

Intergenerational social mobility, income inequality and the Carnegie effect

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Abstract

Using US data, we study how income inequality affects intergenerational social mobility (ISM). We show that higher parental inequality reduces upward ISM at the bottom of the income distribution, but increases downward ISM at the top. We explain these results using a life-cycle model in which individuals are altruistic towards their offspring and suffer disutility of effort. Investment in education and effort increase earnings. This model introduces two mechanisms that explain the different effects of inequality on ISM. First, borrowing constraints limit investment in education and reduce future income of children born in poor families, which explains that higher income inequality reduces upward ISM at the bottom of the distribution. Second, due to the disutility of effort, children from affluent families exert less effort, which explains that higher income inequality increases downward ISM at the top of the distribution. We use the model to study the effect of higher income inequality on future aggregate income.