

CRITERIA FOR EVALUATING METHODS OF ALLOCATION

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Methods of allocation can be evaluated according to various criteria, economic and non-economic. In what follows, attention is concentrated on economic criteria, but some remarks on questions of fairness are also included.

In assessing the efficiency of any method of allocation, four considerations need to be addressed.

- First, how closely does the allocation confirm to an ideal allocation, as judged by some criterion? The criterion most familiar to economists is that of Pareto, whereby a perfect allocation would leave no opportunity for mutually beneficial exchange of the allocated good among the population. This outcome requires that no non-recipient of the good have a higher willingness to pay for it than any recipient. All recipients would thus be located on the upper part of the demand curve, and all non-recipients on the lower part, the point of division depending on the number of units of the good available. In the case of requisitioning of services, all those selected should have a lower opportunity cost than those not selected. The costs of a Pareto-inefficient method of allocation takes the form of a loss of consumer and/or producer surplus.

Rather than willingness-to-pay, the criterion whereby the efficiency of an allocation is judged may be the "deservedness" or "need" of the potential recipients. While such criteria may be difficult to define precisely, they clearly underlie some policies, especially with respect to social welfare.

- Second, what are the fiscal implications of the method of allocation? All non-price methods involve the good being priced below the market-clearing level, and hence raise less revenue for the allocator (which in most cases is a government agency) than market allocation would. This means that for a given level of expenditure on the good, more revenue will have to be raised by other means, typically by taxes. Taxes are not merely transfers, but, by distorting economic entities' choices (e.g. as between labour and non-market activities, or between taxed and untaxed goods) involve real costs as well - the so-called deadweight losses. These are not insignificant, having been estimated for Australia to be perhaps 40 cents in the dollar at the margin. Hence the less revenue raised by a method of allocation relative to what could be raised by market allocation, the less fiscally efficient it is.

In the case of the requisitioning of goods or services from suppliers at below cost, less expenditure is required than if they were acquired by voluntary exchange. Hence this method is fiscally more efficient than use of the market mechanism.

- Third, to what extent is the value of the allocated goods dissipated by the competitive activities of those seeking to obtain them? An obvious example is the practice of queuing, whereby persons competing for a limited supply of some good wait in line, at the cost of time and inconvenience for themselves, in order to qualify for the good. A time price has to be paid, in addition to, or in lieu of, the money price, and unlike the latter, which is a transfer to the supplier, the time price is a real cost, incurred by the "buyer" but benefiting no one else. These costs are generally known as "rent-seeking" costs.

- Fourth and finally, there are the costs of establishing and administering an allocation scheme. These four categories of efficiency (or of cost associated with inefficiency), will be referred to as *allocative*, *fiscal*, *rent-seeking*, and *administrative* efficiency (or cost) respectively.

As well as efficiency, "fairness" is an important criterion whereby methods of allocation are evaluated. Economists are familiar with the concepts of "horizontal" and "vertical" equity, the former referring to the equal treatment of equals, the latter to the appropriate treatment of unequals. The former is the less controversial notion, being almost synonymous with natural justice, though of course there is always room for argument as to what constitutes "equality of treatment" and "equality of circumstances". Vertical equity is typically considered with respect to taxation; for example, whether income taxation should be proportional or progressive, and, if the latter, how progressive. In the case of allocating goods the analogous question is whether, and in what way, income status should determine whether a person should receive the good.

In the case of non-competitive methods of allocation, the question of fairness is likely to arise if the allocating agency can exercise its own discretion in deciding who shall receive the good and who shall not. Suspicious of bias, cronyism, or nepotism are likely to reduce the acceptability of discretionary methods of allocation.