [Diamond \(2016\)](#) and [Fajgelbaum and Gaubert \(2020\)](#). Taking the geometric average of

Figure 1: Evolution of High- v. Low-Skill Earnings and Utility Gaps, USA 1980-2020. 1980 = 1.



Note: Normalized to 1 in 1980.

the measures of welfare changes in equation (26) across cities yields:

$$\frac{\hat{\mathbb{V}}^t}{\hat{\mathbb{V}}^s} = \prod_{n \in \mathcal{C}} \left[\frac{\widehat{A}_n^t}{\widehat{A}_n^s} \left(\frac{\widehat{w}_n^t}{\widehat{w}_n^s} \right)^\alpha \left(\frac{\widehat{S}_n^t}{\widehat{S}_n^s} \right)^{-1} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}} \right]^{\omega_c}, \quad \sum_{n \in \mathcal{C}} \omega_c = 1.$$

Diamond (2016) argues that the quality of amenities enjoyed by high-skill households have increased relative to those enjoyed by low-skill households. In this case, then,

$$\frac{\hat{\mathbb{V}}^t}{\hat{\mathbb{V}}^s} > \prod_{n \in \mathcal{C}} \left[\left(\frac{\widehat{w}_n^t}{\widehat{w}_n^s} \right)^\alpha \left(\frac{\widehat{S}_n^t}{\widehat{S}_n^s} \right)^{-1} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}} \right]^{\omega_c}.$$

That is, the measures of changes in welfare inequality that are reported in Table 5 are a lower bound to true changes in welfare inequality.

We conclude that accounting for non-homothetic preferences considerably changes conclusions on welfare inequality. High-skill households have increasingly flocked into cities with high and fast-growing housing costs, but they did so in a large part because their purchasing power is less affected by housing costs than low-skill households. As a result, welfare inequality has risen by more than nominal inequality, not less.

6 Conclusion

This paper develops a spatial equilibrium model where agents have heterogeneous incomes and non-homothetic consumption preferences. In this framework, the relative price of traded vs. non-traded goods varies across locations, and because agents share identical but non-homothetic preferences, they value locations differently. This generates spatial sorting as a direct consequence of income-inelastic housing demand. We embed this force in a broader model where comparative advantage in production further shapes location choices. Our results show that under general conditions, high-income agents systematically sort into expensive cities, driven both by their lower housing expenditure share and productivity advantages in large cities.

Beyond explaining sorting, the model has implications for welfare inequality measurement in a spatial equilibrium context. We extend standard welfare measurement approaches in economic geography to account for non-homothetic preferences. Applying this framework to the United States (1980–2020), we show that while high-skill workers increasingly relocated to high-cost cities, they did so in part because their purchasing power is less affected by housing costs than low-skill workers. As a result, welfare inequality rose by 30–35%—outpacing the increase in nominal wage inequality.

Our model abstracts from endogenous agglomeration economies, amenities, and trade costs to highlight the role of housing demand in driving sorting. While specific functional forms could incorporate endogenous agglomeration and amenities without affecting our uniqueness results, introducing heterogeneous trade costs poses significant analytical challenges. Existing methods [Allen, Arkolakis, and Takahashi \(2020\)](#) do not apply when agents have heterogeneous incomes and non-homothetic preferences. Addressing this limitation is an important direction for future research.

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Appendix

A Proofs of Section 2: Equilibrium Existence and Uniqueness

Proof of Proposition 1 (Existence). Set $p = 1$ by choice of numeraire. We use bold letters to denote vectors: let $\mathbf{A} \equiv \{A_n\}_{n \in \mathcal{C}}$ and $\ell^t \equiv \{L^t \lambda_n^t\}_{n \in \mathcal{C}}$. Manipulating (10) yields

$$r_n k(r_n, \eta_n) = \frac{r_n \sum_{t \in \mathcal{T}} L^t \lambda_n^t h_n^t}{H_n}.$$

Let $K(r_n, \eta_n) \equiv r_n k(r_n, \eta_n)$. K is continuously increasing in both its arguments, and $K(0, \eta) = 0$. Let

$$E_n \equiv r_n \sum_{t \in \mathcal{T}} L^t \lambda_n^t(\mathbf{r}, \ell^t, \mathbf{A}) h(r_n, \ell_n^t, A_n)$$

denote total expenditure on housing in n . Inverting the housing market clearing condition above yields

$$r_n = K^{-1}\left(\frac{E_n}{H_n}, \eta_n\right) \equiv f_n(\mathbf{r}). \quad (35)$$

An equilibrium of the economy is then a solution of $\mathbf{f}(\mathbf{r}) = \mathbf{r}$. The function \mathbf{f} is continuous on $\mathbb{R}_+^{N_C}$ by inspection since all functions λ_n^t and h are continuously differentiable. The lower bound of E_n is obviously equal to zero. To find an upper bound, assume that the whole labor force settles in city n and that it spends all its income on housing; in this case the numerator inside the parenthesis of f in equation (35) is equal to $E_n^{\max} \equiv \sum_{t \in \mathcal{T}} L^t \ell_n^t$, which is exogenously given and finite, hence $K^{-1}\left(\frac{E_n^{\max}}{H_n}, \eta_n\right)$ is finite, too. The image of f is therefore:

$$S \equiv \prod_{n \in \mathcal{C}} \left[0, K^{-1}\left(\frac{E_n^{\max}}{H_n}, \eta_n\right)\right] \subset \mathbb{R}_+^{N_C},$$

which is compact. Since $f : S \rightarrow S$ is continuous and S is compact, equation (35) admits a fixed point by Brouwer's fixed point theorem. QED.

Proof of Proposition 2 (Uniqueness). Denote $\hat{Z}(\mathbf{r})$ the adjusted aggregate excess demand function for housing as a function of prices (rewriting equation (10)), normalizing the price of the traded good to 1:

$$\hat{Z}_n(\mathbf{r}) = \frac{\sum_{t \in \mathcal{T}} L^t \lambda_n^t h_n^t}{H_n k\left(\frac{r_n}{p}, \eta_n\right)} - 1 \quad \forall n \in \mathcal{C}.$$

The proof makes use of the index theorem. In step 1, we compute the Jacobian of the adjusted excess demand function, $D\hat{Z}(\mathbf{r})$, and compute the corresponding index of the Jacobian at equilibrium prices \mathbf{r}^* , where the index is defined as:

$$Index(\mathbf{r}^*) = \text{sgn}\left(\text{Det}\left[-D\hat{Z}(\mathbf{r}^*)\right]\right)$$

In step 2, we derive conditions under which that this index is necessarily positive at any equilibrium. Using the index theorem, we conclude that under these condition, the equilibrium is also unique.

After some algebra, the Jacobian of $\hat{Z}(\mathbf{r})$ is given by:

$$\frac{\partial \hat{Z}_n}{\partial r_i} = - \sum_{t \in \mathcal{T}} L^t \lambda_n^t h_n^t \left[H_n k \left(\frac{r_n}{p}, \eta_n \right) \right]^{-1} \lambda_i^t \frac{\partial \log V_i^t}{\partial r_i} \quad \text{for } i \neq n \quad (36)$$

$$\frac{\partial \hat{Z}_n}{\partial r_n} = \sum_{t \in \mathcal{T}} L^t \lambda_n^t h_n^t \left[H_n k \left(\frac{r_n}{p}, \eta_n \right) \right]^{-1} \left[\frac{\partial \log V_n^t}{\partial r_n} (1 - \lambda_n^t) + \frac{\partial \log h_n^t}{\partial r_n} - \frac{1}{r_n} \mathcal{E}_n(k, r) \right].$$

We next show conditions under which $-D\hat{Z}(\mathbf{r})$ is an M-matrix, so that all its eigenvalues are positive hence, in particular, $\text{sgn} \left(\text{Det} \left[-D\hat{Z}(\mathbf{r}^*) \right] \right) = +1$. To do so, we use the following characterization of M-matrices: a matrix M with all its off-diagonal elements less than or equal to 0 (i.e., a Z-matrix) is an M-matrix if it is semi-positive. That is, there exists some vector $x > 0$ such that $Mx > 0$.

Note that for $i \neq n$, it is clear from equation (36) that $-\frac{\partial \hat{Z}_n}{\partial r_i} \leq 0$, since $\frac{\partial \log V_i^t}{\partial r_i} \leq 0$, and the other terms are positive. Therefore, $-D\hat{Z}(\mathbf{r})$ is a Z-matrix. We next establish conditions under which it is an M-matrix.

We first consider the case $N_T = 1$, namely, there is only one type t in the economy. In this case, we compute the elements of $-(D\hat{Z}(\mathbf{r}))^T x$ for the positive vector $x = \left\{ \frac{H_n^0 k \left(\frac{r_n}{p}, \eta_n \right)}{h_n^t} \right\}_n$, leading to:

$$- \sum_n \frac{\partial \hat{Z}_n}{\partial r_i} x_n = L^t \lambda_i^t \left(\frac{1}{r_n} \mathcal{E}_n(k, r) - \frac{\partial \ln h_i^t}{\partial \ln r_i} \right) > 0.$$

Therefore, when $N_T = 1$, $-(D\hat{Z}(\mathbf{r}))^T$ is an M-matrix (and so is $-(D\hat{Z}(\mathbf{r}))$, since the transpose of an M-matrix is an M-matrix) and its eigenvalues are all positive. So is its determinant, so that:

$$\text{Index}(\mathbf{r}^*) = +1.$$

The index theorem, which states that $\sum_{r^* \text{ eq.}} \text{Index}(r^*) = +1$, ensures that the equilibrium is unique.

Next, in the case $N_T > 1$, we apply this strategy to the positive vector $x = \{r_n\}_n$ and compute the elements of $-D\hat{Z}(\mathbf{r}) \cdot x$, which are :

$$- \sum_i \frac{\partial \hat{Z}_n}{\partial r_i} x_i = \sum_{t \in \mathcal{T}} L^t \lambda_n^t h_n^t \left[H_n k \left(\frac{r_n}{p}, \eta_n \right) \right]^{-1} \left(-\mathcal{E}_n^t(V, r) - \mathcal{E}_n^t(h, r) + \mathcal{E}_n(k, r) + \sum_{i=1}^N \lambda_i^t \mathcal{E}_i^t(V, r) \right).$$

A sufficient condition for this to be positive is that $\forall n, \forall t$:

$$\mathcal{E}_n(k, r) - \mathcal{E}_n^t(h, r) > \mathcal{E}_n^t(V, r) - \sum_{i=1}^N \lambda_i^t \mathcal{E}_i^t(V, r). \quad (37)$$

Notice that if V is homothetic in the sense of Condition 2, and amenities are multiplicatively separable in utility, then $\mathcal{E}_i^t(V, r) = \text{constant}$ so that the sufficient condition become $\mathcal{E}_n(k, r) - \mathcal{E}_n^t(h, r) > 0$, which is always satisfied when h is a normal good. That is, uniqueness is warranted under homothetic preferences and separable amenities.

If Condition 2 does not hold, the sufficient condition (37) requires that the heterogeneity in $\mathcal{E}_n^t(V, r)$ across cities, for each type, be not too large. A more stringent condition that ensures that equation (37) holds is simply:

$$\inf_n \mathcal{E}_n(k, r) + \inf_{n,t} |\mathcal{E}_n^t(h, r)| > \sup_{n,t} \left| \mathcal{E}_n^t(V, r) - \overline{\mathcal{E}^t(V, r)} \right|,$$

$$\overline{\mathcal{E}^t(V, r)} \equiv \sum_{i=1}^N \lambda_i^t \mathcal{E}_i^t(V, r)$$

which is the one reported in the proposition. When this condition holds, $-D\hat{Z}(\mathbf{r})$ is an M-matrix, hence its index is positive at all equilibrium r^* . By the index theorem, which states that $\sum_{r^* \text{ eq.}} \text{Index}(r^*) = +1$, the uniqueness of the equilibrium is then warranted. Notice, equation (37) is also the condition that ensures that the excess demand system exhibits gross substitutes. Specifically, denoting $Z(r, p)$ the excess demand function, it is clear that $\frac{\partial Z_n}{\partial r_i} > 0$ for $i \neq n$, but condition (37) ensures that, in addition, $\frac{\partial Z_n}{\partial p} > 0$.

B Proofs of Section 3: Sorting

Proof of Proposition 3 (Sorting). (i) The contrapositive (Conditions 1 and 2 \Rightarrow No sorting) is immediate to verify, since in this case location choices are given by:

$$\lambda_n^t = \frac{\left[\frac{T_n}{P(r_n, A_n)} \right]^\kappa}{\sum_{m \in \mathcal{C}} \left[\frac{T_m}{P(r_m, A_m)} \right]^\kappa}.$$

Clearly, λ_n^t is independent of t , hence there is no spatial sorting by type.

(ii) Assume Condition 1 fails but Condition 2 holds. Then:

$$\frac{\partial^2}{\partial T_n \partial t} \ln \left(\frac{\lambda_n^t}{1 - \lambda_n^t} \right) = \kappa (1 - \lambda_n^t) \frac{\partial^2 \ln w_n^t}{\partial T_n \partial t},$$

which is different from 0 for some t, n given that Condition 1 is assumed to fail. Therefore, equation (12) cannot hold generically.

Finally, recast the no-sorting condition (12) as

$$\frac{\partial}{\partial \ln t} \ln \left(\frac{\lambda_n^t}{1 - \lambda_n^t} \right) - \frac{\partial}{\partial \ln t} \ln \left(\frac{\lambda_m^t}{1 - \lambda_m^t} \right) = 0$$

for all n, m , and assume that Condition 2 fails but Condition 1 holds, i.e. $w_n^t = T_n t$. Proceed by

contradiction and assume that there is no sorting. Therefore:

$$0 = \frac{\partial}{\partial \ln t} \ln \left(\frac{\lambda_n^t}{1 - \lambda_n^t} \right) - \frac{\partial}{\partial \ln t} \ln \left(\frac{\lambda_m^t}{1 - \lambda_m^t} \right) = \frac{\partial \ln V_n^t}{\partial \ln t} - \frac{\partial \ln V_m^t}{\partial \ln t} = \frac{\partial \ln V_n^t}{\partial \ln w_n^t} - \frac{\partial \ln V_m^t}{\partial \ln w_m^t}.$$

In turn, if $\frac{\partial \ln V_n^t}{\partial \ln w_n^t} = \frac{\partial \ln V_m^t}{\partial \ln w_m^t}$ generically holds for any T_n, T_m , then $\frac{\partial \ln V}{\partial \ln w}$ is constant; hence V is homogeneous in income, a contradiction.

Proof of Proposition 4 ("Rosen-Roback"). Consider equation (10):

$$0 = \sum_{t \in \mathcal{T}} L^t \lambda_n^t h_n^t - H_n k(r_n, \eta_n).$$

The right-hand side is increasing in A and T , and decreasing in H and η ; it is also decreasing in r , so it has to be that $r_m < r_n$ if $A_n > A_m$ (respectively if $T_n > T_m$, $H_n < H_m$, $\eta_n < \eta_m$), all else equal.

Proof of Proposition 5 (Sorting Patterns). By Definition 1, city n disproportionately attracts high- t workers relative to city m if and only if, for any $s, t \in \mathcal{T}$ with $s < t$:

$$1 < \frac{\lambda_n^t}{\lambda_m^t} \left(\frac{\lambda_n^s}{\lambda_m^s} \right)^{-1} = \left[\frac{v(r_n, w_n^t)}{v(r_m, w_m^t)} \right]^\kappa \left[\frac{v(r_n, w_n^s)}{v(r_m, w_m^s)} \right]^{-\kappa},$$

where the equality follows from equation (8). For further reference, observe also that the share of expenditure devoted to housing is equal to

$$s_n^t \equiv s(r_n, w_n^t) = -\frac{\mathcal{E}_n^t(V, r)}{\mathcal{E}_n^t(V, w)} \quad (38)$$

by Roy's identity. (i) and (ii) By assumption, $T_m = T_n$ so that $w_n^t = w_m^t = w^t$ for all t , and the inequality above obtains if and only if

$$1 < \frac{v(r_n, w_n^t)}{v(r_m, w_m^t)} \left[\frac{v(r_n, w_m^s)}{v(r_m, w_m^s)} \right]^{-1}. \quad (39)$$

Taking logs, we may rewrite this expression as

$$0 < \int_{r_m}^{r_n} [\mathcal{E}^t(v, r) - \mathcal{E}^s(v, r)] d \ln r.$$

The right hand side of this expression is equal to

$$\begin{aligned} \int_{r_m}^{r_n} [\mathcal{E}^t(v, r) - \mathcal{E}^s(v, r)] d \ln r &= \int_{r_m}^{r_n} [-s(r, w_n^t) \mathcal{E}^t(v, w) + s(r, w_n^s) \mathcal{E}^s(v, w)] d \ln r \\ &> \int_{r_m}^{r_n} [-s(r, w_n^t) + s(r, w_n^s)] \mathcal{E}^t(v, w) d \ln r, \end{aligned}$$

where the equality comes from equation (38), and the inequality on the second line follows from $s < t$ and Assumption 3. Finally, the term in the square parenthesis is positive by equation (4) (housing is a necessity), and $\mathcal{E}_n^t(v, w) > 0$ by definition. Hence, this inequality holds if and only if $r_n > r_m$, which can arise only if either $A_n > A_m$, $H_n < H_m$, or, provided that the properties of function k obey equation (6), if $\eta_n < \eta_m$, by Proposition 4 (recall $T_m = T_n$ by assumption).

(iii) For this part, note first that $T_n > T_m$ implies $r_n > r_m$, everything else equal, by Proposition 4. We may rewrite the right hand side of equation (39) as

$$\frac{v(r_n, w_n^t)}{v(r_m, w_n^t)} \left[\frac{v(r_n, w_m^s)}{v(r_m, w_m^s)} \right]^{-1} = \frac{v(r_n, w_n^t)}{v(r_n, w_m^t)} \left[\frac{v(r_n, w_n^s)}{v(r_n, w_m^s)} \right]^{-1} \frac{v(r_n, w_m^t)}{v(r_m, w_m^t)} \left[\frac{v(r_n, w_m^s)}{v(r_m, w_m^s)} \right]^{-1}.$$

This term is larger than unity because

$$\frac{v(r_n, w_n^t)}{v(r_n, w_m^t)} \left[\frac{v(r_n, w_n^s)}{v(r_n, w_m^s)} \right]^{-1} > 1$$

by equation (16) and

$$\frac{v(r_n, w_m^t)}{v(r_m, w_m^t)} \left[\frac{v(r_n, w_m^s)}{v(r_m, w_m^s)} \right]^{-1} > 1$$

by the first part of this Proposition.

C Proofs of Section 4: Welfare

The proof of Proposition 6 is by construction, and is provided in Appendix s C.1 to C.6. Appendix C.7 provides the proof of Proposition 7.

We maintain Assumption 2 throughout in this Appendix, so that we can write $V_n^t = (A_n v_n^t)^\kappa$, where $v_n^t = v(r_n, w_n^t)$ and $\kappa > 1$ governs the migration elasticity.

C.1 Stone Geary

Recall equation (22) from Section 4 in the main text and use Roy's identity to write:

$$v_n^t = \frac{w_n^t - \underline{h}r_n}{p^{1-\psi} (r_n)^\psi} = \frac{w_n^t}{p^{1-\psi} (r_n)^\psi} \frac{1 - s_n^t}{1 - \psi}, \quad s_n^t = \psi + (1 - \psi) \underline{h} \frac{r_n}{w_n^t},$$

where $\psi \in (0, 1)$, and \underline{h} can be interpreted as the subsistence level of housing if it is positive (observe that $s_n^t \in (\psi, 1)$ whenever $\underline{h} \geq 0$). The final expression for v_n^t is the product of a homothetic component, $\frac{w_n^t}{p^{1-\psi} (r_n)^\psi}$, and of a non-homothetic one, $\frac{1 - s_n^t}{1 - \psi}$.

We show in the main text that the change in welfare inequality between types s and t in equation (20) is equal to:

$$\frac{\widehat{V}^t}{\widehat{V}^s} = \frac{\widehat{w}_n^t}{\widehat{w}_n^s} \frac{\widehat{1 - s_n^t}}{\widehat{1 - s_n^s}} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}. \quad (40)$$

This expression is a special case of equation (25) where $\alpha = b = 1$ and $a = \beta = 0$.

Under which conditions is Assumption 3 satisfied when preferences take the form in this section? In this case, we may rewrite the inequality in equation (62) as

$$0 \leq \frac{hr_n}{w_n^t - hr_n},$$

which is automatically satisfied whenever the wage covers the subsistence level of housing. Further,

$$\mathcal{E}_n^t(v, w) = \frac{1 - \psi}{1 - s_n^t}, \quad (41)$$

which is larger than one by $s_n^t \geq \psi$ and increasing in s_n^t by inspection. Thus, $\mathcal{E}_n^t(v, w)$ is decreasing in w (and hence in t). We note also that the Arrow-Pratt measure of risk-aversion, $-\mathcal{E}_n^t(v_w, w)$, is equal to zero in this case: Engel curves are linear.

C.2 PIGL

Boppart (2014) and, in a spatial context, Eckert and Peters (2022) use the following *Price-Independent Generalized Linear* (PIGL) form for indirect utility (Muellbauer, 1975):

$$v_n^t = \left[\left(\frac{w_n^t}{p^{1-\psi} (r_n)^\psi} \right)^\iota - \frac{\nu}{\gamma} \left(\frac{r_n}{p} \right)^{\gamma\iota} \right]^{1/\iota}, \quad \iota, \psi \in (0, 1), \quad |\gamma| \geq 1, \quad \nu \in \{0, 1\}, \quad (42)$$

where ι governs income effects, $\gamma\iota$ governs relative price effects, and v is an indicator parameter; preferences are non-homothetic if $\nu = 1$ and collapse to the homothetic Cobb-Douglas case if $\nu = 0$. Note that Boppart (2014) uses $\psi = 0$ and Eckert and Peters (2022) use $\gamma \leq -1$. Henceforth we set $\nu = 1$, which yields the following expenditure share of housing:

$$s_n^t = \psi + \left(\frac{w_n^t}{p^{1-\psi} (r_n)^\psi} \right)^{-\iota} \left(\frac{r_n}{p} \right)^{\gamma\iota}. \quad (43)$$

Combining equations (42) and (43) leads to:

$$v_n^t = \frac{w_n^t}{p^{1-\psi} (r_n)^\psi} \left(\frac{\gamma}{\gamma + \psi S_n^t} \right)^{1/\iota}, \quad S_n^t = \frac{\gamma}{\gamma + \psi - s_n^t}. \quad (44)$$

Note that this expression for v_n^t is the product of a homothetic component, $\frac{w_n^t}{p^{1-\psi} (r_n)^\psi}$, and of a non-homothetic one, $(S_n^t)^{-1/\iota}$. Therefore the change in welfare inequality between types s and t in equation (20) is equal to:

$$\frac{\widehat{V}^t}{\widehat{V}^s} = \frac{\widehat{w}_n^t}{\widehat{w}_n^s} \left(\frac{\widehat{S}_n^t}{\widehat{S}_n^s} \right)^{-1/\iota} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}. \quad (45)$$

That is, changes in housing expenditure shares and composition of any arbitrary municipality n , as well as an estimate of parameters κ , γ , ι , and ψ , are sufficient to compute changes in utility inequality between any pair of types. This expression is a special case of equation (25) where $\alpha = 1$, $\beta = \delta = 1/\iota$, $a = \psi$ and $b = 1/\gamma$. Note that the Stone-Geary and PIGL cases are isomorphic, and even identical in the limiting case $\iota \rightarrow 1$ and $\gamma + \psi = 1$.

Under which conditions is Assumption 3 satisfied when preferences take the form in this section? In this case,

$$\begin{aligned} \mathcal{E}_n^t(v, w) &= \left[1 - \frac{1}{\gamma} \left(\frac{r_n}{p} \right)^{\gamma\iota} \left(\frac{w_n^t}{p^{1-\psi} (r_n)^\psi} \right)^{-\iota} \right]^{-1} \\ &= \frac{\gamma}{\gamma + \psi - s_n} = S_n^t, \end{aligned} \quad (46)$$

where the second equality uses equation (43), and the last one follows from the definition of S_n^t in equation (44). By inspection, $\mathcal{E}_n^t(v, w)$ is increasing in s_n^t , and hence decreasing in t by $\partial s_n^t / \partial t < 0$, since housing is a necessity; hence, the inequality in equation (62) holds. The Arrow-Pratt measure of risk-aversion $-\mathcal{E}_n^t(v_w, w)$ is equal to $1 - \iota \in (0, 1)$ in this case.

C.3 PIGLOG

Consider next the following *Price Invariant Generalized Logarithmic* (PIGLOG) indirect utility, which is a simplified version of Deaton and Muellbauer's *Almost Ideal Demand System* (Deaton and Muellbauer, 1980):

$$v_n^t = \left(\frac{r_n}{p} \right)^\nu \ln \left(\frac{w_n^t}{p^{1-\psi} (r_n)^\psi} \right), \quad \nu > 0, \quad \psi \in (0, 1). \quad (47)$$

Under Assumption (2), shocks are Frechet distributed, which requires a cardinality for utility such that $v_n^t > 0$; in turn, this requires choosing units such that

$$\forall n \in \mathcal{C}, \quad \forall t \in \mathcal{T}; \quad w_n^t > p^{1-\psi} (r_n)^\psi. \quad (48)$$

Using Roy's identity, it is easy to verify that the expenditure share of housing is equal to

$$s_n^t = \psi - \nu \ln \left(\frac{w_n^t}{p^{1-\psi} (r_n)^\psi} \right). \quad (49)$$

Thus $s_n^t < \psi$ by equation (48). In turn, $s_n^t \in (0, \psi)$ if and only if

$$\ln \left(\frac{w_n^t}{p^{1-\psi} (r_n)^\psi} \right) \in \left(0, \frac{\psi}{\nu} \right).$$

Combining equations (47) and (43) leads to:

$$v_n^t = \left(\frac{r_n}{p}\right)^\iota \frac{\psi - s_n^t}{\nu}.$$

Therefore the change in welfare inequality between types s and t in equation (20) is equal to:

$$\frac{\widehat{V}^t}{\widehat{V}^s} = \frac{\widehat{\psi - s_n^t}}{\widehat{\psi - s_n^s}} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s}\right)^{-\frac{1}{\kappa}}. \quad (50)$$

That is, changes in housing expenditure shares and composition of any arbitrary municipality n , as well as an estimate of parameters κ and ψ , are sufficient to compute changes in utility inequality between any pair of types. This expression is a special case of equation (25) where $\alpha = 0$, $\beta = 0$, $\delta = 1$, $a = 0$ and $b = 1/\psi$.

Under which conditions is Assumption 3 satisfied when preferences take the form in this section? Under Assumption 2, the inequality in equation (17) holds if and only if

$$0 \leq \ln \left(\frac{w_n^t}{p^{1-\psi} (r_n)^\psi} \right) = \frac{\psi - s_n^t}{\nu},$$

where the second equality follows from equation (49). Then the condition above is satisfied since $s_n^t \leq \psi$ by inspection of equation (49). We note also that the Arrow-Pratt measure of risk-aversion $-\mathcal{E}_n^t(v_w, w)$ is equal to $1 - \left(\frac{r_n}{p}\right)^\nu$ in this case.

C.4 CRIE

Next, consider the case of preferences displaying *Constant Relative Income Elasticity* (CRIE) indirect utility (Caron, Fally, and Markusen, 2014; Eeckhout, Pinheiro, and Schmidheiny, 2014; Fieler, 2011; Hanoch, 1975):

$$v_n^t = \left[\left(\frac{w_n^t}{r_n}\right)^{-\psi} + \left(\frac{w_n^t}{p}\right)^{-\mu} \right]^{-\iota}, \quad (51)$$

where the parameters $\{\iota, \mu, \psi\}$ all have the same sign (either positive or negative). Using Roy's identity, it is easy to verify that the ratio of expenditure shares is equal to

$$\frac{1 - s_n^t}{s_n^t} = \frac{\mu}{\psi} \left(\frac{w_n^t}{r_n}\right)^\psi \left(\frac{w_n^t}{p}\right)^{-\mu}. \quad (52)$$

Housing demand is income-inelastic if and only if $\mu < \psi$, and price-inelastic if only if $\mu, \psi < 0$. This configuration is the empirically relevant one, so we focus on the case $0 < \mu < \psi$, $0 < \iota$. Combining

equations (51) and (52) leads to:

$$v_n^t = \left[\frac{(\psi - \mu)^2}{\mu\psi} \right]^{-\iota} \left(\frac{w_n^t}{p} \right)^{\mu\iota} \left[\frac{s_n^t - \frac{\psi}{\psi - \mu}}{1 + \frac{\psi - \mu}{\mu} \left(s_n^t - \frac{\psi}{\psi - \mu} \right)} \right]^{-\iota}.$$

Note that this expression for v_n^t is the product of a combination of parameters, of a homothetic component, $\left(\frac{w_n^t}{p}\right)^{\mu\iota}$, and of a non-homothetic one (the term involving s_n inside brackets). Only three among parameters κ, ι, μ, ψ can be separately identified. We set $\iota = 1/\mu$ so that v_n^t is proportional to w_n^t given s_n^t . Let also define

$$S_n^t = \frac{s_n - a}{1 - b(s_n - a)}, \quad a = \frac{\psi}{\psi - \mu}, \quad b = -\frac{\psi - \mu}{\mu}.$$

By inspection, $0 < a$ and $b < 0$ hold in the combination of structural parameters of interest. Furthermore, S_n^t is positive if $s_n^t \in (a, 1)$, and S_n^t is increasing in s_n^t . This normalization and the expressions above together yield the change in welfare inequality:

$$\frac{\widehat{V}^t}{\widehat{V}^s} = \frac{\widehat{w}_n^t}{\widehat{w}_n^s} \left(\frac{\widehat{S}_n^t}{\widehat{S}_n^s} \right)^{-1/\mu} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}. \quad (53)$$

This expression for relative welfare changes is a special case of equation (25), where $\alpha = 1$, $\beta = \delta = \frac{1}{\mu}$, $a = \frac{\psi}{\psi - \mu}$ and $b = -\frac{\psi - \mu}{\mu}$.

Under which conditions is Assumption 3 satisfied when preferences take the form in this section? In this case,

$$\mathcal{E}_n^t(v, w) = \psi \frac{1}{s_n^t \mu + (1 - s_n^t) \psi}. \quad (54)$$

Observe that $\mathcal{E}_n^t(v, w)$ is increasing in s_n^t by $\mu < \psi$. Thus, $\mathcal{E}_n^t(v, w)$ is decreasing in w (and hence in t). We note also that the Arrow-Pratt measure of risk-aversion is equal to

$$\mathcal{E}_n^t(v_w, w) = 1 - \frac{\psi}{\psi(1 - s_n^t) + \mu s_n^t} \left[\psi - (\psi - \mu)^2 s_n^t (1 - s_n^t) \right],$$

which, under the parameter configuration $\psi > \mu > 0$, can be shown to be bounded above by $1 - \psi$.

C.5 NH-CES

Consider next the *Non-Homothetic Constant Elasticity of Substitution* (NH-CES) indirect utility (Albouy, Ehrlich, and Liu, 2016; Comin, Lashkari, and Mestieri, 2021; Hanoch, 1975; Matsuyama, 2019; Sato, 1977), defined implicitly in :

$$(w_n^t)^{1-\sigma} = (v_n^t)^{1-\sigma+\chi} \left[\Omega (v_n^t)^\mu (r_n)^{1-\sigma} + (v_n^t)^\psi p^{1-\sigma} \right], \quad 0 < \sigma, \Omega, \quad -1 + \sigma - \chi < \mu < \psi.$$

We set $\chi = -\psi$ so that the elasticity of v_n^t with respect to w_n^t in equation (57) below is one, given s_n^t .²⁰ We can thus rewrite the expressions above as:

$$(w_n^t)^{1-\sigma} = (v_n^t)^{1-\sigma} \left[\Omega (v_n^t)^{\mu-\psi} (r_n)^{1-\sigma} + p^{1-\sigma} \right], \quad 0 < \sigma, \Omega, \quad -1 + \sigma < \mu - \psi < 0. \quad (55)$$

The second parameter restriction above is guided by economic logic (indirect utility is decreasing in housing and non-housing prices) and empirical evidence (housing demand is price- and income-inelastic).²¹ The main text sets $\Omega = 1$. This restriction is innocuous because, as we show below, this parameter enters neither the equilibrium expression for changes in welfare inequality in equation (58), nor the expression for the marginal utility of income in equation (59). Using Roy's identity, the ratio of the expenditure shares is equal to:

$$\frac{1 - s_n^t}{s_n^t} = \frac{1}{\Omega} (v_n^t)^{\psi-\mu} \left(\frac{p}{r_n} \right)^{1-\sigma}. \quad (56)$$

We can combine equations (55) and (56) to write v_n^t as a function of s_n^t and two prices among $\{p, r_n, w_n^t\}$. There are three such combinations. Solving equation (56) for $(v_n^t)^\mu (r_n)^{1-\sigma}$ and plugging the result into equation (55) lead to one such combination:²²

$$v_n^t = \frac{w_n^t}{p} (1 - s_n^t)^{1/(1-\sigma)}. \quad (57)$$

This expression is the product of a homothetic component, $\frac{w_n^t}{p}$, and of a non-homothetic one (the term involving s_n^t).

²⁰Finlay and Williams (2022) instead set $\chi = 0$, which yields

$$v_n^t = \left(\frac{w_n^t}{p} \right)^{\frac{1-\sigma}{1-\sigma+\psi}} (1 - s_n^t)^{\frac{1}{1-\sigma+\psi}}$$

and

$$\mathcal{E}_n^t(v, w) = \frac{1 - \sigma}{1 - \sigma + \mu s_n^t + \psi_{NHCES} (1 - s_n^t)}$$

instead of the corresponding expressions in equations (57) and (59) below.

²¹From equation (56) below, the housing expenditure share s_n^t is increasing in its relative price $\frac{r_n}{p}$ if and only if $\sigma < 1$, and decreasing in utility v_n^t if and only if $\mu < \psi$.

²²The other two are

$$v_n^t = \left[\Omega \left(\frac{r_n}{p} \right)^{1-\sigma} \frac{1 - s_n^t}{s_n^t} \right]^{1/(\psi-\mu)}$$

and

$$v_n^t = \left[\left(\frac{w_n^t}{r_n} \right)^{1-\sigma} \frac{s_n^t}{\Omega} \right]^{1/(1-\sigma+\mu-\psi)}.$$

The corresponding expression for the change in welfare inequality becomes:²³

$$\frac{\widehat{V}^t}{\widehat{V}^s} = \frac{\widehat{w}_n^t}{\widehat{w}_n^s} \left(\frac{\widehat{1 - s_n^t}}{\widehat{1 - s_n^s}} \right)^{1/(1-\sigma)} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}. \quad (58)$$

This expression is isomorphic to its equivalents in the Stone-Geary and PIGL cases – in equations (40) and (45), respectively. The corresponding expression for relative welfare changes is a special case of (25) where $\alpha = 1$, $\beta = 0$, $\delta = \frac{1}{1-\sigma}$, $a = 0$ and $b = 1$.

Under which conditions is Assumption 3 satisfied when preferences take the form in this section? In this case:

$$\mathcal{E}_n^t(v, w) = \frac{1 - \sigma}{1 - \sigma - (\psi - \mu) s_n^t}. \quad (59)$$

This expression above increasing in s_n^t by inspection, and hence decreasing in t by $\partial s_n^t / \partial t < 0$ since housing is a necessity; hence, the inequality in equation (62) holds. The equilibrium expression for the Arrow-Pratt measure of risk-aversion, $-\mathcal{E}_n^t(v_w, w)$, is too unwieldy in this case to be revealing.

C.6 HCD

Finally, consider the case of *Heterothetic Cobb-Douglas preferences* (HCD) analyzed by Bohr, Mestieri, and Robert-Nicoud (2024), which is a limiting case of Non-Homothetic CES preferences for $\sigma \rightarrow 1$. Solving equation (56) for v_n^t and taking the limit $\sigma \rightarrow 1$ yield:

$$\begin{aligned} v_n^t &= \lim_{\sigma \rightarrow 1} \left[\Omega \left(\frac{r_n}{p} \right)^{1-\sigma} \frac{1 - s_n^t}{s_n^t} \right]^{1/(\psi-\mu)} \\ &= \left(\Omega \frac{1 - s_n^t}{s_n^t} \right)^{1/(\psi-\mu)}. \end{aligned}$$

In this case, the expression for changes in welfare inequality becomes:

$$\frac{\widehat{V}^t}{\widehat{V}^s} = \left(\frac{\widehat{S}_n^t}{\widehat{S}_n^s} \right)^{-1/(\psi-\mu)} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}, \quad S_n^t = \frac{s_n^t}{1 - s_n^t}. \quad (60)$$

²³Those corresponding to the alternatives in footnote 22 are:

$$\frac{\widehat{V}^t}{\widehat{V}^s} = \left(\frac{\widehat{1 - s_n^t}}{\widehat{s_n^t}} \right)^{1/(\psi-\mu)} \left(\frac{\widehat{1 - s_n^s}}{\widehat{s_n^s}} \right)^{-1/(\psi-\mu)} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}}$$

and

$$\frac{\widehat{V}^t}{\widehat{V}^s} = \left(\frac{\widehat{w}_n^t}{\widehat{w}_n^s} \right)^{(1-\sigma)/(1-\sigma+\mu-\psi)} \left(\frac{\widehat{s_n^t}}{\widehat{s_n^s}} \right)^{1/(1-\sigma+\mu-\psi)} \left(\frac{\widehat{\lambda}_n^t}{\widehat{\lambda}_n^s} \right)^{-\frac{1}{\kappa}},$$

respectively.

C.7 Proof of Proposition 7

Recall $V = \tilde{V}^\kappa$ by equations (1) and (1). Here we explicitly work with \tilde{V} to study welfare changes in a transparent way. Here we allow for amenities to be type-specific and to enter utility in a flexible way (that is, we do not impose Assumption 2); in the text, we work with $\tilde{V}_n^t = A_n^t v(w_n^t, r_n)$. By definition of $\mathbb{V}^t \equiv \left[\sum_{m \in \mathcal{C}} \tilde{V}(w_m^t, r_m, A_m^t)^\kappa \right]^{1/\kappa}$ and $\mathbb{V}'^t \equiv \left[\sum_{m \in \mathcal{C}} \tilde{V}(w_m^t, r'_m, A_m^t)^\kappa \right]^{1/\kappa}$, and making use of the hat notation, we have:

$$\begin{aligned}
\ln \hat{\mathbb{V}}^t &\equiv \frac{1}{\kappa} \ln \frac{\sum_{m \in \mathcal{C}} \tilde{V}(w_m^t, r'_m, A_m^t)^\kappa}{\sum_{m \in \mathcal{C}} \tilde{V}(w_m^t, r_m, A_m^t)^\kappa} \\
&= \frac{1}{\kappa} \ln \sum_{m \in \mathcal{C}} \frac{\tilde{V}(w_m^t \hat{y}^t, r_m, A_m^t)^\kappa}{\sum_{n \in \mathcal{C}} \tilde{V}(w_n^t, r_n, A_n^t)^\kappa} \\
&= \frac{1}{\kappa} \ln \left\{ \sum_{m \in \mathcal{C}} \left[\frac{\tilde{V}(w_m^t, r_m, A_m^t)^\kappa}{\sum_{n \in \mathcal{C}} \tilde{V}(w_n^t, r_n, A_n^t)^\kappa} \frac{\tilde{V}(w_m^t \hat{y}^t, r_m, A_m^t)^\kappa}{\tilde{V}(w_m^t, r_m, A_m^t)^\kappa} \right] \right\} \\
&= \frac{1}{\kappa} \ln \left\{ \sum_{m \in \mathcal{C}} \lambda_m^t \left[\frac{\tilde{V}(w_m^t e^{\ln \hat{y}^t}, r_m, A_m^t)}{\tilde{V}(w_m^t, r_m, A_m^t)} \right]^\kappa \right\} \\
&\approx \frac{1}{\kappa} \ln(1) + \frac{1}{\kappa} \left\{ \sum_{m \in \mathcal{C}} \lambda_m^t \left[\frac{\tilde{V}(w_m^t \times 1, r_m, A_m^t)}{\tilde{V}(w_m^t, r_m, A_m^t)} \right]^\kappa \right\}^{-1} \\
&\times \sum_{m \in \mathcal{C}} \lambda_m^t \kappa \left[\frac{\tilde{V}(w_m^t \times 1, r_m, A_m^t)}{\tilde{V}(w_m^t, r_m, A_m^t)} \right]^{-1+\kappa} \frac{w_m^t}{\tilde{V}(w_m^t, r_m, A_m^t)} \times \frac{\partial \tilde{V}(w_m^t e^{\ln \hat{y}^t}, r_m, A_m^t)}{\partial (w_m^t e^{\ln \hat{y}^t})} \Bigg|_{\ln \hat{y}^t = 0} \times \ln \hat{y}^t \\
&= 0 + \ln \hat{y}^t \sum_{m \in \mathcal{C}} \lambda_m^t \frac{\partial \ln \tilde{V}_m^t}{\partial \ln w_m^t} \\
&= \ln \hat{y}^t \sum_{m \in \mathcal{C}} \lambda_m^t \mathcal{E}_m^t(\tilde{V}, w) \\
&= \bar{\varepsilon}^t \ln \hat{y}^t,
\end{aligned}$$

where the second line uses equation (27) to substitute $\tilde{V}(w_m^t \hat{y}^t, r_m, A_m^t)^\kappa$ for $\tilde{V}(w_m^t, r'_m, A_m^t)^\kappa$, the third rearranges terms, the fourth uses equation (1), the fifth is a Taylor expansion around $\ln \hat{y}^t = 0$ (i.e., $\hat{y}^t = 1$), the sixth uses $\hat{y}^t = 1$ to simplify terms, the seventh uses the elasticity notation \mathcal{E} , and the last one holds by definition of $\bar{\varepsilon}^t$ in the text. Rearranging this expression yields expression (28) in the text.

C.8 The Two-City Case

We claim in Footnote 7 that, in the two-city case $n \in \{1, 2\}$, the sufficient condition for uniqueness in equation (11) is akin to a single-crossing condition in the space of unit housing prices (the proof in Appendix A works with an arbitrary number of cities).

Totally differentiate equation (10) for city 1 with respect to r_1 and r_2 yields

$$0 = \sum_t \theta_1^t \{ [-\mathcal{E}_1(k, r) + \mathcal{E}_1^t(h, r) + (1 - \lambda_1^t) \mathcal{E}_1^t(V, r)] d \ln r_1 - (1 - \lambda_1^t) \mathcal{E}_2^t(V, r) d \ln r_2 \},$$

where $\theta_1^t \equiv L^t \lambda_1^t h_1^t (H_1^0 k_1)^{-1}$, $k_1 \equiv k(r_1, \eta_1)$, and $\sum_t \theta_1^t = 1$. Thus

$$\left. \frac{d \ln r_2}{d \ln r_1} \right|_{Z_1=0} = \frac{\sum_t \theta_1^t [\mathcal{E}_1(k, r) - \mathcal{E}_1^t(h, r) - (1 - \lambda_1^t) \mathcal{E}_1^t(V, r)]}{-\sum_t \theta_1^t (1 - \lambda_1^t) \mathcal{E}_2^t(V, r)},$$

which is positive by $\mathcal{E}_n^t(h, r), \mathcal{E}_n^t(V, r) < 0$. It follows that the locus for an equilibrium in the housing market for city 1 in the (r_1, r_2) -space is upward sloping. By the same token, totally differentiating (10) for city 2 yields:

$$\left. \frac{d \ln r_2}{d \ln r_1} \right|_{Z_2=0} = \frac{-\sum_t \theta_2^t \lambda_2^t \mathcal{E}_1^t(V, r)}{\sum_t \theta_2^t [\mathcal{E}_2(k, r) - \mathcal{E}_2^t(h, r) - \lambda_1^t \mathcal{E}_2^t(V, r)]} > 0.$$

The locus for an equilibrium in city 1 crosses the locus for an equilibrium in city 2 from below in the space of housing prices (r_1, r_2) , where r_1 is on the horizontal axis and r_2 is on the vertical one if and only if, $\forall r, h, k$:

$$1 < \frac{\sum_t \theta_1^t [\mathcal{E}_1(k, r) - \mathcal{E}_1^t(h, r) - (1 - \lambda_1^t) \mathcal{E}_1^t(V, r)]}{-\sum_t \theta_1^t (1 - \lambda_1^t) \mathcal{E}_2^t(V, r)} \frac{\sum_t \theta_2^t [\mathcal{E}_2(k, r) - \mathcal{E}_2^t(h, r) - \lambda_1^t \mathcal{E}_2^t(V, r)]}{-\sum_t \theta_2^t \lambda_1^t \mathcal{E}_1^t(V, r)} \quad (61)$$

(and > 1 for the opposite ordering). Whenever $\mathcal{E}_n(k, r) - \mathcal{E}_n^t(h, r) > (1 - \lambda_n^t) [\mathcal{E}_n^t(V, r) - \mathcal{E}_{m \neq n}^t(V, r)]$ holds for all n, t as in (11), we get that $\frac{\sum_t \theta_1^t [\mathcal{E}_1(k, r) - \mathcal{E}_1^t(h, r) - (1 - \lambda_1^t) \mathcal{E}_1^t(V, r)]}{-\sum_t \theta_1^t (1 - \lambda_1^t) \mathcal{E}_2^t(V, r)} > 1$ (and similarly for city 2), so that the single crossing property holds.

What is the economic intuition for the condition in equation (61)? Denote by (r_1^*, r_2^*) a pair of housing prices that satisfy $Z_1(r_1^*, r_2^*) = Z_2(r_1^*, r_2^*) = 0$ – that is, both housing markets are in equilibrium. Heuristically, if the condition in equation (61) holds, then, whenever excess demand in either or both housing markets is non-zero, market forces whereby the housing price in $j = 1, 2$ rises if excess demand Z_j is positive and falls otherwise, lead prices to return to equilibrium. Further, this equilibrium is unique as condition (61) implies that the two $r_2(r_1)$ curves intersect at most once.

C.9 Implications of Assumption 3

Recall Assumption 3:

$$\frac{\partial \mathcal{E}_n^t(v, w)}{\partial w} \leq 0.$$

Computing the derivative explicitly, we get: $\frac{\partial \mathcal{E}_n^t(v, w)}{\partial w} = \frac{v_w}{v} \left(1 - \frac{w v_w}{v} + \frac{w v_{ww}}{v_w} \right)$ where we use the short notation $f_x \equiv \frac{\partial f}{\partial x}$. Observe that the term outside the parenthesis in the final RHS is positive,

thus

$$\frac{\partial \mathcal{E}_n^t(v, w)}{\partial w} \propto 1 - \frac{wv_w}{v} + \frac{wv_{ww}}{v_w},$$

where “ $x \propto y$ ” is used to mean “ x is of the same sign as y .” Thus, Assumption 3 holds if and only if

$$1 \leq \frac{wV_w}{V} - \frac{wV_{ww}}{V_w}. \quad (62)$$

In turn, $\frac{wv_{ww}}{v_w}$ is negative whenever v is concave, which we assume. Thus a sufficient condition for Assumption 3 is:

$$-\frac{wv_{ww}}{v_w} \geq 1,$$

where $-\frac{wv_{ww}}{v_w}$ is the Arrow-Pratt measure of relative risk aversion associated with v .

D Appendix: Data

Sample

This analysis uses decennial U.S. Census microdata from 1980-2000 and the 5-year American Community Survey (ACS) for 2010 and 2020 from IPUMS (Ruggles et al., 2024). The sample is restricted to individuals aged 26-59 in private households who worked at least 5 weeks in the previous year. The analysis excludes individuals enrolled in school and those born outside the United States.

Unit of Geography

All geographic identifiers are based on the Office of Management and Budget’s (OMB) Metropolitan Statistical Area definitions. To maintain consistent geographic definitions across the 1980-2020 period, we construct a crosswalk between Census METAREA codes (available through 2010) and 2013-based Metropolitan Statistical Area definitions. Using the 2010 Census sample, we observe both METAREA codes and 2013-based MSA codes for each individual. We calculate population-weighted concordance shares that map each METAREA to potentially multiple 2013 MSAs. Specifically, for each METAREA-2013 MSA pair, we compute the share of the METAREA’s population that resides in each 2013 MSA. These shares are used as weights to allocate observations from the 2020 data to METAREA definitions. For 2013 MSAs that span multiple METAREAs, observations are probabilistically assigned based on these population shares, with sampling weights adjusted proportionally.

Education

Education levels are coded into two categories: high school graduates and college graduates (those with 4+ years of college). Experience is calculated as age minus years of education minus 6, where years of education is assumed to be 16 for college graduates and 12 for high school graduates.

Wages

Wages are constructed from annual wage income divided by the product of weeks worked and usual weekly hours. Weeks worked are imputed for categorical responses using interval midpoints.

Housing Costs

Housing costs are measured using gross rent for renters and selected monthly owner costs for homeowners. Housing cost shares are calculated as annual housing costs divided by household income, which we impute to the individual.

Local Prices

Local price indices are constructed following [Moretti \(2013\)](#). The housing component uses rental costs for 2-3 bedroom units. The non-housing component uses local BLS CPI data. Housing expenditure shares are based on BLS Consumer Expenditure Survey weights for shelter plus utilities, ranging from 38.2% in 1980 to 37.7% in 2020.

Covariate Adjustment

All wage and income measures are adjusted for demographic composition by regressing log outcomes on a cubic in experience, gender, and race indicators (White, Black, Asian, and other), separately for 1980-2000 and 2010-2020, nesting [Moretti \(2013\)](#). The adjusted values hold demographic characteristics constant at their period-specific means.

Bartik Instrument

The Bartik labor demand instruments are constructed using local industry employment shares from 1980 interacted with national industry wage growth. We begin with individual-level Census data collapsed to MSA-year-industry-skill cells containing employment counts and average wages. Industries are harmonized using a balanced panel of 1990 Census industry codes following [Autor, Dorn, and Hanson \(2013\)](#). Industries with zero national employment in any sample year are dropped to maintain consistency across years.

For each MSA and skill group (college and non-college), we calculate 1980 employment shares across industries to capture the initial local industrial structure. National wage growth by industry and skill level is computed using a leave-one-out mean that excludes each MSA's own wages when calculating the national trend. Wage growth is measured as the change in log average wages between consecutive decades.

The instrument is then constructed by multiplying each MSA's 1980 industry employment shares by the subsequent national industry wage growth rates and summing across industries within MSA-skill cells. The final relative shock measure is calculated as the difference between the college and non-college predicted wage changes.

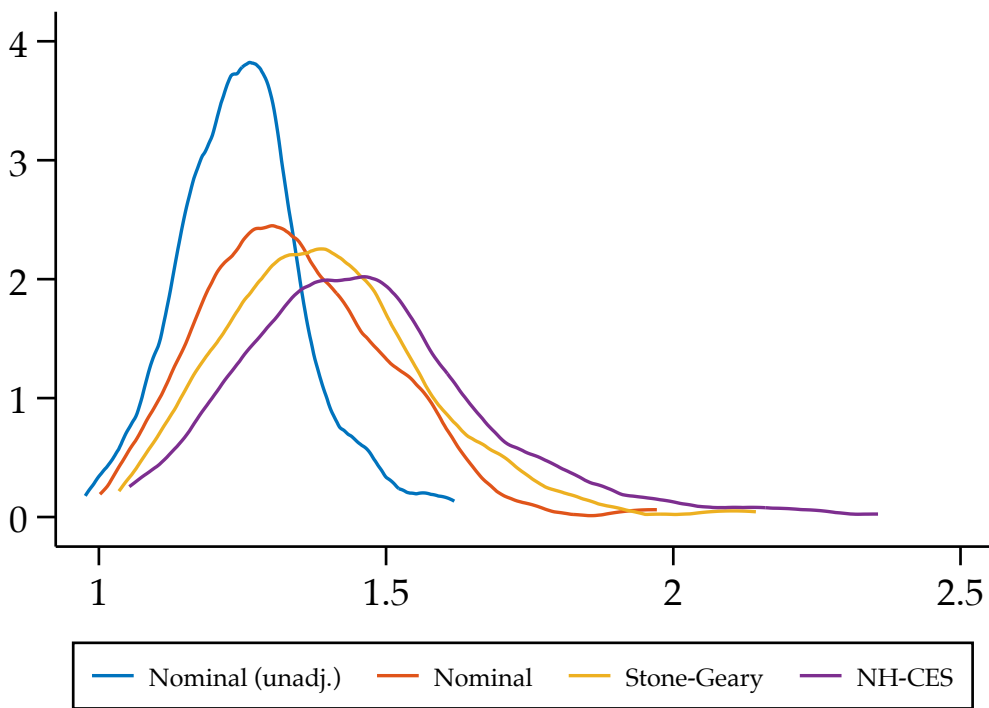
E Additional Results for Section 5 (Measuring Welfare Inequality 1980-2020)

Table 6: Summary Statistics for Expenditure Housing Shares

	Non-College						College					
	1980	1990	2000	2010	2020	Δ	1980	1990	2000	2010	2020	Δ
Renters Only												
Median	0.18	0.20	0.19	0.24	0.24	0.05	0.17	0.18	0.17	0.19	0.20	0.02
Min	0.13	0.15	0.13	0.18	0.16	0.03	0.13	0.12	0.09	0.12	0.13	0.00
Max	0.24	0.25	0.25	0.28	0.29	0.05	0.23	0.23	0.22	0.26	0.24	0.01
p75-p25	0.03	0.03	0.03	0.03	0.03	0.00	0.02	0.02	0.02	0.03	0.02	0.00
Renters and Owners												
Median	0.15	0.17	0.18	0.21	0.18	0.03	0.17	0.18	0.17	0.19	0.16	0.00
Min	0.11	0.12	0.13	0.14	0.13	0.01	0.12	0.13	0.13	0.14	0.12	-0.01
Max	0.21	0.23	0.23	0.28	0.24	0.03	0.21	0.23	0.21	0.24	0.20	0.00
p75-p25	0.02	0.03	0.03	0.04	0.03	0.01	0.02	0.02	0.02	0.03	0.02	0.01

Note: Housing shares represent the proportion of expenditure allocated to housing. The median values show the central tendency across all areas. Minimum and maximum values are derived from Metropolitan Statistical Areas (MSAs). Specifically, we first calculate the median housing share within each MSA, then report the lowest (Min) and highest (Max) of these MSA-level medians. The p75-p25 range represents the interquartile range of these MSA-level medians.

Figure 2: Distribution of Change in Welfare Inequality Across City



Note: This figure plots the distribution of changes in welfare measures across MSAs from 1980 to 2020.