

# WORKING PAPER

## *Executive Summary*

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## ACTUAL AND ANTICIPATED INHERITANCE RECEIPTS

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The average household accumulates very little wealth during its working life. In 2007, the mean non-pension wealth of the average household age 55-64 amounted to only \$29,600. But this figure understates financial preparedness for retirement because it ignores the present value of anticipated inheritance receipts.

The effect of inheritances on financial preparedness for retirement may be small if most are received by households that are already well placed. But for many households, even a small inheritance would represent a large percentage increase in financial wealth. On the other hand, households that form unrealistic expectations regarding either the probability of receipt or the amount receivable may end up even less well prepared for retirement than those that correctly believe they will not receive an inheritance.

The *Health and Retirement Study* (HRS), a panel dataset of individuals born between 1931 and 1941 who have been interviewed every two years starting in 1992, contains data on both the amounts that households anticipate receiving over the next 10 years and the amounts actually received. We use this data to 1) determine the factors predicting receipt of an inheritance, 2) establish to what extent households form accurate and unbiased expectations of the probability of receipt and the dollar amount receivable, 3) calculate the impact of inheritances on the distributions of wealth and lifetime resources, and 4) test a prediction of the life-cycle model of savings behavior, namely that households anticipating receipt of an inheritance should save less than otherwise similar households.

Among the 4,673 married couples in our sample, 34.1 percent received an inheritance at any time, and 20.8 percent received one between 1994 and 2004. Conditional on receiving an inheritance at any time, the mean and median amounts receivable were \$124,416 and \$50,305, respectively. The mean and median amounts received between 1994 and 2004 were \$110,323 and \$44,000, respectively.<sup>1</sup>

We find that the probability of receipt is positively correlated with the individual's own and parental socioeconomic status, and with whether the individual has any surviving parent, reflecting a pattern whereby inheritances pass from the deceased to the surviving spouse and then to their children. In the married couple model, the probability of receiving an inheritance decreases by 4.4 and 6.2 percentage points if the

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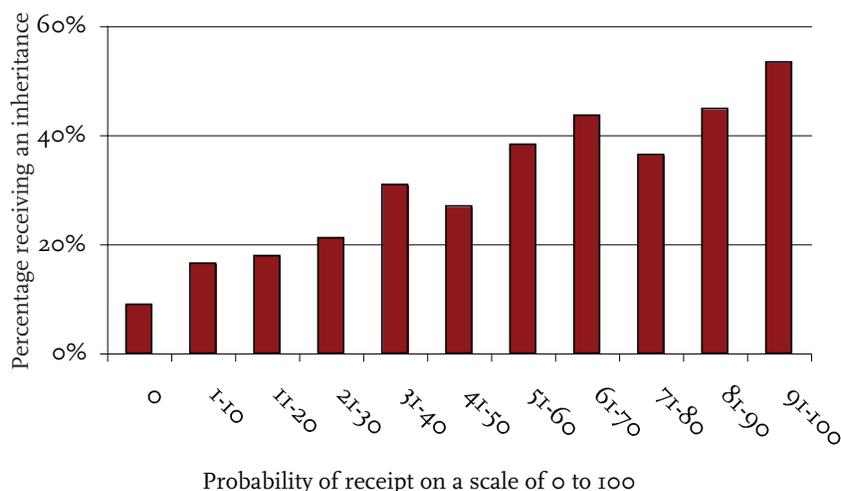
<sup>1</sup> All amounts are in 2004 dollars and exclude investment returns on amounts received.

husband and wife have no living parent. In models in which the log of the dollar amount receivable is the dependent variable, some of the independent variables lose significance, indicating that socioeconomic characteristics are a better predictor of receiving anything than of the amount received.

We consider whether households form realistic expectations regarding both the likelihood of receiving an inheritance and the anticipated amount, in particular, whether forecasts are unbiased and vary appropriately both in cross-section and in panel with factors identified as affecting the actual probability of receipt. Among married couples, the mean self-reported probability of receiving an inheritance between 1994 and 2004 was 22.4 percent, close to the actual percentage.

Figure 1 shows the percentages of households receiving an inheritance, analyzed by the self-reported probability of receiving an inheritance, and demonstrates that self-assessed probability has some predictive power. Among those estimating their probability of receiving an inheritance at zero, 8.9 percent actually received an inheritance, compared with 53.4 of those estimating the probability at 91-100 percent. Multivariate analysis reveals that individuals' subjective estimates of the probability of receipt vary

FIGURE 1. INHERITANCE RECEIPT 1994-2004, BY 1994 SELF-ASSESSED PROBABILITY OF RECEIPT



Source: Authors' calculations from HRS data.

appropriately with socioeconomic characteristics that in turn predict receipt. But many of these socioeconomic characteristics lose significance in models in which the dependent variable is the log of the anticipated dollar amount.

We further investigate whether households make systematic forecasting errors. We create a forecasting error variable  $I - E_r$ , where  $I$  is an indicator variable taking the value one if the household received an inheritance between 1994 and 2004, and  $E_r$  is the household's estimate of the probability of receipt, expressed as a decimal. A positive value indicates that the household received an inheritance that was to some extent unexpected. A negative value indicates that the household failed to receive an expected inheritance. We estimate a regression in which the dependent variable is our forecasting error and socioeconomic characteristics are included as independent controls. We find that although households are somewhat optimistic as to the probability of receipt, no identifiable household types are particularly prone to error.

We then consider the impact of inheritances on the distributions of wealth and lifetime resources available to households. Inequality is customarily measured by the Gini coefficient, which would take the value one if a single household owned all the wealth and zero if there were perfect equality. Although both actual and anticipated receipts are highly concentrated among households in the upper portion of the wealth distribution, their inclusion has little effect on measured wealth inequality. The present value of lifetime earnings is arguably a better measure of the resources otherwise available to the household to fund consumption. We find that the inclusion of actual and anticipated inheritances has a similarly small effect on the inequality of this measure of lifetime resources.

Finally, we test one of the predictions of the life-cycle model, namely that households anticipating an inheritance should save less than other similar households. We estimate regressions in which our dependent variable is the log of 1994 total wealth, and our independent variables include socioeconomic characteristics plus either the self-assessed probability of receiving an inheritance or the log of the expected receipt, the expected amount multiplied by the probability of receipt. We find that households anticipating an inheritance actually have greater wealth than otherwise observably similar households possibly reflecting intergenerational correlation in tastes for saving and financial acumen.

The results have two significant policy implications. First, there is no evidence that low levels of financial preparedness for retirement are the result of misplaced reliance on anticipated inheritance receipts. Second, inheritances reduce inequality of lifetime resources.

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