

EXPLAINING CHANGING PATTERNS OF WEALTH INEQUALITY

The rise of the US stock market during the 1980s and 1990s stimulated public concern about the degree of inequality of wealth among households. Recent data show, for example, that the richest 1% of US families owns one-third of total national net worth. Yet research indicates that over a far longer period - the last 100 years - wealth inequality has declined significantly in both the United States and the UK. At the same time, lengthening life spans - and the prospect of longer and therefore more costly retirement - have not led to greater national wealth accumulation relative to overall income over the past century.

How can these changing patterns of wealth dispersion be explained? Economists' analyses of saving behaviour have long ignored the issue - or been unsuccessful at explaining it. But writing in the latest issue of the *Economic Journal*, Professor **John Laitner** of the University of Michigan demonstrates that a relatively straightforward combination of two prominent analytical approaches can illuminate the determinants, consequences and future of wealth inequality.

One widely used explanation of savings behaviour emphasises households' 'lifecycles'. According to this story, young households face high expenses and have not achieved their peak earnings; middle-aged households are able to save and they do so in anticipation of their retirement; and, finally, retirees draw down their savings for travel, medical expenses, etc.

Another story, one based on 'dynastic' concerns, emphasises the interest some households - perhaps a small minority of the total population - have in building estates to pass to their descendants.

Combining the two ideas, Laitner shows that while retirement-motivated saving may explain most of a modern economy's wealth (two-thirds perhaps), the great accumulations of a handful of dynastic savers may account for the lion's share of wealth inequality.

Laitner's hybrid analysis is also consistent with both the long-term decline of US and UK wealth inequality and the stability of national wealth accumulation relative to overall income over the last century despite longer life spans. According to his analysis, as longevity enhanced the need for retirement savings, lifecycle saving would have displaced dynastic accumulation - but total wealth relative to income would be predicted to have remained steady. On the other hand, with lifecycle saving playing a larger and larger relative role over time, wealth inequality should indeed have declined.

One interesting implication of this analysis relates to public social security programmes such as the one in the United States, which tend to reduce families' needs for private lifecycle saving. If

they were to expand, the economy could revert to depending more on dynastic behaviour to finance its huge stock of plant and equipment, private residences and government debt.

The same consequences would follow if the government became less disciplined about its deficits, allowing government debt to expand. In either case, the very long-term trend towards more wealth equality could reverse itself.

Notes for Editors: 'Secular Changes in Wealth Inequality and Inheritance' by John Laitner, is published in the October 2001 issue of the *Economic Journal*. The author is at the University of Michigan, Ann Arbor, Michigan 48104, USA.

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