

THE MARKET VALUE OF FAMILY VALUES

Ralph Chami and Connel Fullenkamp

Recently, family issues have received much attention from politicians and social commentators. The debate has centered, for the most part, on the decline of “family values” and the commensurate decline of “work ethic” among participants in the labor market. Although economists have no way of measuring values or work ethic directly, they may nonetheless be able to find evidence of changes in values and work ethic to the extent that these changes affect different markets. An extensive literature on the economics of the family has emerged over the past 20 years that documents and analyzes economic interactions between family members, such as bequests and gifts, or inter vivos transfers. When it comes to showing the impact of these family interactions on labor and financial markets, however, economists for the most part have remained on the sidelines. In this paper, we bring economics to the heart of the discussion of family values by using the insights gleaned from existing and recent work on the family to forge and highlight the integral link between the family and the market.

Family Income Transfers and Family Values

Among economists it is well known that familial economic support—whether between parents and children or between spouses—is quite common and represents a significant portion of U.S. wealth accumulation. Moreover, there is now an extensive literature on these transfers that documents their size. Kotlikoff and Summers (1981) estimate bequests to account for four-fifths of U.S. wealth accumulation, Cox (1987) gives an estimate of 63 billion dollars in inter vivos transfers and 40 billion dollars in bequests (in 1979 dollars), and more recently

Cato Journal, Vol. 16, No. 3 (Winter 1997). Copyright © Cato Institute. All rights reserved.

Ralph Chami and Connel Fullenkamp are Assistant Professors of Finance and Business Economics in the College of Business at the University of Notre Dame. They thank Jeff Bergstrand, Thomas Cosimano, Jeffrey Fischer, Richard Sheehan, Paula Tkac, and Rafael Tenorio for their comments.

Wilhelm (1996), using estate tax data from 1988, puts the size of bequests at 130 billion dollars. While we usually think of transfers in monetary terms, these figures do include the value of transfers of goods and services. What they do not include, however, is the value of any gifts given by parents to children under the age of 18. These transfers, though difficult to disentangle from "regular" family consumption, are regarded by family members as being different from usual consumption expenditures and should be included in inter vivos transfers. If included, the total value of inter vivos transfers would be far greater.

Researchers differ as to the motivation behind such transfers. One strand advocates altruism (e.g., Becker 1974), which is the idea that parents care about the happiness of their children and make transfers because they believe the transfers will make their children happy. Another strand argues that benefactors are exchange motivated (e.g., Bernheim et al. 1985), which is the idea that parents are selfish and dangle possible gifts and bequests in front of their children to entice them to give parents the attention they want. Yet a third contends that transfers are accidental (e.g., Abel 1985).

A variation on the exchange motivation for transfers, which comes from other social sciences, links family income transfers to family values quite transparently. This research suggests that gifts and monetary transfers are an essential mechanism through which parental or spousal values and aspirations are conveyed to other family members. Developmental psychologists and sociologists have long recognized the inherent relationship between gift giving and the values of the benefactor. For instance, Schwartz (1967: 2) argues that "the gift is an imposition of identity," while Sussman (1965: 91) points out that parental giving may influence, among other things, the child's "motivation to achieve." Famed examples of parents realizing this link include Commodore Vanderbilt, Andrew Carnegie, and more recently, Warren Buffet. In the case of Commodore Vanderbilt, his more hard working child was favored in the will and put in control of the trust fund set up for the less industrious brother (Clark 1966). Warren Buffet recently indicated that his concern for the potential negative impact of his sizable estate on his children's work effort has convinced him to leave most of his fortune to the Buffet Foundation (Greenwald 1995).

Economists have incorporated into their research agenda the idea that income transfers and value transfers are linked. Interestingly, they have found that the timing of such transfers is critical in determining their effect on the beneficiaries' values and behavior. Assuming that the parent can observe the child's actions, Hirshleifer (1977)

points out that if the parent were to decide on the transfer before the child decides on his action, then the parent will face what Becker (1974) termed the "Rotten-kid" problem. That is, the child, after receiving the transfer from the parent, has little incentive to abide by the parent's wishes. The result is bad behavior by the child—to the dismay of his parent.

If instead the parent chose to make transfers only after the child has taken his action, the parent may face what Buchanan (1975) termed the "Samaritan's Dilemma"—that is, the child, in anticipation of the parent's transfers, would overconsume so as to engender a higher future transfer from his parent.¹ This problem is exacerbated when the parent is dealing with an adult child, where the parent may not necessarily know the action taken by the child. For example, the parent may not be able to ascertain whether unemployment or low wages are due to the child's low effort or to bad market conditions. In this case, if the parent were to opt for having the last word, then the child stands to gain from the benefit of the doubt, which can only provide a disincentive for the child to raise his work effort. On the other hand, if the parent were to precommit to a certain transfer rule, then the child's effort is certainly higher in this case, since the child does not expect to receive any help should he expend lower effort and raise the probability of low output.² This could partly explain the surge in the past five years in the use of "trust funds" by parents, who may resort to such incentive trusts as a way to precommit to transfer rules that reward children for actions that accord with the parent's values (Pederzane 1995).

The economics literature, for the most part, has concerned itself with the dynamics of the nonmarket interaction between the parent and the child or between spouses, and assumed the market activity of the transfer recipients to be exogenous. But a small literature that explores the interaction between family income transfers and market activity of the recipients does exist. Arnott and Stiglitz (1991), in the case of insurance markets with moral hazard, but in the absence of altruism, show that nonmarket transfers—by lowering the effort that individuals take to avoid accidents and raising the probability of accidents—lead to the crowding-out of market insurance. However, altruistic transfers may actually complement market insurance, especially in the case where partners care enough about each other's welfare

¹For a discussion of the benefits of the last word in the case of perfect foresight, see Hirshleifer (1977, 1985) and Becker (1991) when uncertainty is present.

²See Chami (1996) for a discussion of the benefits of precommitment.

(Chami and Fischer 1996).³ In the context of labor markets, Holtz-Eakin et al. (1993) show that inheritances appear to lower the labor supply and labor market participation of the recipients. But virtually no work has been done on how wages, employment levels, and labor contracts reflect the presence of such nonmarket transfers. We now turn to our analysis of this interaction.

Parental Transfers and the Labor Market

Our first task is to build a vehicle for exploring the interaction between altruistic transfers among family members and the market. To make our ideas concrete, we focus on the labor market, though the results can be generalized to other markets.⁴ Similarly, although we couch our discussion throughout the rest of the paper in terms of the parent-child relation, our analysis can accommodate more general settings that include spouses and partners who are linked, though not entirely, by altruism. By allowing for family members, such as adult children or partners, to engage in market activities, members of the family are empowered with certain independence in their decision making. This contrasts with the existing literature, which has typically viewed the parent-child framework from the perspective of the parent, and subsumed the decisions of the child or other family members within that of the parent.⁵ By focusing solely on the welfare of the benefactor, those models imply that any conflict resolution in favor of the parent is pareto efficient.⁶ And under the assumption that a parent can fully observe the activities of her adult child, the parent can dictate the action to the child that maximizes the parent's utility.

By introducing an outside market, such as a labor market, into our framework, we become obliged to consider children as economic agents who make decisions independently of their parents. In other words, parents cannot completely control the behavior of their children. Furthermore, we relax the assumption usually made in the literature that a parent is able to observe the activities and opportunities of her children. Parents gradually lose the ability to observe the activities of their children as the children approach adolescence and

³See Stark (1989) for a similar argument in the context of the family and in the absence of an outside market.

⁴In particular, all of the ideas discussed in this article apply in a straightforward way to insurance markets, or any other market in which some agents act in ways to insure others against some risk.

⁵This criticism is voiced in Lazear and Michael (1988), and more recently in Haveman and Wolfe (1995).

⁶In an empirical study, Udry (1996) shows that Pareto efficiency may not obtain when other members of the same family are modeled independently.

spend more time outside the home. The inability of the parent to discern the child's activities is complicated by the uncertainty inherent in the market, where luck helps determine the child's wages and employment opportunities. In this case, parents may want to rely on the child's output as a sign of the effort level expended. But since market luck is present, the child has the advantage of private information regarding his true effort, which he may choose not to reveal to his parent so as to enjoy the benefit of the doubt.

We incorporate the above ideas into a model of a game whose rules and timing are as follows. The basic game has four players: a parent, a child, the firm, and nature. The parent is altruistic in the sense that in addition to caring about her own consumption, she also receives utility from the child's utility—the happier the child, the happier the parent. The child receives utility from consumption and disutility from *expending effort in the workplace*. To make the asymmetry in altruism clear, we assume that the child does not care about the parent's happiness at all, though all that is necessary to support our conclusions is a situation in which the parent cares about the child's utility more than the child cares about the parent's utility. The firm is a profit-maximizing business producing for a competitive market, and nature is the source of market luck.

The game proceeds in this order. First, the parent makes a transfer of resources to the child. Next, the child secures a labor contract from the firm and then decides on the level of effort he will expend on the job. Finally, this effort is combined with luck to determine the market outcome. The actions we are interested in analyzing include the choice of labor effort on the part of the child and the choice of transfers on the part of the parent. We are also interested in showing how the labor market reacts to these choices, and what consequences this reaction has for parent and child. Ultimately, we intend to piece together the relation between the level of transfers made by the parent, the level of effort chosen by the child, and market outcomes.

An essential step toward understanding the effects of parental transfers on the labor market is to realize that the motivation behind such transfers will be reflected in the types of transfers made. When the parent behaves altruistically—that is, cares directly about the welfare of her child—her transfers, at the margin, will be compensatory in nature. In other words, such transfers are subsidies that attempt to shield the child from, or compensate the child for, possible bad luck in the market.⁷ As long as the child does not share the parent's level of altruism, such transfers can only lower the effort of the child in

⁷See Cox (1987) and Menchik (1988) for a discussion of this result.

the labor market. While the parent intends the transfer to make up for possible bad luck, the child will use the transfer to substitute for effort, which he does not like to expend. For example, absenteeism and incidences of shirking on the job may rise in the labor market, and reckless behavior that increases the possibility of injury also rises in the insurance market. Holtz-Eakin et al. (1993) provide empirical evidence that recipients of inheritances do lower their labor supply and labor force participation. This problem is exacerbated when parents cannot directly observe the child's actions, since the parent cannot accurately infer the extent to which the child's wage outcome is due to luck rather than effort. The child will take advantage of this information asymmetry by further lowering his effort level, receiving the benefit of the parent's doubt in a literal, monetary sense.

The above scenario analyzes the case in which the parent only cares about the welfare of the child without trying to directly impose her will and expectations on her child. But as alluded to earlier, work by Sussman (1965) and Schwartz (1967), among others, argues that parents not only take an active interest in their children's actions, but may also try to influence their children's decisions. Sussman (1965: 91) points out that parental authority extends to "occupational choice, mobility of children and . . . mate selection." Here, the parent is not only altruistic, but also cares directly about the actions taken by the child. Becker (1991: 9) calls this the "merit good" case, where the term merit good refers to the action or behavior the parent cares about. When a merit good is present in the parent's utility function, parental transfers differ in type and in quantity from the case in which the parent is only altruistic. While transfers would continue to provide some compensation for bad luck, transfers now also take the form of incentives that are intended to induce higher effort from the child. For example, the parent can link transfers to the child's effort, or some measure of effort such as income or occupation in the case where effort is unobservable. This leads to parental transfer schemes under which, if the child's income is low, then transfers are lower than in the case in which the child's output is high. Indeed, Vanderbilt, in his will, instructed that his younger and less industrious son be provided with a trust fund that only rewarded his son for "exemplary" behavior.

The merit good, in our analysis of the labor market, is the effort put forth by the child. Parents care directly about this merit good because they know—usually better than the child—that effort is associated with success in life and greater happiness in the long run. Work effort is so important to success and happiness that society has developed a moral value associated with it: work ethic. Parents want

their children to develop a strong work ethic. Children, who do not like to expend effort because they do not receive immediate rewards for doing so, will not develop a work ethic without some kind of external provocation. Parents therefore provide incentives to build up the work ethic of their children, and they do this in great part through the use of carefully designed transfers. Thus, parental expectations and values, reflected in the type of transfers made, play a pivotal role in providing incentives for the effort decisions of their children.

The question now is, why should parental transfers affect market profitability? First, such forms of transfers, which include bequests, *inter vivos* transfers, spousal support, and income pooling, are quite large and commonplace. Second, whereas individual parents and partners correctly perceive themselves as price takers in the market, it is the *collective* impact of the behavior of the recipients of such transfers, through their action in the marketplace, that affects market prices. Thus, although competitive firms may not observe the amount of nonmarket transfers made to the beneficiaries, they will feel the impact of such transfers through the effort level expended by beneficiaries, which in turn will affect the profit margins of the firms. For example, if purely altruistic transfers prevail, then effort expended by workers will be lower, which lowers productivity, raises costs associated with absenteeism, and lowers expected profits for the firms. In the case of labor markets, firms will react to such behavior by exposing the workers to higher risk in order to realign incentives and engender higher effort. This is done by increasing wage dispersion and decreasing job security. The market increases wage dispersion by lowering the market wage for less skilled work and paying a higher premium for skilled labor, by lowering base salaries and relying more on bonuses, and by eliminating fringe benefits. The market decreases job security by increasing layoffs and by replacing full-time employees with contract workers or temps. All of these actions serve to shift risk from risk neutral firms to risk averse individuals, which reduces the efficiency of the market.

The above discussion highlights the role families play in affecting equilibrium market outcomes and how families, in turn, are affected by the market's reaction. Parental values and expectations are reflected in the type and level of transfers made. These differing types of transfers will have disparate effects on the effort decision of the recipients. Thus, the family imposes negative or positive externalities on the market depending on parents' expectations regarding their children's behavior. These externalities cannot be priced out completely by the market, since the source of risk is not entirely exogenous but partly determined by the market participant's effort decision. The market responds to the externality imposed on it by altering

equilibrium prices and quantities of labor, which changes family welfare. It is in this sense that the family values play a central role in forming market outcomes. Ideally, families would have a constructive role in reinforcing market discipline, which will increase efficiency and raise welfare for all market participants.

Public Transfers and Family Values

Public transfers typically attempt to provide a “safety net” that raises or preserves the recipient’s welfare in the face of hardship or misfortune. In this respect, government transfers function very much like transfers from altruistic parents to their children: they are compensatory in nature. Given what we have learned about altruistic family transfers, we can say that compensatory government transfers may have the unintended effect of lowering the recipient’s welfare. Children, knowing that the government will make transfers to them if their incomes fall short, will choose reduced levels of effort, effectively substituting the transfers for the extra income they would have expected to earn by expending higher effort in the labor market. Reduced worker effort will lower expected profits for firms in the market, who will react by lowering employment and increasing wage dispersion. The invisible hand shifts more risk to transfer recipients in an effort to reestablish their incentive to expend high effort. The net effect is that transaction costs for market participants are higher, with risk averse agents—families, and eventually the government—having to absorb more risk. As a result, overall efficiency and welfare is lower. Since the child did not take into account the effect of his actions on the market, the fall in real income he experiences is likely to be greater than the increase in welfare made possible by the government transfer. Therefore aggregate welfare can fall.

The above scenario leaves parents out of the picture. When we include them, we can show that government transfer programs can harm family values and parents’ welfare as well as children’s welfare. We consider the case in which parents are altruistic but also care about a merit good. Compensatory public transfers act as substitutes for family transfers by providing their recipients with an additional avenue through which they can obtain resources for consumption. Because they substitute for parental transfers, which reflect parental expectations and wishes, public transfers provide an alternative to children who may not share their parents’ aspirations.⁸ In other words,

⁸A similar result, albeit in a different context, is found in Chami and Fullenkamp (1996), who study the role of private and public transfers in affecting teenager choices, including fertility, wage earnings and labor supply.

government transfers provide children with a way to disobey their parents without suffering any consequences. Thus government transfers interfere with the ability of parents to pass their values on to their children and to control their children's behavior.⁹ This lower consumption of the merit good lowers parental welfare. For example, Milton and Rose Friedman (1980) pointed out that the introduction of Social Security could be the reason behind the decline in the level of attentiveness given by children to their parents. As the above analysis would suggest, a possible explanation is that public transfers compete to a certain extent with parental transfers in affecting children's behavior. Children substitute Social Security wealth for parental bequests in their consumption calculations and maintain their welfare without having to expend as much effort visiting their parents.

The evidence from academic studies on poverty, while it does not focus on the connection between government programs and parental influence, also suggests that government programs have significant effects on the behavior of children. For example, Haveman and Wolfe (1994), in their summary of recent research, report that welfare reciprocity on the part of parents greatly increases the chances of a child becoming a welfare recipient, and that the generosity of state welfare benefits influences duration of welfare reciprocity. Some social commentators have used this evidence to support their views that government transfer programs have created a culture of dependency and idleness among transfer recipients. While this may be true, it has not yet been proven by rigorous research. Nonetheless, this evidence does tend to confirm that government programs create career and lifestyle paths that compete with the traditional paths preferred by parents and firms.

So long as public transfers are primarily intended to compensate recipients for bad outcomes, they will tend to interfere in the dynamics of family interaction and harm the welfare of all family members. It is reasonable to argue, therefore, that such compensatory social programs should be cut back or even eliminated.

Conclusion

The family plays a pivotal role in affecting the market through its provision of income transfers. These transfers, by affecting the choices made by market participants, can either complement the market or

⁹A report of the National Academy of Sciences Panel on Adolescent Pregnancy and Child-bearing entitled *Risking the Future* (Hayes 1987) cites a decline in parental authority and responsibility as one of the main causes of the high rate of teenage pregnancy in the United States.

impose costs on it. The market, therefore, places a significant value on family values—though not for their own sake. Family values, such as work ethic, have a tremendous impact on the bottom line, through their effects on the skill accumulation and productivity of employees. When work ethic is effectively passed from parents to children, firms will be more productive and will pass their gains to workers in the form of higher wages, lower unemployment, and lower uncertainty about wages and employment in general. But when work ethic declines or is not passed from parent to child effectively, the market reacts to lower efficiency and higher costs by passing these costs on to the family in the form of greater uncertainty about wages and job security. This is essentially the same story of market discipline that plays out with respect to any business practice: actions that raise efficiency and deliver value are rewarded, while actions that lower efficiency and reduce value are punished.

If work ethic and other family values are indeed in decline, as some observers would suggest, then economists should be able to detect the effects of this decline in data on wage dispersion, employment dynamics, and labor contracts. On the other hand, a word of caution is in order before we search for any links between market outcomes and the state of family values in our society. Public warnings about moral decay are as old as the concept of morality itself. Indeed, the practice of older generations of a society criticizing the morals of younger generations is one of our most observed if not most honored traditions. Perhaps these condemnations and warnings are simply another mechanism by which parents ensure that their values are transferred to their children. If this is truly all that the current debate over family values represents, then it is unlikely that economists would find any measurable effects when they conduct their experiments.

As this paper shows, however, the transmission of family values from parents to children has probably been harmed by the emergence of government social insurance programs. These programs, which have only existed for the past two generations, represent a new development in the cycle of family values. Our model suggests that these programs, in their current form, interfere with parental influence and prevent values from being passed effectively from one generation to the next. Their effect, moreover, has probably become more pronounced within the last 25 years as the variety and generosity of government transfers have increased. The introduction of government programs, therefore, can be interpreted as a shock to the system that upset the balance between the family and the market. This raises the likelihood that economists can find evidence of the effects of government programs on work ethic through the programs' effects on

wage and employment data. Carrying out the empirical investigations suggested by this paper, therefore, appears to be a worthwhile endeavor.

References

- Abel, A.B. (1985) "Precautionary Saving and Accidental Bequests." *American Economic Review* 77: 1037-47.
- Arnott, R., and Stiglitz, J. (1991) "Moral Hazard and Nonmarket Institutions: Dysfunctional Crowding out or Peer Monitoring?" *American Economic Review* 81: 179-89.
- Becker, G.S. (1974) "A Theory of Social Interaction." *Journal of Political Economy* 82: 1063-93.
- Becker, G.S. (1991) *A Treatise on the Family*. Cambridge: Harvard University Press.
- Bernheim, B.D.; Shleifer, A.; and Summers, L.H. (1985) "The Strategic Bequest Motive." *Journal of Political Economy* 93: 1045-76.
- Buchanan, J.M. (1975) "The Samaritan's Dilemma." In E.S. Phelps (ed.) *Altruism, Morality, and Economic Theory*. New York: Russell Sage Foundation.
- Chami, R. (1996) "King Lear's Dilemma: Precommitment versus the Last Word." *Economics Letters* 52: 171-76.
- Chami, R., and Fischer, J.H. (1996) "Altruism, Matching, and Nonmarket Insurance." *Economic Inquiry* 34: 630-47.
- Chami, R., and Fullenkamp, C. (1996) "The Government and the Family: Partners or Competitors?" Mimeo. University of Notre Dame.
- Clark, F. (1966) "The Commodore Left Two Sons." *American Heritage* 17: 81-103.
- Cox, D. (1987) "Motives for Private Income Transfers." *Journal of Political Economy* 95: 508-46.
- Friedman, M., and Friedman, Rose (1980) *Free to Choose*. New York: Harcourt, Brace, Jovanovich.
- Greenwald, J. (1995) "Now He's Even Richer; When Disney Landed ABC, Warren Buffett Scored the Biggest Hit." *Time*, August: 54-55.
- Haveman, R., and Wolfe, B. (1994) *Succeeding Generations: On the Effects of Investments in Children*. New York: Russell Sage Foundation.
- Haveman, R., and Wolfe, B. (1995) "The Determinants of Children's Attainments: A Review of Methods and Findings." *Journal of Economic Literature* 33: 1829-78.
- Hayes, C., ed. (1987) *Risking the Future: Adolescent Sexuality, Pregnancy, and Childbearing*. Vol. 1. Washington, D.C.: National Academy of Sciences Press.
- Hirshleifer, J. (1977) "Shakespeare versus Becker on Altruism: The Importance of Having the Last Word." *Journal of Economic Literature* 15: 500-502.
- Hirshleifer, J. (1985) "The Expanding Domain of Economics." *American Economic Review* 75, suppl.: 53-68.

- Holtz-Eakin, D.; Joulfaian, D.; and Rosen, H.S. (1993) "The Carnegie Conjecture: Some Empirical Evidence." *Quarterly Journal of Economics* 108: 413-35.
- Kotlikoff, L.J., and Summers, L.H. (1981) "The Role of Intergenerational Transfers in Aggregate Capital Accumulation." *Journal of Political Economy* 89: 706-32.
- Lazear, E.P., and Michael, R.T. (1988) *Allocation of Income within the Household*. Chicago: University of Chicago Press.
- Menchik, P. (1988) "Unequal Estate Division: Is It Altruism, Reverse Bequests, or Simply Noise?" In D. Kessler and A. Masson (eds.) *Modeling the Accumulation and Distribution of Wealth*, 61-77. Oxford: Clarendon Press.
- Pederzane, J. (1995) "Six Feet Under and Overbearing." *New York Times*, 12 March; Section 4: 5.
- Schwartz, B. (1967) "The Social Psychology of the Gift." *American Journal of Sociology* 73: 1-11.
- Sussman, M.B. (1965) "Relationships of Adult Children with Their Parents in the United States." In E. Shanas and G.F. Steib (eds.) *Social Structure and the Family: Generational Relations*, 62-92. New Jersey: Prentice Hall.
- Stark, O. (1989) "Altruism and the Quality of Life." *American Economic Review* 79 (May): 86-90.
- Udry, C. (1996) "Gender, Agricultural Production, and the Theory of the Household." *Journal of Political Economy* 104: 1010-46.
- Wilhelm, M.O. (1996) "Bequest Behavior and the Effect of Heirs' Earnings: Testing the Altruistic Model of Bequests." *American Economic Review* 86: 874-92.