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Intergenerational transfers, production and income distribution

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Abstract

We consider an overlapping-generations economy where the aggregative production process uses physical capital and human capital. Intergenerational transfers from parents to their children are motivated by 'altruism'. We distinguish between two types of transfers: Investment of parents in the education of their offspring, and capital transfer (the 'gift-bequest motive'). We show that the *intensity* of each type of altruism, and hence the *composition* of the two types of transfers, affect significantly the equilibrium output and the intragenerational income distributions. Comparing competitive equilibria, from the same initial distributions of capital transfers and human capital, we derive: (a) The economy with the higher 'education-inclined' altruism attains *lower* output and *more equal* intragenerational income distributions, if either the production function's elasticity of substitution is not 'large' or the altruism is 'weak' (b) For more 'bequest-inclined' altruism the effects are, usually, reversed (c) Under public provision of education, higher (bequest-inclined) altruism results in *lower* output and *less equal* distribution of income in all dates.
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1. Introduction

Intergenerational transfers, in their various forms, are among the significant factors affecting the aggregate human capital, physical capital stock and the

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inequality in the distribution of income. In recent years economists studied extensively various types of endogenous growth models where human capital is assumed to be the engine for growth. The issues we consider here are related to the following two presumptions which are supported by empirical evidence:

1. Intergenerational transfers in the form of human capital and physical capital affect significantly intragenerational income distribution and capital accumulation.
2. These transfers are motivated mainly by some sort of 'altruism' between parents and children.

Should we distinguish between countries (or societies) where parental transfers to children consists mainly of investments in education and countries where parental transfers are biased towards physical capital? How does the 'mixture' of these two types of intergenerational transfers affect income inequality and output? The coexistence of these two types of transfers has received little attention in the literature (see, for example, Becker and Tomes, 1986; Lord and Rangazas, 1991. An extensive survey is brought in Laitner, 1997). Evidence regarding significant differences in investments in education between countries has been documented in recent years (among the OECD countries see: Education at Glance: OECD Indicators, 1997 for other countries see: World Development Indicators, 2000). It is our main aim to demonstrate the economic importance of the 'composition' of these two different types of intergenerational transfers. Differences between societies (and, hence, economies) emanate from cultural and traditional gaps as well as the nature of the 'altruism' of parents towards their children. We assume that,

(a) The investment of parents in education of their child emanates from their preference for a 'more educated' offspring, and also to affect this way her future earning capability (we call it 'education-inclined altruism').

(b) All sorts of physical capital transfers are motivated by the 'joy of giving' and/or the 'gift-bequest motive' (we call it 'bequest-inclined altruism').

The utility derived by parents from each kind of transfer is assumed to exist but the *intensity* (of the preferences) towards each transfer may differ between economies. Thus, in comparing economies, which differ only in the intensity of each type of altruism, we shall study the following questions:

- When parental transfers to children have larger bias towards education does it imply more equal intragenerational income distributions? higher output?
- Do the answers to the above questions depend on the education provision regime? Namely, is the private provision of education case different significantly from the public provision case?

In an OLG model we compare competitive equilibria of two economies, starting

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