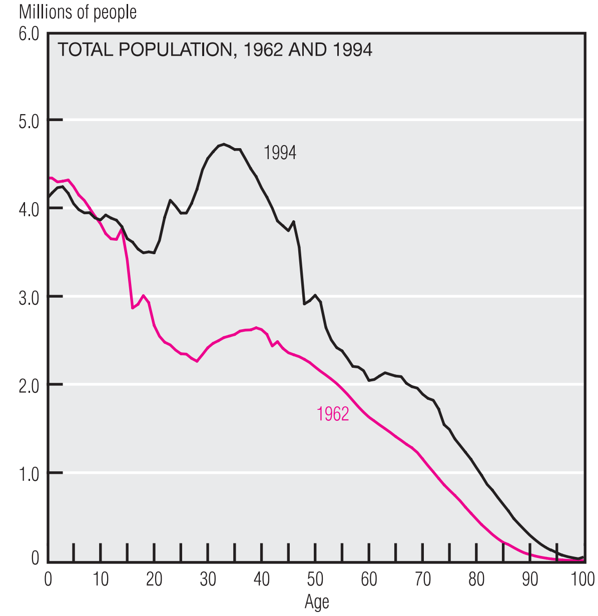
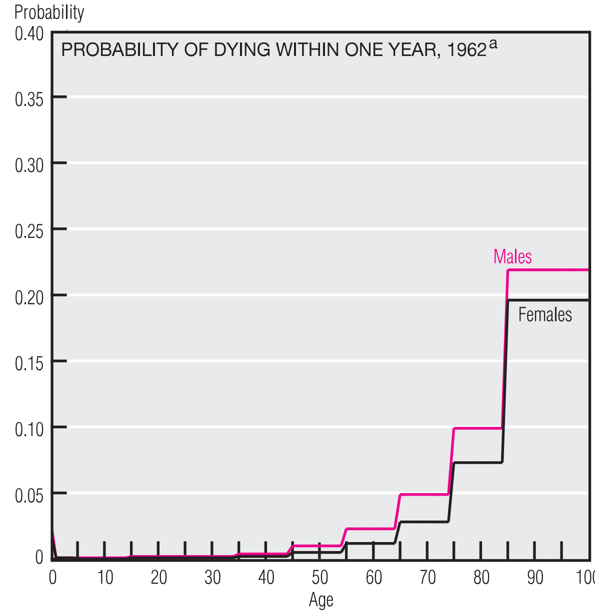
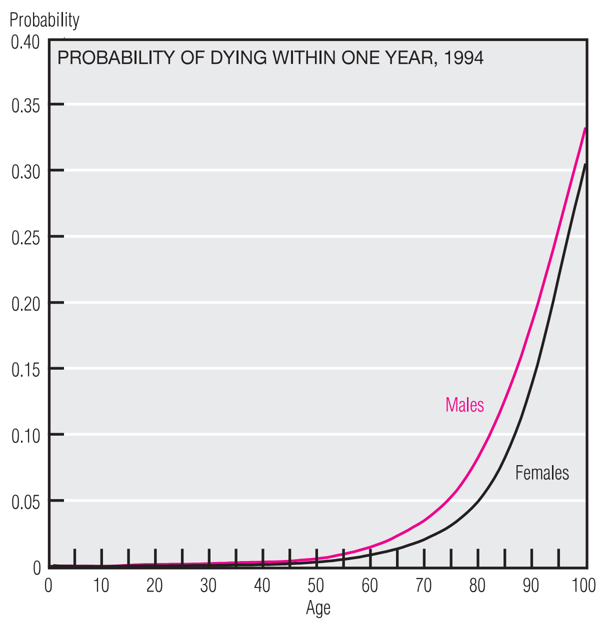
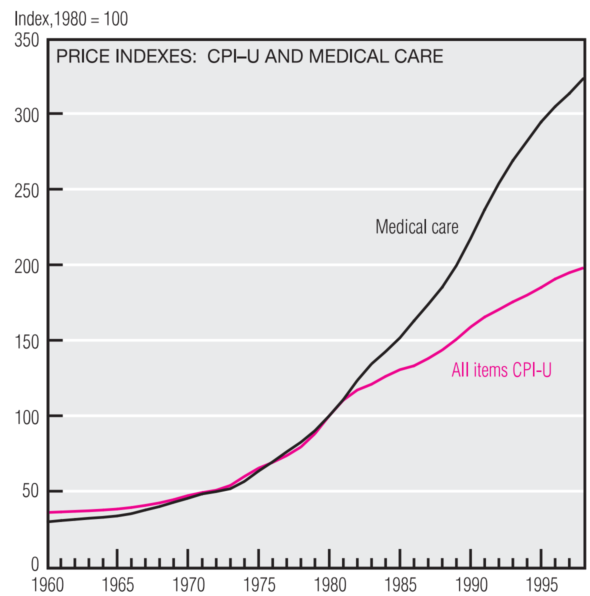
Cross-Generation Wealth Transfers









a. Probabilities after age 85 are assumed to be the same as for age 85.

SOURCES: U.S. Department of Commerce, Bureau of the Census; Social Security Administration; and *Economic Report of the President*, 1999, Washington, D.C.: U.S. Government Printing Office, 1999.

Faced with uncertain prospects for Social Security and Medicare, can baby boomers rely on large transfers from their parents and grandparents to finance their retirement? Although economists generally agree that a major fraction of the existing stock of wealth can be traced to gifts and bequests, there is little direct evidence on the size of these cross-generation transfers. There are two main reasons to doubt that the boomers will receive much larger bequests than their counterparts did 30 years ago or will be able to rely on such bequests for financing retirement consumption.

First, although the population's structure has shifted dramatically in the past three decades, so far the shift has been concentrated at younger ages. During the early 1960s, there were fewer working-age individuals relative to the elderly population. The baby boom was still in progress, and the boomers were young dependants. Today, however, there are many more young workers relative to retirees. Hence, even if bequests are larger than they were 35 years ago, boomers must share them with more siblings.

Second, although their numbers have increased, the elderly are living longer today than they did 50 years ago. A longer lifetime implies more years of retirement consumption and, consequently, smaller bequests upon death. Third, per capita medical costs have accelerated much faster than the general price level, meaning that older individuals' wealth holdings are depleted much more rapidly because of greater spending on medical care.

The charts show smoothed profiles of net worth and term life insurance holdings by age and sex for 1962 and 1994. The net-worth profiles have several interesting

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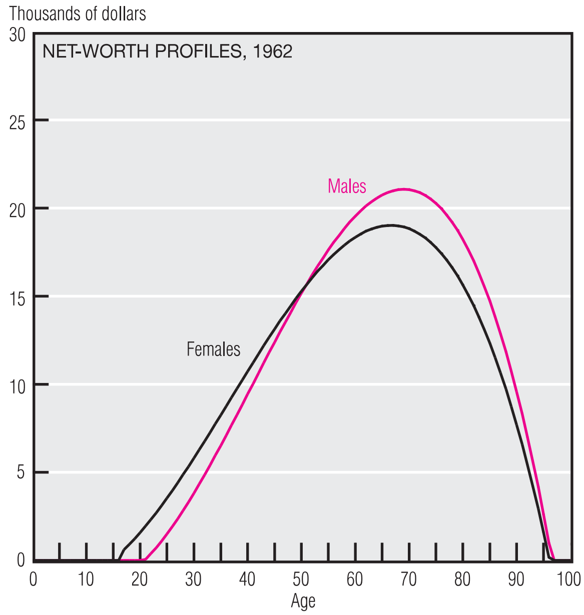
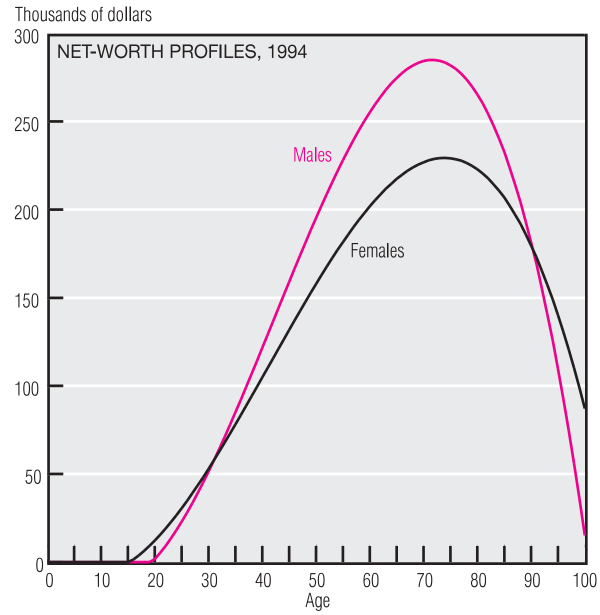
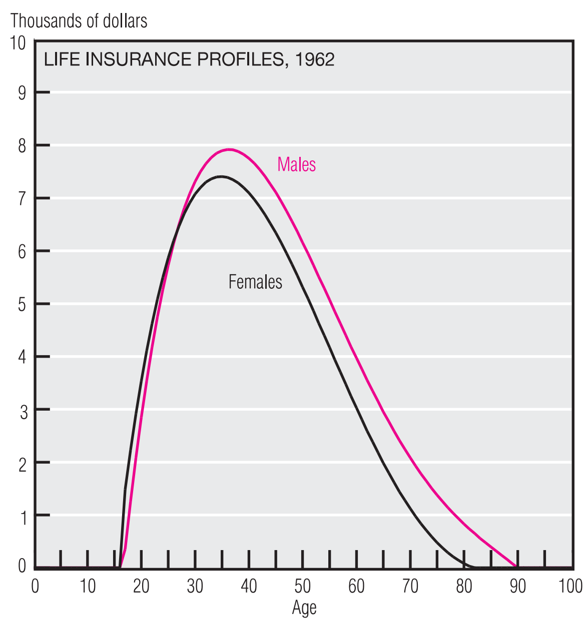
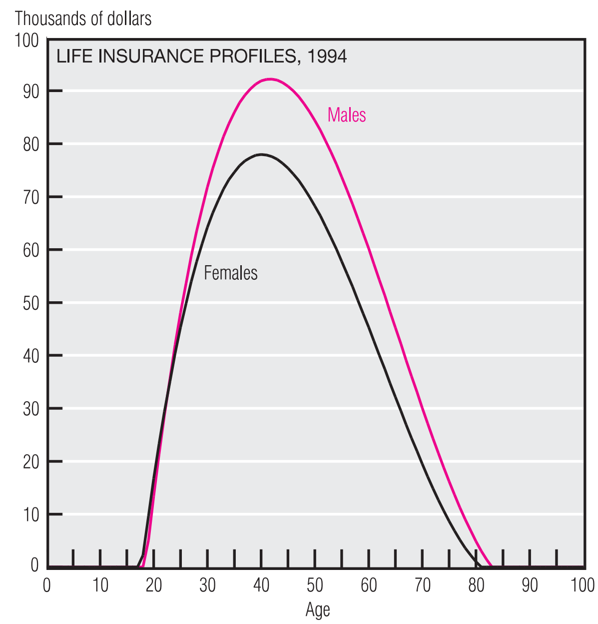
Cross-Generation Wealth Transfers *(cont.)*









SOURCES: Board of Governors of the Federal Reserve System, *Survey of Financial Characteristics of Consumers, 1962–63* and *Survey of Consumer Finances, 1994*; and Federal Reserve Bank of Cleveland.

characteristics. For both years they are hump-shaped, indicating a significant life-cycle pattern—wealth accumulation until retirement and wealth decumulation thereafter. The peak levels of the profiles are roughly 10 times higher in 1994 than in 1962.

The net-worth profiles are higher initially for young women than young men in both years, perhaps because men on average spend more time acquiring education and training and enter the labor force later than women. But men, because they earn more than women, accumulate more wealth by the time they retire. The 1994 profiles suggest that while the rate of wealth decumulation after retirement has slowed for men, the slowdown has been more pronounced for women. The explanation may lie in the greater increase in female longevity over the last several decades.

The life insurance profiles have similar characteristics. The value of term life insurance outstanding peaks during the early working years. Like the net-worth peak, the insurance peak is roughly 10 times higher in 1994 than in 1962. Men's life insurance holdings exceed women's during most of the working lifetime. These features are as expected, since the purpose of life insurance is to protect against loss of future earnings. The male life-insurance profile declines more steeply with age in 1994, perhaps suggesting that the very old now are finding it more difficult to buy life insurance than did their counterparts 35 years ago.

Direct, reliable evidence on inheritances and bequests is not available; indeed, it may be uncollectable. But we can calculate annual bequest flows indirectly as the sum of deaths per year by age and sex

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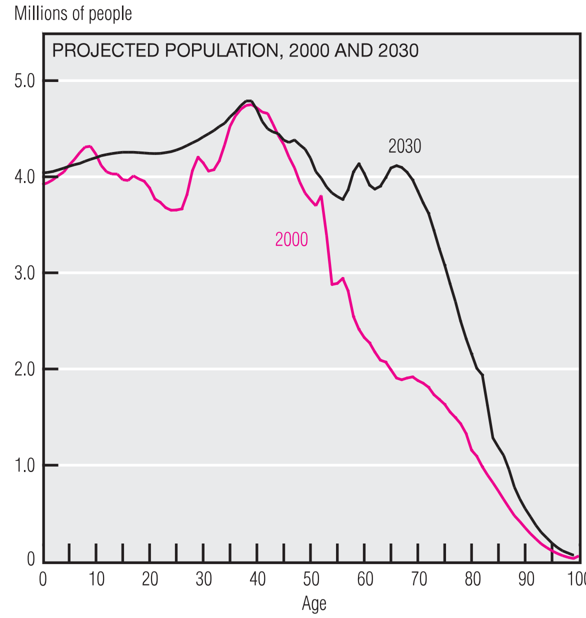
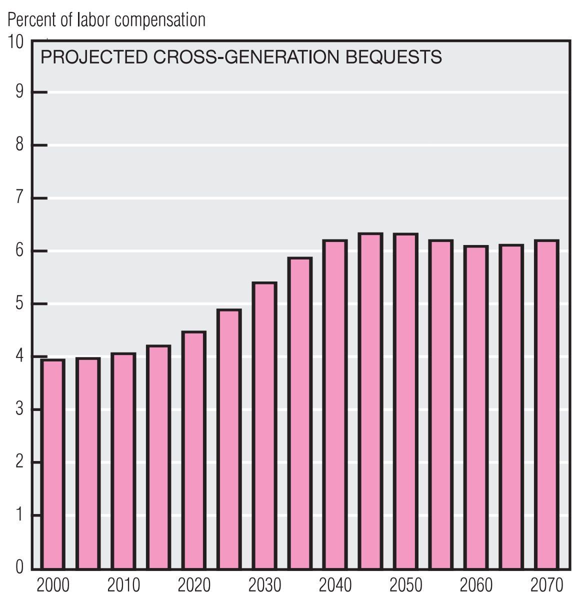
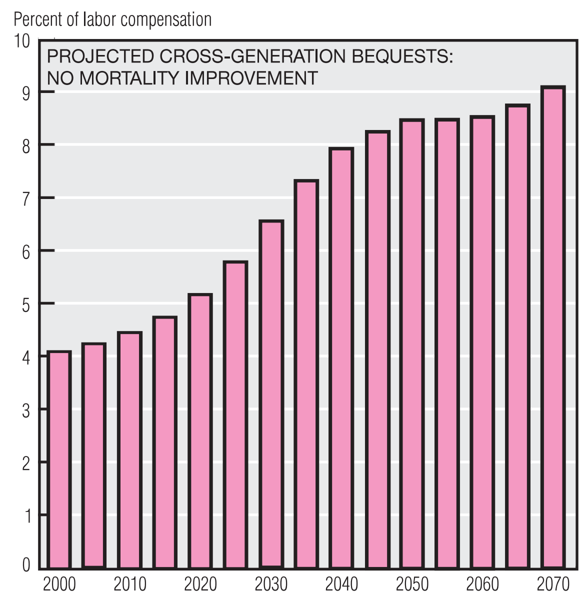
Cross-Generation Wealth Transfers (cont.)

Bequeathable Wealth and Cross-Generation Bequests, 1962 and 1994

	Labor compensation	Net worth plus term life insurance	Cross-generation bequests
1962[a]	1,767.2	13,693.8	53.1
1994[a]	4,412.6	38,854.6	145.1
Ratio: 1994/1962	2.5	2.8	2.7
Annual growth rate (percent)	2.9	3.3	3.2







a. Trillions of 1998 dollars.
SOURCES: Social Security Administration; and Federal Reserve Bank of Cleveland.

times bequeathable wealth by age and sex. Annual deaths for males and females over 50 are estimated using population and mortality data. Bequeathable wealth is the sum of net worth and term life insurance. Under reasonable assumptions about the fraction of wealth transferred to the next generation, bequests are estimated to have grown just a little faster than labor compensation. That is, baby boomers are not receiving substantially larger bequests relative to their labor compensation than did their counterparts in the 1960s.

The population structure will evolve, and mortality is expected to improve in the future—changes that will affect bequest flows between generations. For example, in another three decades, the elderly population is expected to balloon relative to the number of workers, and mortality rates are projected to decline for all age groups. If economic growth is projected at 0.9% per year, cross-generation bequests are expected to rise from just under 4% of labor compensation today to more than 6% by the middle of the next century. It is the offspring of the baby boomers who can expect to have a bequest bonanza. Their windfall will be even larger if mortality improvements occur at slower-than-projected rates. In that case, boomers would die earlier—before further depleting their bequeathable wealth. In the extreme case—if mortality remains constant through 2070—cross-generation bequests would be even larger relative to labor compensation during the coming decades.