EconoFact Chats: How Much Does Income Change From One Generation to the Next?
Steven Durlauf, University of Chicago
Published on 18th June 2023

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I'm Michael Klein, executive editor of Econofact, a non-partisan web-based publication of the Fletcher School at Tufts University. At Econofact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein
America bills itself as the land of opportunity. With enough intelligence, pluck and grit, anyone can get ahead. But without these qualities, you may fall behind. This would imply a lot of intergenerational mobility. Your lot in life is not necessarily tied to that of your parents. Casual observation, however, suggests that this is not the fact. Children of the poor seem more likely to themselves be poor when they grow up, and rich adults seem likely to have grown up in rich homes. Is this casual observation correct? And if so, what explains social mobility or its lack? To address this question, I'm pleased to welcome to Econofact Chats Professor Steven Durlauf of the Harris School of Public Policy at the University of Chicago. Steven is the Director of the Stone Center for Research on Wealth Inequality and Mobility at the University. He's published extensively on the issue of intergenerational mobility. Steven, thanks for joining me on Econofact Chats.

Steven Durlauf
Well, thank you, Michael, for the invitation. I'm very much looking forward to talking.

Michael Klein
Steven, in 1987 the University of Chicago Professor Gary Becker, who would go on to win the Nobel Prize, gave a speech in which he said that children born rich often ended up poor, and children born poor often end up rich. And what did he base this conclusion in? In fact, did it seem to hold up to later analyses?

Steven Durlauf
I think the Becker statement reflected the state of empirical research on intergenerational mobility circa 1987. And a conventional statistic for that was to argue that the so-called intergenerational elasticity of income, which was asking the question, if I raise a child's income by one percent, a parent's income by one percent, excuse me, what's the change in expectation for the child's income? That number was around .2. And that led to the idea of shirt sleeves and shirt sleeves in three generations. If you were to cube the number .2, you get a .006, a very small

number. And so that was the background to the Becker comment. I think there were two empirical limitations. One of them was, and this is what has turned out to be the case in subsequent empirical work, that if one has more accurate measurements of what constitutes parental income and child income, in fact, that relationship is stronger. The second thing, and this is a problem with contemporary work as well, is that these types of statistics, how mobile is society, they're often very linear statistics. And so they aren't naturally able to, the ways that one analyzes the data, are not naturally able to identify poverty traps, affluence traps, or what in my parlance would be ‘bottlenecks,’ places that just make it hard to get out.

Michael Klein
So one of the important concepts here, Steven, is the idea of permanent income as opposed to the income you make in any given year. Can you briefly describe what we economists mean by permanent income?

Steven Durlauf
Yes, and that's a very fundamental issue in understanding why estimates of this coefficient, the so-called ITE, have increased over time. The intuition is that if I were to win the lottery this year, I would have a higher income, of course, but that doesn't entail anything about what my income is going to be next year. So one might think the changes in my salary, in which an increase this year presumably means it's going to increase in the future, have different consequences for children than otherwise. The idea of permanent income is to say that really our incomes every year have two components. One is the vicissitudes of luck. The other have to do with some underlying earnings capacity. Economic theory is suggestive that changes in the parent's permanent income should have particularly powerful consequences or correlations with child income. Transitory income less so. As a result, as data sets were allowed for more precise estimates of permanent income, they allowed scholars to more closely identify how permanent income in one generation affects the next, and that was the source of this increase in the coefficients that were measuring the relationships between parents and children.

Michael Klein
So it was sort of like when I was in my late 20s and just starting out as a professor, by most standards I'd be in the lowest quintile or something like that, but I knew that, or I hoped anyway, that my income would go up, and so I didn't necessarily spend as if I was going to be in the lowest quintile for my whole life. And then again, at the point of retirement, my income will go to zero, but I'm not going to spend as if my income is zero. I'll have saved money. So that sort of smooths things out, correct?

Steven Durlauf
Yes, exactly. And another way to think about these issues is that people have a lifetime budget constraint. When we're younger, we borrow. In middle age, we save, and then as we retire, we begin to, we dis-save. In other words, we live off aspects of our savings. Now obviously, disadvantaged families don't have the luxury of going through these types of patterns, both because they're not going to have periods of substantial savings and because the capacity to borrow is different. But the upshot is that what one ideally wishes to measure is the overall capacity of a parent to influence their child via their income, and that's what permanent income is getting at.

Michael Klein
So for example, if you looked at a rich family and their son or daughter is just starting out and not making very much money, it would look like there wasn't a big correlation between the parent's income and the child's income. But if you look over the course of that child's life, it might be a much higher correlation. Is that correct?

Steven Durlauf
Exactly right. And that's why much of the improved measurement has to do with having more years to observe the parent, more years to observe the child. And so to give a more precise, accurate, estimate of the overall capabilities that the families in each generation have in terms of what they can consume, what they can in turn invest in their children.

Michael Klein
So I think that's interesting just at a more general level, the way in which conclusions are constrained by data availability. And as better data becomes available, better conclusions, or more accurate conclusions can be gleaned from them.

Steven Durlauf
Absolutely. And it is an unfortunate tendency in social science that data acquisition is often regarded as unglamorous, but it's fundamental. And I think that it was Lord Kelvin who said science is measurement. And much of the advances that have occurred in the study of intergenerational mobility have been driven by improved data.

Michael Klein
So I started out the podcast by talking about the notion that the United States is a land of opportunity. In fact, Steven, how does the United States compare to other countries in terms of intergenerational mobility?

Steven Durlauf
If one looks across countries, the United States does not look like an especially mobile country. And what I mean by that is that the sort of statistics that are used to evaluate mobility have not just been done for the United States, they've been done for many different countries. And I think it is a reasonable statement that if one compares the United States to extremely advanced societies, economies, we do not look particularly mobile. Now, some of the examples are going to be unsurprising, and that is Scandinavia in comparison to the United States looks like it has substantially greater income mobility. If one looks at middle income economies, in particular, Latin America, one sees less mobility. If one goes across Europe, it's not the United States is literally less mobile than every country, but it would tend to be in the less mobile group of societies. Now, in saying that, let me issue an important caveat. And that is that these comparisons are reducing societies into single numbers. And if one makes the statement, for example, that Norway is more mobile than the United States, one has to respect the obvious fact that we're dealing with one country of, I believe, five to five and a half million people versus one that's 335 million people, and we're going to have extremely different levels of heterogeneity. And so what I would say is that overall the United States exhibits less mobility, but you might want to split it apart. If I ask the question for immigrants, the United States is going to look very good in terms of mobility. If I define mobility as the diminution of gaps between African-Americans and whites, in other words, I take the most wronged part of American society and compare it to the dominant part, the United States is going to look horrendous. And so I think an important message in these comparisons is not just that we look worse, or not so well relative to the American mythos of opportunity. It's that there are very different dimensions along which one has to do these calculations.

Michael Klein
The late economist Alan Krueger introduced this idea, which he called the ‘Great Gatsby curve’ when looking at cross country comparisons of income mobility. Can you describe what he meant by that, and whether the data support this hypothesis?

Steven Durlauf
So Alan Krueger was working with specifically an empirical study that was due to Miles Corak. And what Corak identified was that if you looked across advanced economies, you could ask the following question: are the economies that have highly persistent levels of income between generations, do they tend within a generation to have higher or lower inequality? And so a mythos that you and I were brought up on is that America had made a choice, and that is compared to Europe, we have greater opportunity, has more mobility, but we also exchange that, so to speak, for higher cross-sectional inequality. What the data found empirically is that that negative relationship just isn’t necessarily so. In other words, if you looked across the set of countries, the countries that were more persistent in socioeconomic status also had greater

inequality. And so Krueger dubbed that the ‘Great Gatsby curve’ after the novel. I'm not exactly sure why he chose that one. I think if it had been me, I would have called it the ‘Grapes of Wrath curve.’ But nevertheless, and I don't mean this in a denigrating way, marketing matters. And so there was a cachet to that, which I think facilitated the curve becoming part of public policy discussion.

Michael Klein
So maybe we'll call this particular podcast the Great Gatsby podcast instead of the Grapes of Wrath. We'll get more listens. Well, you've alluded to this already. We've been talking about overall mobility in the United States, and the ‘Great Gatsby curve’ focuses on mobility for children from poor households. More generally, is there evidence of differences in mobility across different income groups? Do people at certain levels of income tend to show more or less mobility than people at other levels of income?

Steven Durlauf
I think there is evidence of that. I want to be clear, however, that the empirical literature has been relatively unsuccessful in identifying strong evidence of nonlinearity. And that's the mathematical term for this idea. I don't want to exaggerate the strength of the evidence. I think it is a fair reading of the evidence that poverty and high affluence are not literally traps, but they're what I, in my own research, call bottlenecks. In other words, if you're poor, it's a bottleneck to get out of poverty. If you're rich, there's another bottleneck, which is to really become unsuccessful. Not all bottlenecks are necessarily bad ones. And so the notion that underlying these regularities, it's a correlation here versus there, are important heterogeneities across the income distribution. I think that that's correct. And that would also be true for race.

Michael Klein
Let's pick up on that issue of race. I'm reminded of a striking graphic in the New York Times Upshot based on the work of Raj Chetty, a professor at Harvard. This graphic showed that the likelihood of black children raised in relatively well-off black families staying wealthy was not very high. And the likelihood of white children staying in the wealthiest section of the income distribution was actually quite high. And the way the graphic did this, you sort of showed this waterfall of black boys moving from high-income groups to low-income groups, and that not happening for white children. So what can you say about racial differences beyond what you've already mentioned, Steven?

Steven Durlauf
Well, I think you brought up a fundamental and understudied dimension of racial inequality in the United States, and that is the comparative ease that white families have in locking in economic success into their children. And so one way to say the result in Chetty is that the white

families, it's simply much more likely their children will be, if they start in the upper tail, the kids will be in the upper tail. In contrast, African-American families exhibit substantially higher, greater levels of downward mobility. Interestingly, that result is of longstanding importance in sociology. Sociologists, by tradition, focus on occupational mobility. And I will tell you, one of the most disturbing papers I ever read had to do with, I think it was written in 1962, by Otis Dudley Duncan, was looking at occupational mobility between blacks and whites. And I think the data were from the late 50s he was looking at. I apologize, I don't have the numbers at my fingertips. But what he found was for white families, occupational mobility is what you expected. white father, you know, had a white-collar parent, became relatively likely, you had a white-collar child, blue-collar, blue-collar, manual, manual. For African-American families, there was little association between the parent's occupational status and the outcomes, because it was extremely likely that children would be manual workers. Now, sociologists have studied this for many decades. This is actually a topic I'm currently working on with Gueyon Kim, an economist at Santa Cruz, and Xi Song, a sociologist at Penn. And previous work has demonstrated that that extreme lack of ability to lock in has been diminished. But the upshot is, it's an important dimension of inequality. In other words, if we're thinking about groups, we have to think dynamically, and we're asking questions about the conversions between the groups. And with reference to understanding the lack of conversions of African-American families and white families, I think an understudied phenomena is this asymmetry in the capacity to lock in.

Michael Klein
You also mentioned, Steven, something about immigration. And of course, immigration is a hot button issue, and there are concerns, for example, that immigrants can become a public burden. But in one of our earliest Econofact memos by Fran Blau and Gretchen [Donehower], they show, in work that they were doing for the National Academy of Sciences, that over their lifetimes, the net contribution of children of immigrants to the public purse is greater than their parents, in fact, greater than the native born. I guess this reflects the relatively high intergenerational social mobility among immigrants. Is that correct?

Steven Durlauf
Absolutely. I think that immigration is an example of a policy in which the consensus among scholars, economists, sociologists, people who study immigration is very different from the rhetoric is uniquely different in public policy. What I mean by that is, number one, this idea that jobs are being crowded out is a falsehood, and it's for a simple reason. And that is immigrants also create demand, which increases the level of jobs that are needed in society. So the general equilibrium effects in our parlance simply suggest that as an empirical matter, you don't find any important effects of immigration on either employment or on wages. The second thing is what you've raised, and that is there's very powerful evidence, and systematic evidence of upward mobility with respect to immigrant families. Two of the leading scholars on this are Ran

Abramitzky and Leah Boustan, and I would certainly direct the readers to look at the body of work they have done. If I had to summarize it, what I would say is that they have demonstrated throughout American history, and I should say supplemented by the Opportunity Insights work that's been done by Raj Chetty, Nathan Hendren, John Friedman, Maggie Jones, and Sarah Porter, because I have a specific paper in mind when I want to make sure all authors get credit. That is, if you look at cohorts in the United States divided up by the origins of the parents, you see extraordinary mobility across all different nations of origin, all different ethnic groups. And interestingly, you see especially impressive mobility among people from Latin America.

Michael Klein
So maybe without looking at that impressive list of research articles, you could just ask around. My grandmother came over as a child and had a very small grocery store, and her grandchildren are doctors, computer scientists, and even one's a professor. There's a lot of personal examples we can point to as well. You've also been doing some recent research that delves into the issue of not just the income of parents, but when the parents have that income in relationship to the age of their children. Why were you interested in studying this, and what did you find?

Steven Durlauf
I'd say the background to the work was to think about what is it we want to condition on, if we want to say I want to measure mobility. So one idea is I take the average income of a parent, of a household between certain years, and see how does that correlate with the average income of offspring. The vision I have for this is to say that children from birth to age 19, just to make it concrete, they have a set of exposures. One thing they're exposed to is every year the income of their parents. The second thing they're exposed to is family structure, whether the parents are at home or whether it's a single parent household and the like. Another exposure is the neighborhood that one grows up in. Another exposure would be the schools one attends. So the vision I have, and I'm not going to say that the work so far is there, is that the question on mobility is asked the following, and that is can we identify what types of trajectories of family and social influences make economic success likely? I could make that concrete in terms of certain levels of income, in terms of college graduation and the like. Contrast those with the trajectories that make it unlikely. And to say a society is mobile, we want to know kind of how big those categories are. Further, if we want to know how to address mobility, we need to know what defined one of the characteristics that made these trajectories powerful in terms of producing likely economic success versus disadvantage. So that's the big picture is to argue that there's a host of family and social influences, all of which determine the relationship between the parents' socioeconomic status and the child.

Michael Klein
So we've been speaking about some of the reasons behind the lack of intergenerational mobility and some of the statistics about that. But people may argue that there's this nature versus nurture continuum, and that, in fact, nature is important. A lack of intergenerational mobility may just reflect the fact that the children's inherent skills and abilities that the market rewards come from their parents. So parents who are well off are well off because they're skilled, and then their children inherit those skills. How would you address the idea about the nature versus nurture components of intergenerational mobility?

Steven Durlauf
I'd address it at several levels. First, I would make clear that if one is looking at persistent differences between groups of people, there is zero evidence that has anything to do with genetics. And in the context of a podcast, there's no time to elaborate that, but I want to make clear that in answering the genetics question, one has to ask about the scale. The second question is at the family level, the individual level, does the genotype matter? I don't think any serious person would say it doesn't. And so the question is not about whether it matters or not. That's a straw man. What you want to understand is to what extent is it salient, how important it is. Now there, I think that I would make a couple of observations. One is the most systematic effort to decompose the intergenerational elasticity of income between genes, skill, education, and the like was actually done by Sam Bowles and Herb Gintis. And they concluded that the role of genes was very modest. And the way you do that intuitively is you say, well, if you were to attribute IQ differences overwhelmingly to genetic differences, you're going to ask how much does IQ predict differences in income, controlling for other factors. And the upshot in their decompositions was that the genes didn't matter very much. The second thing I would say is other studies, of course, have made different arguments with respect to genes. Those types of studies are going to be based on looking at things such as the relationship between adoptive children and birth children in human capital formation. Another could have to do with identical versus dizygotic or fraternal twins. In those literatures, arguments are made about the role of genes, but they are all subject to an identification problem. And that is, the thing you cannot observe is the way in which parents treat children differently. And so what I mean by that is that if it is the case that identical twins are raised more similarly, than to fraternal twins, then by implication, the outcomes are more similar for identical twins, whether or not it's the genes or the fact the parents responded that way. And so I think that where we are on the role of genetics is to say that there's been a number of very interesting studies that have found correlations that differ across levels of genetic overlap. Where we aren't, as a discipline, able to advance things, and that doesn't mean it won't happen, just this is where we are, is to understand the mechanisms for that. And so studies about nature versus nurture, as I said, I think they're in the stylized facts phase. They're identifying phenomena. Ultimately, to uncover the reasons why you have these types of correlations is going to require a theory of how parents make choices with respect to their children.

Michael Klein
So I'll just plug one of our Econofact memos by Sandy Black, who's at Columbia and her co-authors. And they did an analysis in Sweden, which is, of course, a relatively egalitarian country, of adopted children, and looking at both their biological parents and their adoptive parents, they found that there is a much higher correlation of wealth with the adoptive parents, not the biological parents. And I thought that was a really nice and interesting study.

Steven Durlauf
Yes. And that work is, I think, the state of the art on using adoption as a way to uncover aspects of mobility. And so again, it was not a criticism of their paper. What I would say is the thing that's hard to understand is the mechanisms. They found that the birth parents were more predictive with respect to human capital formation. The next step in this research program is to understand the reasons why.

Michael Klein
So just concluding with that, if a lack of intergenerational mobility is because of the environments that people grow up in, not necessarily in their inherited ability, that means that there's an inefficiency in the economy. The best people don't necessarily get the opportunities that enable them to rise to their potential. Given this, Steven, what are some policies that could address this problem?

Steven Durlauf
Well, I have been an advocate of what I call the 'membership's theory of inequality.' And so the argument that I make is that many of the inequalities we see in society have to do with the group memberships that individuals have. So what do I mean by that? One example of a membership, as corny as it is, is people are members of families. So the identity of the resolution of the birth lottery matters. Another membership is the neighborhood one grows up in. Yet another is the school one attends. And then the final one is the firm or the organizations one works in. I say all of that as background because I think of a lot of inequality as deriving from the ways in which people are assigned to very different families, neighborhoods, schools, and firms. Once you say it that way, then you can ask what the policy remedies are. Obviously, for families, it would be morally monstrous to interfere with who marries who. On the other hand, we can attenuate the role of family background. That's what early childhood investment is all about. It's an argument that you can enrich the environments of children from zero to three in ways that can overcome the disparities that emerge because of differences in parental socioeconomic status. With reference to thinking about neighborhoods and schools, those become sources for thinking about mechanisms to improve the socioeconomic and racial integration of the United States. And so there's a plethora of policies that have been proposed to address issues of economic segregation. The whole 'yimby nimby' debate is part of that. But if one thinks about mixed income housing,

zoning restrictions, and the like, there's policies one would focus on, there. With respect to schools, an obvious remedy is to address the disparities in per pupil education that are induced by the local public finance of K through 12 in the United States. I could push beyond those to say that this is very timely given the imminent Supreme Court decision. The way to understand affirmative action policies, be they for universities or for companies, is that there are policies that are altering the matching process. And so if one takes seriously the importance of social networks in transferring information to members of the networks, if one takes seriously the intergenerational consequences of families with having different experiences, if one thinks about the limitations of high schools in terms of preparing people from different backgrounds to schools when they have the ultimate potential, all of those are arguments that affirmative action not only has the normative justification of addressing group inequality, it can also have dynamic efficiency consequences, which is back to what you said in your initial comment. So what I would emphasize is that in thinking about things from what I call this lens of memberships, I think that with respect to the matching of parents and kids, the obvious thing to do is to attenuate the significance of that fact. And I think easy examples are going to be progressive taxes on one hand or supplementary programs. I think with respect to the other dimensions I talked about, the more social dimensions, I just think that they buttress the general need for America to recommit to its objectives with respect to socioeconomic and racial integration.

Michael Klein
Just to plug another couple of Econofact things, Larry Katz spoke about the 'moving to opportunity' initiative that he started when he was working in the Clinton administration. We have both a memo and a podcast on that. So Steven, these are vitally important issues, and I think you've done a really good job today in describing to our listeners how economists think carefully about this, what some of the conclusions are, although as you're mentioning, a lot remains open, and what kinds of policies we can think of to enable America to live up to its promise. So thanks very much for joining me today.

Steven Durlauf
Thanks go to you. I much enjoyed it.

Michael Klein
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