

Federal Reserve Bank of Cleveland

# The Baby Boomers' Mega-Inheritance—Myth or Reality?

by Jagadeesh Gokhale and Laurence J. Kotlikoff

The economic outlook in the United States may be rosier, but the retirement prospects of baby boomers continue to rest on shaky foundations. Under current projections, Social Security and Medicare will experience revenue shortfalls after 2014—soon after the boomers begin retiring. And while stronger-than-expected economic performance has led to forecasts of substantial short-term budget surpluses, these projections rely on implausible assumptions about future federal government spending restraint. Although both Republicans and Democrats are emphasizing the need to reserve Social Security surpluses for that program alone, they are also advocating large tax cuts and spending increases that may reduce or eliminate non-Social Security (that is, “on-budget”) surpluses—perhaps even turn them into deficits. If the economy slows and tax revenues plummet, Social Security surpluses will have to be used for other government spending—as they were before on-budget surpluses emerged.

Growth in Social Security and Medicare benefits during the past several decades has caused a huge wealth transfer from younger toward older generations. This transfer and the recent surge in stock market prices have substantially increased the economic resources of today’s retirees. This rise in seniors’ wealth raises two interesting questions. First, are inheritances likely to increase substantially during the next few decades? Second, can today’s middle-aged workers depend upon future inheritances to fund their retirement years?

One previous estimate places the sum of inheritance receipts by 2050 at \$14 trillion (in 1999 dollars).<sup>1</sup> The size of this figure suggests that boomers can look forward to an inheritance bonanza and

can, as a group, stop saving for retirement. The truth, we believe, is quite different. Today’s elderly generations are wealthier because of the factors just mentioned, but other factors, which will shrink future bequests, have grown in significance. Moreover, although inheritances may grow larger, whether they will be sufficient to fulfill boomers’ retirement needs must be judged in relation to boomers’ current living standards, which are determined largely by their current labor earnings.

This *Economic Commentary* argues that inheritances are unlikely to augment boomers’ retirement resources significantly. Projections suggest that, relative to labor earnings, there will be no significant rise in total bequests to later generations until the boomers themselves begin to bequeath during the middle of the next century. Even though bequests are larger today in absolute terms than they were in the past, they have not grown substantially compared to inheritors’ labor income. As a group, boomers cannot rely on inheritances to fund their retirements any more than their parents could. Furthermore, inheritances have been and will remain very unevenly distributed among the population, making the receipt of a large inheritance a very improbable event.

## ■ Too Many Siblings Chasing Too Few Dollars

There are several reasons to doubt that the boomers are in for a huge inheritance windfall. First, the bequest pie must be split among more people because boomers are more numerous than their parents. That is, each boomer has a relatively large number of siblings. The magnitude of this effect can be gauged by assuming that parents are generally 25 years older than their children and taking the ratio of those aged 35–45

Retirees are one of the wealthiest segments of the U.S. population, and today’s retirees have more wealth than any previous generation’s. Some have conjectured that bequests out of this wealth will significantly boost the resources of the baby boomers—the next generation of retirees—bridging the gap between their retirement needs and resources. This *Economic Commentary* argues against such a view and explains why boomers have no alternative but to save for their own retirement.

today (the boomers) to those aged 60–70 (their parents). This ratio, which is 2.3 today, was only 1.8 in the 1960s.

Another factor limiting the flow of bequests across generations is the remarkable postwar increase in the degree to which the resources of the elderly are annuitized.<sup>2</sup> Annuitized resources are income flows that cease when the recipient dies. So, for a given amount of total wealth, the larger the share of annuitized resources, the smaller the share of bequeathable assets. Much of the increase in the share of annuitized resources in the last four decades can be attributed to the expansion of Social Security and Medicare. If this trend in annuitization continues, inheritances will become an even smaller share of boomers’ retirement resources.

There is also evidence that today’s retirees are spending down their assets at a much faster rate than their predecessors did four decades ago. Recent research shows that elderly Americans’ propensity to consume out of their resources has risen dramatically since 1960.<sup>3</sup> Moreover, mortality rates are lower now than at any time in the

past, so the boomers' parents will live longer than any previous generation. But the longer they live, the more they will deplete the assets they would otherwise have bequeathed to their children.

Future bequests may also be reduced by one other factor: The desire to leave something for the next generation seems to be weakening over time.

### ■ The Declining Bequest Ethic

Bumper stickers proclaiming “Retired—Spending My Children’s Inheritance” provide soft evidence of a diminishing bequest ethic. It’s difficult to imagine such bumper stickers being displayed back in 1960. Surveys of household attitudes toward saving and bequests yield more concrete evidence. Among all households, the percentage of those who believe it is important to leave an estate for one’s heirs has declined from 52.5 percent to 48.4 percent during the 1990s alone.<sup>4</sup> The decline is even greater among those older than 65—from 55.5 percent to 46.8 percent. According to the latest data, only 27 percent of all households and only 22 percent of households headed by someone over 65 expect to leave a sizable bequest.<sup>5</sup>

Additional indirect evidence suggests that the bequest ethic is declining in the United States. Specifically, the elderly have chosen not to reverse the increased annuitization of their wealth. To a large extent, increased annuitization is imposed on retirees because employer-provided defined-benefit retirement plans and government transfer programs pay out benefits in the form of annuities rather than as lump-sum amounts at retirement. If the elderly were concerned that the forced annuitization of their wealth would lower their bequests, they would fully or partially offset it by purchasing additional life insurance. However, over the last several decades, insurance purchases by the elderly have actually declined as a fraction of their total resources.<sup>6</sup>

Identifying the precise causes of the declining bequest ethic is beyond the scope of this *Commentary*, but changes in family structure caused by divorce and geographical dispersion seem worth mentioning. The dispersion of American families seems to be occurring not only within generations, but also across them—in terms of parent-child living arrangements: Back in 1940, the majority of noninstitutionalized elderly lived with their children, but only 40 percent

did so by the mid-1980s.<sup>7</sup> Among those aged 85 or older, the fraction living with their children dropped from 87 percent to 43 percent over the same period.<sup>8</sup> Some argue that the decline in joint living is due to the increasing economic independence of the elderly. However, recent research suggests that it is not the elderly but their children who prefer independent living arrangements.<sup>9</sup> The decline in the willingness or desire to bequeath may be a consequence of the fact that independent living is costlier. Alternatively, it may reflect a strategic response of older parents to their children’s unwillingness to house them in their old age.

### ■ The Size of Cross-Generation Bequest Flows

Assuming that parents leave all of their bequeathable wealth to their children, how much can baby boomers expect to inherit? Unfortunately, direct and reliable data on inheritances and bequests are not available and, indeed, may not be collectable. So we must estimate the data needed to address this question. To do this, we first estimate average levels of bequeathable wealth by age and sex. Bequeathable wealth is the sum of net worth (bank accounts, stocks, bonds, and houses, minus total liabilities such as mortgage balances and outstanding credit card debt) plus outstanding term life insurance.<sup>10</sup> Next, we use the constructed profiles of average net worth and term life insurance by age and sex to calculate annual bequest flows as the sum of deaths per year by age and sex multiplied by average bequeathable wealth by age and sex.<sup>11</sup>

Table 1 shows the results in constant 1999 dollars. Under our assumptions, the cross-generation bequest flow for 1997 is estimated at \$179.4 billion. This is just over three times the \$54.8 billion bequest flow estimated for 1962. These numbers show that inheritances have grown robustly over the past four decades and that boomers, as a group, will receive a larger inheritance than their parents did three decades earlier. The more interesting question, however, is not whether boomers will inherit more as a group, but whether this larger inheritance represents a greater share of their economic resources than was the case for their parents. To answer that question, we compare the growth of inheritances relative to that of recipients’ labor compensation—the main source of income for working-age individuals.<sup>12</sup> Table 1 shows that

bequests equaled 3 percent of labor compensation in 1962. In 1997, they were 3.7 percent of labor compensation, suggesting that inheritance flows have been more or less stable in comparison to labor compensation; relative to their labor earnings, boomers are inheriting only slightly more than their parents.

The near-stability of inheritance flows relative to labor compensation through the mid-1990s may be significantly altered in future decades. The relative size of the elderly population will balloon as boomers grow older and longevity increases at all ages. To see how such demographic changes might affect future bequest flows, we estimate them using projected population and mortality data, assuming that the age-sex patterns of wealth holding and term life insurance remain as in 1997, but that average bequests as well as average earnings by age and sex grow with labor productivity. Figure 2 shows that the flow of cross-generation bequests as a share of projected labor compensation per year is expected to rise from about 4 percent today to more than 8 percent by the middle of the next century. The rate of increase will be modest during the next 15 years but then will begin to accelerate. By 2015, the ratio will be only 0.8 percentage point higher than it is today. Between 2015 and 2030, bequests as a share of labor compensation will increase by almost 2 percentage points and, in the following 15 years, they will increase by another 1.5 percentage points. This suggests that it is the boomers’ offspring—not the boomers themselves—who can expect to reap a bequest bonanza.

### ■ The Distribution of Bequests

Not only will inheritances represent very minor additions to boomers’ resources, but their distribution across the recipient population is also likely to be highly unequal. This substantially negates the view that inheritances will redress the shortfall in boomers’ retirement resources. Table 2 shows the size of inheritances received by those in various income ranges. The vast majority of households (92 percent) reported receiving no inheritances. Most of the households that reported positive inheritances said they received less than \$100,000. Table 2 shows that the frequency of inheritance is highest for those in the lowest earnings category. However, the receipt of substantial bequests—those exceeding \$100,000—is limited to a

**TABLE 1 COMPONENTS OF BEQUEATHABLE WEALTH: 1962 AND 1997**

Year	Labor compensation <sup>a</sup>	Net worth <sup>a</sup>	Life insurance <sup>a</sup>	Cross-generation bequests <sup>a</sup>	Bequests as a share of labor compensation <sup>b</sup>
1962	1,800.1	11,497.9	3,734.7	54.8	3.0
1997	4,828.0	35,085.7	13,862.9	179.4	3.7

a. Billions of 1999 dollars

b. Percent

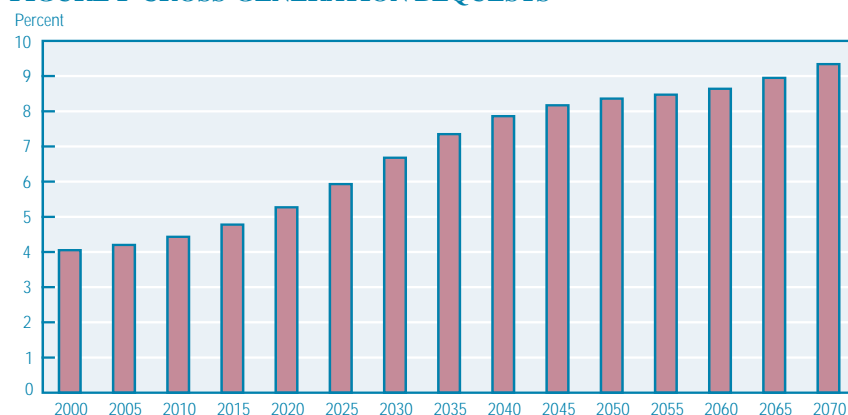
SOURCES: Economic Report of the President, 1999; estimates from the 1998 Survey of Consumer Finances; and American Council of Life Insurance *Life Insurance Fact Book*, various issues.

**TABLE 2 PERCENT OF POPULATION RECEIVING INHERITANCES**

Wage	Inheritance				
	\$0	\$1–25,000	\$25,000–50,000	\$50,000–100,000	More than \$100,000
\$0–10,000	54.9	2.0	0.4	0.5	0.7
\$10–25,000	6.4	0.5	0.1	0.0	0.2
\$25–50,000	14.1	0.7	0.2	0.2	0.2
\$50–75,000	9.0	0.5	0.1	0.2	0.2
\$75–100,000	3.9	0.3	0.2	0.1	0.1
Over \$100,000	3.6	0.3	0.1	0.1	0.2
<b>Total</b>	<b>91.9</b>	<b>4.3</b>	<b>1.1</b>	<b>1.1</b>	<b>1.6</b>

SOURCE: Calculated from the 1998 Survey of Consumer Finances.

**FIGURE 1 CROSS-GENERATION BEQUESTS**



SOURCE: Authors' calculations based on the 1998 Survey of Consumer Finances and the Social Security Administration's projections of the U.S. population.

miniscule fraction of the population (less than 2 percent). Evidence shows that mean inheritances for the majority of recipients are fairly small; large inheritances are limited to a very few lucky individuals. This suggests that although the flow of inheritances will eventually increase significantly relative to labor compensation, its distribution may remain highly unequal.

**Conclusion**

Although baby boomers will inherit more as a group than their parents did, inheritances will be roughly the same as those of their parents when considered relative to labor earnings. Our estimates show that the size of the aggregate flow of U.S. bequests, measured relative to

labor compensation, has not changed much in the last 35 years and is likely to remain near its current level for the next decade and a half.

While boomer parents have more wealth than previous generations of retirees, much of that wealth is annuitized, so that a smaller share is bequeathable. And whatever resources remain to bequeath will be split among more recipients because the boomers have, on average, more siblings than their parents had. The amount boomer parents have to leave their children may be reduced further because parents will live longer than any previous set of retirees, spending down their wealth. Evidence shows that many boomer parents neither expect to leave

significant bequests to their children nor believe it is important to do so.

Our calculations also suggest that bequest flows will increase markedly as a fraction of recipients' labor earnings *only after* the boomers retire and begin to bequeath their own wealth to their children. Since it is uncertain whether Social Security and Medicare will deliver all their promised benefits and boomers are unlikely to inherit much from their parents, they would be wise to fund their retirement the old-fashioned way—they'll have to save for it.

**Footnotes**

1. Robert B. Avery and Michael S. Rendall, "Estimating the Size and Distribution of Baby Boomers' Prospective Inheritances," in the American Statistical Association's *1993 Proceedings of the Social Statistics Section*, 1993, pp. 11–19.
2. Alan J. Auerbach, Jagadeesh Gokhale, Laurence J. Kotlikoff, and David N. Weil, "The Annuitization of Americans' Resources: A Cohort Analysis," in Laurence J. Kotlikoff, ed., *Essays On Savings, Bequests, Inequality, Altruism, and Life-Cycle Planning*, Cambridge, Mass.: MIT Press, forthcoming, 2000.
3. Jagadeesh Gokhale, Laurence J. Kotlikoff, and John Sabelhaus, "Understanding the Postwar Decline in National Saving: A Cohort Analysis," in *Brookings Papers on Economic Activity*, vol. 1. Washington, D.C.: The Brookings Institution, 1996.

4. The response rates reported here are weighted averages calculated from the Federal Reserve Board's 1992 and 1998 Surveys of Consumer Finances.

5. Of all households responding to this question, 22.8 percent said "possibly." An unambiguously negative response was received from 50.5 percent of all households.

6. Gokhale, Kotlikoff, and Sabelhaus (footnote 3).

7. The noninstitutionalized population excludes inmates of penal and mental institutions, sanitariums, and homes for the aged, infirm, and needy.

8. Laurence J. Kotlikoff and John Morris, "Why Don't the Elderly Live with Their Children? A New Look," in David A. Wise, ed., *Issues in the Economics of Aging*, National Bureau of Economic Research. Chicago and London: University of Chicago Press, 1990, pp. 149–69.

9. Axel H. Börsch-Supan, "Why Don't the Elderly Live with Their Children? A New Look—Comment," in David A. Wise, ed., *Issues in the Economics of Aging*, National Bureau of Economic Research. Chicago and London: University of Chicago Press, 1990, pp. 169–72.

10. These data are based on the 1998 Survey of Consumer Finances; they pertain to 1997.

11. Annual deaths for males and females older than 50 are estimated using population and mortality data. All of nonmarried individuals' wealth and 15 percent of married individuals' is included when calculating cross-generation bequests.

12. The relevant issue is whether inheritances will enable boomers to maintain or increase their lifetime living standard by a greater proportion than was the case for their parents. The ideal comparison would be between growth in bequests and growth in living standards between the early 1960s and late 1990s. Because data on living-standard improvement are not available, we use growth in labor compensation instead.

Jagadeesh Gokhale is an economic advisor at the Federal Reserve Bank of Cleveland, and Laurence J. Kotlikoff is a professor of economics at Boston University.

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Federal Reserve Bank of Cleveland  
Research Department  
P.O. Box 6387  
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