Effect of Labelling Cash or In-Kind Transfers on Consumption

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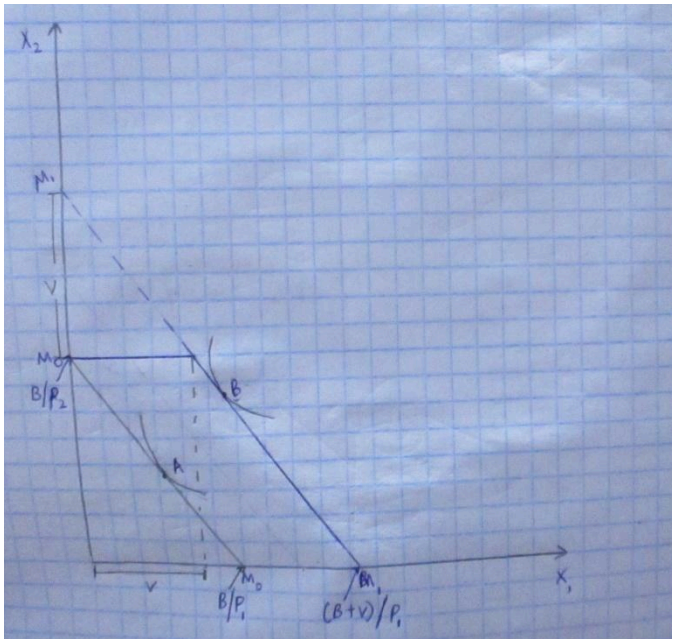
In this paper, the empirical evidence on consumption behaviour following an in-kind benefit presented in Griffiths, von Hinke, and Smith (2018) is evaluated with respect to expectations based on standard micro-economic theory. Under the fungibility assumption, consumers are expected to treat in-kind benefits as an increase in income arising from an equivalent cash transfer. As a result, the increase in consumption of the subsidized good is expected to be lower than the subsidy amount with the gap between the two values expected to vary based on income level. The effect of income level on consumption following an in-kind benefit is also evaluated with reference to distorted and infra-marginal households. Griffiths et al.'s (2018) findings are also compared to the findings of other studies on the behavioural effect on consumption behaviour from labelling benefits and subsidies.

Low-income households are limited in their purchase of healthy foods such as fruits, vegetables, and milk due to budget constraints. Vouchers are akin to an increase in household income as it raises the budget constraint. For distorted consumers – defined as those whose spending on the targeted items would be lower than the value of the vouchers – the utilization of vouchers for subsidized goods was shown to be greater than for other consumers higher on the income rung (Griffiths et al., 2018). Distorted households are incentivized to increase their subsidized foods consumption above the sans-voucher and cash-equivalent benefits levels as they stand to increase the utility of their overall consumption bundle. From a marginal utility standpoint, distorted households obtain higher marginal utility from healthy foods relative to inframarginal households, which would have spent an amount equivalent to or more than the value of the vouchers on the items in the absence of these goods and are, therefore, expected to treat the transfer as equivalent to cash. Infra-marginal households are expected to exploit the income increase, which was the case as the researchers a 90% voucher utilization rate across board (Griffiths et al., 2018). However, these households are expected to utilize their vouchers to cover their current spending on healthy food and reallocate the savings to other goods based on the marginal utility ranking (Griffiths et al., 2018).

The expected behaviour of infra-marginal households is modelled in the figure below. Since the optimal consumption of healthy foods sans-subsidy is higher than the subsidy amount, consumers are expected to reallocate their budget to mimic an in-cash transfer even when the transfer is made as a voucher. Healthy foods are bundled as a single subsidized good (X1) modelled on the horizontal axis while the other normal good (X2) is modelled on the vertical axis. Prior to the subsidy, the optimal consumption bundle occurs at the tangent point of the original budget line M0 and the indifference curve and is labelled A. The £16.90 voucher is labelled V (assume unit price of healthy foods of £1) and shifts the budget line rightward albeit with a kink at the top due to the spending restriction to healthy foods (the maximum quantity of the other good is limited to the budget amount B divided by the good's price). The kink in the demand is not expected to affect the household's decision making on the optimal consumption bundle as the amount that would otherwise be spent on healthy foods can be spent on the other good. Thus, the optimal consumption bundle that would occur if the voucher was made as an equivalent cash transfer (represented by the dotted line) is feasible even as an in-kind benefit.



The findings in Griffiths et al. (2018) support the expectation of money fungibility in infra-marginal households where the was no change in the consumption of fruits and

vegetables and the vouchers were equivalent to cash benefits. Their results contradict the findings reported in Abeler and Marklein's (2015), where the researchers demonstrated the loss of money fungibility among inframarginal consumers when labels were attached to a component of their budget using data collected from a field experiment and laboratory experiment. In the field experiment, restaurant patrons were offered beverage or gourmet vouchers whose value was lower than the minimal value of beverages consumed at the restaurant (Abeler & Marklein, 2015). In the laboratory experiment, the researchers simulated a consumption decision in the reference stage by endowing subjects with a budget of 50 monetary units – earned in a menial and boring computer task – that could be spent on two goods whose payoffs were specified (Abeler & Marklein, 2015). In the subsidy stage, subjects received a budget of 50 and an additional 30 monetary units either as an in-kind benefit or unconditional benefit: the change in the two groups optimal consumption bundle was shown to differ significantly between the two groups.

Their field experiment results show higher spending on beverages in the label treatment group (beverage voucher) in terms of the unit price rather than in the quantity of drinks as subjects consumed more expensive drinks (Abeler & Marklein, 2015). Under the fungibility expectations, the spending on beverages between the two groups should have been comparable. Similarly, in the lab-controlled experiment, participants receiving in-kind benefits consumed significantly higher amounts of the subsidized good and their marginal propensity to consume out of the subsidy was twice as large as the unconditional benefit group's (Abeler & Marklein, 2015).

In contrast to Griffiths et al. (2018) but similar to Abeler and Marklein's (2015) study findings, Beatty et al. (2015) showed that labelling had a behavioural effect on the consumption of older households receiving the Winter Fuel Payment (WFP) cash transfer. The WFP is a universal unconditional cash transfer made to households with a member aged 60 or over and was worth £250 when the oldest qualifying individual was aged between 60 and 80 and £400 if over 80 (Beatty et al., 2015). Standard economic theory predicts that household spending on normal goods including fuel would increase but the proportion of fuel in the budget would decrease as fuel is a necessity and not a

luxury good (Beatty et al., 2015). Their findings, however, showed a disproportionately large allocation of the WFP to fuel: 41% of the amount was spent on fuel when the expected amount assuming transferability of money units was 3%, which is proof of a labelling effect (Beatty et al., 2015).

From the foregoing, the literature on labelling effects is varied with some researchers such as Griffiths et al. (2018) showing adherence to micro-economic expectation while other researchers show contradictory results. A notable difference in Griffiths et al.'s study and the other two is in the former's restriction to low-income households. Abeler and Marklein (2015) used meal price to control for wealth but this approach is not fool-proof as spending varies with occasion and factors other than wealth. This suggests that the labelling effect might be absent in low-income households as the marginal utility of consumption from a wide variety of normal goods is higher in this subgroup.

References

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