Government as a super Becker-altruist:  
A reply

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R. Peter Terrebonne's 'Comment' purports to clarify 'some confusion that has surfaced' in my 1979 paper. Actually his analysis deals with a fundamentally different matter, though both are direct products of Gary Becker's seminal work (1974, 1976). The distinction merits explicit recognition.

My paper studied 'simulated altruism' in the sense that each person in a group linked by an altruist's transfers would forego self-aggrandizing actions which lower the group's total income. I demonstrated that Becker's model yields such simulated altruism only over a restricted set of possible actions. These restrictions were analytically clarified. Finally it was noted that Becker-type incentives for such simulated altruism would apply globally if some authority had the power to tax and transfer to maximize a utility function defined over individual consumption bundles.

In contrast, Terrebonne's 'Comment' deals with reciprocal altruism in which an egoist voluntarily transfers resources to the altruist in order to receive in return a transfer of goods which would yield a net increase in his utility. This is 'simulated altruism' in a very different sense.

Addressing this second form of simulated altruism in the context of a production-exchange economy, Terrebonne does contribute some useful points. He explains that altruism will always involve resources rather than goods and that reciprocal altruism would not arise, if the altruist produces goods at a higher per-unit resource cost than does the egoist. Less self-evident is his derivation of the conditions under which reciprocal altruism could occur when relative productivity favored the altruist.

One basic feature of Terrebonne's model is troubling, with important implications for the theory of altruism and charity in general. Using a simplified model involving constant per-unit production costs, Terrebonne's results embody an extreme form of reciprocal altruism in which the egoist voluntarily yields all of his resources to the altruist, with the latter doing all of the production. Philanthropists from Andrew Carnegie on down would pale in their graves at seeing charity so abused; but this extreme result could easily be eliminated by complicating the model to allow increasing costs and/or a
more realistic utility function. The serious issue is this: Terrebonne posits a mutually beneficial exchange with resources flowing from a less productive to a more productive producer, and goods flowing in return. Yet his analysis excludes any role for market transactions.

In a Crusoe-Friday application of his model this exclusion would be unimportant. The altruist could always find some contrived relative prices to ‘hire’ or ‘buy’ the egoist’s resources, yielding precisely the outcome in Terrebonne’s paper. Terrebonne though does not limit his analysis to such a confined set of circumstances, since he attempts to draw inferences regarding relations between government and citizens. There is something fundamentally curious about inquiring into the conditions under which citizens rationally surrender their resources to government in return for government products, with no hint of public goods considerations. However taking this question as given, Terrebonne’s model must be modified to incorporate the possibility of market exchange. Suppose that the egoists can sell their resources and purchase goods on the market. It is entirely possible that Terrebonne’s conditions for reciprocal altruism are satisfied and yet the egoist might be better off using the market instead to enhance his utility. If so, Terrebonne’s conditions would still be necessary for reciprocal altruism, but not sufficient.

More generally the market can modify altruism and altruism can modify the market. The issue of integrating the two is only most conspicuous in the case of reciprocal altruism wherein mutually beneficial two-way transactions are at the heart of the problem. One interesting aspect of this relationship between markets and altruism can be illustrated in the context of a two person pure exchange model with two goods, $F$ and $G$. Market conditions can be simulated by constraining any exchange outcome to be compatible with competitive behavior – i.e., both individuals must stay on their respective offer curves as defined by their utility functions and pre-exchange endowments. Let person $h$ be an altruist and person $i$ be an egoist with utility functions satisfying:

$$U_h = U_h (F_h, G_i, F_i, G_i)$$
$$U_i = U_i (F_i, G_i),$$

each satisfying the usual properties. In Figure 1, $YZY'$ and $XZX'$ are ridge lines connecting points where $h$’s indifference curves become vertical and horizontal, respectively.

Suppose that the initial endowment is at $A \in YZX$ where a unilateral transfer of $F$ from $h$ to $i$ (by as much as $AC$) will increase $h$’s utility. However the results – the market exchange, the equilibrium relative prices, and the size of the unilateral transfer – all depend upon the ‘institutional’ context: whether the altruist engages in transfers after market exchange is completed; or prior to exchange, irrespective of prices.