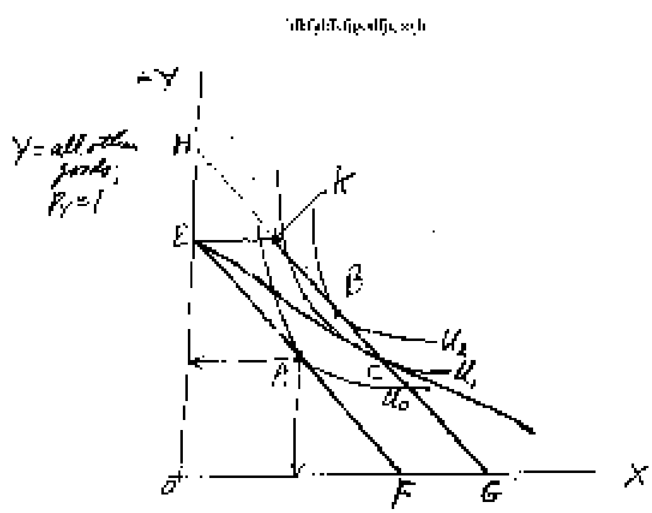
EFFECT OF VOUCHERS

In the graph below, the government decides to subsidize a good, such as health care, housing, or education. Generally, it has four basic choices:

1. **Income** or **lump-sum** subsidy.
2. **Price** subsidy.
3. **Provision of good to users.** Generally users have little or no choice.
4. **Voucher** subsidy. Users either receive pieces of paper called vouchers or the ability to determine how a sum of money will be spent on their behalf, subject to spending the money on a designated type of product. The latter is sometimes called "having the money follow the user" vs. "having the user follow the money," which is #3.

We want to compare these, holding the size of the subsidy constant. Suppose that the good being subsidized is housing. On the graph below, *X* is housing and *Y* is all other goods indexed by the amount spent on all goods other than *X*.



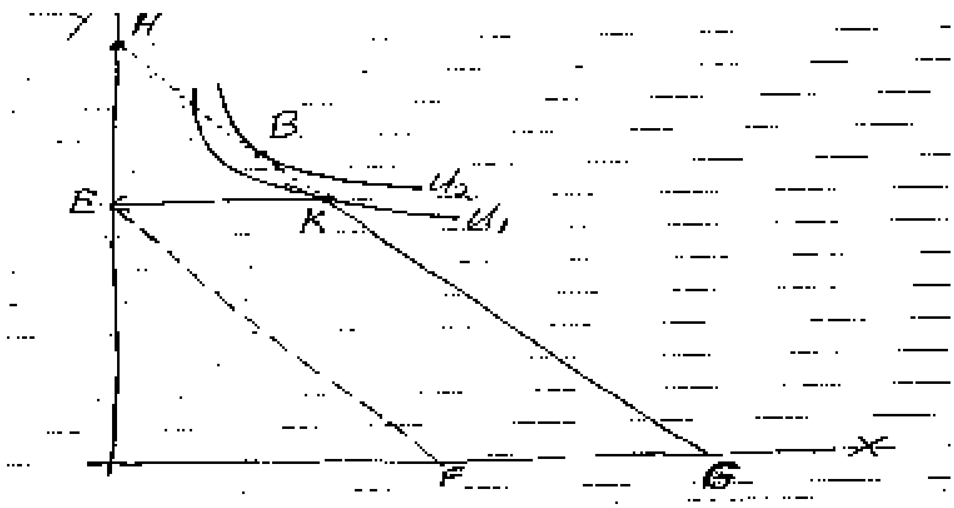
A = solution without subsidy.

B = solution with subsidy given as income or voucher.

C = solution with price subsidy, equal in value to subsidy given as income or voucher.

K = voucher solution when household would choose to buy less housing with an income subsidy than can be bought with the voucher alone.

Thus in the graph below, K is the voucher solution, if B is the solution with income subsidy.



In the above case, it appears that the income subsidy is preferable to the voucher subsidy, since the former takes the household to U_2 vs. U_1 for the voucher. Therefore, when would the voucher subsidy be preferable? This would require some kind of external benefit when the household consumes more of this good. (A benefit is "external" when it goes to members of society other than the consuming household whose indifference curves are shown.) From society's point of view, this household would then be choosing too little housing at B.

"Adequate" housing may yield external benefits to other members of society, by making low income families more productive and more likely to improve their socio-economic standing over time. More spacious and attractive housing may also help to lower the crime rate and to produce a more cohesive society.

If we contrast a voucher with public provision of the same good or service, public provision restricts individual choice more than a voucher does. In effect, the government decides what kind of product to supply, as well as product quantity and quality. Under public provision, moreover, the supplier ultimately has to please the government, not the user of the housing. The government pays for housing to be built, and a low-income household must accept what is offered if it takes advantage of the subsidy.

For example, a household may be offered just one possible rent subsidized apartment, or just one choice of school, or one hospital, and his/her choices may be restricted in some other way. In particular, there may be limited competition between suppliers and/or suppliers may take little interest in the preferences of ultimate users of the benefits. Questionable practices in buying and selling the good can not be ruled out. There may even be opportunities for the supplier or officials in the gov't. agency that buys the housing to co-opt public-sector revenues or assets for their own personal benefit.

From this perspective, a voucher is a way of delivering publicly-financed products with external benefits--such as education, housing, and health care--directly to consumers in a way that maximizes their freedom of choice, subject to the constraint that they must consume more of these products than they would choose to do on their own. Thus, vouchers allow choices related to the nature of the product purchased, as well as choice among suppliers, and they allow payment to be tied directly to the delivery of benefits.

For example, school vouchers allow choice of school, housing vouchers permit choice of home, and pension vouchers (similar to the U.K. system) allow the user to choose a pension plan and one or more suppliers of pension benefits. The "money follows the patient" approach to subsidizing hospital care allows the patient to choose among hospitals, which compete for patients because the government pays hospitals based on the number of patients they attract.

Of all the above subsidies, the seller is likely to prefer public provision and payment, or else a price subsidy. If the price plus per-unit subsidy exceeds both average and marginal cost, this will probably give the seller a higher profit than the income or voucher subsidy, as well as a larger quantity supplied. From the standpoint of maintaining the political strength of a firm or industry, size is important. Being larger and employing more workers means greater political clout.