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Article

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INEQUALITY ACROSS THE GENERATIONS IN NORTH AMERICA AND EUROPE

MILES CORAK*

In thinking about the welfare state, about past accomplishments and future challenges, I would like to begin by borrowing a few pages from the work of Amartya Sen, the 1998 Nobel laureate in economics. Sen's thinking is neatly summarized in his popular book *Development as Freedom*, which in the first instance is directed to issues in development economics, but has broader implications and lessons for social policy in rich as well as less rich countries. Sen argues that the major goal and major means of development should be freedom. Society should offer its citizens the freedom to lead the lives they choose to value.

This idea has in fact been an important undercurrent in the development of the welfare state in North America and Europe, from its earliest days in the 1800s through to the end of the Second World War. Then the emphasis was on the importance of full employment and the need for economic security for those excluded from jobs because of business cycle recessions, because of sickness, or because of the physical limitations of old age. But there has also been an emphasis on active measures involving investments in human capital, first through more and more years of compulsory schooling, then to the broadening of access to higher education and more recently in some countries to early childhood development.

Sen's thinking asks policy makers to focus on the capabilities of citizens and to remove barriers to full participation in society, thereby allowing them to make use of their talents and develop their full potential. He frequently cites the quest for freedom from poverty, adequate health care and education as examples of specific social policies affording citizens these capabilities.

I choose this as my starting point to draw what I think is an obvious link, though one not directly made by Sen or others, to the circumstances of children. There

is in the case of this particular group, I think, a connection between on the one hand freedoms and capabilities, and on the other hand direct measures of these concepts as well as policy levers. Freedom means that children can become all that they can be. In some large sense this means that they are free to realize their full talents, and that their outcomes in life are not tied to their family backgrounds. In other words, for children this means equality of opportunity.

As an economist I am inclined to think about these issues in terms of labour market outcomes, though obviously the issues are broader than just earnings and incomes. The subject of inequality is central to any discussion of the role of the welfare state, but in this essay I will ask you to think not just about inequalities in the here and now but also about how these inequalities play out across generations.

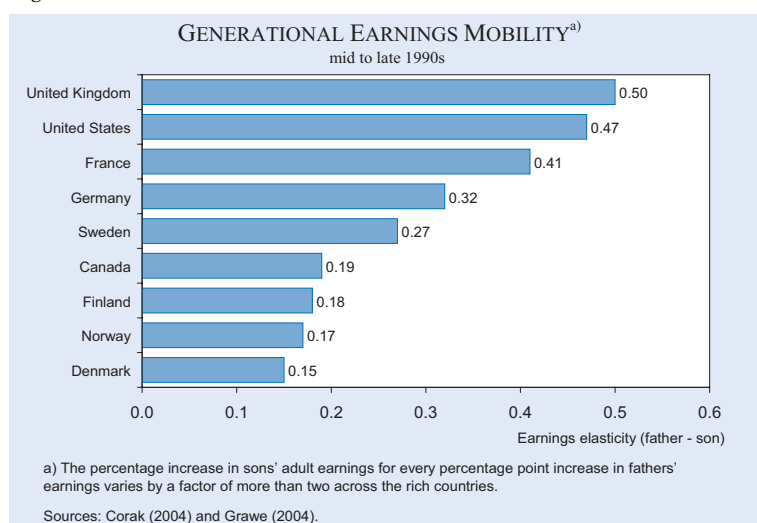
There is a sense in which a high level of income inequality need not necessarily reflect, in Sen's words, an "unfreedom" and would in fact be tolerated by even the poorest in society. This would be the case if there were flux and mobility across the generations, if, in spite of current circumstances, the children of the poor were as likely to grow up to be high-income adults as the children of the rich. Similarly, the same high level of inequality in the here and now may have very different implications for social cohesion and individual welfare when there is very little generational income mobility, when child outcomes are strongly tied to the circumstances of the families in which they were raised.

One direct measure of generational income mobility is the strength of the link between an individual's earnings and his or her parents' earnings when they were raising their family. This tie will determine the income advantage, relative to the average family, that higher income parents pass on to their children. Or for that matter the income disadvantage that lower income parents pass on.

The percentage increase in a child's adult income for every percentage point increase in income of his or her parents is presented in Figure 1 for a number of OECD countries. This information is based upon the comparative research by Nathan Grawe (2004) and a broader synthesis of the literature by myself in Corak (2004). The higher this statistic, the lower the degree of generational mobility. These findings suggest that first there is a good deal of variation across the rich countries – by at least a factor of two – in the degree

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Figure 1



to which an earnings advantage is passed to children. Second, in no country is the inherited parental advantage much lower than one-fifth. The United States, the United Kingdom and to a slightly lesser extent France stand out as being the least generationally mobile societies, with every 10 percent increase in parental income implying that the grown-up child incomes will be 4–5 percent higher. At the other extreme are Denmark, Norway, Finland, and Canada where the relationship is more than half as weak.

In the United States households with children under the age of 18 at the top income quintile had 12 times as much money as those at the bottom quintile. The information in Figure 1 can be used to translate this ratio into the economic advantage a child from the higher-income family can expect to have in the next generation over one from the lower income family. The 0.47 statistic reported for this country implies that the adult income of someone born to a family at the top would be almost three and one third times higher than someone born to a family at the bottom. With a value in the order of 0.2, as for example in Canada, this income advantage would still have been significant, but at less than 66 percent much smaller.

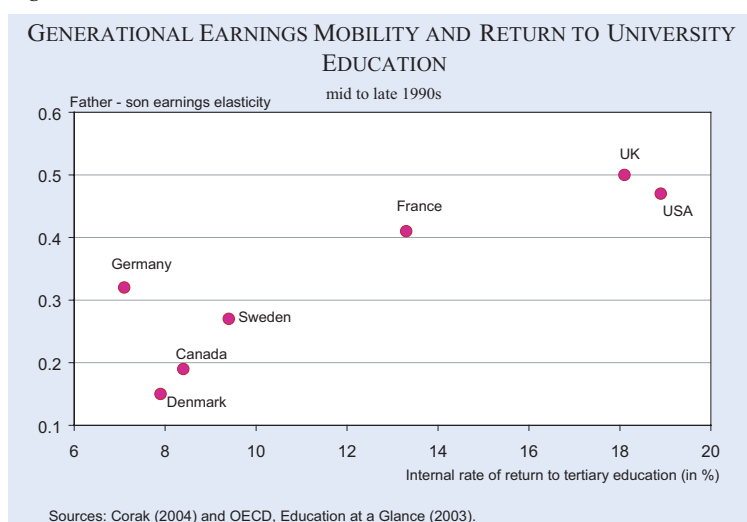
But what exactly does this statistic mean? The information in Figure 1 is purely descriptive and on its own tells us nothing about the reasons for the degree of generational mobility or for the differences among countries. Effective policy intervention requires not

just an awareness of raw correlations, but also an understanding of causal processes. I would like to focus on two of several mechanisms that underpin these generational mobility figures and that open up distinct opportunities for the conduct of public policy. The first has to do with how labour markets work, and the second with the relative benefits of public policy.

By expanding upon the standard theoretical models used by economists to study generational earnings mobility Gary Solon (2004)

argues that more labour market inequality implies less generational mobility. His analysis suggests that in an economy emphasizing human capital as the basis for sustained growth – one in which the economic returns to education have a tendency to rise – more challenges will be placed in the way of generational mobility. Indeed, one important determinant of the degree of earnings inequality is the return to higher education. Figure 2 shows that a higher return to university education is associated with tighter links between father and son outcomes. The Figure presents a scatter plot between the estimates of generational income mobility from Figure 1, and the private rate of return to university education (relative to secondary education). For these countries there is a clear positive relationship. The three countries with rates of return higher than 10 percent – the United States at 18.9 percent, the United Kingdom at 18.1 percent, and France at 13.3 percent – are the countries with the least generational earnings mobility.

Figure 2



Jo Blanden, Alissa Goodman, Paul Gregg and Stephen Machin (2004) also use the framework offered by Solon to examine variations in the degree of generational mobility over time within a specific country, the United Kingdom. They find that the degree of mobility actually declined between a cohort of young people growing up in the 1960s and 1970s and another growing up a decade later. The authors explain this by noting that this period was one of widening wage and income disparities. But they also note that while the educational attainments of the young increased significantly over this period, they did so in a way that was of relatively greater benefit to those with higher-income parents.

In addition to shedding light on developments over time in one country this suggests that there could well be a number of possible explanations for the cross-country patterns observed in Figure 2. In particular it may be that countries with higher rates of return also have very different structures and policies in place in terms of access to higher education, since one of the reasons for an elevated rate of return is the presence of restrictions in the supply of university graduates. In this sense it may also be that a higher rate of return reflects inequality of opportunity. And, further, higher rates of return do change the incentive for parents, leading those who value education most to invest even more in their children.

This explanation focuses on the structure of rewards and private investments in children, but it also raises the question of differences in opportunity, that is, the extent to which children from higher income families are more likely to capitalize on the rewards available to higher education. Thus, the second factor likely to explain cross-country differences in generational mobility has to do with the opportunities children are afforded and the nature of public investment in them.

Susan Mayer and Leonard Lopoo (2004) point out that increases in “progressive” investments – those of relatively more benefit to the less well off – will loosen the link between parent and child outcomes. Traditionally, this was seen as an important aspect of public schooling. Societies differ a good deal in their levels of spending on education. This is illustrated in

Figure 3

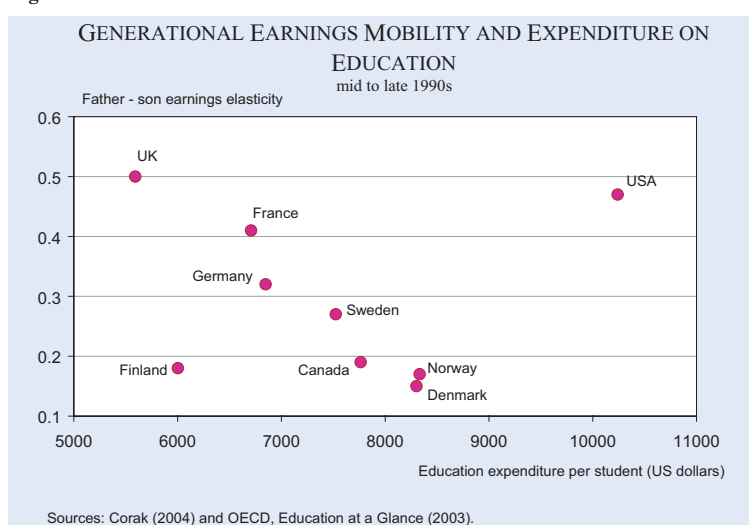


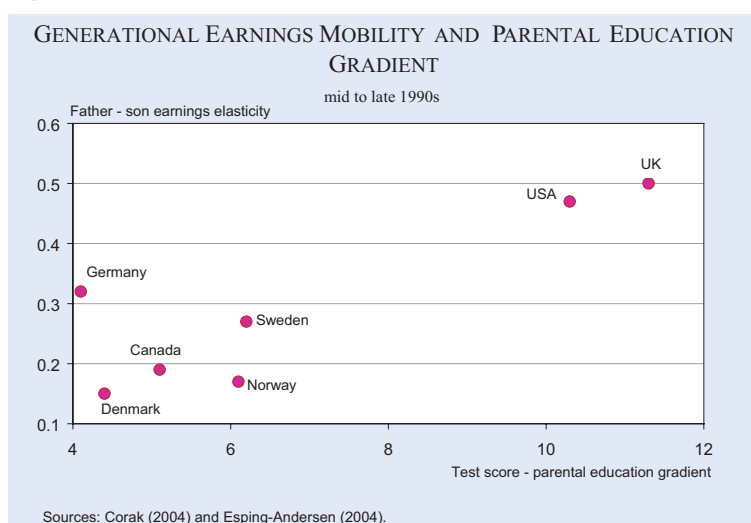
Figure 3, which plots the information from Figure 1 against the education expenditure per student.

More spending per student is generally associated with more generational mobility. But the relationship between spending on education and the degree of generational mobility is not as simple as that. For instance, the United States is a clear outlier, with the highest levels of spending but also one of the strongest tie between fathers' and children's earnings. On the other hand, the United Kingdom and Finland both spend relatively low and similar amounts per student but are characterized by very different degrees of generational mobility.

The important point from these results is that not only the overall level of public spending on education matters, but also *how* the money is spent. In other words, the way education systems are structured and how the cognitive capacities of children are developed to allow them to take advantage of whatever opportunities are made available is important.

The best way to understand these patterns is to recognize the extent to which public investments are of relatively more benefit to the disadvantaged. One possible measure of this is how tightly related the abilities and skills of children are to the educational levels of their parents. Esping-Andersen (2004) argues, for example, that if literacy and numeracy skills in adulthood are strongly correlated with parental educational levels, this suggests that spending on education has done little to level out relative advantages and disadvantages that are based in the home and possibly that public investments have not been terribly “progressive”.

Figure 4



This information is available for seven of the countries highlighted in Figure 1, and the relationship with generational earnings mobility is illustrated in Figure 4. In these countries there is a very strong positive relationship between the numeracy/literacy skills of adult children and the educational levels of their parents, with Germany being the only significant outlier.

This pattern reflects the inequality of private and public investment in children. If the degree of income inequality is higher in one country than another it might be reasonable to expect that not only will the rewards of a given level of investment be higher, but also that the level and distribution of investment in children will be different. A country with more income inequality might also have more inequality in the investment that rich and poor parents can make in their children, and hence a lower degree of generational income mobility.

But the extent to which this is so will also depend upon the degree to which children from less advantaged backgrounds disproportionately benefit from public programs. Under certain circumstances universal government programs can reduce the investment gap between rich and poor children. If the first dollar of investment creates the greatest increase in the well-being of the child, then when government invests equally in all children, poor children are likely to gain more than affluent children. The information in Figure 4, for example, suggests that the UK and the US get relatively little punch in terms of higher generational mobility for every dollar spent on education because the structure of their educational systems reinforces the relative advantages and

disadvantages children get from their home environment rather than levelling them out.

Indeed, the great promise of government investment in the expansion of universal education and increased access to higher education during the postwar period was that it would give children from relatively disadvantage backgrounds an extra push and put them on a par with their fellow students. Figure 4 suggests that there are still very large differences in the extent to which this has been done in the welfare states of

the rich countries, and as such offers an important hint as to why countries differ in the degree to which economic advantage is passed on between parent and child.

In sum, the generational mobility of earnings in the Nordic countries and Canada is higher than other rich countries because first, labour market inequalities and the returns to education are relatively lower, and second, the mix of public and private investments in children has been relatively progressive. But this story reflects the situation of the last 30 years or so, a generation that was born in the 1960s, came of age and went to middle school and university in the 1970s and 1980s, and found its place in the labour market of the 1990s. It cannot be uncritically transposed to today's newborns and elementary school children, who will be attending the colleges and universities of the 2020s and working in the labour market of the 2030s.

One important future challenge concerns access to education. In some countries – the United Kingdom and Canada for example – a climate of higher tuition fees is on the horizon, and it is also likely that the education systems in these countries may also witness more decentralization in the way fees are set. Fees on average will likely continue to rise, but they may also vary a good deal more – between institutions and also fields of study. A much more differentiated post-secondary system is in the offing.

In this context there is a growing concern about access to university education. And while there may be a need for more public funding and for reconsideration of the structure of supports to students, particularly to those from low-income backgrounds, the issues of ac-

cess are more than just financial. Access to higher education is often discussed in very broad terms, that is, whether students are more or less likely to attend university according to their family income. In the coming years the significance of access to higher education may also be more narrowly framed to refer to access to particular institutions or fields of study. Generational mobility will also be influenced by the nature of universities' student selection criteria.

If children from higher income families are more likely to have the skills to gain admittance to those areas most highly rewarded in the labour market, a rise in admission standards and the development of other selection criteria may lead to stronger links between family background and post-secondary participation in particular institutions or fields of study. In this sense it is important for policy-makers to understand the non-financial barriers to accessing higher education, particularly circumstances earlier in the lives of young people that help them continue their education after middle school.

This is why Esping-Andersen (2004) argues that concerns about generational mobility may lead policy-makers to focus increasingly on the family, particularly its role in the development of children's cognitive abilities. Cognitive and social skills are an important determinant of long-run earnings; they are only loosely correlated with educational attainment; and cognitive performance is more closely related to the "cultural capital", or to put it more broadly, the "parenting style" of the family, than it is to its material wealth. In fact, the kinds of parental investments that are decisive are not the monetary kind. The inheritance of education, occupation and income is influenced in the first instance by the impact parents have on a child's cognitive performance, and – as Figure 4 illustrates – societies leveling the playing field with respect to these circumstances have had the most success in promoting generational mobility.

This is also why even in the Nordic countries and Canada as many as one-third of children from low income backgrounds grow up to be low income adults, in spite of the loose overall tie between the incomes of children and parents. On average these societies are very mobile across the generations, but a significant proportion of children fall through the cracks in this fabric.

Early childhood initiatives may play an important role in determining the degree of generational mo-

bility. If this is the case social policy may increasingly be called upon to equalize the impact families have on children's skills, beliefs and motivation. The impact of early childhood initiatives on generational mobility will depend upon the extent to which they prove to be effective and of relatively more benefit to children in disadvantaged families. But John E. Roemer (2004) offers a cautionary note for policy makers concerned with equality of opportunity. Does equality of opportunity imply that there should be no correlation in incomes across the generations? Should in other words governments set the absence of any correlation in generational incomes as a target to guide policy?

Roemer answers these questions by first noting that equality of opportunity implies that inequities of outcome are indefensible when they are due to differential circumstances, but also by noting that societies and parents influence their children through a hierarchy of circumstances. If we are to understand what equality of opportunity means and how it can be influenced, we have to know what these circumstances are. In Roemer's view parents influence their children through a hierarchy of circumstances: through social connections that facilitate access to education and jobs; through family culture and investments that influence beliefs and skills; through the genetic transmission of ability and through the formation of preferences and motivations. These are the successively broader fields – each corresponding to a successively broader definition of equality of opportunity – which policy makers could potentially seek to level.

Roemer makes explicit that equating equality of opportunity with complete generational mobility – with no statistical tie between parent and child earnings – implies that not only should the influence of social connections and also of family culture and investment be eliminated, but so should the genetic transmission of ability and the influence of family on the formation of preferences and goals among children. He argues that this is "a view that only a fraction of those who consider the issue would, upon reflection, endorse".

This is a cautionary note: to eliminate entirely the income advantage that is passed from parents to children would require a degree of intervention into the lives of children and families that the majority in most societies would find untenable. The degree to which the parental income advantage passed on to

children is consistent with equality of opportunity is not self-apparent. It requires a definition of the circumstances unacceptable as sources of labour market success, an understanding of the effectiveness of policy interventions, and recognition of the trade-offs between the gains in eliminating them and the losses in terms of other measures of welfare.

The capacity of children to become self-sufficient and successful adults is compromised not only by monetary poverty, but by poverty of experience, influence and expectation. This argument calls for broader thinking on the mechanisms and causes of generational mobility, and the extent to which it draws governments into broader areas of social and family policy will depend upon societal values.

But what is clear is that the postwar agenda of offering increased access to higher and higher levels of schooling seems to have reached its limit. If the rich societies wish to continue to promote equality of opportunity, then they will need to invest more in children earlier in their lives to ensure that they have the skills and the opportunities to succeed in the labour market. This shift in direction may involve a conception of equality of opportunity that has different degrees of support, because it requires that public policy influences the impact that families have on their children's skills, beliefs and motivation.

In this sense, whether the welfare states of the rich countries are able to offer effective programs of relatively more benefit to the least advantaged is the major challenge determining whether the next generation will enjoy the same degree of opportunity, or – to use Sen's word – freedom, as the last generation.

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