Vouchers and the Provision of Public Services

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Foreword

Over the past few decades, the use of vouchers for the delivery of public services has proliferated. They are now used in many programs—including food stamps, housing assistance, and grants for higher education—that, while well known, are seldom identified as voucher programs. Other programs, such as Medicare and primary and secondary education, are experimenting with vouchers. Some of these experiments have been controversial. In fact, the word *voucher* has often taken on positive or negative connotations in political debates without there being any dispassionate examination of the merits of using vouchers versus alternative approaches to delivering particular public goods or services.

This volume provides the most comprehensive examination available of the use of vouchers. While many past studies have focused on the use of vouchers in a single service area, this book examines a wide variety of applications in such areas as education, child care, employment training, housing, food, and health care. The studies in this volume discuss the dimensions along which vouchers should be compared to alternative delivery mechanisms and analyze the social, political, and economic conditions that might make vouchers an effective mechanism for delivering services. Our hope is that certain lessons can be drawn from the use of vouchers in one service area and applied to others.

The idea for this set of studies was born when William Beeman, then a vice president of the Committee for Economic Development, observed that economics and public finance textbooks paid scant attention to vouchers; if they did, it was only in reference to school vouchers. The Brookings Institution, the Urban Institute, and the Committee for Economic Development decided to launch a collaborative effort to fill this void.

Initial drafts of the chapters in this volume were presented at a conference on October 2 and 3, 1998. At that conference, the authors benefited from the comments of Ophelia Basgal, Gordon Berlin, David Breneman, Steve Carlson, E. J. Dionne Jr., Christine Ferguson, Carol Graham, Jane Hannaway, Ron Haskins, Elliot Mincberg, and Lester Salamon. Mike Petro and Chris Dreibelbis of the Committee for Economic Development and Kathleen Elliott Yinug of Brookings were instrumental in organizing the conference.

Producing a volume with so many authors from so many institutions proved a Herculean task on the part of many individuals. Gary Kessler was patient and methodical in editing the manuscript, Inge Lockwood proofread and Shirley Kessel indexed the pages, and Janet Walker shepherded the volume through the production process at the Brookings Institution Press. Andrea Barnett, Joe Pickard, and Chris Spiro of the Urban Institute provided invaluable administrative and research assistance throughout the project.

The views expressed in this book are those of the authors and should not be ascribed to any of the persons acknowledged above or to the trustees, officers, or other staff members of the Brookings Institution, the Urban Institute, or the Committee for Economic Development.

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Washington, D.C.
May 2000

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PART ONE

Framework

C. EUGENE STEUERLE

1 *Common Issues for Voucher Programs*

IN RECENT years vouchers have come to be used pervasively in most modern economies. Yet debates over different types of vouchers often proceed in isolation, as if no learning can be applied from one area to another. These debates can even take on an ideological fervor. Considered as a tool of public policy, however, a voucher is ideologically neutral and can be compared to other components of a tool chest—helpful for some purposes, less appropriate for others. Even where potentially useful, there may be alternative tools that may be applied to the task, while the voucher itself comes in all sizes and shapes. Put another way, a voucher is simply a means of subsidy or payment, it can be designed in an almost infinite (although bounded) number of ways, and it is always a means to an end, not an end in itself.

Consider the range of services and goods to which vouchers are applied: food, higher education, primary and secondary school education, housing, employment and training, child care, and medical insurance for the nonelderly and for the elderly are among the best-known. But vouchers are also made available for such items as low-flush toilets, taxi rides for the intoxicated, food for panhandlers, neutering of pets, and much else. (For a more comprehensive list, see the chapter by Paul Posner and others). This wide range implies that vouchers are here to stay but does not speak to their merit relative to alternative means of the dispersing of funds. Moreover, it does not help explain why in one area there will be furious controversy over their use, while in another there will be little disagreement at all.

This chapter provides an overview of issues that tend to arise in voucher programs and proposals—more in some than in others. Some of these issues will be addressed in more depth in other studies in this book. Because of its overview nature, this chapter does not attempt to ascertain the relevance or applicability of vouchers to any one area nor to catalogue their availability.

Definition and Boundaries

To begin with, a definition of a voucher is necessary: *a voucher is a subsidy that grants limited purchasing power to an individual to choose among a restricted set of goods and services.*[1] Some elaborations are in order:

—A voucher can give purchasing power to an individual directly or indirectly. While food stamps may be given directly to an individual to spend at a grocery store, for instance, a housing voucher might be paid indirectly through the rental housing owners as long as the subsidized individual is given some choice of where to live. In effect, the payment itself may be made to either the consumer or the provider. The flow of payment tells us little about where the incidence of the benefit lies.[2]

—A voucher can be in the form either of an expenditure or a tax subsidy. A housing voucher, for example, can be designed as either a direct grant or a tax credit. Issues of administration, such as the ability of tax authorities to administer a subsidy for those with no tax liability, may affect whether a program should be *designed* as an expenditure or tax subsidy but not necessarily whether it should be *defined* as a voucher.

—A voucher is normally limited or capped as to how much an individual can spend. It is often set at a particular value, for example, $50 a month for food stamps. Thus an open-ended subsidy, such as a traditional Medicare policy that could cover any and all qualifying medical expenses without limit, does not quite fit the definition. Because it provides a choice of providers to subsidized individuals, however, traditional Medicare is very close to a voucher, and capped vouchers are now offered within Medicare as an alternative to the traditional package of benefits. (See the chapter by Robert Reischauer as well as that by David Bradford and Daniel Shaviro.) Up to the capped amount, however, a voucher can be designed to have copayment rates or deductibles or otherwise cover only a share of costs.[3]

—A voucher both *prescribes* and *proscribes*. On the one hand, the subsidized consumer must have some choice of providers of goods or services (for example, of apartments, schools, or medical plans). Depending on the voucher, providers can be public or private, profit seeking or nonprofit. On the other hand, a voucher restricts the types of goods and services that can be purchased: housing vouchers cannot be spent on clothing; a combined housing and clothing voucher cannot be spent on education. (For a discussion on combined, or "bundled," vouchers, see the chapter by Robert Lerman and C. Eugene Steuerle.)

The range is wide within these boundaries. Vouchers are well suited to provide an intermediate level of choice. Thus choices are proscribed to remain within a particular set, but within this set the consumer has a fair amount of freedom. At one extreme, choices might be extraordinarily restricted. For instance, a voucher might be (and one actually is) provided for food items available in only one cafeteria. At another extreme, a voucher could be provided for almost everything consumable except, say, vacations and alcoholic beverages; for all intents and purposes (other than administration), this latter style of voucher would be almost equivalent to cash.[4] Policymakers, of course, should set boundaries for a program according to goals and principles, not according to whether it will, by definition, be called a voucher.

—All voucher programs are accompanied by regulation, although not necessarily by more or less regulation than would accompany alternative programs. The government always regulates what it subsidizes. While vouchers are often designed to involve less regulation than direct provision of the same goods and services, they tend to regulate more than cash subsidies do.

Government regulations apply to both consumers and producers. Eligibility rules, for instance, determine which consumers can be subsidized and how changes in their behavior (for example, movement to another jurisdiction, attainment of income through work or marriage) might affect their qualification. Suppliers are regulated in the goods and services they can provide (for example, only certain types of food) and in their quality (for example, child care provided in certified settings, education at accredited institutions).

Goals

Most of the discussion of vouchers, whether academic research, policy analysis, or political assertion, tends to address one or two goals only. The selection of goals and the ability of a voucher to meet them tend to vary significantly from one voucher program to another. By scanning the types of goals typically articulated—revealed preferences of a sort—a good deal can be learned about the relative concerns that prevail in the policy process and whether alternative mechanisms are likely to be considered. Almost all of these goals relate to issues of efficiency or equity, broadly defined. Among the goals commonly associated with vouchers are the following:

—*Choice and efficiency.* "Choice" is often the first buzzword that comes up when the potential advantages of vouchers are being discussed. Among policy analysts the emphasis is on improving efficiency by avoiding or reducing the regulation of individual purchases. In choosing, individuals will get greater satisfaction or value if they can decide how to spend a given amount of money in accord with their own preferences. This is the base on which much of the economic theory of the household proceeds.

Sometimes efficiency gains are measured not by the value added by additional options for consumers, but by the cost of production, such as lower cost per unit of output or lower cost for the same "amount" of output. For example, greater efficiency in education might lead to greater levels of "learning" for the same cost or the same level of learning at a lower cost.

Greater freedom of choice may also encourage more competition among suppliers. For example, suppliers of housing may have to compete more if they must regularly face the demands of consumers than if they obtain once-for-all contracts (for example, to construct some permanent housing in particular locations).

Quality improvements are one way that efficiency might be obtained. In his chapter, Robert Reischauer suggests that voucherlike managed-care options under Medicare were favored by some who believed these options would improve the quality of medical care provided.

—*Choice and equity.* While the efficiency aspects of choice are quite appealing, the public—perhaps even more than researchers and analysts—is often attracted by what it considers to be "fair" or equitable. However, efficiency and equity concerns often run in parallel. For example, the rich can easily choose what school their children attend, either by moving across jurisdictions or by simply paying for private school. "Why can't others also have this choice?" the fairness argument goes. A counterargument is that the benefits of choice will not, in practice, inure to those who need help the most, but this again is posed as much as an equity as an efficiency argument. (See the discussion below on adverse selection and on consumers' ability to choose.)

The equity issue comes up in different ways in voucher programs. For example, vouchers for primary and secondary school students are still largely experimental. (For a discussion of these experiments, see the chapter by Isabel Sawhill and Shannon Smith.) Voucher proposals have often succeeded or failed in state legislatures according to the degree to which these equity arguments were persuasive. Indeed, in his chapter in this volume, Burdett Loomis emphasizes that vouchers sometimes bring about coalitions of conservatives who argue for efficiency and liberals who argue for equity, especially for low-income students. The chapter by Arthur Hauptman similarly indicates that access as a matter of equity has displaced quality and efficient choice as a primary goal of higher education vouchers. In the case of child care, some argue that it is unfair to pay neighborhood providers but not grandparents, so grandparents are also made eligible on this equity (as well as efficiency) criterion. In housing programs, it is sometimes deemed unfair (and inefficient) not to permit public housing occupants to take their subsidy to move closer to work or to a better school. Indeed, the chapter by George Peterson notes that vouchers have been used, as a matter of justice or equity, to comply with court-ordered desegregation.

While equity and efficiency arguments are often mutually reinforcing, they may be at odds when efficiency of choice is allowed to create greater disparities in outcomes among recipients. Choice, for instance, can reallocate a greater share of benefits to the more knowledgeable of recipients. Sometimes choice may be sold as a matter of equity but may not efficiently reach that goal if the symbolism has no substance. For example, some individuals may have little choice with a voucher if they lack mobility and knowledge. (See the chapter by Loomis.)

—*Increased competition.* Sometimes vouchers are favored as a way to improve efficiency through more competition among suppliers than is thought to prevail under public provision, especially where there are public monopolies.[5] Where entry of new providers is feasible, vouchers may allow alternative types and quantities of services to be provided. For example, public schools might behave in a monopolistic fashion if the majority of parents are deterred from using alternative providers by prohibitive costs. (One needs to be careful here to distinguish just what characteristic of the good or service is considered worrisome. For example, some parents may not be concerned about teachers but about disruptive settings or uninviting physical structures.) Using an alternative private provider is expensive to the individual if he or she must give up the full value of any public subsidy when turning to a private provider, as in the case of many national health care systems outside the United States and in public education in the United States. As yet another example, housing vouchers may have reduced the power of small groups of construction companies that might have dominated the bidding market for building public housing. At least in theory, housing vouchers could make it more difficult for powerful groups to use anticompetitive zoning restrictions to force subsidized persons to live in selected areas.

The goal of increased competition as a mechanism for enhancing efficiency and equity does not necessarily mean the absence of public providers. Vouchers can exist side by side with publicly provided goods and services, as in the cases of Early Start education and child-care vouchers, or of public housing and housing vouchers. Competition may be enhanced, especially if public and private provisions are subsidized roughly to the same degree and under the same rules.

—*Replacement of other programs.* With significant government presence in a wide variety of social areas, it should not be surprising that new vouchers are often favored—or opposed—not so much on what the voucher may do per se but whether it will be more efficient or equitable than some already established program. It is doubtful, for instance, that opposition to vouchers for primary and secondary education or for capitated payments (limited payments per person or illness) to managed-care institutions under Medicare would be so strong if there were no existing public school or Medicare system. By the same token, vouchers especially come into the limelight as a possible public policy tool when an existing institutional structure for transferring benefits is viewed as inadequate. Here the voucher is often viewed as potentially improving quality, rather than the quantity, of the good or service involved. Thus housing vouchers have been favored as a substitute for public housing for some time now by many liberals and conservatives and by Republican and Democrat presidents alike.[6] Primary and secondary school education vouchers are more controversial, but they, too, are suggested primarily in contrast to public education as it is currently provided.[7] Often only limited comparisons are made in the public debate. For example, a debate over replacing public housing construction with housing vouchers will often dodge the question of whether a subsidy only for housing might be more efficient if it could be spent on education as well.

—*Restriction of choice, or proscription along with prescription.* By the very act of designating a voucher for a specific set of goods and services, policymakers formally restrict what can be bought. Thus vouchers are often intended to restrict the ability of recipients—especially of those on public assistance—to spend their money on items thought less needed or desirable by the majority of voters, legislators, or taxpayers. For example, assistance to low-income individuals might be provided for food but not for recreation. This makes a voucher a two-edged sword.

Why does proscription typically accompany prescription? Efficiency in the broadest sense requires considering both those subsidized and those who are subsidizing—considering preferences of donors as well as those of recipients and considering whether the actions of recipients produce external costs or benefits for others, whether donors or not. Those who are paying may prefer to provide basic or "merit" goods and services such as clothing, food, or other necessities of life more than other goods and services. A balancing act between preferences of recipients and concerns of taxpayers, therefore, is required.

Often the concern for transferors' interests goes under the general heading of "paternalism": those providing assistance, like parents, restrain the choices of the recipient for his or her own good. But in another sense the efforts may be nothing more than attempts to target specific needs and adopt the most efficient method of achieving an equity goal. For example, if the goal is to alleviate poverty—defined as some minimal standard of consumption—then items of consumption not in that standard are not meant to be subsidized.

Similarly, the target of many programs is to get the necessary goods and services to different members of a household even though the payment may be made through one member only. Concentrating assistance on food, housing, and medical care tends to restrict the ability of adults to garner welfare benefits for themselves rather than for their children. Thus proscriptions on use can also be considered administrative devices to ensure that the subsidies go to intended beneficiaries.

Once again, the coin has an equity, as well as an efficiency, side. It might be deemed unfair for the child in one poor family to get less food than a child in another poor family if parents differentially spend assistance on items that are not necessities. Or transferors who pay taxes and live under a tight budget may deem it unfair to be taxed to provide higher levels of subsidized recreation to transferees. Or it may be considered only fair that the young children of a single parent who is required to work receive necessary adult supervision (through child-care vouchers) during the day. Or more equal access to higher education (through educational vouchers) may be considered a matter of equality of opportunity for those with fewer resources, whereas cash or even food assistance to young adults without children does not meet this same equity standard.

—*Budget control.* Vouchers can be and often are designed to provide budget control. A voucher grants a "limited" subsidy to each individual, and typically the maximum is an exact dollar value (for example, food stamps) or a maximum subsidy (for example, rental assistance) placed on the voucher itself. These limits usually give legislatures control over growth in costs over time, at least on a per-recipient basis. Contrast this with programs that are open ended in the sense of allowing new goods and services to be provided continually, or higher prices to be charged, without requiring further decisions by sitting legislators or current voters.[8] For example, many of the Medicare benefits now scheduled for the year 2065 were put in place by legislators 100 years before then.[9]

Vouchers usually try to provide cost control by limiting the subsidy to some maximum amount (which can vary over time) and then encouraging choice within that subsidy amount. Increases in payments generally derive from legislative action, not simply as a response to producers supplying or individuals demanding more goods and services. (In the language of "entitlements," the voucher may or may not be an entitlement—that is, avoid the annual appropriations process—but it is less likely to grow automatically over time.) As opposed to direct public provision, which tries to regulate prices and quantities more directly, vouchers are also argued in many cases to reduce overhead and administrative expense. Some, for instance, believe that public school systems tend to have higher costs because the political decisionmaking process results in a ratio of nonteaching to teaching staff that is too high.[10]

Not all vouchers save on costs. Vouchers may make subsidies more explicit because of expanded choice. They could then become *more valuable,* demand might rise, and more eligible individuals might apply, thereby adding to costs. Similarly, a voucher (or other reform) could increase the accessibility of services, again leading to higher demand and greater costs.

Vouchers may also represent one way that legislators simply dodge the cost of what they have mandated, in effect proscribing what they themselves have prescribed. For example, legislators may mandate that schools perform a variety of functions, that public housing contain certain features and amenities, and that health plans accede to wants such as choice of doctors or limited waiting periods. Then, lacking funds to pay for these mandates, these same legislators may try to put some overall cap on total or per capita expenditures. In effect, the voucher can become a convenient tool to try to put a ceiling on the cost of the very things legislators have mandated. Loomis suggests that cost containment often makes vouchers polit-