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## **HEALTH AND SOCIAL SERVICES IN THE POST-WELFARE STATE:**

### **Are Vouchers the Answer?**

by

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#### **EXECUTIVE SUMMARY**

With the debate about the future of the welfare state in full swing, proposals to replace various government human-service programs with vouchers have suddenly taken center stage in the policy arena.

The White House has proposed converting most of the money spent on federal-housing and job-training programs into vouchers. Conservatives—longtime champions of vouchers for education and low-income housing—have recently proposed vouchers for Medicaid, Medicare and veterans' health care.

While interest in vouchers is growing, little work has been done to systematically study the potential benefits and pitfalls of this approach. A close examination of three relatively long-running human-service voucher programs—food stamps and housing vouchers in the United States and nursing home vouchers in the United Kingdom—helps to shed light on the possible effects of replacing social service programs with vouchers.

The experience with these programs demonstrates that vouchers have numerous advantages over either direct government service delivery or contract delivery. Vouchers can:

- ×reduce unit costs of services;
- ×simplify monitoring;
- ×increase choice;
- ×lower administrative costs;
- ×break the dependency of both government and the recipient on monopoly provision; and
- ×allow for a better match between the preferences of the recipients and the services they obtain.

On the other hand, like all government social programs, vouchers also have unintended effects. Vouchers can increase efficiency, but only within expenditure levels set by politicians and bureaucrats.

*\* Part 1 in a 2 part series examining human-service vouchers.*

In fact, experience demonstrates that the very advantages of vouchers—increased choice, better match of recipients needs to providers' services, etc.—could unleash forces that make costs difficult to control.

By giving people the ability to choose their own service provider, vouchers make the public service more desirable and may thereby draw some people on the margins into the program who previously met their needs outside government. In this way, vouchers could have the effect of not only increasing program costs but moving some people from independence to government dependency—especially for services where an almost unlimited demand for the service exists, such as housing, job training and day care. To the voucher recipient such programs essentially offer "free" consumption of a good. The predictable result is unlimited demand.

For programs that are already essentially entitlements, such as Medicare or veterans' health care, vouchers pose few major risks. In fact, in both programs, vouchers would likely reduce costs and increase quality.

But for other social programs, the only way to eliminate the potential for such effects is by getting government out of the financing and delivery altogether. This would mean moving towards a system in which mediating institutions—families, churches, neighborhoods and community groups—not government, would play the primary role in meeting social needs.

For many human-service programs, such an approach is probably not feasible in the short term. If governments choose to transition to vouchers, the problem of unlimited demand must be addressed. To do so, governments should set a limit on the total amount of support any individual may receive. This can take the form of either a maximum dollar expenditure, a time limit, or a loan instead of a grant. Limits should also be set on overall program expenditures.

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## **I. INTRODUCTION**

From the corridors of Congress to the steps of City Hall, a major rethinking of the American welfare state is underway. Liberals and conservatives alike are conceding that the present system is broken and must be replaced. In the wake of calls for radical change, proposals to replace various government social services with vouchers have suddenly taken center stage in the policy arena.

A voucher is a limited type of currency with a specific denomination of value. Recipients are free to choose their suppliers but are restricted in their choice of goods and services. Unlike money, recipients may not transfer the benefits of their voucher to others. Perhaps the most familiar public vouchers are food stamps. Rather than establishing state-run grocery stores for low-income people, the government provides vouchers to the poor so they can choose their own service provider.

Interest in vouchers cuts across the political spectrum. The White House has proposed converting most of the funds spent on federal housing and job training programs into vouchers. "We propose to take the literally billions of dollars the government now spends on dozens of training programs and consolidate those programs and make that money directly available to people who are now eligible for it," President Clinton told students at Galesburg College.

Conservatives—who have long championed vouchers for education and low-income housing—have recently proposed voucher programs for Medicaid and veterans' health care. And in April 1995, House Speaker Newt Gingrich floated the idea of turning Medicare into a voucher program in which the elderly would choose among competing private health plans.

The growing interest in vouchers has not been accompanied by much in the way of systematic analysis into both the potential benefits and pitfalls of this approach. In some cases, vouchers may help deliver services more efficiently. In others, they may have unintended consequences that could increase program costs and/or encourage persistent dependence of recipients on government subsidies. When are vouchers appropriate? When are they not? What set of safeguards are needed when adopting vouchers? By examining the performance of existing voucher programs, we will tackle some of the difficult questions that arise when governments convert social programs to vouchers. By doing so, we hope to shed some light on the possible

real-world effects of vouchers.

## **II. THE FAILURE OF CURRENT APPROACHES**

The growing interest in vouchers reflects, in part, the increasingly widespread view that the hundreds of billions of dollars a year in social spending by federal, state, and local governments have not had a significant and positive effect on reducing poverty or social pathologies. In fact, by crowding out community and familial solutions, many government social programs may actually have made things worse by weakening self-help capacities.

Leaving aside cash grants, most taxpayer money that goes towards delivering social services is spent in one of two ways: 1) direct government service delivery to low-income citizens (government agencies design, fund, and run the program and directly manage the people delivering the service); or 2) purchase of service delivery from private, nonprofit and for-profit organizations (government employees develop, select, and manage a network of providers). Neither approach has an impressive track record in the social services arena.

### **A. Government Provision**

For several reasons, government is ill-suited to delivering social services. First, as a monopoly provider, government agencies have few incentives to cut costs and increase the quality of services. Without competitive pressures, there exist no powerful restraints on government agencies to control costs and ensure continuous improvement in the quality and efficiency of services.

The second reason is more specific to the nature of social programs. Government is rule-bound and bureaucratic, causing all recipients to be treated alike, even those with very different needs. The result: government is good at dispensing a check, meal, or lodging, but poor at exercising discretion. Successful helping programs often require qualities that government, by its nature, cannot provide well, such as assuming a caring, nurturing role or, when circumstances merit, conditioning aid on changes in behavior.

### **B. Contract Provision of Social Services**

Many governments contract extensively with private providers to supply social services. From asphalt repaving to managing airports to fire protection, contracting out public services has proven to be extremely successful for a wide variety of public services. For social services, contracting out has generally proved more efficient and effective than government provision. However, the results have been less uniformly positive than in the "hard" service areas.

#### *1. Monitoring Problems*

One explanation is the difficulty governments have with monitoring the quality of social services whether provided in-house or by a contractor. For services with measurable ways of evaluating performance such as trash collection or grass cutting, holding a contractor accountable for high-quality services is relatively straightforward. However, in the human service arena, fashioning objective performance indicators is far more complex. For example, how do you assess the quality of a contractor's mental health care or of a child protective-services agency? As one Massachusetts official told us, "[N]o matter whether we do it ourselves or give it to somebody else to do, we don't really know what we get, and we haven't figured out how to ask somebody for what we want either."

Unable to define program goals, never mind measure outcomes and effectiveness, most social service agencies tend to focus on monitoring easily measurable input measures, such as the number of credentialed employees. However, these measures provide little indication about the real quality of the program or service. Outputs, poorly understood, are rarely evaluated.

In the private marketplace, responsibility for monitoring providers—whether of restaurants or car

washes—falls mainly on the consumers of the service. If businesses fail to serve their customers well, their customers go to other providers. No such feedback mechanism exists in the current social service delivery system. The client's only leverage is the threat to leave. But this threat has little effect on the provider because there is always another person waiting in line for the service. One result is wide variations in the quality of services.

## *2.Lack of Competition*

Another factor accounting for social service contracting problems is a lack of competition. Social service contracts are much less likely than other public services to be competitively bid. For example, in 1991, New York City awarded over \$1 billion in social service contracts to sole-source bidders. A 1993 city performance review of New York city job-training programs gave an unsatisfactory rating to 25 contractors, 22 of which had their contracts renewed. In a report highly critical of New York's social service contracting policies, Constance Cushman, the executive director of New York's Procurement Policy Board, comments on this practice:

*Vendor screening is politicized as never before.... We pay dearly for this system in administrative costs, higher prices, and decreased competition, yet still do not succeed in screening out corruption, much less foster quality. A free market is the best safeguard from corruption, and we preclude its existence.*

Public officials cite a number of reasons for not using competitive bidding for social services:

- ×Can't change vendors due to the need for ensuring continuity of services to clients;
- ×The difficulty in obtaining multiple bidders; and
- ×Long-term relationships established with nonprofit providers.

While the specialized nature of the service and client continuity may, in certain cases, be valid reasons for not subjecting some services to competition, the end result is that in the social-service arena governments often fail to realize the principal benefits of contracting out.

## **III. POTENTIAL ADVANTAGES OF VOUCHERS**

The serious weaknesses of both contracting or government provision of social services has caused policymakers to consider vouchers as an alternative. Proponents point to a number of potential advantages from vouchers: client choice, empowerment, increased competition, simplified monitoring and an expanded and more specialized supply of providers. Writes Louis Winnick of the Fund for New York, "[I]t is irrational to ignore this fundamental economic axiom: in markets that serve the poor and needful, the optimal balance between efficiency and fairness is best achieved not by subsidizing a price but by supplementing an income."

### **A. Choice**

Voucher systems allow service recipients and their families to make decisions as consumers by expressing their own particular preferences in terms of price, quality, location and specialization when they choose a service provider. Vouchers also offer flexibility. If clients like the service they're getting from a particular provider, they continue to spend their voucher there. If their experience is unsatisfactory, they have the option to leave and try another provider. Through this kind of feedback, providers discover the best way of providing a service to meet the needs of recipients.

### **B. Competition and Efficiency**

By bringing consumer pressures to bear and introducing competition, vouchers create incentives for

individuals to seek out low-cost, high-quality producers. This forces providers to keep costs and final prices down. The result, in theory, should be lower unit costs of the service and/or higher quality and more diverse services.

### **C. Simplifies Monitoring**

Vouchers could also potentially solve many of the monitoring problems inherent in social-service delivery. Vouchers largely alleviate the need for government monitoring of costs and outputs; quality and price are monitored by the recipient. Government's monitoring function is thus limited to controlling fraud and abuse and supplying clients with information about suppliers.

### **D. Increases Supply and Diversity of Providers**

By putting the choice of providers in the hands of consumers, vouchers also have the potential to break up producers' monopoly on the supply of social services. The result should be an overall increase in the supply, quality, and diversity of providers. Vouchers should prompt suppliers to tailor their programs and services to better meet the particular needs and circumstances of voucher holders. Providers will begin to specialize in meeting different market niches.

## **IV. EMPIRICAL EVIDENCE**

Will social-service vouchers work as well in real-life as in theory This is the question we now address.

Three decades of failed government social programs demonstrate that when government tries to ameliorate social problems, even the best of intentions can have disastrous consequences. One explanation is that policymakers failed to think through the unintended consequences that government programs would have on individual behavior and on a community's capacity to take care of its own residents. In crafting alternatives to the welfare state, it is important not to repeat these same kinds of mistakes. Any and all possible unintended effects of vouchers must be fully explored and understood.

Before moving forward with proposals to replace some social services with vouchers, a number of critical questions must be answered:

- ×Does government need to be financing the service at all
- ×Do vouchers better serve the needs of recipients
- ×Do vouchers control unit costs
- ×Do vouchers control program costs
- ×Do vouchers provide the proper incentives for recipients and providers
- ×Are there possible unintended consequences from moving to vouchers
- ×For what social services are vouchers appropriate and for which are they not

By examining three relatively long-running human-service voucher programs—food stamps and housing vouchers in the United States and nursing home vouchers in the United Kingdom—we hope to yield some insight into these questions and provide policymakers with guidance into the feasibility and desirability of employing vouchers for other social services.

### **A. Food Stamps**

### *1. Description*

The Food Stamp Program (FSP), serving about one in ten Americans at an annual cost of nearly \$25 billion, is the largest voucher program in the United States. Each food stamp has a set monetary value and can be used to purchase food items in some 215,000 different food outlets. The food stamp program is part of the Department of Agriculture's Food and Nutrition Services (FNS), but it is administered by state and local governments. The federal government funds the entire cost of the voucher and shares administrative costs with the states on a 50-50 basis.

Eligibility for food stamps is income-based; the cut-off is set at 130 percent of the poverty level on a gross income basis. While not an entitlement program by definition, Congress effectively made it so in the 1970s by requiring all states to serve all eligible persons.

Women with Infant Children (WIC) is a supplemental food program for nursing mothers, serving some six million women, infants, and children. Eligibility is set at 180 percent of the poverty line. It differs in several ways from the food stamp program: 1) the certificates are valid for a more limited set of commodities; 2) the certificate is quantity based (i.e. one package of diapers) rather than value based (i.e. \$5.00); and 3) the program is entirely funded by the federal government.

### *2. History*

When food stamps were first initiated in the 1930s, the motivation was two-fold: 1) to help alleviate the hunger problem caused by the Great Depression; and 2) to lower the large surpluses of food stocks that had piled up in government warehouses due to farm price supports. When World War II exhausted these food stocks, the first food stamp program was eliminated.

Increasing stocks of food in government warehouses during the 1950s prompted congressional debate on renewing food stamps. To satisfy midwestern farming interests, however, a direct provision program, rather than food stamps, was enacted in the 1950s. This allowed the Department of Agriculture to direct wealth transfers to very specific agricultural interests.

With political power shifting from rural to urban interests, food stamps were reintroduced by President John F. Kennedy. Food stamps, like other social programs, allowed urban legislators to gain wider visibility.

### *3. Unit Costs*

The effect of food-stamp vouchers on costs needs to be examined in several ways: unit costs and total program costs. In terms of unit costs, food stamps are less expensive than it would cost to run government food stores for the poor. By issuing a voucher rather than directly distributing the food, government avoids considerable overhead and personnel costs.

This is substantiated by empirical evidence. The WIC program is a voucher-type program in all states but Mississippi, where the state distributes the commodities directly. Figure 1 shows WIC administrative costs for Mississippi and the average WIC administrative costs for the southeast region and the nation. Mississippi's direct distribution program consistently operates with higher administrative costs than other states.

### *4. Total Program Costs*

Total program costs are another matter. Figure 2 shows the growth of total program costs in WIC, not an entitlement, and FSP, which has become a defacto entitlement, meaning that everyone fitting certain eligibility requirements receives the benefit. Given the rapid growth of other entitlement programs such as Aid to Families with Dependent Children (AFDC), Medicaid and Medicare, the rise in the costs of the food-stamp program is unsurprising. Politicians have strong incentives to increase the pool of people eligible for entitlement programs and to raise the level of benefit payments. Individuals at the margins (near

the eligibility cutoff), meanwhile, have strong incentives to mold their situations in a way that makes them eligible for the government subsidy.

The food stamp programs appear to demonstrate that vouchers provide no restraint on total program costs.

**Table 1: Error Rates in FSP (%)**

Year	Overpayment	Underpayment	Total
1/75 – 12/75	15.8	1.9	17.7
1/76 – 12/76	13.0	1.9	14.9
1/77 – 12/77	11.9	2.2	14.1
10/80 – 9/81	9.9	2.5	12.4
10/81 – 9/82	9.5	2.4	12.0
10/82 – 9/83	8.3	2.4	10.9
10/83 – 9/84	8.6	2.3	10.9
10/84 – 9/85	8.3	2.2	10.5
10/85 – 9/86	8.1	2.3	10.4
10/86 – 9/87	7.6	2.7	10.3
10/87 – 9/88	7.4	2.5	9.9
10/88 – 9/89	7.2	2.5	9.8
10/89 – 9/90	7.4	2.5	9.8

### 5. Monitoring Recipient Eligibility

The costs of redeeming food stamps falls on the federal government, but the cost of accurately issuing the stamps falls partly on state authorities. This creates perverse incentives. To reduce issuance errors, states and local authorities must incur increased costs—in terms of both money and effort—yet the benefit goes entirely to the federal government. With the cost of overissuing being borne wholly by the federal government, states have little incentive to accurately issue food stamps.

High error rates have plagued FSP since the 1970s when monitoring began. In 1975, overpayment errors were running at 15 percent; underpayment at just under 2 percent. Congress responded in two ways: by imposing fines on states exceeding an established limit and offering incentives for states to reduce their error rates. By 1985, states were required to meet a maximum overpayment error rate of 5 percent. In 1983 Congress agreed to pay 75 percent of the costs related to state efforts to reduce high error rates. Between 1975 and 1983, error rates fell by almost half, but between 1983 and 1990 the error rate dropped only another 1 percent, to 7.4 percent. While an improvement, this was still 50-percent more than the desired level. (See Table 1).

### 6. Food-Stamp Fraud

Fraud has always been an issue with food stamps. Vendors have an incentive to accept vouchers for unauthorized items. Recipients can sell the vouchers on the black market, use the money for drugs and alcohol, and claim the voucher was stolen.

Modern technology should make food-stamp fraud much less of a problem in the future. Plans are underway to change the system so that rather than issuing physical stamps and vouchers, an electronic benefit card will be issued. Working in much the same way as credit, debit and ATM cards do, electronic vouchers will offer protection against "stolen" cards and will sharply reduce the costs of, and incentives for, fraud and theft. Pilot programs have been tested in several states and results have been positive.

Such electronically based benefit systems may also prove useful in curtailing other forms of fraud. Some vendors redeem vouchers for unauthorized items. Large retailers generally rely on electronic scanners to read the item and price at the cash register. The software which operates these scanners can be upgraded to recognize authorized and unauthorized items.

## B. Housing Vouchers



## *1. Description*

The federal government has two voucher-type housing programs targeted at low-income renters: Section 8 Rental Certificates and housing vouchers. These programs share a number of common characteristics:

- ×Recipients receive a housing subsidy set at 50 percent of an area's median income;
- ×The federal government pays both the rental subsidy and administrative costs;
- ×Neither is an entitlement program. Though program eligibility is income determined, only a limited number of income-eligible renters receive these subsidies; and
- ×Local Public Housing Agencies (PHA) offices are used for daily administrative tasks, such as recipient- and rental-unit certification and the issuance of the certificates or vouchers.

Section 8 Certificates and the newer housing voucher program are also different in a few important ways.

First, the Section 8 Rental Certificate is a contract between the federal government and the landlord that must be used within a specific geographical area. The vouchers, on the other hand, are fully portable; the housing subsidy recipient can use the voucher to rent a unit outside the jurisdiction of the local housing authority. Recipients can also move freely and take the voucher with them.

Second, Section 8 Rental Certificates are allocated to local housing authorities according to a set number of subsidy contracts. Annual landlord rent increases are approved each year by the housing authority. Unanticipated increases in the rental rates during the contracting period are covered by annual appropriation. Funding for the voucher program, on the other hand, is based on the total dollar amount available. Unlike the certificate program, vouchers receive no additional funding over the five-year appropriation period.

The third difference concerns the rental subsidy. The rental subsidy in the Section 8 program is based on the notion that housing should cost around 30 percent of an individual's income. The maximum rent which can be charged, called the fair market rent (FMR), is set at the 45th percentile of the rents paid by people who have recently moved in the local housing market. Rents cannot exceed this ceiling. Once a tenant chooses a particular rental unit, the housing subsidy is calculated as the difference between the actual rent, subject to the FMR criteria maximum, and 30 percent of the recipient's income. In contrast, the pure housing voucher is calculated using the FMR criteria, not actual rents, meaning voucher recipients have the option of choosing a more expensive housing unit and paying for the difference themselves.

## *2. History*

The Section 8 Housing Assistance programs were enacted in 1974. The voucher program was not established until 1983. By 1987, only 82,000 tenants were receiving HUD vouchers, while 874,000 tenants were receiving Section 8 certificates. Since then, however, the voucher program has been the fastest growing of HUD's subsidized housing programs. Over 340,000 tenants were receiving housing vouchers by 1993, compared to over 1 million tenants in the Section 8 certificate program.

## *3. Costs*

Because housing voucher programs rely on existing housing stock, they tend to cost much less per unit than providing public housing, costing anywhere from one-tenth to one-half the cost of public-housing projects. Some analysts contend that even these savings are understated because the costs of constructing new public housing are often incomplete or under-reported. Administrative costs, the nonsubsidy cost, are also much higher for public housing than for vouchers.

## *4. Section 8 Certificates vs. Housing Vouchers*

The different structures of the Section 8 and housing voucher programs have caused significant variations in average percentage rent increases. Voucher recipients have strong incentives to search for competitively priced units; Section 8 certificate holders do not. "Under the voucher program, the tenant has a strong incentive to negotiate rents with landlords and value changes in housing quality relative to costs," writes Kenneth Ryder, Jr. from the Office of Management and Budget. "Under the Section 8 certificate program, the tenant's only incentive is to maximize quality since the tenant cost is fixed at 30 percent of income." A Rand Corporation study found that these different incentives translated into average initial rent increases of 26 percent for individuals entering the Section 8 program compared to only 1.2 percent for those in a voucher program.

When certificates are issued, they also must remain fully funded. If for some reason the certificate program runs into higher rental costs than anticipated, HUD requests additional funding from Congress. This does not take place under the pure voucher program. This constraint on vouchers forces PHAs to more carefully issue vouchers and explicitly consider potential future changes in the housing market.

### *5. Effects on Area Rental Prices*

A prominent concern with housing vouchers is that by increasing the demand for low-income housing, they could artificially drive up rental prices for all residents. On a national level, there is little evidence to suggest that such effects have materialized—due in part to the fact that both voucher programs still represent a relatively small part of any local housing market.

When a large number of housing vouchers were distributed in two concentrated local housing markets (Green Bay, Wisconsin and South Bend, Indiana), the effects on rental prices were surprisingly quite modest (under 2 percent), according to the Experimental Housing Allowance Program (EHAP), conducted by HUD in the 1970s.

### *6. Client Choice*

By allowing for portability and giving recipients an incentive to shop around for the unit that best fits their income and housing needs, the housing voucher program gives clients a much wider array of options than traditional public-housing programs.

The rental certificate program, however, fails to offer a "shopping" incentive to recipients. This affects performance in two ways: monitoring costs increase; and recipients are prompted to seek the highest quality rather than highest value units. Under the certificate program, recipients have no incentive to choose a housing unit costing less than the full benefit level. Landlords, for their part, fully aware of the FMR in their area, have a strong incentive to boost their rent to this level.

The Section 8 certificate also places an additional burden on recipients. A certificate recipient who has the misfortune to have rent increased above FMR must either move or leave the program, losing all benefits. With the voucher program, recipients have the option of paying the additional rent out of pocket.

### *7. Unintended Consequences*

The evidence suggests that housing vouchers have a number of advantages over traditional forms of public housing: they promote choice and competition; they can be administered without a huge government bureaucracy; and they enable poor people to escape public-housing ghettos.

However, a number of influential writers and academics—such as Howard Husock, Director of Case Studies at the JFK School of Government at Harvard University and author James Bovard—have raised serious objections to proposals to expand the federal housing voucher program. The crux of the argument against housing vouchers is that while they may make some economic sense, they're bad social policy—a bad idea well executed.

Husock, a prominent housing expert, contends that housing vouchers run up against the unwritten rules of American housing traditions. His argument goes like this: Americans fashion communities at many different income levels, each representing a separate rung on the housing ladder. Most people start off at the lower rungs and work their way up the ladder from one community to another. For better or worse, similarities in incomes, education levels and social class have long provided the building blocks for community cohesion. By arbitrarily providing housing voucher subsidies to poor people to live in the community of their choice, government turns the whole notion of the housing ladder on its head, allowing some people to "leapfrog" up the ladder by virtue of their lack of income. "This is a kick in the teeth for those families among the working poor who are struggling to escape neighborhoods plagued by underclass elements and to move up the housing ladder and be rewarded for their effort," writes Husock.

Author James Bovard argues that flooding the market with vouchers or Section 8 housing certificates turns working-class communities into slums as voucher recipients bring with them the crime, illegitimacy, and antisocial behavior characteristic of the public-housing projects they left behind. "Trouble-making public-housing residents will not be transformed into angels simply by moving them into different neighborhoods," writes Bovard. He cites examples in the Chicago area where public-housing residents, armed with Section 8 certificates, have poured into a handful of communities on the city's southern edge, transforming them into "Section 8 corridors." "The intent of the Section 8 program is not to create Section 8 neighborhoods, but that's exactly what's happening," says Michael Roche, executive director of the Fair Housing Coalition of the South Suburbs.

To date, the evidence that vouchers can wreak havoc on working-class communities is mostly anecdotal. Voucher proponents dismiss such objections to vouchers by arguing that there aren't enough Section 8 certificates or housing vouchers on the market to have any real impact on more than a few select communities. Moreover, they point out that the current structure of the Section 8 program forces housing providers to take all applicants—within reason—if they take any. Giving the landlord more discretion in choosing which recipients they could accept could reduce the possibility of creating "Section 8 corridors."

Not enough substantive research has been done on these issues for us to answer definitively that vouchers currently are having serious adverse consequences on the social stability of neighborhoods. However, it is clear that a large expansion of either the Section 8 or voucher program could potentially have two major adverse consequences. First, it could lead to the creation of another entitlement. Second, it could cause a deterioration in the social stability of low-and medium-income working-class communities.

## **C. United Kingdom Nursing Homes for the Elderly**

### *1. Description and History*

The United Kingdom's Residential Care program, a national-level program initiated in 1981 and ended in 1993, gave eligible elderly individuals supplemental income support to fund residential care costs. The British government made payments directly to elderly individuals who could use the vouchers to pay for the residential care or nursing home of their choice.

Registered residential care homes, registered nursing homes, and small homes were all eligible to receive the vouchers. All had to meet certain minimum requirements, although small homes were not required to register with authorities.

Income support was available to all elderly citizens lacking sufficient resources of their own. It was intended to raise a person's income until it equaled the level of fees of the nursing home or residential care, plus an allowance for personal expenses. The amount of the voucher was dependent on the type of care the home provided, meaning it was determined by what the different types of care facilities charged their residents. Local Department of Social Services (DSS) officers certified the recipients but strangely were not allowed to determine what level of care was needed or to evaluate the level of care the home provided.

### *2. Costs and Monitoring*

From the perspective of controlling costs, the U.K. nursing home experience was an unmitigated disaster. The program grew by 50 percent a year between 1979 and 1991. Three main factors contributed to this outcome: 1) the lack of recipient shopping incentives; 2) dysfunctional monitoring by program administrators; and 3) the entitlement nature of the program.

Voucher recipients received a payment for the expenses they incurred. No professional assessment of the appropriate type of care a recipient needed was required. No mechanism was in place to ensure that recipients' needs were appropriately matched with the level of service received. Since recipients didn't bear any burden of the cost, they simply sought the services most desirable to them without any consideration of costs. No incentives existed for the elderly to find alternative ways to meet their needs or to shop for the least-cost providers.

The entitlement nature of the program allowed virtually any costs to be justified. According to D. Jackson and R. Haskings, both officials in Britain's Social Security unit: "Where it was considered unreasonable to require the person to move to less expensive accommodation[s]...supplementary benefit could meet the fees however high they were." Such discretionary benefits were abused, thereby causing huge expenditure increases. From 1981–1985, caseloads soared by over 500 percent and expenditures rose by over 1400 percent. Notes Francois Lacasse of the Organization for Economic Cooperation and Development (OECD),

*[A] ratchet effect seems to have operated: once a recipient was in a home, it proved politically impossible to stop or reduce the subsidy and extremely difficult to resist pressures for improved quality or cost increases.*

To make matters worse, providers had no incentive to keep their prices down. The program provided no means for monitoring the services and prices of providers, other than the level of care a home registered to provide. Care providers soon realized fees could be raised to the maximum allowable level simply by registering for higher levels of care. "Social Security had become a clear incentive to set up homes where the limits were set high," write Jackson and Haskings from the Department of Social Security, "[P]roprietors became more aware of the possibilities and charges began to be leveled up within local limits." Moreover, the expanding pool of suppliers began to heavily advertise their services and availability. This increased latent demand from possible clients—another factor in the rising caseloads.

### *3. Market Distortions*

By only providing vouchers for residential care and nursing home care, Britain's quasi-voucher scheme also had the effect of distorting the market for elderly care. The government subsidies undoubtedly influenced many people in their choice of care, skewing their decisions towards residential care and nursing homes and discouraging the choice of less costly alternatives such as sheltered housing or domiciliary care.

### *4. Conclusion*

The program's soaring costs and perverse incentives caused the British government in 1993 to fundamentally alter the elderly care program. The new system trimmed some of the voucher-like aspects, put in controls over the caseload via needs assessments, and removed the distortions that led to the bias towards high-cost care options.

Britain's elderly care program serves as an important lesson about the behavioral forces unleashed when vouchers are employed in the absence of strict limits on program expenditures. Any scheme in which a voucher is made a universal right or entitlement is likely to experience skyrocketing costs and rising dependency on government subsidies. To the voucher recipient, such programs essentially offer "free" consumption of a good. The predictable result is unlimited demand.

## **V. IMPLICATIONS AND RECOMMENDATIONS**

### **A. Advantages**

These three programs support several conclusions about vouchers. On the one hand, many of the theoretical advantages attributed to vouchers were borne out by real-world experience. The case studies demonstrated that vouchers can reduce unit costs of services, simplify monitoring, increase choice, lower administrative costs, and break the dependency of both government and the recipient on monopoly provision.

As economic theory would predict, voucher recipients proved capable of choosing the service provider who best met their needs. The competition generated by giving clients choices caused a rapid adjustment in supply, encouraging a diversity of providers. This allowed for a better match between the preferences of the recipients and the services they obtained. In all three cases, the private market had little difficulty meeting the increased demand generated by the voucher programs.

## **B. Limitations**

On the other hand, the programs also demonstrated the limits of vouchers as a social-policy tool. Vouchers can increase efficiency, but only within expenditure levels set by politicians and bureaucrats. They provide no guidance or "rationing" mechanism on how much of a given service is provided. In fact, by increasing the quality and supply of government-financed services, vouchers will likely increase demand for the service, thereby making controlling overall program expenditures more difficult than previously. The result: reductions in unit costs generated by competition may be overwhelmed by rising program caseloads.

Exploding program costs are not specific to vouchers; other government programs have experienced similar characteristics. However, in the case of government provision or contracts, physical capacity constraints can easily be reached in the short run. In a voucher program, no such short-run capacity barriers exist—vouchers are simply paper with ink. Unless a binding physical constraint exists in private-market capacity, program size will largely be governed by political pressures. While the rapid increase in expenditures in the nursing home case study cannot be attributed to vouchers themselves, the increase would have been less likely if Britain's local governments had been required to provide the capital for the facilities.

Rising caseloads are not caused by vouchers per se, the main culprit is the entitlement nature of the program. However, employing vouchers is probably more likely than other approaches to lead to the creation of a quasi-entitlement. In his summary of the international experience with vouchers, Lacasse of OECD explains:

*Vouchers as a delivery instrument do not provide an escape from the well-known difficulties of forecasting and controlling expenditures for new entitlements. This has been a common problem in many Member [OECD] countries and reflects our very limited knowledge of the pattern of behavioral and strategic adjustments to new entitlements which always seem to translate into take-up rates much higher than originally expected.*

*Moreover, we believe that vouchers are likely to exacerbate the size and speed of these behavioral adjustments because of their very efficiency in stimulating supply growth, particularly when cost control previously relied heavily on rationing by queues or administrative rule. (emphasis added)*

Lacasse's implication is clear: by giving people the ability to choose their own service provider, vouchers make the social service more desirable and may thereby draw some people into the program who previously met their needs outside government. Government provision in effect is a form of rationing by poor-quality. Vouchers remove this rationing mechanism. For example, many low-income people who find the prospect of living in a public-housing project unattractive or who wouldn't send their kids to state-run day care centers would gladly accept a government voucher for either service if they had the chance to obtain desirable, privately provided service. In this way, vouchers could have the unintended effect of not only increasing program costs but moving some people from independence to government dependency especially for services where an almost unlimited demand for the service exists, such as housing, job training and day care.

## **VI. AVOIDING THE PITFALLS**

As long as government funds social services, some unintended effects are almost inevitable. The source of the problem is that unlike normal market relations, government social programs have three distinct parties: the funder, the producer and the consumer. This tri-lateral relationship separates costs and benefits, thus creating the potential for abuse, dependency and various other unintended consequences.

The only way to eliminate the potential for such effects is by getting government out of the financing and delivery of social services altogether. This would mean moving towards a system in which mediating institutions—families, churches, neighborhoods and community groups—not government would play the primary role in meeting social needs. Numerous reforms have been advanced to encourage such a transition. The Dallas-based National Center for Policy Analysis has proposed allowing people to send their tax dollars now going to government welfare programs directly to the charities of their choice. Another proposal now gaining in popularity is to allow people to take a federal tax credit of up to \$300 for contributions to nonprofit groups engaged in alleviating poverty. By allowing people to keep more of their money, income tax cuts would also almost certainly increase voluntary contributions to private charities. By largely bypassing government, these types of proposals overcome the main defect of vouchers—namely the temptation they provide for individuals to get hooked on government subsidies. They also provide the added benefit of encouraging the strengthening of the weakened institutions of civil society.

### **A. Targeting Those Most in Need**

For certain social services, however, vouchers could offer a compassionate and humane alternative to state provision without experiencing significant unintended consequences. These include social programs in which the state has historically assumed responsibility for providing for those who cannot provide for themselves and where eligibility is based on nonbehavioral or nonchoice characteristics. One possibility might be to convert programs for the mentally handicapped/disabled into vouchers.

This group is likely to represent a fairly stable population size, meaning reasonable estimates of total program costs can be made. To be sure, the availability of a voucher might increase demand. Moreover, political pressures to expand the definition of who fits the target population will still exist. However, the relatively fixed nature of the population makes such scenarios less of a potential issue than for most other social programs.

Most of these individuals will be incapable of making good choices themselves. In these instances, the voucher would be given to the family or guardian who would then be responsible for choosing the service provider most suited to the individual's special needs and circumstances. If there is no family or guardian available, the state would continue to assume responsibility. Similarly, court-ordered services in which state paternalism is required, such as drug and alcohol treatment, child protective services or some instances of mental health care, would be inappropriate for vouchers.

### **B. Create Incentives for Recipients to Exit the System**

Most government spending on social programs is not based on mental disability, but instead on age or a lack of income. Under a voucher system, an almost unlimited number of people could potentially be eligible for such programs, resulting in escalating costs to taxpayers and increased government dependency. Consequently, as a general rule, the best course of action is to rely primarily on the private voluntary sector to serve most social needs.

If, nevertheless, vouchers are provided for such assistance, recipients should generally not expect government subsidies to become a permanent way of life. Social programs should encourage independence not dependence, helping people to be functioning, productive members of society rather than clients of services. They should emphasize individual responsibility.

We can suggest two possibilities for introducing incentives for recipients to exit voucher programs. First, to deal with the problem of unlimited demand, governments should set a limit on the total amount of support any individual may receive. This can take the form of either a maximum dollar expenditure or a time limit. Limits should also be set on overall program expenditures. This would mean avoiding making the voucher an entitlement.

The second option is for government support to take the form of a loan or co-payment arrangement instead of a grant, or some combination of the three. In the latter case, some level of support would be given freely (with a co-payment requirement) over a limited time period, but after a certain point the grant would become a loan. Making public support a scarce resource brings the normal laws of economics into play, and would encourage more responsible behavior, reducing incentives for individuals at the margins to mold their situations to fit eligibility requirements.

This structure also recognizes the reciprocal nature of social support. Creating a one-way relationship of assistance weakens the social fabric which holds societies together. Recognizing reciprocity in public programs reinforces a proper conception of social relationships that is necessary to succeed in a market economy. Success in a market environment depends on more than merely having a salable skill. Market relations are based on reciprocity and intertemporal choices. Social programs based on a giver-taker relationship that focuses on current consumption teach people to maximize current consumption and ignore the future.

Placing limits on the level or duration of public assistance, requiring a co-payment, and providing some assistance in the form of a loan rather than a grant would help to instill a more appropriate "culture." Most would agree that investments in either human or nonhuman capital are a necessary prerequisite to self-sufficiency. A program design which inadvertently teaches the opposite cannot lead to increased independence.

## **VII. CONCLUSION**

Vouchers provide an efficient, flexible delivery system, suitable for many human services but like all government social programs, vouchers can also have their drawbacks. In the rush to embrace vouchers for human services, policymakers must be aware of their limits and potential unintended consequences. The nature of the democratic political process means there is a very real danger that vouchers will turn into an entitlement. For programs that are already essentially entitlements, such as Medicare or veterans' health care, vouchers pose few major risks. In fact, in both programs, vouchers would likely reduce costs and increase quality. However, for new government programs or existing ones that are now essentially being rationed by poor quality, vouchers could unleash forces that make costs difficult to control.

The widely varying nature, scope and size of social programs at all levels of government means that we cannot provide either a blanket endorsement or condemnation of the idea of replacing public health and social programs with vouchers. Whether vouchers will make for better social policy depends largely on the particular characteristics of the particular human service program in question.

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## ENDNOTES

1. State and local governments have already begun using vouchers for a variety of social programs including day care, home care for the elderly, mental health, disabilities rehabilitation and care for mentally retarded children. A 1993 Reason Foundation survey found that 50 percent of state social service agencies and 43 percent of counties had used vouchers to provide social services. The widest use of vouchers is in day care services where at least 20 states have created child care choice programs.
2. Housing and Urban Development (HUD) Secretary Henry Cisneros has proposed converting the money spent on building and maintaining government-run, low-income housing to vouchers so recipients could select the housing of their choice.
3. The administration also hopes to abolish over \$1 billion of federally funded job training programs. Modeled after the Pell Grant program, which provides vouchers to the poor for college, the administration would replace the federal job training programs with vouchers of between \$2,000 and \$3,000 a year for displaced workers to spend on their choice of training programs. "Our proposal is to take all the adult job-training programs and essentially get rid of them and substitute instead a skill grant," said Secretary of Labor Robert Reich. See: Tim Poor, "Reich Offers Outline of Job-Training Plan," *St. Louis Post-Dispatch*, December 17, 1994, p. 1A.
4. President Clinton, speech at Carl Sandberg Community College, Galesburg, Ill., January 10, 1995.
5. The New York Times Columnist William Safire and the Washington-based Cato Institute have suggested giving veterans vouchers for purchasing private health care as a replacement for the current expensive, government-run veterans hospital system. Numerous state research organizations have proposed turning Medicaid into a voucher program.
6. Robert A. Rosenblatt, "Gingrich Vows to Assure Solvent Medicare Future," *Los Angeles Times*, April 29, 1995, p. A1.
7. Cost savings from competitive contracting typically average between 20 and 50 percent and service quality often increases (most public officials cite increased quality as a central reason for contracting out). For evidence, see for example: E.S. Savas, *Privatization: The Key to Better Government* (Chatham, N.J.: Chatham House Books, Inc., 1987) and *Privatization 1994*, Annual Report on Privatization, John O'Leary, ed., (Los Angeles: Reason Foundation, 1994).
8. Official in the Massachusetts Department of Health and Human Services who wished to remain anonymous, April 1994.
9. Louis Winnick, "Privatizing Social Services: Are Vouchers a Pathway," unpublished paper, March 1995, p. 10.
10. *Ibid.*
11. William D. Eggers and Raymond Ng, "Social and Health Service Privatization: A Survey of County and State Governments," Reason Foundation Policy Study No. 168, October 1993, pp. 7-8.



12. Winnick, "Privatizing Social Services," p. 11.
13. This is only applicable for programs in which needs are defined in terms of what the recipient wants. For some services, such as court-ordered drug and alcohol or mental health treatment, the state may find it counterproductive to allow for choice because recipients may opt for the least rigorous program, thus making their choice at odds with the outcome most socially desirable.
14. Competitive markets force producers to seek low-cost solutions. Producers in a competitive market cannot increase prices much above a competitor's price. The only way to increase profits is to reduce costs. With lower costs, a producer either has a higher rate of profit or reduces price to capture market share. In either case, other producers are alerted that a better way has been found to deliver a product or service, spurring them to seek new, cheaper ways of delivering the service.
15. As long as the recipient has a choice, these cost reductions shouldn't be achieved at the cost of reduced quality. Why? Because if service quality falls, recipients will change providers. The competitive market lets producers and consumers engage in a dialogue about cost and quality issues. The simple act of exchange allows both sides to exchange their information and discover what the best price/quality combination will be.
16. The provider offering the best quality/price combination will typically be selected by the recipient. If service quality declines or price increases, the recipient will look to other providers for a better deal. Like any other consumer, the voucher recipient will perform this monitoring function automatically.
17. The competitive incentive for providers to discover low-cost ways of delivering a service is a form of market-induced monitoring. Each producer, in seeking to increase profits, will act as a monitor of the other producers' performance. Producers that cannot or will not keep costs down and quality high will be driven from the market.
18. James C. Ohls and Harold Beebout, *The Food Stamp Program: Design Tradeoffs, Policy and Impacts* (Washington, D.C.: The Urban Institute Press, 1993), p. 12.
19. States can, and some do, make contributions to WIC activities, but are not responsible for any costs.
20. Ohls and Beebout, *The Food Stamp Program*, p. 13.
21. This power shift was due in part to the Supreme Court ruling of one man one vote, which required congressional districts all to be of equal size.
22. Ohls and Beebout, *The Food Stamp Program*, p. 129.
23. *Ibid.*, p. 16.
24. *Ibid.*, p. 80.
25. *Ibid.*, p. 78.
26. U.S. Congress, "State Implementation of Recent Food Stamp Program Reforms," Hearings before the Subcommittee on Nutrition of the Committee on Agriculture, Nutrition and Forests, October 18, 1983, Senate Hearing 98-610 (GPO, 1984).
27. Ohls and Beebout, *The Food Stamp Program*, p. 80.
28. *Ibid.*, p. 147.
29. *Ibid.*, p. 91.
30. PHAs are paid an administrative fee calculated as a percentage of Fair Market Rent (FMR). The current rate is set at 8.2 percent of FMR for a two-bedroom unit. The fee reimburses PHAs for the normal administrative cost of management duties. A start up fee of \$275 is also paid when a new certificate or voucher is issued to cover the additional costs, i.e. certification of client or landlord, associated with starting a new contract.
31. See: Kenneth F. Ryder, "U.S. Housing Vouchers: A Country Report," in "Vouchers: Social Housing

- and Nursing Homes," *Market-Type Mechanisms*, Series No. 4, OECD, Paris, 1992.
32. *Ibid.*
  33. FMR calculation relies on several data sources for determining the range of rents in the local market.
  34. Ryder, "U.S. Housing Vouchers," p. 53.
  35. *Ibid.*
  36. The difference amounts to \$142 vs. \$14 (in 1975 \$) on a monthly basis. See Ryder, *op.cit.*, p. 69. The U.S. Department of Housing and Urban Development, Office of Policy Development and Research, *Final Comprehensive Report of the Freestanding Housing Voucher Demonstration*, Vol. I, Washington D.C., May 1990, p. 168, reports analogous administrative costs. The HUD costs are reported as annual costs in 1990 dollars and pertain to the Section 8 Housing Voucher Program, not the EHAP program as does Ryder's \$14 figure. When adjusted for inflation, the two figures are essentially the same.
  37. Ryder, "U.S. Housing Vouchers," p. 56.
  38. Price Increases Caused by Housing Assistance Programs, R-2677, Department of Housing and Urban Development, 1980.
  39. Ryder, "U.S. Housing Vouchers," pp. 50–51.
  40. Poor planning can easily commit the federal government to higher housing support than was intended. In 1991 and 1992, substantial supplemental funding was required to keep existing certificates fully funded: \$800 million and \$1.1 billion respectively. See Ryder, "U.S. Housing Vouchers," p. 50.
  41. This argument applies to the short-run. Over the long-run, markets should respond with supply increases.
  42. Ryder, "U.S. Housing Vouchers," p. 55.
  43. One reason for the quite modest demand-side effects suggested by RAND economists was that marginally substandard housing is relatively easy to upgrade to standard housing by making small repairs and through better maintenance. This makes the supply of standard housing more elastic in the short-run than the supply of the total housing stock. Thus, the additional demand generated by housing vouchers may have induced some landlords to upgrade their rentals from substandard to standard housing.
  44. The U.S. Department of Housing and Urban Development, "Final Comprehensive Report of the Freestanding Housing Voucher Demonstration," p. 16.
  45. Howard Husock, "Voucher plan for Housing: A Trojan Horse," *The Wall Street Journal*, December 21, 1994.
  46. James Bovard, "Clinton's Wrecking Ball for the Suburbs," *The Wall Street Journal*, August 4, 1994.
  47. James Bovard, "Suburban Guerilla," *The American Spectator*, September 1994, p. 29.
  48. Vouchers could not be used for other possible forms of elderly care such as sheltered housing and domiciliary care (as will be explained later, this created distortions in the market for elderly care). See D. Jackson and R. Hasking, "Vouchers in the Funding of Residential Care," in *Market-Type Mechanisms*, Series Number 4, Organization for Economic Cooperation and Development, Paris, France 1992, p. 26.
  49. D. Jackson and R. Hasking, "Vouchers in the Funding of Residential Care," p. 29. This changed due to the amended Registered Home Act of 1991, which required small homes to register starting in April 1993.
  50. *Ibid.*, p. 28.

51. *Ibid.*, p. 30.
52. *Ibid.*, p. 31.
53. *Ibid.*, p. 30.
54. *Ibid.*
55. Francois Lacasse, "Vouchers: Issues and Experiences," p. 16.
56. The lack of incentive for the elderly to shop for the least-cost provider and the incentive suppliers had to offer only high-cost services was predictably a bad combination, resulting in enormous cost escalations.
57. Jackson and Hastings, "Vouchers and the Funding of Residential Care," p. 31.
58. Francios Lacasse, "Vouchers: Issues and Experiences."
59. *Ibid.*, p. 17.
60. Public resources are not unlimited. This means that some form of rationing will always be necessary whether by price, funding level, eligibility restrictions or queuing.
61. John C. Goodman, "Why Not Abolish the Welfare State," *Common Sense*, National Policy Forum, Washington, D.C., Winter 1995, Volume 2, Number 1, pp. 63–72.
62. It is also possible for recipients to get hooked on private programs, however such programs almost never offer long-term guarantees of continued support.
63. Food stamps, housing assistance, Medicaid, Medicare, and job training and many other social services, all fall under this category.