The Long-Term Distributional and Welfare Effects of Covid-19 School Closures

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November 3, 2021

Abstract

Using a structural life-cycle model, we quantify the heterogeneous impact of school closures during the Corona crisis on children affected at different ages and coming from households with different parental characteristics. In the model, public investment through schooling is combined with parental time and resource investments in the production of child human capital at different stages in the children’s development process. We quantitatively characterize the long-term consequences from a Covid-19 induced loss of schooling, and find average losses in the present discounted value of lifetime earnings of the affected children of 2.1%, as well as welfare losses equivalent to about 1.2% of permanent consumption. Due to self-productivity in the human capital production function, younger children are hurt more by the school closures than older children. The negative impact of the crisis on children’s welfare is especially severe for those with parents with low educational attainment and low assets.

Keywords: Covid-19, school closures, inequality, intergenerational persistence

J.E.L. Codes: D15, D31, E24, I24

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*We thank the editor, two anonymous referees and virtual seminar participants, as well as our discussant Rüdiger Bachmann for many helpful comments and suggestions. Fuchs-Schündeln gratefully acknowledges financial support by the European Research Council through Consolidator Grant No. 815378, and by the DFG through a Leibnizpreis. Krueger thanks the National Science Foundation for financial support under grant SES-1757084. Fuchs-Schündeln and Ludwig gratefully acknowledge financial support by NORFACE Dynamics of Inequality across the Life-Course (TRISP) grant: 462-16-120. Ludwig also thanks Universitat Autònoma de Barcelona for its hospitality during his sabbatical year 2019/20.

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1 Introduction

Governments worldwide have reacted to the Covid-19 pandemic by closing schools and child care centers. In many countries, including the US, these closures started in mid March 2020 and extended well into 2021. Whereas the economic consequences of temporary business closures are immediate and drew significant policy and media attention, the economic consequences of school and child care closures emerge in the longer run and are not always easily measured. Given the importance of human capital for individual prosperity and long-term macroeconomic growth, they are however likely substantial (see e.g. Krueger and Lindahl (2001), Manuelli and Seshadri (2014)).

In this paper, we analyze the long-term income-, welfare- and distributional consequences of the school and child care closures on the affected children. To do so, we build a heterogeneous agent partial equilibrium model with a human capital production function at its core that takes time and monetary inputs by parents and governmental investment into schooling as inputs. Parents also leave inter-vivos transfers to their children, which can be used to finance college and consumption. The key dimensions of heterogeneity we focus on are the age of a child in 2020 (when the school closures first occurred), as well as parental socio-economic characteristics, namely financial resources, marital status, and education. We model school and child care closures as a reduction in the governmental investment in children corresponding to one year less schooling, the average time of school closures in the US until summer of 2021. We also show results based on six months of school closures, assuming partial effectiveness of online teaching. In the model, parents endogenously adjust their investment into children and inter-vivos transfers in response to the drop in governmental inputs, thereby potentially mitigating the adverse consequences of Covid-19 induced school closures. We use our model as a quantitative laboratory to analyze the long-term aggregate and distributional consequences of the Covid school shock on children’s acquired human capital, their high-school graduation and college choice, their labor market earnings, and, ultimately, their welfare.

The key ingredients for the quantitative analysis are the parameters characterizing the human capital production function, which we either take from the literature or calibrate to data moments on parental investments into children from U.S. household micro data. Once the model is parameterized, we subject children and parents to a one-time unexpected Covid-19 school closure shock and document the short- and long run economic consequences. On average (across children aged 4 to 14 when the shock occurs), the model implies that the school closures alone lead to an increase in the future share of children without a high school degree of \(16\%\) and a reduction of the share of children with a college degree of \(-7\%\). On average, the present discounted earnings losses at labor market entry induced by reduced human capital accumulation and lower educa-
tional attainment amount to $-2.1\%$. To put these losses into a macroeconomic perspective, if we discount these losses to the beginning of 2020 and aggregate them across all school children impacted by the Covid-19 school closures, they amount to ca. 3% of 2019 US GDP. These effects materialize despite a significant endogenous adjustment of parental investments into their children: time inputs rise by 16.6% and monetary inputs by 35.4% on impact. Measured as consumption-equivalent variation, the average welfare loss of children from the Covid-induced school closures amounts to $-1.21\%$. Given the temporary nature of the shock, assumed to last one year in the baseline results, we view these numbers as quite large.

These average welfare losses mask substantial heterogeneity by the age and parental socio-economic characteristics of the children at the time of the crisis. Turning first to the age of the child, the adverse impact is most pronounced for younger children of school age (i.e. children of ages 6-10). The welfare losses of children aged 6 at the time of the crisis amount to $-1.57\%$ in terms of consumption-equivalent variation. Even though parents respond strongly to the closure of schools by increasing their time and resource inputs into the child human capital production function, they do not quite fully offset the reduction in public inputs due to schooling. This implies that children arrive at older ages with less human capital due to the Covid crisis, and due to the self-productivity of human capital the effect is stronger for younger children. Additionally, since the human capital production function features dynamic complementarities, the marginal productivity of private investments at future ages is also reduced. Optimizing parents respond to this by investing less into their children at older ages (relative to the pre-Covid scenario). Combined, these effects lead to lower human capital at age 16, adverse outcomes on high-school completion and college attendance, future wages and, consequently, welfare. Older children at the time of the Covid crisis, instead, have already accumulated most of their human capital, and therefore the adverse future effects due to self-productivity and lower incentives for parental human capital investment due to Covid school closures are less severe.

Apart from the age of the child, parental background matters for the negative impact of the Covid shock on human capital accumulation, wages, and welfare. Broadly speaking, children with poorer parents suffer more. There are two reasons for this. First, even without any parental adjustments in investments, children from lower income households suffer more from the school closures, since for them a larger part of educational investment comes from the government. Second, as a reaction to the school closures, rich parents increase their investment into children by more than poor parents. They have more financial resources to do so, and their children have on average higher human capital. Given that the human capital production function features dynamic complementarity, rich parents thus have higher incentives to compensate the reduction in government investment than poor parents. Focusing on each parental characteristic alone, we find that children from single parents, parents from the lowest asset quintile, or high school
dropout parents have around 50% higher welfare losses than children from married parents, parents from the highest asset quintile, or college educated parents. However, these three parental characteristics are positively correlated, and thus losses along a single characteristic compound each other. Children from the most disadvantaged households then have four times larger welfare losses than children from the most privileged households.

1.1 Related Literature

This paper ties into the literature on schooling and human capital formation. Our human capital production function relies on Cunha et al. (2006), Cunha and Heckman (2007) and Cunha et al. (2010), especially on the feature of self-productivity, i.e., higher human capital in one period leads to higher human capital in the next period, and dynamic complementarity, i.e., human capital investment pays out more the higher the human capital.\(^1\) This feature implies that early-childhood education is a crucial determinant of future income (Cunha and Heckman (2007) and Caucutt and Lochner (2020)). Consequently, public schooling is a driver of intergenerational mobility. Relying on quantitative models, Kotera and Seshadri (2017) show that differences in intergenerational mobility across US states can be explained by differences in public school finances. Related, Lee and Seshadri (2019) find that education subsidies can significantly increase intergenerational mobility.\(^2\) Agostinelli et al. (2020) also use a structural model of human capital formation to evaluate the consequences of Covid-19 related school closure, but zoom in on the high-school years of teenagers, and emphasize the loss of peer interactions as an important driver of losses in educational attainment. Jang and Yum (2021) build a general equilibrium model and focus on the effects of the school closures on aggregate outcomes and intergenerational mobility.

Whereas the quantitative literature focuses on the effects of public schooling investment on children’s outcomes and intergenerational mobility, there exists an empirical literature that analyzes specifically the link between school instruction time and outcomes of children. Lavy (2015) exploits international differences in school instruction time, caused by differences in the length of an average school day and usual school weeks, and finds that school instruction time in core subjects significantly affects testing outcomes of children. Similarly, Carlsson et al. (2015) exploit exogenous variation in testing dates in Sweden and report that extra 10 days of school instruction raise scores on intelligence tests by 1% of a standard deviation.\(^3\) There are few studies

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\(^1\)Our human capital production function does not feature innate ability, only innate human capital, and therefore by construction does not include complementarity between ability and human capital investment.

\(^2\)Yum (2020) allows for parental time and monetary investments, as we do, and analyzes specifically the importance of parental time investment for intergenerational mobility. Caucutt et al. (2020) provide estimates of the complementarity of different parental inputs and between parental inputs and market-based child care.

\(^3\)Other papers studying the link between school instruction time and test scores are Rivkin and Schimm (2015) and Fitzpatrick et al. (2011).
investigating longer-term outcomes of school instruction time on children. Cortes et al. (2015) find a positive effect of math instruction time on the probability of attending college for low-performing students. Pischke (2007) exploits short school years associated with a shift in the school starting date in Germany in the 1960s, and finds no significant effects on employment and earnings of affected children. Jaume and Willén (2019) find that half a year less instruction time during primary school caused by school strikes in Argentina lowers the long-term earnings by 3.2% for men and 1.9% for women.

The remainder of this paper unfolds as follows. Section 2 presents the model, and Section 3 its calibration. Sections 4 and 5 then discuss the results, first in terms of aggregate effects, then in terms of its distribution. Section 6 discusses the sensitivity of the results with respect to one crucial parameter, namely the elasticity of substitution between governmental and parental inputs. Last, section 7 concludes, and the Appendix contains further details of the model, the data and calibration, as well as additional quantitative results.

2 A Quantitative Model of Education During the Epidemic

We now describe the structural life cycle model used to quantify the long-run consequences of school closures during the COVID-19 pandemic. After setting out the fundamentals of the economy (demographics, time, risk, endowments, preferences and government policy) we immediately focus on the recursive formulation of the model, since this is the representation we compute.

2.1 Individual State Variables, Risk, and Economic Decisions

Time in the model is discrete and the current period is denoted by $t$. We model the life cycle of one adult and one children generation in partial equilibrium. The timing and events of this life cycle are summarized in Figure 1 below.

Agents are heterogeneous with respect to the generation they belong to $k \in \{ch, pa\}$, either being part of the child or parental generation, and they differ by their marital status $m \in \{si, ma\}$ for single and married, their age $j \in \{0, \ldots, J < \infty\}$, their asset position $a$, their current human capital $h$, their education level $s \in \{no, hs, co\}$ for no higher education (no high school completion), high school attendance and completion, college attendance and completion, and idiosyncratic productivity risk modeled as a two state Markov process with state vector $\eta \in \{\eta_l, \eta_h\}$, where $\eta_l$ is low and $\eta_h$ is high labor productivity, and transition matrix $\pi(\eta' \mid \eta)$ and a transitory shock $\varepsilon \in \{\varepsilon_1, \ldots, \varepsilon_n\}$. The individual state variables and the range of values they can take are summarized in Table 1.
Table 1: State Variables

<table>
<thead>
<tr>
<th>State Var.</th>
<th>Values</th>
<th>Interpretation</th>
</tr>
</thead>
<tbody>
<tr>
<td>$k$</td>
<td>$k \in {ch, pa}$</td>
<td>Generation</td>
</tr>
<tr>
<td>$m$</td>
<td>$m \in {si, ma}$</td>
<td>Marital Status</td>
</tr>
<tr>
<td>$j$</td>
<td>$j \in {0, 1, \ldots, J}$</td>
<td>Model Age</td>
</tr>
<tr>
<td>$a$</td>
<td>$a \geq -a(j, s, k)$</td>
<td>Assets</td>
</tr>
<tr>
<td>$h$</td>
<td>$h &gt; 0$</td>
<td>Human Capital</td>
</tr>
<tr>
<td>$s$</td>
<td>$s \in {no, hi, co}$</td>
<td>Education</td>
</tr>
<tr>
<td>$\eta$</td>
<td>$\eta \in {\eta_l, \eta_h}$</td>
<td>Persistent Productivity Shock</td>
</tr>
<tr>
<td>$\varepsilon$</td>
<td>$\varepsilon \in {\varepsilon_1, \ldots, \varepsilon_n}$</td>
<td>Transitory Productivity Shock</td>
</tr>
</tbody>
</table>

Notes: List of state variables of the economic model.

We assume that parents give birth to children at the age of $j_f$ and denote the fertility rate of households by $\xi(m, s)$, which differs by marital status and education groups. Notice that $\xi(m, s)$ is also the number of children per household. There is no survival risk and all households live until age $J$ and thus the cohort size within each generation is constant (and normalized to 1). We now describe in detail how life unfolds for parents, and then for children, as summarized in Figure 1 below.

2.1.1 Life of the Parental Generation

Parental households become economically active at age $j_f$ just before their children are born. They start their economic life in marital status $m$ and with education level $s$, initial idiosyncratic productivity states $\eta$ and $\varepsilon$ and initial assets $a$. These initial states are exogenously given to the household, and drawn from the population distribution $\Phi(s, m, \eta, \varepsilon, a)$ which will be informed directly by the data.

Parents then observe the innate ability (initial human capital) $h = h_0(s, m)$ of their children which depends on parental education $s$ and marital status $m$. Children live with their parents until age $j_a$ (parental age $(j_f + j_a)$), at which point they leave the parental household to form their own household.

During the parental part of the life cycle in which children live with parents (parental age $j \in \{j_f, \ldots, j_f + j_a\}$), parents invest money $i^m$ and time $i^t$ into the accumulation of human capital $h$ of their children, taking as given public investment into schooling $i^g$. As a result, the human capital of the child evolves according to

$$h' = g(j, h, i^m, i^t, i^g),$$

(1)
Figure 1: Life-Cycle of Child and Parental Households

Life Cycle of Parental Households

*Initial Distribution*
\[ \Phi(m,s,a) \]

*Children Leave Household*
Pay inter-vivos transfers \( b \)

*Earnings while Working*
Wage \( w \) \( e \eta \epsilon \) until retirement
Working time \( l(m) \) depends on marital status
\( e \) = age and educ. specific wage profile
\( \eta \) = persistent productivity shock, 2-state Markov
\( \epsilon \) = transitory productivity shock

Young Children
Choose: \( c, a' \)
Pay taxes

Work
Choose: \( c, a' \)
Pay taxes

Retired
Choose: \( c, a' \)
Receive pension income

Life Cycle of Child Households

*Birth*
Innate ability: \( h = h_0(mp,sp) \)

*Higher Education?*
Given \( h_j \)
\( h_j(h_0,sp) \)
\( \gamma(h_j) = \) fixed effect
\( e \) = age and educ. specific wage profile
\( \eta \) = persistent productivity shock
\( \epsilon \) = transitory productivity shock

Birth

Childhood
Receive: \( i^o, i^t, \) and \( i^g \)

High-School
Given psychological costs \( p(h_0,hs) \) and wage, choose \( a',c \).
Pay taxes

College
Given psychological costs \( p(h_0,hs,co) \), tuition, and wage, choose \( a',c \).
Pay taxes

Work
Choose: \( c, a' \)
Pay taxes

Retired
Choose: \( c, a' \)
Receive pension income
where \( g \) is a function of the child’s age (to reflect differences in the relative weights of education inputs at different ages), and depends positively on the three inputs (parental time, parental resources and public education).

When children leave the household at parental age \( j_f + j_a \), parents may transfer additional monetary resources as inter-vivos transfers \( b \) to their children. After this transfer parents and children separate and there are no further interactions between the two generations.

Throughout the work life parental households spend an exogenous amount of time \( \ell(m) > 0 \) on market work which differs by marital status. Labor productivity and thus individual wages are determined by an exogenous productivity profile \( \epsilon(j, s, m) \) that depends on household age, education and marital status, as well as by a persistent stochastic shock \( \eta \) and a transitory stochastic shock \( \varepsilon \). The persistent shock \( \eta \) follows a first-order Markov chain with state space \( \{\eta_l, \eta_h\} \), transition matrix \( \pi(\eta' | \eta) \) and initial distribution \( \Pi \). Current labor income of parents with characteristics \( j, s, m \) is then given by

\[
y = w \cdot \epsilon(j, s, m) \cdot \eta \cdot \varepsilon \cdot \ell(m). \tag{2}
\]

Parents work until retirement at age \( j_r \), when they receive earnings history dependent per period retirement benefits \( b^p > 0 \) and live until age \( J \). In addition to making human capital investment decisions for their children when these are present in the household, parents in each period make a standard consumption-saving choice, where household asset choices are subject to a potentially binding borrowing constraint \( a' \geq -a(j, s, m, pa) \), which will be parameterized such that the model replicates well household debt at the age at which households have children \( j_f \). The borrowing limit is assumed to decline linearly to zero over the life cycle towards the last period of work at age \( j_r - 1 \). Table 2 summarizes the choices of parents (and children, as described in the next subsection).

### Table 2: Per Period Decision Variables

<table>
<thead>
<tr>
<th>State Var.</th>
<th>Values</th>
<th>Decision Period</th>
<th>Interpretation</th>
</tr>
</thead>
<tbody>
<tr>
<td>( c )</td>
<td>( c &gt; 0 )</td>
<td>( j \geq j_a )</td>
<td>Consumption</td>
</tr>
<tr>
<td>( a' )</td>
<td>( a' \geq -a(j, s, k) )</td>
<td>( j \geq j_a )</td>
<td>Asset Accumulation</td>
</tr>
<tr>
<td>( i^t )</td>
<td>( i^t \geq 0 )</td>
<td>( j \in {j_f, ..., j_f + j_a} )</td>
<td>Time Investments</td>
</tr>
<tr>
<td>( i^m )</td>
<td>( i^m \geq 0 )</td>
<td>( j \in {j_f, ..., j_f + j_a} )</td>
<td>Monetary Investments</td>
</tr>
<tr>
<td>( b )</td>
<td>( b \geq 0 )</td>
<td>( j = j_f + j_a )</td>
<td>Monetary Inter-vivos Transfer</td>
</tr>
<tr>
<td>( s )</td>
<td>( s \in {no, hi, co} )</td>
<td>( j = j_a )</td>
<td>(Higher) Education</td>
</tr>
</tbody>
</table>

**Notes:** List of decision variables of the economic model.
2.1.2 Life of the Children Generation

Children are born at age $j = 0$, but for the first $j_a - 1$ periods of their life do not make economic decisions. Their human capital during these periods evolves as the outcome of parental investment decisions $(i^m, i^l)$ described above and governmental schooling input $(i^g)$. At the beginning of age $j_a$, and based on both the level of human capital as well as the financial transfer $b$ from their parents (which determines their initial wealth $a$), children make a discrete higher education decision $s \in \{\text{no}, \text{hs}, \text{co}\}$, where $s = \text{no}$ stands in for the choice not to complete high school, $\text{hs}$ for high school completion, and $\text{co}$ for college completion, respectively. For simplicity, children are stand-in bachelor households through their entire life-cycle.

Acquiring a high school or college degree comes at a utility (or psychological) cost $p(s, s_p, h)$, which is decreasing in the child’s acquired human capital $h$ and also depends on parental education $s_p$. In addition, college education requires a monetary cost $\iota \geq 0$. Children may finance some of their college expenses by borrowing, subject to a credit limit given by $-a(j, s, ch)$, which is zero for $s \in \{\text{no}, \text{hs}\}$, i.e. for individuals not going to college. As was the case for parents, this limit decreases linearly with age and converges to zero at the age of retirement $j_r$, requiring the children generation to pay off their student loans prior to their retirement.

Youngsters who decide not to complete high school, $s = \text{no}$, enter the labor market immediately at age $j_w(s = \text{no}) = j_a$. Those who decide to complete high school, but not to attend college, do so at age $j_w(s = \text{hs}) = j_h > j_a$. While at high school, $\{j_a, \ldots, j_h - 1\}$, they work part-time at wages of education group $s = \text{no}$. Youngsters who decide to attend college enter the labor market at $j_w(s = \text{co}) = j_c$ and also work part-time at wages of education group $s = \text{no}$ during their high-school and college years $\{j_a, j_c - 1\}$.

At time of labor market entry, $j_w(s)$, the acquired human capital of a worker is mapped into an idiosyncratic permanent productivity state $\gamma(s, h)$. When starting to work, children also draw stochastic persistent productivity $\eta$, which follows the same first-order Markov chain as for the parental generation, and stochastic transitory productivity $\epsilon \sim \psi(\epsilon)$. Labor income of children during the working period is then given by

$$w \cdot \gamma(s, h) \cdot \epsilon(j, s, si) \cdot \eta \cdot \epsilon \cdot \ell(si).$$

Since the children generation does not have any offspring of their own, the remaining decision problem of the child generation amounts to a simple life-cycle consumption-saving problem.
2.2 Decision Problems

Since we focus on a single parent and children generation, we can solve the model backward, starting from the dynamic programming problem of the children.

2.2.1 Children

The children generation makes their first meaningful economic decision at age $j_{A}$, when it leaves the parental household with the receipt of inter-vivos transfers, which constitute initial assets $a$, as well as with human capital $h$.

The Education Decision At age $j_{A}$, based on their initial asset position $a$, their acquired human capital $h$ and the education of their parents $s_{P}$ children make an education decision $s \in \{no, hs, co\}$. Children who decide to drop out of high school, $s = no$, realize after this decision their labor productivity through the fixed effect $\gamma(s = no, h)$, the stochastic persistent income shock $\eta$ and the stochastic transitory income shock $\varepsilon$. Since these shocks only realize at labor market entry, the choice $s = no$-specific state variables prior to labor market entry are thus $(j_{A}, s = no; a, h)$ and the according value function is $V(j_{A}, s = no; a, h)$. Children who decide to continue in high school but to thereafter not attend college, $s = hs$, or who decide in addition to attend college after high-school completion, $s = co$, instead work during their education at a non-stochastic wage process. The problem of these children is thus fully deterministic and the decisions of these youngsters on $s \in \{hs, co\}$ are therefore also time consistent. During high school or college these children additionally experience utility costs that depend on the education of their parents, $s_{P}$. Therefore, the choice $s \in \{hs, co\}$-specific state variables are $(j_{A}, s \in \{hc, co\}, s_{P}; a, h)$ and the value functions are $V(j_{A}, s \in \{hs, co\}, s_{P}, a, h)$. We thus obtain as post-education decision skill state

$$
    s = \begin{cases} 
        no & \text{if } V(j_{A}, s = no; a, h) \geq \max\{V(j_{A}, s = hs, s_{P}; a, h), V(j_{A}, s = co, s_{P}; a, h)\} \\
        hs & \text{if } V(j_{A}, s = hs, s_{P}; a, h) \geq \max\{V(j_{A}, s = no; a, h), V(j_{A}, s = co, s_{P}; a, h)\} \\
        co & \text{if } V(j_{A}, s = co; s_{P}, a, h) \geq \max\{V(j_{A}, s = no; a, h), V(j_{A}, s = hs, s_{P}; a, h)\}, 
    \end{cases}
$$

(3)

where the education decision $s \in \{no, hs, co\}$ determines the children’s permanent productivity in the labor market $\gamma(s, h)$. The pre-education decision value function is given as

$$
    V(j_{A}, s_{P}; a, h) = \max_{s \in \{no, hs, co\}} \{V(j_{A}, s = no; a, h), V(j_{A}, s = hs, s_{P}; a, h), V(j_{A}, s = co, s_{P}; a, h)\}.
$$

(4)
In the computational implementation, we additionally apply Extreme Value Type I (Gumbel) distributed taste shocks to smooth the decision problem. Accordingly, decisions for the three education alternatives are probabilistic and governed by the choice probabilities $\pi(j_a, s = no; a, h)$ and $\pi(j_a, s \in \{hs, co\}, s_p, a, h)$.

**Choices During Working Life** After having made the education decision $s \in \{no, hs, co\}$ which determines their permanent productivity in the labor market $\gamma(s, h)$ children who decided $s = no$ draw the stochastic components of their labor productivity, the persistent shock $\eta \sim \Pi(\eta)$ which then evolves according to the Markov transition matrix $\pi(\eta' | \eta)$ and the transitory shock $\varepsilon \sim \psi(\varepsilon)$. The state variables of the newly formed household of type $s = no$ consequently are $(j, s = no, \eta, \varepsilon; a, h)$ and the continuation value functions $V(j, s = no, \eta, \varepsilon; a, h)$ are determined by a simple life-cycle consumption-saving problem during working ages $j \in \{ja, ..., j_r - 1\}$

$$V(j, no, \eta, \varepsilon; a, h) = \max_{c, a'} \left\{ u(c) - v(\ell(s)) + \beta \sum_{\eta'} \pi(\eta' | \eta) \sum_{\varepsilon'} \psi(\varepsilon') V(j + 1, no, \eta', \varepsilon'; a', h) \right\}$$

subject to

$$a' + c(1 + \tau^c) = a(1 + r(1 - \tau^k)) + y(1 - \tau^p) - T(y(1 - 0.5\tau^p))$$

$$y = w\gamma(no, h)e(no, j, si)\eta\varepsilon\ell(si)$$

$$a' \geq 0$$

where the per period utility function $u(\cdot)$ with household consumption $c$ as its argument satisfies standard properties. Since labor supply is exogenous, the disutility of work $v(\cdot)$ does not affect optimal choices of children, but impacts the child value functions which enter the parental transfer decision problem. In the budget constraint, recall that $\gamma(s, h)$ is permanent labor productivity which depends on acquired human capital and the chosen level of education $s = no$. The function $T(\cdot)$ represents a progressive labor income tax code and $(1 - 0.5\tau^p)y$ is taxable labor income, where $\tau^p$ is the social security contribution rate (and employer contributions to social security are non-taxable income). Accordingly, we can write the education-specific expected value function $V(j_a, s = no; a, h)$ in (3) as

$$V(j_a, s = no; a, h) = \sum_{\eta} \Pi(\eta) \sum_{\varepsilon} \psi(\varepsilon) V(j_a, s = no, \eta, \varepsilon; a, h).$$

---

$^4$Given this structure, the set of individuals exactly indifferent between two education choices is of measure zero and thus it is inconsequential how we break the indifference.
Children who continue in high school but do not attend or complete college, i.e., education group $s = hs$, may work during high school at a deterministic wage and draw after high-school completion stochastic labor productivity $\eta \sim \Pi(\eta)$, $\varepsilon \sim \psi(\varepsilon)$ and accordingly solve the following decision problem at age $j = j_a$

$$V(j_a, hs, s_p; a, h) = \max_{c, a'} \left\{ u(c) - v(\chi(hs)\ell(si)) - p(s, s_p, h) + \beta \sum_{\eta'} \Pi(\eta') \sum_{\varepsilon'} \psi(\varepsilon') V(j + 1, hs, \eta', \varepsilon'; a', h) \right\}$$

subject to

$$a' + c(1 + \tau_c) = a(1 + r(1 - \tau^k)) + y(1 - \tau^p) - T(y(1 - 0.5\tau^p))$$

$$y = w\gamma(no, h)\epsilon(no, j, si)\chi(hs)\ell(si)$$

$$a' \geq 0.$$ 

That is, high-school students work for high-school dropout wages $w\gamma(no, h)$ for a fraction $\chi(hs)$ of their time $\ell(si)$. The term $p(s, s_p, h)$ represents a utility cost associated with attending high school which is decreasing in the amount of human capital $h$ previously acquired by the student. They have to form expectations over their stochastic labor market productivity upon graduating in the subsequent period. Upon graduating, for their remaining working life-cycle $j \in \{j_h, ..., j_r - 1\}$ these individuals solve a dynamic problem analogous to the one of high-school dropouts described above, but with earnings process $w\gamma(hs, h)\epsilon(hs, j, si)\chi(hs)\ell(si)$.

Finally, children who decide, at age $j_a$, to attend (and by assumption, to complete) college have education indicator $s = co$, and solve, during ages $\{j_a, ..., j_{hs} - 1\}$ the same problem as group $s = hs$, with the modification that the continuation value differs at age $j_{hs} - 1$ through the value function $V(j_{hs}, co, s_p; a, h)$. For ages $j \in \{j_h, ..., j_c - 2\}$ they solve

$$V(j, co, s_p; a, h) = \max_{c, a'} \left\{ u(c) - v(\chi(co)\ell(si)) - p(co, s_p, h) + \beta V(j + 1, co, s_p; a', h) \right\}$$

subject to

$$a' + c(1 + \tau_c) = a(1 + r(1 - \tau^k)) + y(1 - \tau^p) - T(y(1 - 0.5\tau^p)) - \iota$$

$$y = w\gamma(hs, h)\epsilon(hs, j, si)\chi(co)\ell(si)$$

$$a' \geq -a(j, co, ch).$$

where $\iota$ is the per-period (net) tuition cost.
At age \( j = j_c - 1 \) their continuation value (but not their budget set) changes to reflect entry into the labor market in the subsequent period, taking expectations over the stochastic component of productivity \( \eta' \) and \( \varepsilon' \) next period:

\[
V(j, s, s_p; a, h) = \max_{c, a'} \left\{ u(c) - v(\chi(co)\ell(si)) - p(s, s_p, h) + \beta \sum_{\eta'} \Pi(\eta') \sum_{\varepsilon'} \psi(\varepsilon') \cdot V(j + 1, co, \eta' ; a', h) \right\}.
\]

For the remaining working phase of the life-cycle \( j \in \{j_c, ..., j_r - 1\} \) these individuals solve a dynamic problem analogous to the one of high-school dropouts described above, but with earnings process \( w\gamma(co, h)\epsilon(co, j, si)\eta\varepsilon\ell(si) \).

**The Retirement Phase** During retirement, at ages \( \{j_r, ..., J\} \), all three education groups of the children generation solve a standard consumption-saving problem given in Appendix A.1.

### 2.2.2 Parents

Given the focus of the paper, we model parental households as becoming economically active at the beginning of age \( j_f > j_a \) when they give birth to children. Parents are endowed with initial assets \( a \), education \( s \), an initial idiosyncratic productivity state \( \eta \), an initial transitory income shock \( \varepsilon \), and are distinguished by their marital status \( m \). Children live with adult households until they form their own households as described above. Thus, for parental ages \( \{j_f, ..., j_f + j_a - 1\} \) children are present in the parental household. Parents derive utility from per capita consumption of all household members and suffer disutility from hours worked as well as time with children. During the age bracket \( \{j_f, j_f + j_a - 1\} \) they solve the dynamic problem

\[
V(j, s, m, \eta, \varepsilon; a, h) = \max_{c, i^m, i^t, a', h'} \left\{ u \left( \frac{c}{1 + \zeta_c(m, s) + 1_{m=ma}\zeta_a} \right) - v \left( \frac{\ell(m) + \kappa \cdot \xi(m, s) \cdot i^t}{1 + 1_{m=ma}} \right) + \beta \sum_{\eta'} \pi(\eta'|\eta) \sum_{\varepsilon'} \psi(\varepsilon') V(j, s, m, \eta', \varepsilon'; a', h') \right\}
\]

subject to

\[
a' + c(1 + \tau^c) + \xi(m, s)i^m = a(1 + r(1 - \tau^k)) + y(1 - \tau^p) - T(y(1 - 0.5\tau^p)) \\
y = w\epsilon(s, j, m)\eta\varepsilon\ell(m) \\
a' \geq -a(j, s, k) \\
h' = g(j, h, i^m, i^t, i^g)
\]
where $h$ is the human capital of the number $\xi(m, s)$ of children in the household characterized by parental education $s$ and marital status $m$. We express monetary investments $i^m$ and time investments $i^t$ on a per-child basis. Notice that the sum of hours worked and weighted time investment in children in the disutility function $v(\cdot)$ is divided by the number of working household members. Parameter $\kappa$ is a weight on time investments into children, and reflects the possibility that reading to children carries a different disutility of time than answering emails at work.

At parental age $j_f + j_a$ children form own adult households and this is the only period in which parents can make inter-vivos transfers $b$. These transfers immediately (that is, within the period) become assets of their children, and thus generate utility for their parents. The dynamic program then reads as

$$V(j_a + j_f, s, m, \eta; a, h) = \max_{c, b, a'} \left\{ u \left( \frac{c}{1 + 1_{m=ma}k_a} \right) - v \left( \frac{\ell(m)}{1 + 1_{m=ma}} \right) + \beta \sum_{\eta'} \pi(\eta' | \eta) \sum_{\varepsilon'} \pi(\varepsilon' | \eta) V(j_a + j_f + 1, s, m, \eta', \varepsilon'; a') + \nu V(j_a, s_p; \frac{b}{1 + r(1 - \tau^k)}, h) \right\},$$

where $V(j_a, s_p; b, h)$ is the pre-education decision value function of their children, cf. equation (4). Maximization is subject to

$$a' + c(1 + \tau^c) + \xi(m, s)b = a(1 + r(1 - \tau^k)) + y(1 - \tau^p) - T(y(1 - \tau^p))$$

$$y = w(e(s, j, m)\eta\varepsilon\ell(m)$$

$$a' \geq 0.$$  

After children have left the household, the parent generation solves, at age $j \in \{j_a + j_f + 1, \ldots, j_r - 1\}$, a standard life cycle consumption-saving problem described in Appendix A.2, and in retirement ages $j \in \{j_r, \ldots, J\}$, all three education groups of parents solve a similarly standard consumption-saving problem laid out in Appendix A.1.

### 2.3 Government

The government runs a pension system with a balanced budget. It also finances exogenous government spending, expressed as a share of aggregate output $G/Y$, and aggregate education subsidies (of pre-tertiary and tertiary education) through consumption taxes, capital income taxes.

---

5 Note that since assets in the value function enter the budget constraint as being multiplied by the gross, after-tax interest rate $1 + r(1 - \tau^k)$, and since inter-vivos transfers are received in the same period in which they are made and thus do not accrue interest, these transfers $b$ have to be divided by $1 + r(1 - \tau^k)$ in the Bellman equation of the parent.
and a progressive labor income tax code. In the initial scenario without the COVID-19 shock, the
government budget clears by adjustment of the average labor income tax rate. In the thought
experiments we hold all tax parameters constant, therefore implicitly assuming that the shortfalls
or surpluses generated by a change in the environment are absorbed by government debt serviced
by future generations.

2.4 Thought Experiment

We compute an initial stationary partial equilibrium with exogenous wages and returns prior to
model period \( t = 0 \). In period \( t = 0 \), the COVID-19 shock unexpectedly occurs, and from
that point on unfolds deterministically. That is, factor prices and fiscal policies are fixed, and
households get surprised once by the shock, after which they have perfect foresight with respect
to aggregate economic conditions. The COVID-19 school closures are represented in the model by
a temporary (1 year) reduction in public investment \( i^g \) into child human capital production. We
then trace out the impact of this temporary shock on parental human capital inputs (both time
and money) and intergenerational transfer decisions, as well as on the education choices, future
labor market outcomes, and welfare of the children generation, both in terms of its aggregates as
well as in terms of its distribution. Since children differ by age at the time of the shock (as well
as in terms of parental characteristics), so will the long-run impact on educational attainment,
future wages, and welfare. We will place special emphasis on this heterogeneity.

3 Calibration

A subset of parameters is calibrated exogenously outside the model, summarized in Table 3.
The subset of second stage parameters, summarized in Table 4, is calibrated endogenously by
matching moments in the data. In the calibration, we use data from the PSID, including its Child
Development Supplement (CDS), and the NLSY79.\(^6\) We now describe in detail our choice of
first stage parameters and the moments we match to calibrate the second stage parameters.

3.1 Age Brackets

The model is calibrated at a biannual frequency. We initialize the parental economic life-cycle
when their children are of age 4, model age \( j = 0 \). The reason for this initialization age is the
calibration of the initial human capital endowment \( h(j = 0) \), which is informed by data on test
score measures at child biological ages 3 to 5. Thus, children are irrelevant to the economic model

\(^6\)Data sources and sample selection criteria are described in Online Appendix Section B.1.
# Table 3: First Stage Calibration Parameters

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Interpretation</th>
<th>Value</th>
<th>Source (data/lit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$j = 0$</td>
<td>Age at economic birth (age 4)</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>$j_a$</td>
<td>Age at beginning of econ life (age 16)</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>$j_h$</td>
<td>Age at finishing HS (age 18)</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>$j_c$</td>
<td>Age at finishing CL (age 22)</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>$j_f$</td>
<td>Fertility Age (age 32)</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>$j_r$</td>
<td>Retirement Age (age 66)</td>
<td>31</td>
<td></td>
</tr>
<tr>
<td>$J$</td>
<td>Max. Lifetime (age 80)</td>
<td>38</td>
<td></td>
</tr>
<tr>
<td>$\xi(m, s)$</td>
<td>Fertility rates</td>
<td>see main text</td>
<td>PSID 2011-2017</td>
</tr>
<tr>
<td>$\Phi(j_f, m, s)$</td>
<td>Distribution of parents by martial status and education, age $j_f$</td>
<td>see main text</td>
<td>PSID 2011-2017</td>
</tr>
</tbody>
</table>

### Preferences

- $\theta$: Relative risk aversion parameter | 1 |
- $\varphi$: Curvature of labor disutility | 0.5 |

### Labor Productivity

- $\{\epsilon(j, s, m)\}$: Age Profile | see main text | PSID 1968-2012 |
- $[\xi_l, \xi_u]$ | Realizations of Transitory Shock | [0.881, 1.119] | PSID 1968-2012 |
- $[\eta_l, \eta_u]$ | States of Markov process | [0.8226, 1.1774] | PSID 1968-2012 |
- $\pi_{II}(s)$: Transition probability of Markov process after lockdown | [0.0493, 0.0486, 0.0456] | see main text |
- $\pi_{I}(s)$: Transition probability of Markov process after lockdown | [0.9630, 0.9624, 0.9594] | see main text |
- $\chi^s$: Hours worked for students, as a fraction of full time (HS and CL) | $\{0.2, 0.5\}$ | see main text |
- $\gamma(s, h)$: Ability gradient of earnings | see main text | NLSY79 |

### Endowments

- $r$: (Annual) interest rate | 4.0% | Siegel (2002) |
- $l(m)$: Average hours worked by marital status (annual) | $\{1868, 3810\}$ | PSID 2011-2017 |
- $a(j_f, m, s)$: Asset distr-n of parents by martial status and education, age $j_f$ | see main text | PSID 2011-2017 |
- $a_j(m = s, s, pa)$: Borrowing limit for parents at age $j_f$ | see section 3.4 | $\{0.006, 0.083, 0.151\}$ |
- $r_p(m = s, s, pa)$: Education-specific repayment amount for parents: singles | see section 3.4 | $\{0.048, 0.129, 0.110\}$ |
- $r_p(m = ma, s, pa)$: Education-specific repayment amount for parents: couples | see section 3.4 | $\{0.048, 0.129, 0.110\}$ |

### Ability/Human Capital and Education

- $\lambda$: College tuition costs (annual, net of grants and subsidies) | $14756\$ | Krueger and Ludwig (2016) |
- $a(j \in [j_h, j_c - 1], co, ch)$: College borrowing limit | $45000\$ | Krueger and Ludwig (2016) |
- $r_p(ch)$: Repayment amount for children who choose college | 0.049 | see section 3.7 |
- $\sigma^h$: Elast of subst b/w human capital and CES inv. aggr. | 1 | Cunha et al. (2010) |
- $\sigma^n$: Elast of subst b/w public inv. and CES aggr. of private inv. | 2.43 | Kotera and Seshadri (2017) |
- $\sigma^m$: Elast of subst b/w monetary and time inv. | 1 | Lee and Seshadri (2019) |
- $\kappa^p$: CES share parameter of monetary and time inv. (age bin 6-8) | 0.5 | normalization |
- $s^p = \tilde{h}^p, j > 0$: Share of government input for ages 6 and older | 0.676 | Kotera and Seshadri (2017) |
- $\Phi(h(j = 0)|s_p, y_p, a_p)$: Innate ability dist-n of children by parental char-s | see main text | PSID CDS I |
- $\theta_0$: Normalization parameter of initial dist-n of initial ability | 0.1248 | PSID CDS I-III |

### Government Policy

- $\xi$: Public CL education subsidy | 38.8% | Krueger and Ludwig (2016) |
- $\tilde{\tau}_j$: Public early education spending by age | $\approx 5000\$ | UNESCO (1999-2005) |
- $\tau_r$: Consumption Tax Rate | 5.0% | legislation |
- $\tau_c$: Capital Income Tax Rate | 20% | legislation |
- $\tau_p$: Soc Sec Payroll Tax | 12.4% | legislation |
- $G/Y$: Government consumption to GDP | 13.8% | current value |

**Notes:** First stage parameters calibrated exogenously by reference to other studies and data.
Table 4: Second Stage Calibration Parameters

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Interpretation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\beta$</td>
<td>Time discount rate (target: asset to income ratio, age 25-60)</td>
<td>0.9808</td>
</tr>
<tr>
<td>$\nu$</td>
<td>Altruism parameter (target: average IVT transfer per child)</td>
<td>0.8380</td>
</tr>
<tr>
<td>$\rho_0(s)$</td>
<td>Normalization parameter (target: $E_\gamma(s, h) = 1$)</td>
<td>$[0.1890, 0.0034, -0.2015]$</td>
</tr>
</tbody>
</table>

**Preferences**

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Interpretation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\kappa$</td>
<td>Utility weight on time inv. (target: average time inv.)</td>
<td>0.7310</td>
</tr>
<tr>
<td>$\kappa^h$</td>
<td>Share of human capital (target: average monetary inv. &amp; slope of time inv.)</td>
<td>cf. Figure 5</td>
</tr>
<tr>
<td>$\kappa^m$</td>
<td>Share of monetary input (target: slope of money inv.)</td>
<td>cf. Figure 5</td>
</tr>
<tr>
<td>$\kappa^g$</td>
<td>Share of government input for age bin 4-6 (target: average time inv. age bin 4-6)</td>
<td>0.4437</td>
</tr>
<tr>
<td>$\bar{A}$</td>
<td>Investment scale parameter (target: average HK at age $j_a$)</td>
<td>1.1989</td>
</tr>
<tr>
<td>$\bar{A}$</td>
<td>Investment scale parameter in HS (target: average HK at age $j_a+1$)</td>
<td>1.0739</td>
</tr>
<tr>
<td>$\phi$</td>
<td>Utility costs $s = hs$ (target: fraction of group $s = hs$)</td>
<td>0.0561</td>
</tr>
<tr>
<td>$\bar{\phi}(s^p = no)$</td>
<td>Utility costs $s = hs$ (target: conditional fraction of group $s = hs$)</td>
<td>1.2120</td>
</tr>
<tr>
<td>$\bar{\phi}(s^p = co)$</td>
<td>Utility costs $s = co$, $s^p = no \land s^p = hs$ (target: fraction of group $s = co$)</td>
<td>0.1707</td>
</tr>
</tbody>
</table>

**Human Capital and Education**

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Interpretation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>$\lambda$</td>
<td>Level parameter of HSV tax function (balance gvt budget)</td>
<td>0.8880</td>
</tr>
<tr>
<td>$p^\rho$</td>
<td>Pension replacement rate (balance socsec budget)</td>
<td>0.1893</td>
</tr>
</tbody>
</table>

Notes: Second stage parameters calibrated endogenously by targeting selected data moments.

for the first 3 years of their biological lives. Parental age at the economic “birth” of children is $j_f = 14$, which we also refer to as “fertility” age. This corresponds to a biological age of 32, when children are of biological age 4.\(^7\) Children make the higher eduction decision at biological age 16, model age $j_a = 6$. Children who complete high school stay in school for one additional model period, thus high school is completed at $j_h = 7$. Children who attend college stay in college for two model periods, thus college is completed at $j_c = 9$. Retirement is at exogenous age $j_r = 31$, corresponding to biological age 66. Households live at most with certainty until age $J = 38$, biological age 80.

### 3.2 Prices and Income Process

We normalize wages to $w = 1$ and set the interest rate to an annual rate of 4% based on Siegel (2002). The calibration of the stochastic wage process based on PSID data involves a standard calibration of the temporary and permanent shock distributions based on GMM estimates, described in detail in Online Appendix Section B.2.

\(^7\)Thus, children are biologically born at parental age 28.
3.3 Preferences

The per period subutility function \( u(x) \) is of the standard iso-elastic power form

\[
    u(x) = \frac{1}{1-\theta} (x^{1-\theta} - 1) .
\]

We assume logarithmic utility \((\theta = 1)\). Thus, equivalence scale parameters are irrelevant for the problem. In the parental household’s problem, the per period subutility function \( v(x) \) is

\[
    v(x) = x^{1+\frac{1}{\phi}}
\]

so that if \( x = \ell \), parameter \( \phi \) can be interpreted as a Frisch elasticity of labor supply. In our model of exogenous labor supply this interpretation of course ceases to be relevant, but it provides us with a direct way of calibrating the power term of the utility function. We set \( \phi = 0.5 \) based on standard estimates of the Frisch elasticity.

When children live in the parental household, we have

\[
    x = \frac{\ell(m)+\kappa \cdot \xi(m,s) \cdot s^i}{1+1_{m=ma}}.
\]

\( \ell(m) \) are hours worked by marital status, which we estimate from the data, giving annual hours of \( \ell(si) = 1868 \) and \( \ell(ma) = 3810 \). The time cost parameter \( \kappa \) is calibrated to match average time investments by parents into the education of children, giving \( \kappa = 0.74 \).

We set the fraction of time working during high school to \( \chi(hs) = 0.2 \), which can be interpreted as a maximum time of work of one day of a regular work week. In college, students may work for longer hours and we accordingly set \( \chi(co) = 0.5 \). When children attend high school or college, they experience utility costs for \( s \in \{hs,co\} \) according to the cost function

\[
    p(s, s^p; h) = \phi(1 + g(s^p)) 1_{j \in [h_h,j_c-1]} 1_{s=co} + \frac{1}{h}
\]

and thus utility costs of obtaining a high-school degree are equal to \( \phi + \frac{1}{h} \), irrespective of parental education, and are thus monotonically decreasing and convex in the acquired human capital \( h \). Psychological costs for obtaining a college degree depend on parental education and are equal to, \( \tilde{\rho}(s^p) + \frac{1}{h} \equiv \phi(1 + g(s^p)) + \frac{1}{h} \). If children choose to drop out of high school, utility costs are zero.

We calibrate the parameters of the cost function to match education shares in the data for the three groups \( s \in \{no,hs,co\} \). We measure these shares for adults older than age 22—which is the labor market entry age of all education groups in the model—and younger than age 38 based on the PSID waves 2011, 2013, 2015 and 2017.\(^8\) Parameter \( \phi \) is calibrated to match the fraction of children without a high school degree of 12.16%, giving \( \phi = 0.06 \). With regard to

\(^8\)Observe that we do not impose that children have the same education shares as parents.
the additional utility costs during the college period we restrict \( \bar{\varrho}(no) = \bar{\varrho}(hs) \) and calibrate it to match the fraction of children with a college degree of 33.21% giving \( \bar{\varrho}(no) = \bar{\varrho}(hs) = 1.21 \). Finally, parameter \( \bar{\varrho}(s^p = co) \) is calibrated to match the fraction of children in college conditional on parents having a college degree of 63.3%, cf. Krueger and Ludwig (2016), giving \( \bar{\varrho}(co) = 0.17 \).

Households discount utility at rate \( \beta \). We follow Busch and Ludwig (2020) and calibrate it to match the assets to income ratio in the PSID for ages 25 to 60 giving \( \beta = 0.98 \) annually.

Utility of future generations is additionally discounted at rate \( \nu \) chosen so that the average per child inter-vivos transfer is 61,200$, as implied by the Rosters and Transfers supplement to the PSID\(^9\) giving \( \nu = 0.84 \).

### 3.4 Initial Distribution of Parents

For the initial distributions of parents at the fertility age, we restrict the sample to parents aged 25-35, leaving us with 3,024 observations.\(^{10}\)

**Marital Status.** Marital status is measured by the legal status of parents. This gives a share of singles of 51.7% and a share of married households of 48.3%.

**Education Categories.** We group the data by years of education of household heads older than age 22. Less than high school, \( s = no \), is for less than 12 years of formal education. High school completion (but no college) is for more than 12 but less than 16 years of education. College is at least 16 years of education. The population shares of parents in the three education categories by their marital status are summarized in columns 2 and 3 of Table 5.\(^{11}\)

**Table 5: Household Shares and Characteristics by Education and Marital Status**

<table>
<thead>
<tr>
<th>Education ( s )/Marital Status</th>
<th>% Fraction of Hhs</th>
<th>No of Children</th>
<th>Lower Asset Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>( s_i )</td>
<td>( s_i )</td>
<td>( s_i )</td>
</tr>
<tr>
<td>( no )</td>
<td>0.2194</td>
<td>0.1621</td>
<td>2.36</td>
</tr>
<tr>
<td>( hs )</td>
<td>0.6064</td>
<td>0.5577</td>
<td>1.86</td>
</tr>
<tr>
<td>( co )</td>
<td>0.1742</td>
<td>0.2802</td>
<td>1.77</td>
</tr>
</tbody>
</table>

*Notes: Columns 2 and 3 show fraction with education \( s \in \{no, hs, co\} \) by marital status. Columns 4 and 5 show number of children, and columns 6 and 7 lower asset limit for parents at model age \( j_f \), expressed in 2010 dollars, by marital status and education.*

\(^9\)This is based on monetary transfers from parents to children until age 26, cf. Daruich (2020).

\(^{10}\)For education, which is not changing much with age, we keep parents aged 22 or above.

\(^{11}\)The educational distribution is consistent with many other studies based on the PSID, cf., e.g., Heathcote et al. (2010).
Demographics. The number of children by marital status and education of parents $\xi(m, s)$ is computed as the average number of children living in households with household heads aged 25-35, cf. columns 4 and 5 of Table 5.

Assets. Conditional on the initial distribution of parents by marital status and education, we measure the distribution of assets according to asset quintiles, which gives the initial distribution $\Phi(a \mid j_f, m, s)$. We set the borrowing constraint of parents as follows. First, we calculate average assets (debt) of the lowest asset quintile at age $j_f$ from the data and set it equal to $a(j_f, m, s, pa)$, the initial debt of parents in the lowest asset quintile in the model. The result is summarized in columns 6 and 7 of Table 5. For all ages $j > j_f$ we then compute the borrowing limit recursively as:

$$a(j, m, s, pa) = a(j - 1, m, s, pa)(1 + r) - rp(m, s, pa)$$

where $rp(m, s, pa)$ is chosen such that the terminal condition $a(j_r, m, s, pa) = 0$ is met.

3.5 Acquired human capital and earnings

The mapping of acquired human capital into earnings for children according to $\gamma(s, h)$ is based on Abbott et al. (2019). We use their data—the NLSY79, which includes both wages and test scores of the Armed Forces Qualification Test (AFQT)—to measure residual wages $\omega(s)$ of education group $s$ (after controlling for an education specific age polynomial) and run the regression

$$\ln(\omega(s)) = \rho_1(s) \cdot \ln\left(\frac{e}{\bar{e}}\right) + v(s),$$

where $v(s)$ is an education group specific error term and $\bar{e}$ are average test scores. The estimated ability gradients $\hat{\rho}_1(s)$ are increasing in education reflecting complementarity between ability and education, cf. Table 17 in Appendix B. In the model, we correspondingly let

$$\ln(\gamma(s, h)) = \rho_0(s) + \hat{\rho}_1(s) \cdot \ln\left(\frac{h}{\bar{h}}\right),$$

where $\bar{h}$ is average acquired human capital at $j = j_a$ (biological age 16) and $\rho_0(s)$ is an education group $s$ specific normalization parameter, chosen such that average $\gamma$'s are equal to one for all education groups.\hspace{1em}\footnote{This gives $\rho_0(s) = 0.19, 0.00, -0.20$, for $s \in \{no, hs, co\}$} This normalization implies that the average education premia are all reflected in $\epsilon(s, j, ma)$, which in turn are directly estimated on PSID data.
3.6 Human Capital Production Function

Innate ability at \( j = 0 \) (initial human capital) \( h = h_0 \) of children is determined conditional on parental characteristics \( s_p, m_p \). At ages \( j_0, \ldots, j_a - 1 \), children then receive parents’ education investments through money and time \( i^m(j), i^t(j) \) and governmental time investments \( i^g \), respectively. Education investments of the government are certain, known by parents, and equal across children. Human capital is acquired given a multi-layer human capital production function

\[
h'(j) = \left( \kappa^h_j h 1 - \frac{1}{\sigma_h} + (1 - \kappa^h_j) i(j) 1 - \frac{1}{\sigma_h} \right) ^ {1 \over 1 - \frac{1}{\sigma_h}} \tag{6a}
\]

\[
 i(j) = \bar{A} \left( \kappa^g_j \left( \frac{i^g(j)}{i^g} \right) 1 - \frac{1}{\sigma_g} + (1 - \kappa^g_j) \left( \frac{i^p(j)}{i^p} \right) 1 - \frac{1}{\sigma_g} \right) ^ {1 \over 1 - \frac{1}{\sigma_g}} \tag{6b}
\]

\[
 i^p(j) = \left( \kappa^m_j \left( \frac{i^m(j)}{i^m,d} \right) 1 - \frac{1}{\sigma_m} + (1 - \kappa^m_j) \left( \frac{i^t(j)}{i^t,d} \right) 1 - \frac{1}{\sigma_m} \right) ^ {1 \over 1 - \frac{1}{\sigma_m}}, \tag{6c}
\]

which partially features age dependent parameters for calibration purposes. We divide the exogenous investments by the government \( i^g \) and the endogenous age dependent per child monetary and time investments by the parents \( i^m(j), i^t(j) \), as well as the CES aggregate of these (normalized) investments, \( i^p(j) \), by their respective unconditional means through which we achieve unit independence (see Cantore and Levine (2012)).

At age \( j_a \) the human capital process is extended to the high school period (i.e., for all children with education \( s = hs \) and \( s = co \)). Time and monetary investments by parents in this phase of the life-cycle are zero, because children have already left the parental household and the human capital production function at \( j = j_a, s \in \{hs, co\} \) is

\[
h'(j) = \bar{A} \left( \kappa^h_6 h 1 - \frac{1}{\sigma_h} + (1 - \kappa^h_6) \left( \frac{i^g(j)}{i^g} \right) 1 - \frac{1}{\sigma_h} \right) ^ {1 \over 1 - \frac{1}{\sigma_h}}. \tag{7}
\]

We view ignoring parental inputs at this age as an approximation reflecting that parental inputs may not be that effective at that age.\(^{13}\) The specification also ignores that children may invest into the human capital formation themselves, which may be of particular relevance for our main experiment of school closures. We thus regard our model of biological age 16 children as a crude approximation and will accordingly not put a key emphasis on those children when discussing our results. However, it is important for parental decisions at younger child ages that parents do

\(^{13}\)It would not be possible in our setup to model parental inputs at that age because children have already left the household.
foresaw that the human capital process for age 16 children continues, which is our main motivation for extending the human capital accumulation process beyond that age.

**Initial human capital.** For calibration of the distribution of initial human capital $h_0(s_p, m_p)$, we recur to the Letter Word test score distribution in the PSID CDS surveys I-III, and match it to parental characteristics by merging the survey waves with the PSID. Table 18 reports the joint distribution of average test scores of the children by parental education and marital status. We base the calibration of the initial ability distribution of children on this data by drawing six different types of children depending on the combination of marital status (2) and parental education (3). Children’s initial human capital is normalized as the test score of that $m^p$, $s^p$-group relative to the average test score. We further scale the resulting number by the calibration parameter $\bar{h}_0$ and, thus, initial human capital of the children is a multiple of $\bar{h}_0$. Parameter $\bar{h}_0$ is calibrated exogenously to match the ratio of mean test scores at ages 3-5 to mean test scores at ages 16-17, which gives $\bar{h}_0 = 0.125$. Initial abilities relative to average abilities and the corresponding multiples of $\bar{h}_0$ for the six types are contained in Table 18 of Appendix B.

**Human capital accumulation process.** The outermost nest (first nest) of the human capital production function augments human capital and total investments. We set $\sigma^h = 1$, and calibrate $\kappa^h_j$ to match (per child) time investments by age of the child. We model age dependency as

$$\ln \left( \frac{1 - \kappa^h_j}{\kappa^h_j} \right) = \alpha^h_0 + \alpha^h_1 \cdot j + \alpha^h_2 \cdot j^2$$

and determine $\alpha^h_1$, $\alpha^h_2$ by an indirect inference approach such that the age patterns of log per child time investments in data and model align for biological ages 6 to 14 of the child. Recall that we in turn match the average level of time investments in this age bin by calibrating the utility cost parameter $\kappa$. Time investments at biological age 4 are matched differently, with details described below. The intercept term $\alpha^h_0$ is calibrated to match average monetary investments. Panel (a) of Figure 5 in Appendix B displays the resulting age profile. Consistent with Cunha et al. (2010), the weight on acquired human capital at age $j$ is increasing in $j$, so that investments

---

14Importantly, by correlating the test score distribution with these parental characteristics, we do not pose a causal link between parental education and children's characteristics. The test scores just give us a convenient way to proxy the initial joint distribution.

15That is approximately the mean value of the parameter for young and old children in Cunha et al. (2010)
become less important in the course of the life-cycle. While our model is not directly comparable to their empirical analysis, also the magnitude of $\kappa^h_j$ is similar.

In the second nest, we set the substitution elasticity $\sigma^g$ between private and government investment to $\sigma^g = 2.43$ estimated by Kotera and Seshadri (2017)—who estimate the parameters of a CES nesting of private and public education investments similar to ours based on US data. Thus, parental and government investments are gross substitutes but substitution across these education inputs is far from perfect. Since this elasticity of substitution is a crucial parameter, we show sensitivity of the results with respect to it in Section 6. We restrict $\kappa^g_j = \bar{\kappa}^g$ for $j > 0$ and calibrate it exogenously again according to the estimates by Kotera and Seshadri (2017), giving $\bar{\kappa}^g = 0.676$. At biological age 4 of the child, children are still in kindergarten, and we separately calibrate $\kappa^g_0$ to match the average time investments by parents into their children at that age. This gives $\kappa^g_0 = 0.44$. $\bar{A}$ is a computational normalization parameter which we choose such that average acquired human capital is equal to 1, sufficiently below the maximum human capital gridpoint, giving $\bar{A} = 1.20$.

The third nest augments the endogenous age specific per child monetary and time investments. As in Lee and Seshadri (2019) we restrict $\sigma^m = 1$. The age dependency of $\kappa^m_j$ is specified as

$$\ln \left( \frac{1 - \kappa^m_j}{\kappa^m_0} \right) = \alpha^m_0 + \alpha^m_1 \cdot j.$$  

We calibrate $\alpha^m_0$ to achieve the normalization $\kappa^m_3 = 0.5$, and $\alpha^m_1$ is calibrated to match the monetary investment profile, which is relatively flat in the data. The resulting age profile of $\kappa^m_j$ is displayed in Panel (b) of Figure 5 in Appendix B. Finally, in the human capital production function of age $j$, we compute $\kappa^h_6$ as a predicted value from the above described regression in (8) and calibrate the additional scaling parameter $\bar{A}$ such that the ratio of average human capital at $j = 6$ to average human capital at age $j = 5$ is equal to the ratio of test scores of ages $16-17$ to age $14-15$ of 1.05. This gives $\bar{A} = 1.07$.

### 3.7 College Tuition Costs & Borrowing Constraint of Children

We base the calibration of college tuition costs and borrowing constraints in college on Krueger and Ludwig (2016). The net price $\iota$ (tuition, fees, room and board net of grants and education subsidies) for one year of college in constant 2005 dollars is 13,213$. In 2008 dollars, the maximum amount of publicly provided students loans per year is given by 11,250$, which is the children’s

---

16Total Investments in our model in the first nest include government investments from the second nest, and we do not distinguish explicitly between cognitive and non-cognitive skills.
borrowing limit in the model for \( s = co \) and \( j \in \{jh, je - 1\} \). For all ages \( j \geq je \) we let

\[
a(j, co, ch) = a(j - 1, co, ch)(1 + r) - rp(ch)
\]

and compute \( rp \) such that the terminal condition \( a(j_r, co, ch) = 0 \) is met.\(^{17}\)

### 3.8 Government

The government side features the budget of the general tax and transfer system and a separate budget of the pension system, all set to mimic the US system. In the general budget the revenue side is represented by consumption, capital income and progressive labor income taxes. Details of the calibration are in Online Appendix Section B.5.

Exogenous government spending (net of spending on education) is set to \( G/Y\% = 13.8\% \). In addition, the government spends on schooling for children and pays the college subsidy for college students. The former we approximate as \( 5000\$ \) per pupil based on UNESCO (1999-2005) data, as for example in Holter (2015). The latter is set to 38.8\% of average gross tuition costs, as in Krueger and Ludwig (2016). Assuming, as in Krueger and Ludwig (2016), that the difference between net and gross tuition costs is due to both a public and a private subsidy with the latter not being explicitly modelled in our setup\(^{18}\) gives an average public subsidy of \( 6,119 \) per student.

### 3.9 Evaluating Non-targeted Predictions of the Model

#### 3.9.1 Time and Resource Investments

Figure 2 shows average time and monetary investments in the model and the data by child age. The good match of the model of time investments in Panel (b) is a consequence of calibration since this is a targeted profile through age dependent parameter \( \kappa_h \) and parameter \( \kappa_0 \). Monetary investments in Panel (a) are slightly downward sloping in the data, and we match the lower slope of monetary investments compared to time investments through the age dependency of \( \kappa_m \).

Figure 3 shows the analogous output by parental education levels, all of which are not targeted in the calibration. The model matches well the positive slope of both types of investment in parental education. Since income and initial wealth of a household is increasing in the household’s education it is perhaps not surprising that more highly educated parents invest significantly more resources in each child, especially since these households have fewer children. The same

\(^{17}\)Note that borrowing is restricted to college-educated children. While in principle they can exhaust their decreasing borrowing limit in all periods of working life, in the model only 4\% of the age group right after finishing college increase their debt from the previous period, and no agent from the older age groups does.

\(^{18}\)The private subsidy is set to 16.6\% of average gross tuition costs as in Krueger and Ludwig (2016).
observation (number of children decreasing in household education) is also responsible for the mildly increasing per-child time investment by parental education (see right panel of Figure 3)

Figure 2: Money and Time Investments by Age of Child

![Money and Time Investments by Age of Child](image)

(a) Money Investments  
(b) Time Investments

Notes: Average money and time investments by children’s biological age in the data (black circles) and model (blue crosses).

Figure 3: Money and Time Investments by Education of Parents

![Money and Time Investments by Education of Parents](image)

(a) Money Investments  
(b) Time Investments

Notes: Average money and time investments by parents’ education in the data (black circles) and model (blue crosses). LHS: less than high school ($s = no$), HS: high school ($s = hs$), CL: college ($s = co$).
3.9.2 Intergenerational Persistence in Education

In our calibration we also do not target directly any measure of inter-generational persistence in education. We measure this persistence by the regression coefficient $\beta_1$ in a regression of the education of a child on parental education, $s = \beta_0 + \beta_1 s^p + \epsilon$. In this regression we form two groups, non-college for $s \in \{\text{no, hs}\}$ and $s^p \in \{\text{no, hs}\}$ and college, for $s = \text{co}$, respectively $s^p = \text{co}$. Standard estimates of inter-generational education persistence according to this metric range from 0.4 to 0.5 and our (non-targeted) coefficient estimate of $\beta_1 = 0.47$ is in that range.\footnote{For example, Hertz et al. (2007) report a regression coefficient for the U.S. of 0.46.}

3.9.3 Evidence on the Long-Run Earnings Impact of School Closures

Our model implies a significant decline of incomes for children affected by the closure of schools. We are not aware of any empirical evidence on the effects of school closures on long-run outcomes of children in the US and therefore resort to the reduced form evidence of Jaume and Willén (2019) on the effects of teacher strikes in Argentina between 1983 and 2014 on long-run economic outcomes of the affected children. Their main estimates refer to the closing of primary schools by half a year, and they report that this leads to a reduction of wages at ages 30-40 by about $2-3\%$. In our model, we consider for our main experiment an exogenous reduction of investments by the government corresponding to a school closure by a year, but in a sensitivity analysis also report results for half year school closures. In that experiment our model predicts an average wage loss at biological ages 30–40 for children who were of biological age 6 in the period of the lockdown of -1.21\%, which is around one half the size of the estimates from Jaume and Willén (2019), for a different country in a different time period.

3.9.4 Time Investment into Children During the Covid-19 Crisis

Finally, our calibration implies that the time investment response of parents in our full experiment—where government education investments $i^g$ are reduced and where parental households are both subject to a negative productivity shock and a negative hours worked shock calibrated as described above—translates to 1.17 hours per day of increased time investments into children during the period of the lockdown of schools.\footnote{We compute this as follows. First, we take the on impact hours responses in the model and compute their average across all children. This gives the average weekly hours increase in our model for a model period. Since each model period spans two years and since this hours response refers to a school lockdown of one year, we multiply the resulting number by 2, which gives the model analogue increase per week for the period of the lockdown. We next divide the resulting number by 7 to compute the increase of hours per day in a week.} This lies well in the range of estimates provided on the basis of real time surveys by Adams-Prassl et al. (2020).
4 Aggregate Consequences of the School Closures

In this section, we start out analyzing the average consequences of the school closures for human capital accumulation, educational attainment, earnings, and ultimately welfare of children. We then describe the optimal parental reactions, analyze their importance in counter-acting the negative effects of the school closures, and their welfare effects for the parents.

4.1 Human Capital Losses, Educational Attainment and Earnings

Table 6: Aggregate Outcomes for Main Experiments

<table>
<thead>
<tr>
<th>baseline</th>
<th>Change for Children of Biological Age</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>average 4 6 8 10 12 14</td>
</tr>
<tr>
<td></td>
<td>change in %p</td>
</tr>
<tr>
<td>share $s = \text{no}$</td>
<td>12.07 1.92 1.66 3.08 2.40 1.85 1.44 1.12</td>
</tr>
<tr>
<td>share $s = \text{hs}$</td>
<td>54.64 0.41 0.10 -0.13 0.35 0.63 0.76 0.78</td>
</tr>
<tr>
<td>share $s = \text{co}$</td>
<td>33.30 -2.34 -1.75 -2.95 -2.74 -2.49 -2.20 -1.89</td>
</tr>
<tr>
<td>change in %</td>
<td>av HK 1.00 -3.32 -2.92 -4.34 -3.85 -3.38 -2.92 -2.48</td>
</tr>
<tr>
<td>PDV gross earn</td>
<td>$846,473 -2.10 -1.82 -2.73 -2.44 -2.15 -1.87 -1.59</td>
</tr>
<tr>
<td>PDV net earn</td>
<td>$696,076 -1.68 -1.45 -2.20 -1.96 -1.72 -1.49 -1.26</td>
</tr>
<tr>
<td>child CEV</td>
<td>0.00 -1.21% -1.09% -1.57% -1.40% -1.23% -1.07% -0.91%</td>
</tr>
</tbody>
</table>

Notes: share $s \in \{\text{no, hs, co}\}$: education share in respective education category $s = \text{no}$: less than high school, $s = \text{hs}$: high school, $s = \text{co}$: college; av HK: average acquired human capital at age 16; PDV gross earn: present discounted value of gross earnings assuming labor market entry at age 22 and retirement at age 66; PDV net earn: present discounted value of net earnings; CEV: consumption equivalent variation. Columns for biological ages 4-14 show the respective percentage point changes of education shares, the percent changes of acquired human capital and average earnings, and the CEV expressed as a percent change, for children of the respective age at the time of the school closures. Column “average” gives the respective average response. The CEV is the consumption equivalent variation of the welfare measure (9).

The lockdown of schools leads to a decline in educational attainment when the children affected by the Covid crisis today make their tertiary education decisions at age 16. As Table 6 (second column) shows, across all age cohorts the share of children that will end up dropping out of high school (i.e., choosing $s = \text{no}$) increases by 1.92 percentage points, and the share of college-educated children will decline by −2.34 percentage points. While these shifts do not appear to be dramatic, they correspond to a 16% increase in the share of children without high school degrees, and a −7% decrease in the share of college educated children.

The reason for the reallocation towards lower final educational attainment is the reduction in the amount of human capital the average child arrives with at age 16, which falls by −3.3%. As
Table 7, first column, demonstrates, in response to the Covid-19 school closures parents increase their private investments into children, both in terms of resources as well as in terms of time. However, as discussed in greater detail below, this reaction is not sufficient to fully compensate the loss of government inputs into human capital production in the form of schooling. Consequently, average human capital at age 16 is lower than without the Covid-19 school closure shock, and the children affected by the shock choose on average lower educational attainment. The lower educational attainment together with the lower human capital in turn imply losses in the average discounted value of gross life-time earnings by \(-2.1\%\), see the 5th row of Table 6. Thus, a transitory shock of closed schools for one year alone leads to a permanent reduction in long-term earnings by more than 2% for the affected children, on average, even after taking optimal parental adjustments into account. In terms of present discounted dollars, this corresponds to an average per-person loss of $17,776 dollars in year 2019 prices.

In order to get a better sense of the magnitude of the future earnings declines, we now discount the present discounted gross earnings losses reported in row 5 of the table, which the children will experience at age 22, to today and aggregate them across all children, using the number of children in the current US population taken from the Human Mortality Database. Relating the resulting aggregate loss to the 2019 US GDP of $21.43 trillion shows that these future earnings losses are equivalent to a loss of \(-3.0\%\) of 2019 US GDP. Thus, the aggregate indirect economic costs caused by the school closures are quite sizeable. The percentage loss in net earnings (after taxes and transfers) is lower \((-1.68\%\), see the 6th row of Table 6). This is due to the progressive labor income tax schedule, which implies that a reduction of gross earnings on average leads to a reduction of tax payments (or an increase in transfers); the mirror image is of course a corresponding reduction in tax receipts by the government.

The remaining columns of Table 6 show that there is considerable heterogeneity in the size of these effects by the age of the child at the time the schooling shock hits.\(^{21}\) Overall, the most severely affected age group are the 6 year old children, i.e., those at the start of primary school. For them, the predicted share of high school dropouts increases by 3.08 percentage points, the share of college educated decreases by \(-2.95\) percentage points, and their average long-term gross earnings drop by \(-2.73\%\), which corresponds to a present discounted earnings loss of $23,109. Younger children are most affected by the school closures due to the self-productivity and the dynamic complementarity implied by the human capital production function: a decrease in human capital accumulation at younger ages due to the school closures translates into lower human capital and lower optimal parental investment in human capital in the future, as we will discuss in greater detail in Section 4.3. Even though the adverse effect of school closures on

\(^{21}\)Children aged 16 have left the parental household in the model and are thus different. We discuss results for them in Appendix C.
human capital accumulation and future educational attainment is most severe for young school children, it is non-negligible even for the cohort of the 14-year olds when the Covid crisis hits. For this age cohort, the predicted share of high school dropouts increases by 1.12 percentage points, the share of college educated decreases by $-1.89$ percentage points, and the present discounted value of their average gross earnings during the rest of life falls by $-1.59\%$, see the last column of Table 6. Note that compared to age 6 year old year children, children of age 4 are more shielded against the negative effect of experiencing closures of day care centers and kindergarten, due to the lower importance of governmental inputs relative to parental inputs in the human capital production function at that age.\textsuperscript{22}

### 4.2 The Welfare Cost of School Closures on Children

We now quantify these welfare losses of the children generation from the Covid schooling shock, based solely on their reduced earnings documented in the previous subsection. We define welfare $W_j$ of children that are of age $j$ at the time of the crisis as average (Utilitarian) expected lifetime utility these children obtain after the education decisions of all members of this group have been made and they have just entered the labor market, i.e. at the college completion age $j_c$,  

$$W_j = \int V (j_c, s, \eta; a, h) \Phi(j_c, ds, d\eta; da, dh \mid j), \quad (9)$$

where $V (j_c, s, \eta; a, h)$ is the value function of children at age $j_c$, i.e. after all education decisions are made (and children with education $s = co$ have completed college). Furthermore, $\Phi(j_c, s, \eta; a, h \mid j)$ is the distribution of children at age $j_c$ over the relevant state variables: education $s$, income realization $\eta$, assets $a$ and human capital $h$. The distribution across these states at age $j_c$ is conditional on age $j$ at which the Covid crisis hits. It is the consequence of the distribution of this cohort at age $j$ just prior to the lockdown, and parental and child education decisions since then. In our partial equilibrium lifecycle model with constant prices and constant government policy parameters, the value function of the children $V (j_c; \cdot)$ upon future post-Covid-19 labor market entry is not affected by the shock (which, at the time of labor market entry at age $j_c > j$, is a shock that lies in the past for all cohorts under consideration). The welfare consequences of Covid school closures are therefore exclusively driven by changes in the distribution $\Phi(\cdot)$. The Covid schooling shock as well as the ensuing parental education investments and child tertiary education choices lead to a different (and typically worse when measured by human capital $h$ and education $s$) cross-sectional distribution of a given cohort $j$ at labor market entry at age $j_c$, relative to the no-Covid-19 scenario.

\textsuperscript{22}Formally, the parameters satisfy $\kappa_0^g < \tilde{\kappa}^g = \bar{\kappa}^g$. 
There are three dimensions along which the cross-sectional distribution for a given cohort deteriorates due to the Covid-19 schooling shock. First, children reach a different human capital position $h$ at age $j_a$ when they split off from the parental household; second, they receive different amounts of inter-vivos transfers from their parents and thus start their working lives with different assets; and third, they make different tertiary education decisions and thus start working life at age $j_c$ with a different education distribution.

To quantify the welfare consequences of the school closures, we compute, for each child cohort $j$, the consumption equivalent variation (CEV) of the Covid-19 schooling shock. That is, we calculate the uniform percentage increase in consumption such that the average labor market entrant of a cohort of age $j$ is indifferent between the welfare consequences arising from the original cross-sectional distribution across states at labor market entry and its Covid-impacted counterpart. As the last row of Table 6 shows, the welfare losses from the closing of schools are quite substantial, with a reduction of welfare as measured by the CEV of $-1.21\%$ on average. Thus, the temporary year-long lockdown of schools has strong long-run welfare consequences for children, worth in the order of $-1.21\%$ of permanent consumption, and this despite the increased human capital investments by parents through home schooling, increased resource investments and increased inter-vivos transfers. For the least affected cohorts, children aged 14 at the time of school closures, the welfare losses are still $-0.91\%$, and for the most affected cohort, children of age 6, welfare losses amount to $-1.57\%$ of consumption. We view these as substantial welfare losses, considering that the school closures are purely temporary shocks, and parents adjust their behavior optimally to counteract the adverse effects on their offspring.

### 4.3 Parental Responses to the School Closures

The previous section painted a fairly dire picture of the long-run outcomes of children impacted by Covid-19 induced school closures. We now document that these effects emerge despite substantial efforts of parents to take mitigating actions. In our model, parents have three principal means by which they can cushion the blow to their children of the Covid-19 induced schooling crisis. They can expand their time investments and their resource investments into the children’s human capital accumulation during the schooling ages, and they can facilitate attending high school and college by providing children with inter-vivos transfers. Table 7 shows that they do all three. For a given age column $j \in \{4, 6, ..., 14\}$, Panel A of Table 7 gives the percent change of investments during the impact period, relative to the pre-Covid-19 scenario. The second column displays the unweighted average, across all children ages, of the age-specific percent changes. Panel B shows the average change across the remaining child years, and therefore takes a longer-term perspective. For example, for children aged 4 during the crisis, Panel B shows the average change
Table 7: Parental Decisions

<table>
<thead>
<tr>
<th>Panel A: In Period of School Closures</th>
<th>Panel B: Averages over Remaining Childhood</th>
</tr>
</thead>
<tbody>
<tr>
<td>baseline $%$-Change for Children of Biological Age</td>
<td>baseline $%$-Change for Children of Biological Age</td>
</tr>
<tr>
<td>average</td>
<td>4</td>
</tr>
<tr>
<td>av mon inv</td>
<td>$1,385$</td>
</tr>
<tr>
<td>av ivt</td>
<td>$61,255$</td>
</tr>
</tbody>
</table>

Notes: Panel A: Columns for biological ages 4-14 show the percent changes of money investments and time investments in the period of the school closures. Panel B: Columns for biological ages 4-14 show the percent changes of money investments, time investments, and inter-vivos transfers for children of the respective age at the time of the school closures. For money and time investments, these are averages of the percent changes of the respective investment over the remaining life-cycle, so, e.g., for a child of age 6 the percent change is the average of the percent changes of investments at ages 6-14 for this child. Column “average” is the raw average across the biological ages of children.

In parental investments from age 4 to 14, while for children aged 14 during the school closure, it captures the change in parental investments only at this age (since it is the last age that the child spends in the household).

On average, parents on impact increase their monetary investments into their children’s education by 35.44\%, their time investment by 16.6\%—which corresponds to about one additional hour per child per day, see footnote 23 above for the relevant transformation—, and their inter-vivos transfers to children, once these children leave the household, by 0.73\%. Thus, overall, parents respond to the school closures with positive and substantial additional investments into their children in all three dimensions, albeit significantly stronger with their direct human capital investments than with their inter-vivos transfers.

As the remaining columns of the table demonstrate, the exact composition of the parental adjustment depends on the age of the child, but is consistently stronger for resource investments (albeit starting from a fairly low level of $1,385 per year per child) than time investment and eventual inter-vivos transfers. Monetary and time parental investments increase the least for 4 year old children, and the most for 14 year old children, with a fairly flat profile between ages 6 and 14. Note that these changes happen against the backdrop of higher pre-Covid investments (especially time investments, see the upper-left panel of Figure 4) for younger children. In absolute terms, changes in time investments are decreasing in the age of the child starting at age 6, but changes in monetary investments are increasing.
Observe that for none of the children ages, parents find it optimal to completely offset the effect of the public school closure on human capital investment during the period of the crisis, since this would compromise their own consumption and lifetime utility too severely. Consequently, all children leave the crisis period with less human capital than they otherwise would have had without the school closures. Due to the dynamic complementarity of human capital and investment, this reduction curbs the incentives for private parental human capital investments in all future periods. This effect is more severe, the longer the human capital accumulation phase during school ages still is, that is, it impacts young children the most. Furthermore, even in the crisis period itself, as Table 7 shows, monetary and time investments increase strongest for older children in percentage terms. For time investments, part of this again comes from the fact that baseline time investment is highest for the youngest children. An additional reason lies in the decreasing importance of investment relative to own human capital in the human capital accumulation process over the child life-cycle: this necessitates stronger investment responses by parents of older children, in percentage terms, to counteract the negative effects of the school closures. Last, parents of young children have on average lower incomes and assets than parents of older children, making it more likely that they are borrowing constrained. Thus, for them it is relatively more attractive to increase future inter-vivos transfers than current resource investments into their children. This mechanism is particularly relevant for asset poor young parents, which constitute the largest fraction of borrowing constrained households in our model.

We display the dynamic adjustments of time- and monetary investments into children that are six years old at the time of the school closures in Figure 4. Panels (a) and (b) depict time- and monetary investments of parents of these children over their life cycle, both in the benchmark no-crisis scenario and in the presence of the school closures. Panel (c) of the same figure shows the resulting evolution of human capital as the child progresses through school ages following the Covid-19 shock, and Panel (d), for better visualization, displays the human capital stock over the life cycle, in deviation of the no-Covid benchmark (and expressed as % of the age 16 pre-Covid human capital level). In the period of the lockdown, at biological age 6, there is a substantial increase in parental investment. Private resource investments rise by 38.1% and time investment by 17.4%. This is not enough, however, to compensate for the 50% decline in government inputs during this two-year period (a year of lost schooling), and thus at biological age 8 human capital is at a slightly lower level than in the no-Covid scenario. In response, future human capital investment incentives are dampened due to the dynamic complementarity feature of the human capital production function. Therefore, both time- and especially resource investments are lower in subsequent periods (at older ages of the child), with the consequence that the child 10 years

\[23\] Note that panels (c) and (d) show human capital at the beginning of the period. Thus, the effect of the Covid-19 shock at age 6 on human capital only shows up at age 8.
Figure 4: Money and Time Investments and Human Capital over Remaining Child Life-Cycle for Children of Age 6

Notes: Average investments for children of age 6 over their (remaining) life-cycle and acquired human capital at respective age. Blue circles: baseline steady state, red crosses: experiment. Panel (a): money investments, panel (b): time investments, panel (c): acquired human capital, panel (d): change of acquired human capital, expressed relative to baseline human capital at age 16. Since these are averages for children of age 6 in the period of the lockdown the initial points at age 4 for investments and at ages 4 and 6 for acquired human capital are identical in the baseline and in the experiment.
after the crisis (at age 16) enters the tertiary education phase with less human capital, therefore opting (on average) for lower educational attainment and the associated reduction in lifetime earnings. However, the widening of the human capital gap shown in Panel (d) of Figure 4 is primarily due to the self-productivity feature of the human capital production function. If in all periods after the lockdown parents were to keep their investments at the (higher) baseline level, the observed human capital gap at age 16 would close by merely 4.6%. Thus, the main driver of the human capital loss at age 16 for children of age 6 at the time of the Covid school closures is the fact that the crisis reduces human capital accumulation on impact (even when partially offset by parental investments) which makes children less effective learners as teenagers and thus results in lower human capital at the age when the tertiary education decision is being made.

In contrast to parental monetary and time investments, inter-vivos transfers increase strongest for the 6 year old children, and then less for older children. Ultimately, parents care about the lifetime utility of their offspring, and not about the means by which they buffer the welfare of children against the adverse schooling shock. Given the dynamic complementarity mechanism explained above, it is relatively more efficient to support younger children more significantly through higher inter-vivos transfers, whereas for older school-aged children, human capital investments are the better option to smooth the Covid schooling shock. Moreover, parents of 6 year old children at the time of school closures are more likely borrowing constrained at that point in time than when the children are 16.

To understand the importance of the reaction of parents to the closure of schools, we analyze the results of a model in which we hold all parental decisions constant. Thus, governmental inputs fall due to the school closures, but parental inputs remain unchanged—both investments into the human capital of their children and their inter-vivos wealth transfers. Results for this experiment on aggregate effects are summarized in Table 8, which should be compared to Table 6.

We observe that the aggregate effects are now larger than in the scenario of school closures and full parental behavioral adjustments. Acquired human capital of children falls now by 4.28% on average instead of 3.32% when parents react optimally. The share of high-school dropouts now increases by 2.60 percentage point instead of 1.92 percentage points when parents re-optimize their decisions. However, the share of college-educated children does not drop by more and in fact decreases by slightly less than when parents react optimally to the school closures, by −2.20 instead of −2.34 percentage points. The reason for a slightly lower drop of the share of college-educated children is the constancy of inter-vivos transfers which induce marginal students to attend college. With re-optimizing parents, inter-vivos transfers would decrease for this group of students because their human capital is lowered from the school closures and thus parents do not find it optimal to transfer wealth to those children. In our main experiment that effect turns out to dominate. The present discounted value of gross earnings now falls by -2.55% rather
than -2.10%, and the CEV associated with the school closures is now on average -1.63% instead of -1.21%. Thus, by optimally adjusting their human capital investments into children as well as inter-vivos transfers, parents mitigate the welfare losses of their children caused by the school closures by more than one fourth. Of course, these adjustments are associated with welfare losses to the parents, as described in Section 4.4.24

Table 8: Aggregate Outcomes under Constant Parental Decisions

<table>
<thead>
<tr>
<th></th>
<th>baseline</th>
<th>Change for Children of Biological Age</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>average</td>
</tr>
<tr>
<td>share ( s = no )</td>
<td></td>
<td>12.07%</td>
</tr>
<tr>
<td>share ( s = hs )</td>
<td></td>
<td>54.64%</td>
</tr>
<tr>
<td>share ( s = co )</td>
<td></td>
<td>33.30%</td>
</tr>
</tbody>
</table>

| change in %p           |          |          |          |          |          |          |          |          |
| av HK                  |          | 1.00     | -4.28   | -3.86   | -5.38   | -4.90   | -4.39   | -3.85   | -3.31   |
| PDV gross earn         | \$846,473| -2.55    | -2.25   | -3.21   | -2.92   | -2.62   | -2.30   | -1.98   |
| PDV net earn           | \$696,076| -2.04    | -1.80   | -2.59   | -2.35   | -2.10   | -1.84   | -1.58   |
| CEV children           |          | -1.63%   | -1.50%  | -2.11%  | -1.87%  | -1.65%  | -1.43%  | -1.22%  |

Notes: This table is the analogue to table 6 where parental money and time investment decisions and inter-vivos transfer decisions are held constant. This is computed by holding parental policy functions constant and by aggregating with a hypothetical distribution of children over human capital computed under constant decisions.

An alternative approach to assess the impact of the parental investments in response to the school closures is to ask by how much parents would have to increase their investments to fully offset the negative effects of the school closures on their children’s human capital. We find that parents would have to increase their monetary investment into the children on average by 315%, from $1385 dollars to $4670 dollars, or alternatively their time investment by 248%, from 25 hours per week to 79 hours per week. Thus, the necessary parental adjustments would be an order of magnitude larger than the optimal adjustments from the parents’ perspective.

4.4 The Welfare Cost of School Closures for Parents

As documented in Table 7, parents react to the closure of schools by increasing monetary and time investments into their children as well as by expanding inter-vivos transfers. To do so, they complement these results by additional decompositions in Appendix C where we hold constant one decision at a time. We show that the on average lower child welfare losses when parents re-optimize their decisions are primarily due to the human capital investment responses, whereas the differences in losses by parental background are mainly driven by the inter-vivos transfer responses.
have to reduce their own consumption and leisure, resulting in a loss to their own lifetime utility. To quantify how these behavioral responses translate into welfare consequences for the parental generation we define welfare of a parent of age \( j \) in the time period of the lockdown as:

\[
W^p_j = \int V(j, s, m, \eta; a, h) \Phi(j, ds, dm, d\eta; da, dh),
\]

(10)

Here \( V(j, \cdot) \) is the parental value function and \( \Phi(j, \cdot) \) is the cross-sectional distribution of parents of age \( j \), predetermined in the period of the lockdown.

Notice that parental utility is reduced through three channels. First, parents increase their monetary and time investments into their children at the expense of own their consumption and leisure. Second, they increase their inter-vivos transfer payments, also at the expense of their own consumption. Third, through the altruistic preferences the value function of parents encodes the value function of their children, which in turn depends on their initial assets and human capital position.

As shown in Table 9, parents on average experience a substantial reduction of their lifetime utilities. The average welfare loss, measured as the CEV of the welfare measure (10) is \(-1.49\%\), which is larger than the average welfare loss for the children generation reported in Table 6. The age pattern of the welfare losses follows that of the age of their children—for parents with children of age 6 and older their CEV-based welfare losses are decreasing in the age of the child. However, the age gradient in the losses is less pronounced than that of the children. This is due to the fact that the dominant force for the welfare effects on parents is the reduction of lifetime utility of their children as well as the increase of the inter-vivos transfer payments, which feature the same age pattern. The welfare effects are not mainly driven by the increase of parental human capital investments through money and time, since this reaction would suggest the opposite age pattern (see Table 7 showing that parental investments increase most for children of age 14).

The second row of Table 9 confirms this argument by showing parental welfare losses under the assumption that the altruism channel is not active, i.e. welfare losses of children do not enter into parental utility (but with parental behavior continuing to be determined as in the benchmark model). In that case, the welfare loss of parents due to the school closures would amount to \(-0.30\%\) rather than \(-1.49\%\), and are fairly uniform across the age of the children. Thus, it is the utility loss of their children which is mainly responsible for the welfare losses of the parents.
Table 9: CEV [in %] for Parents

<table>
<thead>
<tr>
<th>Biological Age of Children in Household</th>
<th>Average</th>
<th>4</th>
<th>6</th>
<th>8</th>
<th>10</th>
<th>12</th>
<th>14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full model</td>
<td>-1.49%</td>
<td>-1.15%</td>
<td>-1.64%</td>
<td>-1.66%</td>
<td>-1.60%</td>
<td>-1.50%</td>
<td>-1.37%</td>
</tr>
<tr>
<td>No Altruism</td>
<td>-0.30%</td>
<td>-0.26%</td>
<td>-0.31%</td>
<td>-0.32%</td>
<td>-0.32%</td>
<td>-0.29%</td>
<td>-0.27%</td>
</tr>
</tbody>
</table>

Notes: Welfare consequences for parents expressed as a consumption equivalent variation (CEV) of welfare measure (10). “Full model”: including the welfare effects from altruism towards children; “No altruism”: altruism switched off.

5 Heterogeneity of the School Closure Effects

5.1 Heterogeneity by Parental Characteristics

The aggregate results presented above mask important heterogeneity in income and welfare losses by parental characteristics. We focus on three dimensions of parental heterogeneity: parental education, net worth and marital status, and summarize the importance of this heterogeneity by the differences in the CEV-based welfare losses derived from (9). The results are in Table 10.

Focusing first on parental education, we observe that the welfare losses, as measured by the CEVs, from the Covid-19-induced school closures are largest (−1.47%) for children whose parents are high school dropouts, and smallest (−0.89%) for children of college-educated parents. Higher parental education and the associated higher parental income partly shield children from the negative impact of the school closures through positive investments and increased inter-vivos transfers by their parents.

In the next two rows of Table 10, we delineate the distribution of the welfare consequences by parental net worth, measured at the time children are born into the adult household. Recall from our description in Section 3 that this cross-sectional wealth distribution in the model is directly estimated from the data. Whereas the differences in the welfare losses between net worth quintiles 2 to 4 are not very pronounced, children of parents in the first wealth quintile experience welfare losses of −1.33%. In contrast, the welfare losses of children in the highest asset quintile amount “only” to −0.98%, respectively. This suggests that low wealth holdings and borrowing constraints of parents are a strong impediment to parents trying to increase their private education resource investments into their children, in response to the reduced governmental investment associated with school closures.

Finally, the last two rows of Table 10 show that the welfare consequences for children from single raising parental households are larger than for children of married couples. The reason for this heterogeneity by marital status is mainly the heterogeneity by education shown in Table 5.
Panel A: Parental Education

<table>
<thead>
<tr>
<th>Education</th>
<th>CEV</th>
</tr>
</thead>
<tbody>
<tr>
<td>(s = \text{no})</td>
<td>-1.47%</td>
</tr>
<tr>
<td>(s = \text{hs})</td>
<td>-1.27%</td>
</tr>
<tr>
<td>(s = \text{co})</td>
<td>-0.89%</td>
</tr>
</tbody>
</table>

Panel B: Parental Assets

<table>
<thead>
<tr>
<th>Asset Quintile</th>
<th>CEV</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>-1.33%</td>
</tr>
<tr>
<td>2</td>
<td>-1.27%</td>
</tr>
<tr>
<td>3</td>
<td>-1.26%</td>
</tr>
<tr>
<td>4</td>
<td>-1.23%</td>
</tr>
<tr>
<td>5</td>
<td>-0.98%</td>
</tr>
</tbody>
</table>

Panel C: Parental Marital Status

<table>
<thead>
<tr>
<th>Marital Status</th>
<th>CEV</th>
</tr>
</thead>
<tbody>
<tr>
<td>(m = \text{si})</td>
<td>-1.48%</td>
</tr>
<tr>
<td>(m = \text{ma})</td>
<td>-0.92%</td>
</tr>
</tbody>
</table>

Notes: Panel A shows the average CEVs (calculated as in 9) of the children aged 4 to 14 when affected by school closures by parental education: less than high school, \(s = \text{hs}\): high school, \(s = \text{co}\): college; Panel B by parental asset quintiles 1 – 5; Panel C by parental marital status: \(m = \text{si}\): single, \(m = \text{ma}\): married.

Moreover, single households have more children per adult household member than married households, making it more difficult for them to increase monetary and time investments into their children in the presence of school closures.

Summarizing, the heterogeneity results imply that the welfare losses for children from the least advantaged households are around 50% larger than for children from the most advantaged households, taking each parental characteristic education, assets, and marital status separately. Yet, these characteristics are correlated in the data. To illustrate the heterogeneity of the welfare effects from school closures depending on parental characteristics most starkly, we now compare the average welfare effects for children coming from households with the least favorable parental characteristics, namely single parents without high school degree and belonging to the poorest asset quintile, with the welfare effects for children coming from households with the most privileged characteristics, namely married parents with a college degree and belonging to the highest asset quintile. As Table 11 shows, for the children from the most disadvantaged families, the welfare effects of school closures lasting twelve months amount to \(-1.63\%)\), while for the children from the most advantaged families they are only \(-0.40\%)\). While these are the results for the two most extreme groups, it is true that the different dimensions of parental characteristics are positively correlated, so the heterogeneity of the welfare effects is large.

We thus far have documented that children of highly educated parents, married parents, and those with substantial net worth, experience lower relative welfare losses. But what is the effect of school closures on measures of intergenerational persistence? In fact, in our experiment with school closures the coefficients in a regression of children’s education on parental education, or children’s log earnings on parental log earnings, slightly go down: from 0.47 to 0.45 in the ed-
Table 11: Losses of Most Disadvantaged and Most Privileged Children

<table>
<thead>
<tr>
<th>Group / Variable</th>
<th>HK</th>
<th>gross earn PDV</th>
<th>net earn PDV</th>
<th>IVT</th>
<th>CEV</th>
<th>Pop Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Most Dis-d</td>
<td>-4.54%</td>
<td>-2.12%</td>
<td>-1.71%</td>
<td>-0.91%</td>
<td>-1.63%</td>
<td>2.63%</td>
</tr>
<tr>
<td>Most Privileged</td>
<td>-2.58%</td>
<td>-1.86%</td>
<td>-1.50%</td>
<td>1.06%</td>
<td>-0.40%</td>
<td>2.60%</td>
</tr>
</tbody>
</table>

Notes: % losses of human capital, PDV of gross earnings, PDV of net earnings and CEV for two extreme groups of children. “Most disadvantaged” are those born into families of single high-school dropout parents with initial assets in the first quintile. “Most privileged” are those born into families of married college educated families with initial assets in the highest quintile. All variables are shown as % changes relative to the respective baseline level. For exposition purposes, inter-vivos transfer responses are expressed as % of the baseline average per child transfer level.

The directional change of inter-generational persistence is ambiguous. On the one hand, we find that less well-off parents increase their absolute monetary investment into children substantially less than better-off parents in reaction to the school closures, which increases persistence. As a result, children of less well-off parents lose unambiguously more in terms of human capital as well as earnings—as Table 12 illustrates.

On the other hand, children of well-off parents have more to lose when it comes to attending college, the major factor determining future earnings, given that their initial college attendance rates are higher. Indeed, we find that college attendance drops by $-3.18\%$ percentage points for children of college-educated parents (whose baseline college attendance rate is 63.58%), but only by $-1.22\%$ percentage points for children of high-school dropouts (whose baseline college attendance rate is a mere 11.00%). This effect decreases intergenerational persistence. Thus, the effects of the school closures on intergenerational education and earnings persistence are ambiguous.

Table 12: Losses by Parental Education

<table>
<thead>
<tr>
<th>Variable /Parental Education</th>
<th>s = no</th>
<th>s = hs</th>
<th>s = co</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Capital</td>
<td>-1.73%</td>
<td>-1.50%</td>
<td>-1.31%</td>
</tr>
<tr>
<td>PDV gross earn</td>
<td>-0.96%</td>
<td>-0.96%</td>
<td>-0.92%</td>
</tr>
<tr>
<td>PDV net earn</td>
<td>-0.76%</td>
<td>-0.77%</td>
<td>-0.74%</td>
</tr>
</tbody>
</table>

Notes: % losses of human capital, PDV of gross earnings and PDV of net earnings by parental education $s = no$: less than high school, $s = hs$: high school, $s = co$: college.

In terms of welfare, however, there is a clear ranking with children from better-off parents suffering smaller welfare losses than children with parents at the lower end of the socio-economic

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25However, the Gini coefficient of gross labor earnings at age 40 increases only very slightly and remains almost unchanged at approximately 0.20.

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distribution. The key to this finding are inter-vivos transfers. Whereas well-to-do parents cannot completely offset the loss of human capital and thus the lower final educational attainment of their children caused by the school closures, they increase the inter-vivos transfers to the children as an additional channel to buffer their welfare losses.  

This in turn explains why the differences in CEVs by parental education in Table 10 are significantly larger than the differences in losses to human capital and earnings documented in Table 12.

5.2 The Impact of Different Lengths of School Closures

In our baseline analysis, we assume school closures of one year. In some regions of the US, schools were however closed for a shorter period of time. Moreover, some degree of online teaching was offered while schools were closed. The literature thus far provides only scant evidence on the effectiveness of online vs. in-person instruction, and thus it is hard to gauge the long-run consequences of online schooling. First results seem to indicate that online learning might on average not be effective at all for elementary school children (Engzell et al., 2021). Moreover, there is evidence that children from disadvantaged households have less access to and/or make less use of digital forms of teaching during the current crisis. Opportunity Insights (Chetty et al., 2020) reports that student participation in online math work decreased immediately for all children at the start of the school closures, but ultimately decreased by 41% for children from low income ZIP codes by the end of the school year compared to January 2020, by 32% for children from middle income ZIP codes, and not at all for children from high income ZIP codes. This pattern continued into 2021. Similarly, Bacher-Hicks et al. (2020) report less use of online learning tools by children from low-income ZIP codes. It is plausible that both the equipment for digital teaching among teachers, as well as the equipment and the provision of quiet learning spaces for students depend on socio-economic characteristics. On the other hand, school closures lasted on average longer in richer areas (Fuchs-Schündeln et al., 2021). Here, we show results for school closures of half a year, accounting for some effectiveness of online teaching.

Table 13 summarizes the results on CEVs showing that the welfare losses are less than half as large if schools are closed half a year rather than a full year. The CEV losses from one year of closed schools is, on average across children, $-1.21\%$, while the welfare loss from a six-month duration of the schooling shock amount “only” to $-0.55\%$. This shows that the welfare effects of school closures are strictly convex in the size of the shock, which is due to the self-productivity of human capital.

Note that the same main results—namely essentially no change in intergenerational persistence, but lower welfare losses for children of well-off parents—hold when the asymmetric income shock is added to the school closures.
Table 13: Welfare Consequences (CEVs) of Prolonged School Closure

<table>
<thead>
<tr>
<th>CEV</th>
<th>6 Month Lockdown</th>
<th>One Year Lockdown</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEV</td>
<td>-0.55%</td>
<td>-1.21%</td>
</tr>
</tbody>
</table>

Notes: Column 1 shows the CEV if schools are closed for six months (the benchmark), column 2 if schools are closed for a whole year.

6 Sensitivity: Elasticity of Substitution between Governmental and Parental Inputs

A crucial parameter for the results is the elasticity of substitution between governmental and parental inputs $\sigma^g$. In the baseline results, we set $\sigma^g = 2.43$ according to Kotera and Seshadri (2017); thus, governmental and parental inputs are substitutes, but far from perfect ones. The higher this elasticity, the easier it is for parents to make up for the losses of their children in human capital accumulation caused by the school closures.

Table 14: Varying Elasticity of Substitution between Governmental and Parental Inputs

<table>
<thead>
<tr>
<th>Variable / Elasticity</th>
<th>$\sigma^g = 2.43$</th>
<th>$\sigma^g = \infty$</th>
<th>$\sigma^g = 1$</th>
</tr>
</thead>
<tbody>
<tr>
<td>change in %p</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>share $s = no$</td>
<td>1.92</td>
<td>1.38</td>
<td>2.40</td>
</tr>
<tr>
<td>share $s = h_s$</td>
<td>0.41</td>
<td>-0.21</td>
<td>1.08</td>
</tr>
<tr>
<td>share $s = co$</td>
<td>-2.34</td>
<td>-1.17</td>
<td>-3.48</td>
</tr>
<tr>
<td>change in %p</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>av HK</td>
<td>-3.32</td>
<td>-1.89</td>
<td>-4.65</td>
</tr>
<tr>
<td>PDV gross earn</td>
<td>-2.10</td>
<td>-1.17</td>
<td>-2.97</td>
</tr>
<tr>
<td>child CEV</td>
<td>-1.21</td>
<td>-0.81</td>
<td>-1.56</td>
</tr>
<tr>
<td>change in %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>av mon inv</td>
<td>14.06</td>
<td>29.39</td>
<td>-1.81</td>
</tr>
<tr>
<td>av time inv</td>
<td>6.73</td>
<td>15.54</td>
<td>-0.85</td>
</tr>
<tr>
<td>av ivt</td>
<td>0.73</td>
<td>-0.49</td>
<td>2.01</td>
</tr>
</tbody>
</table>

Notes: Sensitivity of the baseline results with respect to the elasticity of substitution between governmental and parental inputs. Column 1 repeats the baseline results with $\sigma^g = 2.43$, column 2 assumes perfect substitutability $\sigma^g = \infty$, column 3 assumes a unit elasticity $\sigma^g = 1$. Rows 1-6: Average change in children's outcomes; Rows 7-9: Average change in parental inputs.

Table 14 repeats the baseline results in Column 1, and then shows results under the alternative assumptions of perfect substitutability (Column 2) and unit substitutability (Column 3).\textsuperscript{27} With

\textsuperscript{27}The table shows results without recalibrating the model, but results with recalibration are very similar.
Table 15: Varying Elasticity of Substitution: Child CEV by Parental Education

<table>
<thead>
<tr>
<th>Parental Education /Elasticity</th>
<th>σ⁹ = 2.43</th>
<th>σ⁹ = ∞</th>
<th>σ⁹ = 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEV change in %</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parental Education s = no</td>
<td>-1.47</td>
<td>-1.11</td>
<td>-1.80</td>
</tr>
<tr>
<td>Parental Education s = hs</td>
<td>-1.27</td>
<td>-0.80</td>
<td>-1.66</td>
</tr>
<tr>
<td>Parental Education s = co</td>
<td>-0.89</td>
<td>-0.55</td>
<td>-1.17</td>
</tr>
</tbody>
</table>

Notes: Sensitivity of the baseline results with respect to the elasticity of substitution between governmental and parental inputs. Column 1 repeats the baseline results with σ⁹ = 2.43, column 2 assumes perfect substitutability σ⁹ = inf, column 3 assumes a unit elasticity σ⁹ = 1. Rows 1-3 show the average welfare loss of children by parental education.

perfect substitutability, parents increase their investment into their children over their remaining childhood substantially more than in the baseline calibration: monetary investments increase by almost 30% rather than 14%, and time investment by 15% rather than 7%. As a result of these increased parental investments, the human capital of children on average falls by only −1.9% rather than −3.3%, and the share of college graduates falls by −1.17 percentage points rather than by −3.34 percentage points. Consequently, the PDV of gross lifetime earnings decreases significantly less. Since with this parametrization of the human capital process, parents thus find it easier to compensate their children by investing in human capital they substitute away from inter-vivos transfers. Whereas those increased by 0.7% in our baseline calibration, they fall by −0.5% with the perfect substitutes calibration. Overall, the average welfare effects of the school closures on children are −0.8% compared to −1.21% in our baseline model.

If, on the other hand, there is unit substitutability between governmental and parental investments, i.e. under a Cobb-Douglas aggregation of these inputs, then exactly the opposite results arise. The optimal parental response to the reduced governmental input now involves reduced monetary and time investment into the children, and parents instead increase their inter-vivos transfers by more than in the baseline. The resulting loss in the PDV of gross earnings is substantially larger than in the baseline case (almost −3%), and the welfare losses are also larger than in the baseline, namely −1.56% in terms of the CEV.

While higher substitutability between governmental and parental investments leads to lower average welfare losses, it exacerbates the distributional effects of the school closures. Given that parents optimally react stronger to the closures the higher the elasticity of substitution, the gradient in welfare losses increases with the elasticity of substitution. This becomes apparent in Table 15, which focuses on welfare effects by parental education. While in the baseline calibration the welfare losses of children of high school dropouts are roughly 65% larger than of children of college educated parents, they are 102% larger with an infinite elasticity of substitution.
7 Conclusion

In this paper, we analyze the long-term welfare losses of children caused by school closures in the Covid-19 crisis. We use a partial equilibrium model in which parents differ by marital status, education, income, and assets. The human capital production function of children incorporates governmental inputs through public schooling, as well as monetary and time investments by parents. The Covid-19 crisis is modelled as leading to unexpected school closures of one year. We have three main results. First, school closures lead to substantial reductions in children’s welfare, with a consumption equivalent variation of on average -1.21%. Thus, these temporary measures have substantial permanent effects on the welfare of children. Second, due to self-productivity of human capital, the welfare losses are largest for younger children, and are convex in the length of school closures. Last, there is substantial heterogeneity in the welfare effects, with children of well-off parents fairing better than children of less well-off parents.

Our results present a sign of caution that the Covid-19 induced school closures have significant long-term consequences on the affected children, and reduce especially the welfare of children from disadvantaged households. Note that our model only incorporates the most direct effects of the school closures on children that are caused by reduced public investment into human capital. There potentially exist additional dimensions along which negative long-term consequences are to be expected and which are not incorporated into our model. First, the lack of social contact during the school closures could directly affect children’s welfare, but also their non-cognitive skills and thereby their long-term wages. Second, parents who have to take care of their children during the closures likely experienced increased stress that could affect the well-being of their children, and might induce higher parental risk of job loss or fewer possibilities for career advancement (Alon et al., 2020a), which could induce less investment into children in subsequent years. On the other hand, in our main experiments we model the school closures as a complete loss in schooling, while many schools tried to maintain some form of schooling through distance learning and virtual teaching. Although these measures might have reduced the long-term impact of the school closures, they have possibly exacerbated their distributional consequences.

Another factor contributing to potentially larger distributional consequences of the school closures is the fact that private schools, which children from well-off households are more likely to attend, were closed for shorter periods of time than public schools (for empirical evidence on the heterogeneity in school closure lengths, see Fuchs-Schündeln et al. (2021)). Also, working from home was positively correlated with socio-economic characteristics during the crisis (see, e.g., Bick
et al. (2021), which might have put richer parents in an advantage in the home-schooling of their children.\textsuperscript{28}

We model the impact of the Covid-19 crisis on children as coming exclusively from the school closures. The health crisis was however accompanied by an economic crisis. In the working paper version of this paper (Fuchs-Schündeln et al., 2020), we also show results incorporating the economic crisis, modelled as a short-lived income drop with two characteristics: first, it comes mostly through a reduction in hours worked and thus leads to an increase in the parental time that can potentially be devoted to children; and secondly, it is larger for less educated parents, given the larger rise in unemployment rates for this demographic group. Our main finding is that, from the children’s perspective, the welfare losses coming from the school closures are substantially larger than the welfare losses from the economic crisis. This is a very robust result, which also holds if the fall in income is not associated with a fall in hours worked. The actual modelling of the economic crisis related to Covid-19 is however debatable: despite an initial rise in unemployment rates and drop in GDP, disposable incomes in the US did on average not fall during the crisis due to substantial governmental support. Still, there could be long-term scarring effects coming from the initial job losses that negatively affect disposable incomes in the medium-run (see e.g. Ruhm (1991)) and could lead to decreased parental investment into children. Also, to the extent that households are Ricardian decision makers, they anticipate that debt financed support payments during the crisis will likely have to be financed by higher taxes in the future, which affects the human capital investment decisions of parental households and the higher education decision of children. Modeling this dynamic trade-off requires a general equilibrium environment with government debt and a clearing of the government budget. We leave such extensions for future research.

We conclude that school and child care closures should be considered as a potentially very costly policy measure to avoid the spread of the Corona virus. However, we want to clearly acknowledge that we have not modelled the potential health benefits of these closures as this would require an explicit model that links disease transmission to school activity. We hope to have provided an informative model of the cost side.

\textsuperscript{28}While we focus on the effects on children, Alon et al. (2020b) find that the school closures negatively affect gender equality.
References


A Model Appendix

A.1 Retirement Value Functions

The retirement consumption-saving problem solved by the children generation, at age \( \{j_r,...,J\}\), is given by

\[
V(j, s, \eta; a) = \max_{c,a'} \{ u(c) + \beta V(j + 1, s, \eta; a') \}
\]

subject to

\[
a' + c(1 + \tau^c) = a(1 + r(1 - \tau^k)) + y - T(y)
\]
\[
y = \text{pen}(s, si, \eta_{j_r-1}, h)
\]
\[
a' \geq 0
\]
\[
\eta = \eta_{j_r-1},
\]

where \( \text{pen}(s, si, \eta_{j_r-1}, h) \) is retirement income, whose dependence on \( \eta_{j_r-1}, s \) and \( h \) serves to proxy for the progressive nature of the social security system.

A.2 Working Life Value Functions

During working ages \( j \in \{j_a + j_f + 1, ..., j_r - 1\}\), the dynamic program solved by the parental generation is similar to that faced by children in the main text, and given by

\[
V(j, s, m, \eta, \epsilon, a) = \max_{c,a'} \left\{ u \left( \frac{c}{1 + \frac{1}{m=ma} \zeta_a} \right) - v \left( \frac{\ell(m)}{1 + \frac{1}{m=ma}} \right) + \beta \sum_{\eta'} \pi(\eta'|\eta) \sum_{\epsilon'} \psi(\epsilon') V(j + 1, s, m, \eta', \epsilon', a') \right\}
\]

subject to

\[
a' + c(1 + \tau^c) = a(1 + r(1 - \tau^k)) + y(1 - \tau^p) - T(y(1 - \tau^p))
\]
\[
y = w_\epsilon(s, j, m) \eta \zeta(\epsilon)
\]
\[
a' \geq 0.
\]
B Calibration Appendix

B.1 Data

In the first stage of calibration we use PSID data to estimate the deterministic age wage profiles and to construct the initial distribution of parents. Furthermore, we use NSLY79 data to estimate education-specific human capital gradients of the non-age related wage component. Finally, in the second stage of the calibration we use the Child Development Supplement (CDS) of the PSID, surveys I-III, to obtain empirical moments related to the child human capital and parental investments into children.

**PSID.** The initial distribution of parents by marital status, education, number of children and assets is constructed based on the four most recent PSID waves: 2011, 2013, 2015 and 2017. We use the PSID family files and keep only parents in the sample (i.e., only observations where children are present in the household). We keep only observations with positive hours and labor income of the household head. This leaves us with 7591 observations. Labor earnings and wealth are inflated to 2010 dollars using the CPI. Deterministic age wage profiles are estimated using a PSID sample from 1967 to 2013 based on observations from both households with and without children.

**PSID CDS.** To obtain child related statistics by parental characteristics, we merge the CDS data files with the PSID family files of the respective waves. As children of married couples, we consider children for whom both caregivers correspond to the household head and the spouse in a PSID household, and for whom at least one of the caregivers is the biological parent. This leaves us with 4393 observations (2419 children) for the three waves of the survey.

**NLSY79.** We use the NLSY79 dataset provided in the replication files of Abbott et al. (2019). Following their approach, we approximate adult human capital by the test scores taken from the Armed Forces Qualification Test AFQT89.

B.2 Productivity

**Productivity Process.** We use PSID data to regress by education of the household head log wages measured at the household level on a cubic in age of the household head, time dummies, family size, a dummy for marital status, and person fixed effects. Predicting the age polynomial (and shifting it by marital status) gives our estimates of $\epsilon(m, s, j)$. We next compute log residuals.

\[ \text{In case of singles, only the household head is the primary caregiver.} \]
and estimate moments of the earnings process by GMM and pool those across education categories and marital status.\footnote{We thank Zhao Jin for sharing her code with us.} We assume a standard process of the log residuals according to a persistent and transitory shock specification, i.e., we decompose log residual wages \( \ln(y_t) \) as

\[
\ln(y_t) = \ln(z_t) + \ln(\varepsilon_t)
\]

\[
\ln(z_t) = \rho \ln(z_{t-1}) + \ln(\nu_t)
\]

where \( \varepsilon_t \sim_{i.i.d} \mathcal{D}_\varepsilon(0, \sigma_\varepsilon^2) \), \( \nu_t \sim_{i.i.d} \mathcal{D}_\nu(0, \sigma_\nu^2) \) for density functions \( \mathcal{D} \), and estimate this process pooled across education and marital status. To approximate the persistent component in our model, we translate it into a 2-state Markov process targeting the conditional variance of \( z_t \), conditional on \( z_{t-2} \), \((1 + \rho^2)\sigma_\nu^2\) (accounting for the two year frequency of the model). We draw initial income shocks assuming independence of the asset position according to the stationary invariant distribution of the 2-state Markov process, thus \( \Pi(\eta_l) = 0.5 \). The transitory component is in turn approximated in the model by two realizations with equal probability with the spread chosen to match the respective variance \( \sigma_\varepsilon^2 \). The estimates and the moments of the approximation are reported in Table 16.

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Estimate</th>
<th>( \rho )</th>
<th>( \sigma_\nu^2 )</th>
<th>( \sigma_\varepsilon^2 )</th>
</tr>
</thead>
<tbody>
<tr>
<td>Log Pay</td>
<td>0.9559</td>
<td>0.0168</td>
<td>0.0566</td>
<td></td>
</tr>
<tr>
<td>Notes:</td>
<td></td>
<td>Estimated moments of residual log wage process.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### B.3 Ability Gradient

Table 17 reports the estimated ability gradient \( \hat{\rho}_1(s) \), using NLSY79 as provided in replication files of Abbott et al. (2019).

### B.4 Human Capital Production Function

Table 18 contains the estimated initial ability of children.

Age-specific weight parameters \( \kappa_{ij}^b \) and \( \kappa_{ij}^m \) which are calibrated endogenously to match time and money investment profiles are shown in Figure 5.
Table 17: Ability Gradient by Education Level

<table>
<thead>
<tr>
<th>Education Level</th>
<th>Ability Gradient</th>
</tr>
</thead>
<tbody>
<tr>
<td>HS-</td>
<td>0.351 (0.0407)</td>
</tr>
<tr>
<td>(HS &amp; CL-)</td>
<td>0.564 (0.0233)</td>
</tr>
<tr>
<td>(CL &amp; CL+)</td>
<td>0.793 (0.0731)</td>
</tr>
</tbody>
</table>

Notes: Standard errors in parentheses.

Table 18: Initial Ability by Parental Education

<table>
<thead>
<tr>
<th>Marital Status and Educ of HH Head</th>
<th>Avg. Score</th>
<th>Fraction of $\bar{h}_0$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single Low</td>
<td>35</td>
<td>0.843</td>
</tr>
<tr>
<td>Single Medium</td>
<td>38</td>
<td>0.906</td>
</tr>
<tr>
<td>Single High</td>
<td>46</td>
<td>1.107</td>
</tr>
<tr>
<td>Married Low</td>
<td>39</td>
<td>0.945</td>
</tr>
<tr>
<td>Married Medium</td>
<td>41</td>
<td>0.984</td>
</tr>
<tr>
<td>Married High</td>
<td>45</td>
<td>1.085</td>
</tr>
</tbody>
</table>

Notes: Based on the letter word test of the Child Development Supplement Surveys 1-3 (years 1997, 2002, 2007) of the PSID.

Figure 5: Age Dependent Parameters $\kappa^{h}_{j}$, $\kappa^{m}_{j}$ over Child Age

B.5 Government

The consumption tax rate is set to $\tau_c = 5\%$ based on Mendoza et al. (1994), and the capital income tax rate to $\tau_k = 20\%$, which is the current statutory capital income tax rate on long-term capital gains (assets held longer than a year) for households in the highest income tax bracket.
The labor income tax code is approximated by the following two-parameter function, as in, e.g., Benabou (2002) and Heathcote et al. (2017):

\[ T(y) = y - \lambda y^{1-\tau}, \]

where \( \tau \) is the progressivity parameter and \( \lambda \) determines the average tax rate. We set \( \tau = 0.18 \) as suggested by estimates of Heathcote et al. (2017) and calibrate \( \lambda \) endogenously to close the government budget, giving \( \lambda = 0.89 \).

As for the pension system, the payroll tax \( \tau^p \) is set to the current legislative level of 12.4% and the pension benefit level relating average pension benefits to average net wages is endogenously chosen such that the benefits of the parent generation equal their contributions, giving a replacement benefit level of \( \rho^p = 0.19 \).

C Results Appendix

C.1 CEV by Parental Education and Marital Status

Table 19: Welfare Consequences (CEVs) by Parental Education: Single Parents

<table>
<thead>
<tr>
<th>Parental Education</th>
<th>s = no</th>
<th>s = hs</th>
<th>s = co</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEV</td>
<td>-1.63%</td>
<td>-1.50%</td>
<td>-1.24%</td>
</tr>
</tbody>
</table>

Notes: CEV: consumption equivalent variation of the welfare measure 9 by parental education \( s = no \): less than high school, \( s = hs \): high school, \( s = co \): college.

Table 20: Welfare Consequences (CEVs) by Parental Education: Married Parents

<table>
<thead>
<tr>
<th>Parental Education</th>
<th>s = no</th>
<th>s = hs</th>
<th>s = co</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEV</td>
<td>-1.30%</td>
<td>-1.01%</td>
<td>-0.51%</td>
</tr>
</tbody>
</table>

Notes: CEV: consumption equivalent variation of the welfare measure 9 by parental education \( s = no \): less than high school, \( s = hs \): high school, \( s = co \): college.
Table 21: % Changes of Inter-Vivos Transfers by Parental Education and Marital Status

<table>
<thead>
<tr>
<th>Marital Status/Parental Education</th>
<th>s = no</th>
<th>s = hs</th>
<th>s = co</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single</td>
<td>-1.45%</td>
<td>-3.06%</td>
<td>0.19%</td>
</tr>
<tr>
<td>Married</td>
<td>-2.30%</td>
<td>0.85%</td>
<td>1.50%</td>
</tr>
</tbody>
</table>

Notes: Percent changes of inter-vivos transfers by parental education $s = no$: less than high school, $s = hs$: high school, $s = co$: college.

C.2 Responses of Inter-Vivos Transfers

C.3 Children of Age 16

Children aged 16 have just left the parental household in the model. Therefore, by assumption their parents no longer invest in these children’s human capital. Thus, the only margin of adjustment through which parents can buffer the negative shock of the school closures for children at that age are inter-vivos transfers. At the same time, 16 year old children cannot themselves adjust their investment into their human capital. These two features make children of age 16 quite different from the younger children in the model.

As Table 22 shows, we consequently find that the present discounted value of gross earnings of children aged 16 decreases by $-0.62\%$. The associated welfare losses for children of age 16 are $-0.36\%$. Observe that children of age 16 incur smaller welfare losses than children of age 14 or 12 despite earnings losses of a similar magnitude. This is due to the fact that parents of age 16 children increase their inter-vivos transfers by considerably more than for the two younger cohorts, since this is the only way to shield these teenagers from the negative impact of the Covid shock.

Table 22: Effects on Children of Age 16

<table>
<thead>
<tr>
<th>av ivt</th>
<th>HK age 18</th>
<th>PDV gross earn</th>
<th>CEV [in %]</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.34</td>
<td>-2.86</td>
<td>-1.51</td>
<td>-0.92</td>
</tr>
</tbody>
</table>

Notes: Effects on age 16 children. Percent changes for inter-vivo transfers (ivt), acquired human capital at age 18, average earnings and the consumption equivalent variation of the welfare measure, cf. equation (9).

C.4 Decomposition of CEV

According to (9) the welfare of children of a given age is affected by changes of the distribution along assets, human capital and the resulting endogenous education decision of the children.
Table 23 decomposes the CEV into these various components by subsequently switching off model elements.

As a first step we hold constant inter-vivos transfers. Consequentially, the cross-sectional asset distribution at age $j_c > j$ is not influenced by this element and the education decision of children is altered. Comparison between column 1 (which is the full model) and column 2 shows that the inter-vivos transfers play a crucial role in the model for the heterogeneity in losses by parental background.

We subsequently hold constant money and time investments by parents, with results shown in column 3 of the table. Relative to the previous experiment this increases the level of the welfare losses for all groups whereas the gradient across groups in terms of the percentage point differences in the CEV is unaltered.

Finally, for the results shown in column 4 of the table, we also hold constant the education decision of children. With this additional adjustment mechanism switched off the level of the CEV decreases further but differentially across groups so that the education gradient decreases. In this last experiment, welfare differences across groups arise from differences in the fixed effects in earnings $\gamma(s, h)$ only. Overall, this decomposition analysis shows that the main drivers for the heterogeneity of welfare consequences among children are the parental inter-vivos transfer responses and the re-optimization of children through their education decisions.

### Table 23: CEV Decomposition for Schools Lockdown Experiment

<table>
<thead>
<tr>
<th></th>
<th>full model</th>
<th>ivt const</th>
<th>ivt, inv const</th>
<th>ivt, inv, edu const</th>
</tr>
</thead>
<tbody>
<tr>
<td>$s = no$</td>
<td>-1.47%</td>
<td>-1.41%</td>
<td>-1.80%</td>
<td>tbc%</td>
</tr>
<tr>
<td>$s = hs$</td>
<td>-1.27%</td>
<td>-1.26%</td>
<td>-1.66%</td>
<td>tbc%</td>
</tr>
<tr>
<td>$s = co$</td>
<td>-0.89%</td>
<td>-1.06%</td>
<td>-1.43%</td>
<td>tbc%</td>
</tr>
</tbody>
</table>

Notes: Decomposition of the CEV of welfare function 9. ivt const: inter-vivos transfers are held constant; ivt, inv const: additionally, parental investments through money and time are held constant; ivt, inv const, edu const: additionally, education decisions are held constant.