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Transfers in Kind: Why They Can Be Efficient and Nonpaternalistic – Comment

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Abstract. Bruce and Waldman make an important contribution regarding the Samaritan dilemma: the expectations of inheritance motivates the younger generation at the margin in the direction of welfare reducing behavior. However, these authors misinterpret the standard analysis on this matter as prediction instead of explanation; confuse governmental subsidies with private charitable giving, and uncritically examine Headstart and statist job training programs.

Keywords: altruism, charity, paternalism, bequest, welfare, Samaritan dilemma

Bruce and Waldman (1991) – hereafter BW – seeks to promote a rationalistic interpretation of tied givings, which are typically seen as merely paternalistic.[1] Their analysis is motivated by the fact that many, many wealth transfers are made in kind, even when we can readily assume (e.g., in intrafamily cases) that it is altruism, the concern for the welfare of the recipient, that leads to the giving behavior. Their thesis is that tied gifts need not be interpreted as paternalistic, as is done in traditional economic theory; instead, they can be seen as an attempt to overcome opportunistic acts. To wit, the child who knows he will be a beneficiary in future will take this into account at present: he will save less and spend more than were he not aware of this future bequest possibility. Thus, the next generation thrusts the present one into 'the Samaritan's dilemma' (Buchanan, 1975); it becomes more impoverished, the very opposite of that state of affairs desired by the donor, due to the expectation of this generosity.

BW are to be congratulated for bringing to light a very interesting critique of traditional neoclassical economics. However, their discussion raises a number of interesting points which call out for further analysis.

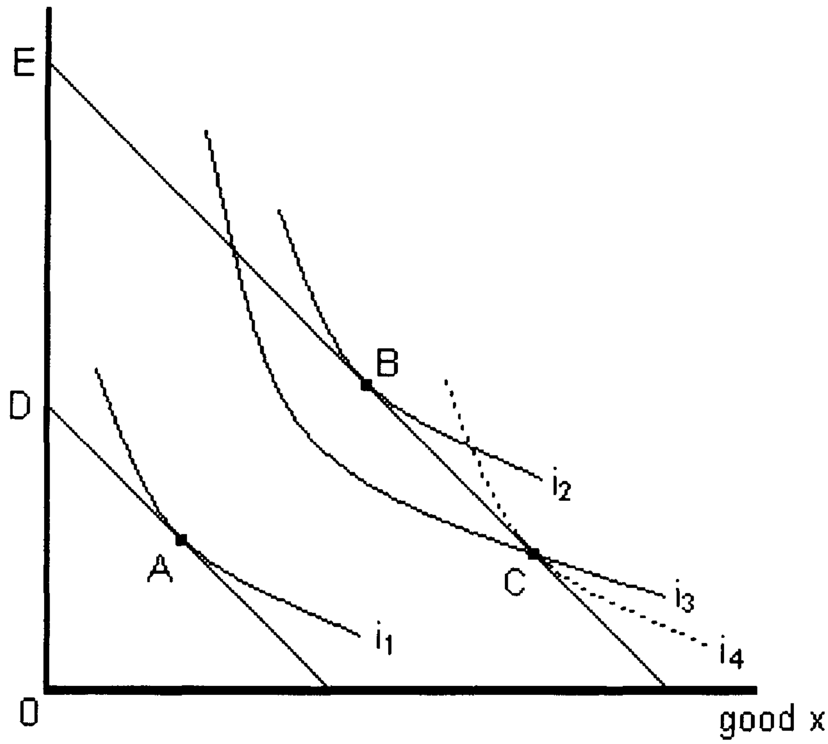

Figure 1. In kind vs. money gifts.

1.

BW claim that 'The traditional theory of altruism makes a strong prediction concerning the form that such a transfer would take: whenever possible the transfer should be given in cash rather than in kind' (1345). But this is not, strictly speaking, true. Rather than a *prediction*, traditional theory makes a claim that *if* the donor wishes to maximize the economic welfare of the grantee, *then* cash is superior to in kind transfers, or to ties of any type. As Figure 1 indicates, if the beneficiary is already at point A on indifference[2] curve *i*1, a grant of money of DE can lift him to point B on indifference *i*2. In contrast, a gift of *x* of the same value will only move him from point A to C. But C is on indifference curve *i*3, lower than *i*2, so economic welfare is enhanced to a greater degree by cash than by a gift in kind of AC of *x*. The only time this result would not obtain is if the recipient would have spent all of his cash gift on *x*, in any case; i.e., *i*3, not *i*2, is the real indifference curve, in which case the grantee is indifferent to the *x* or the money.

How can there be a *prediction* in this regard? Under neoclassical assumptions, in order for us to be able to predict, and to test a hypothesis[3] based on it, we must be able to conceptually distinguish, at least in principle, between tied gifts for paternalistic purposes, on the one hand, and those motivated by a desire to overcome the Samaritan dilemma on the other. This, unfortunately, cannot be done. All we can observe, even in principle, is one person giving money or goods to another. Their motives are not available to us, no matter how well situated we are. To put this in other words, if we are to test a hypothesis concerning a prediction (or about anything else), then, in traditional methodology, we must be able to specify a state of affairs that would falsify it.[4] But how can predictions about paternalism vs dealing with Samaritan dilemmas be falsified? Neither implies an economic act empirically distinguishable from the other.

If it is explanation, not prediction, then nothing uncovered by BW forces us to renounce the traditional analysis. It still holds true, despite the efforts of these two scholars, that, barring the case where the recipient would have spent the cash on precisely the good desired for him by the donor, transfers in money are more efficient than those in kind – at least from the perspective of the grantee.

2.

BW several times liken the government to the private donor with regard to the altruism which is supposed to engender the giving. For example, they state: 'Examples (of tied giving) include a parent who pays for his child's college education rather than giving a cash transfer, government programs that provide job training to the poor, and programs such as Headstart which provide early education to the poor among our youth' (1345). Also, 'The argument of this paper – formalized in the previous section for the parent/child relationship – applies equally to tied transfers made by the government' (1349); and 'This (welfare rolls) setting is completely analogous to the parent/child environment analyzed in the previous section' (1349).

There are difficulties with this position. There are many disanalogies between governmental and private sector giving. In one case the donor disburses his own money; in the other case, the civil servant in charge is giving away money forcibly taken from other people. Altruism makes sense for relationships within the family; but even here Adam Smith's 'self interest' is never totally absent. But to think that this motivation can account in any significant degree for governmental behavior strains credulity. Much more reasonable explanations include rent seeking[5] (Buchanan, Tollison, Tullock, 1980; Krueger, 1974; Posner, 1975; Tullock, 1967), vote buying (Lloyd and

McGarrity, 1995; Grier and McGarrity, 1998), and interest group politics (Anderson and Hill, 1989).

Similarly, these citations support the view that BW insufficiently distinguish between governmental forced transfers of income *vis à vis* private charity. They do not incorporate into their analysis why the latter is so much more successful than the former (Bennett and DiLorenzo, 1994; Hughes, 1988, 1989, 1990), because the recipient is more likely to recognize sacrifice of donor; because it is far easier to switch from March of Dimes to Salvation Army (or vice versa) if dissatisfied, than to refuse to pay that portion of taxes which are transferred to others. Nor do BW take cognizance of the fact that private sector giving, being voluntary, is at least consistent with altruism, while the public sector counterpart, constituting a forced levy, is not (Hoppe, 1992b).

3.

For BW the Headstart program is exhibit 'A' in their case for governmental altruism, and job training programs come in a close second as exhibit 'B.' For example, they state, 'Consider the government programs mentioned in the introduction: job-training programs and programs such as Headstart which provide early education to the poor among our youth. In each case, the fact that the transfer is given in a tied fashion can be interpreted as an attempt of by the government to avoid the problem of the Samaritan's dilemma' (1349). And again, 'Consider for example the Headstart program. We would expect the quality of education received by the poor among our youth to have an effect on the number of these individuals who find themselves on welfare when they are grown' (1350).

Contrary to the expectations of BW, however, there is a wealth of empirical data that casts aspersions on the accomplishments of these two programs.[6] The experience of Headstart indicates that there is indeed improvement with regard to the children who pass through the program in terms of reduction of juvenile delinquency, truancy, etc., as compared to those of equal social-economic background who have not 'benefitted' from these early years of special education. However, these gains are no longer discernable several years afterwards. That is, there are no statistically significant differences between Headstart graduates and non graduates five, ten or fifteen years after attendance, whether in terms of unemployment, incarceration, welfare dependency, etc. This is hardly a ringing endorsement for the claim that altruism motivates these expenditures – that is, *after* these findings have become common knowledge.[7]

As far as government job training is concerned, there are grave problems concerning its accomplishments. For example C.E.T.A. has been found more to be the training grounds for 'leaf raking' and other time wasting activities than real preparation for productive employment opportunities. Nor should this result be seen as accidental. There is nothing in the annals of economic theory which would lead us to believe that the state has a comparative advantage in the industry dedicated to worker training. On the contrary, this is a highly skilled competitive business. Those who have prospered in it have passed a market test of survivability.

Can it be objected that Head Start and C.E.T.A. type training programs are just infelicitous examples, erringly chosen by BW? That the principle maintained by these authors – government as altruist – is a reasonable one, merely wanting for better illustrations? Such a contention would be hard to defend. If anything, it is certainly counter-intuitive, at least within the profession of economic since the advent of the Public Choice School (Buchanan and Tullock, 1971; Buchanan, James M., Tollison, Robert D., and Tullock, Gordon, 1980).

4.

BW take it almost as an article of faith that there is something highly problematic about grantees lowering their savings or labor participation rates, or becoming poorer than otherwise. The essence of their argument is that gifts in kind are not paternalistic, even when motivated by the best interest of their beneficiary; rather, this sort of giving behavior is better interpreted as an attempt to overcome the Samaritan's dilemma. This, in turn, they define in these terms: 'The Samaritan's dilemma is simply that the recipient, if he anticipates that the altruist will act in this manner, will make decisions that make the probability of his becoming impoverished "too high," ' (1346). BW follow up this definition with an example: 'In a pure-altruism model, the size of the bequest from a parent to his child will depend negatively on the wealth that the child has at the time of the bequest. In turn, if the child realizes that his wealth at the time of the bequest can affect its size, he may very well overconsume in periods prior to the bequest' (1346).

There are two possible ways to understand the behavior of the member of the younger generation. One, he is attempting to spend, not in terms with his present income, but with his permanent income (Friedman, 1957). But why is it irrational for the person who expects to receive a gift in the future to lower his present savings and increase his present consumption? All he is doing is straightening out his spending to match his permanent income stream. Surely, there is enough precedent for this behavior in economic theory so that it will not lightly be labeled irrational.

If the donor objects to such behavior on the part of his heir, he has every right to do so. However, is it not the very essence of paternalism to make such an objection, and then to attempt to act upon it? Surely it is a paradigm case of paternalism to seek to overturn the beneficiaries' acts by tying the grant to college attendance, a minimal savings rate, etc.

The second possibility is that the child is acting opportunistically, that is, trying to put himself into a position where his bequest will be higher than that of his brothers and sisters.[8] He can do this, given that the disbursements will be negatively proportionate to the wealth of the children, by purposely impoverishing himself in the short run. He is purposely making himself into a poor ne'er do well, at present, so that he can be a rich one later on.

Here, the two motives are difficult to entangle from one another. For while, by stipulation, he is attempting to increase his wealth at the expense of his siblings,[9] he is *also* necessarily looking to his permanent income. True, he impoverishes himself, but only in the short run, precisely so that his long run prospects will be improved. Discounting both income streams, one against the other, by his calculations this opportunistic behavior will improve his own welfare.[10]

Will tied giving address this problem? Yes, we have to concede to BW that, if reasonably tailored, it may, although this conclusion by no means follows necessarily. For example, while college attendance can be expected to improve productivity (Becker, 1964), it need not do so, certainly not for a would be ne'er do well, who is trying to do well out of all his ne'ering.

Are there better ways to counteract this opportunistic behavior? Yes. Surely an announcement to the effect that the inheritance will be divided equally, and not (negatively) correlated with wealth would tend to nip it in the bud. But the parent may have good and sufficient reason for not acting in this way: in order to forestall his childrens' poverty which does not arise in this manner. If so, there is still another option other than tied giving. For example, the parent could consider, even if only in his own mind's eye, not one but three estimates pertaining to his children's wealth. There would be an ideal or shadow concept $W(i)$, his estimate of the child's wealth without the loss (L) due to opportunistic behavior and the tradition concept of actual wealth W(a), where:

$$W(a) = W(i) - L$$

In this model, instead of basing the bequest on a (negative) correlation with $W(a)$, the measurement which can be manipulated by the self impoverishment arising out of the Samaritan dilemma, it would be calculated using $W(i)$.

There is no denying that objections could be leveled against this solution to the Samaritan dilemma. For example, we must always be aware of what Hayek (1948) has taught us concerning the limits of knowledge. But Hayek was analyzing societal central planning. He made the very valid point that, at the very least, the information required by the planning board would not be made available to it.[11] However, we are presently discussing only a family, not an entire economy. What would be undoubtedly an impossibility on a societal level becomes not only reasonable, but actually doable, on an individual family basis. There is little doubt that most parents make these sorts of estimates literally every day.

Given that the parent has this sort of option open to him, and yet resorts to the far more inefficient alternative of tied giving, it is difficult to reject the hypothesis that paternalism, not solving the Samaritan dilemma, is the operationally meaningful explanation in the present context.[12]

Notes

1. Unless otherwise noted, all page citations are to this one article, BW (1991).
2. My point is that BW's critique of traditional neoclassical economic analysis falls on barren ground in this case. I do not, however, defend the latter against all critics. For the Austrian critique of indifference for example, see Rothbard (1962), Block (1980, 1999).
3. For a critique of this neoclassical methodology, see Hoppe (1992a), Rothbard (1962), Mises (1966).
4. For an alternative view of falsificationism, see Hoppe (1992a), Blanshard (1964), Mises (1966).
5. The difficulty with this Public Choice School nomenclature is that they take a perfectly good word, 'rent,' and needlessly and inappropriately invest it with negative connotations. A far better phrase which more accurately expresses what they mean by 'rent seeking' would be 'booty seeking,' or good old fashioned 'theft.' They are prevented from employing this alternative terminology because of their mistaken view that government is really, at bottom, just a business firm, and that the market process is akin to the political process. See on this Block and DiLorenzo (2000, forthcoming), DiLorenzo and Block (2001), Rothbard (1997).
6. On the Headstart program see Murray (1984).
7. *Ex ante*, this claim might have been more believable; after all, it might have seemed reasonable to some people to expect that when the state throws money at a problem, it usually solves it. But BW write long after the returns are in, and thus it is more puzzling that they should still entertain this thesis.
8. If he is the only child, of course, this whole scenario cannot arise.
9. This model assumes altruism only on the part of the older generation. It certainly has not passed onto the younger one, or at least to this particular person who we are supposing will not only 'cheat' his siblings, but also place his parent in the Samaritan dilemma in the first place.
10. What we have been describing – at least from the child's point of view – is conceptually indistinguishable from saving. In *both* cases the economic actor 'worsens' his present

position so that his future one can be improved, and by more than enough to compensate him, when everything is suitably discounted, for his present plight.

11. For other criticisms of central planning, see Mises (1966), Salerno (1990, 1993), Boettke (1990, 1994).
12. To be fair to BW, they do not deny that 'paternalistic preferences and targeting play a role in the existence of tied transfers' (1345). However, they also 'argue that there is another factor that may play an equal or greater role,' (1345) namely, overturning the Samaritan's dilemma. It is only with regard to the latter claim that we call into question BW's analysis.

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