Paying for Public Services
Minnesota Public Finance Note #2001-01

When can public services be financed by user fees?

Governments can choose among a number of financing mechanisms for public services: general tax revenues, ear-marked tax revenues, administrative revenues (such as license fees and fines), debt financing, or user fees. The choice depends on the government’s fiscal standing and on decision-makers’ and voters’ preferences for different financing methods. The choice may also be influenced by state and federal government restrictions on the use of certain types of funds.

Whether or not a user fee is a practical way to finance a public service depends on the nature of the service. A key factor is whether or not it is possible to exclude those who do not pay the fee from using the service. It is not possible, for example, to exclude non-payers from viewing artwork in a public place or from benefiting from well-lit public streets. In these cases, the service cannot be financed with mandatory user fees.

Even when it is technically possible to limit the service to those who pay the fee, it is not always feasible to do so. The technology may exist to exclude non-subscribers from enjoying public radio broadcasts, but the costs of doing so would surely be high. And charging a toll for the use of every public bridge or road would be an overwhelming burden to drivers. Charging a fee and excluding non-payers, therefore, creates administrative costs that must be weighed against the benefit of being able to demand a fee from users.

Does this mean that it is always best to charge a user fee when the expected revenue from a fee exceeds the cost of administering it?

Not necessarily. There are other factors to consider.

First, governments provide many services because it is believed that the social benefits of the service exceed the private benefits. That is, a service that is purchased by a single family on the private market creates benefits for others who did not pay for it. Consider, for example, a family paying for the education of their children. The fact that those children are well-educated means that they may be more productive and less of a burden
to their fellow citizens than if they had not received the education. The benefits to the entire society of a child’s education exceed the benefits to the child or her family.

In these cases, the government subsidizes the provision of the service, so that more of the service is provided than would have occurred had the provision been left to the private market. Public safety, national defense, transportation services, environmental protection, and public education are all examples of services that are subsidized by the government in order to ensure that they are provided adequately. Often, the government will completely fund these types of service. Even if it is practical to charge user fees for some of these services (sometimes it is, sometimes it is not), the government will generally not charge users the full cost of the service, but will supplement fee receipts with revenue from other sources.

Second, decision-makers may feel that access to a service should not be limited to those who have the means to pay a user fee. They may want to ensure that low-income families have access to the service without charge or at a rate that takes into consideration the family’s ability to pay. Requiring that a user show proof of financial need, however, introduces additional administrative costs as well as privacy concerns. These costs and concerns must be weighed against the advantages of financing the service from user fees rather than from alternative sources.

**Are there other benefits to user fees besides helping to fund the service?**

Yes, there can be:

- When congestion is a potential problem with a service (for example, with access to a bridge or enrollment in community education course), user fees can be used to limit access and control congestion.

- By adjusting the amount of a user fee, administrators can observe how much people seem to be willing to pay for the service. The user charge provides a price signal that can help the government determine how much of the service should be provided.