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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 politically appealing to legislators. Sometimes this approach may work, as when prices paid to providers are above market price and can be reduced; other times, the system may simply be overconstrained, and the balloon simply cannot be shoved into the box. A managed-care plan, for instance, might have trouble accommodating government mandates to provide more services at a reduced voucher payment.

—*Both open-ended and capped incentives.* Vouchers are sometimes chosen as a policy tool because they offer the opportunity to address incentive structures in a very direct way. A typical (but not necessary) design is for a voucher to provide a zero price to the individual (or 100 percent subsidy) for initial purchases but no subsidy beyond some cap. (This structure is more applicable to necessities and less applicable to other items, such as higher education.) This may have the disadvantage of leading individuals to buy more than would be efficient from their own or society's perspective. Moreover, some of the subsidy almost inevitably covers expenditures that individuals would have made anyway. Nonetheless, it helps ensure that at least the voucher amount is spent on the particular good or service if it is considered to be a necessity. Per dollar of expenditure, it also leads to the greatest level of subsidy for the first dollars spent. If there are diminishing returns—less and less benefit from additional amounts for the person assisted—needs are more likely to be concentrated on the first, not last, dollars of expenditure.

While open-ended incentives tend to lead to excessive marginal purchases of the subsidized good or service, a limit or cap on a voucher means that it eventually will provide zero subsidy beyond some limit.[11] At some point this leaves the full cost of the *marginal* purchase (for example, of food beyond the cost of a healthy diet) to the individual.

As demonstrated by Bradford and Shaviro, the "optimal" subsidy rate for the marginal purchase is not necessarily zero, depending on what goals are being pursued and on the response rates of consumers and providers to different price subsidies. Nonetheless, for many practical applications—when the "merit" good sought is some minimum level of well-being, when the response rates of consumers and providers cannot be estimated well, and when there are declining returns to the consumer from additional consumption of the item—a zero rate at some level of consumption has very strong appeal.

One reason is that in the general marketplace a zero rate of subsidy is the rate applied to most goods and services purchased by most individuals. (That is, most goods and services are neither taxed nor subsidized selectively for the population as a whole.) In most applications of public finance, the burden of proof for nonzero tax or subsidy rates is normally placed on the advocate, or else any market interference could be justified. Put another way, assume that the burden of proof is deemed to have been met with respect to subsidizing *some* minimal level of consumption of a merit good or service. Such evidence does not carry over to *all* levels of consumption of that good or service for those who are subsidized. Hence subsidies that are designed mainly to provide assistance will usually be capped at some level or another.

If the goal is not assistance to individuals but subsidization of the general activity—for example, a subsidy for pollution abatement or investment in education that inures to the larger benefit of society—then the logic of a limit or cap does not necessarily apply, or it does not apply in the same way.

Alternative and Related Mechanisms

None of the preceding goals—choice and efficiency, choice and equity, replacement of other programs, restriction of choice, increased competition, budget control, and both open-ended and capped subsidies—are necessarily met better by a voucher than by any and all alternatives. Again, the voucher must simply be considered one of several tools that are available. For some purposes, more than one tool is required. Nor does the inferiority, if any, of current law to vouchers establish the a priori superiority of any particular style of voucher to all alternatives. Among the many alternative tools are the following:

—*Direct noncompetitive public provision*. By longstanding tradition, goods and services can be provided directly by government. Health care can be provided through veterans' hospitals, education through public schools, child care through a public child-care center, housing through the building of public housing projects. Before the existence of food stamps, the government distributed surplus commodities directly to consumers. Even direct public provision, however, entails many private, rent-seeking activities, the most obvious being wage-seeking on the part of those who are paid by government for their labor. The relative cost of direct public provision is affected by whether workers receive more or less when working for the government and by the relative effectiveness of private nonprofit and profit-making suppliers. The efficiency of direct public provision is also affected by the extent to which innovation is allowed to displace less-efficient activity. For example, monopoly or monopsony practices in a government enterprise or in a government union can vary widely.

—*Competitive public suppliers and contracting out to private suppliers.* Competition and choice sometimes can be enhanced through competition among public providers. Public charter schools or even magnet schools, for example, may be an alternative way of providing some choice and competition in education. In a variety of areas, government might give greater choice by setting up alternative programs and letting them compete among themselves. In his chapter, John Bishop implies that the ability of parents and students to choose among public schools and the independence of these schools may be more important than whether the schools are publicly or privately owned. A select list of public training programs, with complete choice for individuals, is very close to a voucher that can be spent only on training programs from a restricted list that includes private providers. In other words, there are a variety of ways to enhance competition.

When government contracts out its work, it uses public funds but private suppliers. Although contracting out is considered relatively new in fields like primary and secondary education, it has always been the common practice in programs like Medicare, which contracts out for almost all its services. Some types of contracts are fairly far from vouchers: they may give little or no choice to recipients, they may maintain a public monopoly of sorts, or they may be open ended in terms of benefits. Other types of contracts can be made to look like vouchers or are vouchers. For instance, a variety of housing vouchers involve contracts with private suppliers of rental housing. Government health payments of a fixed amount to government-selected health maintenance organizations (HMOs) or preferred provider organizations (PPOs) should be considered vouchers if the individual can choose among these provider organizations but the size of the subsidy is limited per individual.

Even if there is only one supplier under a contract, some of the inefficiencies associated with public monopoly provision of public goods and services can be reduced. At least at the time of bidding there is some competition among suppliers for the government contract.

—*Other supplier subsidies and controls.* At times government may try to influence the consumption of particular items simply by increasing their supply. It may, for instance, try to reduce the price of food by providing crop subsidies to farmers. Producer subsidies for items that everyone may purchase, like food, may not always result in the desired targeting of the subsidy. In many less-developed countries, nonetheless, a subsidy to suppliers of some basic staples has been tried, with mixed effect, simply because poverty was spread among a large target population and because of administrative inability to distinguish well among individuals (for example, being unable to "means test" individuals for eligibility). In his chapter, Hugo Priemus notes that property subsidies were used in Europe after World War II to respond to a shortage in housing supply before being gradually replaced with voucherlike allowances.

At other times government tries to control or regulate what producers can do. In the case of rent controls, for instance, government attempts to keep down the price of housing. Limits on what can be charged for basic food items, such as bread, have also been attempted, especially in socialized or less-developed countries. In these cases, however, the government often keeps down the supply as well, usually with bad and sometimes disastrous results for the very groups it is trying to help. Rent controls have been tried in some American cities and in many European countries. (See the Priemus chapter.)

—*Cash payments*. The case for vouchers in some ways takes off from a negative income tax literature arguing that the greatest freedom of choice is established by the provision of cash assistance.[12] Milton Friedman and James Tobin, two economists often on very different sides of many fiscal and government policy issues, are often cited together because of their collaboration at one point in time in favoring the negative income tax.[13] Barring any extenuating circumstances—paternalism, desire of funders that only certain types of goods be purchased—consumers would prefer (or at a minimum, find equally valuable) more options to fewer.[14] Following this logic to its limit, cash should be favored over any in-kind benefit because of the additional options the former provides. It might also reduce administrative costs (more money for recipients, less for government workers) and avoid a stigma (for example, spending cash rather than food stamps at the grocery store).[15] As emphasized above, therefore, vouchers can be considered a hybrid or compromise between cash and complete government determination of how money will be spent (for example, on this particular apartment in this particular block of public housing).[16]

When might cash be preferred? On this question, the United States has experienced an almost complete reversal of attitudes in recent years. Cash used to go mainly to those who did not work, and little or no cash went to those who did. Now more cash is going to those who work and less to individuals who do not work and who rely only on welfare. This change has been reflected partly in the adoption and expansion of a cousin to the negative income tax, the earned income tax credit (EITC), which is now a significant component of income-conditioned assistance in the United

States. The EITC effectively provides a "work test" before it is granted, and it provides higher levels of benefits as earnings increase over certain ranges (for example, for a household with one child in 1997, the credit equals 34 percent of earnings on a base of up to $6,500 of earnings, although it phases out at slightly higher income levels).[17]

Why, one might ask, is society willing to provide cash assistance to those who earn some amount of money from work but not to others? Apparently, where the work requirement is met, many voters who would otherwise reject a pure negative income tax are willing to accept the underlying argument that cash can be an efficient form of transfer. Cash programs may simply be cheaper as well, both because administrative costs are lower and because the recipient may be glad to trade $12 of in-kind benefits, say, for $10 in cash. Such differential valuation of cash and in-kind benefits not only reflects the inefficiency of in-kind benefits but also sometimes leads to fraud and black markets. (See the chapter by Robert Moffitt.)

In balancing the gains from greater choice with the demands of taxpayers and providers, recent experience may imply that U.S. policymakers prefer choice mainly for those individuals who convey through their willingness to work that they are likely to spend the assistance in a form desired by those paying for the transfers. Work becomes an indicator that the transferee has a greater probability of somehow being more competent, trustworthy, or knowledgeable than otherwise. Therefore, some of the extra management and efficiency costs that derive from in-kind provision can be avoided. Or, more simply, the new consensus may be that willingness to work implies an attitude ("personal responsibility") that ought to be funded (with cash).

For those who do not work, in contrast, the federal government has now moved to a situation in which no permanent cash assistance will be available except for those who qualify on the basis of age or disability.[18] The long-term poor will no longer be able to receive Aid to Families with Dependent Children (AFDC) or its replacement, Temporary Assistance for Needy Families (TANF). Thus the EITC has replaced AFDC as the one cash assistance item that will be available to (working) lower-income individuals on a consistent basis.

In practice, of course, a voucher may be very close to cash assistance if it is easily transferable in the market. (See the discussion on food stamps by Moffitt.) From the beneficiaries' perspective, a voucher is as good as cash if they likely would have spent at least that much on the subsidized commodity anyway. (See the Bradford and Shaviro chapter.) In this last respect, the smaller the size of the voucher—especially when it comes to necessities—the more likely it merely covers what would have been purchased with cash. Note, however, that even in this last case, what may be true in general for beneficiaries may not be true for all beneficiaries (for example, 10 percent of beneficiaries would have purchased not food but some less necessary item if given cash instead).

—*Loans and guarantees*. Vouchers, grants, or credits may be inappropriate forms of subsidies for dealing with certain types of market failures. In the case of higher education, for instance, the market failure might result from the lack of efficient lending markets for borrowing against future earnings. Similarly, the market failure in question may relate to inadequate access to loans (for example, in a low-income area with higher rates of default). Here a government guarantee might help someone obtain a loan at a rate closer to what could be obtained elsewhere. Even loan and guarantee programs raise issues of choice, for instance, among potential lenders. A voucher can also be made in the form of loans or guarantees as long as the beneficiary is given some choice over how to allocate the implied subsidy.

—*Block grants*. Although block grants are an intermediate and not a final mechanism for delivery, they deserve at least brief mention, because they are promoted as encouraging competition within the public sector. The competition derives from greater experimentation at lower levels of government. Unlike competition among suppliers for each customer's business, here competition is achieved mainly through comparisons across jurisdictions: approaches that are successful for one state or locality may be adopted by others. Like vouchers, block grants (for example, from states to localities) are also used as a device to restrict budgetary cost by pushing requirements to control costs onto lower levels of government. Block grants sometimes combine and consolidate programs in ways that may provide more choice to the individual as well (for example, when the consolidated program includes more individual options).

Categorical block grants could even be thought of as vouchers for lower levels of government. Many block grants give other levels of government the flexibility to make payments to individuals in the form of vouchers.

—*Combinations of mechanisms*. Alternative mechanisms are not mutually exclusive. They can be combined and spliced together in multiple ways. Indeed, today's income-conditioned assistance programs are an amalgamation of all sorts of program approaches—public schools, vouchers for housing and food, contracted-out medical services, and so on. In addition, subsidies for the same service or commodity are often provided through multiple mechanisms: vouchers and loans for higher education, vouchers and public housing for housing assistance, for example. This does not imply that these combinations are ideal or even effective, only that they are not exclusive.

Market Conditions

A variety of issues come to the fore in determining the effectiveness of a voucher. Many of these relate to the market conditions in which the voucher operates.

Competition among Suppliers

When it comes to a voucher's purported efficiency gains, one of the first issues raised is whether or not it provides greater competition among suppliers. Housing vouchers, for instance, may yield a more competitive supply of housing than public housing contracts will yield, not only initially but also years after the housing has been built. Whether education vouchers provide greater competition depends on many factors, such as the extent of the market. (See the Sawhill and Smith chapter.) For example, there may be a national market for higher education, a regional market for some primary and secondary schools, and a small local market for schooling in rural communities. Vouchers might not do much to improve competition in a rural market with only one school, although even here there may be some enhancement if the voucher is somehow portable or could be used to bargain for other inputs (for example, books and computer learning). In the case of higher education, Hauptman argues that vouchers worked well in the case of the G.I. Bill after World War II because there was adequate supply of places in colleges and universities but that expansion of public institutions may have been the appropriate policy to meet the exploding demand created by the baby boom population. Linda Bilheimer's chapter suggests that the supply of commercial HMO plans for Medicaid recipients might be inadequate because they would face low payment rates from the government and because there may be few health care providers in the inner city. Of course, in a heavily regulated market like health care, potential suppliers react not just to the availability of a voucher but also to the other costs and benefits implied by regulations—such as requirements to accept all applicants, even those that may be costly to the supplier. In some cases, there is a concern that what is sought—for example, training customized for the real needs of employers—cannot really be supplied through a voucher, or through any other public program, for that matter. (See the chapter by Burt Barnow.)

One needs to be careful to distinguish between short-term and long-term supply. If a voucher is newly introduced, especially in a market where government control and regulation has previously dominated, it will take time for alternative suppliers to make their services available. Moreover, if it is a partially regulated market, such as for education or health care, it will often take time for the regulations surrounding the new voucher—for example, legal specification of the service to be provided and to whom the supplier must sell—to sort themselves out.

To make matters yet more complicated, markets can be made more competitive simply by making entry easier, even when there are still limited suppliers. The existing suppliers must meet demands of customers to avoid loss of some of their market. Occasionally, advocates for educational vouchers for primary and secondary education will argue that the threat or presence of a voucher creates significant improvement in public schools as well.

Competition among suppliers depends partly on access by demanders. Housing vouchers can be very restrictive in their use—although there are exceptions, they often cannot be carried across jurisdictions, and in practice their use might be confined to a few areas zoned adequately for low-income housing to be built. Thus suppliers from alternative jurisdictions might be excluded from the market. Even with a voucher for higher education, many individuals with family ties (such as care-taking responsibilities) may be able to use only the nearest college, regardless of the potential for supply competition.[19]

Effect of Vouchers on Prices

Because vouchers may effectively increase the demand for certain goods and services, they may also increase prices. The more prices increase, of course, the more the subsidy goes to suppliers rather than to those who are intended to receive it. Hauptman notes that federal student loans, which effectively operate like vouchers, have been a factor in the rapid growth of college tuitions over the past two decades. Peterson indicates that prices also tend to rise in areas where there is a high concentration of housing (Section 8) vouchers. In both these cases, supply is somewhat constrained or expanded only at higher marginal cost. Douglas Besharov and Nazanin Samari voice concern that if the supply of providers does not expand to meet increased demand arising from vouchers for child care, the price of child care will rise and the subsidy will accrue to providers.

Providers may also gain larger shares of the subsidy if they can discriminate among consumers in pricing (somewhat like airlines do when charging different fares to different types of customers). Bradford and Shaviro raise this as a theoretical consideration, while Besharov thinks that some child-care providers charge lower prices to nonvoucher customers. Since child-care vouchers can also go to grandparents and other family providers, it would not be surprising if those relatives would provide child care even at a zero price in absence of the voucher.

Through regulation, the government itself may influence how much of the voucher is taken up in higher prices. For example, if it sets minimum standards for child care, housing, education, and so forth—and if those minimum standards are beyond what is provided in other parts of the market (regulated or not)—a higher price for the good or service may be required. Whether these regulations result in a net gain must be determined on a case-by-case basis. Few of these issues are unique to vouchers; most arise in the case of almost all types of subsidies.

The broader the market in which the voucher can be spent, the less likely it is to run into conditions of limited supply. Lerman and Steuerle suggest that combining various goods and services into a bundled voucher is one way to give greater choice to individuals. They might then have the ability to change what they buy and therefore deflect increases in price in one good simply by switching some of their purchases to another good.

Ability to Choose by Demanders

In addition to access (raised above also as a supply issue), vouchers constantly raise issues as to the capability of recipients to choose. They could lack either competence or resources. Can they pick an appropriate diet with food vouchers or the right type of college with vouchers for higher education? Is information reasonably accessible and cheap, or are consumers either incapable of shopping around or unmotivated to do so? Is a public service something that has to be experienced (an "experience" good or service), in which case knowledge about it is acquired mainly by trying it out? If so, it may be impractical for consumers to experience all alternatives. A related problem is whether or not there is "asymmetrical information," in which producers know more about their own products than consumers do and, as a result, can mislead consumers.

Problems regarding the ability of consumers to decide vary widely. Moffitt argues that there are few informational problems with food vouchers, because food quality is easily determined and mistakes in choosing can easily be corrected the next time. Search costs are also low. Conversely, Peterson suggests that search costs can be quite high in the case of a housing voucher emphasizing "mobility" in which recipients are given choices among different jurisdictions. This problem in making informed choices is usually not uniform among all recipients but varies according to their perceived capabilities. For example, mentally impaired individuals may not be able to make the same informed decisions as others regarding vocational rehabilitation providers. (See the Barnow chapter.) However, even in this case, their parents or friends may have information not available to a government worker who decides how to allocate the subsidy.

The information issue almost always comes up when a voucher is controversial, especially a new one, as in primary and secondary education and in health care.[20] Note that in both of these cases government already presumes limited information among demanders, whether they have vouchers or not. This is reflected in licensing or certification of a professional class (teachers, doctors) that is given certain powers to make decisions for consumers (prescribing homework or drug treatment).[21] Bilheimer indicates that some Medicaid recipients may be unwilling or unable to make informed choices. Many beneficiaries who are required to enroll in managed care plans do not exercise their right to chose among the available plans. Consequently, they end up being assigned to plans by the state.

COMPETITION AND INEQUALITY. One fear with respect to individual decisionmaking is that not all will get the same benefit for each dollar of voucher spent. Let me be quite direct here: competition by its very nature does imply some amount of inequality. If not all are getting the same product, then those with the least information or competence in choosing are more likely, all other things being equal, to get a lower-quality good or service. This does not mean, however, that they are worse off under a voucher or other device that involves greater choice or competition. An analogy can be made with markets for nonsubsidized goods and services. When savvy consumers compete in the market for cars, they create a demand that leads suppliers to furnish better automobiles to everyone, not just to those who are initially the most savvy. Also, while decisions may not be optimal, they may still be better than in the absence of vouchers.

Whether a market with some choice results in relatively greater inequality is also uncertain. To do a fair comparison, all sources of inequality, of which competition is merely one, must be taken into account. The value of Medicare, for example, varies widely across states and among doctors. Well-informed patients have always done better at picking more capable doctors. The quality of child-care providers differs. Access varies. Ability to vote with one's feet—to move within or across jurisdictions—is far from equal.

With competition, information markets expand in ways that help promote greater equality (for example, toward informing consumers if they are getting a worse deal for their dollars and toward allowing the same good to be purchased for the same price by all customers). In some noncompetitive public goods markets, by the same token, there are only pretenses of equality. Sources of disparity are often kept hidden to try to maintain support for the programs. For example, some children in some inner-city public schools, as in the District of Columbia, may have as much spent on them as children in suburban schools, but the expenditure may not provide an equal-value education or a value to consumers anywhere near to its cost. Large disparities in age-specific Medicare expenditures by different states seem to be related more to different health care practices by providers than to the differential health of the recipients.

Regulation can be and often is invoked to try to reduce or minimize potential disparities in outcomes because of differences in abilities of consumers to choose. Of course, with enough regulation, a voucher could be made to look almost exactly like direct public provision of a good or service. At least some regulation, however, is always required. For example, racially segregated schooling and noncertified education classes generally would not qualify for an education voucher.

INFORMATION SYSTEMS. Information systems for consumers serve vital roles but vary in quality.[22] Small-scale systems might not be able to provide sufficient information for choice, while large-scale systems could inundate consumers with too much or inappropriate information. Information systems themselves may be regulated, leading to more administrative costs. Government may produce or require production of consumer reports, specify formats for information provided to consumers, or serve as an adviser. One "Moving to Independence" program, for example, provides counseling and apartment search assistance for housing certificate holders. Reischauer notes that under 1997 legislation dealing with voucher options under Medicare, the Health Care and Financing Administration (HCFA) must send participants materials describing all the options available to them, including data comparing plans in a given market area. Bilheimer notes that some states are also using enrollment brokers to provide information and assistance to Medicaid beneficiaries to help them choose among managed care plans.

Government may also attempt to restrict what it believes to be misleading or inappropriate advertising. Under the legislation just noted, HCFA regulates marketing materials sent to participants by HMOs. Bishop argues that educational vouchers work best in countries with government-required standardized assessment, which focuses parents' attention on learning rather than on less important criteria. One interpretation of this result is that the publication of standardized test results provides a simplified guide for citizens. It leaves open the question of whether other guides would do as well or better.

The case of training vouchers provides a striking example of the interplay between government-provided information and vouchers. Barnow emphasizes the importance of "individual referrals" to ensure that recipients go to vendors with good performance and reasonable costs that supply training both for occupations in demand and for the recipients' level of skill and aptitude. Lessons learned there may well be applicable elsewhere. Lerman and Steuerle suggest that systems of structured choice, in which a voucher may cover more than one good or service, may require some interplay between the recipient and government workers. For example, a voucher helping a welfare recipient with a wide variety of work-related costs may require both a caseworker and the recipient to choose together among a set of options.

Adverse Selection

Allowing choices, especially among individuals with different capabilities and different needs, sometimes raises issues of adverse selection. Adverse selection generally arises when individuals can sort or "select" themselves into groups in ways that exclude other groups. It typically reduces the amount of redistribution intended. Note that this occurs in the case of a voucher (or other form of subsidy) when it has some inherent characteristic that makes what at first may appear to be the same entitlement to be of different value to different persons, yet in a way that is not explicitly stated or priced on the voucher itself. There is no argument about adverse selection in the case of food stamps, where $10 worth of food stamps provides essentially the same buying potential to almost everyone. Some people may get more food stamps because they have lower income, but the difference is explicit. In this case, individuals cannot further sort themselves into groups that would increase the basic value of their voucher.

With some other types of vouchers, recipients may cluster together in a group to avoid paying for some implicit cross-subsidization. If the healthy buy their insurance together, then the value of their vouchers of fixed monetary value can buy more insurance than if they insure with a group of unhealthy individuals whose vouchers do not cover their expected costs.[23] If a school can avoid taking in more expensive students—those impaired or in need of greater supervision—the remaining students can buy more education with their own vouchers than otherwise. The adverse selection issue is raised mainly in health and education, but it can also occur in housing and other areas. The specific issue at hand is usually whether the neediest (of students, medically insured, tenants, and so forth) will receive some inappropriately low level of benefits.

When there are some externally determined and objectively measurable characteristics that can be used to differentiate among recipients, a subsidy can be designed better to prevent adverse selection. While implicit redistribution formulas often create an incentive for the observant to reorganize to maximize their own benefits, explicit formulas are less likely to offer such options. In health care, therefore, a common explicit alternative suggested is to create subsidies according to different levels of risk. A proposal for voucherlike tax credits for universal health care under President Bush in 1992, for instance, attempted to provide higher levels of subsidy both for those with lower incomes and those with higher risks.[24] Educational vouchers adjusted by income could deal with some of the potential adverse selection against disadvantaged students, at least to the extent that income and disadvantage are correlated. Sawhill and Smith suggest that the subsidy level could vary with student characteristics, such as poverty, disability, or the need to take English as a second language (ESL) to make all types of students attractive to schools.

As long as risk pools contain differences in expected need, however, even subsidized risk pools can only reduce, not eliminate, adverse selection. Reischauer describes how federal legislation (the Tax Equity and Fiscal Responsibility Act of 1982) provided risk adjustment for Medicare vouchers according to age, gender, Medicaid enrollment, and institutional status, but these adjustments covered only a small percentage of the variation in health care costs. Accordingly, sicker individuals still opted for traditional Medicare, while on the supply side HMOs became reluctant to sign up costlier individuals. The government ended up paying more because those who chose vouchers on average already had costs below the voucher amount. Bilheimer raises similar issues with respect to proposed vouchers for the nonelderly. Although no vouchers are generally available for this population yet, low-cost options are sometimes hard to find for individuals operating outside of employer pools because of adverse selection and high administrative costs. Indeed, part of the debate over vouchers or credits for the nonelderly centers on how large adverse selection would be in this market.

Implicit, as opposed to explicit, redistribution, of course, suffers from its own set of problems. Often the implicit redistribution is arbitrary and even regressive. For example, in health insurance it is at least questionable whether nonsmokers should cover all the costs incurred by smokers, or lower-income younger workers cross-subsidize higher-income older workers, or citizens in low-cost states subsidize health care and health providers in high-cost states—implicit redistributions that occur under the current system.[25]

A significant difficulty with denying choice simply for the sake of maintaining implicit redistribution patterns is that it may also deter other equity and efficiency gains that choice would help bring about. For example, would one want to hold back upwardly mobile, disadvantaged students from choosing a school with higher educational standards for the purpose of maintaining educational equality among those in poor schools? The dilemma is that more choice can mean both more efficiency and greater adverse selection at the same time. The two often go hand in hand. The relative importance of each will depend on the nature of the markets and on the extent to which explicit forms of redistribution can be used to deter the adverse selection.

One way to limit increases in inequality through adverse selection is to turn to regulation and ensure that all choices are available to as many people as possible. For instance, a health insurance pool might be required to accept all comers, thus reducing the extent to which the healthy can band together and exclude the unhealthy. An educational institution might be required to accept all applications, or at least to give each an equal probability of acceptance. Even if some inequality still remains, it is more tolerable on equity and efficiency grounds if each person has the same choices and greater equality of opportunity, if not equality of result. By the same token, equal opportunity can be nominal rather than real. It still might be quite easy for groups to sort by employment status or geography even if technically each group is open to all comers. For example, it may not be practical for those in the inner city to travel to a richer suburb for education or to join a health insurance plan whose main constituents are workers cared for by preferred providers near an outlying plant.

Substitutability

Although vouchers can be spent directly only on the authorized category of spending, they free up other household resources for spending on other goods and services. The incremental effect on spending for the targeted category may be quite small—that is, there can be a high degree of substitution in household budgets. Empirical questions have been raised about the substitution effect (or budget fungibility) in all fields where vouchers have been used. Among the many factors affecting substitutability are the level of subsidy and degree of individual differences in tastes. Food stamps have often been considered highly substitutable for cash, especially in a world where the size of the voucher is modest and hence unlikely to purchase more than a basic level of food consumption. Moffitt, however, notes that even food stamps are less than cash equivalent. Regulatory attempts, moreover, have been made to limit substitution through such activities as sales of vouchers to others. These regulations, however, necessarily detract from the value of vouchers to users. (See the chapter by Bradford and Shaviro and that of Moffitt.)

In his chapter, Michael McConnell raises the issue of substitutability to contend with judicial arguments that government should subsidize only secular inputs into primary and secondary education. That is, if the government subsidizes bus transportation to religious schools, the schools can raise tuition because they know parents will now have some money freed up that they would have otherwise spent on transportation. McConnell, who favors vouchers for primary and secondary education, believes that this type of distinction has no economic substance.

The issue of substitution comes up also in a fiscal context—the extent to which the voucher simply substitutes for private spending that otherwise would have taken place. Sawhill and Smith raise this concern for school vouchers that may replace private spending among higher-income individuals who would have purchased education in absence of the voucher. When vouchers are offered in lieu of public education, they may also end up supporting those who already had left public education for private alternatives. This may be considered "fair" by those who don't benefit from current public education expenditures, but it still may raise the net public cost of offering an alternative.

Of course, if vouchers are cash equivalent, they are hardly worth the effort, especially given the extra administrative cost they may entail. Here, once again, we may want to distinguish between a voucher that is cash equivalent for all recipients and one for whom cash equivalence only applies to some. A voucher may still be preferred if it encourages purchase of the subsidized good or service among a subset of individuals who might otherwise spend the money on something society considers less valuable. (See the discussion on restriction of choice or proscription, above.)

Some Issues of Structural Design

A variety of design features determine the effectiveness of the voucher and the way it affects the market for the good or service that is subsidized. The following sections discuss some of the most prominent of these issues.

Universality and Permanence of the Voucher

In a number of cases, policymakers feel that they cannot afford to expand a voucher (or other subsidy) to cover all those who meet the eligibility criteria. In the United States, child care, training, housing, and school vouchers, among others, reach only a small proportion of those who are eligible.[26] Less than full universality, however, raises a number of issues:

—*Queues*. Even when conditioned on the basis of income, many programs still generate queues of "eligible" clients who cannot get vouchers.[27] This excess demand creates its own set of market distortions. For example, it greatly increases the extent to which existing recipients become reluctant to move to find better jobs, educational facilities, or support from related family members, as movement to another jurisdiction may require reentering a queue. Queues are also open invitations for corruption, ranging from the petty brokering of inside information about how to enter the queue to explicit bribes paid to move up in the queue, as was found rampant in the District of Columbia system for housing vouchers and public housing.[28]

With queues, allocation is usually made according to a first come, first served or lottery basis, neither of which is wholly satisfactory for equity or efficiency purposes. Bradford and Shaviro indicate that these secondary criteria sometimes affect other choices, such as the length of time individuals are willing to stay in an area to meet residency requirements. Peterson points out, however, that whether federal or local preference rules are used is crucial, as the wider the jurisdiction in which the queue occurs, the less mobility is affected. Although the issue of queues comes up quite often in the United States in the case of housing, Priemus notes that the issue seems to arise more in the United States than in Europe, because housing is more of an entitlement in Europe.

Although queues usually derive from budget constraints, the same amount of money often could be spread among more or all eligible recipients. Peterson raises the issue of whether housing benefits should be reduced so that housing vouchers can be made more universal.

—*New tax structures*. The income-conditioning of vouchers creates phaseouts that raise marginal tax rates and add, often capriciously, to work, saving, and marriage disincentives for recipients. Typically, these multiple tax and phaseout systems are uncoordinated. This issue is addressed in more detail elsewhere. (See the chapter by Bradford and Shaviro as well as that by Lerman and Steuerle.) Here, note simply that the combined tax rate structures in place in all or almost all countries around the globe show little rationality, system, or development by principles.

Even though they often operate capriciously, hidden tax rate structures achieve political acceptance because they are hidden. Take a voucher system of universal health care. It could be phased out as income increases. Or a voucher or subsidy of the same value could be provided to all individuals, and the cost then covered through direct taxes. In universal systems, it is possible to duplicate almost the same economic structure with direct taxes as with phaseouts, but for budget accounting purposes, the phaseout is not counted as a tax but rather as a reduction in expenditures.[29] That latter makes it "appear" less expensive or intrusive even when it is not.

—*Lack of complete market testing*. When vouchers are limited by income or targeted to one area or group, they may fail to provide a full market test of their effectiveness. For instance, when housing vouchers are available only in limited quantity, the change in demand is restricted and the capability of attracting competitive suppliers is decreased. Similarly, a voucher may have weak effects on competition in markets when it is only temporary. Alternative suppliers of services often will not enter a market if it is not believed to be permanent or long term. Education vouchers in the United States to date have never been supplied on a permanent enough basis (or universal enough basis) to provide a comprehensive test of how well they work. One can, however, draw some inferences from other countries or jurisdictions if vouchers in the area of examination have become a more permanent feature of the policy landscape.

Migration and Mobility

Federal vouchers that may be spent anywhere within the nation make migration across jurisdictions easier than would grants to states for the same purposes; similarly, state vouchers may be superior on this criterion to grants to localities. The amount of mobility or migration in voucherlike programs varies widely. For example, vouchers in higher education can be applied almost anywhere and food stamps are universally available (although one needs to reapply after moving and may receive a different amount), while housing, child care, and training subsidies often require waiting in a queue in a jurisdiction or region. Peterson notes that consolidation of public housing authorities (PHAs) has often increased portability across jurisdictions, while residency preferences have been removed from many PHAs as well. Expanding the boundary within which a voucher may be spent clearly enhances both migration and mobility and generally improves efficiency.

Decentralization

"Devolution" and "decentralization" could be considered ways of putting decisionmaking closer to the level of the individual. In one sense, vouchers might be considered an ultimate form of devolution when choice of suppliers is left to the individual. A corollary is that increasing the regulatory power of states and localities may actually centralize power up from the individual unless it displaces, rather than adds to, the regulatory power the federal government would have exercised anyway.

This issue has come to the fore for the income-conditioned transfer programs financed by the federal government. It turns out that efforts at devolution in the 1990s have actually centralized larger portions of the financing portion of these programs at the federal level, even if there has been some decentralization of some decisionmaking about how to spend a portion of funds.[30] One reason for the centralization of financing is that states have fewer incentives to add to the federal payments when each additional dollar of expense is covered entirely out of state funds. As states have contributed less, the federal government's share of total financing has risen. Even on the expenditure (rather than financing) side, moreover, the more universal voucherlike programs like food stamps and cash programs like the earned income tax credit leave little leeway for state involvement in how to spend funds. Because these latter programs have become an even larger share of the income assistance pie, the devolution of TANF expenditure decisions to the states has actually left a larger share of all expenditure decisions to the federal government.

Ironically, if more controls are given to state and local governments relative to the individual, these programs could become more, not less, centralized. Whether greater regulation improves or hurts the programs is another question. Many who claim they are for decentralization actually mean that they want federal subsidization and state and local control rather than federal subsidization and individual control. Since variations abound, it is difficult to come up with any hard-and-fast conclusion about the influence of vouchers on devolution. For example, a new federal voucher for health care for the nonelderly might be spendable only on a health insurance policy that meets state regulations. Here, there would be devolution of regulatory control but possible further centralization of the financing of medical payments to the national level.

Decentralization, therefore, often means that the federal government (or state government) will provide a national benefit but leave a variety of choices over administration and regulation to the states (or localities). Such decentralization may invite experimentation and push controls closer to a level where they can be administered, which is a primary advantage. By the same token, it can cause headaches. Geographic variation is a major concern in such areas as housing, primary and secondary education, and health care for the elderly. (See the chapters by Peterson, Sawhill and Smith, and Reischauer.) Each case is unique, but all share the attribute that the benefit level can vary not according to the needs or characteristics of individual beneficiaries, but rather by their geographic location. Thus, when benefits vary in value by geographical location, they tend to be less equitably distributed and less portable.

With decentralization, one also needs to worry about what may work well in one area but not in another—for example, vouchers for primary education in urban versus rural areas where selection may be more difficult. Where wide variation already exists in a nonvoucher program, it becomes impossible to substitute some vouchers and still hold harmless all states or localities as well as all producers and consumers. A different type of program inevitably will involve a different distribution of benefits—a major obstacle to voucher reform in Medicare, among other programs.

Loomis notes that decentralization versus centralization debates are often not what they at first appear to be—debates over the proper location for decisionmaking. Instead, they may reflect venue-shopping among interest groups to change the balance of power in their favor.

Methods of Delivery and Control

Vouchers can be provided to suppliers or to the beneficiaries themselves. They may take the form of tax subsidies or direct expenditures. They may be refundable or not, and the degree of regulation and quality control will vary. These and many other choices mean that there are a wide variety of types of vouchers. (See the chapter by Posner and others.)

—*Tax subsidies versus direct expenditures.* The choice of delivery mechanism may be led by political considerations. For example, tax subsidies are recorded in the budget as a negative tax rather than as a positive expenditure. As a matter of budget policy, such accounting tends to hide the additional interference in the economy that the tax subsidy entails. Still, in some cases tax subsidies may be easier to deliver administratively, especially if eligibility for the subsidy can and should be easily determined from the data already reported on tax returns. Although almost never done, there is no reason tax administration authorities could not deliver exactly the same subsidy if the budget authorities more accurately reported it as an expenditure rather than a tax cut.

—*Payment to beneficiaries or suppliers.* Vouchers tend to be delivered to suppliers mainly when administrative considerations dominate. When done this way, there usually will be some type of contractual relationship between the beneficiary and the supplier, as in the case of higher education and some forms of rental housing, but it is simply easier or more enforcable for the government to send its check to the supplier chosen by the beneficiary. Note, however, that the beneficiary still needs a means of certifying eligibility to potential suppliers of the goods or services. Food stamps have recently moved toward a hybrid system where one probably cannot even define whether beneficiaries or suppliers are getting the initial payment. Essentially, it will operate somewhat like a credit card that delivers lines of credit but not actual script to the beneficiary; payments of money rather than credit lines will be made to grocery stores and other suppliers when the card is used. (See the Moffitt chapter.) This new system may both reduce paperwork and at the same time make more difficult the spending of food stamps by anyone other than beneficiary.

—*Refundable or nonrefundable credits.* Refundable vouchers allow recipients to keep the difference between expected purchases to be subsidized and actual purchases. Suppose, for instance, that the expected level of food or education or housing purchase is $300 a month but that the voucher is worth $200. This type of differential arises in programs with a phaseout of benefits, because the beneficiary earns income and is expected to contribute some amount toward the expected purchase amount. If the credit is refundable, the recipient essentially gets the $200 even if less than $300 is spent. For every potential expenditure above $200, in fact, the recipient either pays or saves the full cost. Refundable vouchers are generally viewed as encouraging more cost consciousness by beneficiaries and allowing them to gain by efficiently choosing how to spend their vouchers. Among the vouchers that provide for refundability are the G.I. Bill, Section 8 housing, and, in recent years, food stamps. By the same token, refundability tends to make the voucher more like cash, especially when the voucher amount falls below some minimum that might be expected to be spent by almost any beneficiary.

—*Regulation and quality control.* At times advocates for vouchers will argue that they wish to move away from the regulations that apply to direct expenditures. Such an argument, for instance, is made with respect to health care vouchers in lieu of traditional Medicare. However, some standards and regulation are inevitable. At a minimum, the government will try to ensure that the voucher is spent on the goods and services prescribed and not on those proscribed, and that only "eligible" individuals receive the vouchers.

Quality control arises when there is a potential that the good or service being purchased is not really what is intended. In the case of higher education, for instance, concerns are often raised about schools that promise some form of technical training that is unlikely to lead to jobs or for which advertising costs and profits eat up a large chunk of the voucher. Health care and health insurance already tend to be regulated to a significant extent. But a new program creates its own set of regulatory needs. For instance, should individuals be allowed to spend a medical voucher on an insurance policy that doesn't cover catastrophic care? The government would then be on the hook again if the individual could not cover these costs when they arose.

In some cases, like child care, there are no easy choices. If child-care vouchers must be spent on highly regulated quality care, costs could be raised considerably. Moreover, this would tend to exclude parents and neighbors from providing the care. To complicate matters further, care-giving relatives sometimes give some kickback to beneficiaries.

Quality control within the voucher program itself is required less if the good or service already has to meet various local, state, or national standards. For example, the food offered in grocery stores may already be considered adequately safe to eat.

As always, balance is required. Some regulation is needed to provide quality control, but too much regulation will hamper efficiency. Bishop notes that vouchers to private schools are more effective in countries with exit exams but are less effective when schools do not compete for students or are not allowed to remove disruptive students or incompetent teachers. While private schools need true independence to be effective, complete laissez-faire would result in "diploma mills."

Combined Effects

As vouchers grow in number and value, overlapping issues of efficiency, design, and administration arise. For example, it may be inefficient and restrictive of choice for housing and food stamp vouchers to be separated. There is also a learning curve: individuals who have learned how to use one type of voucher may be much more adept at using another, so that consumer knowledge could grow more than proportionately with expenditures on vouchers. Small vouchers that were at first ineffective might be more effective in a more voucher-oriented world. Administrative efficiency and practicality are also affected by whether or not vouchers are provided on a more general basis: for example, by how many places a poor individual must apply to for different types of assistance. (For a discussion of bundled vouchers or "structured choice," see the chapter by Lerman and Steuerle.)

Constituencies

Vouchers are no different from other programs in the sense that constituencies will develop for the preservation of the program. (See the Loomis chapter.) These constituencies form among both consumers and providers of the good or service. The agricultural lobby, for instance, has become a mainstay of support for food stamps. (See the Moffitt chapter.) When new vouchers are proposed, they are more likely to be supported if they do not threaten any established constituency, that is, if they are complements of, rather than substitutes for, what already exists. Vouchers for higher education were generally viewed as expansive and good for existing educators, who came quickly to support these efforts. Conversely, vouchers for primary and secondary education may threaten those already providing services in public schools. Similarly, vouchers for Medicare may threaten either the level of benefits already received by Medicare beneficiaries or the ability of medical suppliers to charge amounts that may be in excess of what a voucherized system would support. As always, much depends on the actual design of the voucher itself.

The power of constituencies can have an influence on market conditions. Traditional government programs create two types of interest groups that may tend to work against future reform or amendment: the beneficiaries of the program and the public employees who serve them. Vouchers may limit the role of the second category of interest groups if the size of the bureaucracy can be kept smaller. This difference could also make vouchers more adaptable and easier to reform over time.

In some voucher programs, more administrative involvement may be highly desirable (see the Lerman and Steuerle chapter), while competition among public suppliers can be achieved through methods other than vouchers. Therefore, there is no *necessary* reason why vouchers must have a reduced constituency of public employees. Rather, the structure of interest groups and constituencies must be taken into account to determine the long-term advantages and disadvantages of using vouchers versus other alternatives.

Constitutional Issues

Constitutional issues may also arise when vouchers are offered. In this case, the issue becomes the interpretation of constitutional meaning rather than the principles of efficiency and equity invoked from a public finance or administration perspective. Perhaps the most difficult constitutional issue of all within the United States has been over vouchers and similar payments to students who might use them in sectarian schools. (See the chapters by McConnell and by Elliot Mincberg and Judith Schaeffer.)

Opponents of vouchers for primary and secondary schools sometimes emphasize that the *effect* of a voucher would be primarily sectarian today because of the dominance of sectarian schools among those that are now private and would receive the voucher (Mincberg and Schaeffer). Proponents believe that the restrictions placed by the courts on vouchers for primary and secondary education are simply not consistent today with the allowance of many other payments to flow through sectarian organizations, such as institutions of higher learning (McConnell). Opponents would stress the extent to which sectarian education could subsidize sectarian beliefs over other forms of knowledge; proponents point to the success of existing church-related schools in educating students well—often better than public schools—in reading, arithmetic, and other subjects. Opponents believe that little choice is provided by vouchers, because, considered by themselves, vouchers would favor the sectarian schools that exist. Proponents think that vouchers are "neutral" among all forms of education and help establish neutrality when education subsidies are considered as whole.

These issues do not go away when voucher payments are allowed. Once payments flow, government inevitably places some regulation on what is being subsidized, as it wants to ensure that minimal learning and educational standards are met. In turn, church-related schools must cope with the government regulation that results, thus, according to some, opening the door for excessive entanglement between church and state. Many of these issues already play out to some extent with vouchers for higher education.

Measuring Success

Whatever the initial assessment of the merit of vouchers as a mechanism, they also need to be reevaluated over time. Like many government programs, it is often difficult to get good measures of outputs, much less outcomes, as opposed to inputs or dollars spent. Sometimes it is hard even to agree on what the outputs and outcomes should be in the first place! When a program such as vouchers is promoted as a means of fostering competition, however, another measurement problem arises. Take, for example, the common approach of evaluating the success of a voucher program by comparing outcomes for voucher recipients with outcomes for a control group that does not have access to vouchers. If a voucher is ultimately successful in promoting competition, it might improve conditions for both those who receive the voucher and those in the control group, who only have access to some alternative. (For a discussion of experiments designed to measure the effect on public schools without vouchers, see the chapter by Sawhill and Smith.)

A voucher that is truly successful in introducing competition into a given market should improve conditions everywhere. In theory, individuals may not even have to use the voucher, because its potential use may induce other public sector providers to be efficient in their provision of goods and services. Thus even the threat of potential competition may help keep a single supplier more productive. Competition forces all providers to move toward equal value of output per dollar spent; otherwise they will have difficulty surviving. Thus vouchers, like Pell grants for private or public higher education, may improve the quality of output within both types of institutions and for the system as a whole. (See the Hauptman chapter.) This equalization effect of vouchers makes it harder to verify empirically the advantages of alternative delivery systems simply by comparing the quality or price of their output. Even in the absence of empirically measurable differentials, other evidence (although not conclusive) includes theory, the introduction of new levels of competition, or a time series indicating a higher level of average output per dollar spent.

Finally, even when it appears that success is possible with a voucher, other factors must be examined. A voucher may be successful relative to having no program, but less successful than an alternative program that has never been tried. It may also appear to be more successful under some circumstances or at different levels of intervention than others. For example, Bishop's finding that school vouchers seem to work better in countries with standardized testing than in those without does not tell us whether any particular form of standardized testing is the best form of information system to supplement a voucher. Perhaps even more improvement would come from measuring growth in knowledge rather than level of attainment at the end of the year. In effect, attempting to measure success—and to test that success against alternatives—is a never-ending requirement for almost any public program.

Conclusion

The goal of vouchers is to improve efficiency and equity in the provision of public services. Vouchers must compete with direct government delivery, contracting of government services, competitive public suppliers, cash payments, and loans, among alternative delivery mechanisms.

While vouchers work well under the right circumstances, much attention must be given to their market conditions and structural design. Among the market conditions that must be examined are the access of beneficiaries to alternative suppliers, the effect of a subsidy on prices, the ability of those with a voucher to choose and obtain information about the value of services, the amounts of adverse selection that might take place (along with any explicit means of adjusting for risk differentials among recipients), and the extent to which the voucher simply substitutes for purchases that otherwise would have taken place. Structural issues arise over the universality and permanence of the voucher, the tax rate structure to which it implicitly contributes, the allowed migration and mobility of recipients, and the amount of decentralization involved. Structural choices must be made to design a voucher as an expenditure or tax credit, pay beneficiaries or suppliers, make the subsidy refundable or nonrefundable, and decide how far to go with regulations or quality controls. The role of constituencies must be taken into account, including their ability to restrict competition. And, of course, vouchers cannot be implemented unless they are constitutional in the first place.

While it is not always easy to measure the success of vouchers vis-à-vis other government programs, they are a powerful tool in the government's tool chest. Their expansion in recent years attests to their usefulness. Most of all, it increases our responsibility to learn better how to structure and channel this growing body of public expenditures.

Notes

1. *Random House Dictionary of the English Language*, 2d edition unabridged (New York: Random House, 1987).

2. In almost all cases, a stated *intent* of policymakers is that the subsidy inure to the benefit of the consumer, although providers are also sometimes favored in the next breath (for example, farm state politicians favoring the provision of food stamps). Market forces, such as the availability and responsiveness of supply to price changes, obviously may shift the incidence of benefits and mitigate against any initial intent. Of course, just as intended benefits may not inure to consumers, so also suppliers may not gain under a variety of circumstances. For example, food stamp purchases may not help farmers if there is no increase in demand for food.

3. Using the language of David Bradford and Daniel Shaviro's chapter in this volume, a cap implies a declining marginal rate of reimbursement (ending at zero percent). Traditional Medicare is not a voucher, because it does not have a final marginal rate of reimbursement of zero percent.

4. Although no voucher program is this broad, there are at least some that attempt to cover reimbursement for all "employment-related" expenses.

5. Milton Friedman argues that government may *fund* certain services (public goods) to ensure an optimal level of investment, but it does not necessarily have to be the provider. See Milton Friedman, *Capitalism and Freedom* (University of Chicago Press, 1962), pp. 85–107. At times public monopolies can be even more deleterious or harder to change through eventual competition than private monopolies.

6. For example, Jimmy Carter proposed placing an emphasis on existing housing as opposed to the construction of new public housing, Ronald Reagan called vouchers the "cornerstone" of his housing policy and proposed the establishment and expansion of rural housing vouchers, George Bush requested a 27 percent increase in voucher funding in 1992, and Bill Clinton proposed replacing fifty-four thousand public housing units with rental certificates.

7. In their influential book *Politics, Markets, and America's Schools* (Brookings, 1990), John Chubb and Terry Moe begin their argument with a criticism of the bureaucratic constraints of the current system.

8. A very good example is the design of health care programs. In the United States, much of government health insurance for the elderly remains on a fee-for-service basis, with government continually paying larger shares of the nation's income to meet a demand that can only be expected to expand. This approach has made it quite difficult for government to regulate either the quantity of care provided or the payments made to suppliers, although selective restrictions on both have been tried continually. As only one example, diagnosis-related groups (reimbursement for specific treatments) attempted to provide some restriction on cost, but providers responded partly by upgrading their diagnoses (pneumonia became pneumonia with complications), as well as expanding their use of new, better, and more expensive equipment.

9. For a discussion of how automatic growth distorts decisions on national priorities, see C. Eugene Steuerle, Edward M. Gramlich, Hugh Heclo, and Demetra Smith Nightingale, *The Government We Deserve: Responsive Democracy and Changing Expectations* (Urban Institute, 1998).

10. Vouchers, of course, are not the only means of trying to solve any of these problems.

11. If a dollar's worth of consumption costs individuals eighty cents, for example, they will tend to purchase the subsidized item up to the point that its value to them, regardless of cost to society, has been reduced to eighty cents. At that point, the other twenty cents, paid by society, is likely to represent a dead weight loss, barring any "externality" gains to other individuals in society.

12. See C. Eugene Steuerle, "Uses of the Negative Income Tax Framework," *Focus*, vol. 12, no. 3 (1990), pp. 30–32.

13. See, for example, Friedman, *Capitalism and Freedom*, and James Tobin, Joseph A. Pechman, and Peter M. Mieszkowski, "Is a Negative Income Tax Practical?" *Yale Law Journal* (November 1967).

14. See Francis J. Cronin, "A Household's Decision to Accept or Reject a Conditional Transfer Offer," *Southern Economic Journal*, vol. 49, no. 1 (1982), pp. 218–34.

15. For example, Christine Ranney and John Cushman conclude that the welfare stigma associated with food stamps make them considerably less valuable to recipients than cash payments. See Christine K. Ranney and John E. Cushman, "Cash Equivalence, Welfare Stigma, and Food Stamps," *Southern Economic Journal*, vol. 53, no. 4 (1987), pp. 1011–27.

16. Lester Thurow argues that in-kind transfers such as vouchers may be more effective than cash payments in achieving a minimum consumption level of certain goods and services because recipients would spend a lot of the cash on other goods and services. See Lester C. Thurow, "Cash Versus In-Kind Transfers," *American*

Economic Review, vol. 64, no. 2 (1974), pp. 190–95. Edwin West argues that vouchers are superior to cash because they lack fungibility. See Edwin G. West, "Education Vouchers in Principle and Practice: A Survey," *World Bank Research Observer*, vol. 12, no. 1 (1997), pp. 83–103.

17. For 1997, if there is one child, the credit equals 34 percent of earnings up to $6,500 of earnings for a maximum credit of $2,210; this maximum credit phases out between $11,930 and $25,750 of income at a 15.98 percent rate. Other rates and credit amounts apply for different types of families. See *Green Book*, Committee Print, House Committee on Ways and Means, 105 Cong. 2 sess. (Government Printing Office, 1998).

18. Cash transfers through Social Security and Supplemental Security Income remain available for the aged and disabled.

19. To ensure adequate access to health care, a clinic in rural Wisconsin issued vouchers to individuals living too far away to use the clinic or requiring services the clinic could not provide. See Doris P. Slesinger and Cynthia Ofstead, "Using a Voucher System to Extend Health Services to Migrant Farm Workers," *Public Health Reports*, vol. 111, no. 1 (1996), pp. 57–62.

20. Even in housing programs, differences in information among demanders may lead to inequities. Francis Cronin argues that, compared with white families at equal income levels, black families tend to search in fewer neighborhoods and are less likely to search in neighborhoods of different socioeconomic status than their own. See Francis J. Cronin, "How Low-Income Households Search for Housing: Preliminary Findings on Racial Differences," *Urban Institute Working Paper Series*, no. 249 (1975).

21. An important distinction can still be made. In the case of primary and secondary schooling, voucher proponents argue that demand is too constrained because parents and children can contribute more to determining conditions under which education is received. In the case of medical care, voucher proponents assert that demand is too unconstrained, as individuals have little or no understanding of the marginal cost of insurance because existing tax subsidies and expenditure programs encourage purchases to come from government or employers. In one case, demanders know too little about benefits; in the other, about costs.

22. One set of advocates for educational vouchers want to set up a "Parent Information Center" to help parents pick the best school for their children. See Chubb and Moe, *Politics, Markets, and America's Schools*.

23. For a discussion of the problem of adverse selection in health care, see Linda J. Blumberg and Len M. Nichols, *Health Insurance Market Reforms: What They Can and Cannot Do* (Urban Institute, 1998).

24. This effort to subsidize different risk pools was led by David Bradford when he was on the Council of Economic Advisers and is reflected in an important government report sometimes ignored because it was issued at the end of the Bush administration. See White House Task Force on Health Risk Pooling, "Health Risk Pooling for Small-Group Health Insurance" (GPO, January 1993).

25. With automobile insurance, worse drivers pay higher rates even though they also tend to be cross-subsidized by state rules requiring insurance coverage and effectively capping rates that can be charged.

26. For example, until 1998 only 1.5 percent of children were eligible for the Milwaukee school choice program. (See the chapter by Isabel Sawhill and Shannon Smith.)

27. For a discussion on the market distortions caused by queues for housing vouchers, see George E. Peterson and Kale Williams, "Housing Mobility: What Has It Accomplished and What Is Its Promise?" in Alexander Polikoff, ed., *Housing Mobility: Promise or Illusion?* (Urban Institute, 1995).

28. See Cindy Loose, "5 D.C. Housing Employees Charged; Only 10 of 400 New Rent Vouchers Issued since 1990 Didn't Involve Bribery, Probe Finds," *Washington Post*, April 13, 1994, p. A1.

29. The real-world applicability of this point can again be seen in the proposal by President Bush for a universal health care tax credit or voucher. It provided for combined tax rates of 100 percent or so for many individuals between 100 percent and 150 percent of poverty. See C. Eugene Steuerle, "Beyond Paralysis in Health Policy: A Proposal to Focus on Children," *National Tax Journal*, vol. 45, no. 3 (1992), pp. 357–68.

30. See C. Eugene Steuerle and Gordon Mermin, "Devolution as Seen from the Budget," *New Federalism: Issues and Options for States*, no. A-2 (Urban Institute, 1997).