FEDERAL USER FEES: A LEGAL AND ECONOMIC ANALYSIS†

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TABLE OF CONTENTS

† This article is based on a report prepared by the authors for the Administrative Conference of the United States. Our conclusions, however, do not necessarily represent the views of the Administrative Conference.

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User fees are prices a governmental agency charges for a service or product whose distribution it controls. Recently, the federal government has developed substantial interest in financing through user fees a variety of the services it provides.[1] This article explores the propriety of that effort by identifying economic and legal theories that underlie user fees, investigating the means through which implementation of a fee program may advance or frustrate the objectives of user fees, and reaching certain conclusions about standards for the imposition of fees.

Typical discussions about which goods and services government should provide ignore questions concerning methods of payment. The decision to involve government in a particular venture instead centers on factors such as the "rights" or "entitlements" of citizens, or investigations into the "proper function" of government.[2] Isolating the question of service from the question of payment, however, necessarily and unfortunately overlooks important relationships between the two. Both the amount of service provided and the identity of particular recipients will largely be determined by the answer to the question, "Who pays?"

The need to consolidate the questions of provision and payment has become more stark as state and federal governments have increasingly moved from tax-based financing of particular goods and services to user fee-based financing.[3] From 1977 to 1983, such user fee revenues grew 11.4 percent annually, a growth rate two percent higher than that which prevailed during the preceding twenty year period.[4] By 1984, user charges provided about 20 percent of all state and local revenues. This growth reflects both

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[1] The motivation for this interest appears to be a desire to reduce substantial federal deficits without resorting to revenue-enhancing mechanisms that can be characterized as tax increases. *See, e.g.*, Shribman & Young, *Parks Chief Warns of Fund Cutback Impact*, N.Y. Times, June 17, 1986, at A21, col. 4.

[2] *See, e.g.*, Michelman, *Foreword: Protecting the Poor Through the Fourteenth Amendment*, 83 HARV. L. REV. 7 (1969) (discussing claims of the poor to "minimum protection" against economic hazards in terms of "just wants," the concept that people are entitled to have the government fulfill certain existing needs).

[3] *See* R. ARONSON & J. HILLEY, FINANCING STATE AND LOCAL GOVERNMENT 6-7 (4th ed. 1986) (asserting that local user charges have been the fastest growing component of local government revenues since the late 1970's); W. HIRSCH, THE ECONOMICS OF STATE AND LOCAL GOVERNMENT 29-48 (1970) (noting the vital importance of user charges in financing state and local governments); Mushkin & Bird, *Public Prices: An Overview*, in PUBLIC PRICES FOR PUBLIC PRODUCTS 3 (S. Mushkin ed. 1972) ("Continued revenue pressure on urban finances has led many cities to consider carefully the prospect of augmenting their financial resources by introducing or increasing fees and charges for various local government activities."). *Cf.* McCarney, *Increasing Reliance on User Fees and Charges*, in PROPOSITION 2½: ITS IMPACT ON MASSACHUSETTS 351-55 (L. Susskind ed. 1983) (noting that, although Massachusetts's cities and towns have historically relied on user fees less than the national average, reliance has increased in recent years).

[4] R. ARONSON & J. HILLEY, *supra* note 3, at 156.

less generous federal aid to states and localities and public resistance to increased taxes.[5] An increasingly substantial body of economic, legal, and financial management research on local user fees has facilitated increased reliance on user fees,[6] resulting in the emergence of a workable consensus on where and how local governments should employ fees.[7]

While user fees at the federal level are by no means new,[8] they have never accounted for a substantial share of total federal revenues.[9] Prospects for expanding federal user fees, however, have attracted much attention during the Reagan Administration. The Grace Commission,[10] the Congressional

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[5] *See* McCarney, *supra* note 3, at 351-55 (discussing Massachusetts's increasing reliance on user fees and charges).

[6] A useful bibliography may be found in L. DEMERITT, USER CHARGES AND FEES IN LOCAL GOVERNMENT (1985).

[7] *See, e.g.*, G. BREAK, INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES 22-27 (1967) (discussing fiscal problems of federalism); J. MIKESELL, FISCAL ADMINISTRATION: ANALYSIS AND APPLICATIONS FOR THE PUBLIC SECTOR (1982); Berglas, *User Charges, Local Public Services, and Taxation of Land Rents*, 37 PUB. FIN. 178 (1982) (noting that recent literature recommends more extensive use of user charges by local government); Mercer & Morgan, *The Relative Efficiency and Revenue Potential of Local User Charges: The California Case*, 36 NAT'L TAX J. 203 (1983) (noting a potential revenue gain of about 20% in the area of user charges).

[8] Some such fees—postal services, for example—have been collected for as long as there has been a national government.

[9] Definitional and accounting complexities make it difficult to provide a clear picture of the revenue importance of user fees, but the following table provides some sense of their role.

REVENUE SOURCES, 1984

	Percent	
	Federal	*State and local*
Taxes	54	46
Insurance trusts	30	11
User fees	9	20
Intergovernmental	—	15
Other	7	8
Total	100	100

Derived from 1987 STATISTICAL ABSTRACT OF THE UNITED STATES 252.

[10] In 1982, President Reagan appointed the President's Private Sector Survey on Cost Control to investigate mechanisms to reduce costs and increase efficiency in government expenditures. J. Peter Grace served as Chairman of the Executive Committee, and the Survey has become known popularly as the Grace Commission. A User Charges Task Force recommended the expanded use of fees for governmentally provided goods and services and modification of existing statutes to overcome perceived ambiguity in the legal authority to impose fees. *See* PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL, REPORT ON USER CHARGES 234-42 (Spring-Fall 1983) (summary list of revenue and recommendations) [hereinafter REPORT ON USER CHARGES].

Budget Office,[11] the General Accounting Office,[12] and several Executive branch agencies[13] have issued reports exploring various aspects of federal user fees. The Office of Management and Budget's most recent report on impending regulatory initiatives outlines numerous proposals for new or increased user fees that President Reagan has recommended to the Congress.[14] A number of federal agencies that already have statutory authority for user fees have been moving toward implementation of higher fees covering more services.[15]

The active interest in federal user fees is easily understandable. Continuing large federal budget deficits have created a fertile climate for user fees as a supplement to general taxation.[16] Less public attention, however, has been directed to the behavioral and distributional effects that can be expected from the shift to fee-based financing of governmental services. Those who previously obtained free services for which they will now have to pay will presumably demand fewer services. Ultimate recipients may constitute a very different group from those who previously sought the services.

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[11] *See, e.g.*, CONGRESSIONAL BUDGET OFFICE, FEDERAL POLICIES FOR INFRASTRUCTURE MANAGEMENT (June 1986); CONGRESSIONAL BUDGET OFFICE, CHARGING FOR FEDERAL SERVICES (Dec. 1983).

[12] *See, e.g.*, GENERAL ACCOUNTING OFFICE, PARKS AND RECREATION: RECREATION FEE AUTHORIZATIONS, PROHIBITIONS, AND LIMITATIONS (May 1986) [hereinafter PARKS AND RECREATION]; GENERAL ACCOUNTING OFFICE, THE CONGRESS SHOULD CONSIDER EXPLORING OPPORTUNITIES TO EXPAND AND IMPROVE THE APPLICATION OF USER CHARGES BY FEDERAL AGENCIES (March 1980).

[13] *See, e.g.*, OFFICE OF MANAGEMENT AND OPERATIONS & OFFICE OF PLANNING AND EVALUATION, FOOD AND DRUG ADMINISTRATION, USER CHARGE STUDY (August 1983) [hereinafter USER CHARGE STUDY]; R. TRUMBLE & S. GOULD, USER FEES FOR UNITED STATES GOVERNMENT TECHNICAL SERVICES (March 1983) (report for National Science Foundation).

[14] *See* EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT AND BUDGET, REGULATORY PROGRAM OF THE UNITED STATES GOVERNMENT 25-26 (1987) (grazing fees); *id.* at 27-28 (collection of costs for Forest Service in the Bureau of Land Management); *id.* at 431 (U.S. Customs Service merchandise processing user fee); *id.* at 482 (user charges for pesticide registration).

[15] *See, e.g.*, Establishment of a Fee Collection Program to Implement the Provisions of the Consolidated Omnibus Budget Reconciliation Act of 1985, 52 Fed. Reg. 10,226 (1987) (to be codified at 47 C.F.R. §§ 0, 1, 21, 23, 61, 66, 73, 76, 78, 80, 90, 94, 95) (order by Federal Communications Commission to implement procedural changes in fee collection); Fees Applicable to Producer Matters, Natural Gas Pipeline Matters, Etc., 52 Fed. Reg. 10,366 (1987) (to be codified at 18 C.F.R. § 381) (updating Federal Energy Regulatory Commission's filing fees).

[16] The difference between a fee and a tax is typically rooted in the relationship between the exaction and the cost of the service for which the exaction is imposed. Fees may escape the rubric of taxes where they do not exceed the reasonable cost of providing the underlying service. *See, e.g.*, Mills v. County of Trinity, 108 Cal. App. 3d 656, 166 Cal. Rptr. 674 (Cal. Ct. App. 1980) (permitting imposition of "fee" without compliance with state constitutional limit on taxes).

This article examines the effects of a user fee system on the provision of governmental goods and services.[17] In Section I of the article, we draw from economic theory to suggest an ideal model of user fees. We suggest that user fees are best understood as a mechanism for matching the burdens of governmental services with their benefits, structured so as to enhance the efficient provision of governmental services. Where consumption of services confers substantial benefits on nonpayers, it may be desirable to charge fees that recover less than full costs in order to avoid disincentives for individuals or firms to engage in socially useful conduct. We also consider alternative objectives for user fees. Primary among these objectives are considerations of fairness that not only require a matching of benefits and burdens, but also require occasionally providing governmental services without corresponding fees to ensure access to benefits whose distribution should not depend on economic status. In addition, user fees may serve the objectives of enhancing federal revenues and encouraging privatization of government functions.

In Section II, we explore the legal status of federal user fees. Our analysis of the primary statutory basis for federal user fees, the Independent Offices Appropriation Act ("IOAA"),[18] suggests that ambiguity pervades current standards governing user fees. We argue, however, that the existing case law can and should be reconciled with the economic principles presented in Section I of the article. We explain, therefore, how legal requirements of "identifiable beneficiaries" and "identifiable benefits" correspond to the objectives that would be served by an ideal user fee. We also investigate the correspondence, or lack thereof, between those objectives and recently enacted user fee statutes that are not explicitly predicated on benefits received.

In Section III we consider how technical details of user fee implementation may affect the propriety of a user fee program. We analyze the procedural constraints on agencies to impose fees in a manner that does not interfere with overriding policy objectives. We also analyze conflicting interpretations of "benefit" to determine, for instance, whether the term can be employed to recover costs incident to regulation or the imposition of licensing requirements on a private company. We conclude that any efforts to implement a fee program must also take account of the ultimate disposition of fees—that is, whether they should be retained by the agency imposing

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[17] This article primarily focuses on fees charged for goods or services that are provided by government to identifiable private recipients, whose access can be rationed by a price mechanism. Some additional limitations on the scope of this article also seem warranted to keep it manageable. In particular, this article excludes: military functions and transactions with foreign governments; one-time sales of government assets that do not represent an ongoing government function; excise taxes that are not linked to the provision of goods or services to the taxpayer; intragovernmental fees; penalties and fines; fees related to government loans; and insurance programs.

[18] 31 U.S.C. § 9701 (1983).

them or paid into the general treasury—as well as political considerations that might induce agencies to deviate from an optimal fee program.

The article concludes with a series of recommendations for the creation of standards concerning user fees and their implementation, and the creation of a clearinghouse for information concerning fees.

I. User Fee Policy Objectives and Principles

A. *A Definition of User Fees and a Standard for Evaluation*

A user fee is a price charged by a governmental agency for a service or product whose distribution it controls. A user fee is, at least in theory, a benefit-based source of revenue whose logic is simple. Payment of a user fee reflects receipt of a valued service in return, a quid pro quo. By contrast, federal income taxation is generally not benefit-based; rather, it imposes burdens that reflect complex Congressional judgments about, among other things, a taxpayer's ability to pay.[19]

Our primary emphasis in this article is on the extent to which user fees foster a more efficient allocation of goods and services. In our use of an efficiency criterion, we adopt the standard definition of allocating resources to their most highly valued use, generally as indicated by the recipient's willingness to pay for the resource.[20] Our selection of an efficiency criterion emerges from our assumption that the principal reason that the government provides the underlying services is to compensate for the failure of the private market to achieve some reasonable approximation of optimal resource allocation. These market failures may be attributable to the existence of public goods, substantial externalities, information or immobility problems, or natural monopolies. Once government determines that one of these

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[19] Numerous providers of governmental services have begun to argue that beneficiaries of those services should bear the financial burden of their provision. Consider this example drawn from the telecommunications context:

> To the extent that fees do not cover the true costs of reimbursable services, differences must be made up through the appropriation of general tax receipts. Because many taxpayers do not directly or indirectly benefit from each and every service rendered by the Commission we fail to see why they should be required to pay for those regulatory activities that principally benefit private interests. Failure to recover all reimbursable costs is tantamount to forcing taxpayers to subsidize those firms and their customers . . . . Such subsidies may not be legal, necessary, equitable, economically efficient or in the public interest.

Practice and Procedure; Establishment of a Fee Collection Program to Implement the Provisions of the Consolidated Omnibus Reconciliation Act of 1985, 51 Fed. Reg. 25,794 (1986) (to be codified at 47 C.F.R. §§ 0, 1, 21, 22, 23, 62, 73, 74) (proposed July 16, 1986) [hereinafter Fee Collection Program].

[20] For a similar definition of efficient allocation, see M. Brennan, Theory of Economic Statics 6 (2d ed. 1970).

effects renders intervention appropriate, however, there is little reason to deviate from the pricing mechanisms that the private market, had it worked, would have used to achieve an allocation of the good—marginal cost pricing, for example—on the assumption that this mechanism sends signals concerning the socially appropriate amount of the good or service that should be produced.

This "allocation function"[21] does not, of course, exhaust the scope of governmental activity. Government also serves redistributional functions, such as welfare payments, and stabilization functions, such as Federal Reserve policies. To implement these functions, government often imposes charges of one form or another. Exactions may be imposed on the wealthy and redistributed to the poor, federal discount rates may be increased or decreased to affect the rate of economic growth, surcharges may be imposed on certain goods (e.g., sumptuary taxes on liquor or tobacco) considered by a paternalistic government to be "bad" for the consumer. Each of these charges represents government's attempt to modify behavior in the consumption of goods and services. What distinguishes user fees from these other charges is the nature of the intended behavioral modification. Rather than to induce individuals to spend more or less money generally (stabilization) or paternalistically to reduce consumption of "sinful" commodities or to ensure the ability of the economically disadvantaged to consume a specific level of other commodities (moral and distributional functions), the decision to reject or employ a user fee is best viewed as based on a desire to induce a socially optimal amount of the underlying good or service.

At times, these functions may conflict so that satisfaction of one requires subordination of another. For instance, given that redistributional programs seek to separate, or to draw inverse correlations between, the ability to pay and allocation of personal assets, those goods and services that government redistributes appear inappropriate subjects for user fees. In fact, we will suggest that, even with respect to those goods properly subject to a fee, considerations of fairness may vitiate application of the fee or warrant waivers and differential fees. Keeping this exception in mind, however, it becomes useful to review briefly the bases of market failure that user fees may be used to address.

1. Public Goods

Goods and services characterized as "public" may be undersupplied because individuals are unwilling to express their true preferences for them in the marketplace. Public goods exhibit two key features: their consumption is not rival, and nonpayers cannot easily be excluded from their benefits.[22]

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[21] For a general discussion of government's allocation function, see R. MUSGRAVE & P. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 7-11 (3d ed. 1980).

[22] M. TAYLOR, ANARCHY AND COOPERATION 14-15 (1976); *see* R. MUSGRAVE & P. MUSGRAVE, *supra* note 21, at 55-58 (discussing social goods and market failure);

Consumption is not rival if a unit of a good or service, once produced, can benefit a second person without any loss of benefit to the initial consumer or extra cost to anyone. For instance, if resident *A* values street lighting on his block enough to pay the full cost of the service, resident *B* will obtain equal benefit of the lighting, notwithstanding *B*'s failure to contribute anything towards the cost of the service. Where both features substantially appear, as in national defense or mosquito control, unconstrained markets will underproduce the goods because people acting out of self-interest face strong incentives not to reveal their desire for these goods.[23] If resident *B* believes that resident *A* values street lighting sufficiently to incur the total cost, *B* will understate his or her own preference for the service to resist claims for contribution. *A*, however, may follow the same strategy, hoping that *B* will incur the total cost. Consequently, the service will be undersupplied as each potential beneficiary of the service awaits action by others. The conventional solution to this situation, in which no one pays for what everyone wants, is to permit governmental supply of the service, financed through exactions from all benefited residents, i.e., taxes or assessments.[24]

A user fee has limited appeal in this particular situation. Any person in the area served automatically has access to the benefits whether or not he pays

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Head, *Public Goods and Public Policy*, 17 PUB. FIN. 197 (1962) (examining theory of public goods). For purposes of our analysis, it is sufficient that goods and services display these characteristics of a public good. Of course, goods and services may be subject to limited exclusions, and thus share some characteristics of private goods, or different consumers of goods and services may receive different amounts or types of benefit. Even in cases of mixed goods, however, there may be tendencies in favor of public supply. *See* W. RIKER AND P. ORDESHOOK, AN INTRODUCTION TO POSITIVE POLITICAL THEORY 246-67 (1973) (arguing that self-interested actors may undersupply goods if personal benefits would be exceeded by personal costs, notwithstanding that social benefits would exceed personal costs).

[23] For an analysis of variations of this problem, see Taylor & Ward, *Chickens, Whales, and Lumpy Goods: Alternative Models of Public-Goods Provision*, 30 POL. STUD. 350, 352 (1982). Implicit in this statement is the notion that goods may have "public" characteristics without being "pure" public goods. For instance, congested public goods, like highways or national parks, may exist in which use is nonrival up to a point, although additional users may reduce the enjoyment of other users. *See* M. TAYLOR, *supra* note 22, at 15.

[24] For some nonpublic goods, governmental intervention may be required because start-up costs of the project are substantial and not easily recaptured. *See* F. MICHELMAN & T. SANDALOW, MATERIALS ON GOVERNMENT IN URBAN AREAS 35-36 (1970) (suggesting that private industry would not invest in pubic projects such as bridges, dams, and roads, because it could not recover start-up costs without inducing sub-optimal usage); Rose, *The Comedy of the Commons: Custom, Commerce, and Inherently Public Property*, 53 U. CHI. L. REV. 711, 719 (1986) (arguing that a governmental body might be a useful manager where many persons desire access to or control over a given property but are too numerous or whose stakes are too small to express preferences in market transactions).

any fee, so collection based on revealed preference for the service would not be very practicable. A mandatory charge, of course, could be levied regardless of service usage, but that would be a tax, not a user fee. Moreover, since public goods are nonrival in consumption, no additional costs are incurred by making the benefit available to another person located within the service area. Thus, charging a fee for service would seem anomalous because marginal cost, the basis for pricing, would be zero.[25]

Many services contain only one but not both features of a public good. Such services can be nonrival in consumption, but they nevertheless can be rationed by price. Examples of services from which consumers can be excluded by a price mechanism include an uncongested bridge or theatre. A user fee or access fee certainly can be applied to such services, but the troublesome result would be the denial to nonpayers of benefits that are costless. Yet at some point facilities must be replaced, and user fees provide a plausible mechanism for creating a sinking fund that would ultimately finance replacements.

2. Externalities

A marketplace transaction between two people may affect the well-being of a third person in a way that is not reflected in the price of the good or service that is the subject of the transaction. The effects can be either favorable or detrimental to that third person, but in any event the affected person has no direct influence on the transaction. Familiar examples are education (on the favorable side) and pollution (on the detrimental).[26] In these situations, prices emerging from the private market transaction will not reflect its true costs and benefits because the parties are unlikely to consider external effects in calculating the personal value of the transaction. The government often intervenes on behalf of affected third persons, in lieu of their direct participation in the market transaction.[27] The government can assume an allocative role, adopting actions that will encourage increased availability of those goods or services yielding external benefits and reduced availability of those imposing external costs. The more pervasive these external effects, the larger the government's role becomes.

Government intervention in these situations may take a variety of forms. Government may intervene intrusively to regulate behavior and enforce its regulations through a series of fines and penalties. Alternatively, government may assign property rights to persons adversely affected by the transaction and provide a mechanism of adjudication, but leave the decision to

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[25] R. MUSGRAVE & P. MUSGRAVE, *supra* note 21, at 56.

[26] Assume *A* can produce beer for $1 per bottle, but *A* also produces 10¢ of pollution per bottle. If *A* does not have to pay the cost of the pollution to *C*, *A* can charge *B* $1 for the beer. Nevertheless, the pollution injures *C*.

[27] For an argument that government is not necessary to induce consideration of externalities, see M. TAYLOR, *supra* note 22.

use that mechanism in the hands of individual owners of the property rights. Finally, government may induce certain socially desirable behavior by providing the underlying goods or services, or limiting access to them, and then charging users a fee that incorporates the external costs and benefits of provision. Our objective here is not to determine when any one of these means of intervention is desirable,[28] but to investigate the implications and desirability of the user fee selection generally.

Not all indirect effects of a governmental service, however, should be considered as externalities. In some situations, the relationship between those directly and indirectly affected may be such that the former are induced to take the consequences for the latter into their own decision. For instance, when the direct recipient of a governmental service is a business firm, there may be indirect benefits to the firm's customers. A user fee then can be collected from the firm to cover both benefits to the firm and to its customers. The fee will not fully deter the firm from seeking the service, because the firm will not ultimately bear all the costs of the service. Of course, in deciding how much of the fee to pass along to customers, the firm will take account of how the fee will affect the demand of those customers for the firm's products. The point is simply that, when all benefits accrue to a firm and its customers as distinct from other persons, no externality exists.

3. Information and Immobility Problems

Markets cannot operate smoothly if participants lack basic information about the costs and benefits to them of alternative actions.[29] Government can intervene to provide or require others to disseminate such information (for example, auto fuel economy, appliance energy efficiency). Similarly, the government can take on the role of facilitating mobility or job shifting. Information itself is a public good, but its distribution has many characteristics of a normal private good. Later in this article we discuss a number of user fee issues that arise in this connection.[30]

4. Natural Monopoly

In some businesses, producers experience continuously decreasing unit costs as they expand production. The result, absent government involvement, would be domination by the single largest producer, who could underprice all competitors. If the surviving firm then could protect itself from the subsequent entry of potential competitors, it would be able to increase its prices to levels well in excess of production costs. Protecting consumers from such outcomes has formed the rationale for much government activity,

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[28] For an attempt to make such an investigation, see Shavell, *Liability for Harm Versus Regulation for Safety*, 13 J. LEGAL STUD. 357 (1984).

[29] S. BREYER, REGULATION AND ITS REFORM 26 (1982).

[30] *See* SECTION III, *infra*.

such as pipeline regulation, and has figured in the formation or continuation of government enterprises (for example, public power).

B. *User Fees and Economic Efficiency*

Efficient pricing exists if one is deterred from consuming additional units of public service only when the benefits of that consumption are less than its costs to society.[31] As the above discussion suggests, there are many situations in which a user fee can successfully ration limited supplies of currently available goods and services to more highly valued uses, signal whether particular output levels should increase or decrease, avert wasteful usage, and encourage use of more suitable substitutes. In this sense, a user fee is essentially a mechanism available to link the service with the potential consumer of a scarce resource. It is an alternative to first-come, first-served, to lotteries, and to administrative judgment. The central task is to determine those circumstances in which a user fee will be the most satisfactory choice of rationing mechanisms. To make this determination, we begin with the simplifying assumption that those who would pay user fees are motivated by self-interest, rather than by either envy or altruism. An envious payer would be willing to sacrifice some personal benefits to keep noncontributors from receiving it.[32] Envy, therefore, exacerbates the problem of underutilization that we suggest might otherwise accompany the imposition of user fees.[33] Altruistic payers, however, would have the contrary effect. An altruist might be willing to pay for somewhat more of a service than was justified by a comparison of personal costs and benefits precisely because others would also benefit from that action.[34]

If there are no significant externalities associated with a particular service that warrants public provision, then user fees constitute an efficient rationing mechanism. If the government is producing goods that could be provided at least as well by the market, user fees certainly are appropriate.[35] In both

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[31] Goetz, *The Revenue Potential of User-Related Charges in State and Local Governments*, in BROAD-BASED TAXES: NEW OPTIONS AND SOURCES 118 (R. Musgrave ed. 1973).

[32] *See* J. RAWLS, A THEORY OF JUSTICE 530-34 (1971) (discussing the problem of envy in the theory of justice); Leff, *Injury, Ignorance and Spite: The Dynamics of Coercive Collection*, 80 YALE L.J. 1, 18-19 (1970) (discussing the importance of spite in transaction costs).

[33] *See* SECTION III, *infra*.

[34] Here we follow Howard Margolis, who defines "altruistic behavior" as a situation in which "the actor could have done better for himself had he chosen to ignore the effect of his choice on others." H. MARGOLIS, SELFISHNESS ALTRUISM & RATIONALITY: A THEORY OF SOCIAL CHOICE 15 (1982); *see* F. FROHOCK, RATIONAL ASSOCIATION 21 (1987) (arguing that, in the Prisoner's Dilemma, "egoists play to a suboptimal outcome, altruists play to an optimal equity outcome.").

[35] In some such cases, efficient provision might be equally or better served by privatization of the function currently performed by government. *See* Cass, *Privati-*

these situations, a user fee can be relatively successful in encouraging the most productive use of the service, barring possible accounting and managerial complexities.[36]

With the user fee, the potential beneficiary of a government service is the one who must pay the opportunity cost of the service—that is, the additional cost that society will incur in providing an increment of service. There are two important results if the beneficiary freely decides how much, if any, of the service to utilize. First, the consumer for whom the service holds little value automatically will be deterred from its use. Second, persuasive willingness-to-pay evidence will be yielded indicating whether the government should increase or decrease its provision of the service. The former is conducive to maximizing society's material well-being over the short-term; the latter facilitates the same result over the long run.

For a user fee to have these desirable consequences, setting the amount of the fee is quite important. As a general matter, "the costs that should be recovered are the opportunity costs sacrificed at any time."[37] Application of this principle, however, may require attention to varying factors, depending on the specific situation. Consider four possible scenarios:

1. The government can increase or decrease its output of a particular service that is not available elsewhere. The inputs used have known market values, and per unit costs do not decline as more is produced (for example, inspection services). In this situation, marginal cost pricing keyed to full recovery of incremental production costs will be efficient. The opportunity cost will be the personnel and support costs incurred by government in providing the service.

2. A particular service can be characterized exactly as in Example 1 except that it also can be obtained from private firms through market transactions (for example, certain postal delivery services). Assuming continued governmental provision is warranted—a privatization issue—an efficient user fee may properly exceed incremental agency production costs, and instead reflect the service's market value. This conclusion, however, requires some judgment about whether private suppliers are pricing and producing efficiently and whether the government enjoys artificial cost advantages, such as tax exemption.

3. The government is allocating a good or service—grazing rights, for example—that entails little if any current costs of production, the service has scarcity value in that not all who want the service can be accommodated, and more of the service cannot be produced. In this situation, the opportunity cost associated with providing an increment of service to an additional

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zation: Forms, Limits, and Relation to a Positive Theory of Government, 71 MARQ. L. REV. __ (1987) (forthcoming).

[36] *See* SECTION III, *infra*.

[37] Milliman, *Beneficiary Charges—Toward a Unified Theory*, in PUBLIC PRICES FOR PUBLIC PRODUCTS 37 (S. Mushkin ed. 1972).

beneficiary is the value forgone by shifting the service away from the next most interested potential consumer. Where identified—through auction, bidding, or private markets for comparable services—this value should serve as the amount of the user fee if efficiency is to be achieved. This user fee may exceed actual out-of-pocket costs incurred by the government.

4. Considerable past (one-time) cost has been incurred relative to the level of ongoing production costs (for example, dam construction). Sunk costs or historical costs as a general rule should not be factored into user fees; that is, historical cost recovery and efficient user fees are not always compatible objectives. This is an example of a natural monopoly that poses a well-known efficiency dilemma between short-run allocation and long-run replacement decisions.[38] To the extent that user fee revenues fall short of recouping the total costs borne by the government, the gap must be filled with general tax revenues. Then, "[t]he efficiency questions should be concerned with the possible adverse effects of these taxes upon resource allocation versus the adverse effects of the levy of beneficiary charges that might return historical costs but still be inefficient."[39] Moreover, if replacement costs are likely to be encountered at some point, efficiency is not well-served by restricting user fees to the recovery of current production costs alone.[40]

We have thus far focused on situations in which consumption is voluntary. For some, the voluntary use of the good serves as an additional justification for a user fee.[41] Even if there is a degree of coercion in the decision to use the service, however, a user fee may have important efficiency advantages.[42] For example, assume a statute directs each member of a certain group to take a personal safety training course offered only by the federal government. As a general matter, the short-term allocative efficiency objective would not likely be particularly well-served by a user fee, still assuming no externalities. However, suppose further a statute accurately reflects plausi-

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[38] *See* H. ROSEN, PUBLIC FINANCE 306-11 (1985).

[39] Milliman, *supra* note 37, at 39 (emphasis omitted).

[40] Indeed, it would be inappropriate to "tell beneficiaries and public agencies that costs are important before a project is built and then not require cost-recovery the day after." *Id.* at 46.

[41] *See, e.g.*, Goetz, *supra* note 31, at 113 ("Because [user-related charges] are linked to an individual's consumption of specific public services, their payment is in a sense voluntary and directly linked with a benefit.").

[42] While some contend that where usage is involuntary a user fee has little to commend it, *see, e.g.*, J. MIKESELL, *supra* note 7; Mushkin & Bird, *supra* note 3, at 21 (using the example of a returnable bottles program), others advocate user fees even when usage is mandatory, *see, e.g.*, Kafoglis, *The Potential of Local Service Charges*, in LOCAL SERVICE PRICING POLICIES (P. Downing ed. 1977); Seldon, *Enhancement of Public Sector Efficiency*, in PUBLIC FINANCE AND THE QUEST FOR EFFICIENCY: PROCEEDINGS OF THE 38TH CONGRESS OF THE INTERNATIONAL INSTITUTE OF PUBLIC FINANCE (H. Hanusch ed. 1984).

bly paternalistic motives and unambiguously indicates both what groups should be directed to make use of the service and how much they should use. If the statute is based on solid benefit-cost reasoning, a user fee may be superior on efficiency grounds to other means of finance, because it will not burden those who neither use nor benefit from this service, and thus not influence their actions.[43] On the other hand, should the statute have little to commend it on benefit-cost grounds, it is still arguable that a user fee would have favorable longer-term efficiency consequences. The payer would be more inclined to insist on prudent service delivery and to press for closer scrutiny of the levels and terms of service continuation.

To summarize, in the absence of both externalities and mandated usage, user fees are likely to have attractive efficiency attributes in allocating access to the service in the short run as well as in guiding governmental decisions about levels and types of service to provide in the longer run. Moreover, regardless of whether usage is mandated, user fees probably will have desirable efficiency effects in financing service provision. Directly placing the production cost burden on the recipient of the service rather than on other taxpayers will likely limit the excess burden associated with all revenue sources.[44]

Once we relax the assumption that governmental services produce no externalities, the efficiency, and hence desirability, of user fees changes markedly. User fees may be associated with external effects in either of two ways. As our discussion of public goods reveals, where each recipient who pays for a governmental service simultaneously confers benefits on non-payers, a user fee may induce underuse of the service from a societal perspective. Alternatively, where recipients of a governmental service are not otherwise required to incur the corresponding costs of the service, imposition of a user fee may forestall overuse.

Consider first the situation in which partaking of a governmental service by one party necessarily confers benefits on a third party who contributes nothing to the cost of the service, as in the case of spillover benefits or positive externalities. An apt example would be a municipality that offers and charges a fee for, but does not require, weekly garbage collection. Residents who do not accept the municipal service may either remove their

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[43] Of course, one might question whether the statutory coercion would change any decisions by those user group members who are well-informed about the service's benefits to them.

[44] Excess burden refers to the distorted decisions that result when a tax changes private incentives inadvertently by shifting relative prices that guide behavior. To the extent that these distortions impose a loss of welfare on consumers greater than that resulting from the tax payments themselves, the tax generates an "excessive burden" on society at large. W. OATES, FISCAL FEDERALISM 121-22 (1972); *see* H. ROSEN, *supra* note 38, at 275 (suggesting that consumers, when faced with a tax or user charge on a particular product or service, might completely forgo the good or service, thereby producing no revenue).

own garbage or may contract with private collectors. Those persons unwilling to pay the user fee may find less frequent disposal more consistent with their own preferences. Nevertheless, the resulting accumulation of garbage may impose adverse effects on neighbors. More frequent collection, therefore, would confer a benefit on the neighbors, even though they bear none of the commensurate costs. The neighbors (who effectively wish to free ride by changing the collection practices of the infrequent disposer) play no role, however, in determining how much collection will be undertaken by the infrequent disposer. Similarly, the infrequent disposer has no incentive to factor third party benefits into his decision about making use of the service.[45] Consequently, an individual resident will ignore external benefits when deciding whether to use the service. Measured from a societal perspective, underuse of the service will likely result. Elimination or reduction of the user fee to reflect the external benefits might reduce the cost of frequent collection sufficiently to induce the infrequent disposer to take advantage of the governmental service. In other words, user fees that place full costs of service on only a subset of service beneficiaries have an efficiency drawback.[46] Figure 1 explains the situation graphically.[47]

P_c in Figure 1 indicates the marginal cost curve of more frequent garbage collection. MB_p indicates the infrequent garbage disposer's marginal benefit curve for more frequent garbage collection. This individual voluntarily will pay for Q_1 garbage collections per month, the quantity that corresponds to the intersection of MB_p and P_c if a full cost recovery user fee is charged. Marginal social benefits of garbage collection (indicated by the MB_s curve), however, reveal a social preference for the individual to purchase Q_2 units of garbage collection. In order to induce investments to this level without resorting to frequency regulations, society would have to lower the individual's user fee to P_p.[48] The net social benefit that results from reducing the user fee below the full cost recovery level is shown by triangle abc.

Unlike the garbage collection example, in which full cost recovery through user fees may induce underuse, there are other instances in which user fees can avoid overuse. For example, when the government supplies goods or

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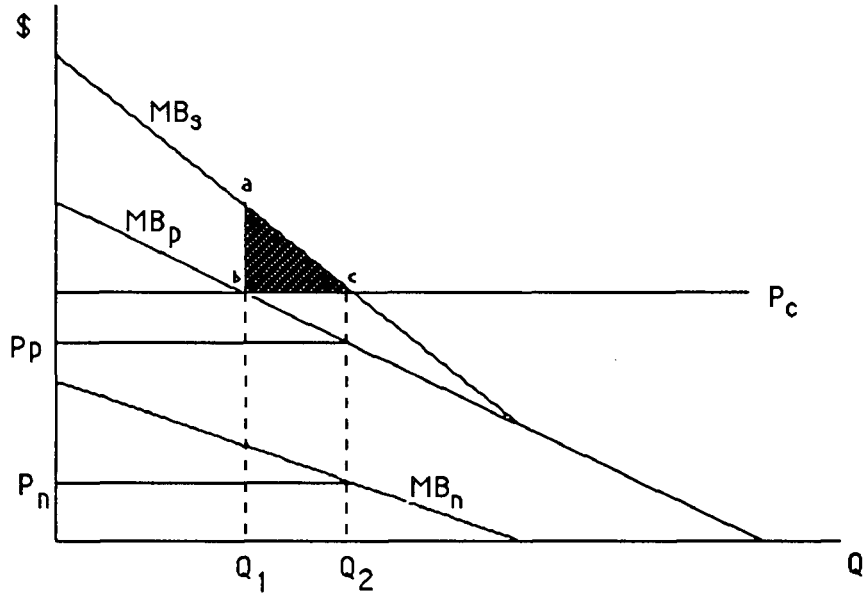
[45] Our assumption here (perhaps a heroic one) is that the infrequent disposer is motivated solely by the price of services when making choices. We recognize, however, that other factors, such as interactions with neighbors and issues of status, may also affect garbage disposal decisions.

[46] "When spillover benefits exist to a significant extent, the imposition of full marginal-cost user pricing will lead to a suboptimal level of the activity in question." Goetz, *supra* note 31, at 123.

[47] Adapted from Kafoglis, *Local Service Charges: Theory and Practice*, in STATE AND LOCAL TAX PROBLEMS 164, 170 (H. Johnson ed. 1969).

[48] Q_2 is optimal in the sense that it maximizes net social benefit. Net social benefit is the amount by which total social benefits (graphically the area under MB_s from the vertical axis to Q_2) exceed total social costs (the area under P_c from the vertical axis to Q_2).

FIGURE 1



Q is the frequency of garbage collections (per month);

P_c is the collection cost per house per pickup;

MB_p is the marginal private benefit (value to a household of more frequent pickups);

MB_n is the marginal external benefit (value to others in the neighborhood of picking up one family's garbage);

MB_s is the marginal social benefit (combined private and external benefits) of more frequent pickups from one family.

services at a charge less than the cost of supplying the service, the recipient necessarily receives a subsidy from others. An individual recipient who can reap the benefits of the service while imposing the corresponding costs on others has an incentive to overuse the governmental resources. One such situation of public "bads," perhaps best referred to as the tragedy of the commons,[49] is likely to arise where scarce property is held in common—public parkland or fishing areas, for example—so that each individual has a claim to use. As each individual exercises that claim, however, the resource may be overused from a societal perspective. Nevertheless, no individual has an incentive to moderate his or her personal use, notwithstanding that

[49] *See* Hardin, *The Tragedy of the Commons*, 162 SCI. 1243, 1244 (1968) (arguing that in a society that believes in the freedom of the commons, individuals will pursue only their personal interests, and disregard societal interests in relation to the commons). For a discussion of the limits of the concept, see Rose, *supra* note 24, at 779.

joint use generates a net social loss.[50] User fees may be particularly appropriate insofar as they discourage overuse by requiring users to bear some of the costs of maintaining the public property or to recognize the costs imposed on others through private use.[51] As a mechanism for pricing access to the commons, user fees provide an alternative to direct government rationing or grants by government to private parties of monopoly rights in the public property.

Quite apart from such commons effects, other types of adverse consequences, such as pollution, often are imposed on nonusers. Failure of the producer to recognize all the costs of its activity is likely to generate overinvestment in the activity. An additional user fee may play an important efficiency role in restraining this excess.[52] Indeed, charges in excess of marginal costs may be justified where the service is receiving some benefit from expenditures made through the general treasury. For instance, if a locality is providing waste treatment and charging a user fee for the service, it may be appropriate for the locality to charge a fee that exceeds the capital and operating costs of the facility and to return the "profit" to the local treasury. This result could be appropriate if the excess charge reflects the costs incurred by the locality in providing police and fire services to the facility, as those services generally will be financed through local taxation.[53]

The extent to which these positive and negative externalities complicate the case for user fees depends on a number of factors, the most important of which are price elasticities, the pervasiveness of the externality, and the feasibility of adjusting the level of the user fee to compensate for the externality. The effect of price elasticities may be seen most readily by considering the effects of sharply increasing user fees for services previously available at only nominal charge. If fee payers' decisions about the quantity of the service to use are insensitive to the fee level—that is, demand is price inelastic—there will be little change in service levels. Whatever net social benefit existed before the fee increase is likely to persist.

Put differently, a user fee has quite limited allocational effects when service demand is price inelastic. Of course, one may be concerned about

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[50] In short, governmental intervention may be necessary to devise a mechanism to allocate the resources "because no one has an incentive to economize in their use." H. ROSEN, *supra* note 38, at 126.

[51] In order to reduce overcongestion of the commons, an ideal fee would equal the difference between the social and the personal marginal cost of use.

[52] Much of the literature on Pigovian taxes applies well in this situation, calling for an extra surcharge on the normal user fee when external costs exist. *See generally* H. ROSEN, *supra* note 38, at 132-35; R. TRESCH, PUBLIC FINANCE: A NORMATIVE THEORY 93-131 (1981).

[53] *Cf.* Town of Terrell Hills v. City of San Antonio, 318 S.W.2d 85 (Tex. Civ. App. 1958) (holding that differential rates for residents and nonresidents were justified because the former paid taxes that financed fire services protecting the utility).

the fairness of letting free riders ride free, to which we turn shortly,[54] but there is not much of an efficiency case against user fees when demand is inelastic.[55] The main efficiency issue then has to do with the relative sizes of excess burdens associated with alternative financing mechanisms. However, when demand is rather sensitive to the fee level, reliance on user fees warrants much more searching scrutiny from an efficiency perspective. The absence of user fees ordinarily will invite overuse of the service if not carefully rationed by other means, while excessive user fees will unduly cut service utilization. It is when service demand is elastic that a properly set user fee—one that reckons with externalities—should have the most favorable efficiency effects; some even argue that user fees are only desirable when demand is elastic.[56]

The pervasiveness of the externality also bears on the appeal of a user fee. Between the polar cases of pure public goods and pure private goods lies the great majority of intermediate cases.[57] In these situations, the larger the external benefits are relative to the benefits derived by fee payers, the more complex the efficiency case for user fees. While some would question the suitability of user fees when there are extensive externalities,[58] at least in principle an efficient fee structure can be designed. As Goetz explains,[59] the user fee should be reduced by a subsidy payment equal to the marginal value to society of the external benefit attributable to the feepayer's use of the service (P_n in Figure 1 above).

As this conclusion suggests, the compatibility of efficient user fees and externalities depends considerably on limitations of technology and economic accounting.[60] Here it may suffice to make two preliminary assertions:

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[54] *See infra* notes 63-73 and accompanying text.

[55] As one author has commented:

> [t]ake the usual argument that . . . recreational services should be priced below cost because this makes for a healthier and happier society to the joint benefit of everyone. This argument has merit only if it can be shown that the demand for the recreational services that are in question is in fact highly price elastic; otherwise low prices fail to fulfill their stated objective.

G. BREAK, INTERGOVERNMENTAL FISCAL RELATIONS IN THE UNITED STATES 221 (1967).

[56] *See, e.g.*, R. WAGNER, PUBLIC FINANCE: REVENUES AND EXPENDITURES IN A DEMOCRATIC SOCIETY (1983).

[57] *See supra* notes 22-25 and accompanying text.

[58] *See, e.g.*, Mikesell, *supra* note 7, at 272.

[59] Goetz, *supra* note 31, at 123 (pointing out that where extensive spillover benefits exist, the subsidy could be the marginal social value of those benefits).

[60] Goetz suggests that technological advances may improve the availability of efficiency-enhancing fees:

> Given the present technology of collecting highway tolls, the delays and other costs attendant on the collection process make it impractical to consider pricing city streets but perfectly feasible to levy charges on trunk highways. Nevertheless, it is not impossible to imagine the development of electronic monitoring

that an efficient user fee will not exceed the incremental opportunity cost of separately providing the service to a fee payer, and that a two-part tariff coupling such a user fee with a tax or other levy may be a way to enhance overall efficiency if either externalities exist or per unit service costs decline as usage rises.

Another issue in economic accounting—one unrelated to externalities—also requires some attention. It is often the case that in producing a service the government incurs some costs, so-called "common costs," that are not easily attributable to particular service users but that do have to be covered in some fashion. Most efforts to allocate common costs fully across service users are flawed from an efficiency perspective. Indeed, Baumol contends that, "[n]o form of cost allocation can pretend to be compatible, generally, with efficiency in resource allocation, no matter how sophisticated its derivation."[61]

A frequently recommended approach to this common cost problem is Ramsey pricing, also referred to as inverse elasticity pricing, which collects a disproportionate share of the unattributable cost from those recipients who make the smallest cuts in their use of the service when the fee rises. For example, airlines may charge higher air fares to business travelers than to discretionary travelers who would not travel at the higher fares. The aim is to cover overhead costs in a way that will induce the least possible change in user decisionmaking, and so impose the smallest excess burden on society.[62]

C. *Alternative Objectives for User Fees*

Presumptively, the government relies on user fees to compensate for market failures; nevertheless, criteria other than efficiency are legitimate and sometimes more important in the decision to institute or forgo user fees. This conclusion does not deny the effect user fees would have on encouraging optimal allocation of resources. It instead asserts that other objectives may conflict with and trump that goal. Prominent among these alternative objectives are fairness, revenue enhancement, and privatization.

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devices that would bring almost-universal road-usage pricing within the realm of practicality. Where the possibility of technological advance seems promising, a public policy of investment in the research and development of exclusionary devices that would facilitate the pricing of roads and other public services may bear very high returns.

Goetz, *supra* note 31, at 118.

[61] W. BAUMOL, SUPERFAIRNESS: APPLICATIONS AND THEORY 146 (1986).

[62] Useful discussions of this aim may be found in *id.* at 143-48, 161-63; S. BREYER, *supra* note 29, at 53, 232, 289. *See generally* E. ZAJAC, FAIRNESS OR EFFICIENCY: AN INTRODUCTION TO PUBLIC UTILITY PRICING (1978). How much of common costs an efficient user fee can finance remains a difficult implementation problem due largely to inadequate data about demand elasticities.

1. Fairness

While the definition of allocative efficiency is relatively unambiguous, concepts of fairness elude any precise, generally accepted definition.[63] Nevertheless, fair distribution appears to constitute a key normative criterion by which to judge any proposed governmental provision of goods and services. Debates about fair distribution often attempt to arbitrate among deontological or utilitarian theories. User fees, however, have particular implications for two conceptions of fairness. The first of these assumes that fair distributions create a correspondence between costs and benefits of governmental provision. Thus, pricing of any governmentally supplied good or service should be set to recover the costs of provision. The second, almost contrary conception is that fair distribution requires redistribution of existing allocations of wealth in order to ensure access to certain goods regardless of one's willingness or ability to pay. In either case, an appeal to fairness may override user fees that otherwise would engender efficient allocations of resources.

(a) *Pricing to recover costs*. The concept of fairness most commonly encountered in the user fee literature entails imposition of financial burdens commensurate with the conferral of benefits, so that full costs are recovered from service recipients.[64] While this may seem only a restatement of the efficiency criterion, it can lead to rather different policy recommendations. The distinction lies between pricing to recover costs—the fairness concern—and pricing to manage use—the efficiency concern.[65] Situations often arise in which efficient pricing would not recoup the government's total outlays on the program, and thus would require a subsidy from non-beneficiaries.[66]

Fair pricing attaches little weight to incentives for particular patterns of use or consumption. Instead, the fairness issue is whether, for any given program, a user fee is a suitable means to lessen burdens that otherwise would be borne by taxpayers who derive little or no benefit from the service. When direct beneficiaries of a government program pay no user fee, or one

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[63] *See* W. BAUMOL, *supra* note 61, at 7-14 (discussing generally the difficulties in deriving a workable definition of fairness).

[64] Thus, Rosen concludes, "fairness requires consumers of a publicly provided service to pay for it." H. ROSEN, *supra* note 38, at 309; *see* Milliman, *supra* note 37, at 29 (arguing that the stress on equity and efficiency gains of having taxpayers pay for benefits received is set within the context of fairness).

[65] It should be recalled, in other words, that efficiency basically focuses on how pricing influences allocative decision. "Efficient use results when the person deciding whether or not to use a given service values it at whatever it costs to provide the specific increment of service he or she seeks." CONGRESSIONAL BUDGET OFFICE, FEDERAL POLICIES FOR INFRASTRUCTURE MANAGEMENT 64-65 (June 1986).

[66] The Congressional Budget Office, for instance, suggests that this phenomenon results from the pricing of space shuttle services. CONGRESSIONAL BUDGET OFFICE, PRICING OPTIONS FOR THE SPACE SHUTTLE (March 1985).

that falls short of the cost of the service they receive, a burden is shifted onto other segments of society (including taxpayers as a whole). The result is a "cross-subsidy." Of course, the user fee also may be unfairly high, in which case the fee payer is subsidizing others.

Economists generally argue that, for a service to be provided free of subsidy, "the cost share of any group of customers in a common project should not exceed the 'stand alone cost' of serving only their needs."[67] The "fair" user fee thus covers at least the incremental opportunity costs—costs that the government can avoid simply by not making additional service available to an additional user—and at most it covers these opportunity costs plus any overhead costs—common costs—that are unaffected by such usage. This establishes a range of arguably "fair" user fees.

When there are substantial common costs that cannot be attributed easily to particular users, the range of "fair" fees likely will be rather wide. Among the approaches developed for selecting particular fee levels within that range of fairness is Ramsey pricing.[68] While one of the noteworthy features of this approach is that its use fosters greater efficiency, some question its fairness. The effect of Ramsey pricing may be to lump disproportionate costs on those most dependent on the service. For instance, charging a premium for public transportation at times of peak usage would impose those costs on wage earners.[69] Some commentators, therefore, have expressed a concern that the efficiency gains of Ramsey pricing may not always outweigh the distributional consequences.[70] On the other hand, a traditional and countervailing tax equity principle is "that those who benefit most should bear a relatively large share of the costs. This suggests that it can be considered 'fair' for customers whose demands are relatively inelastic to pay prices that are relatively high in comparison with the corresponding marginal costs, just as Ramsey pricing prescribes."[71] Numerous other approaches have been developed to allocate common costs, but none, including the more recent game theoretic allocation procedures, inexorably generates a uniquely compelling vision of equitable pricing or income distribution.[72]

User fees warrant particular attention when a cross-subsidy arises inadvertently from service provision. Unfortunately, the task of unambiguously

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[67] W. SHARKEY, THE THEORY OF NATURAL MONOPOLY 41 (1982).

[68] *See supra* note 62 and accompanying text.

[69] W. BAUMOL, *supra* note 61, at 182 ("If most travelers during [peak hours] are wage earners, and if their work hours are beyond their control, then the sufficient conditions for presumptive unfairness may, indeed, be satisfied.").

[70] *Id.* Baumol also suggests that pricing that permits distribution of goods and services at peak periods may adversely affect "group morale" or "the social fabric" by creating a sense of elitism in those who can afford the premium and jealousy by those who cannot. *Id.* at 181-82.

[71] *Id.* at 148.

[72] *Id.* at 182; *see* Cass, *Looking With One Eye Closed: The Twilight of Administrative Law*, 1986 DUKE L.J. 238, 240-44 (discussion of the problem of social good).

identifying and measuring such a cross-subsidy is often quite difficult. Conceptually, any uncompensated externality forms a cross-subsidy. That service benefits accrue unintentionally to nonpaying third parties is largely a reflection of imperfectly established property rights. This may be due to inherent indivisibilities, entailing sizeable common costs, or it may be due to fee collection practices that make payment readily avoidable by some service recipients.

Ideally, a user fee can eliminate many cross-subsidies. As the fee rises from zero toward fully covering the incremental cost of the service, subsidies from the general taxpayer to the direct user of the service decline. If a portion of the benefits or costs of the service accrue to some from whom no fee can be collected (the indirect beneficiaries), how far is it fair to allow the user fee collected from payers (the primary recipients) to rise?

Our discussion of the efficiency criterion concluded that a full cost user fee could be warranted even if externalities are substantial, so long as the demand is relatively price inelastic. This result, however, is difficult to reconcile with any fairness perspective. Indeed, it seems more reasonable to argue that, regardless of demand elasticities, it is only fair to lower the user fee below full cost recovery whenever external benefits arise, and to raise it whenever external costs are created.

How far the user fee should fall when external benefits exist is not easy to determine either conceptually or empirically. The approach referred to earlier[73] as the stand-alone cost test provides a useful upper bound on user fees: unless the fee falls at least to the incremental long run cost of independently providing service to the feepayer, it will be both inefficiently and unfairly high. But if one equates the price of the user fee with benefits received, fees can be further reduced, so that each recipient contributes an amount per unit consumed that equals the personal marginal benefit derived.

Were it possible to measure the increment of satisfaction or material well-being received by nonpayers as a result of the service provision, it would appear equitable to levy a corresponding tax or other duty on these nonpayers. Such revenue then should be applied to help defray the government's costs of providing the service, allowing a further reduction in the user fee.

(b) *Pricing for redistribution*. There are, of course, other concepts of fairness that warrant attention. One is that the recipients of certain government services should pay fees that are keyed to the recipients' relative affluence, or that the disadvantaged or impoverished should receive user fee waivers or exemptions.[74] On this conception of fairness, pricing should not interfere with minimal levels of the relevant goods. For instance, governmental provision of day care services for the poor may easily satisfy the efficiency criteria for a user fee, insofar as the service is made available to

[73] *See supra* note 67 and accompanying text.

[74] *See* R. MUSGRAVE & P. MUSGRAVE, *supra* note 21, at 230-31 (noting that user fees properly can be attached to those who can best afford them).

discrete, excludable beneficiaries and the supply of services is limited, i.e., rival. If, however, the function of the service is to provide gains to the poor other than those related to efficiency—for example, an in-kind form of public assistance—subsidization of day care through the tax system will be appropriate.

Nevertheless, institution of a user fee system does not necessarily entail abandonment of the principle of vertical equity on which an ability-to-pay revenue system is based. Ordinarily, it should be quite possible to structure a user fee system in a way that satisfies concerns that a fee system is inherently regressive.[75] Waivers can be devised to favor whatever population segment "fairness" advocates identify. Even without waivers, a user fee system is fairer to the disadvantaged who make no use of the service than is tax financing.[76]

Federal programs also employ user fees to cross-subsidize particular groups, commodities, activities, regions, or types of businesses in the form of support, subsidy, relief or assistance. In such instances, a user fee is logically not expected to finance the full cost of the service. One special case involves so-called merit goods,[77] use of which the government decides should be increased or decreased despite a lack of user interest or willingness to pay, and despite an absence of obvious externalities.[78] Artificially low access fees for local telephone service are an example. One might also contend that some activities or services are so fundamental, and so embodied in constitutional principles, that they should be accessible to everyone regardless of willingness or ability to pay a fee.[79] For merit goods

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[75] *See, e.g.*, Kafoglis, *supra* note 47, at 857 (arguing that regressive fee systems are the result of misapplied pricing principles, and that appropriate pricing practices would improve efficiency and distribution of goods while diminishing the level of "coercive" taxation).

[76] *See* K. MCCARTHY, EXPLORING BENEFIT-BASED FINANCE FOR LOCAL GOVERNMENT SERVICES: MUST USER CHARGES HARM THE DISADVANTAGED (1984); A. PASCAL, EBBF: A GUIDE TO INSTALLING EQUITABLE BENEFICIARY-BASED FINANCE IN LOCAL GOVERNMENT (1984).

[77] For a brief discussion of the problems of merit goods, see R. MUSGRAVE & P. MUSGRAVE, *supra* note 21, at 83-86.

[78] *See id.* at 84-86; Musgrave, *Social Goods and Social Bads*, in O. OLDMAN & F. SCHOETTLE, STATE AND LOCAL TAXES AND FINANCE 830-31 (1974) (explaining the reasons for creating the concept of "merit goods"); *see also* H. MARGOLIS, *supra* note 34, at 75 (acknowledging that the theory of merit goods accounts for people's actual preferences, but doubting the theory's usefulness in scientific analysis).

[79] We also note, however, that some see the merit good label simply as a cloak for a value judgment that a good or service should be provided collectively. *See, e.g.*, H. ROSEN, *supra* note 38, at 65 (quoting Baumol & Baumol, Book Review, 89 J. OF POL. ECON. 425, 426-27 (1981)). Margolis is even more skeptical, and suggests that a "merit good, in effect, is any item of public expenditure that seems socially reasonable but cannot be accounted for within the ordinary economic theory of demand." H. MARGOLIS, *supra* note 34, at 75.

other than those with constitutional entitlement features, there may be no particular inequity created by choosing a user fee as the way to finance the change in service mandated by government. Of course, it may be quite unclear whether the recipient of the merit good, or society generally, is actually benefiting.

The fairness of a user fee may seem obvious where the mandated service keeps the recipient from imposing external costs on society, such as pollution or a safety hazard; however, a fee's fairness is not so obvious in other cases, such as a mandatory fee for registration of bicycles. The fairness of charging a user fee may be questionable if individuals are required by law to use a service.

A closely related problem arises when the recipient of the service has little or no control over the quantity of the service and the user fee is the same regardless of the volume of service received. The allocational efficiency as well as fairness advantages of user fees are still present in such situations, but they are muted. Goetz's comments on an analogous situation are pertinent:

> The government, in essence, has decided that the benefits from a certain expenditure are divisible between those who are not being specially assessed and those who are being assessed, but are indivisible within the assessed group. This may not be an unreasonable rule of thumb. Unlike the other types of user charges, however, it is then not possible to be certain that the services provided are really worth the price in terms of the assessment extracted.[80]

Finally, fairness concerns may be triggered if the institution of user fees affects prior investments. The transition from a program without user fees to one heavily supported by user fees can cause substantial windfall gains and losses. Taxes and fees are often capitalized in asset values, and a change in the former results in a corresponding change in the latter.[81] Those owning assets affected by a new user fee will experience a loss. This is unavoidable and must be recognized in planning the timing and phasing when introducing new fees.

2. Revenue Enhancement

Perhaps the most transparent objective that user fees serve is that of pricing to raise revenues—cost recovery to lessen budgetary problems. Providing services is not costless, and there are serious constraints on each of the several mechanisms normally available to government to cover these costs.

It may be worth recalling just what these alternatives encompass. The

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[80] Goetz, *supra* note 31, at 120.

[81] *See* Gillette, *Equality and Variety in Delivery of Municipal Services* (Book Review), 100 HARV. L. REV. 946, 959 n.37 (1987) (arguing that capitalization may interfere with efficient provision of local services).

first, of course, is taxation. Tax revenues, however, have not been sufficient to meet overall expenditure levels at the federal level, and there is strong aversion to any increases in tax rates. Recent tax reforms, combining rate reductions with loophole closing, have been defended as roughly revenue neutral at best; they certainly are not likely to close the federal budget deficit. A second alternative with potential cost-saving gains includes further managerial improvements and program pruning, but these fall well short of eliminating fiscal problems.[82] A third alternative is to devolve costly programs to lower levels of government, such as the decentralization components of the current Administration's federalism initiatives. This last alternative certainly has reduced pressures on the federal budget, but it is unclear how much further such decentralization can go. Another alternative that can provide some limited relief is asset and credit transactions—sale of federally owned property, and reversion to additional borrowing maneuvers of various types, but this entails potential costs of divesting resources for which the government is an essential steward. Finally, government might reduce costs of supplying certain public goods, such as disseminating information about products, by replacing its own involvement in the area with regulations that require the private sector to undertake the same task and bear the commensurate costs. Recent efforts at deregulation, however, suggest increased reluctance to mandate such costs.

Regardless of the progress the federal government achieves in economizing on its provision of basic services, it will continue to seek additional ways to finance those services. An increase in the level and scope of user fees constitutes a plausible answer to this financing problem. Moreover, those who want to expand the provision of any particular service may conclude that certain user fees offer an attractive opportunity to enlarge the budget for that service.

Under these circumstances, there may be instances in which a charge was termed a user fee even though it was quite similar to a tax. Unless a service is provided directly to a payer or indirectly to its customers, however, the revenue-producing measure is best evaluated and denominated as a tax, not a user fee.[83]

Even where exactions are linked to benefits, and hence properly designated as user fees, implementation and enforcement costs may have indirect effects on other revenues. Tax collection cost estimates show that about five cents of every dollar collected in federal income taxes is needed just to pay

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[82] Kelman, *The Grace Commission: How Much Waste in Government?*, THE PUBLIC INTEREST, Winter 1985, at 62 (potential of waste-cutting to eliminate federal deficits greatly exaggerated).

[83] *See* Asson v. City of Burley, 105 Idaho 432, 440 n.17, 670 P.2d 839, 847 n.17 (1983) ("To the extent [a] surcharge imposes an obligation on the ratepayer unrelated to the quantity of electricity used, it could constitute a tax.").

for tax administration and compliance activities.[84] Consideration of how costly a user fee is to administer relative to the gross receipts expected from the fee is essential to any user fee being considered on revenue grounds. Moreover, alternative revenue tools—such as an excise tax, or simply general taxation—should be compared to the user fee in this regard.

A user fee also may have an indirect revenue effect worth considering. If a user fee can be treated as a deductible business expense, imposition of that fee will diminish income tax revenues while it increases other government receipts. The net effect is what counts for the overall budget. If there is earmarking, a user fee will have a larger effect on a particular program budget than on the overall budget.

When considering cost recovery and revenue enhancement objectives of user fees, one must consider the amount that should be recovered by a fee. For example, one aim could be to recover from service beneficiaries the actual out-of-pocket costs the government has incurred in making the service available. This amount could turn out to be either too high or too low to be compatible with the norm of economic efficiency.[85] Or the government could strive to set fees much as would a profit-maximizing private entrepreneur, with the net revenues serving to benefit the citizenry as a whole; but that might prove incompatible with norms of fairness to feepayers. This may point to a plausible minimal objective of relying on user fees only in those situations where receipts will be generated well in excess of fee compliance costs and only so long as these fee levels are neither markedly inefficient nor unfair.

3. Privatization

The domain of user fees consists of goods and services that share many similarities with those financed, produced, and distributed in decentralized fashion by private entrepreneurs. User fee services occupy a middle ground between the polar case of purely public goods and the large array of basically private goods. For various reasons relating to economic logic, historical accident, and political influence, the federal government furnishes numerous services to private beneficiaries who can be charged accordingly. As we have seen, it is possible to structure these user fees in ways that more or less successfully generate needed federal revenues, foster a more efficient economy, and enhance distributional equity.

Privatization is a separate normative factor that bears on user fees in two respects. First, only a limited array of federal services, such as national defense, are so unique and vital as to make private substitutes impracticable. For goods that the private sector could produce and distribute successfully, determining the wisdom of continued federal production may precede the

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[84] E. BROWNING & J. BROWNING, PUBLIC FINANCE AND THE PRICE SYSTEM 311 (2d ed. 1983).

[85] *See supra* notes 64-73 and accompanying text.

question of user fee financing.[86] Numerous means and opportunities exist to transfer federal activities and assets to the private sector,[87] and user fees have little role to play once such privatization is accomplished.[88]

For private goods or services whose production or consumption creates external costs or benefits, federal production (and user fees) may be a plausible option, but probably one much less warranted than private production coupled with limited federal intervention. Such intervention would take the form of fiscal tools, such as Pigovian[89] taxes or subsidies, regulatory tools, information strategies, or liability and property rights remedies, to correct market failures.

Second, the design of user fees can have significant implications for the development within the private sector of alternative sources and complementary services, where a continuing federal responsibility has been persuasively reaffirmed for the provision of a service. One aspect of this question is whether potential alternative suppliers should even be allowed to develop in the private sector. The main economic consideration here is whether the government's enterprise can produce the service more economically, but only if protected from competition, than can any other potential suppliers (i.e., whether the situation can be termed a "nonsustainable natural monopoly").[90] The Postal Service has made such an argument, for example, as did the former AT&T system, but most disagree.[91]

Another aspect of this question is how to structure user fees so that they do cover all opportunity costs of producing the service. This is in part a straightforward point about efficiency, discussed earlier. But it also has to do

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[86] For an attempt at such justifications, see Gillette, *Who Puts the Public in the Public Good? A Comment on Cass*, 71 MARQ. L. REV. __ (1987) (forthcoming) (suggesting, as an example, that governmental production could provide a centralized forum for consumer complaint and similar opportunities to exercise a "voice" option).

[87] For a sampling of the different methods of and opportunities for privatization, see S. BUTLER, PRIVATIZING FEDERAL SPENDING: A STRATEGY TO ELIMINATE THE DEFICIT (1985); Cass, *supra* note 35; Kolderie, *Two Different Concepts of Privatization*, 46 PUB. ADMIN. REV. 285 (1986).

[88] And recall that as a definitional matter, this article does not treat proceeds from the one-time sale of assets as a user fee unless as part of an ongoing federal function.

[89] Pigovian taxes would compensate creators of external benefits in order to induce their continued production. *See generally* A. PIGOU, THE ECONOMICS OF WELFARE (3d ed. 1929).

[90] *See* W. SHARKEY, *supra* note 67, at 86.

[91] This is the logic underlying the Postal Service's defense of the monopoly over delivery of first class letters accorded it by the Private Express Statutes. As to the telecommunications example, see S. BREYER, *supra* note 29, at 285-314 (concluding that natural monopoly was less a characteristic of long distance than of local service); G. BROCK, THE TELECOMMUNICATIONS INDUSTRY 303 (1981) ("The current roadblock to competitive conditions [in the telecommunications industry] is local distribution.").

with the climate created for private entrepreneurship. If an innovator wants to offer a service that can substitute for all or a portion of a currently provided government service, the government should not discourage this through unduly low user fees. Indeed some contend that privatization can be fostered quite significantly by setting efficient user fees.[92]

Stated differently, privatization concerns are an extension of the efficiency reasoning with which this section began. If user fees are set too low, entailing cross-subsidies from other governmental activities, the government will be discouraging competition quite artificially. Setting fees at efficient levels would invite competition from private producers and thus permit discovery of whether a market failure really does exist.

II. User Fee Statutory and Case Law

In this section, we will review existing statutory and case law concerning federal user fees and critique current policies in light of the principles of public finance that underlie an ideal system of user fees. To the extent that existing law deviates from the ideal, we will suggest mechanisms by which the particular deviation may be eliminated. Our critique is predicated on a conception of user fees that emphasizes their capacity to induce optimal investment in specific activities. As we have noted above, this objective may occasionally be trumped by alternative, nonallocational objectives. Where those alternative objectives seem particularly appropriate, we will suggest how they might affect the purely allocative approach with which we begin.

A. *Constitutional Considerations*

1. Delegation of Authority to Levy Fees and Taxes

The federal government, and Congress in particular, appears to have unconstrained power to raise revenue through a system of user fees. Congress, however, does not possess the capacity to set individually the myriad fees for the vast array of services that the government provides. That function must, as a practical necessity, be performed by the provider of the service, typically an administrative agency within the executive branch.

The constitutional capacity of agencies to fulfill this function, however, has been challenged in a series of cases that implicitly suggest the existence of some constitutional limit on fee-setting by administrative agencies. In the companion cases of *National Cable Television Association v. United*

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[92] *E.g.*, Seldon, *Enhancement of Public Sector Efficiency by Micro-Economic Control of Public Supply*, in Public Finance and the Quest for Efficiency: Proceedings of the 38th Congress of the International Institute of Public Finance 162 (H. Hanusch ed. 1984).

States,[93] and *Federal Power Commission v. New England Power Co.*,[94] the Supreme Court provided the initial interpretations of the Independent Offices Appropriation Act ("IOAA"),[95] the primary statutory basis for the imposition of user fees. While the opinions in those cases were primarily concerned with the appropriate construction of the IOAA, the Court's interpretation appeared to be influenced by concern for constitutional constraints on the ability of Congress to delegate taxing power to agencies. For this reason, the Court in *National Cable Television* read the IOAA to permit only the imposition of fees, defined as an exaction "incident to a voluntary act, e.g., a request that a public agency permit an applicant to practice law or medicine or construct a house or run a broadcast station."[96] Excluded from this definition were any exactions that might fall within the rubric of a tax, defined as payment unrelated to benefits received by the payer. For this reason, the majority concluded, fees authorized by the IOAA could be measured only by reference to the benefits received by the payer.

Wholly apart from the difficulty these opinions have created in requiring distinctions between taxes and fees and in generating judicial creativity in the discovery of feepayer "benefits," some courts have construed these cases as drawing a constitutional limit on the capacity of Congress to delegate collections that would constitute taxes.[97] Carefully read, however, neither the *National Cable Television* nor the *Federal Power Commission* case necessarily stands for that proposition. Justice Douglas's opinion in *National Cable Television* does state that Congress is "the sole organ for levying taxes,"[98] but there is little reason to believe that congressional monopoly over taxation prevents its delegation, properly constrained by safeguards and standards, any more than congressional autonomy over interstate commerce precludes delegation of that power.[99] What Justice Douglas appears to have been suggesting is that in the case of the IOAA there is no evidence that Congress *had* delegated the taxation power. The

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[93] 415 U.S. 336 (1974).

[94] 415 U.S. 345 (1974).

[95] 31 U.S.C. § 9701 (1982). In *National Cable Television* and *Federal Power Commission*, the Court considered an older version of the IOAA, 31 U.S.C. § 483(a) (1952).

[96] 415 U.S. at 340.

[97] *See, e.g.*, Sohio Transp. Co. v. United States, 766 F.2d 499, 503 (Fed. Cir. 1985) (holding that the Secretary of the Interior did not exceed his authority under IOAA and properly charged plaintiffs its fees); Mississippi Power & Light Co. v. NRC, 601 F.2d 223, 227 (5th Cir. 1979) (holding that monies exacted by the NRC from reactor builders were constitutional "fees" and not unconstitutional "taxes"), *cert. denied*, 444 U.S. 1102 (1980).

[98] 415 U.S. at 340.

[99] The most recent Supreme Court statement concerning the breadth of congressional power under the commerce clause is found in Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528 (1985).

majority opinion suggests that a reasonable interpretation of the IOAA would presume that no such delegation was intended. Thus the Court suggested that reading the IOAA to permit taking into account factors other than benefit to the recipient of governmental largesse "carries an agency far from its customary orbit and puts it in search of revenue in the manner of an Appropriations Committee of the House."[100] Such considerations would transform assessments into taxes, "which under our constitutional regime are traditionally levied by Congress."[101] But there is no statement in the opinion implying that this heavy presumption and longstanding tradition could not be overcome by an express congressional delegation more detailed than was found in the IOAA.

2. Fees on Constitutionally Protected Activities

Some activities susceptible to user fees under the criteria discussed in Section I involve the exercise of constitutionally protected rights. Examples include the availability of governmental facilities that foster the exercise of free speech, for example, the postal service or the maintenance of public forums such as parks.[102] Alternatively, one could view Customs Service inspections of incoming American citizens as incident to a constitutionally protected freedom to travel.[103] In each of these cases, excludable private benefits exist and beneficiaries could be assessed the marginal cost of the governmental service.

Two separate but related justifications favor financing these activities collectively through the tax system, instead of through user fees. The first would be to concede that these services generate essentially private goods, but to conclude that the underlying private activities, by virtue of being embodied in constitutional principles, qualify as the quintessential "merit goods" or "primary goods." In the rubric of Section I, denying these goods to persons unable or unwilling to pay their marginal cost would generate an "unfair" distribution of scarce resources.[104] Thus, it would be suitable to

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[100] 415 U.S. at 341.

[101] *Id.*

[102] *See, e.g.*, Hague v. CIO, 307 U.S. 496, 516-18 (1939) (holding that under the first amendment, a labor organization cannot be denied access to a public meeting hall nor forbidden to distribute printed matter). *But see* United States Postal Serv. v. Greenburgh Civic Ass'ns, 453 U.S. 114, 120 (1981) (holding that statute prohibiting the deposit of unstamped material in a mailbox does not violate the first amendment's guarantee of free expression).

[103] *See, e.g.*, Shapiro v. Thompson, 394 U.S. 618 (1969).

[104] *See, e.g.*, Michelman, *supra* note 2, at 15-16. Professor Michelman postulates the existence of "just wants," the provision of which cannot properly be subordinated to other governmental objectives such as efficient allocation of resources. On the difficulty of defining the scope of a fairness-based constitutional right to particular governmental services, see Diamond, *Constitutional Limits on the Growth of Special Assessments*, 6 URB. L. & POL. 311, 319 (1984).

finance these goods through the tax system, even though the resulting subsidies would generate overuse from an efficiency perspective.

Alternatively, one could argue that denomination of these activities as constitutionally protected presumes that their exercise generates substantial positive externalities (the situation depicted in Figure 1). If nonparticipants or indirect participants receive benefits from the exercise of these activities, then arguably they should contribute to their occurrence through general taxation. For example, the audience watching a political rally on the steps of city hall or the populace at large that benefits from more informed voting patterns perhaps should pay (through taxes) for these benefits. The alternative of imposing fees on the audience, of course, would defeat one of the purposes of the rally—to convert those not already subscribing to the speaker's perspective—as they would be unlikely to pay to hear a view with which they initially disagreed. Indeed, given the public goods aspects of these rights, imposing fees on the direct actors would likely cause undersupply of the activities.

Substantial litigation has evolved at the state and local level concerning user fees for engaging in constitutionally protected activities. Typical cases involve municipal ordinances that require organizers of rallies or parades to post bonds for cleanup fees.[105] Courts have, quite properly, not adopted a per se approach to these fees. Rather, they have inquired into the effect that fee imposition would have on the underlying activity. The propriety of this approach seems apparent since an absolute ban would prohibit recovery of the government's cost of contributing to the activity, while full cost recovery might deter constitutionally protected activities.[106] For instance, an absolute view would presumably invalidate a requirement of placing postage on mail that carried messages protected under first amendment principles of free speech.[107]

[105] *See* Central Fla. Nuclear Freeze Campaign v. Walsh, 774 F.2d 1515, 1523 (11th Cir. 1985) (invalidating ordinance requiring police service fees), *cert. denied*, 106 S. Ct. 1637 (1986); Eastern Conn. Citizens Action Group v. Powers, 723 F.2d 1050, 1055 (2d Cir. 1983) (invalidating state department of transportation administrative fee and liability insurance requirement for political march); Neisser, *Charging for Free Speech: User Fees and Insurance in the Marketplace of Ideas*, 74 GEO. L.J. 257 (1985) (examining the conflict between the first amendment and traditional economic analysis of allocating the costs associated with the exercise of free speech).

[106] For a more skeptical view of balancing, see Aleinikoff, *Constitutional Law in the Age of Balancing*, 96 YALE L.J. 943 (1987) (arguing that using a balancing test to resolve constitutional issues "blinds us to serious problems" and that the balancing debate should be reopened).

[107] Notably, courts have found no due process violation in the analogous area of requiring a large plaintiff class to incur the costs of notification to each member of the class in order to maintain a class action, notwithstanding that the consequent expense threatens the viability of the lawsuit. *See* Oppenheimer Fund, Inc. v. Sanders, 437 U.S. 340, 350-56 (1978) (holding that, absent special circumstances, plaintiff must pay for the cost of notice to class members); Eisen v. Carlisle & Jacqueline, 417 U.S. 156, 177-79 (1974) (same).

On the other hand, unrestricted fees could unduly discriminate, on the basis of wealth, among individuals who desired to engage in protected activities. For instance, a substantial customs fee for re-entering the United States could marginally affect citizens attempting to exercise their right to travel. On a related basis, a Colorado district court has invalidated fees imposed on nonrecreational use of a road within a national monument site. The court considered assessment of a fee inconsistent with a protected property right of public use and contrary to the statutory authority of the National Park Service.[108] The result suggests that in cases involving constitutionally protected rights, an ad hoc approach would be desirable to balance the efficiency and revenue-enhancing gains of fees against the potential adverse effects on the exercise of the preferred conduct.

B. *The Statutory Scope of Permissible User Fees—The IOAA*

Assuming no constitutional restrictions on a proposed user fee, there remain various statutory limits on the capacity of administrative agencies to charge for the services they perform. The IOAA, originally enacted by Congress in 1952 and revised in a substantially equivalent form in 1982, remains the primary statute concerning the imposition of user fees by federal agencies.[109] This statute was intended to authorize a broad range of user fees, as it is predicated on the desire that agencies become "self-sustaining to the extent possible."[110] To that end, the act permits agencies to prescribe regulations establishing a charge for "a service or thing of value provided by the agency."[111] Indeed, courts have considered the congressional intent underlying the IOAA to be sufficiently pervasive that interpretations thereunder have been used to consider the meaning of other statutes that similarly grant fee-imposing authority to agencies.[112]

Nevertheless, the IOAA does not constitute a model of clarity and precision. To the contrary, the statute uses vague terms and invokes ephemeral principles that demand substantial interpretation. The statute provides little guidance concerning the constituents of a "service or thing of value" and leaves fairly open the appropriate mechanisms for computing a proper charge.[113] Instead, the statute recites considerations that are, at best, incon-

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[108] Wilkenson v. Department of Interior, 634 F. Supp. 1265 (D. Colo. 1986).

[109] 31 U.S.C. § 9701 (1986).

[110] *Id.* § 9701(a).

[111] *Id.* § 9701(b).

[112] *See, e.g.*, Nevada Power Co. v. Watt, 711 F.2d 913 (10th Cir. 1983) (interpreting cost-reimbursement practices under the Federal Land Policy and Management Act by referring to earlier regulations under IOAA and the Public Land Administration Act).

[113] *See* Note, *The Assessment of Fees by Federal Agencies for Services to Individuals*, 94 HARV. L. REV. 439 (1980) (arguing that IOAA is unclear in determining when imposing a fee is authorized, and when a fee charges the appropriate amount).

clusive, and, at worst, inherently conflicting. For instance, the statute mandates that charges be based on both "the costs to the Government" of providing the service and "the value of the service or thing to the recipient."[114] Nothing in the statute, however, resolves the issue where these factors substantially diverge. At best, the statute imposes on the agency an obligation to set a fee that corresponds to some conception of what is "fair."[115]

We propose that the most productive interpretation of the IOAA and related statutes requires consideration of the economic principles, elaborated in the first section of this report, that underlie an "ideal" user fee. If the function of user fees authorized by the IOAA is not simply to cause agencies "to be self-sustaining to the extent possible"—a standard best satisfied by the types of fees rejected in *National Cable Television* and *Federal Power Commission*—but also to ensure a socially optimal level of federal activity, compliance with these principles would seem mandatory. Where the decision to engage in the activity is price elastic, fees that fail to reflect those criteria will likely produce either an oversupply or undersupply of the regulated activity. Our inquiry into the interpretation of the IOAA, therefore, will consider not only the internal consistency of judicial and administrative rulings, but also the consistency of those interpretations with the principles articulated above.

1. The Need for Identifiable Benefits and Beneficiaries

The theory of efficient user fees suggests that fees should be imposed only on identifiable beneficiaries for particular benefits. Failure to link fees to particular benefits would inevitably result in the kinds of cross-subsidies that fees are intended to avoid. A fee that simply reflected a regulated firm's pro rata share of the total costs of regulation, for instance, could require that users subsidize the creation of external regulatory benefits enjoyed by the public at large. Similarly, failure to mesh costs with particular beneficiaries, even if an optimal total user fee were collected, would induce substantial gamesmanship within the regulated industries. If, for instance, an agency were to charge each member of a regulated industry a pro rata share of the regulatory budget dedicated to the conferral of total private benefits, one would anticipate that each member would attempt to capture more than its pro rata share of those benefits and thus free ride off the fees paid by others.

It is not surprising, then, that from the earliest Supreme Court interpretations of the IOAA, courts have mandated that an agency justify fees by reference to specific benefits and beneficiaries of regulatory activities. This principle is explicit in *National Cable Television* and *Federal Power Com-*

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[114] 31 U.S.C. § 9701(b)(2)(A)-(B).

[115] *Id.* § 9701(b)(1). By "fair" we mean that the agency divides the total budget of a regulatory agency by the number of regulated entities and charges each a pro rata share of the budget.

mission. In the former case, the Court invalidated FCC fees predicated on the Commission's total budget rather than on private benefits obtained by regulatees. In the latter case, the Court recognized that fees were based on private benefits derived from regulation, but found that charges imposed by the Federal Power Commission were improperly based on the agency's cost of regulating the entire industry. The Court limited the Federal Power Commission collections to "specific charges for specific services to specific individuals or companies."[116] If a company within the Commission's jurisdiction did not, within a given year, take advantage of any of the benefits offered by the Commission's regulatory scheme, that company could not be required to pay a fee during that year. Moreover, the Court was unwilling to find the requisite benefit either in the fact of regulation itself or in the adoption of a practice that benefited the industry generally. Demonstration of an individualized benefit to the payer was instead required.

This same principle is implicit in the legislative history and administrative development of user fees prior to the most recent surge of requests for nontax revenues. The Senate Committee Report on the bill that became the precursor for the current IOAA described its task as not simply revenue raising but "determining the feasibility of offsetting items now necessarily included in the Federal budget as nonreimbursable by transferring the financial burden thereof to the special beneficiaries."[117] Consistent with this intent, the Bureau of the Budget Circular ("the Circular")[118] that has been considered a primary interpretative tool for the IOAA[119] limits user fee application to an "identifiable recipient for a measurable unit or amount of government service or property from which he derives a special benefit."

Subsequent judicial interpretations have also adhered to the need for an identifiable benefit and beneficiary. Thus, the District of Columbia Court of Appeals analyzed the propriety of new Federal Communications Commission rate schedules following remand of the Supreme Court's *National Cable Television* decision by reference to a standard that "an agency must identify the activity which justifies each particular fee it assesses."[120]

2. Indicia of Identifiable Benefits

Notwithstanding this consensus that the benefits of user fees be identifiable, the concept of "benefit" is sufficiently ambiguous to produce sub-

[116] Federal Power Comm'n v. New England Power Co., 415 U.S. 345, 349 (1974).

[117] S. REP. NO. 2120, 81st Cong., 2d Sess. 1 (1950) [hereinafter SENATE REPORT].

[118] BUREAU OF THE BUDGET, CIRCULAR A-25 (1959) [hereinafter CIRCULAR]. The Office of Management and Budget has drafted a revision of Circular A-25 to permit more flexible adoption of user fees. As of this writing, the most recent public version of the new draft was published at 52 Fed. Reg. 24,890 (July 1, 1987) [hereinafter REVISED CIRCULAR].

[119] *See, e.g., New England Power Co.*, 415 U.S. at 349-51 (agreeing with the Circular's interpretation of IOAA).

[120] National Cable Television Ass'n v. FCC, 554 F.2d 1100, 1104-05 (D.C. Cir. 1976).

stantial disparity among judicial decisions and substantial deviation from the public finance principles that we have suggested underlie a proper theory of user fees. Nevertheless, as judicial decisions have begun to accumulate, certain factors and tests of identifiability have evolved.

Although courts have universally determined that regulation itself does not confer a benefit sufficient to subject members of the regulated industry to a fee, numerous judicial opinions have concluded that agency action necessary to qualify an entity for participation in the industry does constitute a benefit.[121] Some legislative history supports this view. In the Senate Report,[122] the Senate Committee on Expenditures in the Executive Department analyzed the concept of benefit that would support a fee. The Committee suggested that the processing of applications and holding of statutorily required hearings constituted "an outstanding example of a service for which a fee may most appropriately be assessed."[123] The same theory pervades the Circular, where special services that support a fee are defined to include the receipt of a license to carry on a specific business.[124]

One of the broadest statements of this doctrine occurs in the Fifth Circuit's decision in *Mississippi Power & Light Co. v. United States Nuclear Regulatory Commission*.[125] In that case, petitioners challenged NRC fees based on guidelines that permitted recovery of direct and indirect costs associated with the creation of "special benefits." The Commission defined the latter term to include all services necessary for the issuance of a required permit, license, approval or amendment, or other services necessary to assist a recipient in complying with statutory obligations under the Commission's regulations.[126] Under subsequent fee schedules, about twenty percent of the Commission's budgeted regulatory costs were considered eligible for fee recovery. Petitioners argued that all Commission regulation was for the benefit of the public; because the license or permit conferred no additional or

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[121] *See, e.g.*, Central & S. Motor Freight Tariff Ass'n v. United States, 777 F.2d 722, 734 (D.C. Cir. 1985) (holding that tariff filings were subject to fees because the filings were required by statute); Nevada Power Co. v. Watt, 711 F.2d 913, 928-31 (10th Cir. 1983) (holding that the Department of Interior could charge utility company for the cost of environmental impact study made in response to application for right of way, because study was prerequisite to the requested license); *National Cable Television*, 554 F.2d at 1101-02 (holding that certificate of compliance has become a necessary, and therefore valuable, license for cable operators, and consequently agency costs incurred in processing could be recaptured through the appropriate fee); Electronic Indus. Ass'n v. FCC, 554 F.2d 1109, 1115 (D.C. Cir. 1976) (holding that the FCC is entitled to charge for services "which assist a person in complying with his statutory duties.").

[122] SENATE REPORT, *supra* note 117.

[123] *Id.* at 4.

[124] CIRCULAR, *supra* note 118, at 2. *See* REVISED CIRCULAR, *supra* note 118, at 24,890, ¶ 6a(1)(a).

[125] 601 F.2d 223 (5th Cir. 1979).

[126] 601 F.2d at 226 n.3.

distinct benefit on the private recipient no fee recovery was warranted. The petitioners attempted to distinguish cases, such as those involving FCC fees, in which regulation was necessary because physical limits restricted the number of licensees. Thus governmental action awarding such scarce resources conferred a benefit on the recipients of those resources. In the instant situation, petitioners argued, only traditional competitive forces restricted the number of entrants. Because any party with sufficient capital could start a nuclear power plant governmental restrictions and licenses were unnecessary, except to benefit the public at large. But if that were true, petitioners implicitly concluded, then under established principles of the IOAA no fee could be imposed on the nuclear plant operator.

The petitioners' contention that the costs of regulation can more readily be imposed on a licensee in cases of natural monopoly has substantial appeal. FCC licenses, for instance, are a case in which governmental regulation is necessary to avoid the type of overcrowding or commons effect already described.[127] Perhaps for this reason, the Senate Report approved fees for the grantees of such licenses, noting that the license conferred "a franchise to a segment of the radio audience" (in pre-television days) and could "assure to the applicant a remunerative business under special Federal protection."[128] Once the FCC granted the license, the licensee had an effective monopoly protected by federal law. Where no such indication of market failure existed, petitioners in *Mississippi Power & Light* argued, governmental intervention was justified only by reference to external benefits—those conferred on the public at large as a result of regulation.

The Fifth Circuit paid little attention to these arguments. Rather than dealing with the purported distinction, the court responded with the blanket statement that a "license from the NRC is an absolute prerequisite to operating a nuclear facility." As such, the process of obtaining the license confers on the recipient a special benefit sufficient to support a fee. But the court also felt obligated to suggest some of the private benefits flowing from licensure. It suggested, for instance, that the limited liability enjoyed by licensed operators of nuclear plants under the Price-Anderson Act[129] and the possibility that NRC inspections would reveal safer methods of operating plants conferred sufficient benefits on the licensee to justify the imposition of a user fee. The court made no attempt to determine whether the value of these benefits was commensurate with the fees being charged. Nor did the court explain why, if plant safety were an issue, workers at the plant would be unable to induce the operator to take sufficient safety measures without governmental intervention. We are not suggesting either that there was an inappropriate relationship between limited liability and the fee charged or

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[127] *See supra* notes 49-51 and accompanying text.

[128] SENATE REPORT, *supra* note 117.

[129] Atomic Energy (Price-Anderson) Act § 170, 42 U.S.C. § 2210 (1973 & Supp. I 1987).

that workers had either the information or the leverage to bargain over safety issues. We simply suggest that the court never addressed the issue.

On the other hand, the court may have had available to it arguments that the plant operators were analogous to FCC licensees. Conceivably, given the risks associated with nuclear power plants, the NRC or Congress would affirmatively ban the operation of such plants if licensing did not exist. Viewed from this perspective, licensees do, in fact, receive a benefit insofar as they are permitted to operate in an area that the government might otherwise take over or eliminate to avoid the risk of substantial negative externalities. But perhaps this argument proves too much. Government might contend that it could ban any activity that it regulates and thus all regulation would confer benefits that support fees.

Certainly, some industries would prefer no regulation to regulation, and in this subjective sense they receive no benefit from regulation. Nevertheless, each court that has addressed the issue has joined the *Mississippi Power & Light* court's judgment that industry distaste for regulation, standing alone, is insufficient to contradict the presumption of a benefit.[130] The rationale for this conclusion appears to be that fees under the IOAA are properly imposed for "voluntary acts," a standard derived from the Supreme Court's analysis in *National Cable Television*.[131] That standard presumes that if an entity voluntarily enters a business believing that the business will return benefits superior to the next best use of the entity's resources, it necessarily assumes all the burdens associated with operating that business, including the payment of fees.

Voluntariness, however, seems an insufficient justification for user fees. We put to the side the difficult issue of defining what constitutes a voluntary act and assume that the decision to enter a business in which members are subjected to a fee satisfies any test of voluntariness. Even so, the relationship between voluntariness and the propriety of fees is unclear. In some cases, imposition of a fee seems appropriate where a volitional request has been made for a governmental service, even where unaccompanied by a tangible benefit. Thus, in *New England Power Co. v. United States Nuclear Regulatory Commission*,[132] the court permitted recovery of processing costs for nuclear reactor license applications even though the applications had been withdrawn. While the applicant received no benefit from the withdrawn

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[130] *See National Cable Television*, 554 F.2d at 1101 (disregarding as irrelevant petitioner's claim that an annual fee levied by the FCC was unjustified because the cable TV industry could have developed better without FCC regulation); Electronic Indus. Ass'n v. FCC, 554 F.2d at 1117 n.17 (holding that the FCC may charge fees for activities which are not beneficial to an applicant, but are necessary to recover the cost of any service necessarily rendered to the applicant)

[131] *See National Cable Television*, 415 U.S. at 340 ("A fee . . . is incident to a voluntary act, *e.g.* a request that a public agency permit an applicant to practice law or medicine or construct a house or run a broadcast station.").

[132] 683 F.2d 12 (1st Cir. 1982).

application, it had caused the Commission to incur processing costs by virtue of its initial filing. A subsequent change of mind ought not to impose on the public the obligation to subsidize what would otherwise be private entrepreneurial activity.

Other cases suggest a more troublesome reliance on "voluntariness." Some voluntary acts, such as initiating a lawsuit that creates a useful legal precedent[133] may return such significant positive externalities that fees could induce underproduction of the activity from a societal perspective. Thus, the voluntary nature of the activity cannot be linked to the propriety of a fee. Finally, even the courts do not systematically adhere to the voluntariness notion. If voluntariness were sufficient to justify a user fee, it would not matter that the fee was either unmatched to benefits received or unjustified by a particular cost accounting method. The complaining entity could simply, and voluntarily, enter a new business. Remaining within the industry would constitute a volitional decision to pay the fee. Thus, something other than a simple appeal to "voluntary acts" must underlie the propriety of the fee system.

There is some support for the proposition that substantial amounts of regulation redound to the benefit of the regulated and give them advantages over what they would receive in a free market. The statutorily granted monopoly that flows from FCC licensing is a classic case of market failure which, without governmental intervention, would have adversely affected entrants. Indeed, recognition of the grant of a monopoly may well have been behind the Supreme Court's statement in *Federal Power Commission* that Federal Power Commission regulations provided "the foundation for the sound financial condition which public utilities and natural gas companies have achieved."[134] Similarly, the District of Columbia Circuit Court of Appeals noted in *Central & Southern Motor Freight Tariff Association*[135] that compliance with Interstate Commerce Commission regulations cloaked the transportation industry with statutory immunity from antitrust liability. In such cases, the benefits received are unique and substantial enough to support a commensurate fee. Perhaps less convincing of a tangible benefit is the same court's earlier argument that regulation gives broadcasters some "credibility in the marketplace."[136] Rather than imposing fees on the grounds that private benefits necessarily derive from statutory compliance, fees should be based on the benefit that regulatees receive from regulation, including their capacity thereby to avoid potentially adverse competition.

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[133] *See* Landes & Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235, 248-49 (1979) (discussing efficiency incentives to produce precedents in arbitration); Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51, 60 (1977) (suggesting that a precedent's efficiency depends on having both sides of a litigation take an interest in resolving it).

[134] *Federal Power Commission*, 415 U.S. at 348.

[135] 777 F.2d 722 (D.C. Cir. 1985).

[136] Electronic Indus. Ass'n v. FCC, 554 F.2d 1109, 1116 (D.C. Cir. 1976).

Indeed, some courts are reaching results independent of, yet consistent with this analysis. In the recent *Central & Southern Motor Freight Tariff Association* case, the court concluded:

> Although we need not endorse the ICC's sweeping view that a statutory filing requirement is always sufficient in and of itself to satisfy fully the private-benefit test, we believe such a requirement is sufficient where, as here, the statute was passed in large measure for the benefit of the individuals, firms, or industry upon which the agency seeks to impose a fee. Here, a principal function of the tariff-filing requirement is "insuring the economic stability of the trucking industry."[137]

The court's holding leaves open the possibility that certain activities would not be susceptible to fees solely because they were statutory prerequisites to carrying on the business, and appears to determine a fee's propriety based on whether it confers some benefit not obtainable in the market, such as monopoly or oligopoly power.

3. Relationship Between Public and Private Benefits

It would be the rare governmental activity that produced a purely private benefit. Because regulation presumably exists for the public good, a regulation that conferred pure private goods would be criticized as inconsistent with an agency's public functions.[138] The interaction of public and private effects resulting from the same activity necessarily raises the question of when, notwithstanding private benefits, the public benefits of an activity are so dominant as to preclude imposition of a fee on private beneficiaries. For instance, the legislative history of the IOAA reveals that some activities that clearly conferred private benefits were so publicly beneficial as to require insulation of the private beneficiaries from fees. Thus the Senate Committee Report[139] concluded that while clearance of drugs and food by the Food and Drug Administration "is an invaluable asset" to manufacturers, no fees related to that activity should be charged because food and drug clearance is "considered to constitute a benefit inuring predominantly to the general

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[137] *Central & S. Motor Freight Tariff Ass'n*, 777 F.2d at 734 (quoting Locust Cartage Co. v. Transamerican Freight Lines, Inc., 430 F.2d 334, 343 (1st Cir.), *cert. denied*, 400 U.S. 964 (1970)).

[138] This is not to say that purely private goods are not generated by regulation; indeed, much of the literature of public choice suggests that private goods are the driving force of publicly interested activity. *See, e.g.*, R. HARDIN, COLLECTIVE ACTION 9 (1982) ("The logic of collective action is . . . merely the logic of the efficiency of the market exchange. . . ."); M. OLSON, THE LOGIC OF COLLECTIVE ACTION 8 (1965) ("Just as those who belong to an organization or group can be presumed to have a common interest, so they obviously also have purely individual interests, different from those of the others in the organization or group.") (footnote omitted).

[139] SENATE REPORT, *supra* note 117.

welfare rather than to any special interest."[140] Similarly, the Senate Report deemed meat inspection services to be "clearly services for which no charge could in propriety be made" because of the overwhelming public nature of the benefits derived.[141]

In *Electronic Industries Association v. FCC*,[142] petitioners argued that the FCC could assess no fee for tariff filings and equipment approvals and certifications because the public interest served by such regulations was so important. The court rejected this proposition, noting the Supreme Court's analysis in *National Cable Television*.[143] There, the Court had determined that unless the regulatory scheme was a total failure, the serving of some public interest would be inevitable.[144] Thus, demonstration of incidental public benefit would not preclude imposition of a fee. Still, the court in the *Electronic Industries* case did require a threshold level of private benefit before a fee would be permitted. The court then distinguished between an "incidental" public benefit, which private beneficiaries could be required to subsidize, and "independent" public benefits, which were not subject to fees:

> If the Commission, in granting an equipment type approval . . . is required to incur expenses for testing or inspection, such expenses can be charged in full to the applicant. These activities have undisputed private benefits although they may also create incidental public benefits as well. But if the agency were to engage in further activity to determine whether a piece of equipment which has already been found to have no potential for creating "harmful interference" . . . meets standards for consumer safety it would be doing so to satisfy some independent public interest, and the charge for these additional expenses could not be included in fees imposed on equipment owners.[145]

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[140] *Id.* at 6.

[141] Of course, the recent shift from this attitude to one favoring fees for these services suggests the malleability of what constitutes private benefit. *See* UNITED STATES DEPT. OF AGRICULTURE, STUDY OF USER FEE OPTIONS FOR THE FOOD SAFETY AND INSPECTION SERVICE 4 (1986) (suggesting that user fees are justified for food safety and inspection services because meat and poultry inspections increase consumer confidence in product safety).

[142] 554 F.2d 1109 (D.C. Cir. 1976).

[143] *Id.* at 1113-16.

[144] *National Cable Television*, 415 U.S. at 343.

[145] *Electronic Indus. Ass'n*, 554 F.2d at 1109 (footnote omitted); *accord*, Mississippi Power & Light Co. v. NRC, 601 F.2d 223, 230 (5th Cir. 1979) (characterizing items properly assessed as fees as, inter alia, expenses incurred in rendering a service to a private beneficiary, but not when the expenses are incurred to serve some independent public interest), *cert. denied*, 444 U.S. 1102 (1980); *see also* Central & S. Motor Freight Tariff Ass'n v. United States, 777 F.2d 722, 730 (classifying, as an example, the FCC's costs of determining whether electronic devices will create "harmful interference" with existing communications networks as subsidizable by applicant fees, but classifying FCC's costs for testing these devices for safety as nonsubsidizable).

In short, if the public benefit necessarily flows from the conferral of the private benefit, the public may be entitled to free ride on the private beneficiary.[146] The extent to which this free riding is permitted, of course, depends on the allocation of costs between the public and private sector. Misallocation of costs, for instance, might lead the private beneficiaries to subsidize, and thus to undersupply from a social perspective, conduct with public goods aspects.

The appropriate allocation of costs is a separate issue to which we turn in the next section. For the moment, it is important only to note that prevailing law does not make the mere existence of public benefit a reason for precluding the imposition of a fee. Indeed, the current revision of the Circular mandates fees that would recover full cost where "incidental benefits" to the general public are provided along with benefits to identifiable persons properly subject to the fee.[147]

C. *The Allocation of Costs for Governmental Services*

If the function of user fees is to generate optimal use of governmentally provided goods and services, then one would expect costs to be allocated to users in a proportion that precisely matched the private benefit obtained. Because virtually all governmental goods and services confer both public and private benefits, however, this ideal allocation is rarely achieved. That is, external beneficiaries are necessarily subsidized by fee payers or, where services are financed out of general revenues, taxpayers subsidize private beneficiaries. Moreover, the enormous administrative difficulties involved in measuring and collecting fees based on a perfect correspondence of benefits and burdens hinders or precludes the achievement of the ideal. Still, one would expect some general principles concerning acceptable deviations from the ideal to arise. Indeed, the inability of local governments to achieve a perfect correspondence of costs and benefits in financing municipal improvements does not transform a permissible user fee into an impermissible tax. Instead, courts have permitted localities to use fee systems despite unavoidable cross-subsidies. Thus courts have permitted municipalities to charge rates for municipal services such as water and sewer supply that not only meet the system's current capital needs and operating expenses, but that also include amounts usable for future capital outlays.[148] Although

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[146] *See Central & S. Motor Freight Tariff Ass'n*, 777 F.2d at 735 (holding that public benefits incidental to agency's provision of private benefits were not independent public benefits, and therefore nondeductible from agency assessments).

[147] *See* REVISED CIRCULAR, *supra* note 118, at 24891, ¶ 6a(2),(3). "Full cost recovery" is defined to include an annual rate of return on the government's capital resources dedicated to the regulatory effort. *See id.*, ¶ 6d.

[148] *See, e.g.*, Hayes v. City of Albany, 7 Or. App. 277, 490 P.2d 1018 (Or. App. 1971) (holding that where ordinances providing for sewer user fee and for increased connection charges specifically provided that proceeds be used to develop and

current residents will subsidize subsequent residents, courts have justified the additional charge on the theory that "raising capital for future use by means of rates and charges may permit a municipality to take advantage of favorable conditions, which would alter before money could be raised through issuance of debt securities."[149] Indeed, most courts have gone further to permit municipal utilities to charge rates that reflect a "reasonable profit," which is then committed to the municipal general treasury.[150] Any such profit may involve a subsidy from ratepayers to taxpayers, as the amounts diverted are usable for municipal purposes that have nothing to do with the utility for which rates are charged. The diversion could be justified on the theory that some utility functions are paid for out of the general treasury—police and fire protection, for example—so that the payment of utility "profits" to the locality simply constitutes reimbursement of those expenses. But because any relationship between utility profits and municipal expenditures on utility property may be purely coincidental, cross-subsidies are likely to remain.

One might anticipate that federal as well as municipal user fees would be subject to limited flexibility in attempting to allocate the costs of services benefiting different groups. The IOAA, however, provides little guidance on the allocation of costs for services that are neither purely private nor purely public. The statute indicates only that any charge is to be:

(1) fair; and
(2) based on—
    (A) the costs to the Government;
    (B) the value of the service or thing to the recipient;
    (C) public policy or interest served; and
    (D) other relevant facts.[151]

Although this statute apparently allows an agency to make virtually any

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maintain sewage disposal system, such ordinances were a valid exercise of power, provided that the levy charged was reasonably commensurate with the burdens imposed on the sewage system); Hartman v. Aurora Sanitary Dist., 23 Ill.2d 109, 177 N.E.2d 214 (1961) (holding that a service or connection charge levied under the Illinois Sanitary District Act of 1917 was a valid method of financing needed extensions in the sewage system).

[149] Contractors and Builders Ass'n v. City of Dunedin, 329 So.2d 314, 320 (Fla. 1976).

[150] *See, e.g.*, Pinellas Apartment Ass'n v. City of St. Petersburg, 294 So.2d 676, 678 (Fla. Dist. Ct. App. 1974) ("There is nothing inherently wrong with the city making a modest return on its utility operation or certain portions thereof, provided the rate is not unreasonable in light of the service provided."); Apodaca v. Wilson, 86 N.M. 516, 524, 525 P.2d 876, 884 (1974) (holding that, because a city was acting in a business or proprietary capacity instead of a governmental capacity, it could charge fees in excess of operating costs as long as the fees were reasonable compared to what private utility companies charged).

[151] 31 U.S.C. § 9701(b) (1983).

allocation it desires, both legislative history and subsequent judicial interpretations have attempted to impose some order on its unregimented standards. Unfortunately, those interpretations are neither internally consistent nor necessarily compatible with the public finance principles discussed previously.[152]

The Senate Report apparently presumes that general taxation would subsidize governmental services. Accordingly, any doubts as to the appropriate measure of private benefit were to be resolved against use of fees. The Report concludes that where "there is a joint benefit to a particular beneficiary and to all of the people, the cost should be equitably divided, and where there is doubt as to the degree or preponderance of benefit, there should be no fee."[153]

Some judicial opinions, however, apparently entertain the contrary presumption. They permit the government to recover through user fees the full cost of a service that confers a special benefit, notwithstanding that the same service simultaneously generates public benefits. In short, the "incidental" public benefit, may, under these decisions, be fully subsidized by private beneficiaries.

The opinion in *Mississippi Power & Light Co. v. NRC*,[154] is particularly instructive in this area. In that case, petitioners contended that some public benefit inhered in NRC regulation and that such portion of the service should be excluded from any fee assessment.[155] The Commission argued that it was not required to segregate public and private benefits, but could instead recover the full cost of providing a service to a private beneficiary.[156] The Court of Appeals for the Fifth Circuit agreed with the Commission and suggested that no allocation was required once a threshold amount of private benefit had been determined.[157] The court permitted NRC to recapture the full costs of nuclear plant inspections because it determined that identifiable beneficiaries obtained identifiable benefits from those activities. The court cited in support only the District of Columbia Circuit Court's opinion in *Electronic Industries Association v. FCC*,[158] which also rejected a strict allocation requirement. But this use of *Electronic Industries* is misleading if not disingenuous. The *Electronic Industries* court in fact remanded the FCC's fee structure on the grounds that the FCC had not demonstrated a link between fees imposed and benefits conferred. The court implicitly accepted the notion that, while exactitude was not required, fees had to be predicated on some reasonable allocation between public and private bene-

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[152] *See* SECTION 1 *supra*.

[153] SENATE REPORT, *supra* note 117, at 3-4.

[154] 601 F.2d 223 (5th Cir. 1979).

[155] *Id.* at 229.

[156] *Id.*

[157] *Id.* at 229-30.

[158] 554 F.2d 1109, 1112-13 (D.C. Cir. 1976) (remanding for reconsideration fees set by strict allocation).

fits. In fact, the FCC ultimately abandoned much of its fee-collecting efforts because of the court's allocation requirements.[159]

As suggested above, allowing full-cost recovery may induce undersupply of activities that generate positive externalities. If a private beneficiary must subsidize public benefits and cannot recapture those benefits through pricing mechanisms—a real possibility where the external benefits take the form of public goods not susceptible to marginal cost pricing—the private beneficiary probably will not engage in an optimal level of the activity from a societal perspective. For some activities, such as licensing, the effect of full-cost recovery may not be evident for any particular case; any applicant may still consider the benefits of seeking a particular approval worth the fee charged. Borderline applicants, however, could be inadvertently deterred.

Courts, however, have imposed some constraints on the level of permissible fees. The Supreme Court in *National Cable Television* restricted the FCC to fees measured by the value of the service to the recipient. Any cost incurred by the agency in excess of the value received by the recipient would be paid through general taxation, even if the agency service generated a purely private good. Thus, the District of Columbia Circuit in *Electronic Industries* required any gradations in fees to be linked to graduated costs incurred by the agency rather than to gradations in revenues received by the fee payer.[160] The court assumed that a given service creates a set value of benefit regardless of revenues. Yet, the same court permitted fees to be scaled to the number of subscribers of any cable company on the theory that those companies with more subscribers received relatively greater benefits from FCC licensure.

While other courts also have limited fees to the value received by the recipients, such a limit effectively places a ceiling on the remainder of the statutory language. That language expressly authorizes consideration of costs to the government and "other relevant facts" in setting the amount of a fee. Other courts have reconciled that language by suggesting that cost to the government may be considered, but only as an alternative ceiling on the fee.[161] One court has avoided the conundrum by equating governmental cost

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[159] *See* T. Seoh, Memorandum to User Charge Task Force of Department of Health and Human Services (Oct. 13, 1982), *reprinted in* DEPARTMENT OF HEALTH AND HUMAN SERVICES, USER CHARGE STUDY, 1983 (Attachment II) (tracing the history of difficulties the FCC faced in meeting the Court's allocation requirements).

[160] *Electronic Indus. Ass'n*, 554 F.2d at 1112-13.

[161] *See, e.g.*, Central & S. Motor Tariff Ass'n v. United States, 777 F.2d 722, 729 (D.C. Cir. 1985) (enunciating three criteria for fees, including that the fee exceed neither the cost to the government nor benefit to recipient); *Mississippi Power & Light Co.*, 601 F.2d at 230 (holding that fee assessed may not exceed government costs); *Electronic Indus. Ass'n*, 554 F.2d at 1114 (suggesting that cost may be a basis for fees, but a desire to increase regulator's revenues may not be a basis if there is no increased cost to the government).

with recipient benefit.[162] In effect, then, courts limit fees to either cost to the government or value to the beneficiary, whichever is lower.[163]

There are some courts, however, that have looked beyond costs to the government or value to the recipient in setting charges. In *Yosemite Park and Curry Co. v. United States*,[164] for instance, the Court of Claims authorized the National Park Service to charge a concessionaire utility rates based on comparable private utility rates rather than the government's cost of production. The court believed that the IOAA guidelines were intended to avoid undercharging for governmental services, and thus to permit charges in excess of cost. If the lower federal production cost in fact reflected cross-subsidies from other federal activities, the conclusion of the court in *Yosemite Park* may be persuasive. Because the concessionaire otherwise would have had to purchase electricity from private utilities, those rates may have accurately reflected the value of the service it actually received. The court, however, did not extend its inquiries or analysis that far.

Finally, the courts are divided over how to interpret the IOAA regarding the issue of allocating agency overhead costs to a special beneficiary. Here again, the Fifth Circuit has given the broadest interpretation to permissible fees, permitting recovery of overhead and technical support costs demonstrably associated with the provision of special benefits.[165] The Tenth Circuit has taken a more conservative stance. In *Nevada Power Co. v. Watt*,[166] the court considered a statute that specifically authorized collection of "actual costs" but expressly prohibited collection of "management overhead." The court permitted the agency to collect administrative costs and "indirect

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[162] *See* Public Serv. Co. v. Andrus, 433 F. Supp. 144, 153 (D. Colo. 1977) (Bureau of Land Management reimbursement fees limited to governmental cost because "[i]t is the cost to the agency which determines the value to the recipient").

[163] This standard for limiting fees is consistent with the predominant standard in local government law that allows recovery through special assessments of improvements that return a special benefit to a limited segment of municipal residents. *See, e.g.*, McNally v. Township of Teaneck, 132 N.J. Super. 442, 334 A.2d 67 (N.J. Super. Ct. Law Div. 1975) (remanding assessment because township could not show that cost was the only factor in determining fees or that cost did not outweigh special benefit to properties assessed) *rev'd in part on other grounds*, 75 N.J. 33, 379 A.2d 446 (1977).

[164] 686 F.2d 925 (Ct. Cl. 1982).

[165] The cost of performing a service . . . involves a greater cost to the agency than merely the salary of the professional employee who reviews the application. The individual must be supplied with working space, heating, lighting, telephone service and secretarial support. Arrangements must be made so that [the employee] is hired, paid on a regular basis and provided specialized training courses. These and other costs such as depreciation and interest on plant and capital equipment are all necessarily incurred in the process of reviewing an application.

Mississippi Power & Light Co. v. NRC, 601 F.2d 223, 232 (5th Cir. 1979), *cert. denied*, 444 U.S. 1102 (1980).

[166] 711 F.2d 913 (10th Cir. 1983).

costs" that did not constitute the general costs of agency administration. Moreover, the court appeared to place on the payer the obligation to demonstrate that indirect costs assessed included an amount for the prohibited category.

D. *Additional Statutory Authority for User Fees*

1. Specific Statutes as Substitutes for Inquiries into Benefit

Although the IOAA is the most general federal user fee statute and the one that has been subject to the most litigation, a wide variety of other statutes authorize federal agencies to charge for services. For the most part, fees derived from these statutes have been directed at specific activities and have implicitly limited fee imposition to direct beneficiaries of particular services. For instance, under the National Aeronautics and Space Administration Act of 1959,[167] the National Aeronautics and Space Administration imposes fees based on a portion of total launch cost to companies that use space shuttles to launch privately owned satellites. In more mundane matters, the Land and Water Conservation Act of 1965[168] authorizes the Department of the Interior to impose daily fees for campsites and vehicle entrances to national parks. The Department of Justice also may charge individuals who seek to utilize Federal Bureau of Investigation fingerprinting services.[169] Similar programs exact fees for government services rendered in reviewing patent design applications,[170] providing grazing areas,[171] and issuing passports.[172]

In practice, the benefits criterion need receive little if any agency attention under many of these statutes. The obvious service recipient is both fee payer and main beneficiary, and the agency's outlays form a measure of the benefit rendered. The agencies collect fees sufficient to cover all of the programs' expenses. For example, the Department of Energy recovers from nuclear power plants all its costs of storing their spent nuclear fuel,[173] and it updates these user fees annually.[174] Similarly, under the United States Grain Standards Act,[175] the Department of Agriculture recovers from the grain industry all expenses incurred by the Federal Grain Inspection Service for inspection

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[167] 42 U.S.C. § 2460 (1973).

[168] 16 U.S.C. § 460*l*-6a (1983).

[169] 15 U.S.C. § 78(q) (1981); 7 U.S.C. § 12(a) (1980).

[170] 35 U.S.C. § 41(a) (1983); 15 U.S.C. § 1113 (1983).

[171] 1978 Public Rangelands Improvement Act, 43 U.S.C. § 1905 (1986).

[172] 22 U.S.C. § 214 (1979) (Supp. 1987).

[173] Nuclear Waste Policy Act of 1982, 42 U.S.C. § 10101-10226, § 10156 (providing for payment of fees to Secretary).

[174] Fees for Federal Interim Storage, Calendar Year 1987, 51 Fed. Reg. 43,765 (1986).

[175] 7 U.S.C. § 79(j), (l) (1980) (Supp. 1987).

and weighing services; indeed the agency states its aim is "to respond to the grain industry's need for quality service."[176]

Benefit-related activities also dominate the federal actions that the President's Private Sector Survey on Cost Control identified as susceptible to increased fees. For instance, the Report on User Charges[177] issued by the Survey recommends initiation of or increases in charges imposed for Freedom of Information Act requests to "identifiable users," and Coast Guard services provided to "identifiable beneficiaries."[178]

Other statutes, however, do not clearly explain the relationship they create between fees imposed and benefits conferred. These statutes occasionally have been the subject of litigation to clarify inherent ambiguities in the proper basis for federal charges. In *Nevada Power Co. v. Watt*,[179] the court considered the circumstances under which fees imposed by the Department of the Interior for processing applications for rights of way on public lands would be "reasonable" as that term was used in the Federal Land Policy and Management Act of 1976 ("FLPMA"). In defining the scope of "reasonable costs" incurred through government action (and hence reimbursable under the Act) Congress provided a substantially more detailed litany in the FLPMA than in the IOAA of activities for which costs are recoverable. For instance, the FLPMA specifies that recoverable actual costs exclude management overhead but include various opportunity costs. The FLPMA, however, also requires consideration of the public benefits that arise from federal action.

In *Nevada Power*, the Tenth Circuit interpreted as mandatory facially discretionary language concerning factors relevant to the imposition of fees.[180] Regulations that set fees could be defended only by demonstration that the Department of the Interior had, in fact, considered the indicia of "reasonableness" contained in the statute. The court viewed these indicia as limiting the capacity of the Secretary of the Interior to impose on applicants all their application costs. Presumably, the statutory requirement to consider public benefit would compel some discount of total costs incurred by government. Further, the court held that regulations be promulgated only after each of the statutory indicia was considered. A review of the criteria considered most relevant by the Secretary in a given case would be inadequate. In short, the specific criteria of FLPMA constricted far more than the nebulous guidelines of the IOAA the discretion of the Department to consider indicia of reasonableness.

FLPMA also circumvents the difficult issue of determining whether specific governmental activities confer sufficient benefit on an applicant to

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[176] 7 C.F.R. § 800 (1986).

[177] REPORT ON USER CHARGES, *supra* note 10.

[178] *Id.* at 183-91 (FOIA requests); *id.* at 168-82 (Coast Guard services).

[179] 711 F.2d 913 (10th Cir. 1983).

[180] *Id.* at 920-21.

warrant a request for reimbursement. The Act, for instance, specifically authorizes reimbursement for costs incurred in the review of an environmental impact statement.[181] Either Congress was willing to impose these costs despite the absence of any benefit to the applicant, or Congress resolved the debate over environmental impact statements by concluding that they did return reimbursable benefits to applicants. The court in *Nevada Power*, however, did not decide between these interpretations. If it had determined that benefits were inadequate to trigger reimbursement, the court would have had to decide the constitutional issue reserved by the Supreme Court—whether Congress could confer on agencies the power to levy non-benefit taxes. Instead, the court distinguished the Supreme Court cases and held simply that the "reasonableness" criterion of FLPMA required discounting the cost of any environmental impact statement by the public benefit that it conferred.[182]

2. The Passing of "Benefit" Related Fees

Recently, Congress has considered elimination of explicit requirements, such as those found in the IOAA, that fees be linked to particular benefits. Instead, Congress has authorized fee collection tied to a percentage of agency budget. Under the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), for instance, Congress requires the Nuclear Regulatory Commission ("NRC") to collect fees from licensees in an amount up to 33% of the costs incurred by the Commission in any fiscal year.[183] The legislative history indicates that these charges were intended to be predicated on a standard "separate and distinct from the Commission's existing authority" under the IOAA in order to permit fuller recovery of the costs of regulation.[184] The NRC has indicated that this authority will permit it to increase its fees from previous levels of $37 million per year to one-third of its annual budget, or $134 million for Fiscal Year 1987.[185]

Similarly, COBRA amended the Communications Act of 1934 to prescribe charges for certain regulatory actions of the Federal Communications Commission that might have been suspect under the IOAA.[186] For instance, the

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[181] Federal Land Policy and Management Act of 1976, 43 U.S.C. §§ 1701-1784 (1986 & Supp. I 1987).

[182] *Nevada Power Co.*, 711 F.2d at 933.

[183] *See* Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272 § 7601, 100 Stat. 117, 146 (April 7, 1986).

[184] 132 CONG. REC. H879 (daily ed. Mar. 6, 1986) (statement of Rep. Gray); 132 CONG. REC. S2725 (daily ed. Mar. 14, 1986) (statement of Sen. Simpson).

[185] Annual Fee for Nuclear Power Reactors Operating Licenses or Applications and Major Materials Licenses and Conforming Amendment, 51 Fed. Reg. 24,079 (1986) (to be codified at 10 C.F.R. §§ 51, 71) (proposed July 1, 1986) [hereinafter Annual Fee for Nuclear Power Reactors].

[186] Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. No. 99-272 § 5002, 100 Stat. 117, 117-21 (April 7, 1986).

Commission fees as passed are based primarily on the cost of providing particular services rather than on the value of the benefits conferred on regulatees.[187] Although the Commission contended that it was not imposing fees under statutory authority for benefits conferred on the public at large, COBRA presumably avoids the difficulties of proving benefits and allocating costs that were imposed by the requirements of the IOAA.[188]

These statutory provisions have various implications for realization of optimal levels of government services. Insofar as authorizations such as those conferred on the NRC disavow any linkage to particular benefits, there is no reason to believe that fees will induce an appropriate level of regulation or request for government services. To the contrary, any relationship between fees imposed and appropriate levels of services provided may be wholly coincidental. The user fee in this situation becomes largely a revenue-raising device imposed on particular recipients of government services. Such a device, although denominated a charge or user fee, is in essence a redistributional tax. This conclusion does not necessarily condemn the exaction, as Congress has the constitutional power to levy taxes.[189] From a political perspective, however, denomination of the revenue raising device as something other than a tax is, at best, disingenuous.

The authorization for new FCC fees may lie on a different foundation. As recounted above, much of the judicial interpretation of the IOAA relates to FCC attempts to comply with that statute. On each occasion, the Commission's attempts to impose and allocate fees were frustrated by failure to comply with technical requirements. The effective result was that the Commission had no substantive authority to impose fees for its regulatory activities. To the extent that the new statutory fees attempt to avoid the technical rigors of the IOAA while still requiring some linkage between the fee and the cost of particular services, these fees may be perceived as "rough guesses" of what would be permissible under the general statute. If this is true, the new fee schedule may generate efficient results insofar as it recaptures from reduced transaction costs related to more exacting calculations what it loses through imprecision.[190]

Even if this justification held true initially, the rigidity of statutory fee schedules may cause subsequent deviations from this efficiency model. If the Commission were to alter its requirements for a particular approval, the costs of processing applications for such approvals might increase or decrease. Nevertheless, an approval-based fee schedule such as the one

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[187] *See* Fee Collection Program, *supra* note 19 at 25,794 (adopting fees as mandated by Congress).

[188] *See id.*

[189] *See supra* notes 93-101 and accompanying text.

[190] *See* Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65 (1983); Ehrlich & Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974).

enacted would not adjust for the alteration in Commission costs. Instead, the Commission would have to return to Congress for any changes in the statutory schedule. While COBRA requires fee adjustments to occur in accordance with the Consumer Price Index, there is no reason to believe that FCC costs will change in direct proportion to that standard. Even if there currently exists a rough trade-off between calculation costs and fees in excess of benefits, that trade-off cannot be expected to continue through the long term.

Most recently, Congress has eschewed any attempt to approximate the private benefits component of the user fee calculus. Instead, the Omnibus Budget Reconciliation Act of 1986[191] permits broad discretion to recover total costs of an agency's budget. Section 3401(1) of the Act requires the Federal Energy Regulatory Commission ("FERC") to "assess and collect fees and annual charges in any fiscal year in amounts equal to all of the costs incurred by the Commission in that fiscal year."[192] No explicit link is required between fees imposed and benefits conferred. Instead, section 3401(2) sets the standard that fees or charges "shall be computed on the basis of methods that the Commission determines, by rule, to be fair and equitable."[193] It is, of course, conceivable that the Commission would attempt to meet that criterion by imposing charges in proportion to private benefits conferred.[194] Because the legislation requires full cost recovery, however, limitation of fees to benefits could exist only if FERC performs no regulatory activities that accrue to the public. This, of course, is the very situation that Justice Douglas in *National Cable Television* refused to assume because it would render the regulatory scheme—presumably predicated on public benefit—a "failure."[195] Beyond Justice Douglas's rhetoric, the economic theory of the previous section[196] suggests that some regulatees consequently would cross-subsidize activities that confer public benefits. This in turn would deter fee payers from engaging in otherwise efficient levels of private activity.

The same legislation approved the imposition on importers of a 0.22 percent ad valorem fee by the United States Customs Service for processing imported merchandise.[197] The ad valorem fee ultimately is intended to cover federal appropriations to the Customs Service for salaries and expenses

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[191] Pub. L. No. 99-509, 100 Stat. 4599 (1986).

[192] *Id.* at § 3401(a)(1); 100 Stat. at 4615.

[193] *Id.*

[194] In fact, the FERC proposal would base charges on annual volume of energy transported. Annual Charges Under the Omnibus Budget Reconciliation Act of 1986, 52 Fed. Reg. 3128 (1987) (to be codified at 18 C.F.R. §§ 375, 382) (proposed Feb. 2, 1987).

[195] National Cable Television Ass'n v. United States, 415 U.S. 336, 343 (1974).

[196] *See* SECTION I, *infra*.

[197] *See* Ad Valorem User Fee Amendments, 51 Fed. Reg. 43,188 (1986) (to be codified at 19 C.F.R. § 24.23).

incurred in conducting commercial operations. While the commercial operations limitation suggests that fees will be assessed only on activities that produce private benefits, there is little reason to believe that customs expenditures on any given merchandise necessarily correlate to the value of that merchandise, and even less reason to believe that private benefits consistently reflect 0.22 percent of that value. To the extent that these relationships do not exist, the spectre of cross-subsidies arises once again.

III. User Fee Implementation Issues

Our concern to this point has been with the economic and legal theories that underlie federal user fees. In this section, we turn to a more detailed investigation of whether those fees that currently exist or that have been proposed conform with the principles that derive from theory. In particular, we investigate whether administrative and interpretive issues that necessarily arise in the implementation of user fees might endanger a fee program's objectives.

Our discussion in this section draws on studies of user fees, proposed and existing agency rules, and interviews that we have conducted with personnel from a variety of agencies and affected interest groups.[198] Because our objective in this section is to analyze the propriety of fees in general, we examine particular issues that raise a representative set of questions about fees. We do not concentrate on particular agencies or particular kinds of fees, but rather consider a cross-section of issues related to areas in which there is room for substantial deviation from rules that would emerge from the underlying theory. We do not cover all fees imposed by the federal government, but rather investigate issues of implementation, definition, and disposition that have generated substantial disparity among agencies.

A. *Procedural Constraints*

1. Limitations on the Ability to Impose Fees

Even an agency that desires only to impose fees that reflect benefits to identifiable users may encounter substantial legal or practical difficulties in implementation. For instance, costs of perfectly administering a user fee structure may exceed the revenues to be gained. In this situation, the conflict between revenue enhancement and allocative efficiency goals may best be resolved through less exacting estimation of agency costs or user benefits. Assuming that allocative efficiency remains the primary goal of a user fee

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[198] Personnel in the following agencies and departments have been kind enough to meet with us: Federal Communications Commission, Department of Transportation, United States Customs Service, Department of the Interior, Nuclear Regulatory Commission, Environmental Protection Agency, Food and Drug Administration, Federal Energy Regulatory Commission.

schedule, however, the mechanism employed to compensate for administrative or legal difficulties should be designed to minimize deviations from results that would be obtained without those obstacles. Nevertheless, achieving allocative efficiency may be frustrated by the possibility that any compromise system may generate undesirable and nonquantifiable by-products that adversely affect both the allocation of governmental services and the social benefits attained through those services.

Recent developments in the Environmental Protection Agency concerning user fees illustrate the problem. Section 26(b) of the Toxic Substances Control Act ("TSCA") authorizes the EPA to impose fees on persons submitting data and seeking EPA review of various notices, such as premanufacture notices (PMNs), significant new use notices, and exemption applications. TSCA, however, imposes statutory limits on these fees, and the limits—$2500, but $100 for a "small business concern"—are substantially below actual agency costs expended in the review process.

In light of this low statutory fee ceiling, and recognizing the unavoidable administrative costs associated with user fees, one basic issue is whether any fee collection effort makes much sense. Certainly low statutory fee ceilings seriously constrain the utility of a fee mechanism. Working within this constraint, EPA has considered two alternative fee structures, realizing that neither would allow full recovery of agency costs. The first alternative is a flat fee set at the maximum level allowed by statute. Flat fees reduce administrative costs, as each submitter within a class, "small business concern" or all others, would be charged the same amount. Flat fees would also maximize authorized revenues, as each submitter would be charged the full statutory fee. A flat fee may have the drawback, however, of discouraging some firms from submitting premanufacture notices or other documents that produce information of public benefit. Indeed, the EPA has suggested that profits on some substances may be sufficiently marginal that the imposition of an undifferentiated fee could discourage chemical innovation and constitute a bias against new business ventures and in favor of existing ones.[199]

The second alternative is a differential fee keyed to a variety of factors. Agency resources expended on review may vary substantially from submission to submission, depending on the inclusion of test data, reactivity levels in the chemicals concerned, and the expected volume of production. Also, processing applications may require additional resources if firms request that their submissions be treated as confidential business information. In such cases, EPA expends resources protecting the interests of the submitter. Varying fees would have the converse costs and benefits as flat fees: maximum fee revenues would not be realized, but firms would be less deterred from innovation.

A flat fee in the maximum amount might not cover full EPA costs in any of

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[199] *See* EPA, PMN USER FEES BACKGROUND PAPER (June 9, 1986).

these cases, and it would fail to distinguish between those firms that impose greater and lesser burdens on the agency. Firms would have little incentive to economize on the burdens their submissions impose on the agency. Although some free riding by submitting firms could be expected in any event, it might be minimized by reducing fees to those firms that required relatively few EPA services. A plausible alternative basis for such differentiation could be expectations that fee levels would loom large relative to potential profits. Despite these potential benefits, any such system would substantially increase administrative costs.

It would be difficult to make a sound choice between flat and differentiated fees using only quantitative information about consequences. Too many important factors, such as the lost benefits of discouraged research, the utility of confidential business information, the public benefits of PMNs, are simply nonquantifiable. Resolution of these difficulties may well have to turn on judgment about ambiguous or unpredicted consequences.

The problem of low statutory ceilings on user fees is common to many program areas. Seven federal land management agencies—National Park Service, Forest Service, Fish and Wildlife Service, Bureau of Reclamation, Bureau of Land Management, Corps of Engineers, and Tennessee Valley Authority—all administer recreational areas at which user fees logically could be collected. Congress, however, has sharply restricted the role of recreational fees, primarily through a succession of amendments narrowing the user fee authority established by the Land and Water Conservation Fund Act of 1965.[200] That act allows various types of fees (such as park entrance fees and camping fees), and provides fee-setting criteria that resemble those of the IOAA. But fees are not suitable for all sites; if a park has multiple entry points and relatively few visitors, for example, collecting fees would be quite costly.[201] Yet many facilities without multiple entry points are congested, and maintenance funding is severely constrained—conditions well suited to user fees. Nonetheless, entrance fees are expressly prohibited or limited for many recreational areas, including congested facilities, where higher fees would be efficient. It is unclear whether these restrictions on fees are predicated on a Congressional perception that some fairness considerations preclude fees that would serve allocative efficiency goals or whether

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[200] *See* PARKS AND RECREATION, *supra* note 12, at 1-2 (letter to Chairman of Subcommittee on Public Lands, Reserved Water and Resource Conservation, Committee on Energy and Natural Resources, United States Senate from Director, Resources, Community, & Economic Development Division, General Accounting Office).

[201] In such a situation, not only would staffing of multiple entry points raise costs, but lack of congestion would also indicate that marginal costs imposed by additional users would be minimal, so that user fees would induce suboptimal use. *See* R. MUSGRAVE & P. MUSGRAVE, *supra* note 21, at 56 (discussing market failure due to nonrival consumption).

these restrictions result from political influence of those who would be subject to fees.[202]

2. Fee Collection Procedures

Once the government determines to impose a user fee for a particular service, various details remain to be decided concerning the collection of the charges. The legal criteria for a user fee generally offer considerable flexibility to the agency in addressing such details. Some arrangements, however, may better achieve the underlying goals of the user fee program, or, indeed, other objectives of the fee-imposing agency. Fee collection procedures, for instance, may clarify or obfuscate appropriate signals to beneficiaries concerning the use of government services. In particular, whether the fee is collected before or after the service is rendered may affect the demand for the service, even though its objective utility remains constant.

The Coast Guard, for instance, has for some time sought, without success, Congressional approval of user fees for recreational and commercial boaters. A fee for rescue of imperiled boaters could be collected by assessing each boater a fee at the time of registration. The fee would reflect the expected cost of rescue—the cost of actual rescue discounted by the probability that rescue would be necessary. Alternatively, the Coast Guard could impose its fee ex post, assessing substantially greater charges on those few boaters who actually became imperiled. On the (arguable) assumption that even those who never utilize Coast Guard services benefit from them, either of these collection plans is defensible. They might, however, create disparate incentives for boaters. Ex ante payments, like insurance premiums, could create moral hazards by inducing individuals who had already incurred costs of rescue to engage in riskier activities. This possibility initially suggests that ex post collections might be favorable. Nevertheless, very few would tolerate a government agency either failing to rescue because the potential rescuees could not pay the cost of the rescue or attempting subsequently to obtain compensation from rescuees. Even those who recognized the allocative efficiency gains of such a program might raise opposition based on what we have described above as a fairness concern—a belief that government has the obligation to assist endangered citizens wholly apart from the individual's ability (or even unwillingness) to pay. Thus, even where potential feepayers rationally determine ex ante that payment for rescue services is unwarranted relative to the expected loss of nonrescue, social values seem to shift markedly in the ex post situation. Recent examples of earthquake victims, construction accident victims, and children caught in empty wells reveal our willingness to spend vast resources on an

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[202] *See infra* notes 253-60 and accompanying text.

endangered identifiable life that were considered unwarranted by an ex ante calculation of risks to statistical lives.[203]

Not all decisions concerning collection of fees are as dramatic as Coast Guard rescue. The Environmental Protection Agency has encountered a similar problem about timing of collection with respect to fees payable for review of PMNs.[204] Several of the substances for which PMNs are desirable never achieve successful commercial marketability. The introduction of additional "up front" charges may induce manufacturers to eschew PMNs or to limit their research concerning substances with a relatively low likelihood of commercial success. The EPA, therefore, has considered deferring the payment of a fee until notice of commencement of production. The agency suggested that this timing would impose less of a burden on innovation.[205] Yet, the agency simultaneously recognizes that fee deferral would substantially reduce revenues, in that only 45 percent of all PMNs it receives ultimately reach commercial production. The effect would be to fill the gap with tax revenues, thereby cross-subsidizing manufacturers. Nevertheless, the information obtained by EPA in the process of analyzing substances for review constitutes a public good, the cost of which should be publicly financed.

The issue whether to impose fees ex ante or ex post may also properly depend on agency familiarity with the product or service submitted for government action. Some activities may entail tasks sufficiently repetitious that a standard fee exacted at the outset corresponds to the effort actually expended. Administrative costs also would be minimized by a flat fee imposed in each individual case. Furthermore, benefits would closely match burdens. For instance, if license applications generally contain the same quantity and quality of information, an agency would be able to calculate in advance the approximate processing costs. This process would reduce the risk of nonpayment and would minimize the costs of collecting from delinquents. Several agencies, therefore, have established fee schedules that link fees to particular tasks.[206]

Where the costs incurred by an agency vary substantially each time the task is undertaken, however, fees may better be assessed according to actual time expended. The NRC, for instance, perceives the inspection of each plant as a discrete task. Because of the various structural, engineering, and design differences among nuclear power plants, inspection or licensing ap-

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[203] T. SCHELLING, *The Life You Save May be Your Own*, in CHOICE AND CONSEQUENCE 115-18 (1984); Mishan, *Evaluation of Life and Limb: A Theoretical Approach*, 79 J. POL. ECON. 687, 693 (1971).

[204] Premanufacture notices contain information about a new chemical product required by the EPA before a firm can manufacture the product commercially.

[205] *See* EPA, *supra* note 199.

[206] This route has been followed by the FCC and the NRC. *See* Fee Collection Program, *supra* note 19, at 25794 (FCC); Annual Fee for Nuclear Power Reactors, *supra* note 185, at 24082 (NRC).

proval time may vary significantly from plant to plant. Thus, the NRC requires its employees to keep substantial records. These time records are ultimately calculated into a final bill that is presented to the regulatee at the conclusion of the Commission's task.

Additionally, from the perspective of revenue enhancement, ex ante collections seem superior to ex post collections insofar as they minimize the risk of nonpayment. The collection system potentially could be linked to an existing system of collection for registrations. For example, if one early stage of registration—of a boat or airplane, for example—already exists, a user fee for subsequent service, such as rescue or navigational maps, could be collected simultaneously.[207] Any ex post system might require an additional level of administration.

One promising intermediate possibility is a two-part user fee now under study by the Environmental Protection Agency for its pesticide regulatory services.[208] The agency's pesticide activities entail, among other things, two cost elements: administrative costs of processing an application to register a new pesticide (registration is necessary before a producer can market a new product), and science review costs arising in part from the firm's initial data submission and in part from later developments that raise new environmental risk questions. The user fee could be structured as a one-time applicant fee covering administrative costs, coupled with an annual fee[209] covering science reviews. The annual fee could be either flat, with all current producers sharing that year's total science review cost, or differentiated, reflecting the relative completeness of submitted data bases and EPA's cost incurred to determine the risks and benefits by certain classes of chemicals. EPA believes such a two-part user fee could have both efficiency and fairness advantages; but this gain would not be costless, as implementation complexities would rise.

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[207] If much time passes before service is provided, an adjustment might be advisable to reflect forgone earnings on the fee.

[208] *See* Regulations for the Imposition of Fees for Certain Activities Conducted Under the Federal Insecticide, Fungicide, and Rodenticide Act, as amended, 51 Fed. Reg. 42,974, 42,979 (1986) (to be codified at 40 C.F.R. § 152) (considering a two-part approach to recover costs of pesticide regulatory services).

[209] Annual payments are a feature now of some licensing/inspection programs, but they are not always interpreted as user fees. The Federal Energy Regulatory Commission, for example, distinguishes between user fees, adopted under the IOAA and keyed to applications, and annual charges adopted under other statutes, mainly the Federal Power Act. The latter do not have a clear "benefits received" emphasis. Other agencies make no such distinctions. As called for by the Consolidated Omnibus Budget Reconciliation Act of 1985, annual payments termed user fees are collected by the Department of Transportation from the pipeline industry to cover the cost of the Department's pipeline safety program. The fee is based mainly on pipeline mileage rather than on any more precise estimates of the incidence of either costs or benefits. Pipeline Safety User Fees, 51 Fed. Reg. 46,975 (1986).

B. *Application of the "Benefit" Criteria*

1. The Breadth of "Benefit"

Perhaps the greatest disparity among—and often within—agencies investigating the utility of user fees lies in deciding whether a "benefit" is sufficient to support a fee. All agencies require identifiable beneficiaries to assure a fee's propriety.[210] Nevertheless, agencies vary substantially in their willingness to discern the relevant benefit.

The potential for disagreement over the "benefit" issue is perhaps best represented by a dramatic recent shift in position by the Food and Drug Administration ("FDA"). From the very outset of the IOAA, FDA officials opposed the imposition of user charges for new drug approval activity. The agency firmly maintained this position in the face of recurring efforts by the Bureau of the Budget, currently Office of Management and Budget, to induce the agency to enlarge the role for user fees. Throughout this period, the FDA contended that the IOAA did not authorize it to charge fees for activities, such as new drug approvals, governed by the Food, Drug, and Cosmetic Act. The rationale for this position appeared to be threefold. First, the agency was not operating in a field—such as portions of the communications industry—susceptible to natural monopoly. Thus, regulation could not be said to protect the regulatees against competition and against natural monopoly's chaotic consequences. Second, the General Counsel of the agency contended that interpretations of the IOAA, in specifying certain activities for which the FDA could impose charges, impliedly precluded the imposition of fees for other services, even those that might otherwise have been authorized under that legislation.

These two arguments were buttressed by the third, and most basic, contention, namely that FDA activities were intended to protect the general public from impure or ineffective products.[211] As long as the public in general constituted the primary beneficiary of FDA activity under the IOAA, the FDA maintained that no fee could be imposed on regulated companies even for incidental benefits that they might receive from regulation. Instead, any benefits, whether public or incidental, would be funded from tax dollars. The FDA, however, did more than interpret the IOAA. The agency opposed numerous requests, mainly from the Office of Management and Budget, to draft legislation explicitly authorizing the application of user fees to FDA activities.[212]

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[210] *See supra* notes 116-20 and accompanying text.

[211] Thus, a 1983 FDA study on user fees concludes:

> The legislative history of the Food, Drug, and Cosmetic Act leaves little doubt that the American citizenry was intended by Congress as the primary beneficiary and without them [sic] as the primary beneficiary, it is unlikely that Congress would have passed the Food, Drug, and Cosmetic Act of 1938 or its major amendments of 1962.

USER CHARGE STUDY, *supra* note 13, at 40.

[212] *See id.*

The FDA position has undergone substantial metamorphosis. The agency currently subscribes to the broad view that any activity—and review of applications for new drug approvals in particular—performed in order to permit a regulatee to satisfy statutory prerequisites constitutes a sufficient benefit to permit imposition of a user fee under the IOAA. The agency takes the position that its regulation provides a more orderly marketplace for drug manufacturers. Natural monopoly conditions do not exist, so regulation is not needed to avoid the turbulence that arises when multiple producers attempt to occupy a market susceptible to natural monopoly. Rather, the FDA contends that federal regulation increases consumer confidence in the effectiveness of drugs on the market. Public safety, in this view, redounds to the benefit of the manufacturers, as they can more readily convince the public to consume their products. The existence of public benefit, therefore, does not preclude the imposition of fees whenever private benefits materialize that are either "incidental to" or the driving force of public safety regulation.

Indeed, the current FDA view discerns sufficient manufacturer benefit to permit imposing fees for new drug approval applications that are ultimately rejected. The FDA reasons that by rejecting a drug that would have produced adverse effects on consumers, the agency is in fact rescuing the manufacturer from subsequent litigation costs.

If FDA regulation does benefit private firms as the above arguments suggest, then one would anticipate that manufacturers would approve of, or even encourage, such regulation. If fees reflected these benefits, one would expect the manufacturers to be willing to pay for these services up to an amount equal to the benefit received. Nevertheless, drug manufacturers do not uniformly rally to the defense of user fees. Some manufacturers support fees if they will expedite the FDA approval process, but not if fee revenues are offset by cutbacks in agency appropriations. Of course, given a prior history of relatively "free" regulation, it is not surprising that the industry would like to protect the subsidy it has received for any of the benefits that it receives from regulation. Thus, the absence of a movement within the industry in favor of fees is, at best, evidential on the issue of industry benefits.

Even where regulatees do agree to pay fees, their acquiescence does not necessarily reflect the conferral of benefits. For instance, the EPA has encountered some industry support for user fees to be imposed for pesticide re-registration applications. The industry believes that such fees would put pressure on the agency to expedite the re-registration process. These fees, however, are not expected to bear any relationship to the benefits enjoyed by the industry as a result of shorter delays. Nor are they expected to reflect pesticide-specific calculations of costs incurred by EPA in the review process, an alternative means of defining "benefit." Instead, an anticipated re-registration fee of some $150,000 (contained in legislation that ultimately

did not pass in the 99th Congress)[213] reflected a compromise reached among the agency, environmental groups, and the industry in an effort to eliminate the re-registration backlog.

The FDA's current conception that regulatees receive a benefit even when a statute mandates agency action is consistent with the dominant definition throughout federal agencies. Certainly the NRC, which received such a broad grant of fee-imposing authority in the Fifth Circuit, subscribes to this theory; so does the EPA. For example, in support of its proposal for IOAA-based registration fees for new pesticides[214] (as distinct from the re-registration legislative issue discussed above), EPA explains the connection between fee and benefit in terms similar to those now embraced by the FDA: "registration is a license that allows the registrant to market a product."[215] The EPA's proposal is fairly narrowly drawn in that the applicant would be charged a fee intended only to defray the costs—direct, indirect and overhead—clearly attributable to processing the type of registration application submitted; fee revenues would amount to about one-quarter of the total costs of the agency's pesticide activities, $18 million out of $67 million, annually.[216] In requesting comment on possible future approaches for collecting post-registration costs, the EPA has indicated that a broader effort may lie ahead. The corresponding concept of benefit to the applicant would be that these other agency activities "allow pesticides to remain on the market."[217]

A rather different consideration arises in a recent FERC rulemaking concerned with electric utility rate filings.[218] The Commission was responding to arguments of utility companies that a user fee should not exceed the benefit—mainly revenue increases—a utility derives from approved rate changes. The Commission believes that, under the IOAA, "fees are properly based on the costs this agency incurs" and not "on the value of the service to the applicant," pointing out that "the IOAA requires agencies to be as

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[213] H.R. 2482, 99th Cong., 2d Sess. (1986).

[214] Regulation for the Imposition of Fees for Certain Activities Conducted Under the Federal Insecticide, Fungicide, and Rodenticide Act, as amended, 51 Fed. Reg. 42,974, 42,975 (1986) (to be codified at 40 C.F.R. § 152) (recognizing that pesticide applicants and registrants receive certain benefits from EPA's registration activities, and proposing to implement fees to make the pesticide registration program as self-supporting as possible) (proposed Nov. 26, 1986).

[215] *Id.*

[216] *Id.*

[217] *Id.* at 42,974.

[218] *See* Fees Applicable to Electric Utilities, Cogenerators, and Small Power Producers, 51 Fed. Reg. 35,347, 35,349 (1986) (to be codified at 18 C.F.R. § 381) (clarifying issues raised by the FERC final ruling of Oct. 3, 1986, which established fees under the IOAA for services the FERC provides to electric utilities, cogenerators, and small power producers) (proposed Oct. 3, 1986).

self-sustaining as possible."[219] This position appears compatible with our efficiency criterion, so long as fee payers are under no obligation to apply for a rate change.

Notwithstanding a broad construction of "benefit," the term should not be employed, and user fees should be avoided, when the payer group receives no demonstrable advantages over the general public in the provision of a particular government service. In such a situation, user fees serve as pure cross-subsidies to the public at large and thereby induce underuse by the payer group of the service. For instance, there recently have been suggestions that the U.S. Travel and Tourism Administration, a federal agency that promotes tourism in the United States, be funded through a "user fee" imposed on tickets for international air travel.[220] If the distinct beneficiaries of the agency action are hotels and restaurants that cater to international tourists, and American citizens traveling outside the United States do not occupy those restaurants and hotels, U.S. fee paying citizens would receive no benefit from the service distinct from the benefit to particular business groups or the American public at large. Such a fee therefore would seem particularly inappropriate.

2. The "Benefits" of Involuntary Requirements

The benefits received by regulated entities seem more attenuated when the presumed beneficiary ostensibly receives no positive return from compliance with the regulation. Perhaps the starkest example of this form of benefit is an environmental impact statement ("EIS") requirement that must be satisfied before a number of actions may occur. We take as our example the need to obtain an EIS prior to constructing a pipeline. The EIS provides information of value in determining whether the impact on the environment is sufficiently deleterious to warrant stopping of a proposed project.

It first would appear that the immediate beneficiaries of this requirement are those who live in the area affected by the pipeline. Arguably, the benefits are even broader. If we believe that conservation or preservation of wildlife areas or virgin land likely to be invaded by such a project produces substantial benefit spillovers, then the EIS that protects those interests may constitute a public good typically financed through tax revenues. Indeed, the one group that appears not to receive substantial net benefits from the EIS paid for by the company that seeks the pipeline would appear to be consumers of products that flow from the pipeline, as they ultimately will bear the additional costs for governmental review of environmental impact.

By this line of reasoning, it is difficult to construe the EIS as a benefit on the regulatees who must comply with the requirement. The benefit rather is

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[219] *Id.*

[220] *See* Webb, *One More Dollar for the Road*, Wash. Post, Jan. 19, 1987, at A17, col. 3 (proposing a one dollar fee on every ticket written for trips to and from the United States on airplanes and cruise ships).

to residents of the area where pipeline-caused environmental damage may occur, and broader segments of society that value environmental preservation. Placing a user fee on the pipeline would not represent payment for a beneficial service received by the pipeline owner. This is true whether or not the pipeline can pass along the fee to its customers.

Nevertheless, a broader concept of benefit that takes into account societal risk leads us to quite a different conclusion. Namely, these companies should pay user fees that reflect at least the costs related to governmental review of environmentally suspect projects and, arguably, fees that reflect the expected amount of environmental damage. Under the efficiency rationale for user fees, the primary concern is to ensure that a private activity be undertaken only when its marginal social benefits outweigh its marginal social costs. Presumably the EIS can be helpful in performing that calculus. If the information developed through analysis of the EIS redounds to the benefit of the public at large, the costs incurred in undertaking the analysis should be borne through the tax system. The information, however, is required only because a private firm proposes a project and anticipates a net benefit from it. Moreover, *not* imposing a fee could encourage a larger project (with greater environmental risk) than is efficient. In these cases, there may be a sufficient link between the governmental service and a private benefit to support a user fee.

This same rationale appears to underlie more traditional user fees imposed by local governments. Localities have, with some frequency, conditioned parades or rallies on the payment of fees intended to cover the costs of additional municipal services.[221] Although these services benefit those involved in the public display—for example, by protecting them from hecklers[222]—their primary function appears to be assisting those inconvenienced, either by re-routing traffic, or cleaning up after the event.[223] Thus, the fee collected from those who use the public ways alleviates the costs imposed on the public at large by that use. Although such fees have been struck down as constitutionally impermissible because they interfere with activities protected by the First Amendment,[224] presumably the constitutional issues

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[221] *See* Neisser, *supra* note 105, at 268 (noting that license fees ranging from $5 to $3000 have been charged with Court approval when the government permits a peaceful assembly, and the amount of the fee relates directly to the actual costs of administering the licensing system).

[222] *Id.* at 334.

[223] *Id.* at 333.

[224] *See* Central Fla. Nuclear Freeze Campaign v. Walsh, 774 F.2d 1515, 1523 (11th Cir. 1985) (holding that city ordinance which requires persons wishing to use city streets and parks for demonstrations to prepay an amount of costs for additional police protection as determined at the discretion of the chief of police violates the first amendment), *cert. denied,* 106 S. Ct. 1637 (1986); Collin v. Smith, 447 F. Supp. 676, 685 (N.D. Ill.) (holding that an ordinance requiring groups of fifty or more persons seeking to parade or assemble in village to obtain liability insurance of at

would not have been reached had the fees been deemed not to confer "benefits" on the payers.

The approach generally taken by agencies in this situation reaches a similar result but through different reasoning. The Department of the Interior, for example, takes the position that:

> environmental studies that must be performed to grant a permit are an integral part of the permit granting process and bestow a special benefit on the permit recipient; however, the studies also have obvious incidental public benefits. . . . [T]he cost of providing public benefits incident to a private benefit may be recoverable and need not be separated from the private benefit.[225]

More problematic is the issue of whether the user fee should reflect costs related to the actual environmental harm of the project, in addition to the processing costs of determining what that harm will be. Again, efficiency requires that all costs be recognized in deciding whether to undertake the project. Such an internalization process could be ensured by any of three routes. First, victims who suffer adverse effects from the project could be permitted to adjudicate claims against the private company through the tort system. Second, government could perform the cost-benefit calculus and regulate the activity accordingly, for instance through licensing standards. Third, government could impose user fees that reflect the expected environmental harm.

The use of fees in this situation, although administratively complex, would have the advantage of forcing consumers of the project—those who use the products that flow from the pipeline—to pay all of the costs involved with their use. The firm presumably would pass on the cost of fees to its customers, and they, accordingly, would decrease their demand for the relevant products. Fees could then effectively deter individual usage that caused environmental harm in excess of customers' benefits. Additionally, user fees might be superior to litigation in situations where environmental injuries were either diffuse—small injuries to large numbers of victims—or were primarily threatening to future generations.[226] Each of these situations con-

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least $300,000 and property damage insurance of at least $50,000 was unconstitutional), *cert. denied*, 439 U.S. 916 (1978); *see also* Cox v. New Hampshire, 312 U.S. 569, 577-78 (1941) (holding that statute which authorized licensing of parades and established a range of fees was constitutional when the fee was imposed to meet the expenses incidental to the statute's administration and to the maintenance of public order for the licensed event); *cf.* Murdock v. Pennsylvania, 319 U.S. 105, 113 (1943) (holding that municipal ordinance requiring distributors of religious material to pay a flat license fee as a prerequisite to conducting their activities is unconstitutional because it is a tax on the exercise of a privilege granted by the Bill of Rights).

[225] UNITED STATES DEPARTMENT OF THE INTERIOR, DEPARTMENTAL MANUAL, Part 346, § 2.3B, 2.3B(1) (guidelines for identifying recoverable programs).

[226] Where injury is diffuse, the prospect of free riding may deter any victim from instituting legal action. The victim will receive the same benefits (in the form of an

stitutes a practical impediment that discourages victims from bringing litigation. An appropriate internalization of costs would require one of the alternative methods. A conceptual issue does arise in denominating this internalization process as a "benefit" that is appropriate for a user fee. The "benefit" of the fee-induced reduction in pollution initially appears to redound to the benefit of the public that would otherwise be affected. Nevertheless, effluent charges may be explained as fees imposed on activities that use the capacity of natural resources—air and water—to assimilate pollutants.[227]

User fees for applications to engage in activities that generate substantial externalities might also allow "fine tuning" of the regulatory process. An application to enter such an activity typically presents the regulatory agency with a binary choice: it can grant the application or deny it. Any judgment the agency makes about the utility of a proposed project, therefore, is limited to a statement about the existence or absence of net benefits. User fees, however, can be set in amounts that reflect more precisely the relative utility of a project. For instance, the EPA might set fees for PMNs that reflect the relative hazards of an herbicide, thereby encouraging the production of less hazardous and discouraging more hazardous products, notwithstanding that both receive regulatory approval. While similar incentives might be created through the litigation system, where plaintiffs may be able to recover for injury by demonstrating the existence of a less hazardous product, a scale of user fees could build on ex ante informational advantages possessed by private firms rather than ex post information that victims would have to exact during a costly and potentially incomplete litigation discovery process.

In order to achieve our objective of providing incentives for proper levels of the activity, imposition of user fees probably should be conjoined with a bar on individual causes of action for injury caused by the project. A contrary rule would require the private company to pay twice, once through a user fee and once to the victim. A bar on suits against the payer, of course, would require that the subsequent victim either self-insure or bring a claim against a fund that could be financed with the collected fees. The latter route would continue the general tort scheme of matching injurers with victims, but could cause difficulties where harms materialize to a degree greater than anticipated when fees were set and collected. In such a case, however, victims might either bring an action for the excess harm—a potential administrative nightmare if some claimants have already recovered full injuries against the fund when the excess harms materialize—or the government might be permitted to extract additional fees from the company to augment

injunction), or some benefits (in the form of precedent), while bearing none of the commensurate costs if some other victim initiates the action. The resulting Prisoner's Dilemma likely generates undersupply of litigation arising from diffuse harms. For a general discussion, see C. Gillette & J. Krier, Risk and Hubris (unpublished manuscript on file with authors).

[227] Mushkin & Bird, *supra* note 3, at 19-20.

the now-insufficient fund. Any such scheme would presumably introduce substantial complexity into the litigation and regulation processes. Administrative costs might be so great as to render user fees impractical, notwithstanding that they otherwise would be justified. Even if external costs are not built into user fees, however, exactions may still be warranted in amounts that reflect the government's costs incurred in measuring the amount of external harm that a given project will produce.

An additional problem arises where regulation takes the form of requiring targeted actors to alleviate the negative externality, rather than simply providing information to the government. Assume, for instance, that government imposes on auto owners an obligation to monitor auto emissions by having inspections every 10,000 miles and to pay the inspection costs. While this program may be defended on the theory used for the EIS of avoiding the imposition of external costs, this same result was presumably achieved by the regulatory requirement. Once government regulations optimally control negative spillovers, a user fee adds no efficiency implications. Indeed, because the user fee now becomes superfluous from an efficiency perspective, this situation stands on its head the logic that courts employ to permit more latitude for user fees where the underlying activity is mandatory.[228]

An efficiency case might be available in this situation if the regulation controls externalities suboptimally. If, for instance, the penalty for violating a regulation failed to deter inefficient infractions, the incentive effects of a user fee might close the gap between desirable and actual conduct. But such a justification must explain why the regulation would fail to set the regulatory standard correctly—such as imposing a sub-optimal fine—yet correctly set the user fee. Conceivably, a privileged group could successfully lobby for suboptimal penalties, yet object less strenuously to user fees that did not connote the moral opprobrium of a fine. Short of such an explanation, however, user fees for mandated activities would seem to rest on some justification, such as cost recovery, other than efficient allocation.

3. Identifiable Beneficiaries as Inappropriate Payers

Apart from the difficulty of discerning "benefit," dependence on that criterion to determine the propriety of a fee can be incompatible with the efficiency criterion. "Benefit" to the payer may exist in situations in which imposition of a fee would deter optimal production and may be absent where fees would induce optimal production.

Even where there exist identifiable beneficiaries of a government service, and the good supplied allows the beneficiary exclusive access, application of a user fee may induce underuse from a social perspective. This is likely where there exist low-cost substitutes for the good that do not require payment of a user fee, but that confer fewer external benefits. For instance, the FCC currently is authorized to impose a $6000 fee for hearings. This

[228] *See supra* text accompanying notes 119-30.

additional cost can be expected to reduce the expected gains of adjudication before the Commission and thereby increase the number of settlements. In the absence of fees for hearings, parties are more likely to litigate excessively, as they do not internalize all the costs of the procedure. Litigation, however, also produces public benefits in the form of decisions that serve as precedents for future actors.[229] Deterring litigation through additional fees, therefore, does not unambiguously improve allocative efficiency.

This same concern that fees on beneficiaries could induce suboptimal behavior has been expressed by representatives of the Department of Transportation in discussions concerning the supply of frequently updated marine and aeronautical maps. If these maps were sold on a full-cost recovery basis, prices would increase substantially. Marginal users of these maps would be less likely to replace them on a regular basis, and would thus fail to obtain the most recent information, primarily safety-related, that these maps contain. Social losses in the form of additional accidents would increase, notwithstanding that they could have been efficiently avoided if decisions were based on marginal benefits and costs to society. Of course, fully rational, self-interested mariners and aviators might recognize that the marginal private benefit of the most recent maps exceed their marginal private cost;[230] but dissonance—a denial of the dangers inherent in an activity—might interfere with an actor's ability to recognize all the costs of an activity in which one has invested substantial resources.[231] In such a case, the additional cost of maps might be viewed as too high to justify replacing the information they already possess. Apart from other social costs associated with additional accidents, underuse of maps is likely to require the expenditure of additional governmental resources for search and rescue of mariners and aviators who become endangered.

The situation is exacerbated where the alternatives to governmental services do not reflect all the costs associated with their use. In these cases, the theory of the second best, garnered from economic analysis, suggests that less safe alternatives will be substituted for safer activities that are relatively expensive.[232] The theory of the second best suggests that if it is not possible

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[229] *See, e.g.*, Landes & Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J. L. & ECON. 249 (1976).

[230] For a survey of psychological constraints on rationality, see D. KAHNEMAN, P. SLOVIC & A. TVERSKY, JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES (1982).

[231] *See* Ackerlof & Dickens, *The Economic Consequences of Cognitive Dissonance*, 72 AM. ECON. REV. 307, 308-09 (1982). Ackerlof and Dickens explain cognitive dissonance as the premise that workers choose to believe a job is safe in order to avoid constant fear or unsettling doubts about how wise it was to take a dangerous job. Under this theory, workers may consequently choose less safe practices, and observe fewer safety precautions.

[232] *See* Lipsey & Lancaster, *The General Theory of the Second Best*, 24 REV. ECON. STUD. 11 (1956).

to internalize the costs of each activity, it is not necessarily true that all possible costs should be internalized. The theory implies that legal rules predicated on internalization do not necessarily induce efficient behavior. For instance, commentators have argued that imposing strict liability on sellers of defective products may be undesirable if lessors of those products continue to face liability only for negligence, as consumers will substitute potentially riskier leased goods for purchased ones.[233] Another commentator has argued that the tort system as a whole favors older, "private," but more dangerous activities to newer, "public," but safer ones insofar as the system attaches liability only to those who engage in the latter.[234]

Second best theory suggests that less costly, more dangerous activities will be undertaken by potential recipients of governmental services who seek to avoid costs related to those services. Assume, for instance, a mariner having difficulty at sea. The mariner has three options for obtaining assistance: self-help; help from other mariners; and help from the Coast Guard. If neither the mariner nor those private individuals in a position to assist are well-trained in rescue efforts, they are likely to be less capable of conducting a successful rescue than the Coast Guard. Nevertheless, if a request for Coast Guard services triggers requests for ex post compensation, while neither of the riskier alternatives requires explicit money payments, endangered mariners may eschew the safer alternative. The result would be less efficient rescues and, arguably, more accidents.

A similar inefficiency may result if government attempts to recover fully the costs associated with generating information useful to the public. Here, again, mapping provides a helpful illustration. The Geological Survey within the Department of the Interior collects information that is subsequently translated into maps that are sold to the public. Map prices, however, reflect only the marginal costs of printing, inventory, and distribution, not the much greater cost of acquiring the information. Considering that government data cannot be copyrighted, any attempt to incorporate data collection expenses into map prices would presumably give private map printers a competitive advantage in map sales. They would be able to purchase a government map, copy it, and sell it at prices that reflected only the marginal printing price.

These possibilities could be avoided if government simply abandoned the map printing business and sold the information to private map makers. But that solution fails to recognize the mixed character of the governmentally supplied good or service. Maps themselves are private goods, the owner of which may exclude others from deriving benefits. But the information on which the map is based has aspects of a public good. Here, again, nonidentifiable beneficiaries exist, and attempting to impose costs solely on the identifiable would induce underuse of the information.

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[233] *See, e.g.*, Henderson, *Extending the Boundaries of Strict Products Liability: Implications of the Theory of the Second Best*, 128 U. PA. L. REV. 1036 (1980).

[234] *See* Huber, *The Old-New Division in Risk Regulation*, 69 VA. L. REV. 1025 (1985).

4. Manufacturers as Conduits for Public Beneficiaries

Even if the applicant for a government good or service is not considered the beneficiary of the governmental action, one might still justify imposing a user fee if the applicant is in a position to induce the true beneficiaries to internalize the costs of the products they consume. This may be the case if the applicant against whom the user fee is assessed can pass that cost along to the true beneficiaries. In this way, the latter group will bear both costs and benefits of governmental activities. Assume for instance, that consumers of drugs, rather than drug manufacturers, were considered the true beneficiaries of regulation by the Food and Drug Administration. If the costs of regulation were imposed on the industry and passed on to consumers on a dollar-for-dollar basis, the prices of drugs would reflect the governmental costs of ensuring pure drugs to the consumers. The drug manufacturers would effectively serve as a collection agency for the government. Increased prices would presumably decrease demand for drug products and hence, manufacturer revenues would decline. Nevertheless, this decline would presumably reflect elimination of the free ride that consumers were receiving when the benefits of regulation were subsidized by those who did not use drugs.

Two objections may be raised to this "conduit" argument for imposing fees on regulatees. The first is the public goods argument that we have already discussed. Those who do not use drugs may receive substantial benefits from the presence of pure drugs, such as the relatively quick containment or elimination of contagious diseases. The more nonusers realize the benefits of a service or regulation, the more difficult it becomes to justify imposing user fees on users through an industry conduit. The user fee will always bypass the external beneficiary.

Second, the conduit theory assumes a dollar-for-dollar relationship between costs imposed on the regulatee and the costs passed on to the beneficiary-consumer. The Food and Drug Administration has expressed concern that any user fee imposed on industry would be factored into a pricing process that attached a multiplier along each link in the distribution chain. Thus, if an agency assessed a manufacturer a user fee of $\$X$, the manufacturer, seeking a ten percent profit on total costs, might sell the drug to a wholesaler at a price that included 110% of the user fee. By the time the ultimate beneficiary-consumer bought the drug, the retail price would include an amount substantially in excess of the original user fee. This price, one might fear, would artificially depress demand below what would exist if the beneficiary were required to bear only the actual costs of regulation.

Economic theory suggests that this concern probably is overstated. If adding multiples to the costs of regulation would artificially depress demand, one would expect that it would cut enough into sales to depress profits. If that is true, sellers would have no incentive automatically to apply multipliers to their prices. Only where the products at issue have a relatively low elasticity of demand, as may be the case with drugs, will sellers be able to

impose multipliers without adversely affecting revenue. Even in that situation, the desire of drug manufacturers to be perceived as furthering public welfare may dampen incentives to capture all the profits available from inelasticity.

5. Benefits of Exclusive Use

In many situations, user fees are collected when an agency decides which of several applicants will be allowed to use a particular scarce resource, such as grazing rights, camping sites in popular recreational areas, airport landing rights, or segments of the broadcast spectrum. The benefit to the successful applicant is obvious, and the cost to the government of making available, maintaining, and allocating the resource may be quite small.

Often comparable resources are available for lease or sale in the private sector, and the commercial value of the resource is not difficult to establish. If the user fee is set high enough to cover only the government's operating costs, all knowledgeable parties who place a commercial value on the resource in excess of government's cost will apply for the resource. Because these applicants may offer to cover no more than the government's costs, it is unlikely that the successful applicant will be the one who values it most highly.[235] This is true to the extent that one is willing to accept market price as the best indicator of economic value and willingness to pay that price as the best indicator of relative ability to use a resource productively.

The most important opportunity cost associated with exclusive use decisions is the denial of access to that unsuccessful applicant who could have made the next best use of the service. That cost is best measured by the amount the unsuccessful applicant would be willing to pay to get the service, as indicated in comparable marketplace transactions or through an auction. Ordinarily, this sum will be larger than the agency's own budgetary outlays on this service or activity, assuming the agency is merely deciding who receives an existing resource. The efficient user fee, to be collected from the successful applicant, should be the larger of the two sums. While unsuccessful applicants for exclusive use also impose costs on the agency, they derive no benefit from the process. If an efficient fee is charged to the successful applicant, there is little advantage in charging others.

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[235] Take, as a hypothetical, a fee of $\$X$ to cover the costs of replenishing and administering federal grazing lands. The commercial value of the grazing lands is $\$(X + Y)$. Farmers A, B, and C apply for use of the lands. A is willing to pay $\$X$, covering only the government's costs. B is willing to pay $\$(X + Y)$. C is willing to pay an amount greater than A but less than B. If the government decides among A, B, and C by pulling a name out of a hat, then there is only a one-in-three chance that B, the most efficient user, will actually get to use them. Similarly, if the government were to distribute the lands on a first-come, first-served basis, B would be precluded from using the lands if either A or C bid first.

It is quite important to distinguish this exclusive use case from the case in which the government is producing a service. For the latter, such as granting a license for a new drug or pesticide, the opportunity cost is, in the main, the value of the agency staff time taken away from other agency business (or newly hired for this purpose) and can be measured properly in terms of actual staff compensation.[236]

C. *Disposition of User Fees*

At first glance, it would appear that efficiency objectives of user fees would be satisfied solely by the imposition of an appropriate charge. The ultimate disposition of a user fee, however, may also affect the efficiency of a user fee program insofar as that disposition creates incentives for agency conduct. These incentives may arise from agencies' desire to expand their budgets or from concern about the agency's relationship with its various clients—Congress, regulated groups, and the public.

Currently, the disposition of user fees varies. Those user fees based on IOAA authority flow into the U.S. Treasury's general fund, to be appropriated in the same way as are taxes and other revenues. Other user fees are earmarked for spending only on the activity generating them. This earmarking can take the form of a dedicated trust fund, aviation and highways, for example, a revolving fund, or a special fund, which differ in various ways, including the extent to which appropriations measures are involved in spending the funds.[237]

Even in earmarking situations, user fees are rarely the sole source of an activity's funding, serving instead either to supplement regularly appropriated funds or to be a partial substitute for such funds. At one extreme, user fee receipts can be offset on a dollar-for-dollar basis by cutbacks in other revenue sources, mainly appropriated tax receipts. In that situation, earmarking may have no practical effect on the level of service an agency provides. Without such offsets, service levels will generally expand and contract with fee receipts. Even then, however, other constraints—such as personnel ceilings—may exist, and annual appropriations actions may still be necessary.

The user fee principles outlined earlier in this article shed some light on the question of how fee receipts ideally should be channeled, and current

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[236] Agency personnel costs are often understated in user fee calculations in that they rarely include the unfunded liability of employee retirement, a significant cost. Letter from David K. Kleinberg, Executive Office of the President, Office of Management and Budget to Jeffrey S. Lubbers, Research Director, Administrative Conference of the United States (Mar. 20, 1987).

[237] *See* UNITED STATES ENVIRONMENTAL PROTECTION AGENCY, INTERIM REPORT OF TASK FORCE ON FEES, § 5, 5-9 (April 1986) (outlining the advantages and disadvantages of general funds, special funds, revolving funds, and trust funds as applied to EPA fee disposition options).

agency practices offer some interesting contrasts. Recall first that having the recipient pay the opportunity cost of a service is an essential feature of efficient user fees. For then the service will probably be used with the most productive results possible; low priority uses will be discouraged. If the agency determines the nature and amount of service to be offered without regard to fee revenues, user fee disposition itself is simply not an efficiency issue. It is crucial that the proper fee be paid by the consumer, but who receives it is of no significance for efficiency.

However, if the manner in which user fee receipts are allocated does affect decisions to maintain, increase, or decrease current service levels, user fee disposition will have efficiency consequences. As pointed out earlier, efficiency warrants agency program expansion if consumers are willing to increase usage of efficiently priced services.[238] Were the agency operating as a business, dependent for its continued existence on the adequacy of the fees it receives, disposition of fee revenues would be of great importance for efficiency as well as for program survival. Efficient outcomes over time likely would ensue as fee revenues guided decisions to expand or contract the level of service being provided.

But agencies do not often face the same constraints and incentives as private firms.[239] If the service cannot be expanded or contracted because of policy constraints imposed on program managers—for example, an established policy of no staff expansion—dedicated user fees are not likely to assure efficient responses to changing needs. Moreover, program managers may have objectives that incorporate factors beyond those reflected in fee levels, such as bureaucratic incentives for program growth regardless of fee economics. Finally, even if it were business-like in motivation, the agency may face physical constraints on service expansion such that no additional service would be feasible regardless of funding levels. Then an increase in fee receipts merely represents accumulation of economic rent, payment (but not receipt) of which is essential for efficient outcomes.

An additional point concerning fee receipts is important if the fee covers not only the agency's own costs of providing the service but also external costs—costs borne by society as a whole or by parties inadvertently burdened by actions associated with the government service. Such a fee recoups societal costs beyond those reflected in the agency's budget. The agency then will receive fee revenue in excess of its own service costs. The corresponding surplus over agency costs should not be interpreted as an automatic indication that additional service should be provided. In fact, the agency should not retain that surplus at all, because it represents costs borne by others. It rarely will be administratively practicable to return that excess revenue to the third parties who do bear the burden; normally the prudent

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[238] *See supra* notes 30-35 and accompanying text.

[239] *See* Cass, *Allocation of Authority Within Bureaucracies: Empirical Evidence and Normative Analysis*, 66 B.U.L. REV. 1, 36-40 (1986).

course would be to place such receipts in the Treasury's general fund for the appropriation process to allocate.

The less bearing that the size of user fee receipts has on decisions to offer more or less service, the less will user fee disposition decisions affect efficiency. Note that the key factor is not the accounting mechanism—whether fees flow into a trust fund or a special fund or the general treasury—but rather the relationship between receipts and decisions about service provision. If there is reason to believe that fees from additional sales will be offset by reductions in other appropriated resources, user fee dedication is more apparent than real.

The effects of disposition are apparent in two recent FDA proposals to collect fees in the approval process for new drugs. The FDA's rulemaking proposal of August 1985[240] envisioned user fees that would flow into the general treasury with no earmarking involved. This choice was dictated by the IOAA, under which the agency was proceeding. But in explaining the logic of the user fee proposal, the FDA added: "[I]n the current period of intense and growing concern about the size of the Federal deficit, failure to invoke currently available law to assess these charges to help reduce the size of the deficit could be viewed as not fully responding to the agency's public trust."[241] Here the law would not permit earmarking user fee receipts, however efficient that might be. Instead the agency defended its proposal in part by embracing another criterion, the one we referred to earlier as revenue enhancement.

The absence of explicit dedication provisions, of course, does not necessarily mean that user fee revenues will have no positive net effects on agency resources. In the annual appropriations process, an agency might prevail in arguing for budget increases reflecting the Treasury's new fee-based revenues. But this result is uncertain, and one firm in opposing the FDA proposal commented that:

> There is no correlation apparent between federal income from the user fees and the future improvement of the [new drug approval] process, because it appears the FDA will derive no benefit from having the fees in place (and indeed will have a net processing cost outflow . . .).[242]

The possible net cost outflow reflects the fact that the agency would incur some administrative costs in any new user fee program even if its budget appropriation does not rise.

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[240] *See* New Drug and Antibiotic Application Review; Proposed User Charge, 50 Fed. Reg. 31,726, 31,726 (1985) (to be codified at 21 C.F.R. § 314) (proposed Aug. 6, 1985) (collection of fees is based on IOAA authority and no other provision for disposition is provided).

[241] *Id.* at 31,728.

[242] Letter from James T. O'Reilly, Legal Division of The Proctor & Gamble Company, to Dockets Management Branch, Food and Drug Administration, 2 (Oct. 18, 1985).

Congress subsequently directed the FDA to cease work on this user fee rulemaking, and the focus has since shifted from the rulemaking setting to the legislative arena. Senator Hatch introduced draft legislation supported by the Administration in August 1986 calling for much the same kind of user fees as the FDA had proposed without success a year earlier. However, the draft bill had a different fee disposition. It specified that fee receipts could be spent only on FDA new drug approval activities. Moreover, Senator Hatch saw the bill as a possible means "of increasing the amount of money devoted to new drug review."[243] Yet the bill provides no assurances that the agency's appropriations from other sources would not be cut in an offsetting manner after user fee receipts begin to materialize.

The two FDA proposals differ sharply on fee disposition, and implicitly on the bearing that fees will have on the FDA service provision. The agency and much of the potential fee-paying industry want expanded service activity, given widespread concern about the slow pace of new drug approvals. Indeed, there appears to be a willingness on the part of many drug companies to pay new fees if this will augment agency resources. For example, the Pharmaceutical Manufacturers Association ("PMA") in April 1986 testimony before the House Appropriations Agriculture Subcommittee stated that: "PMA would support user fees if the fees were reasonable; specifically targeted to improving the drug-approval process; additive to FDA's regular funding, and part of a multi-year commitment to improve the drug-approval process."[244] But without stronger assurances than the Hatch bill contained, there is little industry support for these fees.

The normative basis for dedicated fees in the FDA case is complex. It may be true that current service recipients are cross-subsidized by the general taxpayer, and fees may be warranted to lessen this cross-subsidy even if service levels remain constant—if fee receipts do not augment agency funds. In such a case, a plausible result would be some combination of slightly higher consumer drug prices, lower drug industry profits, and slightly lower incentives to submit drug approval applications. It also may be true that expanded service levels are sufficiently efficient to lessen the delay problem in drug approvals. Dedicated fees that did augment the agency's other resources, rather than being offset, then would serve the useful purpose of expediting the approval process. This in turn would probably moderate the three results just mentioned.

Conceptually, there is some desirable degree of revenue offsetting when a fee program is initiated, as fees come to substitute for tax proceeds in financing the FDA service; but beyond that shift, there may be a strong case for expanded service levels. Insisting that every dollar of new fee revenues

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[243] 132 CONG. REC. S11436 (daily ed. August 12, 1986) (statement of Senator Hatch) (proposing the user fee as a possible means of bridging the gap in funds due to anticipated Gramm-Rudman-Hollings Act cuts, and as a means of increasing the funds devoted to new drug review).

[244] PMA testimony before House Appropriations Subcommittee, April 1986.

be added to existing appropriations is not sound, for it ignores the present pattern of cross-subsidies. This suggests that dedicated fees are warranted but need not be fully additive. The Congressional appropriations oversight and control process then can provide a pragmatic resolution by lessening cross-subsidies and enhancing service levels.

Fee paying groups, however, are often sensitive about the disposition of their fee payments. Potential payers oppose fees that are not used to increase service quantity or quality. We have previously alluded to this phenomenon in discussions between the pharmaceutical industry and the FDA concerning fee proposals. The same concern exists in the airline industry. The eight percent assessment on airline tickets has often been justified on user fee grounds, in that it allegedly covers the costs of aviation capital improvements.[245] Substantial unused balances have arisen in the aviation trust fund however, and until Congress appropriates them for aviation spending, these funds are available for other federal spending programs. They are not segregated from general Treasury funds. The reaction of USAir chairman Edwin I. Colodny is typical: "I think it's quite unfair to tax our users for a system that's supposed to be in the national interest, and then to take the money and spend it for something else."[246]

Any user fee program based on the IOAA, of course, channels all receipts to the Treasury general fund, and the majority of agencies with which we have consulted favor such fee disposition practices. For instance, the Federal Communications Commission expressed concern that any link between its user fees and revenues would complicate financial relations with its major client groups, Congress, and the communications industry. Congress might be reluctant to grant budgetary increases if the agency could become self-sufficient through fees. The industry might subsequently suspect that fees reflected agency budgetary needs rather than costs of regulation, much as drivers might suspect fines imposed by judges whose salaries depend on such collections.[247]

Nuclear Regulatory Commission staff were similarly concerned that if fees were retained by individual agencies, fluctuations in agency receipts could wreak havoc with internal budgets. This objection is more telling in an agency like the NRC, which has fewer clients to regulate and whose activities may be sporadic, than in an agency with a large industry base and a more regular pattern of fee-generating activities.

If the dedication of fee receipts makes sense in other respects, however, problems of fluctuating receipts could be resolved while still preserving the

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[245] *See, e.g.*, UNITED STATES GENERAL ACCOUNTING OFFICE, AVIATION FUNDING: OPTIONS AVAILABLE FOR REDUCING THE AVIATION TRUST FUND BALANCE (May 1986).

[246] *Delays in Air Travel*, Wash. Post, Nov. 8, 1986, A8, col. 4.

[247] *See* Ward v. Village of Monroeville, 409 U.S. 57 (1972); Tumey v. Ohio, 273 U.S. 510 (1927).

fee dedication feature. Fee receipts could be made available for agency use with a one or even two year lag, so that revenue surges or declines would occur early enough to allow an agency to implement corrective action in the form of either adjustments in fee levels or agency service levels, or requests for supplemental appropriations. Alternatively, a multi-year averaging arrangement could be established, with the amount of fee proceeds made available in any given year being the average annual receipts for the prior, say, three years, possibly with a trend factor built into the calculations.

Nuclear Regulatory Commission staff noted a more pervasive concern about fee disposition—retention of fees would not inure to the benefit of the individual agencies if Congress cut the agency budget in a proportionate amount. Under this scenario, retention of fees is anticipated to carry little additional benefit and substantial internal cost if for no other reason than the additional accounting effort required. While some agencies have mentioned the additional political capital garnered by demonstrating that the agency has been responsible for additional federal revenues, the same point can be made where the collector does not retain possession of the fee collected. Yet, we have learned at FDA and elsewhere as well that fee retention is expected by some to result in augmentation of resources otherwise available. Indeed, the EPA favors legislative action to permit dedication of receipts from specific EPA fees collected under IOAA authority.

Little if any of the argument we have heard for or against retention of fees is based on concern for allocative efficiency. Nor is this argument rooted in alternative conceptions of fairness that might be used to trump an efficient allocation of society's resources. Rather, each argument presented emerges from a conception of what would maximize an agency's budget or minimize difficulties it otherwise might encounter with a client group. Consequently, if allocative efficiency is an appropriate goal for the imposition of user fees, proper resolution of the fee disposition issue should be addressed through a broader forum than the agency itself is likely to provide. Endogenous designs can be expected to reflect agency self-interest rather than socially optimal outcomes.[248]

One development that bears on these points is underway at the Customs Service. The Fiscal 1987 Omnibus Budget Reconciliation Act of 1986 in calling for a new fee of 0.22 percent on the value of commercial imports, authorized an advisory committee with members drawn from both the private and public sectors to scrutinize the fee's implementation.[249] It also calls

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[248] This is not to say either that parochial bureaucratic interests always adversely affect user fee decisions or that Congress can be counted on to ensure efficient user fees. Public rulemaking proceedings at agencies may offset inherent parochialism if a broad array of interests are represented. Moreover, agencies generally are better equipped than Congress to deal with the technical complexities of fee design and implementation.

[249] Omnibus Budget Reconciliation Act of 1986, Pub. L. No. 99-509, § 8101, 100 Stat. 1874, 1965-67 (1986) (to be codified at 19 U.S.C. § 1202); *see* Ad Valorem User

for a novel type of fee disposition, involving a trust fund with a new wrinkle. While receipts are dedicated to funding Customs inspection services, the latter are subject to normal budgetary controls exerted by OMB and the appropriations process, and the fee collected will be adjusted biennially to avoid surpluses or deficits. While elsewhere we have expressed doubts about the economic logic of terming this particular measure a user fee as distinct from a tax,[250] two of its provisions—the advisory committee and the disposition mechanism—appear promising. But whether the advisory committee will have the kind of membership that can usefully broaden the agency's perspective remains to be seen.

D. *Political Considerations*

The final element that may skew user fee levels and applications is the effect of political considerations on the assessment of fees. Political considerations may emerge in either the legislative or administrative area. Legislatures may fail to authorize fees that would further allocative, fairness, or revenue enhancement goals, while administrators charged with setting specific fees may similarly fail in the implementation process. To the extent that either of these "failures" results from robust, deliberative debate in which those favoring and opposing a particular fee are represented and decisions are predicated on an informed view of the public interest, it is difficult to speak of a failure of the process at all. Indeed, a political decision not to impose a fee after a hearing involving all sides of the issue may be evidence that even an efficient fee had been trumped by considerations of fairness. Such an event, for instance, may account for a rapid turnaround concerning fees in the late 1940s. According to the Senate Report on the IOAA, after Congress provided for transferring the cost of meat inspection services from the federal government to the industry there arose a "furor . . . so violent that before the fiscal year had expired, the Congress . . . passed Public Law 610, providing that thereafter all meat-inspection costs should be borne by the Federal Government."[251] The Report concluded that "[t]his instance is an excellent example of a service rendered by the Government for the good of all the people . . . ."[252]

Our concern for political skews, however, assumes that decisions to impose fees depend on factors other than the public interest. Contemporary theories of administrative law suggest that regulation is susceptible to general problems of collective action. Regulation itself constitutes a public

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Fee, 51 Fed. Reg. 43,188, 43,189 (1986) (to be codified at 19 C.F.R. § 24) (interim regulations Dec. 1, 1986) (allowing U.S. Customs Service to assess a .22% fee on commercial imports).

[250] *See supra* text accompanying note 195.

[251] SENATE REPORT, *supra* note 117, at 5.

[252] *Id.*

good, in that those who would benefit will not be adversely affected if they fail to contribute to the cost of government intervention.[253] Instead, they can free ride off the efforts of others. Only those whose personal benefits would exceed the substantial costs of influencing government, therefore, can be expected to take action to advance their interests. Since few members of the public at large will satisfy this criterion, regulation originally intended to serve the public interest actually comes to serve the private interests of regulatees.[254] These regulatees have an interest in petitioning or lobbying regulators, as the personal benefits of obtaining favorable regulation are substantial. Simultaneously, these firms' costs of lobbying are relatively small, as industries are capable of forming trade associations or other systematic contacts with administrators that reduce per capita expenditures. Regulated groups may also avoid tendencies for free riding with relative ease. If the group is small, monitoring the contributions of others and inflicting reputational damage on free riders may have significant incentive effects on inducing contributions. Even where a regulated industry is composed of substantial numbers of members, free riding may be minimized where lobbying is performed through a trade association financed by those members, as long as the total benefits of association membership—for example, opportunities to make business contacts, exchange information—are sufficient to attract a large percentage of the industry.[255] The effect of the resulting one-sided lobbying is exacerbated if we relax the assumption that regulators are themselves publicly interested. Contemporary theories of administrative law dismiss as naive any suggestion that much administrative behavior can be explained by reference to public-spirited altruists. Instead, these theories suggest that administrators seek to maximize self-interested goals of wealth, power, or opportunities for advancement that might deviate substantially from public interest.[256]

These theories of administrative behavior hold substantial consequences for the optimal application of user fees. The beneficiaries of fees—those who would otherwise subsidize government activities from which they get little

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[253] D. PARFIT, REASONS AND PERSONS, 64 (1984); Gillette & Krier, *The Un-Easy Case for Technological Optimism*, 84 MICH. L. REV. 405, 417-26 (1985).

[254] *Cf.* Peltzman, *Toward a More General Theory of Regulation*, 19 J. LAW & ECON. 211, 212-13, 231 (1976) (describing a political auction in which the highest bidder receives the right to tax the wealth of everyone else); Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. 3 (1971) (arguing that every industry or occupation that has enough political power to influence government policy will seek to do so).

[255] *See* R. HARDIN, *supra* note 138, at 31-35 (discussion of the by-product theory).

[256] *See, e.g.*, Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65, 101-02 (1983) (interpreting contemporary theories as suggesting that administrators, although they may enjoy promoting "the public good," pursue actions motivated by "a mix of selfish desires and idiosyncratic notions of social welfare" which only incidentally correspond with social optimization).

benefit—are diffuse: they constitute the majority of taxpayers. Further, the cost of not having user fees, while substantial in the aggregate, is likely quite small for any individual. Thus, few individuals can be expected to appear before legislators or bureaucrats in favor of fees. Those adversely affected by fees—those who currently free ride on subsidies—are often represented by trade associations with ready access to decisionmakers. In addition, they have substantial incentives to take advantage of their access, since the imposition of fees would significantly increase their costs, notwithstanding their ability to pass some of those costs along.

Taken in isolation, this paradigm suggests that those whose interests favor user fees will fail to be represented while those whose interests oppose user fees will gain access to decisionmakers. The result, suggested by an interest group or faction theory of politics, is that user fees would be not be imposed in all circumstances where they are appropriate. But the effects of interest groups are not unidirectional. Bureaucrats similarly form an interest group. Substantial scholarship in administrative law suggests that bureaucrats attempt to maximize their own budgets.[257] Those agencies entitled to supplement their budgets from user fees, therefore, would have an interest in oversupplying user fees. Even an agency dependent on Congressional appropriations might wish to maximize revenue from fees in order to convince budget officials that they should increase the agency's budget. On the other hand, agency concerns that it would have to absorb the administrative costs of the collections while retaining none of the fee receipts would dampen agency enthusiasm for user fees.

Another aspect of this political dimension entails federalism issues. State and local governments are very sensitive to implications that the federal user fee debate may have for their independence and fiscal responsibilities. Federal fees can affect the political and economic climates surrounding state and local fee collections, indirectly influencing the fiscal capabilities of those governments. These concerns are especially important in program areas such as environmental protection and transportation where extensive and complex interaction exists between federal and state governmental units. The April 1986 report of the Environmental Protection Agency Task Force on Fees examines state reaction to federal user fee initiatives. It finds that states are supportive of user fees of their own design but quite leery of any imposed on them by the federal government. States already collect some fees, and they can be expected to resist policies imposed on them, especially when those policies require alteration of existing practices. States want to be substantively involved in developing user fee systems, in part because of concern about administrative and enforcement problems they could face.

The federal government already has delegated many environmental duties to states in areas such as air and water protection, and wants to further

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[257] *See, e.g.*, W. NISKANEN, BUREAUCRACY AND REPRESENTATIVE GOVERNMENT 45-52 (1971).

delegate its permit granting program responsibilities. The EPA has mixed incentives as to user fees in areas that are delegable to states. From a staff perspective, the task of devising federal user fees, even without state involvement, is not easy and would have limited payoff, assuming further delegation results in states gradually taking over the fee systems and revenues. Thus once the need for federal-state coordination is factored into the situation, it is hardly surprising that little headway has resulted in developing user fees in delegable program areas. Yet at the same time that bureaucratic incentives and coordination problems impede progress, there appears to be much underlying support for the user fee concept. Despite state misgivings about a system of national fees, the EPA reports that: "[g]overnments at both the Federal and State levels are serious about the idea of passing on either some or all of the costs of environmental protection to those entities contributing most directly to environmental pollution or to the cost of administering the law."[258]

In the transportation sector, numerous political considerations, some related to federalism and others to interest group effectiveness, have shaped user fee systems. While user fee revenues in transportation are quite large relative to most fee programs, they do not come close to covering agency costs of providing the corresponding services and are in general suboptimal from an efficiency perspective.[259] In fiscal year 1984, combining federal, state, and local government data, user revenues amounted to just under 65 percent of the government's expenditures on transportation.[260] Moreover, this figure masks much diversity across particular transportation modes; user revenues as a percentage of governmental expenditures, by mode, that year were:

Type of Public Transportation	*User Revenues as Percentage of Government Expenditures*
highways	78
air	77
water	35
transit	29

IV. CONCLUSION

As we noted at the outset, federal user fees may be instituted to achieve various goals, including distributional equity or fairness, revenue enhance-

[258] UNITED STATES ENVIRONMENTAL PROTECTION AGENCY, INTERIM REPORT OF TASK FORCE ON FEES 3-4 (1986).

[259] *See* J. GOMEZ-IBANEZ & M. O'KEEFE, THE BENEFITS FROM IMPROVED INVESTMENT RULES: A CASE STUDY OF THE INTERSTATE HIGHWAY SYSTEM 10-12 (1985).

[260] UNITED STATES DEPARTMENT OF TRANSPORTATION, FEDERAL STATE AND LOCAL TRANSPORTATION FINANCIAL STATISTICS FISCAL YEARS 1977-1984 10 (May 1986).

ment, and privatization. Our focus, however, has been on allocative efficiency as the presumptive criterion for the desirability, amount, and disposition of any given user fee. Our review of diverse agency experience with user fees leads us to conclude that suitably structured fees can aid agencies in better managing service usage and recovering costs from service recipients. For this to occur, however, attention to various considerations is essential.

First, a user fee should be collected only when a government-provided good or service either creates an identifiable benefit for the payer or its customers, or lessens a burden the fee payer imposes on others. Second, the amount of the fee collected from the recipient of the good or service should equal the opportunity cost of its provision. Measuring this standard depends on the type of good or service involved. Where exclusive use or access to scarce resources is being granted, as with aircraft landing rights at congested airports, auctions can establish the pertinent value. Where the service substitutes for privately marketed services, as with grazing rights and delivery services, market value pricing based on data from private markets will be appropriate, unless such prices are artificially supported. For the more commonly encountered types of government services like inspections and application processing, opportunity costs amount to those agency outlays attributable to the increment of service being provided. As a rule, previously incurred capital costs or other sunk costs should not be recouped through fees for current services. However, fees should cover any anticipated capital replacement or repair costs related to the ongoing provision of the good or service.

Where provision of the good or service creates substantial external benefits, user fees should be reduced to reflect judgments about the relative magnitudes of the marginal social benefits entailed. Similarly, where provision imposes substantial external costs, fees should be increased accordingly. In the event of external effects, the following principles should apply:

1. The fee level normally should be set without regard to whether the fee payer is itself the beneficiary of the government good or service or whether it distributes those benefits to its customers or employees. However, selection of the point of collection should take into account the costs of administration.

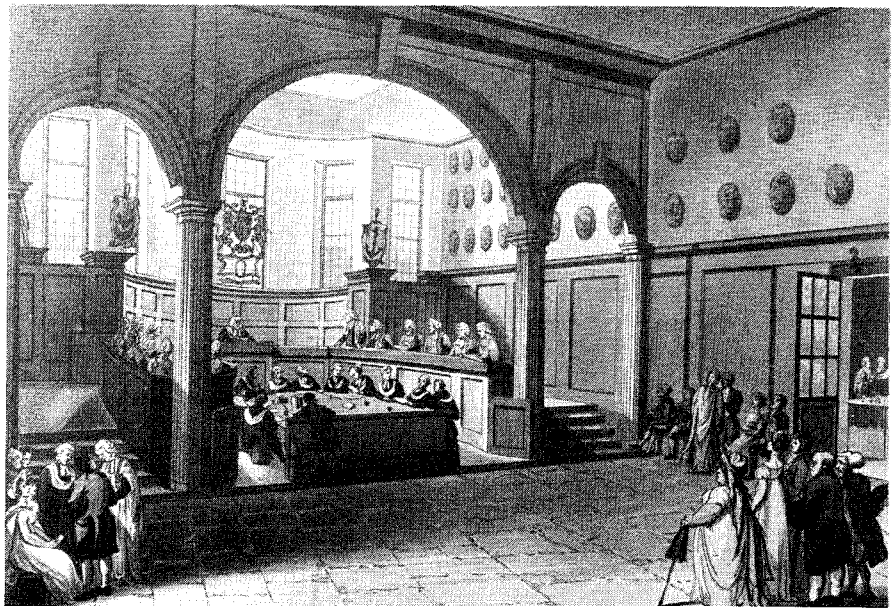
2. Where external benefits exist, that is, where uninvolved third parties can be shown to benefit significantly from a governmental good or service, user fees should not be expected to recover fully the cost of providing that service. Nor should user fees imposed on the recipients of one of an agency's services subsidize other services. Thus, user fee schedules for a particular government good or service should not be predicated on a percentage of an agency's budget unless there is a realistic expectation that a fee established in this manner will approximate the actual cost or benefit related to that good or service, as derived from the foregoing standards. Similarly, agencies should not collect fees

based on a percentage of their budget, unless that percentage reflects the opportunity costs of services provided to fee payers.

3. A primary objective of the governmental service may be to lessen the risk or burden that a commercial activity imposes on third parties (e.g., safety inspections and pesticide approvals). In such cases, the user fee normally should not be less than the agency's full costs; indeed, if suitable data exist, the user fee should reflect the (presumably higher) marginal social cost of the risk or burden at issue.

4. The proportion of service costs to be recovered by user fees as opposed to alternative financing mechanisms should be determined by taking into account (i) the practicability of allocating costs between fee payers and third party beneficiaries, (ii) potential adverse effects on agency program goals caused by fees that are unduly high with respect to fee payers, and (iii) the relative advantages and disadvantages of alternative financing mechanisms.

Three further conclusions reflect the fact that objectives other than allocative efficiency play an important role in the use of fees. User fee receipts ordinarily should not be earmarked, but should flow into the general treasury to facilitate overall budgetary allocations that are responsive to the public interest as manifested through the political process. Additionally, other criteria—such as program goals and fairness—may influence the setting of fees or granting of waivers or reduction in fees. For instance, a concern for multiple points of view on the airwaves might justify departure from pure auctions for FCC licenses. Since allocative efficiency is the presumptive goal of fees, however, in such cases the agency should provide a statement of its reasons for departing from allocative efficiency principles in structuring its fees. Finally, a material boost toward implementation of the foregoing principles might result from creation of a user fee information center to monitor all aspects of agency fee administration and to serve as a clearinghouse for data on user fee practices. Such a center, located within the Office of Management and Budget or the General Accounting Office, could also identify specific statutory or other impediments to more efficient user fee design.



The Court Room at Doctors' Commons in 1808, from I THE MICROCOSM OF LONDON, facing 224 (1808) (pub. Rudolf Ackermann). Court is in session. To the immediate right is the door to the Hall and Library, where a Proctor and a Doctor can be seen enjoying a drink. Doctors are sitting in the higher tier around the Judge, while Proctors, who served a role similar to common law solicitors, are sitting at the table below. In the foreground, a Doctor and a Proctor are seen consulting with clients. The figures are executed by Thomas Rowlandson (1756-1827), a famous draughtsman and caricaturist.