Intergenerational Transfers, Job Search, and Income Inequality

Thomas Palmer

McMaster University

February 2023

Motivation

Large increase in between-group income inequality since the 1970s

- Income share of top 1% grew from 9% (1979) to 16% (2016)
- Inequality persistent across generations:
    - Intergenerational elasticity estimates range from 0.23 to 0.50

Large increase in family material support between 1970 and 1990

- Average parent-to-child transfer amount of 44% of mean income
- Annual incidence of transfers range between 14% to 18%
- High-income families 3x more financial support

This paper: Studies particular channel of intergenerational pass-through

- Inter-vivos transfers during young adulthood

This Paper

Question: How do inter-vivos transfers affect life-cycle inequality?

Mechanism: Inter-vivos transfers help insure against labour market risk

- Credit constraints and debt affect job search behaviour
  - Luo and Mongey (2019); Herkenhoff (2019); Li (2021)
- Credit constraints and debt affect early career occupational choice
  - Rothstein and Rouse (2011); Herkenhoff et al. (2019)
- Family insures against unemployment, college, divorce risk
  - Kaplan (2012); Guler et al. (2012); Hendricks and Leukhina (2017)

Contribution: Joint theory of inter-vivos transfers and search behaviour

Structure of Analysis

Three Parts:

1. Empirical: Establish facts about incidence and value of transfers
   - Direct financial aid for education
   - Direct transfers of money during early career
   - Indirect support for housing (co-residence)
2. Theory: Model of transfers, job search, and earnings risk
3. Quantitative:
   - Quantify insurance value of inter-vivos transfers
   - Quantify contribution of transfers to aggregate inequality
   - Conduct counterfactuals to study welfare implications of transfers

Identification and Selection

Two Challenges:

1. Unclear how to define the boundaries of transfers
   - Employment networks, neighbourhood choice, etc.
2. Substantial heterogeneity among transfer recipients
   - Student debt (or lack thereof) insufficient to identify high/low ability
   - Transfers amounts may be endogenous to credit/loan access
   - Initial conditions (human capital, assets) important for inequality

Data I

Education and Labour Market Longitudinal Platform (ELMLP)

- Administrative panel data platform from 1998 to 2020
  - Canadian Education Savings Program (CESP)
  - T1-Family Tax Records (T1-FF)
  - Canada Student Loans Program (CSLP)

Survey of Labour and Income Dynamics (SLID)

- Panel survey data on labour market outcomes from 1993 to 2011

Canadian Income Survey (CIS)

- Repeated cross-sectional successor to SLID from 2012 to 2020

Data II

Key Benefits of ELMLP:

- Information on value and incidence of specific educational transfer
- Establishes direct link between transfers and other loans
- Establishes direct link between transfers and family characteristics
- Establishes direct link between transfers and income

Key Benefits of SLID and CIS:

- Information on job search and earnings
- Establishes direct link between search and inter-vivos transfers
- Potential to infer co-residence through homeownership information

Model Components

Goal: Construct joint theory of transfers and search to study inequality

1. Overlapping generations
   - Required to study intergenerational transfers and inequality over time
2. Job search and unemployment risk
   - Required to study the response of search decisions to transfers
3. College choice and student loans
   - Provides alternative to transfers as a source of education financing
   - Required to replicate observed trade-off between transfers and loans
4. Risk aversion and incomplete markets
   - Provides a motive for intergenerational transfers and debt

Quantitative Analysis

Understanding how transfers affect inequality requires model structure

- Transfers are endogenous to job search behaviour
- Transfers are endogenous to other forms of private/public debt

Three Steps:

1. Quantify value of inter-vivos transfers at individual-level
2. Quantify how much transfers contribute to aggregate inequality
3. Study the implications of counterfactual public transfer programs

Value Added

Question: Why should we care about inter-vivos transfers?

1. Affect public transfer programs (UI, student loans, etc.)
   - Family transfers becoming a more prevalent source of financial aid
   - May distort functioning of publicly-provided financial aid programs
2. Affect income inequality
   - Transfer amounts/incidence unequally distributed across population
   - Transfers largest and most frequent at the top of the distribution
3. Major source of income for young adults
   - Data limitations have restricted our understanding of transfers

Conclusion

Objective: Highlight role of inter-vivos transfers on inequality

- Document a new set of facts using under-explored data
  - Direct information on specific educational and more general transfers
  - Links transfer amounts to public insurance, labour market outcomes
- Propose a joint theory of inter-vivos transfers and job search
  - Transfers alleviate college debt and insure against unemployment risk
  - Enable individuals to search for better employment matches
- Quantify macroeconomic effects of inter-vivos transfers
  - Analyze welfare from counterfactual public insurance regimes

Thank You