Distributional Impact of Fiscal Policy
In-Kind Benefits: Food, Health, Education

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The World Bank
What is best practice in identifying economic incidence of in-kind transfers?

- Cost of provision or private value?

- In-kind education provision
  - Nature of benefits
  - Conceptual issues
  - Evidence
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  - Cost of provision or private value?

In kind education provision
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  - Conceptual issues
  - Evidence
Most frequent method takes cost of provision and allocates by use:
- Justified by feasibility more than theoretical attractiveness
- Should be aware of possible distortions introduced

Aim should be to evaluate impact of government provision on welfare in a way that can be combined with analysis of effect of cash transfers.

Cost of provision is relevant because of the need to finance this cost but this is captured in associated tax payments.

The ideal measure of benefit should be the equivalent monetary value of the service to the recipient.
Cost of provision or private value

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  - Justified by feasibility more than theoretical attractiveness
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- Aim should be to evaluate impact of government provision on welfare in a way that can be combined with analysis of effect of cash transfers
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Problems with using cost

- Evaluating by cost obviously goes wrong if the service provided is actually harmful.
- Democratic processes should be expected to ensure typically beneficial provision.
- Benefits and costs arguably linked in aggregate by rational policy making.
- However, distribution of willingness to pay and costs of provision may be weakly correlated.
An example where use of cost gets it right

- Suppose a good is privately provided and
  - demands are proportional to income
  - the good is competitively provided at constant marginal and average cost
- The government takes over provision and
  - provides the same quantities, proportional to income
  - funds provision by proportional tax payments
- Government provision has no effect on welfare
- Evaluation according to cost allocated by use is exactly right
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Private value: publicly-provided *private* good
How use of cost could get it wrong

- Suppose now that government provision is equalised
  - everyone receives mean provision
  - if we like, assume now funded through a uniform lump sum tax
- Everyone except the mean recipient is worse off
- Total cost now exceeds total benefit
- The distribution is not captured by the distribution of use
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Private value: publicly-provided *private* good
Distribution of private values: publicly-provided private goods
Private values as a function of income: publicly-provided *private* goods
If individuals can opt out
  - richer households for whom value would otherwise be negative will choose to consume privately instead
Publicly-provided *private* goods: opting out
Public provision of private goods: topping up

- If individuals can opt out of public provision then
  - richer households for whom value would otherwise be negative will

- If individuals can supplement public provision then
  - benefits will not decline for richer households
  - cost of provision will accurately reflect use at the top end
Public provision of private goods: topping up

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![Graph showing the value of uniform public provision against income.](image-url)
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If individuals can supplement public provision then
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If individuals can sell the publicly provided good then
- provision will be equivalent to a cash transfer
- benefits will be flat
- cost of provision will accurately reflect use throughout the distribution
Public provision of private goods: private reselling

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Publicly-provided *private* goods: reselling

![Graph showing the value of uniform public provision against income. The graph transitions from a positive value of PQ at lower income levels to a constant value of PQ as income increases.](image-url)
Distribution of quantities

- Distributional impact follows from
  - the level of service provided
  - the way in which willingness to pay for service provided varies with income
- The determination of level of service is a matter of political economy
  - Presumably suits the politically most influential
- More affluent individuals may be able to find ways to enhance entitlement to consumption of better quality services
  - They may (moving to better neighbourhood) or may not (social advantage) have to pay for that
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Sources of information on valuation

- Several potential sources available to the inventive
  - Willingness to pay surveys
  - Voting data
  - Capitalisation of locally specific benefits
  - Markets for substitutes
- ... but none of these seem especially robust
Part of the benefit of education may be consumption benefit but most is received in monetary terms in improved future earnings.

This raises important conceptual issues:

- Need to model returns to education
- Benefits received in future - calls for life-cycle perspective
- Identity of beneficiaries is unclear - parents, children, dynasties?
  - Makes a difference whether costs allocated according to income of parents, current income of student, future income of student
Distributional impact of education spending

- To what extent do benefits vary with income?
  - Participation differs with income
    - Private costs of participation (forgone work, earnings) higher for more borrowing-constrained - higher nonattendance, higher dropout
    - Selection into higher levels of education favour the better-off
  - Returns differ with income
    - Return to education may be complementary to income-related characteristics
    - Better educated families more familiar, more socially at ease with system
    - Peer effects may be significant
  - Quality of school differs with income
    - Rich can afford more effort to satisfy entry criteria (moving near to better schools)
    - Political economy of provision may direct resources to the better off
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