Approved: Phill Kline
Date

MINUTES OF THE HOUSE COMMITTEE ON TAXATION.

The meeting was called to order by Chairperson Phill Kline at 9:00 a.m. on February 14, 1995 in Room 519-S of the Capitol.

All members were present except: Rep. Pat Pettey - excused

Committee staff present: Chris Courtwright, Legislative Research Department
Tom Severn, Legislative Research Department
Don Hayward, Revisor of Statutes
Ann McMorris, Committee Secretary

Conferees appearing before the committee: Listed after each bill heard.

Others attending: None signed.

Chair requested introduction of committee bills.

Moved by Kline, seconded by Donovan, introduction of a bill directed toward helping Wyandotte County to market delinquent property. Motion carried.

Moved by Kline, seconded by Donovan, introduction of bill to permit the program for urban revitalizatrion to retain state sales and property taxes for spending with a development plan. Motion carried.

Moved by Kline, seconded by Donovan, a bill to allow investments and organizations to receive tax credit to help urbdan revitatization. Motion carried.

Chair opened hearing on:

HB 2171 - Property tax exemption for business machinery and equipment.

Proponents
Rep. Gene Shore (Attachment 1)
Ron Smith, General Counsel, Kansas Bar Association
Austin Nothern, Attorney, Topeka

Comments and questions from committee to proponents and staff. Request from committee from staff for data on inheritance taxes from estates of under $600, 000.

Hearing was closed.

Chair opened hearing on:

HB 2150 - Inheritance tax deduction amounts increased

Proponents
Rep. Tim Carmody (Attachment 2)

Comments and questions from committee. Hearing was closed.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON TAXATION, Room 519-S Statehouse, at 9:00 a.m. on February 14, 1995.

Adjournment.

The next meeting is scheduled for February 15, 1995.

Attachments - 2

STATE OF KANSAS

EUGENE L. SHORE
REPRESENTATIVE, 124TH DISTRICT
GRANT, W. HASKELL, MORTON,
STANTON AND STEVENS COUNTIES

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TOPEKA, KANSAS 66612-1504
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TOPEKA

HOUSE OF
REPRESENTATIVES

COMMITTEE ASSIGNMENTS

VICE-CHAIRMAN: EDUCATION
MEMBER: TAXATION
MEMBER: TRANSPORTATION

Testimony to House Tax Committee
February 14, 1995
HB 2171

HB 2171 is a pro-family bill with a positive fiscal note for the people of Kansas. The meat of the bill is New Section 1, lines 21-40, on page one.

The federal government has an estate tax which is determined the day of death. If the deceased has money in the bank, stocks or bonds, grain in the elevator, or real estate, the value the day of death is the determining factor as to tax owed. It is simple, quick and as fair as an estate tax can be.

The IRS allows the states to keep a certain percentage of the amount collected as a credit to the state. The state can tax more, but if it taxes less, the balance goes to the federal government. The amount of tax the state can withhold from the federal government is called a "pick up tax".

Kansas has an inheritance tax system which is complicated, time consuming and expensive for all concerned. Before it can be implemented, the will has to be probated so you know who inherits what. Closer relatives pay a smaller percent than more distant relatives and much less than non-relatives.

HB 2171 would allow Kansas to collect the "pick up tax" and would cease the complicated and expensive method of collecting the inheritance tax. **HB 2171** is a common sense end to Kansas tax policy which seems to say "Federal government, your idea is good, but we want more." Allowing the "pick up tax" is a fair approach to estate taxation.

I stand for questions.

House Taxation
2-14-95
Attachment 1

6788 E. RD 24
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HB

DRAFT

SCOPE STATEMENT

Reviewing the Department of Revenue's Enforcement of the Kansas Inheritance Tax

Chapter 79 of the Kansas Statutes imposes an inheritance tax on property passed by a decedent to his or her heirs. The amount of the tax is based upon the value of the property transferred and the relationship of the heir to the deceased. Inheritance tax collections have increased about 20 percent over the past five years from about $45.2 million in fiscal year 1988 to $54.4 million in fiscal year 1992.

Recently legislators have expressed concerns that Kansas may be losing significant amounts of inheritance tax revenue from Kansas citizens who place financial assets out-of-state, with provisions for that property to be paid to the owner's heirs upon his or her death. Specifically, legislators are interested in knowing whether the Department of Revenue has adequate enforcement procedures to ensure that all inheritance taxes due the State are collected.

An audit of this topic would address the following question:

1. **Has the Department of Revenue established adequate controls to ensure that it collects inheritance taxes owed to the State?** By reviewing the statutes we would determine when inheritance taxes should be collected and in what amounts. Through interviews with appropriate Department of Revenue officials, and by reviewing any written procedures and regulations, we would determine what systems the Department has established to ensure that all inheritance taxes are collected. We also would determine what interstate agreements or compacts may exist that allow states to notify each other about changes of asset ownership that could be subject to inheritance tax. On a sample basis, we would test the Department's systems for identifying and collecting inheritance taxes to ensure that they are working as described and effective in identifying inheritance taxes that should be paid. *We would review records at the Register of Deeds office in several counties to determine whether an inheritance tax return had been filed in cases where a death certificate was filed to remove a name from the title to real estate. If we can obtain access to bank records, we would attempt to determine if names were removed from a bank account by reason of death of an owner, without a corresponding inheritance tax return being filed. Also, we would review Probate Court records to determine whether inheritance tax had been paid in cases where a conservator had been appointed to manage an estate.* Through contacts with officials from surrounding states, we would determine *what their inheritance tax rates are* and what controls they have established to collect inheritance taxes. Finally, we would compare those controls to Kansas's controls to determine if improvements could be made.

Estimated completion time: 10-12 weeks

House Taxation
2-14-95
Attachment 2-1

Citation: Institutional Investor, June 1994 v28 n6 p143(5)

Title: The coming inheritance bonanza. (Money Management)

Authors: Shapiro, Harvey D.

Subjects: Baby boom generation_Finance
Aged_Finance
Inheritance and succession_Economic aspects

Reference #: A16124516

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Abstract: The baby boom generation stands to reap a financial windfall as the wealth of their generally affluent parents passes on to them in the form of exceptionally high bequests. Between 1995 and 2005 when the majority of the parents of the boomer generation are expected to pass away, average bequest size is expected to rise from an estimated $55,951 to $76,194. Given the shaky financial position of many maturing boomers, this transfer of wealth should lead to a surge of interest in investments since most boomers are expected to save their inheritance to supplement their savings. Mutual funds and discount brokerages are likely to get the bulk of these bequest funds since boomers are expected to seek out managers capable of ensuring maximal returns. Other financial institutions may not be so fortunate. Insurance companies, for example, are unlikely to win a significant share of the market unless they adapt their marketing style to the needs of boomers.

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Their frugal parents will soon be making the largest transfer of wealth in history to baby boomers, who'll -- surprise -- invest it.

No one ever figured out how Ward Cleaver supported his family so comfortably, since he never seemed to work. But, actuarially, Ward and his wife, June, are destined to pass away soon, and whatever money they've got, well, you can be sure they're going to leave it to Beaver.

Like Beaver Cleaver and his brother, Wally, characters in the '50s TV sitcom, millions of members of America's vast baby boom generation -- those born between 1946 and 1964 -

- are on the verge of inheriting their share of the largest transfer of wealth in history. The baby boomers' parents, the Depression generation, will be dying off in substantial numbers in the next few years. And Cornell University economics professors Robert Avery and Michael Rendall calculate that these frugal parents will leave behind a startling $12.1 trillion.

"That is no statistical mirage -- today's elderly have accumulated a vast amount of wealth, and they're not going to spend it down," says Edward Wolff, a professor of economics at New York University. "This is a really special moment in generational history. There's never been such a significant wealth transfer." Its dimensions are likely to surprise both the boomers -- many of whom have no idea how much money their parents have -- and the financial services industry, which will be competing vigorously for this treasure trove.

"There's a major financial avalanche about to occur, with enormous implications," says Kenneth Dychtwald, president and CEO of Age Wave, a consulting firm that specializes in the ramifications of a maturing population. "And this massive intergenerational wealth transfer will be guided by few protocols, few experts and very little public discussion. Oprah !Winfrey^ hasn't done a show on this, and it's not a mass-market phenomenon, but it ought to be."
The windfall generation

Bequests to baby boomers from their thrifty parents will rise steadily well into the next century.

Year	Total(*) ($ billion)	No. of heirs (thousands)	Mean(*)(**) ($)
1990	$ 39.4	900	$ 43,814
1995	84.3	1,506	55,951
2000	143.8	2,202	65,289
2005	216.9	2,846	76,194
2010	286.2	3,255	87,918
2015	335.9	3,389	99,130
2020	334.5	3,135	106,717
2025	288.5	2,650	108,870
2030	201.6	1,881	107,180
2035	106.8	1,090	97,997
2040	40.7	417	97,636
Total	$10,365.0	114,953	$90,167

* Figures are in 1989 dollars.

** Figures for mean bequests have been adjusted to reflect technical factors not included in this table.

Source: Professors Robert Avery and Michael Rendall, Cornell University.

Much of this windfall is going to go into savings and investments, not consumption, Dychtwald adds. Those who can figure out how to win the allegiance of the boomers will do very well indeed. At PaineWebber, executive vice president Dennis Hess says, "since the guys at Cornell did their studies, most of us have become aware of this huge intergenerational flow of funds, and people here are asking, 'What do you have to do to stand in that flow so we can participate in the business it will generate?'"

Most of the attention being focused on the impending inheritance boom can be traced to professors Avery and Rendall. Avery, who used to work for the Federal Reserve Bank of Boston, has been studying Internal Revenue Service data on inheritances for a number of years. He and Rendall presented a paper on their findings to the American Statistical Association last year, and they have been offering variations on it at other academic gatherings. "We don't think we've got the definitive paper yet," Avery says.

What they have got, however, is pretty definitive evidence of the wealth of older Americans. Although 3 percent of the nation's elderly live in poverty, households headed by someone 65 or older have a net worth of some $260,000, on average, more than that of any other age cohort. The baby boomers' parents have accumulated particularly sizable amounts, says NYU's Wolff, because "they happened to be in the right places at the right times. They bought houses in the 1950s and '60s when prices were low and rode up the large appreciation in house values -- that's the main source of their wealth accumulation."

Moreover, those reared during the Depression were schooled in thrift. "That generation has had the highest rate of financial savings of any generation," Wolff notes. They not only experienced the Depression but also the ensuing rise in living standards. Such people, says Wolff, "tend to save more because there is a lag effect between income and consumption." They also put more of their savings into stocks and enjoyed the fruits of the massive post-World War II bull markets. Then, too, they generally had smaller families than previous generations. That means their estates are not going to be dissipated among seven or eight kids, as in earlier generations, but divided among only two or three.

The elderly rarely go on spending sprees. "The evidence is very strong that people don't dissipate wealth as they age," says Avery. They reach a point where they're mild dissavers, but they don't spend down their wealth." One good reason: They don't know how long they're going to live. In some cases, catastrophic health problems eat up reserves, but that doesn't affect a high percentage of the elderly.

Economists who have been tracking the buildup of wealth say the vast transfer is about to begin. "The youngest boomer is now 30 and the oldest is 48," says Dychtwald. "Some of their parents may be 48 and some in their 90s, but the epicenter for most parents is between 65 and 75." That means they will be meeting their Maker -- and leaving

bequests -- in growing numbers in the next few years. "Not all these moms and dads will pass away on the same afternoon," Dychtwald says. "This is going to go on for the next 25 years."

According to Avery and Rendall, in 1990 there were 900,000 bequests totaling $39.4 billion, translating into a mean bequest of $43,814 (in constant 1989 dollars; see table). By 1995, they say, there will be 1.5 million bequests totaling $84.3 billion, for a mean bequest of $55,951. All the numbers will keep rising until 2020, when there will be 3.1 million bequests involving $334.5 billion, or an average bequest of $106,717. Then the number of bequests starts falling rapidly, although their size declines only slightly. By 2035, when the youngest boomers will be 71 and any surviving parents will presumably be well into their 90s, the number of bequests will have fallen back to near the 1995 level.

The way Avery and Rendall measure transfers, a bequest is from one household -- a couple or the surviving widow or widower -- to one offspring. A couple composed of two boomers could collect from both sets of parents ($112,000 on average in 1995, $152,000 in 2005). Since the boomers grew up amid the breakdown of the American family, lots of them will be collecting from their mother and father plus their stepmother and stepfather. Maybe there'll even be a little something in the will of mom's gentleman friend, from those last couple of years when she was a widow in Sun City.

Of course, the figures are all averages. Avery and Rendall say that one third of the wealth transfer will go to 1 percent of the boomers, who will inherit an average of $1.6 million; a further third will go to 9 percent of the boomers, who will get an average of $396,000; and the last third will be split among the remaining 90 percent of the boomers, for an average bequest of $40,000.

For most inheritors the amounts won't be enough to dramatically change their lifestyles: They won't be able to quit their jobs and buy villas in St. Tropez. But five- and six-figure sums aren't chopped liver either, for the boomers or for Wall Street.

"This is the first time you're getting transfers going from the elderly to their children -- previously it went from middle-aged families to their parents," Wolff notes. "You have a very sharp reversal of historic patterns of wealth transference. There will be plenty of surprised offspring, because the Depression generation doesn't talk about money."

There's a catch: The parents of the boomers are not only the wealthiest generation in American history but they are also the longest-lived. They're going to leave a bundle, all right, but their life expectancy is well into the 80s, and many will live into their 90s. Right now, says Dychtwald, "10 percent of the senior citizens in this country already have children who are also senior citizens." A fair number of long-lived members of the Depression generation are going to see no point in leaving money to their 65-year-old baby boom children and will bequeath their money directly m their grandchildren -- 30-something couples having babies and struggling to buy homes.

Many baby boomers are going to receive inheritances when they're in their mid-50s. By then their homes will be nearly paid for and their children's college educations nearly finished. So what will they do with the money? Will they continue the free-spending ways they made famous in the 1980s? Or will advancing age change their habits?

"They're going to save it," Wolff says firmly. "Their peak consumption years have passed." Their appetite for fast cars and expensive controlled substances will be fond memories only, while the real mementos of their yuppie years are big debts and small bank balances. "They overextended themselves and got into debt," Wolff says, "so I don't think they're going to fritter away their inheritance; I think they've learned their lesson. They may buy a BMW, but basically, they're going to save a large portion of it because they have to think of their own retirement."

Dychtwald agrees: "The boomers are not only worried about retirement but also about getting laid off -- that's become a real fear for this generation." Though "a certain amount !of the boomers' inheritance^ will be used for vanity purchases -- a trip around the world, a wild new convertible, cosmetic surgery and a lot of self-oriented stuff," he says, most of the money will be saved.

A study for the Equitable Life Assurance Society completed last year found that when 600 boomers were asked how they might have handled their finances differently, 42 percent said they would have saved more and spent less. In this year's version of the study, 47 percent of respondents said they were not saving enough for retirement, and 85 percent said they should have started saving for retirement earlier in life.

Saving will be a new experience for many baby boomers. "They have been borrowers, not investors or savers," says Dudley Nigg, an executive vice president of Wells Fargo Bank. That suggests that their financial allegiance will be up for grabs.

Some hints of what they're likely to do with their money can be deduced from their attitudes and attributes, says Nigg, adding, "While they may be very diverse, they do have some common characteristics." Their parents' generation, he notes, tended to concentrate more on minimizing risk. They saw people lose everything in the great crash, and that was the calamity that shaped their attitudes. The boomers are "more focused on risk-reward relationships," Nigg says. They see the risk of falling behind the inflation rate as well as the risk of losses.

That creates problems for banks. Most baby boom heirs are not going to be rich enough to be clients of either the private banking or trust departments of commercial banks, nor are they going to sock money away in certificates of deposit, as their parents did. So if banks want their share, they must accelerate their efforts to offer investments. At the end of 1993, bank-sponsored mutual funds had 10 percent of the market, up from 5.5 percent in 1988. But that's a small share, considering that most of the billions of dollars flowing into mutual funds have been coming out of bank deposits.

Baby boomers, those active spenders, won't be passive investors. "The baby boom generation has experienced a lot of market volatility," points out Richard Hoey, chief economist and a portfolio manager at Dreyfus Corp. "They had the worst bear market in bonds since the founding of the republic, and then we had a 12-year bull market and the '87 stock market crash." In contrast to their parents, they've also seen housing prices go down as well as up. The upshot, he argues, is that "boomers !are^ sensitized to big changes in the markets, creating pressure for a more active role in making investment decisions." Laurence Kotlikoff, a professor of economics at Boston University, adds that the proliferation of defined-contribution plans has "added to the idea that you need to take personal responsibility for your investments."

The consensus, however, is that though many boomers actively watch their money, they don't actively manage it. The boomers are behind the surge in mutual fund investing, and their inheritances will provide a further big boost to the fund business. "The baby boomers understand that securities are better than bank accounts," one economist says, "but they consider themselves too busy to spend a lot of time and effort picking individual investments."

The generation that routinely hires people to clean its houses, improve its tennis game and tend its children is certainly going to want someone to manage its investments. And mutual funds are easy and cheap. Besides, boomers have been acclimated to mutual funds through their 401(k) plans. Hoey notes that the rise of mutual funds has been accompanied by innumerable magazine articles about them, so it's relatively easy to get information to guide decisions. This spring Wells Fargo launched its Lifepath funds, premixed collections of asset classes designed to provide a specific return at an exact point in time: Boomers can now get investments that are like their VCRs and microwave ovens -- programmable to do the job when they want it done.

"This generation," says Nigg, "cares about value." That spells trouble for funds with high front-end loads. Indeed, the boomers have been steadily driving down the market share of load funds.

Discount brokers should also fare well in the inheritance sweepstakes. Less sophisticated boomers will take to them because they represent a cut-rate way to buy securities to be held forever. More sophisticated boomers wanting in buy and sell securities know that the discounters' execution is usually as good as that of other brokers (whose research recommendations aren't necessarily worth the extra commission cost). Boomers who grew up cheerfully copying other people's floppy discs rather than buying software are apt to be perfectly comfortable getting research from full-service brokers while trading at Quick & Reilly. Even those who invest in mutual funds have shown they like the one-stop shopping and easy switching that discounters now emphasize.

The boom in the discount brokerage industry, in fact, has been fueled largely by boomers. Research conducted in 1992 showed that the big customers of Merrill Lynch had an average age of 65, while at discount brokerage firms Charles Schwab & Co. and

Quick & Reilly, the average age was 47. Last year two prominent baby boomers, Bill and Hillary Rodham Clinton, each reported having a Schwab brokerage account.

Full-service brokers may have a lot to worry about. The Depression generation saw stockbrokers as educated professionals, comparable to accountants or pharmacists; boomers think of them as characters they went to college with who now like to play the market. "The baby boomers have less faith than their parents in a broker's ability to pick stocks and less willingness to pay high commissions," notes one economist.

Though the discounters and the mutual funds insist that full-service brokers, like full-price airlines, are dinosaurs, PaineWebber's Hess says that's nonsense: "There will always be people who buy off the pipe rack, but as they have more to invest, people are going to need advice more and more. They will put a premium on that. And firms like ourselves have to deliver a value-added service, and advice is the difference." Even if newly enriched baby boomers lean toward mutual funds, he notes, "there are now more mutual funds than there are stocks listed on the New York Stock Exchange, so people have got to get advice on which mutual funds."

Of all the competitors for the baby boomers' patrimony, insurance companies may have the worst prospects. They're the ones paying out the big death benefits that boomers will inherit, yet as they try to recapture those inheritances, their best prospects are what one economist calls "the two extreme ends of the IQ spectrum: those dopey enough to buy whatever their lodge brother wants to sell them and those really sophisticated investors who understand the tax advantages of using the inside buildup of a life insurance structure to accumulate invested assets." For many of those in between, he says, "the insurance industry's high-cost, commission-driven distribution system offers limited prospects of connecting with the boomers, even though insurers have some good products, like variable universal life insurance and variable annuities."

Ultimately, the battle for the hearts and minds and inheritances of the baby boomers may be fought not with products but with attributes and images. "The boomers are very demanding in terms of service," says Nigg, but "service to the boomers may mean something very different than it did to their parents' generation." Whereas the parents tended to equate service with personalized treatment, he explains, boomers are "increasingly equating service with technological delivery as opposed to personal delivery." Older people want someone to be nice to them; baby boomers want a 24-hour 800 number they can call from their car phone and an e-mail address they can access from their laptop's modem.

Distrustful of authority figures (this is the '60s generation in large part), the baby boomers tend to regard "people who come on as experts !as^ immediately suspect," according to Dychtwald. "They don't want hand-holding or preaching. The key is to offer information that they can use to make their own decisions."

That's the approach T. Rowe Price Associates is taking in marketing mutual funds to baby boomers. It stresses providing boomers with educational information on their two

main financial concerns: retirement and college costs. The firm's retirement planning kit and college planning kit are "our efforts to reach this baby boom generation," says one executive at the firm. "And because this generation is so computer-oriented," he adds, the firm put its retirement planning kit on floppy discs "and sold 80,000 at $15 each." T. Rowe is betting that the boomers will buy their funds from the same outfit that sold them the floppies.

Vendors to baby boomers need marketplace staying power. John Coghlan, senior vice president of Schwab, explains: "You definitely have to be out there with your message consistently so that when someone finds themselves !inheriting money^, you are there with a solution -- either you're the one they think of or they open the newspaper and you're there talking abofit their situation. If you remember how numerous the baby boomers are, that kind of advertising makes sense."

Because the baby boomers are a large, complex and diverse group, says NYU's Wolff, "they don't seem to be a market that the financial community has really focused on so far." That, he adds, provides an opportunity.

And Now, The Bad News

Baby Boomers are being told to expect big inheritances. Here's why it won't work out that way.

By ANDY ZIPSER

ONE OF THESE DAYS, Mom and Dad will die. When they do, you'll get a lot of money. We know that's what you're hoping, and though *you* [illegible] not know it yet, a lot of other folks [illegible] hoping you get rich, too. The list of [illegible]-wishers includes a gaggle of lawyers [illegible] brokers and bankers, all eager to [illegible] invest your inheritance. More and [illegible] of these characters have been [illegible]ing around the nation's Baby [illegible]ers since last year, when two Cor[illegible] University professors presented "Inheritance and Wealth," a research paper indicating that America's 77 million Baby Boomers stand to reap $10.4 trillion in inheritances. It's been billed as "the largest intergenerational transfer of wealth in American history."

Since the study was unveiled, scores of banks, insurance companies, mutual-fund families and software makers have been using it as an excuse to urge even more of their services onto the generation born between 1946 and 1964. Some of these efforts go beyond hyperbole, as in the recent press release from a Madison Avenue public relations firm that purrs, "There is a whole new class of millionaires in the United States today—people like you and me who, because of inheritance and job mobility, suddenly have a lot of money to invest."

But it's not enough to know the money's out there: Many purveyors of financial services are out to convince Boomers they lack the smarts to use their money wisely. Thus, Equitable Life Assurance Society earlier this year asked 600 Baby Boomers to evaluate their own investment skills. The results? Of those surveyed, 4% rated themselves "excellent," 20% as "above average," 48% "average" and 27% "below average." The insurance company's conclusion: That boomers are "insecure in [their] investing skills" because most rate themselves "as average to below average."

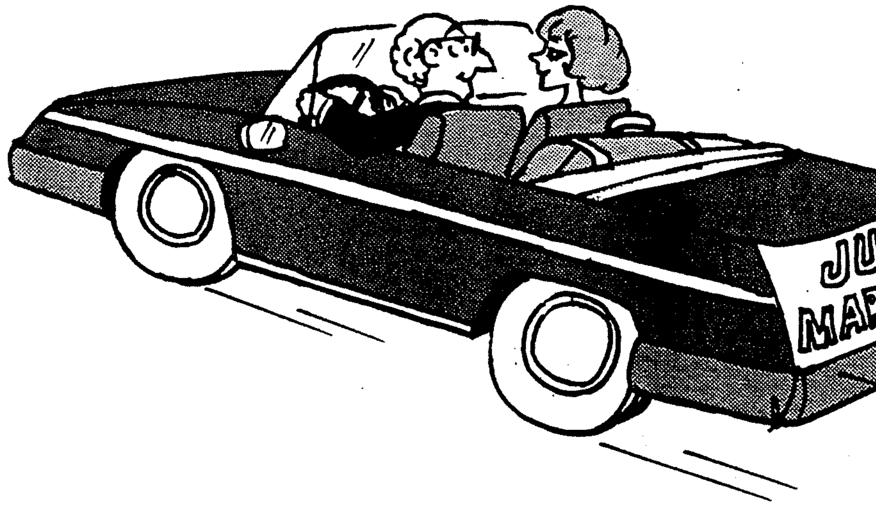
Or, as Equitable President Jim Benson announced at the time, "Unfortunately, many Baby Boomers lack faith in their investment skills. We see a real need for professional guidance from financial experts." ▶

ILLUSTRATIONS: JOSEPH FARRIS for *Barron's*

2-10

Truth is, however, the widely cited $10.4 trillion figure is a wild guesstimate – and its authors readily acknowledge as much, if in more measured terms. The lofty projection is also irrelevant. To begin with, any inheritance Boomers get from their parents is likely to be less than they anticipate, will represent a smaller proportion of their income than would have been true 30 years ago and is only a fraction of the wealth that has gone *from* the Boomers *to* their parents. The greatest intergenerational transfer of wealth in American history already has occurred, right beneath everyone's noses, and Mom and Dad would like to thank you very much.

As for the myriad offers of "professional guidance from financial experts"? If you're not already rolling in dough, or soon about to be, forget about it. The best financial planning most Baby Boomers can undertake is to build a spare bedroom—in their children's homes.



A BOMBSHELL FROM ACADEMIA

▶The authors of the aforementioned "Wealth and Inheritance" are Cornell professors Robert B. Avery and Michael S. Rendall, and as a team they have come up with some pretty stupefying prose. Which may explain why the mass media were put into a coma by the professors' scribblings about "inheritances and inter-vivos transfers" as "a potentially significant factor in determining aggregate U.S. savings and wealth accumulation." Yet the media did stir when the professors dropped a bombshell at the bottom line: The nation's Baby Boomers can look for an inheritance windfall of $10.4 *trillion.*

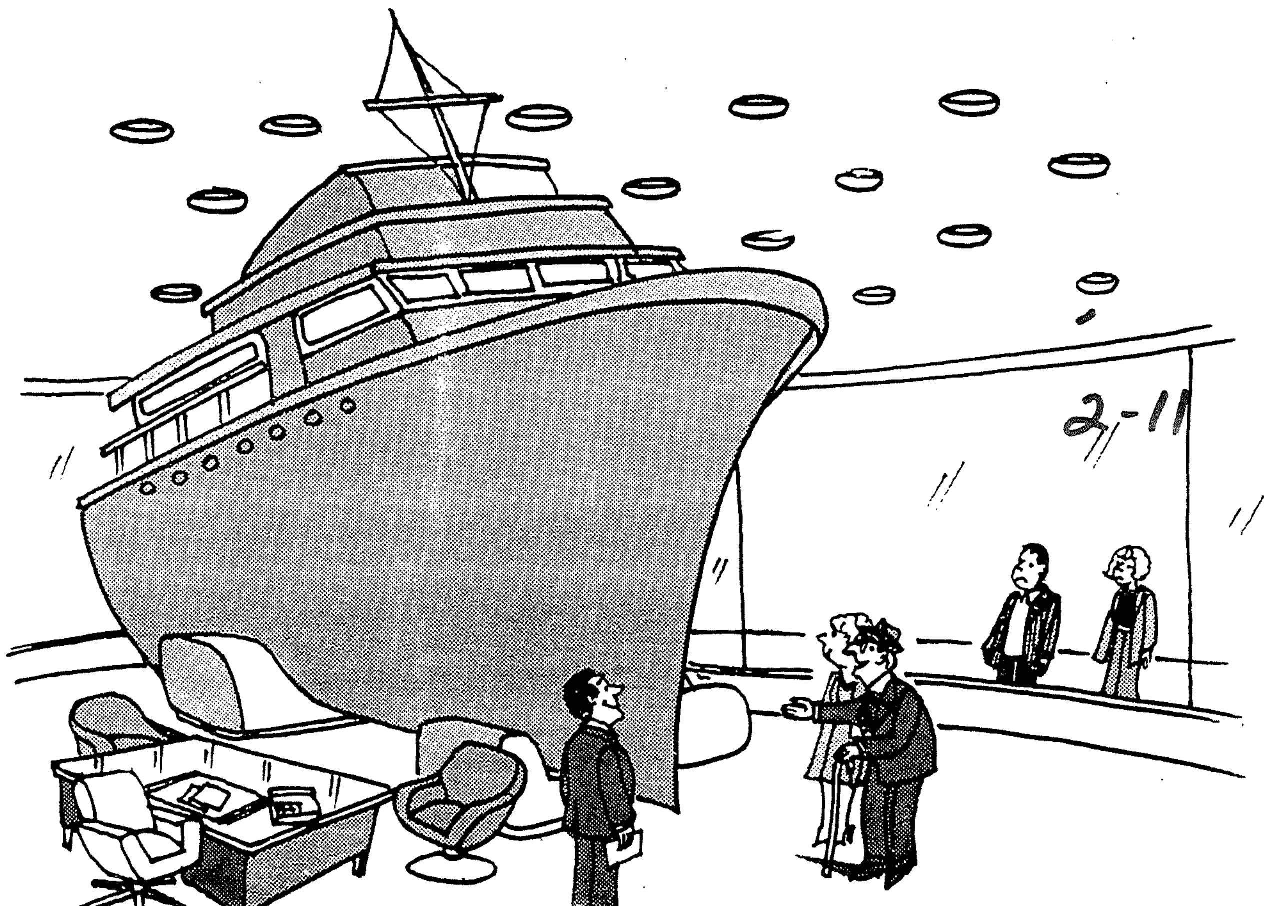
That's the kind of number that can shake even jaded headline writers into attentiveness, providing us with a carillon of such recent bell-ringers as "The Coming Inheritance Bonanza" and "Baby Boomers to Inherit Earth – or $10.4 Trillion of It." But buried in all the socio-mathematical language of the Cornell report are a lot of ifs, ands and buts. As Avery and Rendall concede from the outset, a truly accurate forecast would have required such complex calculations of economic and demographic dynamics that they took a bunch of short-cuts, such as assuming all bequests will go to surviving children, not foundations or other charitable institutions. Moreover, their "simplifying assumptions" include a decision to ignore the costs of death, such as those pesky estate taxes.

And there are lots of gaps beyond oversimplification. Among the missing elements, for example, is "the crucial link between wealth near to the time of death and bequests passed on to children or other relatives upon death." In other words, 11th-hour gifts to charity and the high cost of medical care in one's last days go unaccounted for in the Cornell stud

There are so many holes in the data fact, that Rendall and Avery broa proclaim their forecasts "should not interpreted as any more than suggest as to the true numbers."

Another reason that the $10.4 tril so readily bandied about is misleadin that it's expressed in 1989 dollars – spread out over 50 years. "It's a number," acknowledges Laurence Ko koff, an economist at Boston Univer who wrote the watershed book, *Gen tional Accounting.* "GDP's a big num too. So what?"

Start deconstructing the $10.4 tri bonanza and you come face to face some decidedly soft spots. The mean "average" bequest calculated by A and Rendall is a hair over $90,000 – that isn't reached until after the year 2 so factor in another 15 years of infla



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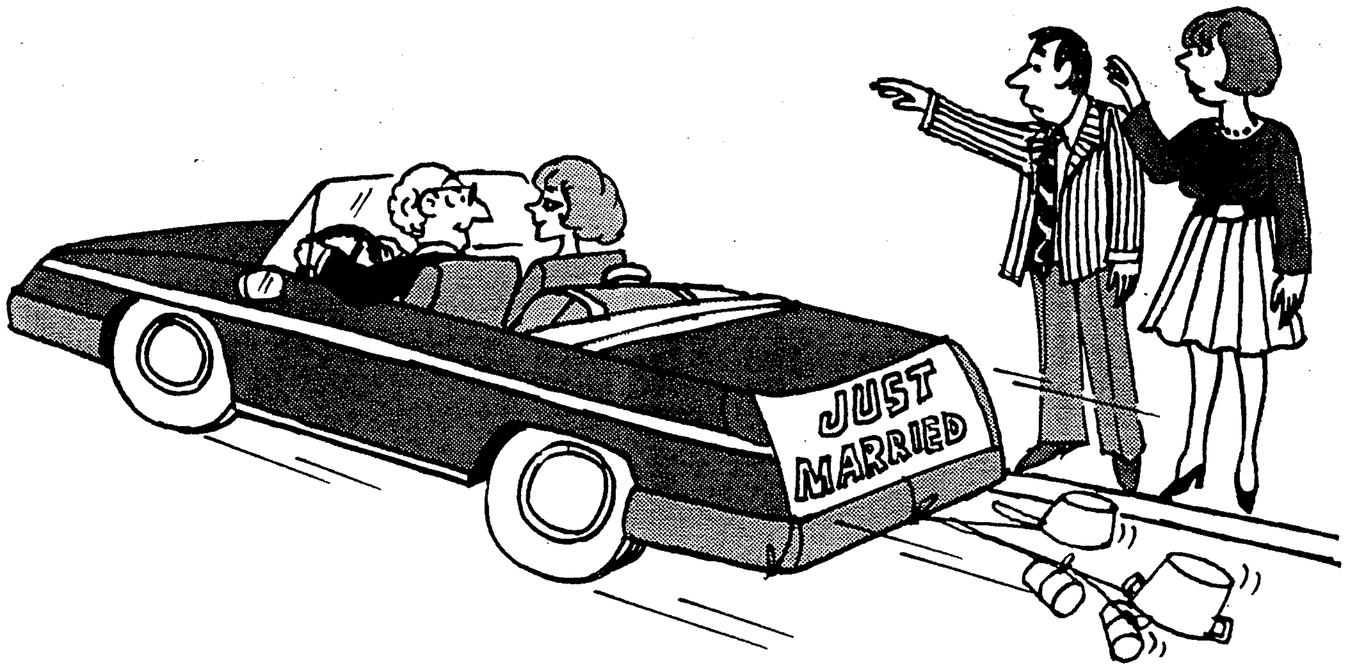

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lion of It." But buried in all the socio-mathematical language of the Cornell report are a lot of ifs, ands and buts. As Avery and Rendall concede from the outset, a truly accurate forecast would have required such complex calculations of economic and demographic dynamics that they took a bunch of short-cuts, such as assuming all bequests will go to surviving children, not foundations or other charitable institutions. Moreover, their "simplifying assumptions" include a decision to ignore the costs of death, such as those pesky estate taxes.

And there are lots of gaps beyond oversimplification. Among the missing elements, for example, is "the crucial link between wealth near to the time of death and bequests passed on to children or other relatives upon death." In other words, 11th-hour gifts to charity and the high cost of medical care in one's last days go unaccounted for in the Cornell study.

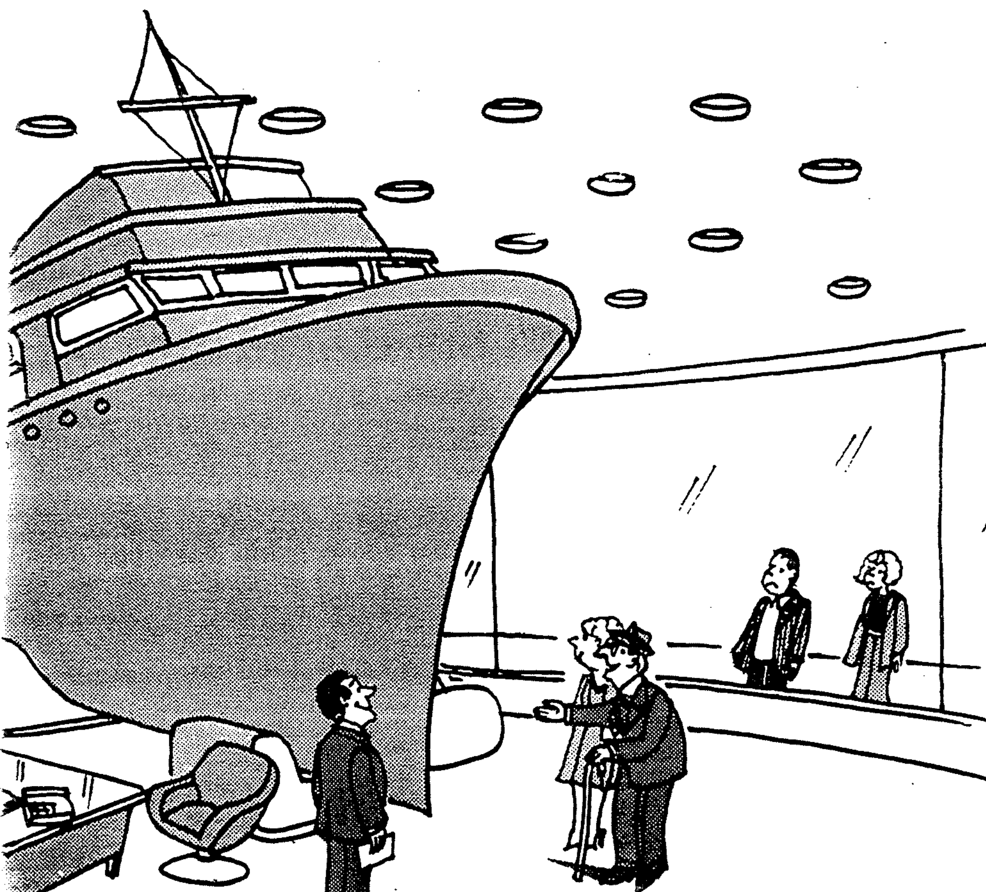
There are so many holes in the data, in fact, that Rendall and Avery broadly proclaim their forecasts "should not be interpreted as any more than suggestive as to the true numbers."

Another reason that the $10.4 trillion so readily bandied about is misleading is that it's expressed in 1989 dollars – and spread out over 50 years. "It's a big number," acknowledges Laurence Kotlikoff, an economist at Boston University who wrote the watershed book, *Generational Accounting*. "GDP's a big number, too. So what?"

Start deconstructing the $10.4 trillion bonanza and you come face to face with some decidedly soft spots. The mean, or "average" bequest calculated by Avery and Rendall is a hair over $90,000 – but that isn't reached until after the year 2010, so factor in another 15 years of inflation. Meanwhile, the mean inheritance for 1995 will be an estimated $56,000, rising to only $65,000 by the end of the decade. That might underwrite a college education, but it isn't the sort of "wealth" that makes financial planners' hearts go pitter-pat.

Nor are mean measurements particularly useful until they're contrasted with medians, which give a better idea of how the dollars are distributed. Although the Cornell study doesn't perform that calculation, a concurrent analysis by the Congressional Budget Office came up with a dismayingly low $23,000. That means half of all those expectant Boomers out there will inherit less than it takes to buy a fancy new car.

Then, too, as Avery and Rendall do note, household wealth – the source of bequests – "is highly concentrated, even more so than income." Moreover, "inheritances are more unequally distributed than estates, implying an inverse relationship between size of estate and number of heirs" – or, to put it more simply, "larger estates are divided between fewer heirs." Such skewing implies "that wealth inequality will grow rather than diminish as a result of prospective inheritances," Avery and Rendall conclude, which is a roundabout way of saying the rich will continue getting richer and vice versa. So it's easy to see why there may not be so many new millionaires being created as bankers and brokers would like.



PUBLICITY MACHINE GRINDS ON AND ON

▶ But that's not stopping the publicity machine. Using figures that even Rendall and Avery would agree are overly optimistic, a public relations firm flogging Fidelity Investments' High Net Worth Group confidently avers that because of inheritances the number of U.S. millionaires "will more than triple to 7.8 million in the next 20 years." These millionaires, the firm says, just won't have "the time or inclination to manage their financial resources themselves."

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Similarly, First Interstate Bank recently surveyed 500 Boomers to find out how they plan to use their bequests. More than half said they would pay off debts or fund their children's education. But half

ity of purpose as signaling a lack of investment sophistication. "Financial managers – especially banks – must find creative ways of demystifying the planning and investment process so it is more accessible to the vast majority of the American public," announced Russell Snow, head of First Interstate's trust and private bank group, in releasing the survey results.

All this elbowing might be worth a moment's chuckle if not for the larger truth it obscures: Most Baby Boomers are heading for a fall. And to the extent their financial peril is muddied by flim-flam rhetoric about multitrillion-dollar bonanzas, that fall will be even more catastrophic than it need be.

Avery and Rendall hint at the adverse propaganda value of their work when they note "some evidence that savings rates of Baby Boomers may be lower as a result of anticipated inheritances." That view undoubtedly was strengthened by last year's Congressional Budget Office study, which concluded that Baby Boomers will be better off in retirement than their parents because of four primary factors – including, significantly, their inheritance of "substantial wealth." On the question of savings, however, or lack thereof, the CBO uttered scarcely a peep.

Yet those savings clearly are in short supply. Indeed, if anything is guaranteed to produce more handwringing among financial planners than the lack of Boomer financial sophistication, it's the lack of Boomer savings – which, of course, serves only to feed the presumption that this is an unsophisticated bunch. Nor is the shortfall merely a nagging concern: When contrasted with the Boomers' own retirement needs – as those needs generally are defined – the shortfall looms so large it acquires mythic overtones. Merrill Lynch, for example, issued a study on the subject earlier this year under the flag-waving title, "Saving the American Dream."

Although that dream is only sketchily defined, as "the optimism that each generation will do better than the one before it," there is no question what that means at Merrill: The American capacity for consumption is in a long-term decline. The American Dream "may be ending."

Philosophical musings on the American dream aside, the brokerage firm is correct. Boomers *are* saving too little. They will get disappointingly scant help from their parents. But here's the ironic rub: The main reason they're not saving more, the main reason why the inheritances that might have bailed them out will be so meager, contends Boston University economist Kotlikoff, is that their parents have been on a 30-year spending spree. Thanks to Mom and Dad, the Boomers are facing a "horrific" future, he says.

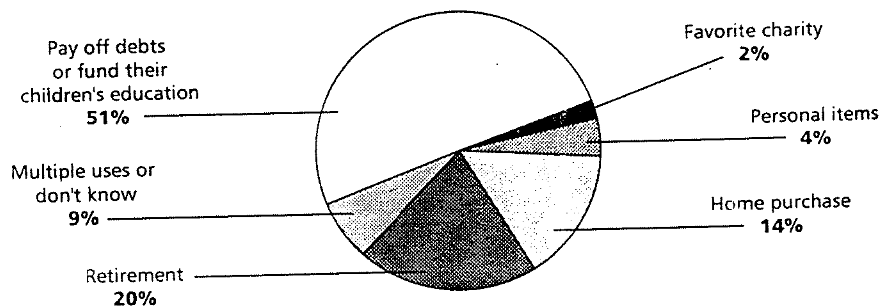
Forget the bumper stickers plastered on recreation vehicles, proclaiming "we're spending our kids' inheritance." It's true that inheritances can be whittled away by the intertwined trends of older folks living longer, marrying for a second or third time, and feeling no compunction about spending freely in old age, whether on yachts or travel or just plain fun. But that's child's play compared with the ravages of "the pyramid game called Social Security, Medicare and Medicaid," through which today's grandmas and grandpas have been draining money out of their children's wallets for decades.

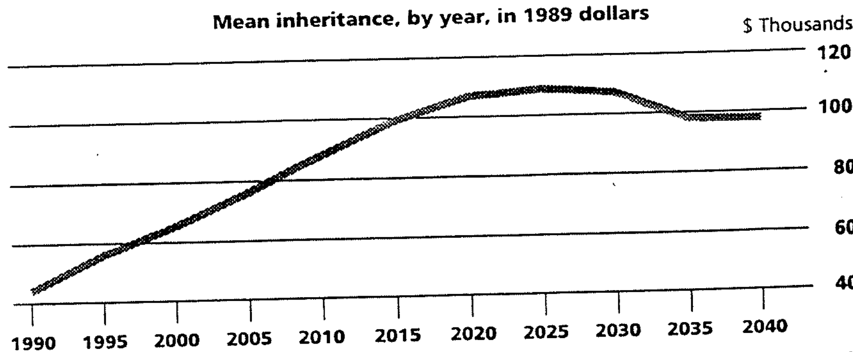
HOW MOM AND DAD SPEND THE LAST DIME

▶ At the same time, the amount of bequeathable wealth is being curtailed through the growth of what the generation watchers call annuitization: Where past generations might have put the bulk of their retirement money into stocks, bonds or bank accounts, nowadays people rely more on annuities, which disappear upon the death of their owners, leaving nothing for the would-be heirs. On a related note,

HOLD THE CHAMPAGNE

▶ Inheritances should increase markedly over the next 20 years, according to the Avery & Rendall study. But Baby Boomers will likely be forced to use much of the windfall to pay down debts.





BARRON'S • First Interstate Bank Trust's Private Banking Group; Avery & Rendall at Cornell Uni...

December 5, 1994

Because Mom and Dad h... on a 30-year spending... Boomers face a "horrific"... says economist Kotli...

...ew Boomers have any idea how diligently foundations are pushing senior citizens to participate in "painless giving" programs, in which assets are signed over but a continuing income stream is assured to the donor – as long as he or she is alive.

Through such diversions, Kotlikoff maintains, the Boomers' parents have "dramatically" increased their consumption, with the unfortunate result that "the flow of bequests as a share of labor income is smaller than it was 30 years ago." Indeed, Kotlikoff says today's bequests would be 42% larger, on average, if the public and private annuitization of wealth were at the same level as in 1960.

While Avery and Rendall attempt to determine head-on how much wealth Baby Boomers will get from their parents, Kotlikoff has explored the same issue indirectly by comparing tax burdens with government transfer payments. The two groups of research numbers are not directly comparable, but they do offer a contrasting perspective. The Cornell study shows an average inheritance of $90,000, which sounds nice. But Kotlikoff's research concludes that males who were 0 years old in 1989 could expect to pay the government $176,200 apiece more than they get back over their lifetimes – whereas their 65-year-old fathers could expect to pull out $31,800 more from the government than they paid in. In effect, Dad will have to leave his son a $208,000 inheritance just to balance the books – a sum not found in even the most optimistic reading of the Cornell study.

While Kotlikoff cheerfully admits to having one of the bleakest outlooks on the Boomers' future, his generational approach has won increasing acceptance at the federal Office of Management and Budget and has provided a conceptual framework for others' less apocalyptic findings. One of the most notable, if only because he provides grist to the mighty Merrill Lynch marketing machine, is Stanford University professor Douglas Bernheim, who last year created something that Merrill promptly dubbed the Baby Boom retirement index." *That* index concluded Boomers were saving only 33.8% of the amount they'll need for their own retirement, assuming "a standard of living after retirement that is consistent with preretirement years." *This* year's index, which updates the earlier work, has slashed that relatively optimistic conclusion by two-thirds, contending the Boomers are saving only a dime of every dollar they should be setting aside.

Ironically, the new index was updated in response to criticisms that came, among others, from the Congressional Budget Office, which labeled Bernheim's first analysis as "perhaps the most controversial study of savings by Baby Boomers." ...the new, lower assessment results ...n factoring in the federal government's

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unfunded liabilities, which CBO's study glossed over but which Bernheim contends will force sharp reductions in entitlements or significant tax increases long before the Boomers hit retirement age. "The savings crisis is far worse than previously imagined," he glumly concludes.

The much-criticized CBO report, by way of contrast, insists that Baby Boomers will benefit in retirement not only from those "substantial" bequests but because of *higher* Social Security benefits, based on the observation that Boomer families are more likely to have two wage-earners instead of one. Then again, the CBO also assumes "that wages will grow more rapidly than prices during the next 40 years," which is debatable, to say the least.

Neither of Bernheim's indexes factored in the potential impact of bequests, although so much dust has been kicked up by the inheritance brouhaha that next year's survey will ask respondents if they expect an inheritance and, if so, how much. Still, neither Bernheim nor Merrill expect significant changes based on this question. "Inheritances just aren't going to make much of a difference for the average American family," explains analyst Andrew Sieg, who works for Merrill's private client group.

Industry cheerleaders for the economically curative power of bequests notwithstanding, the Baby Boomers themselves apparently agree with Sieg. Equitable's "nest-egg study," which focused specifically on how Boomers are preparing themselves for retirement, found respondents on average expect to get only 2% of their retirement income from inheritances–the same minuscule percentage they expect to get from Social Security.

ALL BOOMERS ARE NOT ALIKE

► While the chimera of a $10.4 trillion windfall can be tossed onto the trendy trash heap already occupied by the Information Superhighway, it would be a mistake to ignore the issues of wealth, economic sophistication and social policy that it raises.

For openers, it's worth noting that Avery and Rendall were unusually diligent in acknowledging the assumptions they made and the data gaps they bridged. Oversimplification in the Boomer-watching industry is rampant, beginning with the very definition of the subject at hand: It is the rare study, for example, that acknowledges "early" Boomers – born, say, between 1946 and 1955 – are significantly different from "late" Boomers. And their differences are economic, cultural and philosophical. Although "Baby Boomer" is a handy demographic label, like many labels it tends to conceal more than it reveals.

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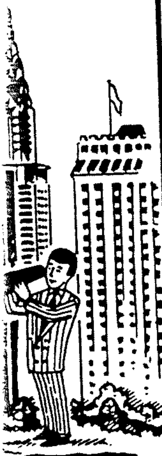

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The differences aren't merely academic. Early Boomers, to cite one example that likewise verges on oversimplification, tend to be more suspicious of authority and "experts." Late Boomers are more likely to place a premium on expert advice. The early Boomers also happen to be significantly better off financially, according to the CBO, in part because they're older and have had more time to accumulate wealth and income, but more importantly because they benefited from a more favorable economic cycle, which enabled them to catch more of the explosive growth in wages and real-estate values over the past 30 years.

The split between early Boomers and late ones has profound implications for a financial marketplace in which the customers of "do-it-yourself" brokerage houses, like Schwab and Quick & Reilly, are on average 47 years old – compared to Merrill's average of 65 for its major customers. With financial-services marketers tripping over each other in search of new business – by one estimate there now are five people selling financial services for every one wealthy potential client – it's no wonder Merrill is thumping the theme of the vanishing American Dream with such vigor. Whether the brokerage giant can successfully scare Boomers into feeling the need for its brokerage services remains an open question. After all, it was the Boomers who made low-overhead outlets like Home Depot and Wal-Mart into the success stories of the 1980s and 1990s.

Meanwhile, the astonishing lack of consistently solid data means a lot of garbage has been gift-wrapped in meaningless statistics. For example, only 39% of Equitable's 600 Boomers said they expect to get an inheritance – yet First Interstate polled 500 Boomers and was told by 62% that they expect a bequest. Statistically speaking, that gap is the Grand Canyon – and is just as much an impediment to forward motion.

Or consider the flat assertion by Richard Cantor and Andrew Yuengert, in the current Federal Reserve Bank of New York Quarterly Review, that Boomers "have accumulated appreciable wealth" compared with their parents at a similar age. Boston University economist Kotlikoff maintains that the Boomers' rate of consumption is half that of their parents at this age, who also could expect triple their offspring's rate of real wage growth.

The squishiness of so much data makes it malleable enough to support almost any self-serving observation, which helps explain why government studies end up more or less affirming the status quo while the private sector insists the ship is sinking. Fast. The CBO study is classic in this regard, insisting on its admittedly "optimistic view" of Boomers' financial future despite a slew of offsetting factors that it notes but inexplicably discounts.

IGNORING RISKS THAT LIE AHEAD

▶ Among the potential snags that the CBO all but ignores: the likelihood of "sluggish economic growth" over the next 20-40 years, increasingly problematic funding of entitlement programs, and the possibility of a substantial real decline in real-estate values – the major repository of Boomer wealth – due to changing demographic patterns. A shrinkage in the number of American families or in their average size, for example, could put a noticeable dent in the value of four-bedroom suburban homes.

Yet while government-sponsored analysis largely fails to come to grips with the erosion of the Boomers' financial outlook, the private sector persists in churning out material designed to stampede the Boomers into its expert arms. Last month's sortie by Merrill included its latest "financial literacy test," which posed

December 5, 1994

▶ Here's how Avery and [illegible]
calculated in 1989 dollars, [illegible]
today's grandpas and grand[illegible]

Year	EXPEC[illegible] Total [illegible] ($ Billions)
1990	$ 39.4[illegible]
1995	84.3[illegible]
2000	146.3[illegible]
2005	216.9[illegible]
2010	286.2[illegible]
2015	335.9[illegible]

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TO HEIR IS DIVINE?

Here's how Avery and Rendall arrive at their $10.4 trillion estimate for Baby Boomers' inheritances. But that fi... calculated in 1989 dollars, meaning it doesn't factor in inflation. Also, the study does not deal with estate taxes or the fa... today's grandpas and grandmas seem to be spending more than previous generations.

Year	Total ($ Billions)	Cumulative ($ Billions)	Number (Thousands)
1990	$ 39.4	$ 39.4	900
1995	84.3	365.7	1,506
2000	146.3	959.3	2,202
2005	216.9	1,897.7	2,846
2010	286.2	3,203.0	3,255
2015	335.9	4,801.4	3,389

Year	Total ($ Billions)	Cumulative ($ Billions)	N... (Th...)
2020	$ 334.5	$ 6,505.7	
2025	288.5	8,061.9	
2030	201.6	9,254.1	
2035	106.8	9,966.5	
2040	40.7	10,294.4	
Total	**$10,365.0**	**$10,365.0**	**1...**

Source: Avery and Rendal...

...questions to 1,000 respondents — of ...m 820 flunked by being unable to ...wer six or more correctly. (Poor Alan ...enspan: Only one-third of the respon- ...ts knew he is the chairman of the ...deral Reserve.) Coming on the heels of ...similar test that was given last year ...lly to Boomers, who performed just as ...ly, the latest quiz has convinced Mer- ...l that "this is not a generational di- ...ma—it is a national one."

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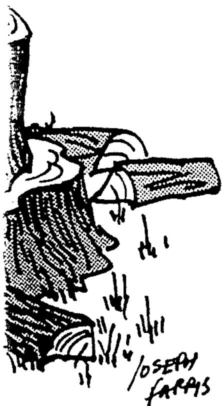
Whether the Boomers will actually hit the mark is another story: Bernheim obviously thinks not, and even among Equitable's cheery sample only 51% thought they were saving enough to meet their goal. But here, too, spoken and unspoken assumptions color the outlook. The most notable, and obviously the most unsustainable, is the expectation on the part of many financial planners that the Boomers must be even more profligate consumers than their parents or be deemed failures — in Merrill's terms, the death of the American Dream.

Setting savings targets based on that assumption, and concluding that missing the target constitutes a "savings crisis," can be a self-fulfilling prophecy. It might prick yuppie angst, but ultimately it constitutes an untenable social policy. A more reasoned conclusion might be that America's post-World War II experiment of fragmented households and tax-subsi- ...dized care of the aging and infirm may ...



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TO HEIR IS DIVINE?

▶ Here's how Avery and Rendall arrive at their $10.4 trillion estimate for Baby Boomers' inheritances. But that figure is calculated in 1989 dollars, meaning it doesn't factor in inflation. Also, the study does not deal with estate taxes or the fact that today's grandpas and grandmas seem to be spending more than previous generations.

EXPECTED BEQUESTS			
Year	Total ($ Billions)	Cumulative ($ Billions)	Number (Thousands)
1990	$ 39.4	$ 39.4	900
1995	84.3	365.7	1,506
2000	146.3	959.3	2,202
2005	216.9	1,897.7	2,846
2010	286.2	3,203.0	3,255
2015	335.9	4,801.4	3,389

EXPECTED BEQUESTS			
Year	Total ($ Billions)	Cumulative ($ Billions)	Number (Thousands)
2020	$ 334.5	$ 6,505.7	3,135
2025	288.5	8,061.9	2,650
2030	201.6	9,254.1	1,881
2035	106.8	9,966.5	1,090
2040	40.7	10,294.4	417
Total	$10,365.0	$10,365.0	114,953

Source: Avery and Rendall, Cornell University

questions to 1,000 respondents – of m 820 flunked by being unable to wer six or more correctly. (Poor Alan enspan: Only one-third of the respon-s knew he is the chairman of the eral Reserve.) Coming on the heels of milar test that was given last year ly to Boomers, who performed just as y, the latest quiz has convinced Mer-that "this is not a generational di-ma–it is a national one."

True enough. What's missing, how-, is any way of knowing if America's ancial literacy" is any worse than it 10 or 20 or 30 years ago, and therefore ther Merrill is inventing a problem or ly quantifying a reality that has al-s existed. While the brokerage firm nly concludes that "most Americans financially illiterate," its 1993 test ed respondents to rate their own finan-knowledge – and found "a strong cor-tion between self-assessments and scores." In other words, most people a pretty good idea of whether they're rant.

What the supposedly illiterate ers are saying, in survey after sur-s that they understand Social Secu-s going bust, that they don't expect if any help from inheritances and yes, they are worried about their ment years – but first they have to eir own kids through college, sup-heir ailing parents and pay off debt. ven though financial planners worry oomers underestimate their future the Equitable survey suggests just posite: On average, its respondents ey'll need an $830,000 nest-egg to or more than twice as much as ted by Bernheim for those now $75,000 a year.

ther the Boomers will actually hit k is another story: Bernheim thinks not, and even among s cheery sample only 51% they were saving enough to meet . But here, too, spoken and assumptions color the outlook. notable, and obviously the most ble, is the expectation on the y financial planners that the must be even more profligate than their parents or be ures – in Merrill's terms, the American Dream.

avings targets based on that and concluding that missing constitutes a "savings crisis," fulfilling prophecy. It might angst, but ultimately it con-tenable social policy. A more nclusion might be that -World War II experiment households and tax-subsi-

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3,389	**Total**	**$10,365.0**	**$10,365.0**	**114,953**

Source: Avery and Rendall, Cornell University

cally high expectations and a growing tidal wave of red ink. The American Dream never was simply to "do better," although that's part of it, but to do better in a context of family and community. When you think about it, would you rather spend your last years in an outrageously expensive nursing home, or in an extra bedroom in your kids' house?

Face the facts: Mom and Dad can't bail out the old version of the American Dream with a $10.4 trillion check because they don't have the money. And when you think about it, the wonder is that anyone ever contemplated the possibility that they might. ■

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