



Cash by any other name? Evidence on labeling from the UK Winter Fuel Payment[☆]



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ABSTRACT

Government transfers to individuals are often given labels indicating that they are designed to support the consumption of particular goods. Standard economic theory implies that the labeling of cash transfers or cash-equivalents should have no effect on spending patterns. We study the UK Winter Fuel Payment, a cash transfer to older households. Our empirical strategy nests a regression discontinuity design within an Engel curve framework. We find robust evidence of a behavioral effect of labeling. On average households spend 47% of the WFP on fuel. If the payment were treated as cash, we would expect households to spend 3% of the payment on fuel.

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1. Introduction

Government transfers to households and individuals are often given labels indicating that they are designed to support the consumption of a particular good or service. For example, many countries provide transfers to households with children and label them a “Child Benefit”. When such transfers are made in cash there is no obligation to spend all, or even any, of the payment on its ostensive purpose. Standard economic theory implies that the label of a particular transfer should have no bearing on how that transfer is ultimately spent since all income is fungible. The recipient of a transfer with a suggestive label is expected to react in exactly the same way as he would have reacted had he been given a transfer of equivalent value with a neutral label. The receipt of an in-kind transfer such as food stamps is similar as long as

consumers are infra-marginal – i.e. for those whom consumption of the good in question is already larger than the voucher amount. Why then do governments label transfers? One possibility, of course, is that doing so makes redistribution more palatable to voting taxpayers. Another intriguing possibility, though, is that standard economic theory is mistaken on this particular point, and spending patterns *can* be influenced by the labeling of cash or cash-equivalent transfers. In this paper we provide novel evidence on the behavioral effect of labeling from the UK Winter Fuel Payment (WFP).

The theoretical proposition that labeling is irrelevant has been challenged. For example, Thaler's (1990, 1999) framework of mental accounts is one mechanism through which the labeling of a transfer might affect its usage.¹ There is, though, very little previous empirical evidence to support the idea that the labeling of a transfer payment matters.

Kooreman (2000) and Blow et al. (2012) find evidence that additional child benefit differs from other income in its effect on household spending patterns among child benefit recipients in the Netherlands and the UK respectively. Kooreman finds some evidence of a labeling effect (i.e. the child benefit is spent on child-related goods); in contrast,

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¹ In the present context, income would be labeled according to its source, and so the Winter Fuel Payment would be allocated to a mental account for spending on heating.

Blow, Walker and Zhu's results suggest that child benefit is spent disproportionately on adult-related goods.² Finally, Edmonds (2002) also looks at child benefit payments (in this case among families in Slovakia) but finds no evidence of a labeling effect. These studies use quasi-experimental difference-in-difference designs, exploiting differential changes over time in the real value of benefits for different types. Effects are identified by a common trend assumption.

A complication with these studies is that it is not possible – in two-adult households – to separately identify a labeling effect of child benefit income from the alternative explanation that the increase in the share of total household income received by the mother (child benefit is almost always paid to the mother) leads to the change in spending patterns. That is, it could be who receives the money, rather than the label, that matters, and the potential labeling effect cannot be disentangled from a “reciprocity” or intrahousehold effect. This issue of intrahousehold allocation may be particularly important in the case of spending on children. Among single-mother households, for whom these intrahousehold considerations are not relevant, Kooreman finds an effect in the direction consistent with labeling mattering. However, in his baseline specification the effect is not statistically different from zero at conventional levels. Similarly, Blow, Walker and Zhu find weaker results for single-parent households.

Turning to in-kind transfers, such as food stamps, while some researchers have claimed to find evidence contradicting standard economic theory, the studies with the most credible and convincing designs find the opposite. In particular, Moffitt (1989) and more recently Hoynes and Schanzenbach (2009) find no evidence that infra-marginal consumers treat food stamps differently than an equivalent cash payment.

In contrast, Abeler and Marklién (2010) have recently compared in-kind grants and (unlabeled) cash grants in small laboratory and field experiments and find evidence against the fungibility of money in those contexts.^{3, 4, 5}

The WFP, which we study, is a universal annual cash transfer paid to households containing an individual aged 60 or over. Its payment is unconditional – there is no obligation to spend any of it on household fuel. The payment during most of the period covered by our data was worth £250 to households where the oldest person is aged between 60 than 80 and £400 where the oldest person is 80 or over. The sharp age cut-off for receipt eligibility (the fact that all households where there is somebody aged 60 or older at the cut-off date qualify for the benefit, and no households where all members are younger than 60 qualify) presents an excellent opportunity to employ a regression discontinuity design to assess whether there is a labeling effect associated with the WFP. Relative to small laboratory or field experiments, studying the WFP has the advantage that the WFP is an actual transfer received by a large population. Relative to studies of the child benefit, the WFP offers very clean identification of a labeling effect through the regression discontinuity design. In our sample confounding by a possible intra-household effect is much less likely. This is because, to avoid concurrency of the onset of eligibility for the WFP and the female state pension, we exclude couples where the woman is the older

partner and so, at the eligibility threshold, the WFP is received by the male. We also have sufficient sample size to test for effects in single person households.

The WFP delivers additional disposable income, but eligibility for the WFP, being based on age, is easily anticipated. Thus the additional disposable income may not lead to a change in total spending at the onset of eligibility. To the extent that the additional disposable income that the transfer delivers does lead to an increase in total expenditure,⁶ we would expect this to be associated with an increase in spending on fuel (because fuel is a normal good) and a decrease in the fuel budget share (because fuel is a necessity), regardless of whether the transfer is labeled. This variation in fuel spending and budget share with total expenditure is the “income effect” of standard demand theory. To measure a labeling effect, we need to account for this possible income effect. Therefore, in our analysis we embed our regression discontinuity design within a consumer demand framework. To model standard income effects we estimate an Engel curve for fuel expenditure allowing for flexible effects of total expenditure on the fuel budget share, and to test for a labeling effect we augment this with smooth age effects on preferences and a discontinuity at age 60. This discontinuity captures the effect of payment of the WFP on share of total expenditure spent on fuel, *holding total expenditure constant*. The size of this shift is informative about the proportion of the WFP that is spent on fuel above and beyond what would be expected from the usual income effect (as measured by the slope of the Engel curve.)

We find statistically significant and robust evidence of a substantial labeling effect. We estimate that households spend an average of 47% of the WFP on household fuel. If the payment was treated in an equivalent manner to other increases in income we would expect households to spend only about 3% of the payment on fuel. We conduct a number of robustness and falsification tests. We carefully test – and reject – the possibility that this effect arises from non-separabilities between consumption and leisure: the effect we observe cannot be explained by retirements around age 60 altering the demand for heating fuel. Moreover, we find no effect in data drawn from the period before the WFP was introduced. In the program period we find a statistically significant effect for both singles and couples, confirming that this is not an intrahousehold allocation effect. Thus this dramatic difference in the marginal propensity to consume fuel out of the WFP is evidence that the name of the benefit (possibly combined with the fact that it is paid in November or December) has some persuasive influence on how it is spent.

Understanding the effect that labels have is important for public policy. If labeling cash or cash-equivalents influences how they are spent, then governments might use labels innovatively to increase consumption of particular goods or services that are thought to be under-consumed.⁷ Of course, if the aim of a particular transfer is not to increase spending on any particular good or service but rather to carry out a straightforward redistribution of resources then an operative label might actually imply a utility cost – and care should be taken in naming benefits.

This paper proceeds as follows. Section 2 gives a brief introduction to the Winter Fuel Payment and to the data that we use (the Living Costs and Food Survey). Section 3 outlines the empirical framework that we apply to identify the labeling effects, and our estimation methods. Section 4 presents graphical evidence and our estimates of the labeling effect. Section 5 provides further discussion of the estimates and Section 6 concludes.

² This does not imply that parents disregard their children's welfare. The paper finds evidence that this spending effect comes from the unanticipated variation in child benefit, which suggests that parents are altruistic and insulate their children from income variation.

³ First Abeler and Marklién show in a field experiment in a restaurant that beverage vouchers increase beverage consumption by more than a general voucher towards their total bill. The difference is statistically significant and larger than what might plausibly be attributed to the small number of patrons for whom the transfers might be distortionary. They then show a similar effect with notional consumption of two goods in a laboratory experiment with students.

⁴ There is much better evidence that labeling of transfers between levels of government has an important effect on how the transferred funds are spent. This is called the “flypaper effect”. See Hines and Thaler (1995).

⁵ Card and Ransom (2011) find large effects on voluntary supplemental savings contributions depending on the share of mandatory contributions to a defined contribution pension plan that is labeled an employee contribution rather than an employer contribution.

⁶ Research such as that by Parker et al. (2013) suggests that households only increase total spending on receipt of predictable transfers and not in anticipation of them.

⁷ Because labels do not impose constraints, this would be very much in the spirit of Thaler and Sunstein's (2008) “libertarian paternalism”.

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