

# The Family and the State\*

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## 1 Introduction

Children are immature. They are not mentally developed, so they can't marry, they can't have contractual agreements, have to have caretakers etc. That's why laws protect them. Child abuse is punished etc.

We always want efficiency. A criterion for efficiency is that the monetary gains to those benefiting from a deviation do not exceed the monetary loss to those harmed. Unfortunately, children's immaturity sometimes makes efficient arrangements between children and parents harder. This difficulty in establishing efficient relations within families let us introduce the interpretation of the heavy state involvement in the family. We believe that many regulations of the family by the state, improve the efficiency of family activities. These regulations raise the welfare of children, but they also raise that of the parents, or at least raise the combined welfare of parents and children.

The efficiency perspective implies that the state is concerned with justice for children, if "justice" is identified with the well-being of children. But it does not imply, however, that the effect on children alone determines whether the state intervenes. The effect on parents is considered as well. The state tends to intervene when both gain or when the gain to children exceeds the loss to their parents.

We cannot prove that efficiency guides state involvement in the family, but we will show that state interventions in the market for schooling, the provision of old-age pensions, and access to divorce are consistent on the whole with the efficiency perspective.

## 2 Altruism Toward Children

We assume that large majority of parents are altruistic to their children in the sense that parental utility depends on the number of children and the utility of each child as well as on their own consumption.

Sometimes cited against the importance of parents' altruism is that parents seldom insure the lives of their children. However, optimal insurance works to equalize the marginal utility of income in different states of the world. Support for the importance of altruism comes from the time and effort parents devote to lowering the probability of accidents, illness, or other harm to children. These "self-protection" activities respond not to the effect of a child's mishap on the marginal utility of parents' income but, rather, to their effect on the level of parents' utility.

The analysis says that frequent contact among members often raises the degree of altruism. Thus altruism may well have some of the properties of an addictive taste that is fostered by its consumption. This explains the fact that parents leave larger bequests to children who visit them more frequently.

The "rotten kid" theorem says that under certain conditions, both altruistic parents and their selfish children work out efficient relations that maximize the combined resources of the family as a whole. Then state interventions are not necessary.

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\*There was no single equation in this paper

This theorem fails when parents do not give children bequests. They may not give because their altruism is weak, but even if their altruism is strong, they may not give when they expect their children to be much better off than they are (when economic growth is rapid etc).

### 3 Investments in the Human Capital of Children

Even parents who are altruistic have to consider the trade off between investing in children's human capital and decreasing their own consumption. But if they can leave bequests, they can avoid this trade off since the bequests will help finance their investments in children. Altruistic parents who leave bequests will invest until the marginal rate of return on human capital equals the rate of return on assets. If the marginal rate of return on investments in children exceeds the rate of return on assets accumulated over the life cycle to provide either old-age consumption or gifts and bequests, parents who give gifts and bequests could invest more in children without lowering their own consumption by accumulating fewer assets.

When the rate of return on savings is less than the marginal rate on human capital, both parents and children can be better off with a "contract" that calls for parents to raise investments to the efficient level in return for a commitment by children to repay in future. But children cannot make such contracts. So this is where government comes in. State intervention in the provision of education and other human capital would raise investments in children to the efficient levels (example: compulsory schooling).

But it might work in the other way. Children who expect gifts in the future might save less and increase current consumption, since they know that the parents will help them out. Children might not work hard in school since they know that parents will support them if their earnings were lower. To prevent those inefficiencies, parents could pre-commit the amount of future gifts.

### 4 Social Security and Other Old-Age Support

At the end of the day, children help their parents.

Richer families who leave bequests rely less on their children. They can reduce bequests to finance consumption when they live longer than expected etc. So the opportunity to draw on bequests provides some kind of protection for the parents. But children will support them anyways.

Children in poor families will support parents who agree to invest the efficient amount in the children's human capital. Though the agreement is not in a form of "contracts", it is usually a social "norm". Public expenditures on the elderly, and public expenditure on children's education can fill the void if the norm breaks down (in a modern society, or in cities).

### 5 Divorce

Altruistic parents who do not leave bequests might divorce, even when they know that the children will get hurt. The reason is that the children do not have a credible way to "bribe" their parents to stay if they cannot commit to old-age support or other future transfers to parents contingent on the parents not getting a divorce.

The story is different for parents who leave bequests. If divorce does not change the degree of altruism toward children and if a divorce only affects future earnings and the value of other tradable resources, then children would also be made better off if their parents decide to divorce. Parents raise their gifts and bequests to compensate children for any losses from the divorce. This is an implication of the rotten kid theorem.

But children might still suffer if the divorce reduces the non-tradable goods consumed by children (children gets sad). And if the effect on non-tradables lowers the marginal utility to children of tradable resources, altruistic parents who divorce would reduce their gifts of tradables, which will make children still worse off.

As shown earlier, degree of altruism responds to the frequency of contacts between parents and children. So after the divorce, divorced father might become less altruistic, and reduce support payments, which will make children even worse off.

So divorce generally makes children worse off. That's why in many countries, governments used to restrict divorce when parents had many children. But now, in the modern society with less children, the restriction has become much loose.

## 6 Optimal Population

We now depart from the relationship between parents and children, and consider parents and potential children. Suppose that a potential child could commit to compensating his parents if he was born. This "contract" is Pareto improving, if the child would prefer to be born. But since such contracts are impossible, some children may not get born even when both parents and children could be better off. Thus both fertility and population growth are too low when compensation from unborn children to their parents would be Pareto improving.

But for parents who leave bequests, compensation lowers the utility of parents. Compensation from potential children will reduce net gifts to these children. But parents don't need those compensation to reduce gifts, since they can reduce bequests in any case if they choose to do so. So families with bequests do have the Pareto-efficient number of children. And compensation from unborn children will make parents worse off.

We know that poor families are less likely than richer ones to leave bequests. So we can say that fertility in poorer families are too low from optimal, and fertility in rich ones are optimal. Thus the aggregate private fertility rate is below the Pareto-efficient rate. This might sound strange since poor families have lots of children. But other factors may be causing large fertility rates of poor families, such as welfare, subsidies etc.

## 7 Political Competition Between Generations

Children cannot vote, so parents dominate the political power. So it is possible that old generations exploit future generations. But altruism limits their desire to do so. Altruistic parents, both who leave bequests and who do not, can use their political powers to raise education and other trainings, and if they wish, they can issue obligations to future generations that extract this increase in children's wealth.

Selfish parents might want to extract as much as possible, but altruistic parents will want to share some of the increased wealth with children. This means that future generations may also benefit from the political power of present generations.