What is the source of the intergenerational correlation in earnings?

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Parental earnings tend to be correlated with offspring earnings.

Many studies: intergenerational earnings correlation in the US: 0.3-0.8.

Not nearly as many studies that aim to understand the causal mechanisms behind the persistence.
What does this paper do?

- This paper is one of the few papers to attempt this:

- Q: What are the causes of intergenerational persistence in earnings?

- This is important especially if we want to understand what fraction of the persistence in earnings can be 'corrected' by policy vs is inevitable.
Model

- Life-cycle model with intergenerational links through altruism.
- People are born at age 25 with a "type" = (education, skill, race, gender).
- Immediately, matched with a spouse via assortative matching.
- Each period they make joint, discrete decisions on fertility, labor supply, and time investment in offspring.
- Wage is a function of type, age, and experience.
Model

- A fraction of family income goes to monetary investment in children exogenously.

- Rest goes to family consumption: no borrowing or saving (bequests).

- An offspring’s type (skill and education) is determined stochastically as a function of:
  - parental type,
  - time and monetary investments they receive,
  - number and timing of siblings.

- They estimate this model using 2 generations from PSID.
Results

- Model fit:

Table: Benchmark Calibration Procedure

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Data</th>
<th>Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fathers and sons</td>
<td>0.356</td>
<td>0.266</td>
</tr>
<tr>
<td>F and S (family earnings)</td>
<td>0.337</td>
<td>0.251</td>
</tr>
<tr>
<td>Mothers and daughters</td>
<td>-0.032</td>
<td>0.204</td>
</tr>
<tr>
<td>M and D (family earnings)</td>
<td>0.286</td>
<td>0.222</td>
</tr>
</tbody>
</table>

Average earnings between 30-40.
Causes of intergenerational earnings persistence:

- Decompose the contributions of various channels to intergenerational persistence:
  - Assortative mating,
  - Age profile of earnings,
  - Effect of experience on earnings,
  - Non-linear returns to labor supply,
  - Dependence of monetary cost on parental education.
The current decomposition exercise is not very policy relevant.

Decomposition exercises that aim to understand what fraction of persistence is inevitable would be valuable:

1. Force all parents to make identical monetary investment.
2. Force all parents to make identical monetary and time investments.

Adding policy to the model: monetary transfers or Head Start.
Other comments

- What if household decision making occurred via bargaining?

- Period discount factor is estimated to be 0.81. Too low if model period is a year.

- All siblings become adults at the same time in the model. That may have strange implications for when couples have children in the model. Is that true?

- Intergenerational transfers other than human capital investments are not allowed. This might overestimate the importance of human capital channel.