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Inheritances and inequality over the life cycle

Inheritances have been growing as a share of national income in the UK since the 1970s. This trend looks set to continue as generations at older ages hold more wealth than their immediate predecessors but younger generations have no higher incomes than the generations born just before them.

What will this mean for inequalities in living standards and wealth? Does the growth in inheritances mean people's living standards will increasingly be determined by who their parents are? If people anticipate that they are going to inherit in future, could that influence their decisions about how much to spend and save today?

Here, we summarise the findings of our new research that sheds light on these questions. Our focus is on those born in the 1960s, 1970s and 1980s in the UK. We make projections of inheritances to be received by these generations, how this breaks down across the income distribution, and how this may influence spending and savings decisions over people's whole lifetimes.

There is a large amount of uncertainty in the outcomes we are projecting. Our results illustrate the implications of projecting forwards current trends under a number of assumptions. Full details of the methodology are contained in the main report.[1] The uncertainty should be borne in mind when interpreting our results.

[1] Bourquin, Joyce and Sturrock (2021), 'Inheritances and inequality over the life cycle: what will they mean for younger generations?', Institute for Fiscal Studies (IFS) Report R188, https://www.ifs.org.uk/publications/15407

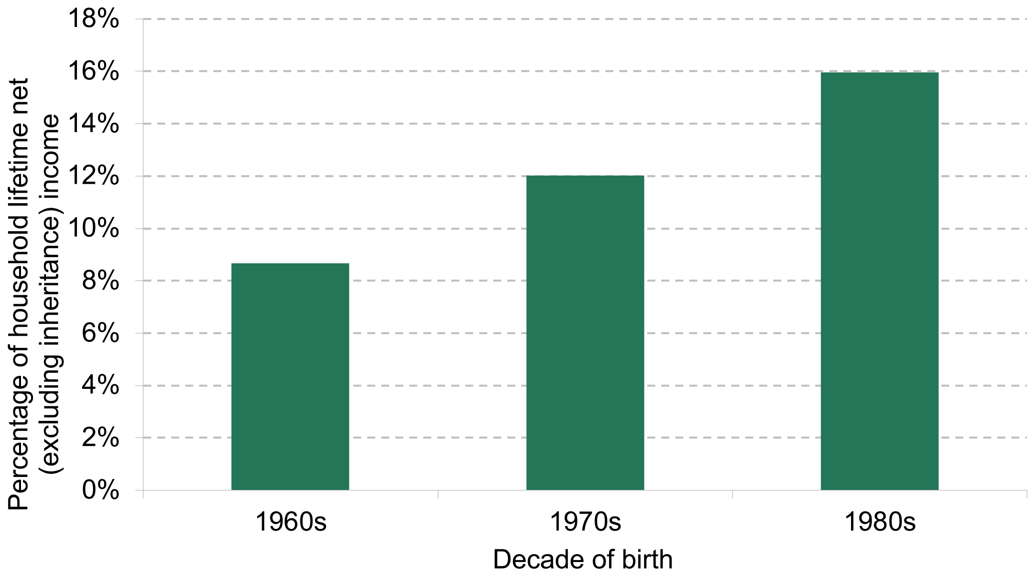
Inheritances are likely to be larger compared with lifetime incomes for younger generations than for their predecessors

Previous research has found that inheritances have been growing compared with national income since around the mid-1970s. Three factors mean that the growth of inheritances is set to continue. First, later-born generations have parents with higher levels of wealth. Second, those born later typically have fewer siblings, meaning that their parents' wealth will likely be shared among fewer heirs. Third, the incomes of the generations we examine were (even pre-pandemic) no higher than the incomes of those born 10 years earlier, when they were the same age.

We project forwards the wealth held by the parents of those born in the 1960s, 1970s and 1980s to project inheritances that they will receive. We also project the incomes of these generations, against which we compare the projected inheritances.

- **We project that average inheritances compared with lifetime income for the 1980s-born will be almost double that of the 1960s-born (Figure 1.1).**

Figure 1.1. Median of inheritances as a percentage of household lifetime net (excluding inheritance) income, by decade of birth



Source: Figure 2.7 of main report.

Inheritances are set to be around the same share of lifetime income for both low- and high-income households

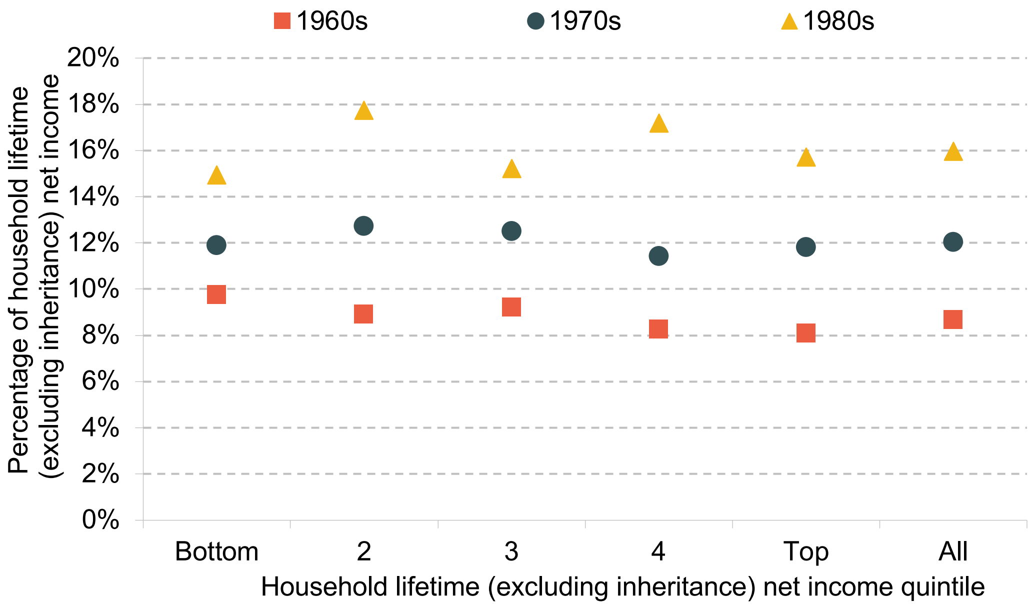
In each generation, we project that those with higher incomes will inherit more.

- **Among the 1980s-born, we project that the median lifetime inheritance receipt for households in the bottom fifth by lifetime income will be around £150,000, and for households in the top fifth it will be around £390,000.**

However, inheritances as a *percentage* of lifetime income look likely to be similar, on average, for low- and high-income households (Figure 1.2).

- **Among the 1980s-born, we project that the median lifetime inheritance receipt as a percentage of lifetime income will be around 15% for households in the bottom fifth by lifetime income, very similar to the 16% projected for the top fifth.**

Figure 1.2. Median inheritance as a percentage of lifetime net income by household lifetime (excluding inheritance) net income quintile and decade of birth



Source: Figure 2.7 of main report.

This means that while inheritances will likely increase the gaps between low- and high-income households in *absolute* terms, they look unlikely to have a big impact on standard inequality measures, such as the Gini coefficient for lifetime income, as these only depend on the *relative* size of households' resources. Whether what matters is the impact of inheritances on absolute or relative differences (or both) is a topic of debate.

It is important to understand that while inheritances look similar compared with lifetime income *on average,* when comparing those with low incomes and those with high incomes, this masks significant variation *within* different income groups. This variation is particularly stark further down the income distribution. For example, for those born in the 1980s, while more than one-in-10 households in the lowest fifth by lifetime income will inherit an amount worth less than their annual average income, this figure is just 6% for those in the top fifth by lifetime income. At the same time, one-in-10 households in the lowest fifth by lifetime income are projected to inherit an amount worth over half their lifetime income. We project that this will be true of less than 1% of those in the top fifth by lifetime income.

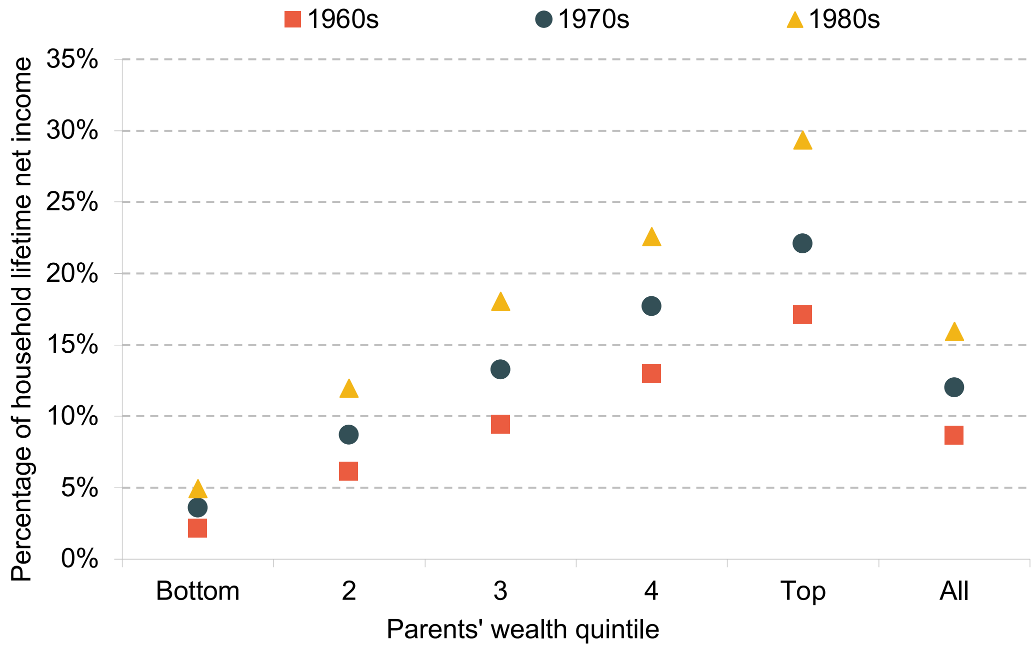
Why are differences in the effects of inheritances more stark at the bottom of the income distribution? While those with low incomes are more likely to have poorer parents, this isn't universally true. Some will inherit modest sums and a minority will inherit substantial sums. For those with low incomes, even a modestly sized inheritance will make a large difference to their income. In that sense, parental wealth has the potential to make much more difference to lifetime income at the bottom of the distribution, a point we take up again when we turn to social mobility.

Inheritances are set to be increasingly important in reducing social mobility

While the implications of future inheritances for standard measures of inequality look likely to be modest, the implications for social mobility are set to be much starker. A society with high social mobility is often defined as one where someone's position is not strongly related to their parental background. Inheritances are a source of wealth that is very strongly related to someone's parental background – in terms of their parents' position in the wealth distribution. We project the following.

- **For those born in the 1960s, inheritances increase lifetime incomes by 2% on average for those with parents in the bottom fifth of the wealth distribution and by 17% for those with parents in the top fifth (Figure 1.3).**
- **This gap by parental background is set to grow, with equivalent figures for the 1980s-born being 5% and 29% (Figure 1.3).**
- **While inheritances are projected to account for around a quarter of the inequality in lifetime consumption (i.e. living standards) by parental background for those born in the 1960s, this rises to a third for those born in the 1980s.**

Figure 1.3. Median inheritance as a percentage of lifetime (excluding inheritance) net income, by parental wealth quintile and decade of birth



Source: Figure 2.9 of main report.

Inheritances look set to play a particular role in reducing upwards social mobility in lifetime income for those from the poorest backgrounds.

- **For the 1960s-born whose parents are in the poorest fifth, we project that inheritances will increase the proportion who end up in the poorest fifth by lifetime income themselves from 38% to 41%.**
- **However, amongst those born in the 1980s, the equivalent rise is from 40% to 48%, meaning inheritances have an impact that is around twice as big.**

This happens because, as inheritances get bigger, those from poorer backgrounds have more ground to make up through their own earnings if they are to catch up with those with richer parents and move up the distribution of lifetime incomes.

How is it that inheritances can have such a profound effect on social mobility while leaving inequality essentially unchanged? This is because inheritances re-order who is where in the distribution of lifetime incomes, moving those with wealthy parents nearer to the top. While the percentage gaps between different parts of the lifetime income distribution are not expected to change much as a result of inheritances, where people sit in the distribution is more strongly dependent on their parental background as a result of inheritances. This dependence on parental background is stronger as inheritances become larger, compared with other lifetime income.

Most younger people expect to inherit and many expect to use an inheritance as a source of retirement funding

- **The percentage of individuals expecting to receive an inheritance rose from 72% of those born in the 1960s to 81% of those born in the 1980s.**

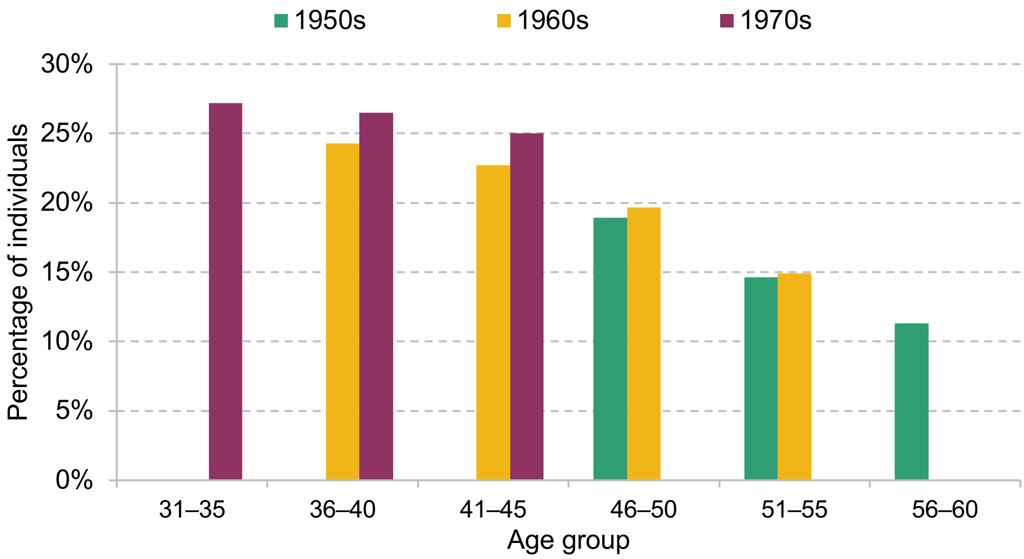
Different people expect to inherit different amounts, in a way that lines up with the broad patterns in parental wealth and inheritances we project.

- **Among those born in the 1960s and 1970s, 38% of the highest-earning quarter of degree-holders expected to inherit £100,000 or more. Among the lowest earning quarter of those with no more than compulsory schooling, only 3% expected to inherit such a sum.**

The fact that many people expected to inherit – and, in some cases, expect to inherit large amounts – raises the possibility that the anticipation of receiving an inheritance could affect their saving and spending decisions today. Indeed, a substantial minority of people expect to use an inheritance as retirement funding.

- **When they were in their late 30s, 24% of those born in the 1960s expected to use a future inheritance as a source of retirement funding. This rose to 27% of those born in the 1970s (Figure 1.4).**

Figure 1.4. Percentage of individuals reporting that they expect to use a future inheritance as a source of retirement funding, by age group and decade of birth



Source: Figure 3.2 of main report.

The bulk of inheritances will likely be spent in later life, once they are received, but a minority may be 'spent' in advance by saving less today

The bulk of inheritances will likely be 'spent' after they are received.

- **Households that inherited in recent decades increased their spending by an average of around £3,300 per year after that point.**

The reasons that people do not bring forward more of the spending that an inheritance allows can be because they are not certain of how much or when they will inherit, or because they do not have savings to cut back on (and cannot borrow against their future inheritance). Using a model of savings behaviour incorporating these factors, we estimate the following.

- **For the 1960s-born, households who inherit will, on average, have spent an additional £250 per year *before* they have received their inheritance, as a result of anticipating an inheritance.**
- **This means that around one-fifth of their inheritance is effectively spent in advance of receiving it.**
- **For the 1980s-born, we estimate that this will rise to around one-quarter, or an extra £400 per year of spending, in advance of receipt.**

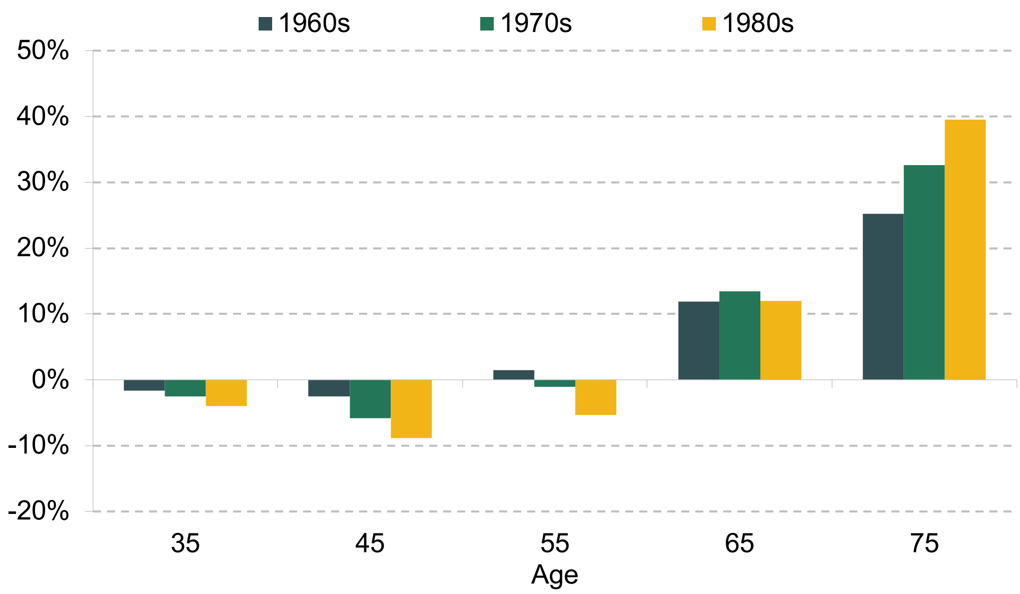
By spending more and saving less in anticipation of an inheritance, people will likely accumulate less wealth in early adulthood, before inheritances are received.

- **Inheritances are estimated to reduce the level of assets held at the age of 45 by 9% among the 1980s-born (Figure 1.5).**

Inheritances will substantially increase wealth in later life, once they are received.

While there is considerable uncertainty around the estimates made by our model, this suggests that the anticipation of future inheritances is a non-trivial factor when interpreting differences in wealth across generations.

Figure 1.5. Estimated effect of inheritances on households' wealth at selected ages, by decade of birth



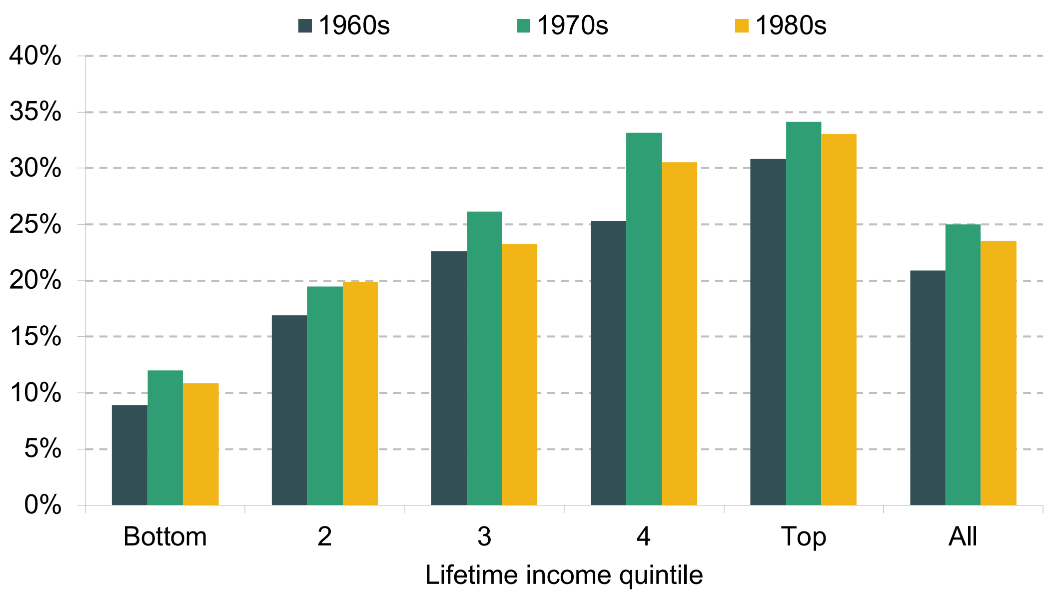
Source: Figure 4.4 of main report.

Higher-income households are likely to be more able or willing to reduce their saving in anticipation of an inheritance

Higher-income households tend to save more of their income than lower-income households. This means they are more likely to have savings that they can cut back on in anticipation of an inheritance. Lower-income households may also be more discouraged from anticipatory spending by uncertainty about when or how much they will inherit. This is because, if a household with low lifetime income receives less inheritance than they had planned and has to cut back on spending, this is likely more painful for them than it is for a household with higher lifetime income.

- **Our modelling projects that for those born in the 1980s, the bottom fifth of households by lifetime income consume 11% of their inheritance in advance whereas the top fifth by lifetime income spend 33% in advance (Figure 1.6).**

Figure 1.6. Effect of inheritances on households' consumption before they receive their inheritances, as a percentage of inheritance received, by decade of birth and lifetime income quintile



Source: Figure 4.12 of main report.

This difference means that better-off households likely benefit more from inheritances early in life than poorer households. As a result, inheritances will tend to be 'worth more' to higher-income households than an equivalent inheritance received by a low-income household, as they are able to spread the extra spending from inheritances over their lifetimes, rather than concentrating it towards the end.

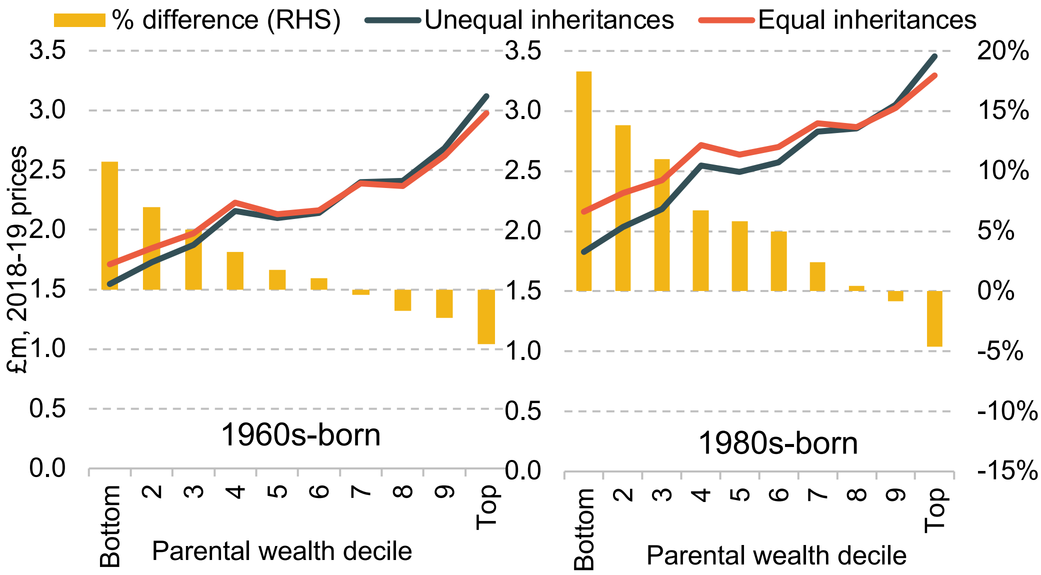
The growth of inheritances means that policies that successfully redistribute them would have larger effects on inequality and social mobility for later-born generations

To quantify the effects of changing inheritance tax and other measures to redistribute inheritances, one would need to consider and model the responses of parents. In our analysis, we do not do this; we take the behaviour of parents as given and analyse the responses of the receivers of inheritances. While we therefore cannot model the effect of any specific, real-world policy change, we can model what would happen if a certain amount of redistribution of inheritance income – achieved through a means we do not specify – were to occur.

We consider the effect of equalising all inheritances at their average value for that generation. This would have substantial effects on inequality and social mobility.

- **For those born in the 1980s, equalising inheritances at their mean value is projected to increase lifetime consumption for the bottom tenth by 18% and decrease it by just under 5% for the top tenth (Figure 1.7).**
- **This reduces the same gap in lifetime consumption between those with the richest and poorest parents by over 40%.**
- **This is a much larger effect than for those born in the 1960s, where equalisation of inheritances reduces the gap in lifetime consumption between those with the richest and poorest parents by around a quarter.**

Figure 1.7. Mean lifetime equivalised household consumption, by parental wealth decile, with and without equalising inheritances at their mean value, for 1960s-born (left) and 1980s-born (right)



Source: Figure 4.20 of main report.

This example should not be interpreted as a viable policy option – trying to redistribute inheritance income would likely lead to some avoidance behaviour – but it does show the increasing amounts potentially at stake from policies in this area.

Here, we have considered inheritances being equalised but still received at the same time that we expect them to be received. A 'citizen's inheritance' funded by inheritance tax revenues and paid at the beginning of adulthood has been championed by Thomas Piketty and the late Tony Atkinson. Our finding that households with lower lifetime income would likely place additional value on inheritance income received earlier in life suggests that the timing of redistribution would be of even greater value to those with lower lifetime incomes.