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**Before the
Committee on the Budget
United States Senate**

March 10, 1982

Mr. Chairman, I am pleased to appear before your committee to discuss the pricing of government services. My remarks today will concentrate on two topics:

- o The economic rationale for increasing the fees charged for government services; and
- o The appropriate standards for federal fees, first with market prices and then with full cost recovery as the benchmark.

THE ECONOMIC RATIONALE FOR USER FEES

When federal expenditures benefit the nation as a whole, it is appropriate that the taxpayers bear the costs. But many federal services benefit clearly identifiable groups. In such cases, concerns with both economic efficiency and fairness suggest that these specific beneficiaries should pay for what they receive.

Under current policy, most user fees are set well below the economically appropriate levels. Increasing fees either to their market equivalent or to levels that recovered all the government's costs would improve the long-run efficiency of the economy, could help reduce federal deficits, and would help allocate the burden of deficit reduction in a manner generally perceived as fair.

Economic Efficiency and the Pricing of Government Services

Many federal services have counterparts in the private marketplace: examples include the Federal Reserve's collection and sorting of checks for commercial banks, the provision of grazing land, and uranium enrichment. In such cases, market prices can serve as a guide for federal fees. Such charges would provide an incentive to use the most economic level of government service and would correct distortions that result when one group receives low-cost government service while another must pay the market price.

Mineral leasing offers an example of how market pricing has been applied effectively. Under current policy, production rights to offshore oil and gas properties, or onshore mineral tracts, are leased through sealed-bid auctions. As a result of competitive bidding, the market price paid for a mineral lease reflects its potential production and level of risk. The competitive nature of auctioning assures that resources for mineral development will be directed toward their highest economic value. Charges of this type might also be applied to other services such as federally supplied water.

Most federal services, however, are not amenable to market-based pricing. Among these are the services provided by federal infrastructure

investments--the roads, waterways, and other facilities that make up the physical framework for the nation's economy. Since the market offers no equivalent for these services, an appropriate benchmark can be full recovery of the government's cost. Fees that accomplish this would help to shift the patterns of investment toward a more efficient economic infrastructure. To the extent that users of these facilities reimbursed the government for investments made in their behalf, they would have an incentive to work with the government to ensure that only cost-effective investments are made. Waterways, to which I will turn shortly, are an excellent example of this.

Most user fees now in effect are set well below full cost or market prices. Raising fees would improve efficiency and yield the secondary benefit of reducing net federal expenditures. Higher user fees cannot by themselves eliminate the deficit, but they can help in two ways: by increasing revenues and by reducing outlays. In the areas that the Congressional Budget Office (CBO) has examined for increased or altogether new user fees, net federal expenditures could be reduced by about \$130 billion between 1983 and 1987. Of this sum, roughly half would be collected through fees under current law. Much of the remaining savings could be achieved by increasing the application of user fees. It should be noted, however, that these fees will be deductible as business expenses from the taxes of individuals and corporations. Thus, about one-fourth of the gross revenue gain from the newly increased user fees would be offset by reduced income tax collections.

The Transition Costs of Increased Federal Fees

Some transition costs necessarily accompany any move toward a more efficient economy. In the near term, higher fees might cause severe dislocations for regions and groups that have made investments on the expectation that low-cost, federally supported services would continue. Changing past commitments might, in effect, be asking these parties to bear the costs of making national economic gains. To mitigate this, increases in federal fees could be phased in gradually, thereby easing short-run effects but not sacrificing the ultimate results.

Some inflationary effects would probably result from increased user fees, inasmuch as the increases would be passed through to consumers in the final costs of goods and services. Any such adverse effects are likely to be slight, however, and they would eventually diminish with improved economic efficiency and with reductions in interest rates that would accompany a lower deficit.

GREATER APPLICATION OF FEES

By way of example, I would like to give four areas closer attention--irrigation, inland waterways, deep-draft navigation, and the Strategic

Petroleum Reserve. Each is an important issue now before the Congress, and each illustrates the advantages-- and the difficulties--of increasing the prices of government services.

Irrigation and Market Pricing

At the turn of the century, the federal government began to subsidize the provision of water to encourage the development of the West. Eighty years later, western farmers are still receiving water at subsidized rates. These subsidies encourage wasteful use of water in regions that may no longer need subsidized development. They also distort farmers' decisions about which crops to grow. In some places, for instance, farmers with access to federally subsidized water are growing two crops that they would not otherwise raise at all: cotton and rice. Two problems result from this. First, market gluts can occur, driving the market values of those commodities downward, in turn prompting the government to raise values artificially by means of price supports, which have federal costs of their own. Second, regional distortions can develop. For example, subsidized irrigation water for cotton and rice in the West puts production of those crops at a competitive disadvantage in other regions (primarily in the South) where irrigation water is not subsidized. Furthermore, because of the subsidy, farmers have no incentive to invest in water-saving irrigation methods or crop choices; in fact, rice is a particularly water-intensive crop.

Under current policy, the federal government will invest roughly \$3.8 billion from 1983 through 1987 in irrigation facilities. Of this amount, roughly \$275 million would be recovered with charges now in place. If prices for new or renegotiable water contracts were raised to market levels, net receipts of as much as \$1.0 billion might be collected from 1983 through 1987. If all contracts could be converted to market prices immediately, this would yield roughly \$16 billion over this same period. But many of these contracts run for as long as 40 years, so the rate of conversion is likely to be slow.

Raising the price of federally supplied water would improve long-term efficiency in use of this resource, but not without short-term costs. The product mix from irrigated western agriculture would change, and higher-priced water would raise the prices of some agricultural products. At the outset, some farmers would probably respond by improving water conservation with lined delivery canals and by using better irrigation schedules and methods. As water prices increased over time, farmers could switch to crops that need less water, probably requiring investment in new equipment. As water prices rose still higher, a reduction in water used for farm irrigation would augment the supply available for municipal or industrial customers able to pay higher prices.

Inland Waterways

Towboats using the inland waterways pay a fuel tax of 6 cents per gallon, the only fees now charged for these facilities. Under current law, this tax will rise to 10 cents per gallon by 1986. Federal expenditures for inland waterways will amount to some \$3.1 billion between 1983 and 1987, of which fees at their currently scheduled rates will recover only \$240 million. As a result, inland waterways are heavily subsidized. Such a policy encourages waterway projects that are not cost effective. It also diverts some traffic from railroads or trucks to waterways; such diversion would not occur if shippers had to pay the full costs of using each mode.

Domestic inland water transportation received the highest subsidy of any freight mode in 1980--3.9 mills per ton-mile. This is well above the 2.2 mills per ton-mile received by railroads and the 1.8 mills per ton-mile received by trucks (see Table 1). Pipelines, which carry more ton-miles than either barges or trucks, receive no federal capital or operating subsidies.

Present federal subsidies for the inland waterways are particularly large relative to the total cost of moving goods. In 1980, subsidies covered more than one-fourth of the costs of all inland waterway shipping. This is more than four times the portion of shipping cost covered by rail subsidies and almost 30 times more than truck subsidies.

TABLE 1. COMPARISON OF FEDERAL SUBSIDIES TO FREIGHT TRANSPORTATION

Mode	Mills per Ton-Mile (In constant 1982 dollars)	As a Percent of Total Costs
Truck -- 1980 Actual	1.8	1.0
Railroad -- 1980 Actual	2.2	6.2
Inland Waterway		
Current Policy -- 1980	3.9	29.5
1987 Administration Bill	0.7	7.0
1987 Domenici Amendment	1.1	10.7

SOURCE: Congressional Budget Office.

The Administration has proposed (in S. 810 and Amendment No. 637) sharply increasing the fees paid by users of the nation's inland waterways. This plan would yield about \$2.0 billion in additional revenue over the next five years. A similar proposal introduced by Senator Domenici (Amendment No. 32) would generate about \$1.3 billion in additional revenue during the same period. Both of these proposals would shift policy closer to full-cost-recovery pricing for waterways, resulting in subsidies that are comparable to those received by other modes of transportation.

Coal, soybeans, and grain would be among the commodities most affected by increased user fees. Much of the coal goes to utilities that have

made substantial investments in coal-burning equipment. Barge operators could probably pass along most of the increased user fees to shippers, and relatively little traffic would be diverted. Ultimately, most of the fees would be passed along to consumers. Under the Administration proposal, consumers in affected regions could end up paying about 1 percent more for their electricity.

Similarly, higher user fees would drive up the transportation costs for soybeans and grain. But farmers are not likely to bear this burden alone: part would also be transferred to water carriers, grain handlers, and domestic and foreign consumers. If half of the cost increase implicit in the Administration's proposal were borne by farmers, then they would absorb a loss of about 1 percent in gross revenue from corn and wheat and about one-half percent from soybeans. For a representative commercial farm producing 400 acres of corn and soybeans each year, these user fees would cause a loss of gross annual revenue of about \$900.

By removing much of the favored treatment of water transportation, higher fees for inland waterway users would encourage a more economic pattern of investment in these facilities and in competing modes. Both taxpayers and users would have a common interest in ensuring that only economic projects are undertaken. Nevertheless, such a shift in policy could adversely affect some interests, such as grain farmers. A balance between

the efficiency benefits and adjustment costs might be struck by phasing in the increased waterway fees, as is proposed in the Domenici Amendment.

Deep-Draft Navigation

Under current policy, the Coast Guard and the Army Corps of Engineers will spend about \$4.8 billion between 1983 and 1987 to build, operate, and maintain deep-draft navigation facilities. Under an Administration proposal (S. 809), ports would return about \$2.1 billion for government operation and maintenance costs. A similar proposal introduced by Senator Domenici (Amendment No. 31 to S. 809) would recover about \$1.5 billion in operation and maintenance costs, plus around \$0.7 billion in capital costs over the same period. In addition, in its fiscal year 1983 budget, the Administration proposed user fees to collect \$1.4 billion over this period for Coast Guard operating costs related to deep-draft navigation. Together with the proposed deep-draft port fees, these would virtually cancel out the substantial subsidies now received by coastwise, foreign-flag, and Great Lakes shipping.

The impact of user fees to recover operating and maintenance costs for ports would probably be small. Total transportation costs of most exports and imports would increase by less than 1 percent. Many smaller

harbors with relatively high operation and maintenance costs, could experience increases well above these averages, however.

Fees also could be much higher in ports that plan major capital improvements, particularly dredging of deeper channels to prepare ports to handle large, highly efficient coal-carrying ships. As a result, such ships might be charged an additional \$1.00 per ton of coal in some ports. But even this substantial fee is far less than the anticipated savings from using the larger ships. Thus overall transportation costs would be lower, and coal exports would be stimulated.

The Strategic Petroleum Reserve and Full Cost Recovery

As an insurance policy, the Strategic Petroleum Reserve (SPR) is perhaps the single most important element of our nation's oil security. In the event of a major disruption in foreign supply, a fully stocked reserve could offset gross national product (GNP) loss of about \$150 billion and counter the attendant inflation and unemployment.

Though the SPR would benefit the economy at large, these benefits would be allocated in proportion to oil use. Heavy users would benefit more from an SPR than those who use less, but under current policy, the

taxpayers at large would finance the SPR. By contrast, financing the SPR with a charge on oil consumption would be appropriate.

The Congress placed this program off budget for 1982, and hence its costs are not counted as part of the unified deficit. Nevertheless, outlays for the SPR--projected to total \$13.6 billion between 1983 and 1987--represent a real expenditure, the impact of which is exactly the same as if it were on budget. A tax of 50 cents per barrel--perhaps in the form of an import fee on crude oil and refined products, or a refiners' fee with equivalent tax on imported products--would increase federal revenues by as much as \$2.9 billion in 1983 and \$14.5 billion over the 1983-1987 period. This would be felt by consumers in the form of increased prices for petroleum products. Gasoline, for example, would cost roughly a penny per gallon more at the pump if this tax were in effect.

CONCLUSIONS

User fees can have a far wider application to federal expenditures than is generally recognized. I have treated four examples in some depth to illustrate how the concept would work and to suggest some of the federal expenditures that appear best suited to user fees. Numerous others also warrant consideration. Besides irrigation, candidates for market pricing

include uranium enrichment, credit subsidies, and federal hydropower. Taken together, these could reduce net federal expenditures by as much as \$18 billion from 1983 to 1987 relative to current policy. Candidates for full cost recovery include highways, aviation, and radioactive waste disposal. Full cost recovery for these and other programs could provide about \$47 billion more than under current policy from 1983 to 1987. Tables 2 and 3, appended to this statement, provide details of these and other potential user fees.

In summary, Mr. Chairman, there is a strong economic case for charging those who benefit from federal services the full cost of the expenditures made in their behalf. This would be a small but important step toward a reduced federal deficit. But more important, the proper application of user fees would help guide long-term investments toward a more efficient national infrastructure and provide appropriate levels of federal service. Inevitably, there are short-term costs to be borne, and these are a major consideration. Phasing in fee increases would mitigate some of these transition costs. But ultimately, fuller application of user fees would make a strong contribution to the long-term health of the economy.

Thank you, Mr. Chairman.

TABLE 2. POTENTIAL USER FEES FOR COST-REIMBURSED PROGRAMS (In billions of current dollars)

Programs and Services Covered	Five-Year Total 1983-1987		
	Outlays Potentially Recoverable	Receipts Under Current Policy	Receipts Under Administration's Proposals
<u>Highways.</u> Recovery of spending from the general fund and an end to highway tax exemptions for state and local governments, buses and alcohol fuels.	45.6	36.7	36.7
<u>Strategic Petroleum Reserve.</u> Department of Energy costs for the Strategic Petroleum Reserve.	13.6	0.0	0.0
<u>Aviation.</u> Recovery of Federal Aviation Administration capital and operating costs excluding 15 percent for military aviation. (Currently, general aviation users pay 5 percent of their allocated costs and commercial aviation 82 percent.)	13.5	9.5	17.2 <u>a/</u>
<u>Postal Service.</u> Recovery of federal subsidies for Saturday mail delivery, remote area service, and preferred mail rates (for non-profits, newspapers, etc.) and for future cost-of-living adjustments for postal pensions now paid by the federal government.	5.5	0.0	0.6
<u>Coast Guard.</u> Search and rescue, aids to navigation, and other programs that aid recreational boating and commercial users including fishermen. Administration proposal would recover only operating costs.	4.9	0.0	3.4

(Continued)

TABLE 2. (Continued)

Programs and Services Covered	Five-Year Total 1983-1987		
	Outlays Potentially Recoverable	Receipts Under Current Policy	Receipts Under Administration's Proposals
<u>Inland Waterway Navigation.</u> Corps of Engineers operating and capital costs for the inland waterway system. Administration plan would amortize capital costs over 50 years.	3.1	0.2	2.0
<u>Deep-Draft Navigation.</u> Corps of Engineers operating and capital costs for channels and harbors more than 14 feet deep. Administration plan would amortize capital costs over 50 years or let local ports finance themselves.	2.8	0.0	2.8
<u>Radioactive Waste Disposal.</u> Research, development, and eventual construction costs for storage of high-level radioactive waste from electric power generation.	2.6	0.0	2.6
<u>Patent and Trademark Fees.</u> Processing costs for patents and trademarks.	0.5	0.3	0.5
<u>Miscellaneous.</u> Includes recreation fees, Federal Energy Regulatory Commission, Commodity Futures Trading Commission, Securities and Exchange Commission, Federal Communication Commission licensing, and charts and maps.	<u>2.1</u>	<u>0.7</u>	<u>1.3</u>
Totals	94.2	47.4	67.1

SOURCE: Compiled by Congressional Budget Office.

a/ The Administration estimate includes cost recovery for new air traffic control equipment.

TABLE 3. POTENTIAL USER FEES FOR MARKET-ORIENTED PROGRAMS (In billions of current dollars)

Programs and Services Covered	Five-Year Total 1983-1987	
	Potential Receipts	Receipts Under Current Policy
<u>Credit Subsidies.</u> Market rate interest for all new direct federal loans. About one-half this amount is in agricultural programs, including price supports, agricultural credit, and Farmers Home Administration loans. Net budget reductions could be substantially greater since some loans might not be made through the federal government at market rates.	9.7 <u>a/</u>	0.0 <u>a/</u>
<u>Uranium Enrichment.</u> Uranium processing by Department of Energy for sale to domestic and foreign customers.	12.1	10.2
<u>Irrigation.</u> Water sales by Bureau of Reclamation to farmers, municipalities, and commercial users. If all long-term contracts were renegotiated, receipts could reach \$16.0 billion on a market basis.	1.0	0.3
<u>Hydropower.</u> Power sold by federal power marketing administrations with a 10 percent return on capital--as allowed private power companies.	<u>13.4</u>	<u>7.4</u>
Totals	36.2	17.9

SOURCE: Compiled by Congressional Budget Office.

a/ Does not include interest already being paid on these loans.