Doing Well by Doing Good: A Market for Favors

K. K. Fung

Marian is a welfare mother with two preschool children. She works in a community daycare center taking care of her own and 10 other children. She does not get paid in cash. Instead, she earns six favor credits an hour from the center. She goes to classes two days a week to train as a nurse's aide. On those two days, she pays for day care with her favor credits. By the time she finishes training and gets a paid job, she will have accumulated enough favor credits for a year's day care.

John is a retiree on Social Security. He works in an after-school homework center in an elementary school. He also earns favor credits for his service as a tutor. He saves some of his credits to pay for future home care when his knees get too weak to walk. He uses some as partial payment for his vegetables from the neighborhood garden. He donates 10 percent of his credits to charities for a tax deduction toward his investment income.

Michael is an unemployed computer programmer receiving unemployment benefits. He is helping the senior center computerize its favor exchange database. For his service, he gets an office and access to various equipment, which he uses to facilitate his job search. He also earns favor credits for his service. He plans to donate most of them to obtain a tax deduction when he gets a paid job. Meanwhile, he uses some as partial payment for a membership in a health club that accepts favor credits as a cash discount.

Marian, John, and Michael are all residents of Favorville, FE. Favorville has a regular economy exactly like the one we find in every city in the United States. What makes it different from other cities

Cato Journal, Vol. 15, No. 1 (Spring/Summer 1995).

K.K. Fung is Professor of Economics at the University of Memphis. He thanks Carolyn Shaw Bell, Cyril Chang, Kanji Haitani, and Joyce Jacobsen for insightful and meticulous comments.

is that it has a complementary "favor economy." In Favorville, transfer recipients like Marian, John, and Michael have an additional source of income besides transfer payments. They can work in the favor economy, earning favor credits to supplement their transfer checks without reducing their transfer benefits. And by helping to produce much needed services for themselves, they reduce the fiscal burden of their benefits on taxpayers. In addition, the danger of creating a stigmatized class forever dependent on transfers is reduced. By working in the favor economy, transfer recipients are learning skills that are marketable in the money economy when they are ready and paid jobs are available. Because welfare recipients are active in meaningful and productive activities, their self-esteem is maintained.

A Formal Favor Economy

Favorville, FE, does not exist. It is a conceptual formal favor economy in which people exchange favors using a means of exchange generally accepted in the favor economy. This means of exchange is a formal "favor credit" earned by performing services not for money but for return favors. Favors are returned when services produced by the formal favor economy are purchased with the favor credits. With the newly created opportunity to earn favor credits, those transfer recipients who choose to remain idle would incur the opportunity costs of forgone favor credits.

Members of close-knit groups have long exchanged favors informally. However, increased mobility has undermined those exchanges because there is no easy way to ensure return favors. Formal favor credits would overcome that problem, as favors done need not be returned by the same favor recipients. Instead, they can be returned by anyone willing to accept the formal favor credits. The generally acceptable formal favor credits can be used as full payment for other favor goods and services produced in the favor economy, or as partial payment for goods and services produced in the money economy.

Without a formal favor economy to facilitate favor exchanges, those who are not employed in the money economy rely increasingly on transfers from government in the form of public assistance or social insurance. Although the transfer economy cushions the money economy, it is an expensive buffer. The size of the transfer economy becomes a problem when it is larger than the working population can support. The subsidized leisure of nonworkers is particularly controversial when the services required to support them are increasingly expensive and much-needed services for the working poor go unprovided. A formal favor economy changes incentives by making transfer recipients more self-sufficient in these maintenance services.

This paper explains how a formal favor economy might be established. In addition, it explores the micro and macro implications of a formal favor economy serving as a transition or buffer between the transfer economy and the money economy. The paper ends with a discussion of the many issues relating to the integration of the favor economy into the existing money economy and the voluntary sector.

To separate the money economy from the formal favor economy, I shall precede money-economy concepts with the words "money" or "paid." For example, a "paid input" is an input or resource purchased with money in the money economy, or a "money cost" refers to a cost payable in money. Similarly, favor-economy concepts are preceded with the word "favor." For example, a "favor input" is an input rewarded with favor credits only. And a "favor product" is a good or service made with a significant percentage of favor inputs by chosen "favor employers" who recruit favor inputs to work with paid inputs.

Why a Parallel Favor Economy?

In a market economy, not all of the human and material resources are or can be absorbed into the money economy. Even for those people who are actively seeking jobs, full employment is considered to have been reached when the unemployment rate is well above zero. For example, the U.S. labor force is said to be fully employed when the rate of unemployment is 5 to 6 percent. Although many factors lead to inactivity in the money economy, all inactive resources can be regarded as surplus in some sense to the money economy. At present, those resources are largely supported by transfer benefits. For example, over 50 million people in the United States receive either Aid to Families with Dependent Children (AFDC), Social Security, or unemployment benefits.

But the transfer economy is a very expensive and inflexible buffer for the money economy for the following reasons. First, transfer recipients need not perform any quid pro quo for their benefits. The one-way transfer encourages a sense of entitlement among transfer recipients. Second, transfer recipients are not allowed to engage in any meaningful gainful activity without jeopardizing their benefits. This restriction encourages idleness and reduces employability and self-esteem among transfer recipients. Third, transfer benefits make it financially feasible to live apart from close relatives. This possibility increases the transaction costs of intergenerational exchange of favors for Social Security recipients and teenage welfare mothers.

Reducing transfer benefits would force some of the transfer recipients back to the job market. But it is not clear that such a move would actually reduce the nation's poverty rate or improve the quality of its labor force.

Making transfer recipients active instead in the favor economy reduces money transfer benefits without reducing real benefits. If favor products are acceptable substitutes for paid products and if favor products can be produced with a substantial amount of favor inputs, the money costs to taxpayers of providing a given level of real transfer benefits would doubtlessly be reduced. Instead of providing transfer benefits in cash to be used to buy paid products, taxpayers would simply fund the paid inputs to work with favor inputs. The favor credits earned by the favor inputs then could be used to buy favor products.

Currently, transfer payments by all government levels are about 15 percent of GNP. If the formal favor economy can conservatively substitute 10 percent of the paid products purchased by the transfer economy with favor products, there will be a gross savings of some $90 billion. In other words, with the help of a formal favor economy, money transfer benefits can be reduced without a reduction in real benefits.

When transfer recipients can exchange favors in a formal favor economy, a more flexible and less expensive buffer between the money and the transfer economy is possible. This additional freedom comes from a new source of purchasing power that is acceptable primarily in the favor economy. Because of their restricted circulation, favor credits would not be counted as additional money earnings that would otherwise trigger a drastic reduction in transfer benefits. Favor credits would be taxed only by the formal favor economy and not be subject to government taxation as normal money income would be. This separation of favor credits from money offers other advantages than just reducing the money costs of transfer benefits.

First, favor credits earned by transfer recipients can be used to turn a one-way transfer of benefits from the government into a two-way exchange between money taxpayers and transfer recipients. That happens when taxes on favor credits payable to the formal favor economy are used to subsidize favor products purchased by low-income money taxpayers. For example, the transfers received by the elderly from the federal government are more than 10 times as much as transfers received by children under age 18 on a per capita basis (Richman 1992: 34). Even if it is collectively desirable to redistribute those benefits from the elderly to young children, it is politically difficult to do it directly by shifting money transfers. But, if the elderly provide child care and homework assistance for favor credits, the taxes they pay on the favor credits can be used by their favor employers to subsidize low-income users of the children-oriented services.

Second, funding paid inputs to work with favor inputs in the formal favor economy can channel surplus resources into producing much-needed services. If surplus resources are absorbed indiscriminately into the money economy, there is no assurance that they will be absorbed into sectors producing the much-needed services in short supply.

Third, the formal favor economy can reduce the money costs of moving working-age able bodied transfer recipients back to the money economy. For example, welfare mothers will go back to work sooner if child care is made more affordable by mobilizing surplus resources in the favor economy (Cattan 1991: 3–9). Because transfer benefits from the money economy would not be reduced by productive activity in the formal favor economy, the temporarily unemployed can maintain their self-esteem and employability by staying active. The same function can, of course, be achieved by creating subsidized or government jobs in the money economy. But if subsidized jobs are created in the private sector, there is no guarantee that those new jobs do not simply displace unsubsidized jobs. If government jobs are created to absorb the unemployed, the additional payrolls may simply add to the budget deficit unless the jobs produce enough tax revenue to cover the additional tax expenditure.

Thus, the formal favor economy is an important complement to the money economy. It will also reduce the harmful effects of the current transfer economy by transforming one-way transfers into two-way exchanges between money taxpayers and transfer recipients.

Service Deficit without a Formal Favor Economy

The more favor products can be made to replace paid products, the better the complementary role of the formal favor economy will be served. The favor products preferably should be those much needed by transfer recipients and yet too expensive to buy in sufficient quantity in their paid forms. Many of those products are labor-intensive services. Because labor productivity in commercial production of the services is not much higher than home production and the transfer economy is labor abundant, the formal favor economy enjoys a comparative advantage in producing such labor-intensive services.

Ironically, low labor productivity in commercial production of those much-needed services also explains why a serious deficit occurs in the services. If commercial production does not result in higher labor productivity, low-wage workers can ill afford to replace all the services they previously produced at home. The net gain from employment would be too small when other job-related costs are included if all the previously home-produced services are replaced.

A drop of home producers, therefore, means a service deficit. For example, rising labor-force participation among married women with children under age six from 18 percent in 1960 to 57 percent in 1988 (Fuchs and Reklis 1992: 42) has resulted in a deficit of parenting services (Garland 1989: 68). A 1989 survey conducted by Parents United for Child Care in Boston showed that 75 percent of working parents could not be home every day after school. Yet only 14 percent of the children were in any kind of formal after-school program each day. Nearly 50 percent of the working mothers in the survey claimed they could not call their children from work or receive calls from their kids, even in an emergency (Caminiti 1992: 53). A 1990 Urban Institute study reported that 12 percent of children between ages 5 and 12, the so-called "latchkey" kids, took care of themselves either before or after school.

The rising participation in the labor force of many full-time women homemakers who have traditionally performed community services has led to a deficit of community services. The shortage of community services can be gauged by the changing pattern of staffing in charitable organizations. As the supply of full-time female volunteers dwindles, leadership positions have been divided up. Copresidents and shorter terms have become more common. Inexperienced volunteers are tapped to fill once sought-after positions. Volunteers are offering smaller blocks of time and are more interested in short-term projects (Lombardi 1993: 1).

Some of the service deficits could have been offset by the rising population of retired persons. Between 1960 and 1990, the number of Americans ages 65 and above almost doubled, from 17 to 31 million (Fuchs and Reklis 1992: 41). But that age group, with the most leisure time, also had the lowest volunteer rate (1992 Independent Sector Survey). Not only were they not super-volunteers, they were also not super-grandparents. If they lived closer to their children and grandchildren, they could have replaced some of the personal services previously produced by nonworking mothers with young children. Financial independence made possible by Social Security benefits has encouraged many retirees to relocate far away from their children and grandchildren.

Even though retirees do not offer much help in reducing the service deficit of younger families, their failing health places a heavy burden on home health-care services. There is no evidence that Medicare or

Medicaid can cover all the needed services or that the elderly are engaged in any significant amount of mutual help.

Establishing a Formal Favor Economy

Lowering Transaction Costs through Formal Favor Credits

The coexistence of substantial surplus resources and increasing service deficits would have promoted a thriving favor economy except for high transaction costs. Those transaction costs are related to the absence of a generally accepted means of exchange within the favor economy. Unless favor exchangers happen to have mutually coincident needs, favor-doers must accept informal favor credits. But because there is no fixed value to informal favor credits, they are not generally acceptable. And because informal favor credits are seldom recorded in writing, they are not easily carried into the distant future. Not surprisingly, favor exchanges are mostly conducted among members of close-knit groups to reduce transaction costs (Fung 1991: 450).

The transaction costs would increase if members of an otherwise close-knit group became more mobile and separated over greater distances. Americans are well known for their mobility. An average American family changes residences once every seven years. One contributing factor is the availability of third-party retirement funding, which enables retirees to relocate to distant retirement communities. Mobility trends have no doubt increased the transaction costs of informal favor exchanges. Data from the 1987–88 National Surveys of Families and Households not surprisingly showed that adults living within 10 miles of their aging parents were 50 percent more likely to exchange intergenerational support (Hogan, Eggebeen, and Clogg 1993: 1444).

With computerization, favor credits could be formally recorded, and matching of needs could be more easily coordinated. But, without a generally accepted means of exchange within the favor economy, favor credits and debits still cannot be easily settled. Just as market exchanges cannot function properly without money, favor exchanges cannot function properly without formal favor credits. Mere tabulations of supply and demand for favors in incommensurable physical units without the mediation of prices cannot lead to efficient settlements. What can be done to lower transaction costs of favor exchanges, given the high mobility of potential favor exchangers? The answer lies in establishing a system of generally acceptable favor credits.

Favor credits become a generally accepted means of exchange in the favor economy when they are a generally accepted means of storing value in the favor economy. And they become a means of storing value when their issue is controlled and favor products are priced in terms of favor credits.

When formal favor credits are given for favors done, there is no longer a need to barter for favor exchanges. Recipients of favors do not have to be the parties who return the favors. If favor credits are stored on a debit card, for example, there should be no geographic restriction to their acceptability. Favors can be done in one place and the favor credits earned can be spent in another. Mobility and physical distance need not be barriers against favor exchanges. Favor credits can just as easily be transferred from one person to another as donated to one's favorite charities.

Thus, the ability to earn formal credits for doing favors means that the extent of favor exchanges need not be limited by inadequate generosity. Because favor credits can be used to secure desired favors, self-interest alone would go a long way toward expanding the favor economy.

Who May Earn Favor Credits?

There is no reason why the formal favor economy should be limited to transfer recipients. Other people who are not transfer recipients and would have volunteered their services to charitable organizations may find the formal favor economy an attractive way to offer their services for favor credits. For example, school-age children and other people who do not have a substantial amount of leisure time may be encouraged to work in the formal favor economy by the reward of formal favor credits.

Setting Favor Credits

How many favor credits should favor-doers be paid when they offer their services as favor inputs? To achieve seamless integration with the money economy, favor inputs should be priced the same as their money-economy equivalents. For example, if day-care attendants in the money economy are paid $5 an hour, those who perform day care of equivalent quality in the favor economy will be awarded five favor-credit dollars.

There may be some ideological objections to transferring all the market imperfections from the money economy to the formal favor economy by adopting the same prices. Indeed, some service credit programs that facilitate service exchanges among their members give one service credit for one hour's service regardless of skills and experience involved (Cahn and Rowe 1992). While this egalitarian arrangement is morally satisfying and workable on a small scale, uniform pricing of time deprives the favor economy of the means to eliminate shortages and surpluses of favor inputs. Paying scarce inputs the same as abundant inputs would only perpetuate shortages because there is no incentive to increase the quantity of scarce inputs supplied.

Tying favor-credit dollars to money dollars lends instant credibility to favor credits as a means of exchange. In addition, such market-based favor credits offer the following operational advantages:

1. Market-based favor credits make it easy for funding agencies to compare the efficiency of different favor employers. For example, favor employers need full-time paid labor to supervise and work with mostly part-time favor labor to produce favor products. The more favor inputs they can recruit, the fewer paid inputs they need to buy. The fewer paid inputs they have to buy to work with favor inputs, the greater the leverage effect per unit of money dollars. And the more productively the inputs (paid and favor) are managed, the lower the total (favor and money) costs for a given amount of favor products. Thus, when paid and favor inputs are priced competitively, the efficiency of different employers can be compared directly. That is, the larger the total (favor and money) costs and the higher the proportion of paid inputs for a given amount of favor products, the less efficient the favor employer must be. A given amount of funding for paid inputs can lead to more favor products if the more efficient favor employers are funded.
2. Market-based favor credits also make it easy for favor-doers to verify whether they have been rewarded fairly and for favor employers to price their products competitively in terms of favor credits.
3. The return of the temporarily unemployed to the money economy will be easier if they are aware of the market wages of money-economy jobs through the competitively priced favor-economy jobs. By working for the highest favor credits per hour, they are automatically honing the same skills that also command higher pay in the money economy.

Controlling the Issue of Favor Credits

Because the favor economy is intended to supplement the money economy, favor credits should be issued only by employers who are willing to accept favor credits as primary payments for their products or give a money price discount to low-income users who cannot otherwise afford their services. Those employers may be nonprofit operators who mostly use favor inputs but rely on government or charitable funding for their paid inputs. Or they may be for-profit operators who use some favor inputs, but rely on their own funding for their mostly paid inputs.

The total amount of favor credits to be issued is determined by the total value of favor inputs the chosen favor employers have committed to hire after their proposed budgets are accepted by agencies that fund paid inputs. Favor employers will retain their power to issue favor credits only if they deliver to users the proposed amount of favor products at specified prices within the budgeted amount of favor credits.

Favor credits will be recycled to favor employers who issue them when their favor products are sold to users who pay with favor credits to partly or fully cover their favor costs. If favor employers sell the whole output of favor products at the specified prices, they should be able to recoup the same amount of favor credits (or their money equivalent) that they started with.

What Are Favor Credits Good For?

Favor credits could be used for favor products produced in the favor economy. The products can range from day care and home health care to vegetables from neighborhood gardens. Favor credits could also be used as full or partial payments for paid products. For example, businesses can run sales promotions by offering a money price discount to customers who can make up the difference between the full cash price and the discounted price with favor credits. Colleges may even accept favor credits as partial payment for tuition and trade the favor credits for money.

In addition, favor credits could be saved and deposited in favor-credit banks for future use. The savings then could be loaned to those who do not have enough favor credits to buy the favor products they need now. Part of the interest the borrowers pay will go to reward the savers. Making loans with savings will ensure that there is enough purchasing power to buy all the favor products at prices sufficient to cover the favor costs.

Redistribution of Favor Credits through Taxation and Donations

With the current method of volunteer services, volunteers commit to a one-way transfer of services to the needy. There are no favor credits in return for their services. In the formal favor economy, however, favors are rewarded with formal favor credits. If favor credits are not taxed or donated, the formal favor economy will serve only to exchange favors among favor doers. When favor credits are taxed or donated, the taxed or donated credits can be used to subsidize favor products for low-income users.

To encourage donations of favor credits, money tax deduction for donated credits should be considered by the Internal Revenue Service. Currently, tax deductions are allowed by the IRS for donations of material goods only. If this practice continues after the formal favor economy is established, then donations of favor credits earned from offering material goods will be tax deductible but donations of favor credits earned from offering time will not be. Such an anomaly can be eliminated if all donations of favor credits are made tax deductible.

How Should Favor Products Be Priced?

Because all favor inputs are paid in favor credits at the same rate as equivalent paid inputs, favor products should be priced at the same rate as equivalent paid products. Pricing favor products at the same rate as paid products ensures that the formal favor economy is at least as efficient as the money economy. It also ensures that those who pay with money would enjoy no price discount if they chose to buy favor products instead of paid products.

The prices actually paid would vary depending on the forms of payment and the income status of users:

1. Low-income users who do not have favor credits will pay a money price equal to part of the paid costs plus part of the favor costs. The percentages would be determined by how much of the money costs come from renewable subsidies and how much of the favor costs are covered by favor-credit donations and favor-credit taxes. The higher the share of money costs funded by renewable subsidies and the higher the share of favor costs covered by favor-credit donations and favor-credit income taxes, the lower the money prices will be for those low-income users.
2. Low-income users who pay primarily with favor credits will pay favor credits to cover the full favor costs and money to cover that part of the money costs not funded by renewable subsidies.
3. High-income users who may or may not have favor credits will pay the same prices for favor products in money or in favor credits as the money prices of money-economy equivalent products. This competitive pricing for high-income users ensures that the formal favor economy will not compete with the money economy.

Pricing favor products competitively with equivalent paid products should recover all the favor costs and the money costs not funded by renewable subsidies if the mix of favor products is exactly what the users want and the users spend a mix of money and favor credits equal to the mix of money costs and favor costs.

But, if users spend more money than favor credits to buy favor products, favor employers will receive more money than is needed to recover fully the nonsubsidized money costs. And the demand from those who use mainly favor credits will not be fully met. The resulting *shortage of favor products* will signal the employers to produce more favor products. The extra money income can be used then in the next period to hire more paid inputs that will work with more favor inputs to produce more favor products. On the other hand, if favor products are left unsold, neither the money costs nor the favor costs of those unsold favor products will be covered. The resulting surplus of favor products will signal the employers to produce less of the favor products.

In general, shortage and surplus of favor products, rather than their prices, will be used to regulate supply. The prices of favor products will rise or fall only in response to the costs of paid inputs and favor inputs and the money prices of equivalent paid products.

Trading Favor Credits for Money?

Such a clean separation between money and favor credits, as payments for favor products, is possible only if exchange between them is forbidden. Attempts to separate money from other means of payments have not been entirely successful. For example, some food-stamp recipients sell their food stamps for money to buy nonfood items that cannot be purchased with food stamps. The illegal use of food stamps effectively defeats the purpose of providing affordable food items to low-income families. Might not favor credits be traded illegally for money to buy paid products?

The incentives to trade favor credits for money certainly exist. First, because earned favor credits are not subject to IRS taxation or taken into account for computing transfer benefits, favor credits converted into money can be concealed easily from the IRS and transfer-benefit agencies. Thus, *earning favor credits is a convenient way to avoid* paying the exorbitant net marginal tax rate (Laffer 1984) transfer recipients are subject to when they openly earn money through paid work. Second, money can buy all paid products while favor credits are good mostly for favor products.

There are also incentives to trade money for favor credits. If favor credits can be bought with money at, say, 50 percent of their face value, they can be used to buy favor products at half their cash price. But if favor credits are embodied in debit cards and not in denominated bills, favor credits cannot be transferred easily to others without giving up the card itself. Trading favor credits for money through electronic transfers is of course possible. But such transactions leave easily detectable traces and are usually avoided in illegal transactions.

Nationwide and Communitywide Administrative Structures

To run the favor economy, some nationwide and communitywide administrative structures are needed. The most important component of the nationwide administrative structure is the favor-credit banking system. A banking system is needed to accept deposits and make loans, to clear transactions between favor-credit accounts, and to issue favor-credit debit cards. The tendency toward inflation by awarding too many credits is controlled by the funding for paid inputs and the prices of money-economy equivalents of favor inputs. The funding for paid inputs determines how many paid inputs can be hired to work with the favor inputs. And the prices of money-economy equivalents of favor inputs determine how many favor credits should be issued. The most important job of communitywide administration structures is to determine what favor products to provide and their priorities in the allocation of funding for paid inputs.

In addition, the administrative structures should be responsible for (a) collecting taxes on favor-credit income and accepting donations of favor credits; (b) distributing favor-credit taxes and donations to favor employers according to the same priorities governing the allocation of funding; (c) soliciting funds from the money economy; (d) dealing with publicity, recruitment, interviewing, referral, orientation, training, and liability insurance (Chapin 1977); and (e) making routine and long-term policies for the favor economy. As nationwide and communitywide administrative services are shared, contributions of funds to their providers should be prorated to individual favor employers by the number of favor credits issued.

Sources of Funding

All the paid inputs needed to staff these administrative structures and produce favor products must be paid in money dollars if surplus resources are to be mobilized in the formal favor economy. Such funding can come from revenues from the sale of favor products (i.e., that part of the payments for favor products in the form of money rather than favor credits) and from redirected government or charitable funding.

Redirected government or charitable funding is the part of funding previously used to buy paid products that is redirected to fund paid inputs to work with favor inputs to produce favor products. For example, a board of education may use part of its budget for reducing class size to fund on-site after-school homework centers staffed partly by favor-doers. Or a Medicaid waiver program may channel part of the budget for institutional care to fund home care partly staffed by favor-doers. Or government funds intended for subsidized paid jobs in the private or government sector can be diverted to the favor economy to create a lot more favor jobs. Although these specific funds probably cannot be diverted to fund services in other programs, part of them can be used to fund the core administrative infrastructure for all favor exchanges.

Allocation of Funding

How should funding for paid inputs be allocated among different favor products? Three levels of decisions must be made.

First, favor products could be prioritized through citizen surveys or a representative political process in each community. That regional approach allows the list to vary according to local needs.

Second, given the list of priorities, favor employers in each category of favor product will be selected through competitive bidding. Employers that can provide a given amount of favor product at the lowest total (favor and money) cost with the highest component of favor inputs will be funded. That selection criterion ensures that the limited funds have the maximum potential in mobilizing surplus resources.

Third, once the budget proposals of potential favor employers are examined, funds can be allocated to the most efficient favor employers in light of the priorities given to different favor products.

Who May Apply for Funding?

The primary recipients of funding for paid inputs should be those nonprofit favor employers who accept primarily favor credits for payments or offer money price discounts to low-income users. Although for-profit employers should be allowed to issue favor credits if they are efficient producers of favor products and are willing to lower prices to low-income users, they should not be eligible for funding unless there are no nonprofit employers.

Anticipated Objections

Can Benefits Justify Costs?

Promoting favor exchanges among favor-doers with surplus resources is a romantic idea that can readily appeal to many people. But their enthusiasm quickly wanes when they realize that a formal favor economy requires its own infrastructure and regulations to run smoothly. They wonder if the infrastructural costs of a formal favor economy might not eat up most of the benefits of formal favor exchanges.

Even though favor inputs need not be paid in money, they are still priced in terms of favor credits at the same rate as equivalent paid inputs. If the infrastructural costs of the formal favor economy are so high that favor products must be priced above their equivalent paid products to cover their paid and favor costs, favor products would not be competitive with paid products. But as long as the infrastructural costs of the formal favor economy are comparable to those for the money economy, the fact that a parallel infrastructure must be set up should not lead us to question the cost effectiveness of the formal favor economy.

There are reasons to believe that the average infrastructural costs per favor exchange are comparable to those for paid exchanges.

First, there are substantial economies of scale resulting from the large number of transfer recipients. For example, the number of food-stamp and Social Security recipients alone amounts to some 60 million people. A favor economy serving that many people is much larger than some independent money economies in the real world. If those money economies can afford their exchange infrastructures, a formal favor economy in the United States can surely afford its own favor exchange infrastructures.

Second, existing transfer agencies can perform most of the functions required by the formal favor economy. For example, the food-stamp administration, which is in the process of replacing food-stamp bills with debit cards, can also handle the issue of debit cards for favor credits. The Medicaid administration can select favor employers to provide favor home-care by setting aside some funds originally intended for paid home-care. Local boards of education can similarly select favor employers to provide after-school on-campus tutorial day care by setting aside funds originally intended for more paid teachers to reduce class size.

Third, the marginal real costs of some favor inputs may be close to zero because they have no alternative uses. In other words, some favor inputs need not be paid any favor credits at all because there is no demand for equivalent paid inputs. For example, older computers that are too slow for the money economy need only be paid favor credits equal to the salvage values of their constituent materials. But they may still be fast enough to service the favor-credit banks.

With all those cost advantages, the infrastructural costs of the formal favor economy should be manageable. In addition, because favor employers are selected on the basis of cost efficiency, favor products should be competitive with paid products.

Does the Formal Favor Economy Really Exchange Favors?

Because informal favors create a sense of indebtedness in the recipients that motivates reciprocity, favor exchanges are usually regarded as socially integrative. The integrative power is believed to be stronger if the favors are done unconditionally or if the indebtedness is not fully discharged (Boulding 1973: 15–34). It seems to follow that if favors are rewarded in full with market-based favor credits in the formal favor economy, favors no longer serve any integrative functions. Instead, favor exchanges would be no different than market exchanges in the money economy.

Such a conclusion is unwarranted because it overlooks the important role the formal favor economy can play in promoting reciprocity from transfer recipients to money taxpayers. Because transfers are presently handed out as collective favors from taxpayers by impersonal bureaucratic agencies, transfer recipients do not feel obligated to return those favors. Instead, they regard such transfers as their rights. Whether the transfers impose excessive burden on taxpayers is the last thing on their mind. Unless their subsidized leisure is looped back to the pocketbooks of taxpayers, transfers will remain a purely coercive obligation of taxpayers. When transfer recipients start paying taxes on or donate the favor credits they earn in the formal favor economy, they will be able to return favors to low-income taxpayers in the form of subsidized favor products. When transfer recipients can exchange favors among themselves and when they maintain their employability in the money economy by staying active in the formal favor economy, they are returning favors to money taxpayers by reducing the fiscal burden of their transfer benefits.

The formal favor economy is not intended as a substitute for informal favor exchanges between acquaintances who interact on a regular basis. Such informal favor exchanges will still be conducted without any formal favor credits because formal favor credits can be issued only by approved favor employers and not by individual favor recipients. Rather, the formal favor economy is simply a means to reduce the high transactions costs of exchanging mutual help between large groups of strangers outside the money economy.

The Formal Favor Economy and the Nonprofit Sector

Together with the government transfer economy, the nonprofit charitable sector has long served to buffer fluctuations of the money economy. It is where volunteer labor and nonlabor donations have concentrated (Weisbrod 1988: chaps. 5 and 7). The introduction of a formal favor economy will provide a formidable competitor for the nonprofit sector because it offers formal favor credits to surplus resources that it employs and price discounts to low-income users of favor products.

However, it does not mean existing nonprofits would be entirely displaced. On the contrary, existing nonprofits could continue to operate provided that they meet the efficiency requirements of the funding agencies. Economic efficiency requires that only those nonprofits that have the lowest overall budget using the largest percentage of favor inputs for a given amount of favor products would be funded for their paid inputs. Even if an existing nonprofit is not funded for its paid inputs, it can still continue to issue favor credits for the surplus resources it employs provided that its favor-product prices are competitive with those nonprofits that are funded for their paid inputs and its products fall within the community-determined priority list.

Because funding for favor employers must be subject to popularly determined priorities, some nonprofits that pursue narrowly defined objectives will not be funded nor be allowed to issue formal favor credits for surplus resources they may still be able to attract.

Thus, the superimposition of the formal favor economy on the nonprofit sector will have an efficiency-enhancing effect on the management of nonprofits and ensure that any operating surplus will not be dissipated for unintended purposes but must benefit users of favor products in the form of lower (cash plus favor credit) prices.

Is the Favor Economy a Complement to or a Competitor with the Money Economy?

Because the formal favor economy promises to produce favor products that are substitutes for similar paid products, it could potentially affect the money economy in the following ways: (a) For-profit employers may substitute favor inputs for paid inputs, (b) non-transfer recipients and high-income users may substitute favor products for paid products, (c) favor employers may squeeze out paid employers, and (d) favor products may squeeze out paid products.

Substitution of Favor Inputs for Paid Inputs? If favor inputs need not be paid money wages, may employers substitute favor inputs for paid inputs to increase profits? When that happens, the demand for paid inputs and hence their money prices will be depressed. But it happens only if the cost savings from favor inputs can be kept by for-profit employers. If employers must charge high-income users the full costs of paid and unpaid inputs and channel the cost savings only to those who cannot afford the full price, there is no profit motive for employers to substitute favor inputs for paid inputs.

For nonprofit employers, if money cost savings cannot be transferred to other uses, the substitution of favor inputs for paid inputs (after funding for a given amount of paid inputs has been approved) would not bring them any benefit.

Leakage of Favor Products? Although favor products are less expensive in money terms for low-income users and favor-doers, there is no price advantage for high-income users. For them, favor products cost the same in money terms as paid products.

Unfair Competition to Paid Products? Given a fixed amount of transfer benefits, favor products can be produced only if some of the funds are diverted from paid products to hire paid inputs to work with favor inputs. With the fund diversion, more products are available. But the absolute output of equivalent paid products will be lower and the paid inputs otherwise used by paid employers will be used by favor employers instead.

With growing transfer benefits and only a partial diversion of the funds to hire paid inputs in the formal favor economy, output can grow of both paid products and equivalent favor products. Employment of paid inputs can also increase in both economies. That is especially true when paid products are too expensive to meet the needs of transfer recipients and low-income users. Given such an elastic demand, a controlled growth of favor products at lower money costs would only reduce the unsatisfied needs and not divert absolute demand from equivalent paid products.

Conclusion

The transfer economy supports surplus resources that could not be easily integrated into the money economy. The size of the transfer economy is particularly controversial when the services required to support its members are increasingly expensive and much-needed services for the working poor go unprovided. The fiscal burden on taxpayers to support the transfer economy can be greatly reduced and transfer benefits can be more evenly redistributed if the surplus resources are mobilized to produce many of these services for return favors instead of money. The transaction costs of the favor exchanges can be reduced greatly if formal favor credits are created. With favor credits as a generally accepted means of exchange within the favor economy, favor exchanges will no longer be limited by inadequate generosity, mobility, and physical distance among potential favor exchangers.

In addition to providing valuable services at little money costs, the favor economy can effectively buffer fluctuations in the money economy. By working in the favor economy, transfer recipients can maintain their self-esteem and learn new skills that could be transferred to the money economy when the individuals are ready and paid jobs are available.

By pricing favor inputs according to their money-economy equivalents, funding agencies can easily compare the cost effectiveness of different favor employers. This ability should impose a much-needed efficiency discipline on the nonprofit sector, which has been a major user of favor inputs.

References

Boulding, K.E. (1973) "The Micro Theory of Grants and Granting Behavior." In *The Economy of Love and Fear*. Belmont, Calif.: Wadsworth Publishing Co.

Cahn, E., and Rowe, J. (1992) *Time Dollars*. Emmaus, Pa.: Rodale Press.

Caminiti, S. (1992) "Who's Minding America's Kids?" *Fortune*, 10 August: 50–53.

Cattan, P. (1991) "Child-Care Problems: An Obstacle to Work." *Monthly Labor Review* 114(10): 3–9.

Chapin, H. (1977) *Tapping the Untapped Potential: Towards a National Policy on Volunteerism*. The Canadian Council on Social Development. Ottawa, Ontario.

Fuchs, V.R., and Reklis, D.M. (1992) "America's Children: Economic Perspectives and Policy Options." *Science* 255(3): 41–46

Fung, K.K. (1991) "One Good Turn Deserves Another: Exchange of Favors Within Organizations." *Social Science Quarterly* 72(3): 443–63.

Garland, S.B. (1989) "America's Child-Care Crisis: The First Tiny Steps Toward Solutions." *Business Week*, 10 July: 64–68.

Hogan, D.P.; Eggebeen D.J.; and Clogg, C.C. (1993) "The Structure of Intergenerational Exchanges in American Families." *American Journal of Sociology* 98(6): 1428–58.

Independent Sector and Gannett News Service (1992) *Giving and Volunteering 1992*. Washington, D.C.

Laffer, A. (1984) "The Tightening Grip of the Poverty Trap." Cato Policy Analysis No. 41. Washington, D.C.: Cato Institute.

Lombardi, K.S. (1993) "Hunt for Volunteers Grows Harder in a Changing World." *New York Times*, 18 October: 1.

Richman, L.S. (1992) "Struggling to Save Our Kids." *Fortune*, 10 August: 34.

Weisbrod, B.A. (1988) *The Nonprofit Economy*. Cambridge, Mass.: Harvard University Press.