BEQUESTS, SAVING, AND WEALTH INEQUALITY[†]

Inheritances and Wealth Inequality, 1989–1998

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The paper explores whether inheritances and other wealth transfers are, on net, equalizing or disequalizing with respect to current wealth holdings. The study makes use of the Survey of Consumer Finances for the United States over the 1989–1998 period. As far as I am aware, this is the first study on this question.

I. Literature Review on Inheritances

Survey evidence on the importance of bequests is fairly consistent. Dorothy Projector and Gertrude Weiss (1966), using the 1963 Survey of Financial Characteristics of Consumers, reported that only 17 percent of families had received any inheritance. Paul Menchik and Martin David (1983), using probate records of men who died in Wisconsin between 1947 and 1978, estimated that the average intergenerational bequest amounted to less than one-fifth of average household wealth in 1967 and about 10 percent of the average household wealth of families 65 or over in age.

Michael Hurd and Gabriella Mundaca (1989) found from the 1984 Survey on the Economic Behavior of the Affluent data that only 12 percent of households in the top 10 percent of the income distribution reported that more than half their wealth came from gifts or inheritances, and only 9 percent in the 1983 Survey of Consumer Finances. However, William Gale and J. K. Scholz (1994), using the 1983 Survey of Consumer Finances, estimated that at least 51 percent of household wealth is accounted for by inheritances and other "intentional" wealth transfers.

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II. Data Sources and Methods

The data sources used for this study are the 1989, 1992, 1995, and 1998 Survey of Consumer Finances (SCF) conducted by the Federal Reserve Board. Each survey consists of a core representative sample combined with a high-income supplement. For some years and assets, asset values are adjusted to align with total balance-sheet values computed from the Flow of Funds data (see Wolff [1996, 1998] for details).

The wealth concept used here is marketable wealth (or net worth), defined as the current value of all marketable assets less debt. Assets include houses and other real estate; bank and money market accounts; financial securities; whole-life insurance; defined-contribution pension plans, including IRAs, Keogh, and 401(k) plans; corporate stock and mutual funds; unincorporated businesses; and trust funds. Total liabilities are the sum of mortgage debt, consumer debt, and other debt. This measure includes only assets that can be readily converted to cash (i.e., "fungible" ones). Consumer durables such as automobiles are excluded here, since these items are not easily marketed. The other notable exclusions are the value of future Social Security retirement benefits ("Social Security wealth") and that of defined benefit pensions ("pension wealth"). Even though these funds are a source of future income to families, they are not directly marketable.

III. Trends in Inheritances

Questions on inheritances and gifts are asked in two different ways in the SCF. First, there are several questions on "general wealth transfers," which are asked in a special section on gifts and inheritances and refer to any type of gift or inheritance. Second, there are specific questions on inheritances and gifts of real estate and busi-

TABLE 1—TIME TRENDS IN WEALTH TRANSFERS, 1989–1998

Measure	1989	1992	1995	1998
Percentage of households receiving wealth transfers[a]	23.5	20.7	22.2	20.4
Present value of wealth transfers for recipients only[b]				
Mean	312.2	313.3	345.8	256.9
Median	51.8	50.0	51.9	54.5
Present value of wealth transfers as a percentage of net worth	29.7	25.8	35.5	19.4

Note: The table reports own computations from the 1989, 1992, 1995, and 1998 Survey of Consumer Finances.

[a] The figures record the proportion of households who indicate receiving a wealth transfer at any time before the time of the survey.

[b] The figures show the present value of all transfers received up to the time of the survey and accumulated at a real interest rate of 3.0 percent.

nesses. In 1998, 20.3 percent of households responded "yes" to the questions on general wealth transfers, and only 0.1 percent reported receiving a specific wealth transfer but not a general wealth transfer. It seems very likely that the answers to the general-wealth-transfer question capture almost all of the specific wealth transfers. I therefore include specific wealth transfers only when no general wealth transfer was reported.

On the basis of both the value and date of wealth transfers, I compute the present value of all inheritances received as of the survey year using a real interest rate of 3.0 percent and then converting to 1998 dollars. There is disagreement in the literature about whether all capital gains received on past inheritances should be counted as part of inheritances or as part of savings. My procedure is essentially a compromise. I assign a normal rate of return of 3 percent on assets received from wealth transfers and count only this part of the return in the inheritance portion of current wealth.

As shown in Table 1, 20.4 percent of all households reported receiving a wealth transfer in 1998. This figure is comparable to those from previous U.S. surveys. The fraction receiving a wealth transfer declined from 23.5 percent in 1989 to 20.7 percent in 1992, rose to 22.2 percent in 1995, and then fell once again to 20.4 percent in 1998. In 1998, the mean present value of wealth transfers among recipients was $260,000 and the median was $54,500. The results of Table 1 also indicate a sharp decline in the mean present value of wealth transfers between 1989 and 1998—almost 18 percent. The median value showed a moderate increase of 5 percent.

The present value of wealth transfers received as a percentage of the current net worth of households was 19.4 percent in 1998. This figure is comparable to previous estimates for U.S. households. However, since net worth has risen during the 1990's and the wealth transfers have declined, this ratio has also fallen rather sharply, from 29.7 percent in 1989, 25.8 percent in 1992, and 35.5 percent in 1995.

As expected, the share of recipients rose very strongly with income and wealth level (Table 2). In 1998, 39 percent of households in the highest income bracket reported a wealth transfer, compared to 14 percent in the lowest income bracket; and 45 percent of households in the highest wealth bracket received a transfer, compared to 10 percent in the lowest wealth bracket (the patterns are very similar for other years).

The proportion of non-Hispanic white households reporting a wealth transfer in 1998 was more than twice as great as the share of non-Hispanic African-Americans (23.8 vs. 10.8 percent). Only 4.2 percent of Hispanic households reported a wealth transfer, and only 9.1 of Asian and other races. As expected, the likelihood of receiving a wealth transfer also increased with age. In 1998, the share of households under age 35 receiving a transfer was 12 percent, compared to 34 percent of those in age bracket 65–74.

I also find similar patterns for the mean value of wealth transfers. They tend to rise with household income and wealth. In 1998, the mean present value of wealth transfers for the top income class was almost 16 times as great as for the lowest, and more than 25 times as great for the top wealth class as for the lowest. Wealth transfers were 54 percent greater for non-Hispanic whites than for non-Hispanic African-Americans. The mean transfer for households age 75 and over was six times as great as that for the youngest age group (under age 35).

However, surprisingly, while both the percentage of households receiving a wealth transfer and the value of those transfers rise almost monotonically with income and wealth class, the present value of wealth transfers as a share

TABLE 2—PRESENT VALUE OF WEALTH TRANSFERS AS A PERCENTAGE OF NET WORTH, 1998

Category	Percentage of households with transfers	Mean wealth transfer for recipients[c]	Transfers as a percentage of net worth
All households	20.4	256.9	19.4
A. *Income Level (1998\$):*			
Under \$15,000	13.7	155.4	44.8
\$15,000–\$24,999	21.9	140.9	35.2
\$25,000–\$49,999	19.9	208.7	33.8
\$50,000–\$74,999	21.5	131.1	12.6
\$75,000–\$99,999	20.5	176.0	11.0
\$100,000–\$249,999	32.2	357.3	13.0
\$250,000 or more	38.9	2,416.8	18.0
B. *Wealth Level (1998\$):*			
Under \$25,000	9.9	52.7	9,896.9
\$25,000–\$49,999	20.0	82.4	45.5
\$50,000–\$99,999	19.6	100.8	27.1
\$100,000–\$249,999	26.0	120.5	19.6
\$250,000–\$499,999	31.7	180.4	16.5
\$500,000–\$999,999	35.5	427.4	22.6
\$1,000,000 or over	44.9	1,325.9	17.1
C. *Race:*			
Non-Hispanic whites	23.8	264.9	19.7
Non-Hispanic African-Americans	10.8	171.6	31.9
Hispanics[a]	4.2	118.6	6.3
Asian and other races	9.1	272.6	9.7
D. *Age Class:*[b]			
Under 35	11.8	109.0	21.8
35–44	15.5	134.0	11.4
45–54	19.4	205.5	11.6
55–64	27.7	274.5	14.7
65–74	34.5	247.7	18.8
75 and over	28.4	609.1	57.1

Note: The table reports own computations from the 1998 Survey of Consumer Finances (see notes to Table 1).

[a] Hispanics can be of any race.

[b] Households are classified according to the age of the head of household.

[c] Values reported are thousands of 1998 dollars.

of household net worth tends to *decline* with both income and wealth. In 1998, the ratio was 0.45 for the lowest income class and only 0.18 for the highest income class. Likewise, the ratio was 0.46 for second-lowest wealth class (99 for the bottom wealth class), compared to 0.17 for the top wealth class. The rationale is that, while the dollar value of wealth transfers is greater for wealthier groups, small gifts and bequests mean more to poorer families.

It is also of note that wealth transfers amount to a greater proportion of the current net worth of African-American than of white households: 32 percent versus 20 percent in 1998. Wealth transfers as a share of current wealth tend to have a U-shaped relation with respect to age. The share is high for young households, because of their low savings, and for older ones, because of the high absolute value of such transfers. It is low for middle-age ones, because of their relatively small amount of inheritances and large level of savings.

It is not possible to simulate here the effects of eliminating wealth transfers on the size distribution of wealth. Such an exercise would require a full behavioral model of household savings. However, one can use a decomposition analysis to assess the effects of inheritances and other wealth transfers on the inequality of wealth. As derived in Wolff (1987), for any variable $X = X_1 + X_2$,

$$\mathrm{CV}^2(X) = p_1^2\mathrm{CV}^2(X_1) + p_2^2\mathrm{CV}^2(X_2) + 2\mathrm{CC}(X_1, X_2)$$

where CV is the coefficient of variation (the ratio of the standard deviation to the mean), CC is the ratio of the covariance to X^2, $p_1 = X_1/X$, and $p_2 = X_2/X$.

It is first of note that the correlation between wealth transfers (WT) and current wealth holdings excluding transfers (NWX) is negative in all four years; that is, households with lower wealth holdings exclusive of wealth transfers received higher wealth transfers (Table 3). The value of the correlation coefficient varied over time, from -0.30 in 1989 to -0.71 in 1992. In 1998, the value was -0.47. As a result, in all four years, the (negative) correlation between WT and NWX served to reduce overall wealth inequality. However, the distribution of wealth transfers is much more skewed than the distribution of NWX. In 1998, the coefficient of variation of NWX was 9.1, compared to a value of 22.5 for WT. From this effect, the addition of wealth transfers to other wealth holdings serves to increase overall wealth inequality.

TABLE 3—CONTRIBUTION OF WEALTH TRANSFERS TO OVERALL WEALTH INEQUALITY, 1989–1998

Category	1989	1992	1995	1998
A. *Decomposition of $CV^2(NW)$*:				
p_1^2CV^2(NWX)	45.5	80.5	79.5	54.2
p_2^2CV^2(WT)	12.0	52.9	49.5	18.9
2CC(NWX,WT)	−14.2	−92.6	−80.5	−29.9
CV^2(NW)	43.3	40.8	48.4	43.2
Correlation(NWX,WT)	−0.3	−0.7	−0.6	−0.5
B. *Percentage Decomposition of $CV^2(NW)$*:				
p_1^2CV^2(NWX)	105.1	197.5	164.2	125.4
p_2^2CV^2(WT)	27.6	129.8	102.2	43.7
2CC(NWX,WT)	−32.7	−227.3	−166.4	−69.1
CV^2(NW)	100.0	100.0	100.0	100.0

Notes: The table reports own computations from the 1989, 1992, 1995, and 1998 Survey of Consumer Finances (see notes to Table 1). Key: CV = coefficient of variation; CC = covariance (NWX, WT)/NW^2; NWX = total net worth excluding wealth transfers; WT = wealth transfers; NW = NWX + WT = Total net worth; p_1 = NWX/NW; p_2 = WT/NW.

The net effect of inheritances and other wealth transfers on overall wealth inequality depends on the relative magnitude of the two effects. In all four years, the covariance effect outweighed the direct effect of adding wealth transfers to other wealth holdings and actually resulted in a sizable reduction in wealth inequality (the coefficient of variation declined by 28 percent in 1989 and 1998 and by 50 percent in 1992 and 1995). From this standpoint, the net effect of wealth transfers has been to equalize the overall distribution of wealth.

IV. Concluding Remarks

The most surprising finding is that inheritances and other wealth transfers tend to be equalizing in terms of the distribution of household wealth. Indeed, the addition of wealth transfers to other sources of household wealth has had a sizable effect on reducing the inequality of wealth. The results appear counterintuitive. Richer households do receive greater inheritances and other wealth transfers than poorer households. However, *as a proportion of their current wealth holdings,* wealth transfers are actually greater for poorer households than richer ones. That is to say, a small gift to the poor means more than a large gift to the rich. However, the results do not imply from a behavioral point of view that inheritances lead to less wealth inequality, since the poor are liable to spend their (meager) inheritances, while the rich are likely to save them.

Another surprising finding is that a higher fraction of the wealth of African-Americans comes from wealth transfers than that of whites and other races. Low-income households and the young and old also receive a higher share of their wealth from transfers, relative to other groups.

Oddly enough, though wealth inequality has risen in the United States between 1983 and 1998, the increase may have been even greater were it not for the mitigating effects of inheritances and gifts. The results also suggest that the current structure of the estate tax is quite good from the standpoint of equity. It tax-exempts relatively small wealth transfers (including gifts), whereas it taxes large ones. Small transfers are equalizing in terms of wealth and should be maintained.

Two provisos for these results should also be mentioned. First, I have assumed that the underreporting biases (which likely exist in the recall method) are not systematically correlated with the level of household wealth. If the underreporting bias is greater for richer households, then the equalizing effect of wealth transfers will be overstated. Second, I have used a 3-percent capitalization rule for all inheritances and other wealth transfers. If the full capital gains received on wealth transfers are counted, then this method might raise the value of wealth transfers of the rich relative to the poor.

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