

What is an "economic analysis" of public policy?

- (a) Identify market failure (if there is one).  
If none, then efficiency isn't a (normative) rationale, fairness may be.
- (b) What is stated goal? Use economic analysis to predict whether goal will be achieved. (Positive analysis).
- (c) Use economic analysis to consider cost effectiveness: could the goal be achieved at a lower cost?
- (d) Use economic analysis to predict other consequences, esp. unintended consequences and conflicts with other goals.

# Policies directed toward the poor.

## Goals

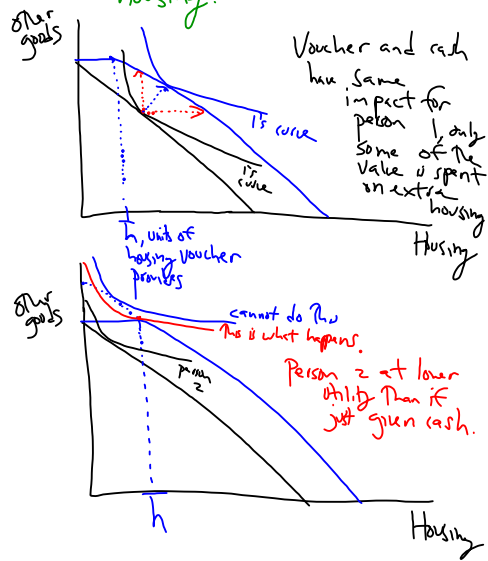
- Raise their utility.
- Give them money.
- Increase their consumption of certain goods.

↳ Probably the usual goal.

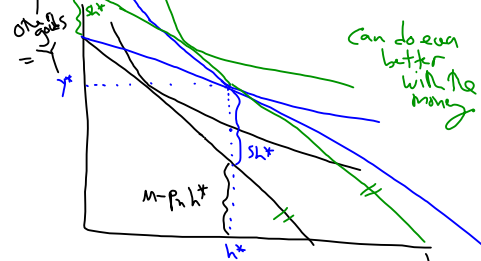
Theoretical problems with focusing on consumption of particular things:

- Harder to do than it seems.

Consider a voucher for housing:



Same kind of result with a price subsidy.



$$P_h \cdot h + Y = M$$

$$(P_h - s) \cdot h + Y = M \quad \text{income}$$

At  $(h^*, Y^*)$ , we have

$$Y^* = M - (P_h - s) h^*$$

Cost to govt of subsidy to this person is  $s h^*$ .

This is also vertical distance between the constraints at  $h^*$ :

$$\begin{aligned} s h^* &= Y^* - [M - P_h h^*] \\ &= M - (P_h - s) h^* - M + P_h h^* \\ &= s h^* \end{aligned}$$

So suppose I give the person money equal to  $s h^*$  instead of the price subsidy.

Then we get:  $P_h \cdot h + Y = M + s h^*$  as constraint.

⇒ Where the targeted nature of the subsidy matters, can get higher utility gain at same cost with cash. So what?

## Actual policies

Cash welfare: TANF, SSI  
In-kind: Food stamps,  
Medicaid, public housing,  
WIC (nutrition).

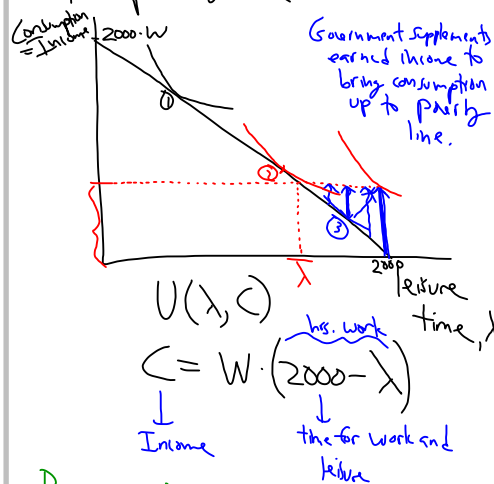
Secure  
stability

work requirements,  
time limits.

## Moral Hazard:

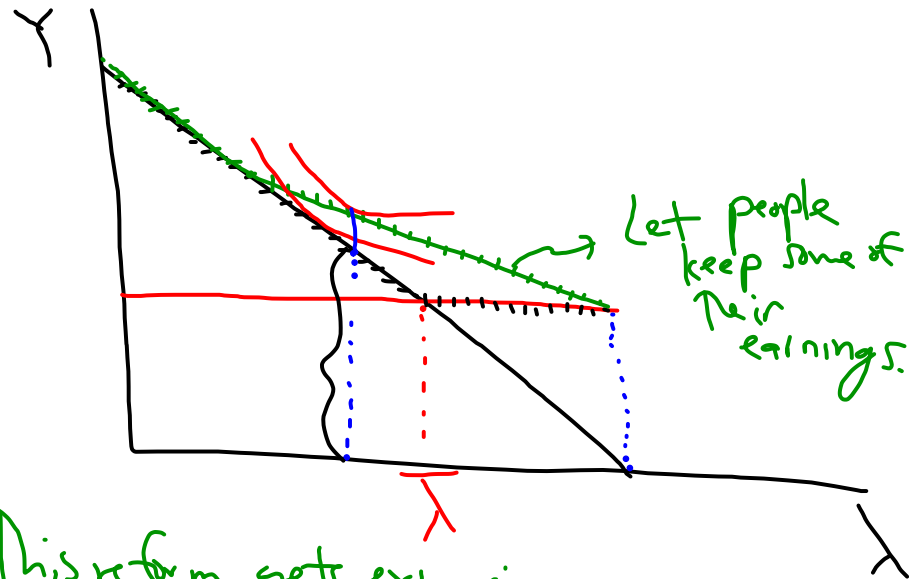
Having the "social insurance" affects whether you enter the "bad" state. So, working less, to become poor, too qualify for assistance.

Illustrated through assistance to bring people's consumption above the poverty line.



Program cost cannot be calculated by just looking at working poor and how much it would cost to bring them up to poverty line.

## Overcoming moral hazards.



This reform gets expensive.

Can also have some unintended consequences on those who weren't affected by the original program. Income and substitution effects toward more leisure, less work

## Targeting

"We only want to help the subset of people with low earnings who have low earning capacity."

[Really? Are all those with low earnings and high capacity engaging in moral hazard? <sup>No</sup> (Other unworthy choice? <sup>Maybe</sup>.)

We could assist those with low earning capacity if we could observe that capacity, and we probably want to, and there would be no moral hazard.

Cannot observe the low capacity but can observe things correlated with this that are not cheaply mimicked.

\* Single motherhood.

(Correlated with low earning capacity, not cheaply mimicked, and in fact

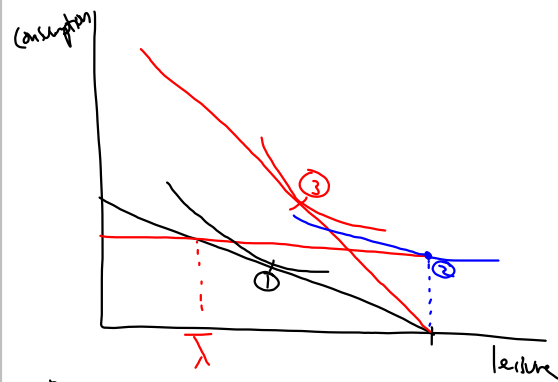
the benefit from programs has been low enough that his data suggest

women aren't becoming single mothers just for the benefit.)

\* Ordeals: something that high capacity want to do, but low capacity will. Training and work requirements.

Iron-kill instead of cash, esp. lower quality stuff. Lines, host<sup>l</sup>. <sup>Simpler mfg.</sup>

\* Improve the outside option  
dramatically.



Really increase wage, people will opt out of  
government program, less moral  
hazard of all kinds (people originally  
below and above poverty line who stop working).

Training programs we have don't seem  
to manage this.

So, focus remains on orders and other  
kinds of targeting