

It is agreeable to think of one's forefathers when one feels at one with them and conscious of having acted as they would have done.¹

Thomas Mann (1901). *Buddenbrooks*

Chapter 1. Introduction: the formation of preferences

1.1 The formation of social and individual preferences

The purpose of this Section is to discuss briefly how the subject of the formation of preferences and the channels through which preferences are shaped has been addressed in economics.

Preferences can be defined as binary relations on the set of alternatives allowing the comparison of pairs of alternatives from the set (Mas-Collel et al., 1995). In other words, “preferences are reasons for behavior, that is, attributes of individuals that (along with their beliefs and capacities) account for the actions they take in a given situation” (Bowles, 1998). Preferences define who people are, what they want and what they value. Where are preferences coming from?

Smith (1759), Hume (1740), and Pareto (1916) noted that the human mind depends on one's sentiments that constitute the initial motor for behavior, consistent with psychological perceptions (Zajonc, 1980). Sentiments are partly individual endowments, and partly a result of interactions with others. Bourdieu (1970) emphasized the two-dimensional nature of preferences that are both a reason for and a consequence of human actions. “Habitus” (Bourdieu, 1970) both shapes interaction and is shaped by interaction. The concept of “habitus” can be interpreted as the entire set of preferences an individual has.

Individual preferences as exhibited in the marketplace were believed to be pure self-interest. Non-market actions were excluded from economic analysis and placed in the domain of moral sentiments (Smith, 1776). Pareto (1916) was of the opinion that preferences can only explain rational actions. He classified human actions with respect to objective and subjective goals, and to the means undertaken to achieve the goals. If subjective and objective goals were the same, and adequate means for achieving them were undertaken, the action was deemed rational (Pareto, 1916). Irrational actions such as tradition-propelled behavior could not be

¹ Quoted from Mann, Thomas (1901). *Buddenbrooks*. London: Vintage Books. (1999 Edition), p. 393. Translated from German by H. T. Lowe-Porter.

explained using economic methods. Pareto developed a theory of sentiments in order to explain irrational actions.

Becker (1993) and others (see, for example, Sen, 1977) expanded the economic method by looking at a broader range of behaviors without assuming pure self-interest as the sole motivation of human action. The concept of altruism was developed (Becker, 1976). The economic approach could be employed in the analysis of behavior that was treated as irrational by Pareto (for example, addictions, see Becker and Murphy, 1988). Even if adding altruism to self-interest in one's preferences is insufficient to predict behavior in many settings (Granovetter, 1985), then thanks to Becker (1981), preferences were allowed to encompass different motivations for behavior and to differ across situations and over time.

Broadly speaking, preferences are acquired via the channels of biology, psychology, and socialization. Biological determinants can be treated as a genetic endowment. Psychological dispositions refer to internal processes operating within the individual. Socialization refers to interactions between the individual and other members of the society.

Biological determinants of preferences can be treated as exogenous in the short run, because the span of a single human life is too short for the evolutionary process to be operative. The remaining channels (psychological dispositions and socialization) are endogenous. Psychological dispositions can be changed due to individual experiences. The endogenization of preferences can be modeled using economic methods. Socialization is an ongoing, dynamic process involving many individuals where the basic units of analysis are individuals as members of a dyad. Such a framework is employed in economic studies on reciprocity (Bardsley and Sudgen, 2006).

Two main channels of preference formation are assumed in this study. These are replication and learning. The latter includes learning from parents, learning from preceding generations other than parents, and learning from one's own generation. Learning is a channel of transmission of the existing social norms, rules of conduct, and morals. Learning instills rules of behavior acquired during interaction. Exposure and repetition condition behavior (Bandura, 2007). This approach can be criticized for reducing human behavior to automatic reactions. It neglects intentionality of actions and the fact that different unobserved motivations can lead

to the same observed behavior. Thus, a broader concept of learning was developed in this study in order to explain more complex phenomena such as tradition.

The role of the family in the learning processes is unique. A family is a group of people linked by regular and intensive direct relations where primary socialization takes place (Cooley, 1909). Membership in a family is not voluntary for children. Children interact with parents on a daily basis and are dependent on them at least until reaching adulthood. The family remains the most influential environment for shaping preferences (Grabowska, 1989). Empirical findings confirm that in Poland, for example, children share attitudes towards religion, freedom, and patriotism with their parents (Grabowska, 1989). Studies show that children attribute their choices to values learned from their parents (Oliner and Oliner, 2004). Empirical evidence confirms that family members are linked also by the relations of financial and non-financial support (Laitner, 1997).

The basic framework for the analysis of family traditions used in this study looks at the family through the prism of three generations. The learning of generation P from the experience it had with the preceding generation G conditions the behavior of P towards the next generation K. There is more to intergenerational links than the relation between two adjacent generations. It is in this vein that this study approaches a specific behavior of parents towards their children, namely, P's bequest behavior.

1.2 Definition of, and special features of bequests

The microeconomic theory of individual choices explains both market behavior and non-market behavior. Whenever an individual with well-defined preferences faces a limited set of possibilities, the economic models are geared at predicting the decision that he is going to make, even if his information is limited. The predictions derived from theoretical models require empirical verification. The range of issues covered by microeconomic modeling reaches far beyond the classic consumer choice, as it covers decisions on fertility, conception, marriage, health, human capital formation, migration, assimilation, wealth transfers and so forth. An application of microeconomic modeling to bequest behavior can be found in Barro (1974), who analyzes the relation between government bonds and net wealth. The aim of that paper is to analyze a macroeconomic phenomenon, but it is based on a microeconomic model of decisions made by individuals that take into account not only own consumption but also

the utility of members of the subsequent generation. This feature of individual utility function was referred to by Becker (1974) as intergenerational altruism; the concept remains present in mainstream economics.

Despite numerous explanations of planned bequeathing (for example, different types of altruism (Becker, 1974), strategic giving (Bernheim et al., 1985), warm-glow (Andreoni, 1990), and the demonstration effect (Cox and Stark, 2005a; Mitrut and Wolff, 2009)), the existing empirical literature does not reject the hypothesis that bequests are accidental, that is, left unintentionally. If so, the economic reasoning fails to provide an insight into this phenomenon since accidents cannot, in general, be treated as an outcome of a calculated decision-making process. Thus, there is still a need to pose basic questions about bequest behavior, among which the intention to bequeath is an important one.

The distinction between planned bequests and accidental bequests is crucial, since only the former can be explained by the presence of a bequest motive in an individual's utility function. The planned bequest is chosen by the individual as a result of utility maximization, while an accidental bequest is left independently of a desire to leave or not to leave wealth to others. It is the planned bequest that brings utility to the donor before death, which captures the nature of planned bequests as a goal to be reached, whereas accidental bequests may not confer utility to the donor.

1.2.1 Definition of bequests

A bequest is an act of transmission of personal property to heirs after the death of the donor. Mostly, bequests are made to family members belonging to the generation following that of the donor. The transfer can be executed either according to the will that specifies who inherits and how much, or according to a law that specifies legal rules of wealth division if a will is lacking or invalid. Regardless of the form of the transfer, it is executed after the death of the donor, and its amount and division is in the public view. A bequest to children can be considered as a form of parental care, love, and gratitude towards the heirs.

Like all financial transfers, a bequest cannot occur in the absence of resources. Since not all forms of personal property can be bequeathed, a distinction between bequeathable and non-bequeathable wealth needs to be made. The division of bequeathable wealth depends on the

family situation, especially on the presence of children. Moreover, the presence and division of bequests between heirs can be affected by the fact that the will is publicly announced after one dies. In the absence of a will, district courts announce who has a claim to the estate. Such publicity makes bequest behavior different from private inter-vivos transfers that often remain a matter exclusively between the donor and the beneficiary.

That bequests are executed after the death of the donor has many consequences. Bequests are irreversible and they cannot be accompanied with a reverse gift (a gift that a beneficiary of the initial private transfer provides to the donor). Moreover, the bequeathed assets are under the full control of the heirs, which is not the case of other transfers; since the donor is not alive, he or she cannot control the disposition of the transferred wealth, which is possible in the case of inter-vivos transfers. Data from SHARE (Survey on Health, Ageing and Retirement in Europe, coordinated by the Mannheim Research Institute for the Economics of Aging (MEA), and harmonized with the US Health and Retirement Study (HRS) and the English Longitudinal Study of Ageing (ELSA)) on individuals aged 50 and more in selected European countries² provide evidence that a large proportion of inter-vivos transfers are made with a specific purpose in mind. For example, among the Polish population aged 50+ in 2007, 88% of all transfers were given in order to meet particular need such as a family event, legal obligation, unemployment, divorce, or expenses on education or household (Kalbarczyk and Nicińska, 2009). This observation is in line with the claim that inter-vivos transfers are usually tailored to specific needs of a beneficiary.

Moreover, since the will is executed after death, it is crucial for those who intend to bequeath that the desired distribution of one's bequeathable wealth will be planned in advance. One way of planning in advance is to draw a will, but a will without bequeathable wealth is, in a sense, an empty shell. Bequests need to be preceded by an accumulation of bequeathable wealth, which could make the planned bequest a goal to be reached by lifelong saving. The uniqueness of bequests that distinguishes them from other types of transfers results in a limited substitution between bequests and inter-vivos transfers as they affect the utility of the donor in a different way.

² These are: Austria, Belgium, the Czech Republic, Denmark, France, Germany, Greece, Ireland, Israel, Italy, the Netherlands, Poland, Spain, Sweden, and Switzerland. The permission granted to me to use the SHARE data is gratefully acknowledged.

1.2.2 Bequests and inter-vivos transfers

Since lifelong wealth can be consumed, bequeathed, or given as an inter-vivos transfer, there is a relation between bequests and inter-vivos transfers. If bequests are accidental, the impact of intergenerational inter-vivos transfers on the amount of bequests is straightforward, as it reduces resources available to the donor in the last period of his or her life. However, once we allow for an operative altruistic motive both for bequests and for inter-vivos giving, then a complex tension between the two types of support provided to children may occur inasmuch as the timing and taxation make either channel of wealth transmission more advantageous. Kessler and Masson (1989) claim that some parents may prefer to finance college education, while others may choose to make a bequest, and that the main difference between the two means of financial support provided to children is the age of children when they receive a transfer. Page (2003) found evidence supporting the claim that higher inheritance tax rates significantly increase the giving of gifts in the US. McGarry (1999) argues that inter-vivos transfers depend on the current income of the child, whereas bequests depend on the permanent income of the child. Additional issues concerning the relationship between inter-vivos transfers and bequests are dealt in an extended framework where motives other than altruism are incorporated. These include strategic giving (Bernheim et al., 1985), demonstration effect (Cox and Stark, 1994 and 2005a), and relative deprivation (Stark, 1998).

The relation between the two types of intergenerational transfers discussed briefly above depends strongly on the motives that underlie the corresponding type of behavior. There are numerous reasons why the motivation for inter-vivos transfers may differ from the motivation for leaving bequests. (These reasons include: the way in which transfers can be executed, since bequests are activated either by a will or by the application of inheritance laws; the public nature of information on bequests; the irreversibility of bequests; the lack of control of a donor over the bequeathed wealth; and the awareness of both the donor and the heir that bequests are given only once.) Therefore, there is a need to explore bequeathing mechanisms as distinct from mechanisms that govern other intergenerational transfers.

1.2.3 Individualistic and unitary approach to bequest behavior

In the case of bequests, the role of a spouse is important insofar as often the individuals that we consider have been living with a partner, made common decisions on the division of labor

within the household, accumulated common lifelong wealth and so on, and thus it is plausible to assume that they will make a joint decision on how much to pass on to their children. As in the case of many other family decisions, there is a controversy whether individualistic or unitary approach of modeling utility maximization should be applied.

The unitary framework assumes that a household behaves as if it was maximizing a common utility function and treats the entire household as a decision unit (Browning et al., 1994). This approach has been especially popular in labor economics. The strict assumption of the household's social utility function, meaning that all household members have identical preferences, was relaxed by the framework of individuals with homothetic but not necessary identical preferences, sharing income equally. It was shown that under these assumptions, the family demand for consumption can be rationalized as the choice of a single individual (Chipman, 1974; Shapiro, 1977). However attractive the assumption of equal division of incomes between the partners may seem, it is unlikely to hold in reality.

The unitary framework has serious weaknesses as it contradicts the fundamental microeconomic assumption of methodological individualism. Hence, an alternative to the unitary approach was developed and it models the household as a two-person collectivity undertaking Pareto-efficient decisions (Chiappori, 1988; Rubinstein, 1982). The individualistic approach assumes that the decision is made by a household not subject to unanimity, but through a bargaining process in which individual interests interact and lead to a stable and unique Pareto solution. It does not mean that the choice brings equal utility to both partners, as the choice depends on their bargaining powers which, in turn, depend on individual characteristics, resources, and opportunities. The individualistic approach was employed also in empirical research, usually in labor economics (for example, Chiappori, 1992; Vermeulen et al., 2006).

It rarely happens that both spouses die at the same time. Usually, half of the estate goes to the surviving partner and the other half is divided between the other heirs. If so, it is the individual who dies first who bequeaths, not the couple. Possibly, the bequest decision is made together by both spouses in advance, perhaps in a bargaining process. Full execution of the plans of both spouses is timed such that the partners decide on first-stage bequests to be executed when the first of them dies, and on second-stage bequests once the other dies. However, once a spouse is deceased, the surviving spouse may have an incentive to deviate

from the agreement whenever the agreement is not in accord with his or her own preferences. Even if a will is a special form of an agreement between the couple, the incentive and possibility to deviate after a partner's death still remain, just as in case of any other informal, unregistered agreement made by a couple.

1.3 Planned bequests as an intergenerational transmission of preferences

In the intergenerational context, imitation is a mode of transmission of behavior from a preceding generation to the generations that follow (McDougall, 1926). Imitation of behavior usually involves a process of intergenerational transmission of preferences. Planned bequests left by parents to their children can shape the preferences of the children who, when it is their turn to bequeath, may mimic the bequeathing behavior of their parents. Furthermore, planned bequests made known to children prior to the actual bequests could affect the behavior of the children in a predictable manner. In this Section we define planned bequests and describe channels through which planned bequests may transmit bequest preferences between generations.

1.3.1 Definition of planned bequests

In the opinion of psychologists (see Ossowska, 1949; Ajzen, 1991), an act of human behavior is preceded by an intention to undertake the behavior. The growing economics literature on reciprocity provides models of human behavior where individuals act while taking into account not only the actions, but also the intentions of the other party of the interaction (Falk et al., 2000). Even though intentions are not explicitly defined by economists, the concept can be reconstructed as a consciousness of something being conceived by an individual in a particular way. The intention is derived from individual desires (Miller et al., 2004). Ajzen (1991) decomposes desires into subjective norms and attitudes.³

We follow Niebrzydowski (1995) and use the term “motive to bequeath” for any reason or desire to bequeath. The motive is a reason for which an individual is willing to undertake a specific action (Niebrzydowski, 1995). The motives enter one's preferences. According to

³ The theory of planned behavior emphasizes the role of perceived behavioral control (Ajzen, 1991) in the decision making process. Full actual and perceived control over own bequest behavior is assumed.

some (Ossowska, 1949), a distinction between motives and intention can be neglected, but we find it useful. There may be more than one motive for a single intention, as defined by Ajzen (1991). An individual is aware of an intention to bequeath, but does not have to be aware of all the motives to bequeath that operate during the associated decision making processes (Wójtowicz, 1984). We prefer to discuss specific motives rather than the general intention to bequeath.

An individual with a motive to bequeath makes a decision to bequeath if his budget constraint allows it. In the case of bequest behavior, a decision to bequeath is made before the bequests are actually transferred. Planned bequests are an outcome of a conscious decision making process that can be modeled by maximization of utility function. An individual planning to bequeath may draw a will where the planned bequests are written explicitly. Planned bequests are known to the donor prior to the moment when they become known to the heir. Actual bequests are the bequests that the beneficiary receives. Planned bequests and actual bequests are defined in two different points in time. Actual bequests may differ from planned bequests.

1.3.2 Receiving planned bequests from parents

Often, the experience of inheriting involves strong and unique emotions, since planned bequests are transferred to a child in circumstances of bereavement. The death of a parent happens only twice in one's lifetime. The event is painful even for adult children. The experience of inheriting from parents affects children a great deal, especially if it is accompanied by a will. The fact that the will was drawn is a proof that bequests were planned. The child enjoys the inherited wealth. Moreover, the fact that the parent planned to leave bequests is important. The will can be interpreted as the last letter from the parent. Wills often contain words of love and care such as "To my beloved son" (Brown and Berk, 1977). The son interviewed by Brown and Berk (1977) describes his relationship with his father as very strong but difficult because of the severe intergenerational conflicts involved. The planned bequest left by the father in the will was interpreted by the son as a manifestation of parental love, care, and also as a signal of forgiveness (Brown and Berk, 1977). Receipt of planned bequests in this case was inherently connected with the words written in the will.

The form of the inherited wealth may have an impact on children's preferences concerning bequeathing. People tend to develop an emotional attitude towards objects and places such as

land or a house inhabited for a lifetime. Personal belongings are sometimes treated as part of the personality of their owner (Stanisz, 2009). Planned bequests that consist of cherished items (such as a house, furniture, paintings) may shape the heir's preferences differently from planned bequests of equivalent money value. A child who inherited a house from his parents may have a motive to leave a house to his own child as a bequest, rather than to leave equivalent financial assets. Furthermore, even inexpensive objects that were important to parents for essentially sentimental reasons (such as tableware, earrings, cuff links, etc.), when left as planned bequests accompanied by a will, may prompt children to develop a strong motive to bequeath in a similar fashion.

The focus of this dissertation is on the relations between the generations of parents and children. A third generation of grandchildren is involved as well. The grandchildren observing parents receiving an inheritance may find such behavior desirable and expect their own parents to mimic the bequest behavior of the grandparents. Parents who believe that their children are expecting an inheritance might be additionally motivated to bequeath because of this belief. If such a mechanism operates, then heirs with children have less degrees of freedom than their childless counterparts. Grandchildren who observed planned bequests left by their grandparents and who experienced inheritance from parents can well be inclined to continue this behavioral pattern of family tradition to bequeath.

1.3.3 Revealing planned bequests to children

Immanuel Nobel bequeathed to his son Alfred a medal awarded to him by the Royal Swedish Academy of Sciences. That was the only bequest that Alfred received from his father and, as the story goes, the only bequest that he wanted to receive. According to the information that we obtained from the Nobel Foundation, Alfred Nobel expressed a wish to inherit the medal and Immanuel Nobel took that wish into account when making his bequest decision. Apparently, the father and his son discussed the planned bequests of the father. This is not a general characteristic of planned bequests: usually, bequests are made public only upon being executed. There is uncertainty surrounding the period of time between drawing the will and the transfer of bequests. One may decide to revise the planned bequests as unexpected events unfold. Planned bequests can be easily adjusted by writing a new will, especially when the preceding version of the will was not revealed.

One reason for not revealing bequest plans is the fact that the uncertainty associated with non-revelation is, in and by itself, an incentive device for children to treat their parents well. If any reduction of the uncertainty is detrimental to the children delivering desirable behavior, one would expect the uncertainty to be maintained, and thereby for the contents of the will not to be revealed. According to the strategic considerations model (Bernheim et al., 1985), children are aware that bequests will be transferred to them only as long as they provide desired attention to parents. If the attention is not provided, children will be disinherited. Within this framework, revealing the will to the children in advance could be perceived as a conditional commitment: both parents and children recognize that planned bequests are conditional on the behavior of the children. If the behavior of the children changes for the worse, the will can be changed accordingly. One might think of parents revealing their will to be using a carrot-and-stick approach to induce their children to provide due care and attention, where the will revealed to children is a “carrot,” and the threat of disinheritance is a “stick.”

Parents may use the revelation of their will as a device for eliciting gratitude from their children. The revealed will motivates grateful children to provide care to their parents. The consequent sensing of gratitude after learning about the will induces the children to supply the desired attention and care without a need for the parents to resort to a carrot-and-stick strategy. In this setting, planned bequests do not create financial incentives for children to take care of their parents since the planned bequests are not conditional on the behavior of the children. There is no threat of disinheritance. Could the revelation of the planned bequests be questioned for credibility by the children on account that the will can be modified easily? It seems unlikely that parents would revise a will if their promise to bequeath was followed by a desirable behavior of their children. Moreover, the children may find revealing planned bequests to be an effective instrument for instilling gratitude, and thus choose to apply the same instrument towards their own children. Once again, a possible family tradition sequence could be in place.

An individual from a dynasty with a long-lasting tradition of transferring planned bequests from one generation to the following is likely to follow this tradition. The stronger the hold of family tradition to bequeath, the less degrees of freedom parents have, and hence, the less of an inducement role uncertainty plays in inducing behavior, and the more likely parents are to gain little by not revealing the contents of their will. Holding other things constant, the

stronger the family tradition, the more likely it is that wills will be “in the open” with parents resorting to other means to elicit desirable behavior from their children.

The uncertainty associated with the time gap between planned and actual bequests is reduced once the time left before the execution of planned bequests becomes shorter. The testator’s state of health may be a predictor of the length of the period left to the transfer of the planned bequests. Therefore, holding other things equal, the worse the health of the testator, the weaker the incentive to keep the will secret. There are wills drawn up shortly before the testator dies. These wills are likely to be publicly known at the very moment of making them, especially if they are “informal wills.” For example, under the Polish law, “informal wills” can be made orally in circumstances of threat to life and in the presence of three witnesses (with anyone who is mentioned as a beneficiary in the will not being allowed to serve as a witness; Cisko, 1994).

Another reason for not disclosing wills is that parents may treat planned bequests revealed to children as a promise. Such parents would feel obliged to execute planned bequests as written in the will in order to be seen as keepers of their word. If they fail to keep their promise, they will feel guilty (Charness and Dufwenberg, 2006). Such parents are then unlikely to reveal the planned bequests to children in advance if there is a risk that the planned bequests will not be executed.

To our best knowledge, there are no data showing how often wills are made public before the planned bequests are transferred. The Polish law provides that the will may only be opened in court. The court makes the will public only if the death certificate of the testator is delivered. Thus, the official opening of the will always takes place after the will was actually made. Nonetheless, one may plausibly claim that at least some of the inheritances received come as no surprise to the heir. The 8,020 respondents in the SHARE data set of the population of 50+ in Europe have at least one parent alive and answered the question on chances to receive an inheritance in the future. 11% of them reported certainty of receiving an inheritance, 32% declared probability greater than one half of receiving an inheritance, 16% declared positive probability but smaller than one half of receiving an inheritance, and 41% declared certainty about receiving no inheritance in the future. 52% respondents declared certainty about future inheritance. One source of certainty regarding future inheritance might well be that parents have revealed the bequest plans to their children.

Parents may shape the preferences of their children unconsciously, merely by their behavior (say, by leaving a planned bequest). The heirs enjoy bequests planned by their parents and may find it desirable to behave likewise towards their own children. An example of behavior approved and exhibited by the parents, and enjoyed by the children, is bundled with the inheritance. This concerns also the manner in which planned bequests are transferred. Children may find planned bequests written in a will a proper way both of bequeathing and of expressing feelings. Receiving planned bequests may shape a motive to bequeath that is likely to result in planned bequests, especially if other motives to bequeath are already present. Furthermore, parents may shape the preferences of children consciously by discussing the planned bequests with their children and revealing the will in advance. Parents who want their children to mimic their own bequest behavior may reinforce the impact of leaving planned bequests by discussing the will.

Planned bequests are an important part of the relationship between parents and children. “Such relationships do not terminate with the death of one person. Memories remain; internal dialogue continues ... behavior [may] alter because of the past relationship” (Brown and Berk, 1977). A statistical analysis of selected aspects of the intergenerational transmission of preferences via planned bequests will be conducted in Chapter 5 of this dissertation.