ACHIEVING SOCIAL OBJECTIVES THROUGH PRIVATE TRANSFERS
A Review

Donald Cox
Emmanuel Jimenez

Private interhousehold cash transfers are an important source of income in many developing countries. Among the countries whose experience is reviewed in the article, the proportion of all households receiving private transfers ranges from a fifth to a half. The amounts received are large, particularly when compared with the incomes of the poorest households.

Understanding more about these transfers is important for designing policy because, among other things, these remittances provide social and economic benefits similar to those of public programs, such as unemployment insurance, pension support, educational credit, and health assistance. As such, private transfers may supplement or overlap with public transfers, and, if private donors give less as public transfers increase, the effect of public programs on beneficiaries would be less than originally intended. Or the transfers may alter the distributional effects of public programs: for again, if private donors give less as public transfers increase, they share in some of the benefits of public programs.

Private interhousehold transfers are a sizable element of household income and spending in developing countries. Understanding how they work is important for designing policy because the transfers serve a variety of social and economic functions that impinge on the objectives and functions of public programs. Among other things, these remittances provide insurance against shortfalls in income, support for the elderly in retirement, loans for education, help during illness, and the funds for rural-urban migration. As such,
they may supplement or overlap with public transfers, particularly those programs aimed at people who have retired or experienced a decline in earning power.

There are at least two reasons policymakers should be informed about the size and determinants of private transfers. One is that if private donors cut back their transfers as public transfers increase, the effect of public programs on beneficiaries would be less than originally intended. The other is that some of the benefits of public programs would be shared with givers of private transfers.

But private transfers have as yet been little studied, primarily because data have only recently become available. Empirical work is in its early stages, and researchers are finally beginning to analyze motivations for private-transfer behavior.

This article explores fundamental questions about private transfers with a focus on developing countries. How large are private transfers? How important are they for policymakers? Why do they occur? What are the empirical patterns of private transfers? Can we anticipate how such patterns will react to public policy?

The Size of Private Transfers

Table 1 lists information on private transfers for several countries. The definitions of transfers, derived from a variety of sources, are not strictly comparable, but the table does illustrate the importance of private transfers in many countries. For example, among a sample of urban poor in El Salvador, 33 percent reported having received private transfers, and income from private transfers accounted for 39 percent of total income among recipients. Ninety-three percent of a rural south Indian sample received transfers from other households. In Malaysia, private transfers accounted for almost half the income of the poorest fifth of households. Nearly three quarters of rural households in Java, Indonesia, gave private transfers to other households. About half of a sample of Filipino households received private cash transfers.

Rempel and Lobdell (1978) surveyed economic and anthropological studies of urban-to-rural remittances covering countries in Asia, Africa, and Latin America and found significant private transfers in virtually all instances. Remittances accounted for notable fractions of income in Ghana, Liberia, Nigeria, Pakistan, and Tanzania. Furthermore, private transfers are not simply a reflection of rural-urban migration. Knowles and Anker (1981), for example, found that over half of all transfers for a sample of Kenyan households did not cross urban-rural boundaries.

Why Private Transfers Are Important

The evidence in table 1 attests to the magnitude of private transfers, but size or frequency is not sufficient reason to pay attention to them. Transfers are not
Table 1. Private Transfers in Selected Countries

<table>
<thead>
<tr>
<th>Country and segment of population</th>
<th>Year</th>
<th>GNP per capita (1986 U.S. dollars)</th>
<th>Percentage of households</th>
<th>Average transfer amount as percentage of average income</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Receiving</td>
<td>Giving</td>
<td>Receiving</td>
</tr>
<tr>
<td>El Salvador (urban poor)</td>
<td>1976</td>
<td>820</td>
<td>33</td>
<td>11</td>
<td>8</td>
</tr>
<tr>
<td>India (rural)</td>
<td>1975–83</td>
<td>290</td>
<td>93</td>
<td>0</td>
<td>8</td>
</tr>
<tr>
<td>Indonesia (Java) Rural</td>
<td>1982</td>
<td>490</td>
<td>31</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>72</td>
<td></td>
<td>8</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>44</td>
<td>45</td>
<td>20</td>
</tr>
<tr>
<td>Nairobi (urban poor)</td>
<td>1971</td>
<td>-</td>
<td>89</td>
<td>21</td>
<td>-</td>
</tr>
<tr>
<td>Nationwide</td>
<td>1974</td>
<td>-</td>
<td>27</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>Rural</td>
<td></td>
<td></td>
<td>19</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Urban</td>
<td></td>
<td></td>
<td>62</td>
<td>4</td>
<td>-</td>
</tr>
<tr>
<td>Mexico (two villages)</td>
<td>1982</td>
<td>1,860</td>
<td>-</td>
<td>16–21b</td>
<td>-</td>
</tr>
<tr>
<td>Peru a</td>
<td>1985</td>
<td>1,090</td>
<td>22</td>
<td>23</td>
<td>2</td>
</tr>
<tr>
<td>Philippines d</td>
<td>1978</td>
<td>560</td>
<td>47</td>
<td>9</td>
<td>-</td>
</tr>
<tr>
<td>United States</td>
<td>1979</td>
<td>17,480</td>
<td>15</td>
<td>1</td>
<td>-</td>
</tr>
</tbody>
</table>

- = not available.

a. Average income includes the incomes of those who did not receive or give transfers. The average transfer received as a percentage of recipients' income is much larger: 39 percent in El Salvador and 9 percent in Peru. Similarly, the average transfer given as a percentage of givers' income was large: 21 percent in the 1968 Kenya urban sample and 6 percent in Peru. For Peru, the average transfer amount is computed as a proportion of total consumption expenditures.

b. Averages not available; figures denote upper and lower bounds.

c. Number in parentheses denotes percentage for households in lowest income quintile.

d. Cash gifts in a large informal housing area.
determined simply by custom. There are many reasons to expect private trans-
fers to respond to social, economic, and policy influences. And private transfers
pose a problem for policymakers: they could affect the outcome of public pol-
icy in unexpected ways.

Consider a hypothetical pair of households, one young and the other old,
which pool and share their resources, so that the consumption of individual
members is based on the aggregate income of the two. Introducing a social se-
curity program that taxes the younger household and subsidizes the older one
but leaves aggregate income unchanged may leave the consumption of the in-
dividual household members unchanged as well. The policy might have no
effect on the distribution of well-being. If the program involves administrative
costs, both households could be made worse off.

Consider a related problem: evaluating how effective a program of public
health insurance may be in distributing well-being. A simple method is to sub-
tract appropriately valued health benefits from household income and compare
income distribution before and after the subtraction. But in failing to take pri-
vate transfers into account that method might miss the mark: if the program
were genuinely removed, private interhousehold transfers might fill the gap.
A web of private safety nets could offset changes in public transfers. Put an-
other way, public transfers might simply be crowding out private ones; hence
they might be less effective as an instrument of income redistribution than mea-
surement of their initial, direct effect suggests. It is possible that private trans-
fers, without drawing on the public purse, may alleviate poverty more
efficiently than the government can. We return to this point later.

Private transfers can affect calculations of the distribution of income. If a
data set does not include income from private transfers, assessments of dispar-
ity in income calculated from the data would be biased. Inequality would be
exaggerated, for example, if the omitted private transfers flowed from high-
income to low-income households.

Private transfers could also figure prominently in credit markets. These mar-
kets do not work well in many developing countries, partly because of the high
cost of obtaining information and trustworthy collateral, but also because of
government regulation. Private interhousehold transfers may act as an informal
credit market designed to overcome barriers to borrowing. If this is so, policies
designed to increase household access to formal credit markets might prompt
reductions in private transfers. If, for example, parents reduce their lending to
children in school when government educational loans become available, their
private transfers will dilute the effect of the policy.

Finally, private transfers could facilitate labor mobility and household mi-
gration. Again, the presence of private transfers has implications for policy: a
program designed to help workers to respond better to economic incentives,
say, by making rural-urban migration easier, might achieve nothing more than
to reduce or divert private transfers.
Motives for Private Transfers

The motives for private transfers matter because they determine the effect of the transfers on public policy.

Why do people make transfers? Two principal motives exist. The first is altruism. Adults, for example, might give to their parents because they care about them and get vicarious satisfaction from giving. Becker (1974) was one of the first to develop a rigorous economic model of altruism's implications; many researchers (for example, Adams 1980, Tomes 1981, Menchik and David 1983) have used Becker's model to analyze bequests in the United States. But the altruism model has received less attention in the literature on developing countries.

The second main impetus for private transfers is self-interested exchange. For example, family members might help with home production or provide other forms of in-kind support in exchange for financial transfers. Such exchange could be contemporaneous or part of a long-term contract. Cash transfers given today might be repaid, in cash or in kind, in future years. Economists have recently begun to apply the exchange idea in a variety of settings, including household production (McElroy and Horney 1981), private annuity insurance (Kotlikoff and Spivak 1981), and the exchange of cash for in-kind services (Bernheim, Shleifer, and Summers 1985; Cox 1987).

Exchange is implicit in many analyses of family behavior in developing countries. In their survey of the literature on migrants' remittances, Rempel and Lobdell (1978) conclude, "Remittances should be seen as reflecting primarily the self-interest of the migrant" (p. 336). They suggest that remittances might aptly be interpreted as repayments for assistance with migration or as insurance premiums against shortfalls in income. Rosenzweig and Wolpin (1985) explain family-farm dynasties as the outcome of intergenerational contracts that maximize gains from knowledge about farm characteristics. Kaufmann and Lindauer (1986) view private transfers as the outcome of an implicit social insurance contract among a network of related households, with transfers to temporarily disadvantaged households acting as insurance payments.

Lucas and Stark (1985) eschew the strict dichotomy between altruism and exchange in favor of an eclectic framework that recognizes each motive as "tempered altruism or enlightened self-interest" (p. 901). Family members enter into insurance contracts to protect against individual shortfalls in income, and mutual altruism helps enforce the contracts. But Cox and Jakubson (1989) show that often, even if transfers are influenced by both motives, only one predominates in any given instance.

Motivation matters because it determines the outcome of redistribution of public income. The altruism model predicts that public transfer programs have little effect on the distribution of economic well-being; exchange-motivated transfers interact with public transfers in an entirely different way.
When altruism is at work, changes in public transfers are simply offset by corresponding changes in private ones. To see why this occurs, consider the main premise of the altruism model. The donor gives in order to experience indirectly the increased well-being of the recipient. The donor calculates total pretransfer income and, based on his or her feelings of altruism toward the dependent, determines how much they both will consume by making a private transfer.

Now suppose that a public transfer program taxes the donor and gives the proceeds to the dependent. The combined income of the spending unit (defined as donor plus dependent) has not changed, and neither, presumably, has the donor's attitude toward the dependent. So the donor's calculation of optimal consumption for both donor and dependent will not change. All that has changed are the individuals' incomes before the private transfer. The donor need not make as large a private transfer to attain the desired consumption for the dependent. The effect of the public transfer program is completely offset by changes in private transfers.

Of course, not all public transfer programs leave the aggregate income of the spending unit unchanged. Furthermore, such a program might give the dependent more than he or she would have received privately. Also, many households neither give nor receive private transfers, and in these instances there are no private transfers to be displaced by public ones. Each of these considerations moderates the crowding out of private transfers. Still, the altruism model predicts that if altruistic private transfers occur, they diminish the effect of redistribution of public income.

In an extremely influential article, Barro (1974) uses an altruistic framework to show how private transfers can undo the forced intergenerational transfers associated with deficit spending and social security. His analysis predicts that, with operative private transfers, the national debt will not hurt future generations because older ones will leave higher bequests, so that deficits matter little for either generation. A similar argument applies to social security: public transfers from young to old merely reduce private ones. Again, altruism is necessary for these results.

Exchange-motivated transfers, by contrast, can actually amplify, rather than offset, the effect of redistributive policies, such as social security payments, on the well-being of recipients of private transfers. Consider the following contrived but illuminating example. Suppose a donor makes private transfers in exchange for in-kind services (for example, home production). The donor happens to transfer to the recipient an amount equal to what the latter would have received at the hourly market wage rate. Now consider the effect of taxing the donor and subsidizing the recipient’s wage. The first-order effect of this scheme is the same as if there were two unrelated individuals: that is, the donor is made worse off and the recipient better off. But a second-round effect occurs: the donor must pay higher compensation for the recipient’s services. This detracts
further from the donor's well-being and adds more to that of the recipient. This amplification is exactly the opposite of that predicted by the altruism model.

Knowing the motives behind a private transfer is essential for understanding the connection between public and private transfers. The connection is important since nearly all public policies, including those that focus on the economy's general performance, redistribute income from one group to another. A large fiscal deficit, for example, shifts income from future generations to the present one. The motives for private transfers determine the effect of deficits on the relative well-being of generations.

Evidence on Private Transfers

Empirical evidence on patterns of private transfers indicates a variety of functions and effects: they narrow income inequality; function as social insurance; ease constraints on borrowing; contribute to investment in human capital (such as schooling and migration); and interact with public transfers. As for motives, the evidence is mixed. Some functions and effects can be explained by altruism alone, others by exchange. Some could be generated by either motive or a combination of the two.

Transfers and Inequality

Private transfers tend to even out income inequality. In particular, they tend to boost the incomes of the poorest households: for example, private transfers increase incomes of urban households in the lowest quintile in Kenya by 90 percent (Knowles and Anker 1981); they raise the lowest quintile's share of aggregate consumption by 14 percent in Peru (Cox and Jimenez 1989); and they have a substantial equalizing effect on incomes in the two Mexican villages analyzed by Stark, Taylor, and Yitzhaki (1986). Private transfers also narrow the range of incomes in the United States (Cox and Raines 1985). And the evidence is strong that higher-income households do give more transfers (Johnson and Whitelaw 1974 and Knowles and Anker 1981 for Kenya, Ravallion and Dearden 1988 for rural households in Java, Cox and Jimenez 1989 for Peru, and Cox and Raines 1985 for the United States), whereas lower-income households are more likely to receive transfers (Cox and Jimenez 1989 for Peru, Cox 1987 for the United States).

An effect that contributes to equity would, on the face of it, suggest altruism as the impetus, and the pattern of rich giving to poor is certainly consistent with this motive. But a closer look at patterns of transfers indicates that altruism may not, in fact, be the dominant motive.

First, the pattern of rich giving to poor could be stimulated equally by an exchange motive. Suppose, for example, that financial transfers purchase in-kind services. If the demand for services is income elastic and the supply price
of services is inversely related to income, a pattern of rich giving to poor emerges (Cox 1987).

Second, the simple direction of transfer, from rich to poor, is not a discriminating test for motivation. A better test comes from the relation between the recipient's pretransfer income and the transfer amounts received. The two hypotheses, altruism and exchange, can part company when it comes to this relation. The altruism model predicts that it is always negative. A shortfall in the recipient's resources, for example, always prompts more generous transfers. But the exchange model admits a positive relation between the two variables. Higher income strengthens the bargaining position of recipients in exchange, so that when their income increases, they can get higher transfers.

The empirical evidence on this crucial relation is mixed. Some studies find an inverse relation between recipients' resources and transfer amounts received (for instance, Kaufmann and Lindauer 1986 for El Salvador, Kaufmann 1982 for the Philippines, Ravallion and Dearden 1988 for rural households in Java, and Tomes 1981 for bequests in the United States). But others (Lucas and Stark 1985 for Botswana, Cox 1987 for the United States, Ravallion and Dearden 1988 for urban households in Java, and Cox and Jimenez 1989 for Peru) find a positive relation, which contradicts the altruism hypothesis. In casting doubt on altruism, the latter findings also call into question the Barro-Becker hypothesis that public transfers merely crowd out private ones.

**Transfers as Social Insurance**

Private transfers can insure against reductions in earning potential related to illness, disability, unemployment, and old age. This insurance function may be particularly important when publicly provided social security programs are inaccessible, as is often the case in many developing countries. What is the evidence?

**OLD AGE SUPPORT.** Although many developing countries have public pensions, most of these apply only to urban workers in the formal sector. So, except in some urbanized countries (mostly in Latin America), coverage is limited. The problem is compounded by underdeveloped financial markets, which lower the returns from saving for retirement (World Bank 1989). Older generations have to rely on the young for supplements to their income.

Patterns of transfers are consistent with the notion that transfers provide support in old age. More than a quarter of private transfers in Kenyan and Peruvian samples were given to parents by children; in Peru, more than a third of the elderly (age sixty-one and over) received transfers—more than twice the comparable figure for those age forty-one to fifty (Knowles and Anker 1981, Cox and Jimenez 1989). Butz and Stan (1982) and Ravallion and Dearden (1988) found significant transfers from young to old in Malaysia and Java,
respectively. As earnings decline late in life, the probability of receiving a private transfer dramatically increases (see figures 1 and 2).

Indeed, some argue that, in developing countries, support in old age is the main reason for having children. Nugent's (1985) review of the literature on support in old age and fertility documents much controversy, but most evidence indicates that decisions on having children are motivated at least partly by the desire to insure against the uncertainties associated with old age. Support from children in old age includes time-intensive care in addition to money (see Butz and Stan 1982).

These findings support the observation that the desire to provide for support in old age is a strong motive for private transfers. They are not conclusive, however, because the same patterns could be generated solely by inadequacy of capital markets: that is, if financial markets were adequate, people would rely on investing in them, rather than in private transfers, to provide for their old age.

**DISABILITY, ILLNESS, AND UNEMPLOYMENT.** Some empirical evidence suggests that private transfers ameliorate the effects of being disabled, ill, or
unemployed. In Peru, households reporting illness four weeks before the survey were more likely to have received private transfers. Transfers apparently respond to the availability of publicly subsidized medical care. In Indonesia, donors assist the sick and those with newborns in rural but not in urban areas, where public health clinics are more accessible (Ravallion and Dearden 1988). High-quality public health coverage also weakens the connection between private transfers and illness in Peru (Cox and Jimenez 1989).

In Peru, being ill raises the chances of getting a transfer, but the amounts are lower than those received by healthy counterparts. Exchange is a possible explanation. Illness would limit the quality of in-kind services heads of households provide for others, which would reduce exchange-related transfers. Households with unemployed members are more likely to receive transfers and receive them in greater amounts. In Peru and in Indonesia, being unemployed significantly increases the probability of receiving a transfer, as well as the amount of the transfer (Cox and Jimenez 1989, Ravallion and Dearden 1988).
FEMALE-HEADED HOUSEHOLDS. A consistent pattern across countries is that females or female-headed households are more likely to receive transfers, and in larger amounts than their male counterparts (Salvadoran households in Kauffman and Lindauer 1986, Botswana individuals in Lucas and Stark 1985, Peruvian households in Cox and Jimenez 1989, U.S. households in Cox 1987). This result is due not merely to the fact that female-headed households are poorer: even after holding constant for current income—comparing transfer amounts across households with similar income levels—the effect persists. Why?

One reason is simply that females tend to live longer than males and may get more of the old-age transfers. Another reason may be that private transfers compensate females for discrimination in the formal labor market. Although the female effect is strong even with current income held constant, the transfers may compensate for past discrimination. Also, if discrimination holds females back from the formal labor market, they may engage in other activities that entail transfers but are, in reality, payment for services rendered—such as child rearing or fosterage (Ainsworth 1989).

Migration and Education

Another connection between private transfers and risk, analyzed extensively by Lucas and Stark (1985), is migration. Households can minimize risk by diversifying their portfolio of jobs. A rural family, for example, might send a family member to the urban formal sector to insure against shortfalls in income arising from poor harvests. Lucas and Stark find migrant remittances are targeted to farms with riskier (for example, drought-sensitive) assets. Rosenzweig (1988) finds that Indian households insure against shortfalls in income arising from bad weather by being linked to geographically distant kin.

Migration, however, does more than lessen risk. Like education and training, it is an investment in human capital. Such investment is most profitable when done early, so that improved skills can be used over a long time span. But constraints on borrowing are likely to be most severe in the early stages of life. Private transfers can facilitate investment in skills by helping to overcome such constraints.

Observed patterns of transfers support the idea that private transfers are connected to investment in human capital. In Peru, for example, the incidence of transfer receipts among the young (age fifteen to thirty) is twice that among the middle-aged (age forty-one to fifty)—28 as opposed to 15 percent (Cox and Jimenez 1989). Moreover, those with more advanced schooling receive much higher amounts than those with a primary education.

Furthermore, private transfers appear strongly responsive to constraints on borrowing. In Peru, the incidence of transfers mirrors exactly the profile of
earns at various ages: the chances of receiving a transfer are lowest when
earnings peak (see figures 1 and 2). Evidence from the United States supports
the idea that transfers are targeted to people who face constraints on borrowing
(Cox 1990, Cox and Jappelli forthcoming).

Public Policy and Private Transfers

The few available studies suggest a strong connection between private and
public transfers. Cox and Jimenez (1989) find that private transfers from young
to old in Peru would have been 20 percent higher without social security pen-
sion benefits. Peruvian social security health benefits dampen private transfers
as well. Cox and Jakubson (1989) find that private transfers would have been
14 percent higher in the United States without public income transfer pro-
grams.

These estimates are lower than the complete crowding out predicted by
Barro and Becker but seem large enough to warrant interest among policy-
makers. They are particularly important for developing countries in which
tight budgetary constraints and adverse macroeconomic conditions have forced
governments to look for more efficient means of undertaking social programs.
Unfortunately, the relation between public and private transfers in developing
countries has received very little attention. It is an important area for future
research.

Private transfers in developing countries are widespread and responsive to
social and economic conditions, but evidence on the motives for them is mixed.
Economic theory suggests that private transfers should also respond to public
policy, and initial empirical work shows that they do.

The direction, functions, and effects of private transfers, such as the follow-
ing, indicate that they could be an important element of social and economic
policy design:

• Private transfers equalize income.
• Private transfers are directed toward the poor, the young, the old, women,
  the disabled, and the unemployed.
• Public tax and subsidy programs can affect private-transfer behavior.

What lessons can be learned from this research? First, policymakers should
realize that many social objectives are already being met through private means
without reliance on the public purse. Second, government subsidies may have
less effect than originally intended if they displace public transfers. Although
the empirical evidence does not support the view that private transfers could
completely offset public transfers, the dampening effect is not trivial. Third,
the benefits of a public transfer program may be shared by private donors if
they feel they can give less than before.
The implications for policy are important; when private behavior adjusts, there may be unforeseen or unintended implications for public transfer programs with respect to who benefits and by how much. Additional research is needed to complement and substantiate the few available studies if these private adjustments are to be used to make public policy more effective and efficient.

Note

Donald Cox is an associate professor of economics at Boston College. Emmanuel Jimenez is a senior economist in the Country Economics Department of the World Bank. Fiona Mackintosh provided editorial assistance.

References

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