THE INHERITANCE OF WEALTH: LIKE PARENT LIKE CHILD?

by

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A large body of economic literature exists on the intragenerational distribution of income and wealth. Some of it is devoted to specific historical periods or trends over time; other work scrutinizes the tools and methods used to measure this distribution. Until recently, however, little effort was devoted to studying intergenerational effects on this distribution—the passing on of wealth from parent to child; and most of those studies concentrate on the transmission of human wealth (lifetime earnings ability) rather than nonhuman wealth (wealth received through gifts and bequests).

To illuminate the process of the transmission of nonhuman wealth across generations, an analysis was done of Connecticut probate records of parents who died during the 1930s and 1940s. These records were matched with the probate records of their children who died prior to 1977. The following specific issues were examined:

1. How is estate wealth divided among children? Does sex or birth order have any influence, and does asset composition make a difference?

2. Do the children of wealthy parents tend to be well off themselves? How much wealth mobility exists between generations?

3. What is the relationship between the wealth inherited by children from their parents and the wealth these children leave upon their own death?

Primogeniture or Equal Sharing?

Is there a tendency for male or firstborn children to enjoy a greater material inheritance than female or later-born children? Since, in applying economic models that predict the distribution of income and wealth over a number of generations, primogeniture results in more inequality than does equal sharing, this question is clearly an important one.

Probate data drawn from 379 estates revealed that the parents provided, on average, equal shares to male and female children; moreover, the proportion of the estate bequeathed to each sex did not vary significantly with estate size. The data also showed that firstborn children did not receive more material inheritance than their siblings. The median bequest per child varied inversely with family size, due to wealth-splitting. This finding is in accord with the human inheritance literature which suggests that human endowments per child fall as family size increases.

Equal sharing of parents’ estates among children appears to be the rule: In 60 to 70% of the cases, each child received an equal (or within one percentage point of equal) share. This contradicts the hypothesis of some scholars that differential bequests are used by parents as compensatory or equalizing devices, the child (children) with lower earnings ability receiving the greater share. But even if we assume that all within-family variation is for compensatory purposes—and this is by no means clear—it is not apt to attenuate greatly the relative economic position of the children for two reasons. First, the overall degree of bequest inequality is quite low—much lower than earnings inequality in the economy or among siblings. Second, for the overwhelming majority of heirs, wealth received by inheritance is dwarfed by lifetime earnings.

Is there less bequest equality in families holding farms and businesses than in those whose wealth is primarily in liquid assets? Though it was found that the value of such estates as a whole was shared equally, among smaller estates it is more likely that a male child received the family enterprise than a female. Since smaller businesses are more likely to be owner-operated, this is consistent with some sociological literature on unequal inheritance of occupation between the sexes.

Wealth Mobility

The question of wealth mobility of individuals and family members over time is another generally neglected area. Societies characterized by a given degree of inequality can be either static, with individuals and families at the top maintaining their position, or mobile, with a shuffling of the distribution over time based upon individual abilities. Most people would, in line with normative judgments about the value of equality of opportunity, consider the latter state to be more “fair.”

If we were to array parents and children according to their places in the wealth distribution, it is evident that for a child of parents at the bottom to rise to the top, it would be necessary for a child of parents at the top to move down. Thus, to the extent that material inheritance ensures that children born into the top groups maintain their position, it lessens the degree of wealth mobility in a society.

How much wealth mobility is there in our society? What are the chances that you will fail to be wealthy if your parents are wealthy? Again using Connecticut probate records from the 1930s and 1940s, the estates of 300 children were matched with the estates of their parents to answer this question in three different ways. The sample of parents was a relatively wealthy one, with at least one in each pair of parents possessing an estate of at least $40,000.

The first method was to compare the wealth of the children with that of their parents. Such a comparison showed children of wealthy parents to be nearly as wealthy as their parents—this in spite of the equalizing effect of estate-splitting among heirs. The median child at the time of his death possesses an estate 85% the size of his parents’, even after all “transaction costs” (inheritance and estate taxes, costs of administration, legal fees) and inflation have been accounted for.

A second method was to assess the relation between the wealth of the parent and the child. One measure of this
From the parent with poor [rich] children to another's with rich [poor] children), to guarantee that such a tax will not be regressive—that is, that the burden will not fall disproportionately on the less well off—the total tax bill levied from each income group must, of course, be the same proportion of their total resources. Since the tax base is consumption spending, the tax base will shrink as a proportion of total resources as those total resources increase, given that lifesaving increases with increases in total lifetime resources. That rate at which that base is taxed will have to increase very sharply as consumption increases in order to counteract the fact that for every 10% increase in lifetime resources (as we saw) lifesaving increases at two and one-half times that rate. If a progressive tax were desired, the rate structure would have to rise even more quickly than lifesaving for specified resource levels.

How Does Inherited Wealth Influence Final Wealthholding?

The first way to answer this is to compare what a child inherits with what that child leaves at death. One finds, from the Connecticut data again, that 30% of the child’s wealth can be attributed to parental inheritance if the actual amounts listed in the records are compared. This, however, is clearly not the appropriate comparison, because wealth earns returns over time and inherited wealth can certainly be expected to grow over the rest of the inheritor’s life. On the conservative assumption that the inheritance earns the bond rate of return over the rest of the child’s lifetime, the proportion of the child’s wealth at death that is attributable to what he inherited from his parents is 50%. Using a stock market index and assuming that all dividends are reinvested raise the proportion to substantially more than 50%.

The second way to relate inherited wealth to final wealthholding is to look at “lifesaving”—the difference between lifetime resources (earnings plus inheritances and gifts) and lifetime expenditures. For the wealthy Connecticut sample, the share of their lifetime resources saved rose substantially as resources increased. According to the data, if the lifetime resources of one person were 10% higher than those of a second person, the estate left by the first would be, on average, 25% higher than that left by the second.

Implications for a Consumption Tax

There has been recent interest in some quarters in changing the federal tax system from one based on personal income tax to a system based on a consumption tax. An annual tax on consumption, with a lifetime averaging scheme in which each year’s tax is based on the average of present and past years, is tantamount to a lifetime consumption tax.  

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Implications for the Equality/Output Debate

A second implication of this work concerns the effect of the distribution of income on total spending in the economy. If lifesaving rises disproportionately with income, as reported, then redistribution of income toward equality would ultimately lead to increased levels of spending. If, as Keynesian economists hold, unemployment in our economy is partially a consequence of a shortfall of total spending, then income redistribution in the direction of greater income equality would lead to lower levels of unemployment and higher levels of output. Thus, the argument often made that reducing inequality must come at the expense of the level of output in the economy as a whole is not consistent with the finding reported here. Indeed, increased equality and greater output would seem to go hand in hand.
