Abstract:

Do people end up in financial trouble simply because of adverse shocks, or is financial trouble related to persistent differences in financial attitudes and behavior that may be transmitted from generation to generation? We address this question using a new administrative data set with longitudinal information about defaults for the universe of personal loans in Denmark. We provide non-parametric evidence showing that the default propensity is more than four times higher for individuals with parents having defaulted on a loan compared to those with parents not in default. This inter-generational relationship is apparent soon after children move into adulthood and become eligible to establish debt, and it is remarkably stable across age groups, levels of loan balances, parental income levels, child school performances, time periods and measures of financial trouble. Simple theory points to three explanations of the correlation across generations in financial trouble: (*i*) Children and parents face common shocks; (*ii*) Children and parents insure each other against adverse shocks; (*iii*) Financial behavior differs across people and is transmitted across generations. We provide evidence indicating that the last explanation is by far the most important. Finally, we show that the inter-generational correlation in financial trouble is not fully incorporated in interest setting, pointing to adverse selection in the market for personal loans.