

Local Intergenerational Elasticities*

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Abstract

The intergenerational elasticity (IGE) is the most common parameter reported in the intergenerational mobility literature. This paper proposes a “local” intergenerational mobility parameter (LIGE) that allows the effect of parents’ income to vary across different values of parents’ income. We also extend this result to an “adjusted” local intergenerational elasticity (ALIGE) which adjusts for differences in the distribution of observed characteristics at different values of parents’ income. We develop the asymptotic properties of the LIGE and ALIGE, and apply them to study intergenerational mobility using data from the PSID. We find that the intergenerational elasticity is much larger for low values of parents’ income (indicating *less* mobility) relative to high values of parents’ income; adjusting for differences in characteristics reduces the local IGE at all values of parents’ income as well as flattening it across different values of parents’ income.

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1. Introduction

The intergenerational elasticity (IGE) is the most commonly reported measure of intergenerational income mobility (see, for example, Solon (1992)). It is the coefficient from the regression of the log of child's income on the log of parents' income. Large positive values of the IGE indicate a relative lack of mobility and small values indicate relatively high mobility. The IGE, however, is a global measure of intergenerational mobility and some researchers have explored how the IGE varies across different values of parents' income (e.g., Landersø and Heckman (2017)) as a local intergenerational mobility measure.¹ One important reason to consider local versions of the IGE is that the relationship between parents' income and child's income may be nonlinear. For example, Becker and Tomes (1986) discusses how borrowing constraints for poor families can lead to a nonlinear relationship between parents' income and child's income.² Researchers studying intergenerational mobility have also been interested in the role of other background characteristics (e.g., race and education) that are correlated with both parents' income and child's income in explaining intergenerational mobility (e.g., Bowles and Gintis (2002), Blanden, Gregg, and Macmillan (2007), and Richey and Rosburg (2017)). In part, this line of research is interested in understanding to what degree controlling for other covariates affects estimates of the intergenerational transmission of income.

This paper develops new tools for estimating a local intergenerational elasticity after (possibly) first adjusting for differences in the distribution of characteristics across different values of parents' income. Just like in the IGE case mentioned above, whether one wants to adjust for covariates is likely to depend on whether or not one wants to document local correlations between parents' income and child's income or to see to what extent these correlations remain after adjusting for differences in the distribution of covariates across different values of parents' income.

The interpretation of local intergenerational income elasticities is somewhat subtle. First, they are local effects and should be interpreted as the effect on average child's income for *marginal* changes in parents' income. They do not indicate what would happen if parents' income changed dramatically. Also, local intergenerational elasticities are the effect on average child's income (possibly after adjusting for differences in covariates) and do not answer questions like how parents' income affects the probability that child's income is below the poverty

¹Also relatedly, Bratsberg et al. (2007) and Björklund, Roine, and Waldenström (2012) group their data by percentiles of parents' income and calculate intergenerational elasticities within groups which is similar to our procedure; Murtazashvili (2012) uses a random coefficients model to allow the effect of parents' income to differ across individuals.

²See also Section 2 of Bratsberg et al. (2007) for a detailed discussion about other possible causes of a nonlinear relationship between parents' income and child's income.

line.³

We propose a semiparametric estimator of the adjusted local intergenerational elasticity that allows for the effects of parents' income and covariates on child's income to change across different values of parents' income. We develop the asymptotic properties of a local linear estimator of the local intergenerational elasticity and our adjusted local intergenerational elasticity. Our estimators converge more slowly than parametric estimators though they do not suffer from the curse of dimensionality.

We apply our method to data from the Panel Study of Income Dynamics. Without adjusting for covariates, the local IGE is relatively large and tends to decrease with parents' income. Adjusting for covariates decreases the local IGE across all values of parents' income; however, there is still a strong relationship between child's income and parents' income. Adjusting for covariates also substantially flattens the local IGE across different values of parents' income.

2. Parameters of Interest

Let Y denote the log of child's income, T denote the log of parents' income, and X denote a $k \times 1$ vector of covariates. Next, we define our two main objects of interest.

Definition 1. *The **Local Intergenerational Elasticity (LIGE)** is given by*

$$LIGE(t) = \frac{\partial E[Y|T = t]}{\partial t}$$

$LIGE(t)$ measures the local effect of parents' income on average child's income at a particular value of parents' income t . This type of parameter has been considered in Landersø and Heckman (2017). We are also interested in the effect of parents' income on child's income after adjusting for differences in the distribution of observed characteristics that are related to child's income (e.g., parents with high income are likely to have relatively high education as well) across different values of parents' income. Note that here we are not attempting to establish the causal effect of parents' income; rather, we are trying to imagine what average child's income would be if the return to observed characteristics were held fixed but the distribution of characteristics was changed to be the same as the distribution of characteristics for all individuals in the population.

Next, note that the observed average child's income conditional on parents' income is given by

$$E[Y|T = t] = \int_{\mathcal{X}} E[Y|T = t, X = x] dF_{X|T}(x|t)$$

³Richey and Rosburg (2016) and Callaway and Huang (2018a) consider how parents' income affects the entire distribution of outcomes though the approaches in those papers are substantially different from that of the current paper.

which holds by the law of iterated expectations and where \mathcal{X} denotes the support of X . We consider the counterfactual average outcome conditional on parents' income where the return to characteristics and parents' income is held fixed but the distribution of observed characteristics (conditional on $T = t$) is changed to be the distribution of characteristics for the entire population; that is

$$E^C[Y|T = t] = \int_{\mathcal{X}} E[Y|T = t, X = x] dF_X(x)$$

Given this counterfactual, we define our main parameter of interest next.

Definition 2. *The **Adjusted Local Intergenerational Elasticity (ALIGE)** is given by*

$$ALIGE(t) = \frac{\partial E^C[Y|T = t]}{\partial t}$$

$ALIGE(t)$ corresponds to $LIGE(t)$ except that it occurs after adjusting for differences in the distribution of covariates across different values of parents' income. Our next aim is to develop a flexible model for $E[Y|T, X]$ in order to ultimately estimate the $ALIGE$. We make the following assumption

Assumption 1 (Smooth Coefficient Model).

$$Y = X'\beta(T) + U$$

Assumption 1 is key for implementing our method. This type of semiparametric model is called a smooth coefficient model (see, e.g., Li, Huang, Li, and Fu (2002) and Cai, Fan, and Li (2000) as well as Callaway and Huang (2018b) for a similar model in the context of decompositions with a continuous treatment). It allows for the effect of each covariate to change across different values of parents' income. The model also includes a constant so the effect of parents' income itself can change across different values of parents' income. It is a semiparametric model because it imposes that, locally in parents' income, the effect of each covariate on child's income is linear. It seems very natural to impose this sort of structure in a model for intergenerational mobility because parents' income can be treated in a distinct way from the other covariates that we include in the model.

A leading alternative idea would be to estimate $E[Y|T, X]$ nonparametrically and plug in these estimates to obtain estimates of the $ALIGE$. With the moderate amount of data typically available in applications, this approach is not likely to be feasible as it suffers from the curse of dimensionality.⁴ Even in a case like ours where most of the covariates are discrete, splitting the sample for each possible combination of the discrete variables and then employing nonparametric estimation does not appear to be a feasible strategy either due to sample sizes

⁴The curse of dimensionality would be somewhat mitigated from integrating out X ; however, the fully nonparametric approach is still likely to be difficult to carry out in practice.

being extremely small within some cells. It is straightforward to handle this case with our approach though.

Another alternative would be to assume that the conditional expectation follows some particular parametric model, but it seems challenging in practice to specify the right functional form; in particular, for the derivative of $E[Y|T, X]$ to depend on X , the functional form must include interactions between T and X which may be difficult to choose appropriately. Our approach, on the other hand, is quite flexible. We allow the effect of covariates and parents' income to depend on the value of parents' income. For example, the effect of parents' education on child's income can vary across different values of parents' income.

Finally, our approach is also related to the idea of dividing parents' income into several groups (this is often based on income quartiles) and computing an IGE for each group;⁵ this idea is also related to transition matrices.⁶ One advantage of our approach relative to these is that it does not require the researcher to specify how to divide parents' income into groups. The way to divide income is inherently *ad hoc* (Bhattacharya and Mazumder (2011)). In addition, when income inequality increases, observations in particular groups can come from families with parents' income that are actually substantially far apart.⁷ In contrast, with high income inequality (and for a fixed number of observations), our approach would continue to use observations with similar parents' income; in this case, there would tend to be fewer observations with similar parents' income though and this would be reflected in relatively larger standard errors. This would seem to be desirable behavior for an estimator of local IGEs though because, in this case, the data would effectively be less informative about the local effect of parents' income.

The next result characterizes the ALIGE under Assumption 1.

Proposition 1. *Under Assumption 1,*

$$ALIGE(t) = E[X]' \frac{\partial \beta(t)}{\partial t}$$

Proof. First, notice that under Assumption 1,

$$\begin{aligned} E^C[Y|T = t] &= \int_{\mathcal{X}} x' \beta(t) dF_X(x) \\ &= E[X]' \beta(t) \end{aligned}$$

Taking the derivative with respect to t implies the result. □

⁵Work that uses this approach includes Bratsberg et al. (2007) and Björklund, Roine, and Waldenström (2012).

⁶There are many papers that use transition matrices in the context of intergenerational mobility. The most closely related part of this literature to our approach are papers that use transition matrices in the presence of covariates; this work includes Bhattacharya and Mazumder (2011), Chetty and Hendren (2018), Chetty, Hendren, Jones, and Porter (2018), and Richey and Rosburg (2018).

⁷We thank a referee for pointing this out. One particular example of this, due to Bhattacharya and Mazumder (2011), is that one of the (partial) explanations for less observed upward intergenerational mobility of black individuals than white individuals using transition matrices is that, within parents' income groups, black parents tend to have relatively lower income; thus, for children of black parents to move to a higher income group, they have to increase their income relatively more than children of white parents.

Our approach exploits the uniqueness of T among the set of conditioning variables. Importantly, unlike the fully nonparametric approach, our approach will not suffer from the curse of dimensionality. Our estimator will converge at a slower rate than parametric estimators, but its rate will not slow down due to adding more covariates.

3. Estimation

Estimating the LIGE is relatively straightforward. We use local linear kernel regression and an estimate of the derivative is given by the (local) coefficient on the linear term (also notice that the results for the LIGE are a special case of the results for the ALIGE by taking X to only include a constant). For estimating the ALIGE, notice that a first order Taylor approximation of the model in Assumption 1 around t implies

$$Y \approx X'\beta(t) + (T - t)X'\frac{\partial\beta(t)}{\partial t} + U$$

Then, a local linear estimator of $(\beta(t), \partial\beta(t)/\partial t)$ is given by

$$\begin{pmatrix} \hat{\beta}(t) \\ \frac{\partial\hat{\beta}(t)}{\partial t} \end{pmatrix} = (\mathbf{X}'\mathbf{K}(t)\mathbf{X})^{-1} \mathbf{X}'\mathbf{K}(t)\mathbf{y}$$

where \mathbf{X} is an $n \times 2k$ matrix (where k is the dimension of X) with the i th row given by $\mathbf{X}_i = (X'_i, (T_i - t)X'_i)$ and $\mathbf{K}(t)$ is an $n \times n$ diagonal matrix whose i th diagonal element is given by $K_h(T_i - t) = K((T_i - t)/h)$ where K is a kernel (satisfying some regularity conditions; in practice, we use a trimmed Gaussian kernel though other choices are possible) and h is a bandwidth.

Then, one can estimate the ALIGE as follows

$$\widehat{ALIGE}(t) = \left(\frac{1}{n} \sum_{i=1}^n X_i \right)' \frac{\partial\widehat{\beta}(t)}{\partial t}$$

In practice, we estimate $LIGE$ and $ALIGE$ over a grid of L possible values for t given by $t^* = (t_1, t_2, \dots, t_L)$.

3.1. Asymptotic Theory

This section develops the limiting distribution of the LIGE and the ALIGE.

For estimating the LIGE, first let $Y = g(T) + \epsilon$ where $g(t) = E[Y|T = t]$. Under standard regularity conditions for local linear estimators (see, e.g., Li and

Racine (2007, Theorem 2.7)),⁸ one can show that

$$\begin{aligned} n^{1/2}h^{3/2}(\widehat{LIGE}(t) - LIGE(t)) &= \frac{1}{\kappa_2 f_T(t)} n^{-1/2} h^{-3/2} \sum_{i=1}^n (T_i - t) K_h(T_i - t) \epsilon_i \\ &\xrightarrow{d} N(0, V_L) \end{aligned}$$

with $V_L = f_T^{-1}(t) \kappa_2^{-2} \kappa_{22} E(\epsilon^2|t)$ and where $f_T(t)$ is the marginal density of T , $\kappa_2 = \int v^2 K(v) dv$, and $\kappa_{22} = \int v^2 K^2(v) dv$.

Next, for the ALIGE, consider

$$\widetilde{ALIGE}(t) = E[X]' \frac{\partial \widehat{\beta}(t)}{\partial t}$$

\widehat{ALIGE} and \widetilde{ALIGE} are asymptotically equivalent because $n^{-1} \sum_{i=1}^n X_i$ converges to $E[X]$ faster than the terms that we estimate nonparametrically. Thus, the asymptotic behavior of \widehat{ALIGE} is driven by the behavior of the local linear term. Under standard regularity conditions for smooth coefficient models (see Cai, Fan, and Yao (2000) and Li, Huang, Li, and Fu (2002)) one can therefore show that

$$\begin{aligned} n^{1/2}h^{3/2}(\widehat{ALIGE}(t) - ALIGE(t)) \\ &= n^{-1/2}h^{-3/2} \sum_{i=1}^n E[X]' (\kappa_2 f_T(t) E[XX'|t])^{-1} X_i (T_i - t) K_h(T_i - t) U_i \\ &\xrightarrow{d} N(0, V_A) \end{aligned}$$

where $V_A = f_T^{-1}(t) \kappa_2^{-2} \kappa_{22} E[X]' E[XX'|t]^{-1} E[XX'U^2|t] E[XX'|t]^{-1} E[X]$. In practice, we carry out pointwise inference using the wild bootstrap.

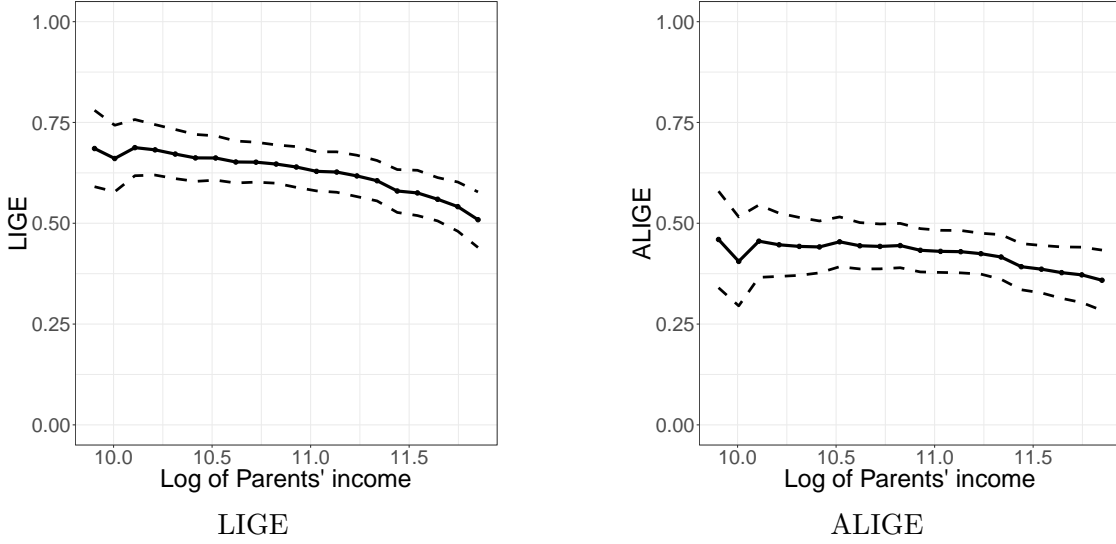
4. Application

We use data from Callaway and Huang (2018a) which comes from the Panel Study of Income Dynamics (PSID). The data consists of 3,630 child-parent measures of permanent income along with many other child and parent characteristics. We include both daughters and sons in our analysis; and, for both parents and children, we use family income (rather than individual income) averaged over at least three years as our measures of permanent income. See Callaway and Huang (2018a) for a detailed discussion of this particular dataset as well as for summary statistics. Regressing the log of child's income on the log of parents' income results in an estimated IGE of 0.603.⁹

⁸Practically, the most important regularity condition is on the bandwidth. We use cross-validation to choose the bandwidth. In practice, this will “undersmooth” for the derivative term in the local linear estimator leading to the bias term going to zero asymptotically.

⁹This estimate of the IGE is somewhat large relative to most work on the IGE though it is consistent with Mazumder (2005). One possible explanation is that IGE estimates tend to be larger in more recent periods (as is the case in the current paper); see, e.g., Chetty et al. (2014) and Davis and Mazumder (2018).

Figure 1: The LIGE and ALIGE as a Function of Parents' Income



Notes: The left panel plots the LIGE and the right panel plots the ALIGE. Each is estimated using the approaches discussed in the main text. The outcome is the log of child's permanent income. For the ALIGE, the covariates are child's gender and birth year as well as the family head's gender, race, educational attainment, and veteran status. In each panel, the dashed lines are pointwise 95% confidence intervals computed using the wild bootstrap with 500 iterations.

Sources: Panel Study of Income Dynamics, as described in text

Our main results are presented in Figure 1. We estimate the LIGE and ALIGE over a grid of twenty equally spaced values of t ranging from $\log(20,000)$ (roughly equal to the poverty line) to $\log(140,000)$. Without adjusting for differences in covariates, the LIGE is equal to 0.69 for children whose parents' income was \$20,000. It declines substantially in parents' income. For children whose parents' income was \$140,000, the LIGE is 0.51. These results suggest that the effect of parents' income on child's income varies across different values of parents' income; standard measures of intergenerational mobility such as the IGE cannot show this type of heterogeneity.

For the ALIGE, the covariates that we include in our analysis are child's gender and birth year, and the family head's gender, race, educational attainment, and veteran status. We report estimates of $\beta(t)$ and $\frac{\partial \beta(t)}{\partial t}$ in the Supplementary Appendix. Adjusting for covariates somewhat diminishes estimates of local intergenerational elasticities. However, even after adjusting for differences in observed covariates across different values of parents' income, the link between child's and parents' income is still strong. For children whose parents' income was \$20,000, the ALIGE is estimated to be 0.46. Interestingly, adjusting for covariates also substantially flattens estimated local intergenerational elasticities. The point estimates of the ALIGE are very similar across all values of parents' income (perhaps somewhat declining) and we cannot reject that the ALIGE is constant for all values of parents' income.

5. Conclusion

This paper has developed new local measures of intergenerational elasticities that allow for the researcher to adjust for differences in the distribution of characteristics across different values of parents' income. We developed a flexible semiparametric estimator of the adjusted local IGE and studied its properties. We found that adjusting for covariates decreased the local IGE at all values of parents' income and tended to flatten the local IGE as well. From a policy perspective, our results suggest that differences in background characteristics are partly responsible for differences in mobility across different values of parents' income, but that they are not fully responsible. Going forward, it may be possible for policymakers to affect some of these background characteristics (e.g., parents' education) that influence intergenerational mobility.

There are many interesting possible extensions of the current framework. First, it would be interesting to develop formal tests that the LIGE or ALIGE is constant across all values of parents' income which could be accomplished using results from the specification testing literature (e.g., Hardle and Mammen (1993) and Zheng (1996), among many others); or, relatedly, to develop uniform confidence bands for the LIGE or ALIGE. Second, one could develop tests for whether the LIGE and ALIGE are equal at particular values of parents' income or across all values of parents' income. Finally, it would be relatively straightforward using our approach to examine the role of each covariate in *explaining* the difference between the LIGE and ALIGE. This would allow one to decompose the gap between the LIGE and ALIGE into parts due to, for example, differences between the distribution of race and education at particular values of parents' income and the overall distribution of race and education. We leave these extensions to future work.

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