TABLE 5-1 What Government Can Do

Action	Illustrations
Regulate	Licensing, inspection, enforcement of standards, application of sanctions. Specific examples: environmental, health, and workplace safety regulation; corporate financial regulations.
Subsidize	Loans, direct payments or benefits, tax credits, price supports. Specific examples: student loans; subsidies to farmers; dairy price supports; low interest loans for disaster recovery.
Ration	Limit access to scarce resources. Specific examples: permits for backpacking in national parks; the Oregon Health Plan's limitations on coverage of health care services.
Tax and spend	Tax an activity at a level that encourages or discourages it. Specific examples: allowing home mortgage deductions to encourage home ownership; imposing cigarette taxes to discourage smoking. Spend money on preferred programs. Specific examples: defense weapons, prisons, AmeriCorps, public higher education.
Contract out	Contract for government services from private sector or buy products for government agencies. Specific examples: defense contracts for weapons procurement; purchase of computers and fleet vehicles for federal or state governments or public schools.
Use market incentives	A special category of taxation or imposition of fees that creates incentives to change behavior and achieve goals and objectives. Specific examples: raising gasoline taxes to encourage conservation of fuel and reduce carbon dioxide emissions; tax rebates for purchasing hybrid vehicles.
Privatize	Transferring public services from government to the private sector. Specific examples: turning over management of public schools to private companies; partially privatizing the Social Security system by allowing individuals to manage a portion of their retirement savings.
Charge fees	Fees for select services. Specific examples: hunting and fishing licenses; requiring students to pay to ride the school bus.
Educate	Provide information to the public through formal programs or other actions. Specific examples: formal public meetings; public education services; food safety labels; information on toxic chemical releases; automobile fuel efficiency labels.
Create public trusts	Holding public property in trust for citizens indefinitely. Specific examples: local land conservation trusts; state and national parks and recreation areas.
Conduct research	Conduct or support research and development. Specific examples: National Science Foundation support for academic studies; defense and environmental research; medical science research through the National Institutes of Health.

STEPS TO ANALYSIS

POLICY DESIGN TOOLS

Policy design is the consideration of a variety of possible approaches, instruments, or tools that may be appropriate for a given policy problem. The tools described here derive from anticipating how different policy actors are likely to respond to what governments attempt to do.

Authority tools. They assume people behave because someone in authority asks them to do so. The use of such tools, not always effective or democratic, is dependent on the perceived legitimacy of government. These tools may be particularly suitable during times of crisis when favorable responses by the public are more likely.

Inducements and sanctions. The assumption here is that people are rational actors who seek to maximize their self-interests. Inducements encourage people to act in a certain way because they will gain from doing so. Sanctions are negative incentives or penalties that are thought to discourage behavior that is inconsistent with policy goals.

Capacity-building tools. They provide training, education, information, and technical assistance, and they aim to inform or enlighten and thus empower people, either those in the target population or policy agents.

Hortatory tools. Governments invoke images and values through speeches, proclamations, and other communication to exhort people to behave in a certain way.

Learning tools. Policy agents and target populations are encouraged to participate and learn, for example, through citizen advisory panels and collaborative processes.

Source: Adapted from Anne Larason Schneider and Helen Ingram, *Policy Design for Democracy* (Lawrence: University Press of Kansas, 1997).

Table 10.1 *Freeing, Facilitating, and Simulating Markets*

Generic Policies	Perceived Problem: Market Failure (MF), Government Failure (GF), Distributional Issue (DI), Limitation of Competitive Framework (LCF)	Typical Limitations and Collateral Consequences
Freeing Markets		
Deregulate	GF: Allocative inefficiency from rent seeking LCF: Technological changes	Distributional effects: windfall losses and gains, bankruptcies
Legalize	LCF: Preference changes	Transitional instability
Privatize	GF: Bureaucratic supply	
Facilitating Markets		
Allocate through property rights	MF: Negative externalities	Distributional effects: windfall gains and losses
Create new marketable goods	MF: Public goods, especially open access	Thin Markets
Simulating Markets		
Auctions	MF: Natural monopolies MF: Public goods DI: Transfer of scarcity rents	Collusion by bidders, opportunistic behavior by winning bidder, political pressure to change rules *ex post*

Table 10.2 *Using Subsidies and Taxes to Alter Incentives*

Generic Policies	Perceived Problem: Market Failure (MF), Government Failure (GF), Distributional Issue (DI), Limitation of Competitive Framework (LCF)	Typical Limitations and Collateral Consequences
Supply-Side Taxes		
Output taxes	MF: Negative externalities DI: Transfer of scarcity rent	Frequent adjustment of tax levels required
Tariffs	LCF: Market power of foreign exporters	Deadweight losses for consumers; rent seeking by producers
Supply-Side Subsidies		
Matching grants	MF: Positive externalities MF: Public goods DI: Increase equity	Diversion to general revenue by reduction in effort
Tax expenditures (business deductions and credits)	MF: Positive externalities MF: Public goods	Misallocation of resources across industries; horizontal tax inequity
Demand-Side Taxes		
Commodity taxes and user fees	MF: Negative externalities MF: Information asymmetries MF: Public goods, especially open access	Deadweight losses and black markets
Demand-Side Subsidies		
In-kind subsidies	MF: Positive externalities LCF: Utility interdependence DI: Floors on consumption	Restricts consumer choice; bureaucratic supply failure; lumpiness leads to inequitable distribution
Vouchers	MF: Positive externalities DI: Increase equity GF: Bureaucratic supply failure	Informational asymmetries; short-run supply inelasticities; institutional resistance
Tax expenditures (personal deductions and credits)	MF: Positive externalities DI: Increase equity	Poor targeting of subsidies; vertical and horizontal tax inequities

Table 10.3 *Establishing Rules*

Generic Policies	Perceived Problem: Market Failure (MF), Government Failure (GF), Distributional Issue (DI), Limitation of Competitive Framework (LCF)	Typical Limitations and Collateral Consequences
Frameworks		
Civil laws (especially liability rules)	MF: Negative externalities MF: Information asymmetries MF: Public goods DI: Equal opportunity LCF: Thin markets	Bureaucratic supply failure; opportunistic behavior; imbalance between compensation and appropriate deterrence
Criminal laws	MF: Negative externalities MF: Public goods LCF: Illegitimate preferences	Costly and imperfect enforcement
Regulations		
Price regulation	MF: Natural monopolies DI: Equity in distribution of scarcity rent DI: Equity in good distribution	Allocative inefficiency; X-inefficiency
Quantity regulation	MF: Negative externalities MF: Public goods, especially open access	Rent seeking; distorted investment; black markets
Direct information provision (disclosure and labeling)	MF: Information asymmetries MF: Negative externalities	Cognitive limitations of consumers
Indirect information provision (registration, certification, and licensing)	MF: Information asymmetries MF: Negative externalities GF: Bureaucratic supply failure	Rent seeking; cartelization

Table 10.4 *Supplying Goods through Nonmarket Mechanisms*

Generic Policies	Perceived Problem: Market Failure (MF), Government Failure (GF), Distributional Issue (DI), Limitation of Competitive Framework (LCF)	Typical Limitations and Collateral Consequences
Direct Supply		
Bureaus	MF: Public goods MF: Positive externalities MF: Natural monopolies DI: Equity in distribution	Rigidity; dynamic inefficiency; and X-inefficiency
Independent Agencies		
Government corporations	MF: Natural monopolies MF: Positive externalities DI: Equity in distribution GF: Bureaucratic supply failures	Agency loss
Special districts	MF: Natural monopolies MF: Local public goods MF: Negative externalities DI: Universal provision	Agency loss; insensitivity to minorities with intense preferences
Contracting Out		
Direct contracting	MF: Public goods, especially local public goods GF: Bureaucratic supply failures	Opportunistic behavior by suppliers; lock-in and low-balling
Indirect contracting (nonprofits)	MF: Positive externalities GF: Bureaucratic supply failures DI: Diversity of preferences LCF: Endogenous preferences (behavior modification)	Weak coordination of services

Table 10.5 *Providing Insurance and Cushions*

Generic Policies	Perceived Problem: Market Failure (MF), Government Failure (GF), Distributional Issue (DI), Limitation of Competitive Framework (LCF)	Typical Limitations and Collateral Consequences
Insurance		
Mandatory insurance	LCF: Adverse selection	Moral hazard
Subsidized insurance	MF: Information asymmetries DI: Equity in access LCF: Myopia LCF: Misperception of risk	
Cushions		
Stockpiling	LCF: Adjustment costs GF: Price controls	Rent seeking by suppliers and consumers
Transitional assistance (buy-outs, grandfathering)	LCF: Adjustment costs LCF: Macroeconomic dynamics	Inequity in availability
Cash grants	DI: Equality of outcome LCF: Utility interdependence	Reduction in work effort, dependency

Table 10.6 *Searching for Generic Policy Solutions*

	Market Mechanism	Incentives	Rules	Nonmarket Supply	Insurance and Cushions
Traditional Market Failures					
Public goods	S	S	S	P	
Externalities	S	P	P	S	
Natural monopolies	S	S	P	P	
Information asymmetries			P	S	S
Other Limitations of the Competitive Framework					
Thin markets			P		
Preference-related problems	S	S	P		
Uncertainty problems			P		S
Intertemporal problems			S		P
Adjustment costs					P
Macroeconomic dynamics		P			S
Distributional Concerns					
Equity of opportunity		S	P		S
Equality of outcomes			S	S	P
Government Failures					
Direct democracy			P		
Representative government	P		S		
Bureaucratic supply	P	S	S	S	
Decentralization	S	P		S	

Sources for solutions (though not necessarily most often used!): P—primary; S—secondary.