

# AN ALTERNATIVE PROVISION OF PUBLIC SERVICERS – THE USE OF VOUCHERS

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**Abstract:** *As a part of the newly approved legislation in the field of social services and social benefits in the Czech Republic a possibility to provide some social benefits through vouchers came into the view. The potential of voucher use in the public sector and for regional and local government services especially, is much wider. The article contents analytical framework for studying vouchers as an alternative way of providing public goods and services.*

**Key words:** *Vouchers, public services, typology and characteristics of vouchers, theoretical perspectives for analyzing vouchers.*

## 1. Introduction

In March 2006 Parliament approved a set of three new acts related to social benefits with the date of implementation on 1<sup>st</sup> of January 2007: Act on Assistance in Material Need, Act on Living and Existence Minimum, Act on Social Services<sup>1</sup>. Strengthening the financial incentives for job-search in the welfare system and stricter control on eligibility for social benefits are the main objectives of new social legislation.

The new Act No. 111/2006 Coll Assistance in Material Need enables also provision for social allowances in kind. The provision in kind should be maintained either in the form of vouchers (tokens) which are intended for buying basic food, clothes or in the form of special credit cards scheme. The planned widening of provision for social benefit in kind is concerned since 2009 for all types of social benefits and allowances. The aim is the closer connection with the labor market and social assistance benefit system. At present, in some Czech municipalities and city districts there are pilot projects in progress with this scheme of social benefits provision (Ondráčková 2007a, p. 10, Ondráčková 2007b. p. 26).

Taking into account that this way of public services financing is relatively new in the Czech Republic, the aim of this article is to give a wider theoretical and methodological description of this issue.

## 2. Characteristics and definition of vouchers

Vouchers can be used to distribute public finance amongst alternative service providers in direct proportion to users of their service outputs, facilitating exit and voice on the part of service users (see Bailey 1999, pp. 40-60) and providing incentives to reduce organizational slack on the part of service providers. Introduction of vouchers usually requires legislative reform or some other act of approval by the state (e.g. new legislation in Czech Republic) mentioned above. The economic literature (see Blöndal 2005, pp. 96-103, Bailey 2003, p. 242) argues that the potential use of vouchers to allocate public services is enormous. Vouchers can be used to distribute all goods and services except those which are purely collective. Collective or pure public goods and services are non-excludable and non-rival in use, the service benefits everyone simultaneously and no one can be prevented from

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<sup>1</sup> For more details see Ministry of Labour and Social Affairs of the Czech Republic (2007) Propojení trhu práce se sociálním systémem. [on line] Dostupné na <http://www.mpsv.cz/cs/4109>

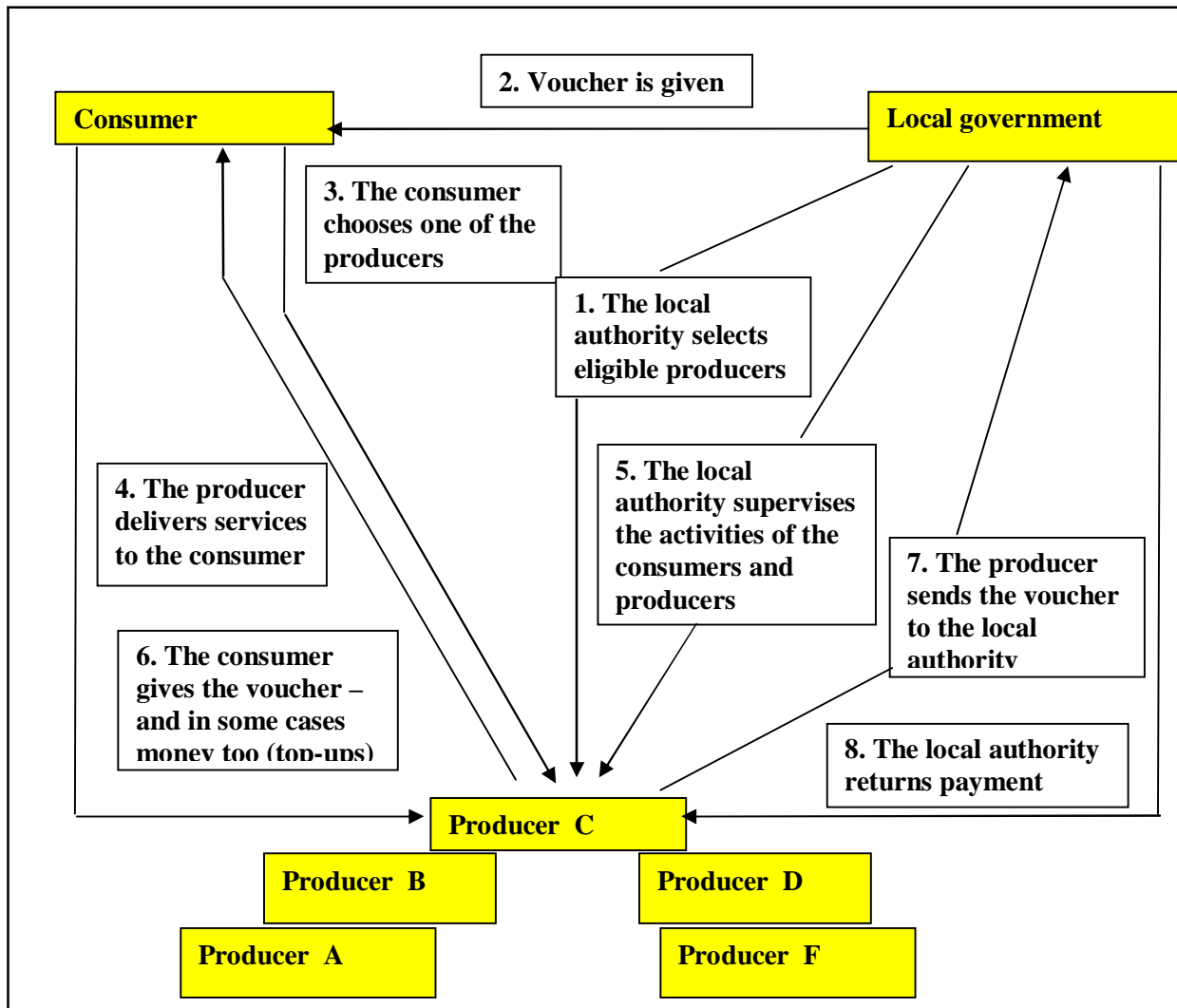
benefiting. But only a small number of local government services are pure public goods. Such services as schooling, personal social services and culture and leisure services are either private or impure public goods. These goods and services are the most suitable goods for distribution through vouchers because payment can be enforced at the point of use of the service.

The definitions of vouchers expressed in the literature emphasise the holder's purchasing power and ability to consume and acquire service(s). OECD defines the voucher as a "token that may be exchanged for goods and services" (OECD, 1998, p. 3). A more comprehensive definition of vouchers is described by Bailey (2003, pp. 267-268). He alleges that vouchers entail a distinction between the principal, a holder and an agent. The principal is the organization that finances and issues the voucher. A holder is the person receiving the voucher and, thereby, the service, commodity or other such benefit. An agent provides the service, commodity or other such benefit in exchange for redeemable voucher. The general definition of voucher according him is "*voucher is an instrument issued by a principal that can be redeemed by the holder for a service, commodity or other such benefit provided by an agent*". Bailey (2003, p. 267).

A definition of a "public service" voucher can be derived from the above definition. A public service voucher is "*publicly directed consumption with individualized choice of production and payment*" Bailey (2003, p. 268). It is publicly directed consumption because it is given to those in need of a service, is limited in its purpose and manner of use, enables the use of public and/or private service and transfers both the right and responsibilities to its holder and to the service producer. It is individualized choice of production because, within a competitive system of plural provision, vouchers enable choice of eligible service producer in any or all of the public sector, the non-profit sector and the private sector. It is individualized choice of payment because choice of service producer determines which supplier receives payment and payment can be withdrawn via exit.

In the voucher environment, the provision for public services is separated from its financing. The funding remains with the government in the form of a voucher which is issued to individuals, entitling them to exchange the vouchers for services at a range of suppliers. The individual voucher-holder chooses among the different suppliers and pays with the voucher. A detailed model of voucher within local government is outlined in (chart 1).

Chart 1 A local government voucher model



Source: Bailey, J., S. Strategic Public Finance, 2003, p. 252

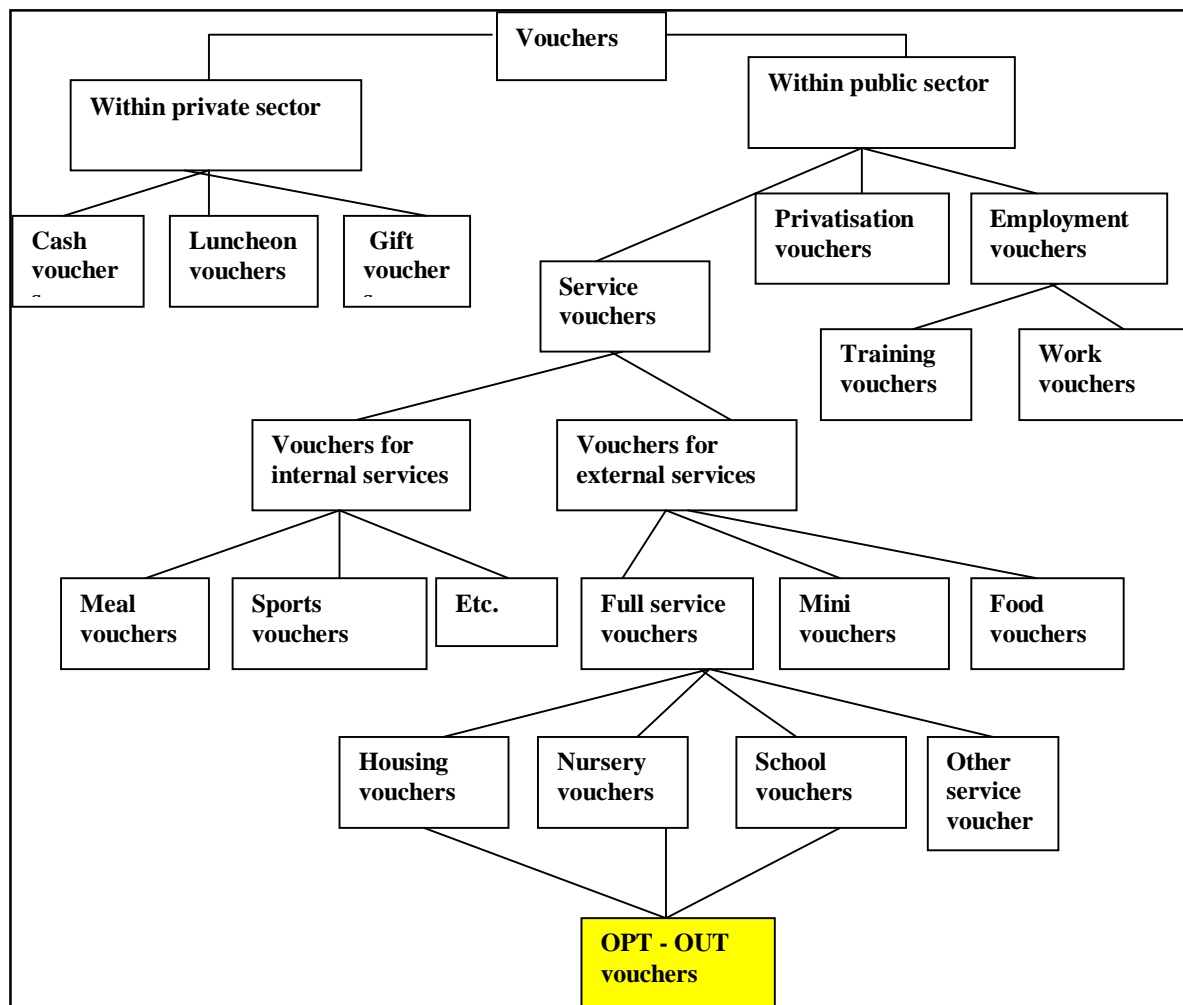
### 3. A typology of vouchers

Generally speaking, vouchers can be divided into two categories: **private vouchers** and **public sector vouchers** (see chart 2). In the private sector “cash vouchers” are sometimes given to the purchaser of service of certain value. They can be exchanged for cash when purchasing another product within limited period of time. “Gift vouchers” can, in turn, be exchanged for goods and services supplied by a particular store. “Luncheon vouchers” are provided by some employers to their employees and can be used for meals at participating food outlets.

**Public sector vouchers** can be divided into three categories:

- 1) *Privatisation vouchers*: given to the public free of charge or for registration fee (e.g. in Czech Republic and other East European countries)
- 2) *Employment vouchers*: help get people into work by subsidizing work or training. *Job vouchers* belong to this category. When a job seeker qualifying for a voucher finds a job, the state pays the employer financial support that covers part of the salary costs (maximum for one year). *Training vouchers* are used to cover all or a share of the fixed and variable costs of training.

**Chart 2 Typology of vouchers in private and public sectors**



Source: Bailey, J., S. Strategic Public Finance, 2003, p. 245

- 3) *Service vouchers*: used to support consumption of specific internal and external services.
- *Internal service vouchers* – given to employees by their employer for use of in-house facilities (e.g. sports vouchers, meal vouchers - to be used in staff canteens).
  - *External service vouchers* – for use in either the public and/or private sectors:
    - § *Food vouchers* are given to poor and underprivileged people by social welfare workers. These vouchers differ from meals vouchers in that they are meant for buying unprepared food rather than catering services.
    - § *Mini vouchers* afford holders additional levels of service.
  - *Full service vouchers* differ from mini vouchers in that they entitle the holder to the full public service. They include *housing vouchers*, *nursery vouchers* – used to stimulate the supply of day care for preschool children; *home help and nursing vouchers* – used in old people’s home-help services in home nursing; *taxi vouchers* – handicapped and elderly people who fulfil the required criteria could be given transport support in this form; *health service vouchers* - vouchers like support system can be used for rehabilitation services and to provide medical aid equipment; *arts vouchers* are sometimes given to the low-income groups to

stimulate their attendance at museums and galleries; *school vouchers* exist in implicit form where parents have free choice for their school children and schools receive state support in proportion to the number of pupils they educate.

§ *Opt-out vouchers* which allow service user to choose private instead of public service (for example for home helps, nursing or medical services).

According to the **nature of vouchers**, there are three basic forms:

- 1) *Birthright vouchers*. Such vouchers are distributed to those who are registered citizens but not to temporary residents or immigrants (at least those not yet granted nationality), for example privatization vouchers.
- 2) *Compensation vouchers* – are distributed to those to be in need of a public service (e.g. hospital treatment) but to whom access to that service is denied because of shortage of supply or other capacity constraints. Opt-out vouchers may effectively act as this type of vouchers.
- 3) *Award/privilege vouchers*. This category is allocated neither as compensation nor as a birthright. These vouchers confer privileges on their holders, examples being higher education vouchers and employment vouchers. Private sector gift vouchers also fall into this category.

As concerns of **attributes of vouchers**, there are two distinct categories:

- 1) *Consumption vouchers*. This type of voucher increase the recipient's consumption possibilities either generally (that is, cash vouchers) or specifically in respect of a particular good or service. However, consumption vouchers do not necessarily achieve 100 per cent net additionality (i.e. the increase in consumption equals the value of the voucher).
- 2) *Wealth voucher*. These vouchers lead to direct or indirect increases in the wealth (rather than consumption) of the recipient. Privatisation vouchers are this case. Also employment and training vouchers increase the recipient's wealth indirectly by allowing the holder accumulate human capital in terms required skills and work experience.

Vouchers can take at **two main forms**:

- An *explicit voucher* has a physical form, traditionally resembling banknotes, coupons or smart cards. Ultimately, physical cards may be replaced by virtual vouchers using personal identification numbers (PINs) and information network to distribute service rights.
- An *implicit voucher* takes the form of qualified recipient choosing from a number of designated suppliers and, upon registering with one of them, the government pays directly to that provider of service (“money follows the user”).

These categories are not necessarily mutually exclusive.

#### **4. Theoretical arguments for and against vouchers**

One of the most frequently stated arguments in favour of vouchers is that vouchers enhance the service user's freedom of choice. Freedom of choice encourage diversity, brings about a need and demand for greater information. Having freedom of choice may make people more interested in the relative performance of alternative service providers. The counter argument by opponents of vouchers is that in many situations freedom of choice is dangerous if only because voucher holders do not possess enough information about the

different options or about well-grounded selection criteria. Moreover, vouchers-holders are often not competent enough to make rational decisions. Competent and rational choices are more likely if the municipality/government or other policy-making body obliges service producers to provide relevant information about their activities and to publish benchmarking information.

Voucher systems are likely to change employment practices. For proponents this is a necessary and beneficial outcome of increased competition which often leads to structural changes. Some services suppliers would have to hire new personnel while others will have to make employees redundant.

Free market groups argue that vouchers create competition and so increase the efficiency of service producers (Savas 1987, p. 272). Efficiency is improved where vouchers increase productivity, enhance technical development and improve the responsiveness of service producers. The theoretical counter-argument is that transaction costs may inhibit competition. High transaction costs occur when three service characteristics occurs simultaneously. The first is “bounded information” which occurs due to the imperfect information and limited abilities to process information. The second characteristic is “asset specificity” which occurs when service infrastructure cannot easily be deployed (e.g. special medical facilities such). The third characteristic is “scope for opportunism”. This occurs when the service contract between principal and agent is ambiguous, for example in specifying and monitoring the efficacy of medical treatment. The extent and size of transaction costs is an empirical question (see Bailey 1999, pp. 45-46).

Populist advocates of vouchers argue that vouchers bring about psychological benefits, the consumer being encouraged to become an active decision-maker, less dependent on the services produced by society. They argue that vouchers can lead to greater equity in relation to need and ability to pay. Many public services are produced in the form of services for the public as a whole, and everyone has the right to use them freely. In comparison, vouchers are directed at specific individuals and families. Hence vouchers enable public funds to be used more effectively by more accurately targeting subsidy on need. Opponents of vouchers argue that they may in fact increase inequity. Not all municipalities would introduce vouchers; there is no private production of public services in many municipalities. Hence there is a lack of alternative supply.

Another counter-argument is that vouchers may cause social discord or problems by leading to two-tier services. If a voucher offers a uniform payment level irrespective of the costs associated with servicing different categories of users – such as disabled children in child, weaker persons in long-term care – this can accentuate “cream-skimming” behaviour from suppliers. In such conditions there is an incentive for private suppliers to screen voucher recipients for those who cost less than others and to exclude higher costs recipients (Blöndal 2005, p. 103). Service units charging higher prices and attracting wealthier clients could hire more qualified staff, acquire better equipment and provide a higher standard of service.

Other counter-arguments are that vouchers lead to increase expenditures if their holders choose to use privately produced services. The municipality will not be able to reduce its personnel quickly enough and it must still pay the fixed costs of past investments in service production. On the other hand a short-term shortage of attractive suppliers is not uncommon. Many services require a heavy investment in order to expand the supply of services by individual providers. Public expenditure would also rise if vouchers increase administrative costs (e.g. means-tested vouchers). Additionally, vouchers may make budgeting much more complicated, again leading to higher public expenditures.

We can summarize that right-wing think tanks advocate in favour of vouchers because vouchers enhance individual liberty; enhance the service user's freedom of choice. Left-wing groups are typically ideologically predisposed against vouchers, instead preferring a greater role for the state in society and economy. Free-market economists are theoretical predisposed in favour of vouchers as means of strengthening market mechanism via competition, leading to improved efficiency in both production and consumption services. However institutional economists argue that these beneficial effects will not be achieved because the free-market theoretical case fails to take account of institutional, behavioural and cultural barriers to competition.

## 5. Key issues

Any voucher scheme will only be viable if it is consistent with the dominant ideology of the policy making body or organization. An effective voucher system must satisfy the following conditions (Savas 1987, p. 113; Blöndal 2005, pp. 101-103):

- There have to be widespread differences in people's preferences for service, and these preferences are recognized and recognized and accepted as legitimate.
- Individuals have to be well informed about market conditions.
- An optimal market situation needs many competing service suppliers; the voucher-holders must be able to exercise a genuine choice of suppliers. The need of competitive market is essential.
- For some type of vouchers, there is a tendency to establish rigidly defined service standard so that little or no product differentiation may be possible from suppliers.
- Service users can easily assess and determine the quality of service. It may be difficult for users of services to make informed judgments about individual service providers. This undermines the competition mechanism.
- The service has to be relatively inexpensive and purchased frequently, so the users learn by experience. Many public services are not "search goods", with the characteristic that an individual can find out everything about the service before making a choice. Rather, they are "experience goods" where the consumer only finds out about the service in the course of using it.

There is no single voucher type or voucher system. However voucher schemes have three dimensions into which any scheme's criteria can be grouped (Bailey 2003, p. 264): *the finance dimension* (the measurement unit used to determine the voucher's value; the value of the voucher; whether the service producer can charge the holder more than the value of the voucher; whether the service user can purchase additional services (top-ups); whether any unused part of a voucher can be given as cash to the service user; *the regulation dimension* (to whom the voucher is given; what goods or services it can be used for; the voucher's geographic area of validity; the service producers from the voucher will be redeemed; the conditions and criteria of the service producers' operations; *the information dimension* (eligibility criteria for receipt of the voucher; information on the service available to the holder of the voucher; from which suppliers the consumer can obtain services; what to do in the event of unsatisfactory service provision).

## 6. Use of the vouchers in OECD member countries

The extent of use of forms of vouchers mentioned above is significant in some sectors in OECD member countries, with their use being mainly focused on housing, education (primary and secondary), child care (nursery education) and care for the elderly.

The United **food stamps programme** is the largest and oldest explicit voucher programme in OECD member countries (Blöndal 2005, p. 97). Started in 1961, it provides 19,1 million low-income individuals with an electronic card they can use like cash at most grocery stores to ensure that they have access to a healthy diet.

The good example of vouchers is **housing assistance** to low-income families. Instead of large housing estates that cluster low-income families together, vouchers offer them the possibility to participate in the general housing market. These explicit vouchers are generally designed such that they provide for the difference between actual rent paid, up to a limit based on family size and local housing market conditions, and a certain percentage of the recipient's salary (so called means-tested vouchers)

These types of vouchers are used in United States (introduced in the mid-1970s) which provides benefits to about 2 million low-income households in 2003. Another example is the "accommodation supplement" in New Zealand (launched in 1993), which provides benefits to 250 000 people. This voucher programme does not differentiate between rent or mortgage payments.

Vouchers are most often discussed in terms of **primary and secondary education**. For example in Netherlands the constitution guarantees equal government funding for students in public and private schools. The government funding is provided through an implicit voucher in that each school – whether public or private – receives an equal amount per student enrolled. The similar policy that also guarantees equal government funding to public and private schools was introduced in Sweden in 1992. The government funding is also provided through an implicit voucher.

The use of explicit vouchers for primary and secondary education is most documented in the United States but its use is very limited. Explicit vouchers are used in some cities but they generally provide funding to relatively few students to opt-out of the public school system and enroll in private schools. They cater mainly to students from disadvantages background. A related development in the United States is the creation of charter schools which operate on an implicit voucher basis, e.i. the government provides funding for them in the same manner as public schools.

As for the use of vouchers for the provision for **child care (nursing care)** services, the most comprehensive reform has been implemented in Australia (see Blöndal 2005, p. 99). The reform aimed at equalizing the level of public funding per child across public and private institutions by channelling all public funding through users, replacing the previous system based on grants to no-profit organizations and local government. Now, public funding is distributed to families via the "child care benefit" earmarked for child care provided in government – approved services. The Netherlands, Norway are currently considering similar comprehensive reforms. In the UK the nursing vouchers have been used in pilot projects between 1996 and 1998 and are still used for certain post-school training schemes. In the United States, child care vouchers have gained ground in federal family support programmes since the early 1990s.

Vouchers have also been used for the long-term care for **the elderly** where publicly funded provision is growing relatively rapidly in OECD countries. Providing publicly funded long-term care in private nursing homes and residential institutions typically takes the form of vouchers – either implicit voucher paid directly to the institution based on the number of residents, or by reimbursing the fees paid by residents in part or in whole. According to the evidence (Blöndal 2005, p. 100) public finance increasingly often goes to private providers.



A growing range of programmes provides allowances for the families of the elderly and disabled to retain their role as caregivers, or for the elderly to employ personal attendance of their own choice (this form of assistance is substantially less expensive than institutional care). This most often takes form of an explicit voucher. The scheme based on these form of financing have been introduced in France in 1997, in Finland in 1993, in Germany in 1995 and partly also in Czech Republic by approving by the set of three acts related to social benefits.

## 7. Conclusion

The extent of vouchers use in OECD member countries is significant. The examples show the wide range of sectors where vouchers can be utilised. Some of the areas are in their infancy or development phase, and the use of the voucher can be expected to increase in future years. Especially for regional and local government services, vouchers could be used much more extensively than at present, as an alternative service delivery system.

Public service vouchers can more effectively match provision for service with user preferences and encourage greater efficiency in the production of services. Vouchers can help local government to achieve best value for money in being an alternative to, or further development of, the competitive contracting of local public services. They can help promote quality initiatives by giving service users greater opportunities for exit and voice; the threat of losing customers or clients give service providers greater incentives to the views of service users. These potential savings will be at least partially offset by relatively large administrative costs of voucher systems. Voucher systems must be carefully designed and regularly evaluated against objectives. An inappropriately designed voucher can simply accentuate pre-existing problems with the delivery of public services.

Whether that potential can be achieved in practice is open to question. Vouchers are subject to unique challenges in terms of design and contextual factors. Learning from the success or failure of individual voucher schemes has to paid appropriate attention.

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