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Insurance against Income Shocks, Parental Investments, and Child Development

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Faced with income shocks, households may be unable to smooth their consumption, because of limited insurance possibilities. Likewise, it may also be difficult to smooth investments in children. This could have large consequences for their human capital if there are sensitive periods of learning, or if investments are not perfect substitutes over time. In this paper we estimate the impact of transitory and permanent shocks to household income in different periods of childhood on the human capital of their children, using administrative records from Norway. Across outcomes, the impacts of transitory and permanent shocks are largely similar regardless of the age at which they occur, with a few exceptions (small in magnitude). The impact of transitory shocks is larger for college enrolment and obesity if these shocks occur at earlier ages. The impacts of permanent shocks on high school graduation are larger the later in childhood they occur.

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Highlights

- Household income shocks may drive child human capital if the parents are unable to fully insure investments in children against unexpected changes to income
- The timing of these income shocks may be particularly important if there are sensitive or critical periods of learning, or if investments are not perfectly substitutable across time
- Using Norwegian administrative data, we find that the timing of income shocks across childhood matters very little for child schooling, IQ, health and teen pregnancy
- In some instances, the timing of the shocks does matter – transitory shocks to income have more impact on college enrolment and obesity *earlier* in the child's life, whereas permanent shocks to income *later* in life matter more for high school graduation

Why does this matter?

Identifying the periods of childhood where parents find it harder to insure against income shocks will help to design optimal social insurance programmes