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Econ 309

Week 5: Means-Tested Programs

- I. The Logic of Means-Testing
 - A. Means-testing encourages people to change their behavior, usually in perverse ways.
 - 1. Help the poor, get more poor.
 - 2. Help the sick, get more sick.
 - B. A massive literature measures these effects.
 - 1. Ironically, the more you downplay these behavioral changes, the worse the case for universal benefits gets!
 - C. Still, means-testing has one huge advantage: It saves enormous amounts of money.
 - D. Furthermore, the stricter the means-testing, the fewer people's behavior you potentially change in perverse ways.
 - E. Example: Giving a UBI to everyone is extremely expensive, and heavily discourages work. But giving money to low-income seniors – who probably wouldn't be working anyway – costs much less and discourages work much less.
 - F. “College kids already have a UBI.” True?
- II. Cash Versus In-Kind Redistribution
 - A. In practice, governments often redistribute “in kind.” Instead of money, they give free or subsidized medical care, housing, education, and such.
 - B. Big problem: This often means giving people expensive products they barely appreciate.
 - C. What's the point?
 - 1. Paternalism: The poor don't know their own interests.
 - 2. Child protection: Money for children gets funneled through parents, so we don't want them misusing it.
 - D. Big danger: What if governments thinks it knows better when it doesn't? Then we get massive waste.
 - E. Strong example: health care. Standard view among medical researchers is that medicine has a much smaller effect on health than most people suppose. Lifestyle and genes matter much more.
 - 1. Costa Rica, which spends under \$1000 per year per person on health care, has a higher life expectancy than the U.S.!
 - F. Another example: FDA and new vaccines. The FDA banned vaccination until *they* decided vaccines were safe and effective, which killed a lot of people who wanted earlier vaccination.
 - G. The main means-tested health program in the U.S., Medicaid, spent \$734B in 2021 on just 19% of the population, which comes to almost \$12k per recipient.

- H. What share of these recipients would rather have \$12k in cash instead?
 - I. Alternate formulation: How much would recipients typically pay for last \$1000 of medical care?
 - 1. Question for the paternalist: Is this really such a foolish choice?
 - 2. The case of Cuba
- III. The Success Sequence
- A. Why are there so many poor people in a rich country like the U.S.?
 - B. Main answer is behavioral: Live responsibly, and you are highly unlikely to be poor.
 - C. Specifically, researchers define the following “success sequence”:
 - 1. Finish high school
 - 2. Work full-time after graduation
 - 3. Marry before having kids
 - D. Americans who follow this sequence have a 97% chance of being out of poverty by early adulthood. Wang and Wilcox: “97% of Millennials who follow what has been called the ‘success sequence’ — that is, who get at least a high school degree, work, and then marry before having any children, in that order—are not poor by the time they reach their prime young adult years (ages 28-34).”
 - E. Is this really causal? How could it not be?
 - F. Is this really easy? Yes, because:
 - 1. Standards in high school are low.
 - 2. The poor themselves heavily agree that finding a job is not hard.
 - 3. People understand where babies come from, and effective birth control is widely available.
 - G. Of course, 3% who follow the success sequence are still in poverty, but compare this to 15% for the general population – and 53% who violated all three steps. Many of the 3%, moreover, are only temporarily in poverty.
 - H. Upshot: Almost all adults really are able to provide for themselves if they are moderately prudent. If you restricted poverty assistance to people who followed the success sequence, the cost would be very low.
 - I. In practice, of course, governments rarely impose any such restrictions.
- IV. The Political Case Against Means-Testing
- A. In a famous debate between Milton Friedman and former HEW Secretary Wilbur Cohen, Cohen attacked means-testing:

“I also oppose any wholesale substitute for the social security system, whatever its name (such as a negative income tax, a guaranteed income or what have you) that makes payments only to the poor. A program for the poor will most likely be a poor program.”
 - B. What is the argument even supposed to be? The story, apparently, is that you have to trick the non-poor into helping the poor by pretending that you’re “helping everyone.”
 - C. What evidence is there for this claim? Almost none! Virtually every

country has some means-tested programs. The U.S. spends over \$1T per year on such programs.

1. While “welfare” is unpopular, programs to “help the poor” are popular. Just as SDB predicts, because “helping the poor” sounds great.

D. Suppose Cohen’s argument were true. This implies that the true cost of helping the poor is many times the apparent cost. If the poor are 20% of the population, the cost of helping them is 5x the apparent cost.

E. From the standpoint of CBA, this is a strong argument against all redistribution, rather than an argument for replacing means-tested programs with universal programs.

V. EA Versus Nationalism

A. While the total level of redistribution is massive, almost all redistribution is “intra-national.” The U.S. helps Americans, Mexico helps Mexicans, Bolivia helps Bolivians.

B. Foreign aid does exist, but it is a rounding error in most national budgets.

C. From the perspective of Effective Altruism, this is crazy. “Poor people” in the U.S. are rich by world standards.

1. Insurance? If you’re willing to treat having low ability as an insurable problem, how about being born in a poor country?

2. Altruism? Shouldn’t you care about starving people in other countries more than “underprivileged” people in your own?

3. Pigovian remedies? Are poor Americans in Laredo really so much more dangerous to you than poor Mexicans in Nuevo Laredo?

D. Of course, you could just say that, EA notwithstanding, you have high altruism for fellow citizens and little for foreigners.

E. But as usual, actions speak louder than words. How much of their own money do people give to poor fellow citizens? Doesn’t this show that most alleged love for fellow citizens is just SDB?

VI. Why the Standard View of the Welfare State Is Wrong

A. The “standard view” of the welfare state: there is a trade-off between compassion and efficiency. The most compassionate policies would fully take care of the poor, but these would have severe efficiency costs. Real-world policies try to strike a reasonable balance. Life was terrible back in the 19th century before the welfare state existed; only “mean,” and “uncaring” people could prefer it to what we have now.

B. This is wrong on several levels.

C. First, most of the welfare state is about helping the old, not the poor.

D. Second, the help for the poor goes to *relatively* poor Americans who are already quite fortunate by global standards.

- E. Third, the goal of "helping the (American) poor" is probably the main justification for immigration restrictions that greatly harm poor foreigners.
- F. In the 19th century, people had to fend for themselves, but anyone was free to move to the U.S. and try their luck. Policy was far more "compassionate" then than it is now, all things considered.