

## **Reallocation, Selection, and the Sources of Earnings Growth in Cities**

R. Jason Faberman, Federal Reserve Bank of Philadelphia  
Matthew Freedman, ILR School, Cornell University\*

August 2009

### **Abstract**

Recent research has explored the interaction of urban agglomeration with dynamic processes such as worker sorting and firm selection. To quantify the importance of these processes relative to potential location-specific benefits that occur purely within establishments, we explore their contribution to the variation in earnings growth across metropolitan areas. We use a decomposition methodology from the industrial organization literature often used to quantify the sources of productivity growth within an industry. The methodology allows us to quantify the importance of earnings growth that occurs purely within establishments relative to growth that results from compositional changes in accounting for variations in aggregate earnings growth across cities. We use a panel of administrative data of all establishments within U.S. metropolitan areas. Preliminary evidence suggests that worker reallocation and the selection out of low-growth establishments accounts for a sizeable portion of earnings growth within a metropolitan area, but variations across areas are mostly due to differences within establishments and relative growth differences of their entrants.

\*Faberman: Jason.Faberman@phil.frb.org, Research Department, Ten Independence Mall, Philadelphia, PA, 19106. Freedman: mf439@cornell.edu, 359 Ives Hall, Ithaca, New York 14853. Any opinions and conclusions expressed herein are those of the authors and do not necessarily represent the views of the U.S. Census Bureau, the Federal Reserve Bank of Philadelphia, or the Federal Reserve System. All results have been reviewed to ensure that no confidential information is disclosed.