

Policy Issues Affecting User Fees

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As the State Legislature continues to threaten to impose limits on local property tax rates, more and more local governments across Wisconsin are looking at user fees as potential revenue sources. This paper summarizes what the field of Economics says about user fees, so policymakers can make more informed decisions as to whether and where to impose them.

As with most public policy issues, the desirability of user fees hinges on two questions: do they increase or decrease economic efficiency, by leading to either a more or less desirable use of public resources, and do they promote fairness. Since the fairness question is simpler, I'll review it briefly first, before discussing the more complicated question of efficiency.

I will not attempt to address here whether it would be more appropriate to cut spending or to maintain that spending through user fees. Rather, I assume here that local policymakers have already identified which local government spending projects are worth funding and which are not, and are at this point only discussing how the acceptable projects should be funded, through taxes or through fees. In general however, most project that are not worth spending tax money on are probably not worth spending fees on, and *vice versa*.¹

Fairness

Everyone pays taxes, but only the users of a publicly provided service pay user fees. So when the users are only a small segment of the taxpaying population, it may be more fair to make that small minority pay for the service through their fees than have the majority pay for something they derive no benefit from.

This fairness argument for fees is stronger, the smaller the fraction of the population that uses the government service. If however the service is used roughly equally by everyone -- e.g. municipal garbage collection -- paying for it through fees rather than

¹ There may well be spending projects that supply substantial benefits to a very small group of users, that make sense only as long as those users pay for the project, rather than the general public. I do not however intend to examine the related spending decisions in this paper.

through property taxes merely replaces a somewhat regressive financing mechanism with a very regressive levy.² And there are additional costs associated with collecting most fees -- billing, recording, depositing, plus auditing to prevent embezzling -- as well as, from the public's perspective, the nuisance factor in having to make an additional payment to local government above and beyond the taxes they've already paid. So fees should probably only be considered when well under half the population benefits from the service.

Who the users are may also influence the fairness question. If the service is used primarily by the low income -- e.g. many county social services, or municipal public transportation -- we might consider a fee less appropriate than if it disproportionately benefits the wealthy -- e.g. raising bridges or operating boat locks for recreational boat owners to pass through. And if the service is primarily for children -- public education, playgrounds, or youth sports and recreation -- we may decide That it is all of society's responsibility, not just the parents', to shoulder the costs through taxes rather than fees.

I would note that how evenly or unevenly we perceive a service to be used may very well depend on our time frame of reference. In any one year, very few families have either birth or death certificates issued, so perhaps they should pay a fee to cover the cost of issuing the certificates. On the other hand, over our lifetimes, every one of us will have one of both issued, so maybe the cost should just be covered by our property taxes. Is it better to have me pay 50¢ a year in property taxes for 50 years, or have my parents and children each pay \$12.50 in fees, to cover these costs?

Efficiency

In discussing whether a fee is efficient or not, I will continue to assume that the question of whether or not to provide the public service in question has already been settled. The issue to address then is this: now that we've decided to provide public transportation, or parks and recreation, or bridge raisings, do we get a more efficient usage of those publicly provided services by charging user fees, or by not charging fees?

The answer to that question depends on what it costs to make the service available to one additional user. In general, we want a fee that matches that cost. If the fee is set too high, it will deter people from using the public service needlessly, and result in an inefficiently low level of usage. If it is set too low, the opposite problem arises, and wasteful overuse will result.

For many publicly provided services -- health and building inspections, courts and legal-related services -- each user requires the personal service of one or more public

² There is a long-standing debate about the degree of progressivity or regressivity of property taxes in Economics. However, even if property taxes are on average progressive, a local increase in property taxes in any single jurisdiction is clearly at least somewhat regressive (see Zodrow (2001)). Nevertheless, an equal fee per household would be even more regressive.

employees, often for an extended period of time. From a pure efficiency perspective, a fee should always be charged for such services, at a level reflecting the wage costs of those public employees, to discourage wasteful overuse (e.g. frivolous lawsuits, or requests for building inspections before the building is ready for inspection).

Other considerations may alter the desired fee: we may not want to charge any fee when the service involves counseling a troubled young person, even though that young person uses up a considerable amount of a public professional's time. But as a general rule, economic efficiency requires that users pay for personalized, one-on-one services.³

These personalized services are actually just one special case within a broader category of publicly provided services: services that are rival in nature.⁴ A good or service is rival if my use of that good or service reduces its availability to other prospective users, unless more of that good or service is produced. For example my eating an apple means that apple is no longer available for you to eat, and my request for the building inspector this afternoon means that inspector will not be available to inspect your project for a few hours. Since my use has imposed costs on others -- an apple no longer available, a delay in getting inspected -- the good or service is rival in nature.⁵

Unless I get substantial benefits from a good or service, sufficient to justify the costs I've imposed on others, I should be deterred from using the good or service. A user fee does just that, in the same way that any market price does, by ensuring that only those who are willing to pay for the cost of producing the apple or the building inspection consume that product or the inspector's limited available time.

There are many examples of rivalry above and beyond the personalized services I've already discussed. When I park my car in a public parking space, or reserve a park shelter for my family reunion, that's a parking space or park shelter that's no longer available to others. Typically, rivalry only occurs when my use diminishes (or has a high probability of diminishing) other people's use: when I park downtown or reserve one of the city's or county's few park shelters for a summer Saturday afternoon, other

³ Technically, economists would categorize these personalized services as private goods, that could be provided by private businesses at a market price (and in some cases are, e.g. certain types of quality inspections, arbitration services, and counseling services). They are often government provided because the public has a stake in the quality of the service, for example health inspections and legal decisions. Nevertheless, economic efficiency requires that fees reflecting the cost of providing the service be charged.

⁴ For a complete discussion of the concepts of rival and nonrival goods, and the distinctions between public goods and private goods, see the chapter on Public Goods in any recent Public Finance or Public Sector Economics textbook. Some of the more widely available in UW System libraries across the state are various editions of the texts by Bruce, Due and Friedlaender, Haveman, Hyman, Rosen, and Stiglitz.

⁵ All private goods are rival. Most (but not all) public goods, as defined by Economists, are nonrival. See any Public Finance or Public sector Economics textbook.

prospective users are most likely inconvenienced, but not when I park on an uncrowded residential street or reserve a shelter for a Tuesday afternoon in October.⁶

In some cases, the rivalry might involve different but competing uses. A merchant setting up a sidewalk display blocks the path of passing pedestrians. A boat owner who forces a bridge to open delays all the motorists who must wait until the bridge is back down again. In all these cases however, one user is imposing costs on others, by making them drive further to park, wait longer to go over the bridge, or lose out on the use of a park shelter for their event.

Failure to charge a fee, or even charging too small a fee, will generally result in excessive, inefficient overuse.⁷ As with the fee for personalized services, the goal here is to limit use to only those users who derive enough benefits from the use that they are willing to pay the fee. If I'm not willing to pay 50¢ to park there for an hour, or the \$50 to reserve the park shelter, or the \$10 to have the bridge raised, then it makes no sense to inconvenience the other parkers, picnickers, or drivers to provide the service to me. Again, unless some other public policy objective alters the story, user fees should always be levied on publicly provided services that are rival.⁸

For the great majority of publicly provided services however, use is essentially nonrival: my use of a sidewalk, a streetlight, or an uncrowded park in no way inconveniences any other actual or prospective user. Since my use is essentially costless, the efficient fee to charge me is essentially no fee whatsoever.⁹

Again, recall that charging a fee for a service discourages use of that service. When the service is rival, i.e. costly to provide to one more user, discouraging excessive use is appropriate and efficient, since we don't want people to use the costly service unless they benefit enough to justify that cost.

⁶ In Economic jargon, this is the distinction between a congested and an uncongested public good.

⁷ One way to tell whether a fee is too low is to observe whether some nonprice rationing is occurring. For example, if park shelter fees are too low, users will be assigned on a first-come-first serve basis, and late arrivers will lose out on a use opportunity. This will often show up as a competition to be near the front of the line whenever reservations can first be made.

⁸ This assumes that it is possible to levy a fee. Highway use during rush hour is often rival: each additional motorist slows all the other motorists down. However, on most highways there is no way to charge fees for highway use. See the discussion of excludability in the Public Goods chapter in any Public Finance or Public sector Economics textbook.

⁹ It is important here to distinguish between the cost of providing the service versus the cost of an additional user. With a rival good or service, these costs are the same: the cost of having my restaurant inspected is \$30 per hour, the cost of hiring an inspector. With a nonrival good or service, the former is nonzero but the latter is zero. For example, it may cost \$1 to operate a streetlight for a week, but my spending the evening in a lawn chair beneath the streetlight neither uses up more electricity nor takes light away from any other user. My use of the light is costless.

But when the service is nonrival, and costless to provide to one additional user, discouraging anyone who benefits from the service from using it would be inefficient, because we would be eliminating some benefits without reducing any costs at all. When the service is nonrival, again unless other policy objectives dictate otherwise, a user fee is not appropriate.

Notice that the efficiency of a fee often depends critically upon how heavily a public resource is used.¹⁰ Parking fees make sense where parking spaces are frequently occupied, but not where they remain mostly unused. User fees on a heavily used field where softball, soccer, and ultimate frisbee teams compete for use would efficiently ration the use of that field; the same user fees on a sports league that plays on an otherwise vacant field merely decreases sports participation without putting the field to better use.

Conclusion

Often in the political arena, debates about user fees revolve almost exclusively around the fairness issue: should we all pay for it, or just the users. Hopefully, this paper makes clear that there is a whole other dimension to the question, and that the misapplication of user fees -- either the failure to levy them on rival government services, or the decision to levy them on nonrival services -- will result in an inefficient use of our public resources. Public policy makers who incorporate this efficiency dimension into their decisionmaking process will be far more likely to make good user fee decisions.

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¹⁰ Again, in Economic jargon, the issue is whether or not the public good is congested.