SUMMARY SHEET

Income Inequality, Equality of Opportunity, and Intergenerational Mobility[*]
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Key Points

Descriptive, US, comparison across countries and time

Goal: To explain (1) why America differs from other countries, (2) how intergenerational mobility will change in an era of higher inequality, and (3) how the process is different for the top 1 percent.

1. The **interaction between families, labor markets, and public policies** structure a child's opportunities and determine the extent to which adult earnings are related to family background (the degree of intergenerational earnings mobility).

2. These drivers are most likely to **lower the degree of intergenerational earnings mobility** for the next generation of Americans in a more polarized labor market.

3. Intergenerational mobility is also lower in the US because children of **top-earning** parents are more likely to become top earners in their turn.

1 The Great Gatsby Curve (Descriptive)

1.1 Intergenerational elasticity

The Great Gatsby Curve: a relationship showing that countries with more inequality at one point in time also experience less earnings mobility across the generations (see Figure 1[1]).

Intergenerational elasticity:

$$lnY_{i,t} = \alpha + \beta lnY_{i,t-1} + \epsilon_i$$

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[1]x-axis: rank of income inequality measured by Gini coefficient; y-axis: rank of intergenerational mobility measured by intergenerational earnings elasticity (β)

Y: permanent earnings for individuals from family i

α: the trend in average incomes across generations

β: intergenerational earnings elasticity, higher β indicates higher intergenerational transmission/lower intergenerational mobility.

Figure 1

The Great Gatsby Curve: More Inequality is Associated with Less Mobility across the Generations
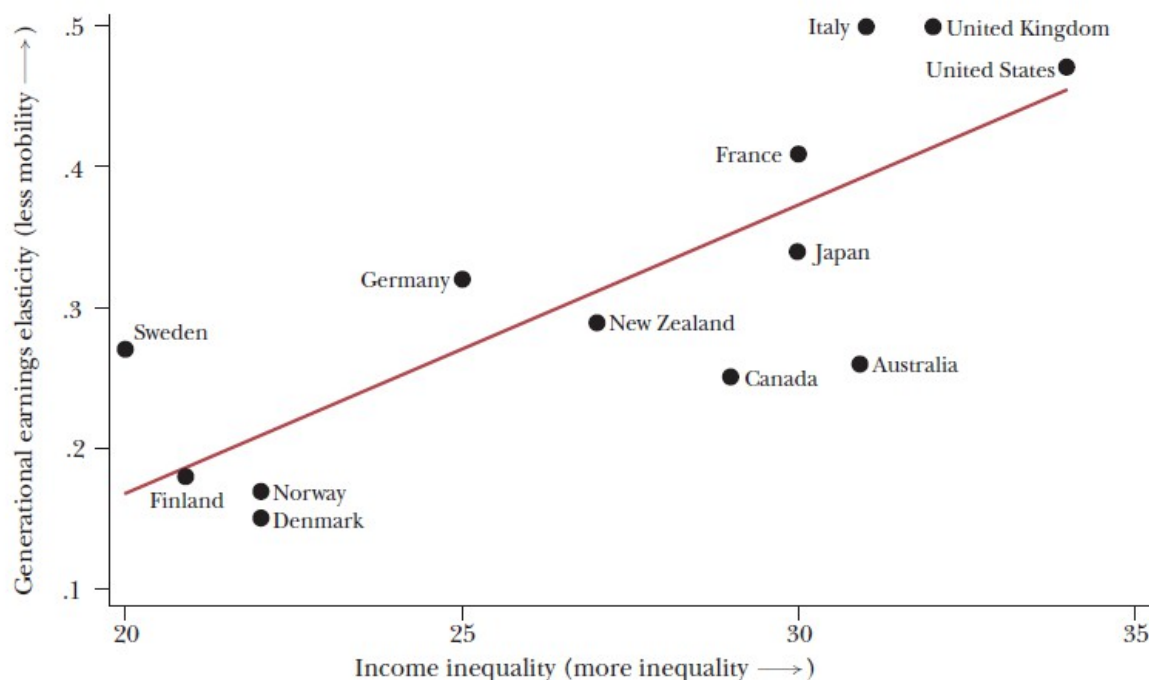
1.2 Decile transition matrices

The Great Gatsby Curve can be understood to be signaling, rather than directly measuring, a negative relationship between inequality and equality of opportunity.

See Figure 2.

The American intergenerational earnings elasticity, at about 0.5, is twice as high as the Canadian, and this has little to do with the degree of mobility of children raised by families in broad swaths of the middle part of the distribution. **It is at the extremes of the distribution that the two countries differ.**

2 Discussion of Causality

2.1 Mechanisms

Socioeconomic status influences a childs health and aptitudes in the early years $\rightarrow$ influences early cognitive and social development, and readiness to learn $\rightarrow$ influence success in

primary school, which feeds into success in high school and college → family resources and connections affect access to good schools and jobs, and the degree of inequality in labor markets determines both the resources parents have and ultimately the return to the education children receive → shapes earnings in adulthood.

The Great Gatsby Curve is a summary of all of these underlying gradients. The reasons for the differences in the intergenerational elasticity across countries have to do with the different balances struck between the influence of **families**, **the labor market**, and **public policy** in determining the life chances of children.

2.2   Framework for discussion of causality

Model: Becker and Tomes (1986, 1979). Adaptation for making comparisons across countries and over time: Solon (2004).

2.2.1   The heritability of traits

If the traits[2] are strongly transmitted across generations, and if they are valued by labor markets over time, then there will be an intergenerational association of incomes.

If there is **significant demographic diversity** across countries then we should not be surprised that there is an upward slope to the Great Gatsby Curve even if all societies are equally meritocratic.

2.2.2   Return to human capital and Investment in human capital

Across countries and over time evidence: the higher the return to college education, the lower the intergenerational mobility.

It differentially changes **both opportunities and incentives** for families to invest in their children. Families with more human capital invest more in their children.

Monetary investments   See Figure 6. Family income & family culture.

Nonmonetary capacities   Family environment (the age of the mother, the education of the mother, the incidence of living with both biological parents, as well as the incidence of living in a single parent household).

Labor market connections   See Figure 7. The intergenerational transmission of employers.

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[2]Becker and Tomes (1979, p. 1158) refer to these as endowments of capital that are determined by the reputation and connections of their families, the contribution to the ability, race, and other characteristics of children from the genetic constitutions of their families, and the learning, skills, goals, and other family commodities acquired through belonging to a particular family culture.

2.2.3   Public policy

Public policy can affect (1) the investments made in children across the entire income distribution and (2) how families interact with labor markets.

Public spending directed to high-quality **early childhood education and to primary and secondary schooling** accessible for all is likely to be of relatively more benefit to families lower in the socioeconomic scale than if it were directed to high-quality **private tertiary education** accessible to only a few.

Example: education system   US: higher education as a priority, less spending on students from disadvantaged backgrounds.

Example: Public regulations and provision of goods associated with human capital   Canada: more flexibility in making childcare and work arrangements (paid parental leave, income tax system, full-time kindergarten)
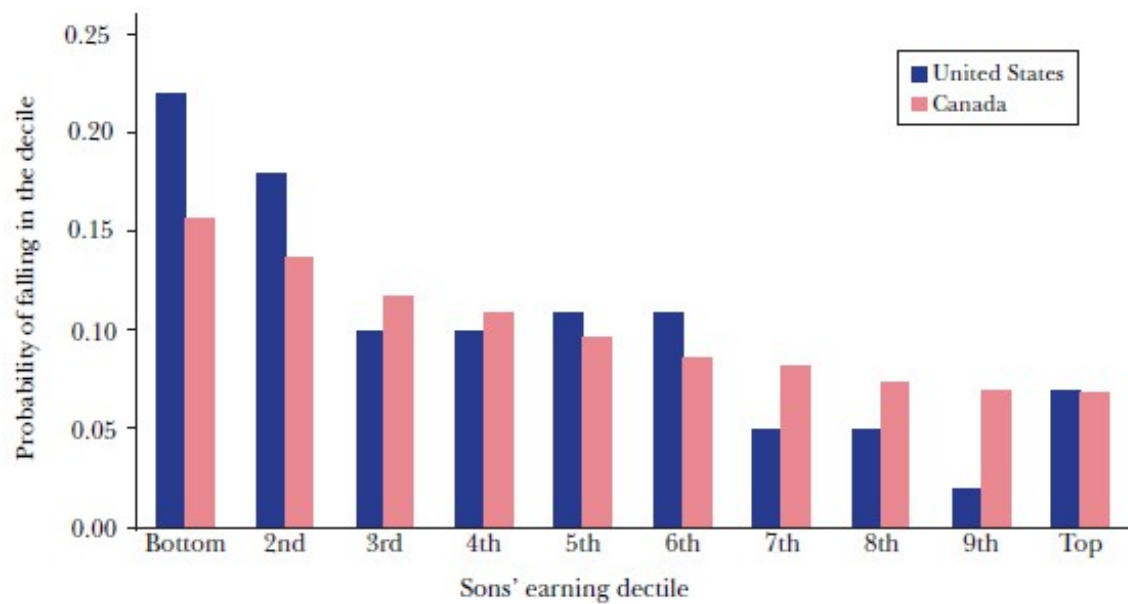
Figure 2

Earnings Deciles of Sons Born to Top Decile Fathers: United States and Canada
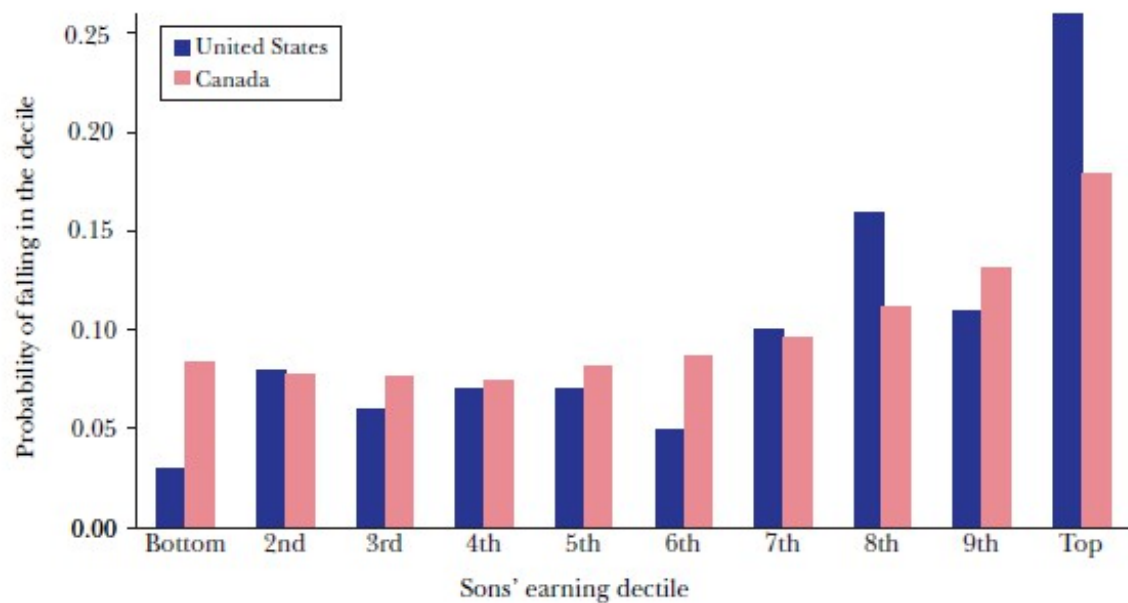
Source: Corak and Heisz (1999, table 6); Mazumder (2005, table 2.2).

Figure 3

Earnings Deciles of Sons Born to Bottom Decile Fathers: United States and Canada

Source: Corak and Heisz (1999, table 6); Mazumder (2005, table 2.2).