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A tale of three distributions: inheritances, wealth and lifetime income

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Overview

- We provide new evidence on the impact of receipt of inheritances and other intergenerational transfers on inequality in wealth and lifetime incomes

- We look at the impact of wealth transfers on the distribution of a broad measure of wealth including state and private pensions
  - Find that effect on inequality is negligible

- We show that our results provide the best available guide to the impact of wealth transfers on inequality in lifetime incomes
  - Broader measure of wealth roughly proportional to lifetime income

Perceptions and previous literature

- Usually assumed in public debate that inheritances and gifts increase wealth inequality
  - Likelihood and size of receipt correlated with other indicators of socioeconomic advantage

- But previous literature finds wealth transfers reduce inequality (or at least do not increase it)
  - Wolff (2002) and Wolff and Gittleman (2013) for the US
  - Klevmarken (2004) for Sweden
  - Karagiannaki and Hills (2013) for the UK

- All look at marketable wealth (ie. excluding pension wealth)

Data: English Longitudinal Study of Ageing (ELSA)

- Biennial panel survey of over 50 population in England
  - Similar to HRS in the US and SHARE in Europe
  - Contains detailed information on income and wealth holdings

- We use a representative sample of 3,750 individuals aged 65 to 79

- Construct three measures of wealth
  1. “Non-pension wealth”: net financial wealth, net property wealth and physical wealth
  2. “Total private wealth”: non-pension wealth + estimated value of private pension income
  3. “Total wealth”: total private wealth + estimated value of state pension income

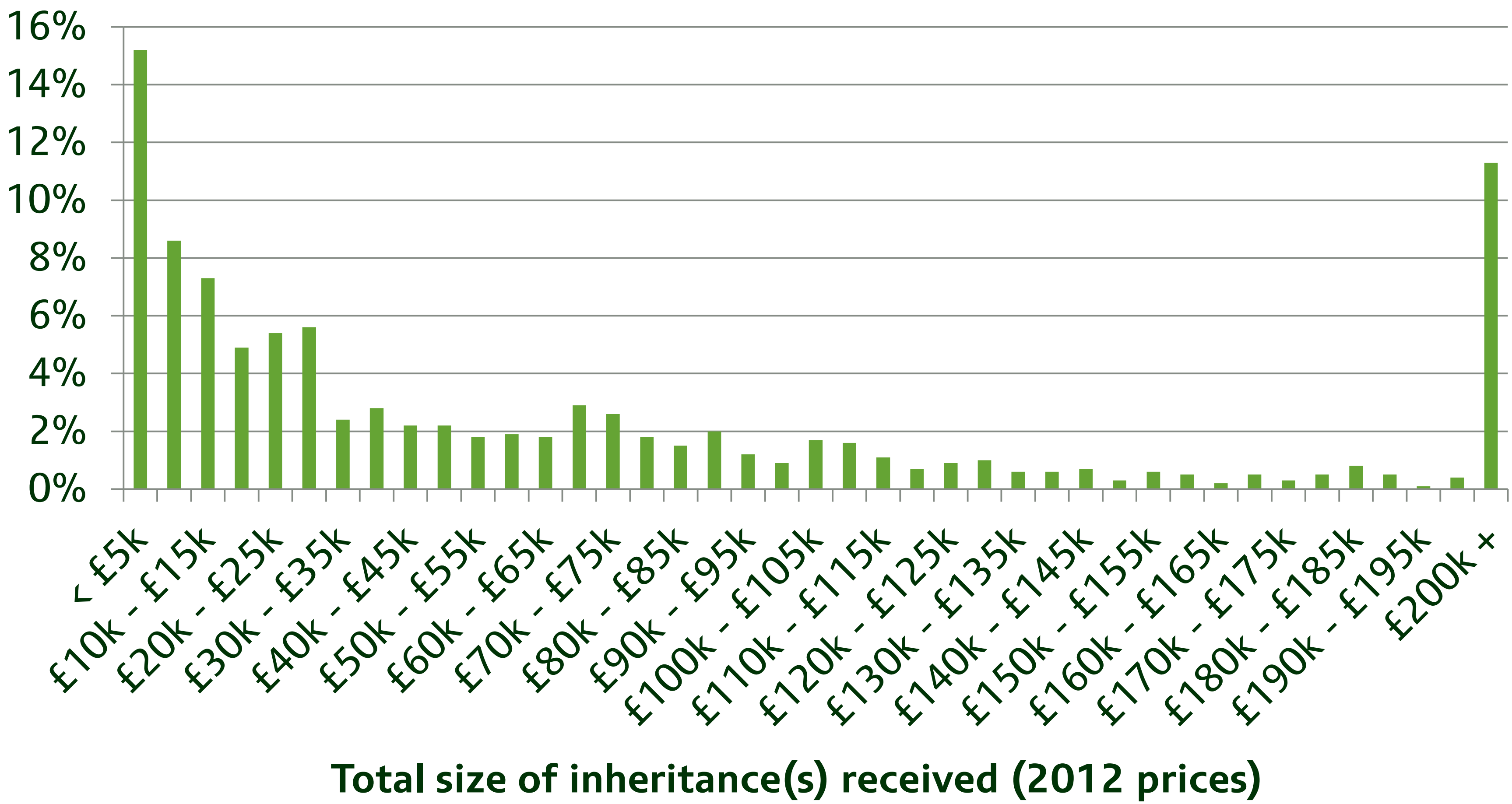
Distributions of different wealth measures

Household wealth per person (2012 prices)	**Non-pension wealth**	**Private wealth**	**Total wealth**
Mean	£212,028	£326,263	£466,671
Median	£141,160	£230,261	£373,123
Gini coefficient	0.524	0.482	0.338
Top 10% share	37.6%	33.3%	26.1%

Data: lifetime receipt of inheritances and gifts

- Wave 6 of ELSA (2012/13) asked respondents about the value of up to 3 inheritances and large gifts (> £1000) over their lifetime
  - Nearly a third of our sample (65-79s) have received an inheritance, and 6% have received a large gifts

Distribution of size of inheritances received



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Data: lifetime receipt of inheritances and gifts

- Wave 6 of ELSA (2012/13) asked respondents about the value of up to 3 inheritances and large gifts (> £1000) over their lifetime
  - Nearly a third of our sample (65-79s) have received an inheritance, and 6% have received a large gifts
- Distribution of inheritances highly unequal…
  - 15% of recipients received <£5,000 in total, 11% more than £200,000
- … and correlated with education level and household income
- Evidence of correlation in inheritances across partners
  - 53% of those whose partner inherited also received an inheritance, compared to 18% of those whose partner did not inherit

Calculating the contribution of transfers to current wealth

- Extremely contentious issue in the literature
  - Koltikoff and Summers (1981) vs. Modigliani (1988)

- True impact will depend on the impact of wealth transfers on saving and labour supply decisions
  - We abstract from these behavioural responses throughout

- We capitalise wealth transfers at a real rate of 3% since the time of receipt
  - Simplest interpretation is no crowding out of private saving, no impact on the return to private saving, and 3% real return
  - But could reflect some crowding out, offset by effect of inheritances in increasing return to private saving

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The impact of transfers on wealth inequality

- Given these assumptions, we can split current wealth (W) into wealth excluding transfers (WX) and wealth transfers (T)
- Then recover the impact of transfers on wealth inequality by comparing the distributions of W and WX
  - Do this for each of our three measures of wealth

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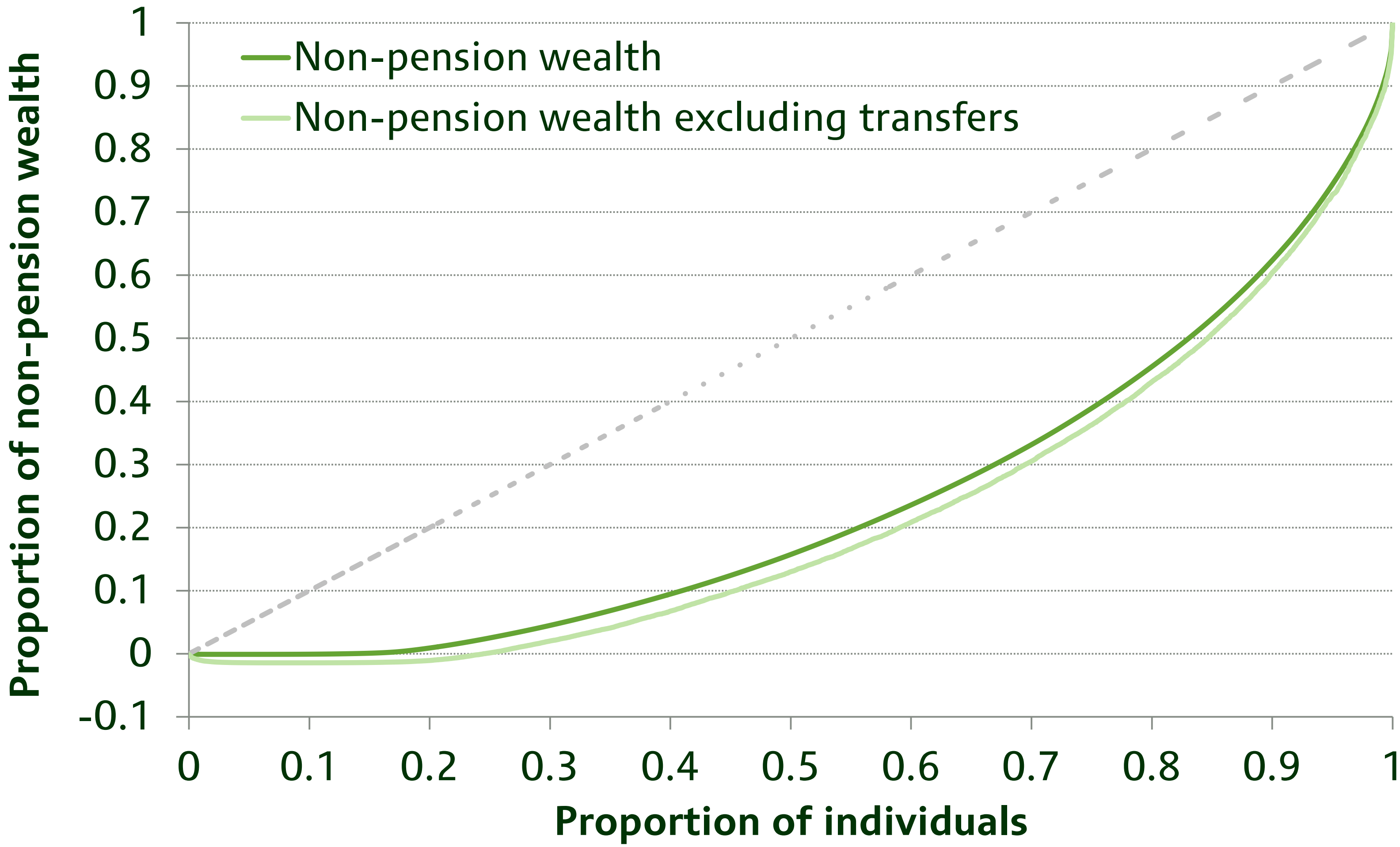
The impact of transfers on the distribution of non-pension wealth (Lorenz curves)



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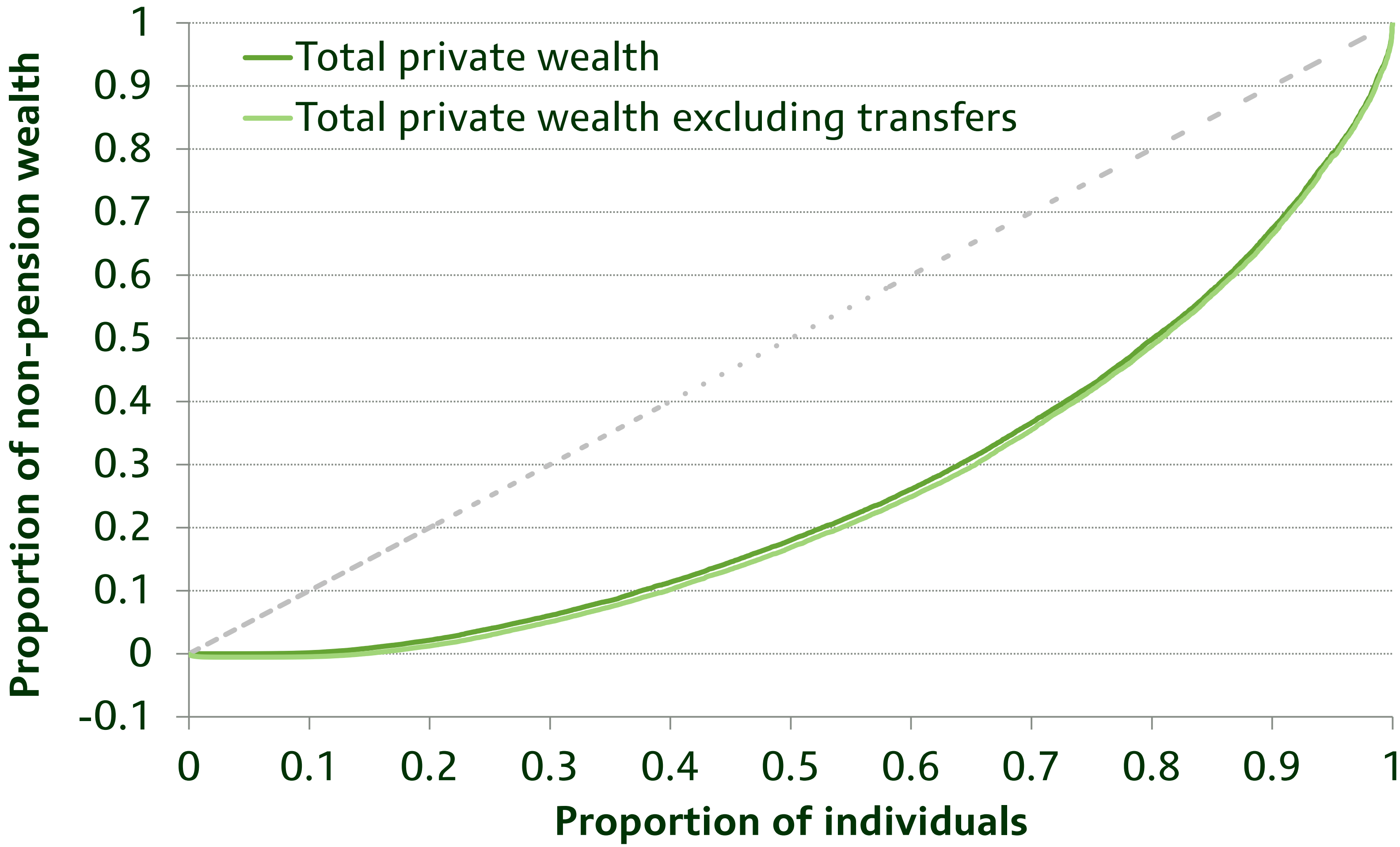
The impact of transfers on wealth inequality (1)

- Given these assumptions, we can split current wealth (W) into wealth excluding transfers (WX) and transfers (T)
- Then recover the impact of transfers on wealth inequality by comparing the distributions of W and WX
  - Do this for each of our three measures of wealth

- Transfers reduce inequality in non-pension wealth
  - Gini coefficient falls from 0.57 to 0.52
  - Top 10% share falls from 39.6% to 37.6%

- Why? Transfers are a bigger *share* of wealth towards the bottom of the distribution

The impact of transfers on the distribution of total private wealth (Lorenz curves)



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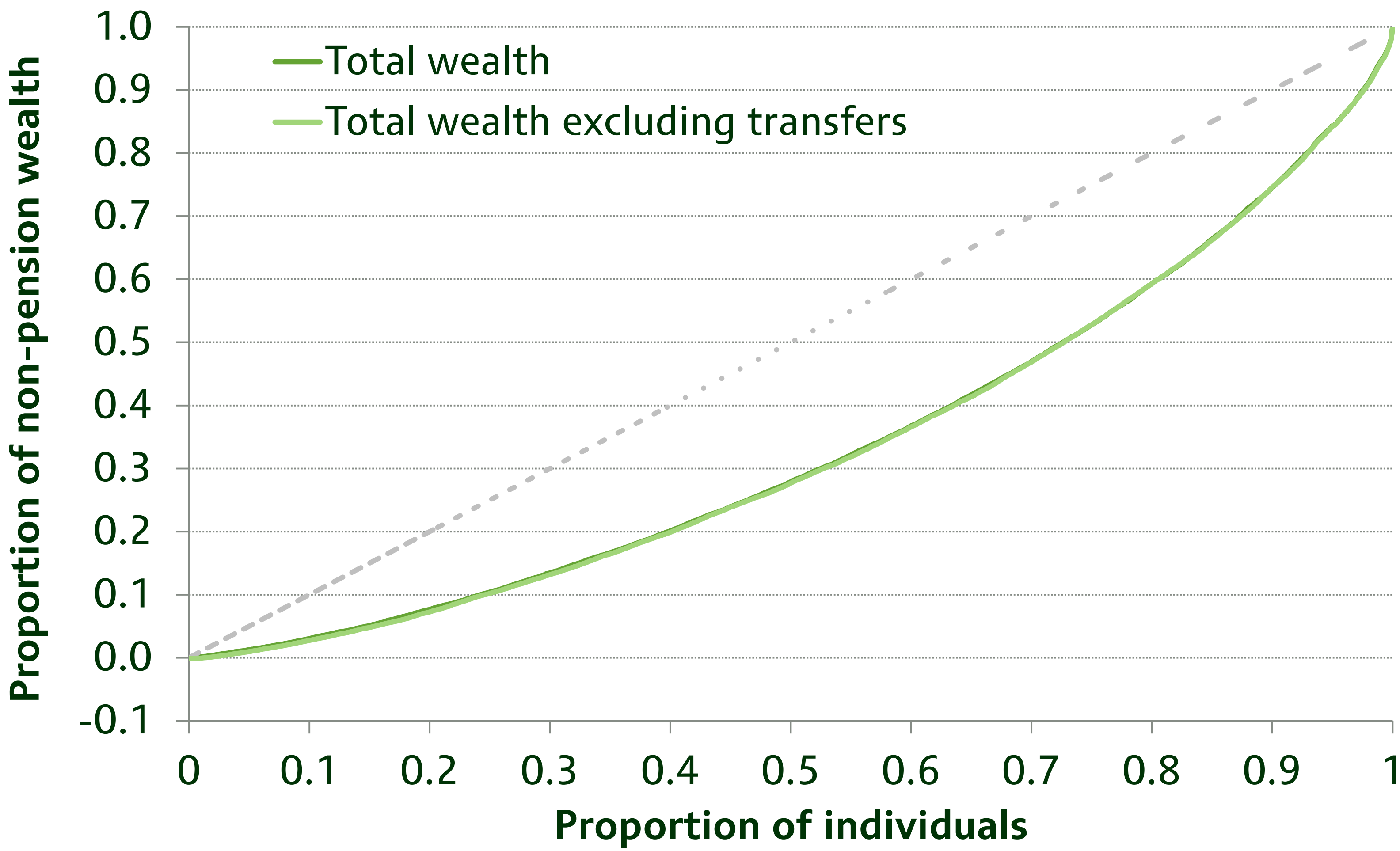
The impact of transfers on the distribution of total wealth (Lorenz curves)



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The impact of transfers on wealth inequality (2)

- Key result: wealth transfers do not reduce inequality in total wealth (including state and private pension wealth)
- Gini coefficient is unchanged (at 0.34) and the top 10% share are also broadly unaffected
- Why? State pension wealth is much more important towards the bottom of the distribution
  - Once it is included, transfers no longer give a disproportionate boost to low-wealth individuals

What about the impact on lifetime income inequality?

- We do not currently have data containing lifetime incomes and lifetime receipt of wealth transfers for the same individuals

- Our approach is to go "via" the wealth distribution
  - Using data containing both individual's lifetime incomes and wealth holdings in retirement for a slightly earlier cohort

Data: the ELSA-NI administrative data link

- Wave 1 of ELSA (2002/03) linked to National Insurance records
  - Records annual earnings since 1975 (topcoded until 1997) and number of weeks worked between 1948 and 1975
  - Can be used to construct full lifetime earnings histories
  - No data on unearned income, state benefits or employer pension contributions

- We construct three measures of net lifetime income
  1. Net lifetime earnings + net lifetime state pension income
  2. Net lifetime earnings + net lifetime state pension income + 0.5*net lifetime private pension income
  3. Net lifetime earnings + net lifetime state pension income + net lifetime private pension income

What about the impact on lifetime income inequality?

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- Our approach is to go “via” the wealth distribution
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- Can look at the relationship between net lifetime incomes and our three measures of wealth
  - Do the lifetime rich save more? (Alan, Atalay and Crossley (2014), Bozio et al (2013), Dynan, Skinner and Zeldes (2004), Venti and Wise (1998, 1999, 2000))

Median regression of the ratio of wealth to net lifetime income (including 50% private pension income)

	Non-pension wealth	Private wealth	Total wealth
Constant	0.155*** (0.010)	0.211*** (0.013)	0.583*** (0.014)
Quintile 2 of net LI	0.003 (0.014)	0.037* (0.019)	-0.051*** (0.020)
Quintile 3 of net LI	0.017 (0.014)	0.102*** (0.019)	-0.016 (0.020)
Quintile 4 of net LI	0.062*** (0.014)	0.127 (0.019)	-0.008 (0.020)
Quintile 5 of net LI	0.111*** (0.014)	0.254*** (0.019)	0.047*** (0.020)

Notes: Sample size is 1,567 individuals. *,**,*** on constant indicate statistically different from zero at 10%, 5%, 1% confidence interval (respectively). *,**,*** on quintile coefficients indicate coefficient is statistically different from the previous quintile at the 10%, 5%, 1% confidence interval (respectively).

Wealth and lifetime incomes

- Non-pension wealth as a share of lifetime income increases signficantly across the lifetime income distribution
  - 16% for bottom quintile, 22% for fourth quintile, 27% for top quintile
  - ie. non-pension wealth is more unequal than lifetime incomes
- Total wealth as a share of lifetime income much more similar across the lifetime income distribution
  - 58% for bottom quintile, 57% for fourth quintile, 63% for top quintile
  - ie. inequality of total wealth similar to that of lifetime income

Inheritances and lifetime incomes

- (Negligible) impact on inequality in total wealth likely to be better guide than (negative) impact on inequality in non-pension wealth
  - Distribution of total wealth more similar to that of lifetime income

- Impact on distribution of total wealth and lifetime incomes likely to be qualitatively similar
  - Smaller impact on distribution of lifetime incomes
  - Under assumption that correlation between transfers and non-transfer wealth close to that between transfers and lifetime income

- All conclusions for this cohort of older individuals in England
  - Might be different among later cohorts for whom wealth transfers are more prevalent

Conclusion

- Growing policy concern about the role of wealth transfers in widening inequality and strengthening intergenerational links
  - But academic literature to date suggests transfers reduce inequality in marketable (non-pension) wealth
- We show that this inequality-reducing impact does not hold for a broader measure of wealth including private and state pensions
  - Wealth transfers no longer give disproportionate boost to low wealth households
- Use link to lifetime earnings to suggest negligible impact on total wealth inequality is better guide to impact on lifetime incomes
  - Distributions of total wealth and lifetime incomes similar