

COSTS AND BENEFITS OF IN-KIND TRANSFERS: THE CASE OF MEDICAID HOME CARE BENEFITS

ETHAN M.J. LIEBER AND LEE M. LOCKWOOD *

October 2013

Introduction

Should welfare transfers be provided in cash or in-kind? A fundamental principle of economic theory suggests that consumers will at least weakly prefer receiving transfers in cash to cost-equivalent in-kind transfers. Cash transfers afford recipients greater flexibility in tailoring their consumption to their tastes and circumstances. Yet providing transfers in-kind potentially has offsetting benefits: improving targeting of benefits to intended recipients, reducing moral hazard in the context of the Samaritan's Dilemma, and increasing the efficiency of the tax system. Thus, it is an empirical question whether a particular transfer is more efficiently provided in-kind or in cash.

Much of the empirical literature to date has focused on the costs of in-kind transfer programs (the consumption distortion), and much of this literature has focused on food stamp programs (e.g. Moffitt, 1989; Whitmore-Schanzenbach, 2002). Much of the theoretical literature, by contrast, has considered possible benefits of in-kind transfers, such as improved targeting of benefits to desired beneficiaries (Nichols and Zeckhauser, 1982; Blackorby and Donaldson, 1988), improved tax system efficiency (Munro, 1992), and the Samaritan's dilemma (Bruce and Waldman, 1991). Such benefits imply that providing benefits in-kind can in some cases be optimal, despite the resulting consumption distortion.

Prominent among the potential benefits of providing in-kind benefits is improved targeting efficiency. Governments and private insurance pools face a major difficulty. Information problems limit their ability to finely condition the benefits they deliver on the state of the world, i.e., to effectively target benefits to intended beneficiaries and not others. In practice, they have to make transfers contingent on coarse bundles of states rather than particular states, and the coarse bundles may include component states with widely varying levels of optimal transfers. Well-chosen in-kind benefits can potentially alleviate this problem. Because there is heterogeneity in the values that people place on a particular good, a planner could strategically choose the bundle of goods that is provided in-kind to attract only a subset of the population to participate in the program (targeting on the extensive margin) or lead to differential intensity of program participation among participants (targeting on the intensive margin). Providing transfers in cash does not automatically allow for the same targeting benefits: a dollar is worth a dollar to everyone. Providing transfers in cash makes the program equally attractive to both targets and non-targets.

* **Ethan M.J. Lieber** is assistant professor of economics at the University of Notre Dame. **Lee M. Lockwood** is assistant professor of economics at Northwestern University. This Research Brief is based on MRRC Working Paper 2013-294.

Methodology

In this paper, we undertake a theory-guided investigation of the costs and benefits of providing transfers in-kind. Our empirical application focuses on the provision of home health care benefits by the US Medicaid program. Medicaid provides certain individuals assistance with tasks to enable them to live at home instead of in a nursing home. For example, beneficiaries can obtain help with bathing, housekeeping, eating, and other personal care tasks. Medicaid contracts with approved agencies to provide this “formal care” to recipients. However, Medicaid participants supplement their “formal care” with “informal care” provided by family and friends.

Home health care is a particularly good setting to assess the costs and benefits of in-kind provision for a number of reasons. First, informal care is used widely and can be a close substitute for formal care in many situations. That implies that the consumption distortion due to in-kind provision could be very large. On the other hand, there is considerable unobservable heterogeneity in the costs of informal care across individuals. That implies that in-kind provision could lead to significant targeting benefits. To quantify the trade-offs, we (i) measure the consumption distortion from the in-kind provision of Medicaid home care benefits using randomized experiments; (ii) provide a variety of evidence on the targeting benefits of the in-kind provision of Medicaid home care benefits; and (iii) discuss the implications for Medicaid and other programs.

Findings

To estimate the consumption distortion due to in-kind provision of transfers, we use data from the Arkansas, Florida, and New Jersey Cash and Counseling experiments. In these experiments, participants were randomized to receive regular Medicaid benefits (control group) or the value of the benefits in cash (treatment group). Although the cash was restricted in allowed uses, Medicaid recipients were allowed to pay their informal care providers. Thus, being randomized to treatment greatly expanded the set of home health care goods the recipient could purchase. We find that on average, members of the treatment group reduced their use of formal care by more than 50 percent. This suggests that Medicaid recipients’ home health care use is severely distorted by the in-kind provision of the transfer. We then estimate the deadweight loss due to this consumption distortion and find it ranges from \$526 to \$2,505 per Medicaid home care user per year. Extrapolating those figures to the entire Medicaid home health care population, the aggregate deadweight loss due to the consumption distortion ranges from \$1.5 billion to \$7.1 billion per year.

Given the significant consumption distortion, it is important to evaluate the potential benefits of providing home care in-kind. We estimate the extent to which providing the current bundle of benefits in-kind helps Medicaid target its “desired beneficiaries,” defined in various ways. We find that paying benefits in kind offers a significant advantage in terms of targeting efficiency compared to paying cash benefits. In other words, Medicaid’s particular bundle of in-kind transfers helps target benefits toward desired beneficiaries. Our estimates suggest that the targeting benefits due to the in-kind provision of Medicaid home care are \$1.7 billion. We do not find strong evidence that providing benefits in-kind increased tax system efficiency or reduced moral hazard in the context of the Samaritan’s Dilemma. Taken together, our results suggest that the benefits of in-kind provision are in the same ballpark as the cost due to the consumption distortion.

University of Michigan Retirement Research Center
Institute for Social Research 426 Thompson Street Room 3026
Ann Arbor, MI 48104-2321 Phone: (734) 615-0422 Fax: (734) 615-2180
mrrc@isr.umich.edu www.mrrc.isr.umich.edu

The research reported herein was performed pursuant to a grant from the U.S. Social Security Administration (SSA) through the Michigan Retirement Research Center (MRRC). The findings and conclusions expressed are solely those of the author(s) and do not represent the views of SSA, any agency of the federal government, or the MRRC.

Regents of the University of Michigan: Julia Donovan Darlow, Laurence B. Deitch, Denise Ilitch, Olivia P. Maynard, Andrea Fischer Newman, Andrew C. Richner, S. Martin Taylor, Katherine E. White, Mary Sue Coleman, Ex Officio