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The Intergenerational Transmission of Income Volatility: Is Riskiness Inherited?

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Abstract

This paper examines the intergenerational transmission of income risk. Do risky parents have risky kids? Income volatility, a proxy for risk, is not observed directly; instead, it must be estimated – with substantial error – from the time-series variability of income. I characterize a process for income and use it to obtain individual-specific estimates of permanent and transitory income volatility for parents and their adult children in the Panel Study of Income Dynamics (PSID).

I find that parents with higher income volatility have children with higher permanent income volatility. This effect is similar in magnitude to the intergenerational transmission of education. These results are apparent only after correcting explicitly for the attenuation bias induced by measurement error in the parents' volatility parameters.