Chapter 1

Introduction

Opportunities for economic success are usually not equal across individuals in a society; in fact, they are characterized by inherited social structures. During feudalism in medieval Europe personal economic success, and thus the distribution of income and wealth in society, was determined by the property passed from father to (first-born) son. In contrast, today education is one of the most important factors for personal economic success. However, family background still plays a crucial role, as parental income influences children's opportunities through investment in their human capital. Therefore income levels are to some degree persistent across generations. Shedding light on this persistence on both theoretical and empirical grounds is the subject of this part of the thesis.

Redistributive policy to reduce economic inequality may enhance intergenerational income mobility. For example, education policy diminishes the economic inequality that exists across generations *ex ante* and in addition may increase mobility. Apart from influencing income mobility, redistributive policy also affects equality of opportunity, which means equal life chances for all citizens concerning schooling, occupation, and other areas of personal advancement.[1] An individual's prospects of success are (at least partially) dependent on his or her social origins. Poverty, for example, tends to be passed from generation to generation. Education policy, as an investment in the human capital of the children in society, can be understood as intergenerational transfer payments. Such policies diminish long-term intergenerational inequality and promote greater equality of opportunity. Hence, education policy can be rationalized not only by efficiency arguments (e.g. external effects, imperfect capital markets), but also to promote greater equality of opportunity, for example a distributional argument.

[1]For this, see Weizsäcker (1999).

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Part I of this thesis initially aims to analyze the influence of redistributive policy, namely education policy, on intergenerational income mobility in society (Chapter 3). Subsequently, Chapter 4 empirically investigates the main channels through which economic advantage and disadvantage are passed across generations, focusing on Germany. Here the role of education in transmitting income inequality across generations is examined further.

Looking first at Chapter 3, public education affects not only equality of opportunity and income mobility, but also the parents' behavior when it comes to investing in their children's human capital. Investing in a child's human capital enhances his or her prospects of success. Therefore parents have to decide how much of their available income they are willing to spend as human capital investment in their child, facing the trade-off between their own consumption and a higher income for their children through such investment. When analyzing the effect of education policy on the degree of intergenerational mobility, besides the direct effect, its indirect effects on individual behavior—namely parent's reaction to varying education policies—is explicitly taken into account. The optimal level of private investment in the child's human capital increases with both parental income and the future earnings' rate of return of human capital investment.

In addition, the level of private investment in human capital depends on public education, allowing for the three potential interactive effects of public and private human capital investment: (i) public and private human capital investment are substitutes for each other, (ii) there is no relationship between public and private human capital investment, and (iii) public and private human capital investment are complements. It turns out that the underlying interactive effect of public and private human capital investment is vital for the success of education policy in enhancing intergenerational income mobility. Only if public education crowds out private human capital investment, the implementation of such education policy will increase intergenerational income mobility. Put differently, if public and private human capital investment complement each other, public education will decrease intergenerational income mobility. Hence, in addition to affecting parents' behavior, education policy significantly influences intergenerational income mobility. Beneficial for individual prospects of success, human capital substantially influences intergenerational income mobility.

Here family background and the return to education strongly determines an individual's level of human capital and thus his or her prospects of success.

Capturing the importance of human capital formation, the mechanisms that underlie income persistence across generations in Germany were empirically analyzed in Chapter 4. Here the focus is on the role of education in the intergenerational transmission process, but also other potential pathway factors are taken into account for transmitting economic advantage and disadvantage across generations, such as occupation and labor market attachment. In this context intergenerational income immobility—as a measure of the size of the economic parent-child connection—is decomposed into its direct and indirect components. Here the direct components are any factors not explained by the pathway factors included in this analysis. The indirect components measure the extent to which income persistence across generations is explained by the pathway factors. For example, examining education as a pathway of intergenerational transmission, the indirect component consists of (i) the effect of parental income on educational attainment and (ii) the influence of education on economic success. Thus, in line with theory, the indirect component comprises the influence of family background on educational attainment and the return to education. It turns out that at least one-fifth of the income persistence in Germany is explained solely by education. To insure robustness, the findings for Germany are compared to those for Great Britain and the United States as measured by Blanden, Haveman, Smeeding, and Wilson (2014). Education and occupation are the main channels in all three nations through which economic advantage and disadvantage are passed across generations. However, there are large differences in the explanatory power as well as the existing income mobility across the nations mainly because of varying returns on specific pathways.

Part I is organized as follows: Chapter 2 points out connections to the existing literature on this topic. Chapter 3 theoretically addresses the influence of public education on intergenerational income mobility within society. Chapter 4 empirically investigates mechanisms that underlie income persistence in Germany. Finally, Chapter 5 summarizes Part I.

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