REORIENTING THE WELFARE STATE

"Bottom-up" vs. "Top-down" Funding

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When government uses a particular mediating structure to advance its social welfare purposes, it funds specific activities through a grant (or contract) made directly to that organization. Known as "third party government," this form of assistance has become a substantial proportion of total government spending for noncash social welfare programs. And the social service arms of many mediating structures have grown accordingly.

Unfortunately, government often selects the wrong mediating structure for the job. And even when it chooses the right one, its assistance often comes with entangling strings that threaten to destroy the very characteristics that make that mediating structure effective. That is why many thoughtful observers decry all government assistance to mediating structures.

Some services (residential care and health care, for example) are too expensive to be funded by the private sector alone, however. If mediating structures are to perform these functions (and many would say that they should not), ways must be found to help them escape what the revised edition of the AEI book To Empower People calls "government's fatal embrace." This paper argues that the dangers caused by government funding of mediating structures can be lessened by an approach to funding that is "bottom up" rather than "top down." In fact, a bottom-up approach has much broader benefits, and it would be easier to institute than many people imagine.

Do the protections afforded by a bottom-up approach outweigh the inherent hazards of government support to mediating structures? As we will see, the answer probably depends on the specific situation (especially since government often regulates mediating structures, even when it does not provide financial support). But readers will have to judge for themselves.

Three Axioms

Stuart Butler presents the starting point for this paper's discussion. In To Empower People, he writes, "Don't decide--let the people decide for you." Before I describe how this principle might be implemented, it may be helpful to emphasize certain axioms implied by his advice.

> ***1. Direct government funding of social welfare agencies (including mediating structures) is likely to create the wrong winners and losers.*** The process is analogous to establishing an industrial policy: that is, government tries to pick the best service provider (instead of the best manufacturer, for example). Unfortunately, governmental decisions are less likely to be correct than are the cumulative decisions of thousands, or millions, of consumers. Worse, once government funding begins, political pressures make it almost impossible to end support. Thus, in his research on the differences between private and government support for start-up companies, Allan Meltzer found that private decision makers were more successful because they were more

likely to abandon an obviously unsuccessful project than was the government. In other words, government is not capable of performing the key aspect of good decision making: creating losers (Meltzer, 1993). Many Head Start providers, for example, were chosen for reasons having little to do with their ability to care for children--and many others continue to be funded even though they are pale reflections of their former selves.

2. Direct government funding of social welfare agencies can alter the nature of their services and raise their costs. When government chooses the service (or agency) for clients, it often imposes costly quality standards on the service. Since government tends to impose regulatory standards with less regard for whether they result in a better service than do individuals (who must pay for the service out of their own pockets), government-supported services or programs tend to be more expensive than those that individuals purchase themselves. And government often decides that it knows how to provide the service better than the actual provider, so that it often requires even successful providers to alter their programs. No better example of this two-sided dynamic exists than the "quality"/cost differentials between publicly and privately funded child care.

3. Direct government funding often requires mediating structures to abandon the very features, like religious activities, that make them effective. Of course, the government, through its police power, always has the authority to regulate the activities of mediating structures even when not giving them money (subject to various but limited constitutional constraints such as the right to the free exercise of religion). (An important point that I return to in the conclusion.) But the temptation to attach requirements to the behavior of mediating structures--and the political support for doing so--is greatly increased when there is direct funding. After all, goes the argument, the money is public money and must be spent in accordance with the "public trust."

What I have described as direct government funding can also be seen as top-down funding. (This issue is widely discussed in the academic literature concerning the "implementation" of social programs.) (E.g., Sabatier, 1986; Palumbo, 1987.) That is, the money is transferred from the government to an agency that, in turn, provides services to its clients.[1] But what if individual clients could make these funding decisions? Although some might select inferior services, on average, they will do better than government because they are in a better position to determine what they need, and because their individual decisions are less likely to be determined by extraneous factors (such as political favoritism). Thus, the cumulative impact of their decisions would likely establish a stronger cadre of services.

Moreover, if individuals rather than government bureaucrats were selecting programs, there would be less chance that institution-distorting strings would be attached. The defunding of apparently unsuccessful services or programs would also be easier because consumers would simply stop selecting them.

Thus, one way to protect mediating structures is to create mechanisms that transform cumulative consumer demand *directly* into funding for their activities (that is, without an intervening governmental decision). This paper examines four methods of achieving this sort of bottom-up funding: (1) cash assistance, (2) lower tax rates, (3) vouchers, and (4) reimbursement for copaid services. It then describes the various situations in which one of the other mechanisms seems most appropriate and the residual dangers that they all pose to mediating structures.

Cash Assistance

Cash assistance can be used for those purchases that can be made in the open market with minimum supervision of the consumer. Cash assistance maximizes consumer choice and requires no special regulation of providers. In addition, giving cash allows individuals to spend less than might have been anticipated on the service--and to use the difference for other purposes. (This approach creates downward pressure on their individual expenditures, on total expenditures, and also on the price of goods and services purchased.)

Cash assistance can take the form of a cash grant to specified clients, an automatic tax benefit for designated classes of taxpayers, or an across-the-board tax cut.[2] The best-known cash approaches are probably Aid to Families with Dependent Children (AFDC) and the tax exemptions for dependents. The House Republican proposal for an increase in the exemption for dependent children under 18 is an example of using the tax code to provide cash assistance for general purposes.

Food stamps, which are discussed next, are usually considered to be vouchers. However, food stamps are increasingly like cash because there is now a black market for purchasing them. If recipients are willing to accept about a 20 percent discount off their face value, most are able to trade their stamps for cash, thereby escaping the need to spend the benefit only on food stuffs. Moreover, even when used properly as vouchers, food stamps have many attributes of a cash grant: Clients are able to use them to purchase any number of different items, so that there is relatively wide consumer choice and corresponding competition among providers.

Recently, welfare agencies have made cash grants available to clients in job training and work programs to pay for child care. Cash grants, as opposed to vouchers to clients or contracts to agencies, allow clients to purchase child care from a variety of informal sources, including family members. Although some advocacy groups feared that parents might seek out inadequate or dangerous placements (to save money), so far there is no evidence of this.

Lower Tax Rates

Many people would view tax cuts, for low- and middle-income families, at least, as a form of cash assistance. Over the past 30 years, a greater portion of the federal payroll and income taxes has been shifted to low- and middle-income workers and to families with children. One of the main reasons for this shift has been the decline in the relative value of the personal exemption. Eugene Steuerle has provided some of the best analysis of this issue (Steuerle and Juffras, 1991; Steuerle, 1983). That greater tax burden on lower-income workers and families puts added financial stress on them and creates more pressure in two-parent households for both parents to work (Besharov and Weicher, 1985).

Some experts justify this shift in tax burden on the basis that low- and middle-income families now receive additional benefits from the federal government. But why do we need to take money from families in order to give it back to them?

Taking money from families (or all taxpayers, for that matter) and giving it back to them in the form of categorical assistance is a way of controlling their spending decisions. So, for example, when tax funds are used to provide student loans to middle-class families, we are taking money from one pocket and putting it into another--because we do not think that parents can (or will) save the money themselves.

This kind of forced saving, or intertemporal redistribution of wealth, sometimes makes good policy sense. Some degree of social engineering is probably inevitable. But we do it far more than we should, and with harmful results. In fact, the process can easily get out of hand, and can hook Americans on a never-ending upward spiral of tax increases to pay for programs designed to relieve the very burdens created by those taxes.

In 1993, for example, the original Clinton proposal to expand the Earned Income Tax Credit (EITC) proposed providing this "low-income" tax benefit to families earning almost $30,000--even as we tax the same families to help pay for the benefit. The administration quickly withdrew this proposal, although I must add that the current EITC has many problems that should be addressed (Steuerle 1995, 1993).

Vouchers

Vouchers force clients to use a specific service or provider (unless, like food stamps, they can be traded for cash or other services). The best examples are probably vouchers for housing and for child care, since they are hard to trade or sell.[3] And since clients cannot pocket the difference between a lower-cost provider and the assumed value of the voucher, they have no incentive to be cost conscious.

Vouchers also increase the tendency of the government to impose standards on the service or program. Generally, to prevent fraud in voucher programs, the government must designate those who may accept the voucher. (Again, food stamps are an exception, because of the large and competitive consumer market for food.) Since the service providers have to be approved, the temptation grows to regulate them--to make sure that the money behind the voucher is not misused.

Contrary to popular impression, tax credits (and, to a lesser extent, tax deductions) are for most purposes more like vouchers than cash--because they can be used only for a designated purpose (if one assumes that the purchases would otherwise not have been made). But what if the purchase would have been made anyway, so that the credit or deduction has no effect on behavior? Then, tax credits are more accurately considered a cash subsidy to a group of taxpayers who happen to behave in a certain way (or have certain expenditures). Thus, President Clinton's 1995 proposed tax deduction for college or other postsecondary education was at most a voucher and, as some complained, might have been no more than a subsidy to the upper-middle class (whose children would likely go to college whether or not its cost is deductible).

An interesting hybrid between cash and voucher systems is "grant diversion." Under this procedure, an individual's cash grant (under, say, Supplemental Security Income, SSI, or AFDC) is paid directly to, for example, a service provider (such as a residential drug treatment program), an employer (to supplement earnings), or a landlord (when rent goes repeatedly unpaid). Since the diversion is for designated purposes, the payment, although formally denominated in dollars, is more like a voucher. As efforts to reshape the behaviors of public aid recipients grow, we should expect greater use of grant diversion-like mechanisms. A system could be established, for example, that allowed homeless individuals to use their food stamps and any other welfare-like payments to cover their housing and food costs. Christopher Jencks, in his book *The Homeless*, makes a similar suggestion (Jencks, 1994). Requiring a copayment might add additional market considerations to the selection process, as described next.

Reimbursed Copayment Systems

Reimbursement for copaid services rendered requires consumers to pay part of the cost of a particular service, often under a sliding fee scale arrangement. The government then "reimburses" the provider for the rest. Copayments are usually seen as a method of constraining costs or rationing services by making individuals feel the costs of their decisions (or at least to feel them partially). Thus, copayment schemes are most attractive when there is a need to encourage recipients to set priorities among what would otherwise be discretionary purchases. Today, they are most often seen in child care programs.

An unappreciated benefit of both total reimbursement systems and copayment systems is that they allow individual choice.[4] Thus, if structured properly, they can provide all the benefits of other bottom-up approaches. For example, even though the government may initially pick allowable providers, it could drop them based on the actual selections of clients: A rule could be established that a minimum number of clients must select that particular service provider over a designated period of time; otherwise, the provider is dropped from the list.

Ordinarily, a reimbursement system, such as Medicaid or Medicare, is subject to runaway costs because recipients have no incentive to economize and providers do not compete on the basis of cost. Copayment requirements help, but program costs are still hard to control. Hence, many programs adopt additional ways to restrain costs, such as by limiting the number of approved service providers (if the number of approved providers is small enough to restrict access). Medicaid uses this approach to limit the number of heart transplants it funds. Income-eligibility guidelines can also restrain costs, by limiting the number of potential clients.

Conclusion

Except for lower tax rates, each approach described above can be applied to funding any mediating structure, from the family to organized religions.[5] And taken together, they provide a menu of approaches that reduce the risk that government assistance will prove to be a fatal embrace for particular mediating structures.

Nevertheless, except for cash, each approach does increase the risk of greater government control of mediating structures. In fact, this is a real danger even when government does not provide financial support. Government regularly uses its police power to regulate the activities of the mediating structures it does not fund. (In many places, for example, church-based day care is regulated even when no public funds are involved.)

There is, though, the other lurking problem with government funding of mediating structures: It builds a politically connected constituency for continued (and increased) government spending. In some areas, like education and health care for the poor, such spending is all but inevitable in the modern world; in others, constituency politics can drive up expenditures.

The issue, then, is one of balance. And the trade-offs vary by context. Medicaid and Medicare funding of church-related hospitals, for example, has created client-driven systems without changing the essential character of those institutions (although the issue of mandating abortion services arises regularly).

There may be other funding devices we have not thought of yet. A surge of fresh imagination would certainly be useful.

NOTES

1. The money usually moves from the federal government to a state government and thence to service providers, but this paper's argument is independent of issues of federalism. The same three axioms apply to state- and locally-funded programs.

2. For brevity of presentation, I have treated a tax cut as cash assistance, even though it is the taxpayer's own money that is involved.

3. Hence, deciding to use a voucher scheme requires a prediction of the degree to which they can be sold or traded, and then deciding if the predicted level of abuse is acceptable.

4. This paper does not endorse total reimbursement schemes, such as Medicaid and Medicare, because, although they maximize client choice, they do not provide sufficient incentives for recipients to constrain costs.

5. Because each approach relies on individual decision making, they all would probably survive the challenge that they provide an aid to religion.

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