

PENNIES FROM HEAVEN: WILL INHERITANCES BAIL OUT THE BOOMERS?

Introduction

Financial security in retirement is of increasing importance to boomers as they approach their golden years. A topic of recurring interest is whether boomers are going to inherit large amounts of wealth from their parents.

Whether this constitutes wishful or realistic thinking is not an idle question, given the implications for retirement security and how inheritances might influence decisions to work and retire.

In this Data Digest, we review existing estimates of inheritances and compare them with data from the Federal Reserve Board's Survey of Consumer Finances (SCF) to determine how boomers are faring in this area of financial security. After discussing how inheritance amounts are estimated, we report the median value of inheritances already received and how many families expect to receive an inheritance. We then examine the distribution of inheritances by total net worth and conclude with a discussion of the role inheritances are likely to play in boomers' retirement security.

Estimating the Size of Inheritances

Much of the interest in inheritances was initiated by a report published a decade ago by Avery and Rendall (1993). The authors projected that approximately \$10 trillion in bequests would go to boomers between 1990 and 2040 in the form of nearly 115 million bequests—about 1.5 bequests for every boomer ever born or an average of \$90,000 per bequest.¹ Since then, other reports have

¹ Avery and Rendall (1993) estimated an average bequest of \$43,814 in 1990, increasing to \$107,180 in 2030 and decreasing to \$97,636 by 2040 (all figures in 1989 dollars).

projected average bequests of \$44,000² per household (Smith, 1997) or \$285,000 per estate³ (Havens and Schervish, 1999). These estimates vary not only because of the different measurement units—individuals, households, and estates—but also because researchers use a variety of assumptions when estimating the total wealth of individuals and projecting the amount that will be distributed to heirs.

For example, Avery and Rendall as well as Gokhale and Kotlikoff (2000) rely on age, sex, and current wealth to forecast total bequeathable wealth; however, they use different assumptions to calculate wealth transfers when a married individual dies and leaves a spouse behind. While Avery and Rendall assume that all household wealth transfers to the surviving spouse, Gokhale and Kotlikoff estimate that 15 percent of transferred wealth is immediately bequeathed to the couple's children. While such differences in methodology may be justifiable, they result in varying estimates of aggregate wealth transfers between generations.

The number and value of inheritances will also vary depending on assumptions about bequest motives and family size. While some researchers exclude childless couples from their analysis, others suggest that such couples often plan to leave bequests and include them (Avery and Rendall, 1993; Smith, 1997). We discuss

² Smith projects an average inheritance of \$44,000 among all households, or \$150,000 (in 1992 dollars) among households receiving an inheritance.

³ Based on an estimated aggregate amount of \$25 trillion (in 1998 dollars) among 87,839,311 estates between 1998 and 2052. See Havens and Schervish, Table 1.

additional factors that may affect the size of inheritances later in this Data Digest.

Finally, inheritance estimates vary because matching bequests with the financial records of heirs is difficult. For example, surveys that include questions about inheritances (such as the SCF and the Health and Retirement Survey conducted by the University of Michigan) do not solicit information from both potential bequestors and their future heirs. Additionally, inheritance plans and expectations may subsequently be altered by unexpected health or end-of-life expenses. Estate records are a very reliable but limited source of information because the Internal Revenue Service reports only taxable estates, which must exceed \$1,000,000.⁴ Fewer than 2 percent of all estates are taxable.

Methodology

This Data Digest relies on self-reported inheritances, gifts, or trusts in the SCF, a triennial survey providing detailed information on the finances of U.S. households.⁵ For simplification, we use *inheritances* to refer to any inheritances, gifts, or trusts and report the present value of all amounts received.⁶

⁴ The exclusion amount was \$600,000 at the time the data used in this report were collected.

⁵ The SCF asks “Including any gifts or inheritances you may have already told me about, have you . . . ever received an inheritance, or been given substantial assets in a trust or in some other form?” and solicits the year the amount was received. Our analyses exclude families in any survey year who reported that they had received an inheritance with a negative or zero value; a total of 27 families were excluded over the five survey years. The number of SCF respondents varies by survey year; our original sample size in 2001 is 4,442.

⁶ Each reported inheritance is increased by a real interest rate of 3.0 percent since the year of receipt and adjusted for inflation.

We present our findings for three age cohorts:

- *pre-boomers*, born before 1946;
- *boomers*, born in 1946 through 1964; and
- *post-boomers*, born after 1964.

Factors Influencing the Number and Size of Inheritances

A variety of factors influence the number and size of inheritances. These factors include the following:

Overall economic prosperity of the age cohort. Just as parental wealth affects the size of individual bequests, the economic prosperity of older generations affects the size of inheritances received by subsequent generations. One study found that relative to labor earnings, boomers are inheriting “only slightly more” than their parents (Gokhale and Kotlikoff, 2000). It remains to be seen if relatively high boomer earnings and economic prosperity (Keister and Deeb-Sossa, 2001) result in higher bequests to succeeding generations.

Life expectancy and retirement age. During the past half-century, average life expectancy at birth has increased from 68 to 77 years (Arias, 2002), while the median retirement age declined by a little more than five years⁷ during the same period (Gendell, 2001). As a result of these trends, income and savings must provide for retirement security over a greater number of years, reducing the amount available for bequests.

Unanticipated events and health care expenses. Unanticipated events such as reduced earnings or failing health may, as Hurd and Smith (1999) put it, “break the link between current intentions and future

⁷ Labor force data indicate a decline in retirement age of 4.9 years for men and 6.2 years for women between 1950 and 2000 (Gendell, 2001).

reality” when planning bequests. Even when out-of-pocket medical expenses are anticipated, they reduce the likelihood of a bequest (Smith, 1997).

Family size. The number of siblings directly affects the size of each gift or inheritance. On average, the parents of pre-boomers have 2.6 children, while boomer parents have 3.3 children and post-boomer parents have 2.6 children.⁸

Heritable wealth. Annuitized assets, such as Social Security, certain kinds of pensions, and health benefits (including Medicare and Medicaid), cannot be transferred to heirs. Social Security and pensions alone account for about half of all wealth held by segments of the population age 50 and older (Auerbach et al., 1995; Gustman et al., 1997).⁹

Taxes and charitable giving. The amount of assets available for bequests may be reduced by estate taxes and contributions to charitable organizations.

How Many Families Have Received or Expect to Receive an Inheritance?

In each of the SCF survey years, the percentage of families who have received or expect to receive at least one inheritance generally increases with age, as we would expect, although the differences among age cohorts are small. (See Table 1.)

In 2001, just over one-quarter (26.8 percent) of all boomers reported that they

had received or expected to receive at least one inheritance at some point in their life. Similarly, 27.0 percent of pre-boomers and 25.1 percent of post-boomers reported that they had received or expected to receive an inheritance.

Table 1: Percentage of Pre-Boomers, Boomers, and Post-Boomers Who Have Received or Expect to Receive an Inheritance, 1989–2001

| Year | Pre-Boomers (%) | Boomers (%) | Post-Boomers (%) |
|-------------|------------------------|--------------------|-------------------------|
| 1989 | 35.4 | 36.9 | 28.2 |
| 1992 | 31.1 | 28.8 | 27.6 |
| 1995 | 31.4 | 29.4 | 27.7 |
| 1998 | 32.5 | 28.0 | 27.2 |
| 2001 | 27.0 | 26.8 | 25.1 |

Source: Federal Reserve Board, Survey of Consumer Finances, 1989, 1992, 1995, 1998, 2001.

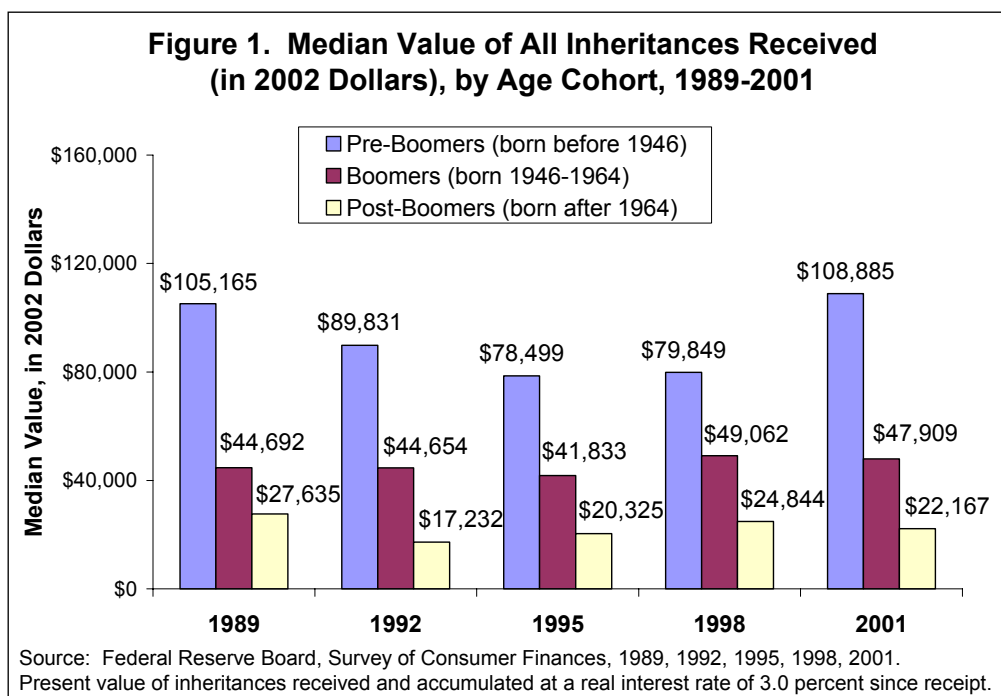
Between 1989 and 2001, the percentage of persons in each age cohort who reported receiving or expecting to receive an inheritance declined. For example, the percentage of boomers who reported receiving or expecting to receive an inheritance declined from 36.9 percent in 1989 to 26.8 percent in 2001. We would expect the total receipt of inheritances for a given cohort to be correlated with age and to increase over time, so this pattern is puzzling; the trend may reflect declining expectations over time or it could be the result of error that exists in every survey. We explore this trend later by examining separately the percentage of inheritances received versus expected.

How Much Money Do Families Receive from Inheritances?

Among boomer families that had ever received an inheritance by 2001, the median amount received was \$47,909 (in 2002 dollars). In comparison, the median for pre-boomers and post-boomers was \$108,885

⁸ Averages calculated based on total fertility rates for 1917 through 1986 (National Center for Health Statistics, 1976, 2002).

⁹ Auerbach et al. estimated that for persons aged 65 and older, 51 percent of wealth held by men and 54 percent of wealth held by women was annuitized as of 1990. Gustman et al. found that 50 percent of the wealth held by persons aged 51-61 was annuitized.



and \$22,167, respectively. (See Figure 1.) These amounts may include both *inter vivos* (between living people) gifts as well as bequests (transfers following death).¹⁰

Older cohorts (pre-boomers) have received larger total inheritance amounts than younger cohorts, reflecting the fact that they, and their parents, are older. The value of total inheritances received within each cohort also increases over time as the individuals and their parents grow older, but the trend is not consistent. While the median amount ever received by boomers did increase from \$44,692 in 1989 to \$47,909 in 2001, reported inheritances did not always increase during the 12-year period. Total inheritances ever received by pre- and post-boomers also fluctuated during the same period. These fluctuations may again be due to sampling error across surveys, or they

may reflect measurement error due to faulty recall.

How Many Families Have Received or Expect to Receive an Inheritance: A Closer Analysis

Among the families who reported receiving an inheritance, we find that 17.3 percent of boomers reported that they had already received at least one inheritance by 2001. Not surprisingly, a larger percentage of pre-boomers (24.0 percent) reported receiving an inheritance, reflecting the fact that they are older than boomers and have therefore had more opportunity to receive wealth transfers. In contrast, and reflecting their relatively young age, only 11 percent of post-boomers reported receiving an inheritance. (See Table 2.)

While the percentage of inheritances received by each of the age cohorts declines slightly from 1989 to 2001, the pattern is erratic, and probably cannot be attributed to faulty expectations because these numbers refer to actual (reported) inheritance experience. The reason for the

¹⁰ The survey question does not specify what should be considered a gift. It is therefore not possible to determine if gift amounts include wealth transfers such as college expenses paid by a parent.

Table 2: Percentage of Pre-Boomers, Boomers, and Post-Boomers Who Have Received At Least One Inheritance, 1989–2001

| Year | Pre-Boomers (%) | Boomers (%) | Post-Boomers (%) |
|------|-----------------|-------------|------------------|
| 1989 | 29.1 | 17.4 | 12.4 |
| 1992 | 27.1 | 15.5 | 9.9 |
| 1995 | 27.7 | 18.0 | 11.8 |
| 1998 | 29.1 | 16.9 | 11.8 |
| 2001 | 24.0 | 17.3 | 11.0 |

Source: Federal Reserve Board, Survey of Consumer Finances, 1989, 1992, 1995, 1998, 2001.

erratic pattern may simply be measurement or sampling error. Individuals who have already received an inheritance may, of course, receive another inheritance in the future.

In contrast to the slight decline in the percentage of inheritances received, the percentage of inheritances expected by each of the age cohorts fell sharply for pre-boomers and boomers between 1989 and 2001. (See Table 3.) This decline may reflect a greater certainty about bequest plans as people age (Smith, 1997).

In 2001, just under 15 percent of boomers expected to receive an inheritance in the future. Only 5.8 percent of pre-boomers in 2001 expected to receive any inheritances at this stage in their lives, most likely reflecting that they are the least likely of the three cohorts to have living parents. In contrast, 18.4 percent of post-boomers in 2001 expected to receive an inheritance.

The small decline in inheritances received by each cohort over time (Table 2) and the larger drop in inheritances expected (Table 3) appear to resolve the mystery of the puzzling pattern in Table 1: From 1989 to 2001, reports of inheritances received were stable, while expectations have changed.

Table 3: Percentage of Pre-Boomers, Boomers, and Post-Boomers Who Expect to Receive an Inheritance, 1989–2001

| Year | Pre-Boomers (%) | Boomers (%) | Post-Boomers (%) |
|------|-----------------|-------------|------------------|
| 1989 | 10.8 | 26.9 | 20.6 |
| 1992 | 8.4 | 19.3 | 24.6 |
| 1995 | 6.4 | 18.1 | 20.7 |
| 1998 | 6.2 | 16.4 | 19.3 |
| 2001 | 5.8 | 14.9 | 18.4 |

Source: Federal Reserve Board, Survey of Consumer Finances, 1989, 1992, 1995, 1998, 2001.

Who Receives Inheritances?

The distribution of inheritances by amount for each age cohort is shown in Table 4. More than four-fifths (82.2 percent) of all families reported that they had not received any inheritance by 2001. As noted in Table 2, pre-boomers were the most likely of the three age groups to have received an inheritance, and they were more likely to have received larger inheritances. Only about 7 percent of all those who had received an inheritance reported inheriting more than \$100,000, although this was the most frequently reported amount. More pre-boomers (12.8 percent) received this amount than boomers or post-boomers (5.4 and 2.0 percent, respectively).

Do the Rich Get Richer?

Among those who have received at least one inheritance, families with high net worth receive larger inheritances than those with low net worth. (See Table 5.) Families in the 4th and 5th (top two) quintiles have a net worth of at least \$140,283 and together received almost two-thirds (26.7 and 38.3 percent) of all inheritances. While 38.9 percent of all inheritances received were larger than \$100,000, just over 86 percent of these (33.6 percent of 38.9 percent) were received by families in the top two net worth

| Inheritance (in 2002 \$) | Pre-Boomers (%) | Boomers (%) | Post-Boomers (%) | All (%) |
|-------------------------------------|----------------------------|------------------------|-----------------------------|--------------------|
| No inheritance | 76.0 | 82.7 | 89.0 | 82.2 |
| \$1–\$20,000 | 3.2 | 5.2 | 4.9 | 4.4 |
| \$20,001–\$50,000 | 3.8 | 3.6 | 2.4 | 3.4 |
| \$50,001–\$100,000 | 4.2 | 3.1 | 1.7 | 3.1 |
| More than \$100,000 | 12.8 | 5.4 | 2.0 | 6.9 |
| Total | 100% | 100% | 100% | 100% |

Source: Federal Reserve Board, Survey of Consumer Finances, 2001.

Quintile limits are \$6,867, \$50,344, \$140,283, and \$381,030. Present value of inheritances received and accumulated at a real interest rate of 3.0 percent since receipt.

| Inheritance (in 2002 \$) | Net Worth Quintile | | | | | All |
|---|---------------------------|-----------------------|-----------------------|-----------------------|-----------------------|------------|
| | 1st | 2nd | 3rd | 4th | 5th | |
| \$1–\$20,000 | 2.8% | 4.9% | 6.7% | 7.0% | 3.5% | 25.0% |
| \$20,001–\$50,000 | 0.6 | 3.8 | 4.6 | 5.0 | 4.8 | 18.9 |
| \$50,001–\$100,000 | 0.9 | 2.1 | 3.2 | 5.9 | 5.2 | 17.3 |
| More than \$100,000 | 0.2 | 1.4 | 3.8 | 8.8 | 24.8 | 38.9 |
| Total Received by Net Worth Quintile | 4.5% | 12.2% | 18.3% | 26.7% | 38.3% | 100% |

Source: Federal Reserve Board, Survey of Consumer Finances, 2001.

Quintile limits are \$6,867, \$50,344, \$140,283 and \$381,030. Present value of inheritances received and accumulated at a real interest rate of 3.0 percent since receipt.

quintiles. One-quarter of all reported inheritances larger than \$100,000 were received by people in the top wealth quintile. The rich do appear to get richer.

Inheritances and Retirement Decisions

With only one-fifth of the population reporting that they had received any inheritance, it is clear that very few people receive a large windfall. But what of those who do? Does it have any effect on their behavior? Are these people likely to retire earlier or reduce their work hours?

Several researchers have examined the effect of unearned, transitory income on labor force participation. Holtz-Eakin et al.

(1993) found that the likelihood of leaving the labor force increases with the size of the inheritance. Other research has concluded that aggregate boomer inheritances are not likely to substantially reduce their labor supply (Joulfaian and Wilhelm, 1994). A study of lottery winners found similar results, with winners between 55 and 65 years old reducing their labor earnings more than younger winners (Imbens et al., 2001). Overall, however, the impact of unearned income on labor force participation was small.

Other research has examined the effect of unexpected income gains from the stock market in the 1990s on the timing of retirement (Coronado and Perozek, 2003;

Sevak, 2002). While these studies did not examine boomers, they concluded that large capital gains received by people nearing retirement increased early retirement rates and encouraged workers to move up their retirement date. To the extent that stock market and inheritance windfalls are analogous, we would expect people who receive large inheritances near retirement to retire earlier than those who receive a small inheritance or nothing at all.

Conclusion

Our analysis of the SCF data found that by 2001 the overwhelming majority (82.7 percent) of boomers had yet to receive an inheritance.

Among all boomers who received at least one inheritance by 2001, the median value was \$47,909 (in 2002 dollars). However, inheritance size is positively correlated with net worth: families with a net worth of \$140,283 or more received almost two-thirds of all inheritances. Other research suggests that these families may reduce their labor earnings if the inherited amounts are substantial.

As of 2001, only 14.9 percent of boomers expected to receive an inheritance in the future, suggesting that for most people inheritances will remain an elusive, or small, contributor to their retirement security.

In general, inheritances will not make a significant splash in the retirement savings of most boomers. For those who do receive them, they are not likely to have much of an effect on labor supply, but for those nearing retirement, a large inheritance might be a factor in the timing of their retirement.

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