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Bequests, control rights, and cost–benefit analysis

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Abstract

Consider a public project that produces a consumption good that benefits future generations. Let a conventional cost–benefit analysis find that it gives higher benefits than projects it would displace in the private sector. Voters may, nevertheless, oppose the public project: the combination of a desire to control bequests and the lack of control over who benefits from a public project makes the public project unattractive. In contrast, private projects have owners, allowing parents to control whether their children will receive the benefits from such projects. Parents can, therefore, better influence the behavior of their children when they have the option of giving the children title to private projects.

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1. Introduction

A large literature discusses the discount rate government should use in evaluating public projects. Most analyses implicitly assume that the same discount rate can be used for projects that impose costs and generate benefits to the current generation as for projects that impose costs on one generation but give benefits to future generations. Programs with such delayed benefits are increasingly important, particularly in environmental policy. Thus, reductions in carbon or CFC emissions impose costs on persons now alive, and will benefit people yet unborn.

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When capital and other markets are perfect, who will be alive when benefits appear is irrelevant. We shall show, instead, that generational differences do matter when considering public projects that yield benefits to a future generation.

Our essential idea is that a parent who wants to induce particular behavior by a child may do so by conditioning a bequest on the child's behavior, and that such inducement is more effective if the parent controls the assets than if the parent spends some assets on a governmentally controlled project.

Consider a parent evaluating a tax increase to fund a government program that would reduce carbon emissions. The program has no immediate effects, but will benefit the next generation. Suppose that standard cost–benefit analysis, which compares the present discounted value of social costs to benefits, calls for undertaking the program. Let consecutive generations, say parent and child, implicitly bargain over how much services the child provides the parent in exchange for a bequest. We shall show that the parent may oppose even a costless public investment that benefits the child. The opposition arises because the benefits of the public project increase the child's income, which is her threat point when bargaining with the parent, and so reduces the parent's utility after the bargaining.

The parent's interest in her child's behavior can be paternalistic. A mother may want her daughter to avoid drug use, marry within the religion, or complete a college degree. Or the motive may be selfish, with a mother wanting her daughter to take care of the mother in her old age. Since the literature has considered in depth the last motive, we shall mostly speak here in terms of it.

Thus, we largely follow Bernheim et al. (1985), Cremer and Pestieau (1991), Cox and Rank (1992), and Cremer et al. (1992) in supposing that parents leave bequests to their children because they want to obtain services (such as care) from their children. We shall also consider limited altruism, with the mother demanding less attention from her daughter, or leaving a larger bequest, than pure selfishness would dictate.

Bernheim et al. (1985) provide strong evidence for the strategic bequest motive, finding in particular that attention to parents by children increases with bequeathable wealth, but decreases with nonbequeathable wealth. A novel element of our analysis is to consider a public project as generating nonbequeathable wealth.

Also consistent with the strategic bequest model, Borsch-Supan et al. (1992) find that children who earn higher wages spend less time with their elderly parents. Laitner and Ohlsson (2001) study Sweden and the United States, finding that parental bequests increase with the parents' lifetime resources, and decline with the earnings potential of the heir. These results are consistent with both an altruistic motive and a strategic bequest motive, but, the authors state, perhaps better fits the strategic bequest motive. Hochguertel and Ohlsson (2000), who examine predeath gifts made by parents, also reach conclusions consistent with the strategic bequest model: in the United States a child is more likely to receive a gift if she works fewer hours and has lower income than her brothers and sisters.

Some recent works, however, question the hypothesis: in the United States children's provision of care to parents is little guided by a strategic bequest motive (see Perozek, 1998 who, unlike Bernheim et al., 1985, controls for the number of children in a family, and Sloan et al., 1997, who study the amount of time children devote to disabled elderly parents).

The strategic bequest motive appears far stronger outside the United States. Horioka et al. (2000) compare the responses of survey respondents in the United States and Japan. In