PUBLIC PRICING:
One Answer to the Human Service Fiscal Dilemma

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Sound management in an era of scarce resources requires creative use of alternative revenue sources. Because public pricing potentially offers some relief from the fiscal constraints of the 1980s, this article will address some issues surrounding the practice as a revenue source.

Public pricing is a generic term referring to "fee for services," "user charges," or "beneficiary charges." Advocates of public pricing as a substitute for and supplement to taxation or grants claim that it increases both efficiency and equity in the allocation of goods and services for public purposes. Furthermore, a pricing mechanism is particularly suited to human services that are provided at the local level. Critics, however, claim that fees are regressive, placing a disproportionate burden on the poor.

Our purpose here is to acquaint the reader with the advantages and limitations of public pricing. The equity problem will be discussed, and alternative pricing schemes that take income differences into account will be evaluated.

PRICING AS REVENUE ALTERNATIVE

The theoretical underpinnings of public pricing are found in public finance economics. Economic theory suggests that user charges can be applied if the goods or services in question have characteristics similar to a private good. Thus, economists would classify prices as appropriate if (1) there are clearly identifiable benefits,
(2) nonpayers can be excluded, (3) few benefits spill over onto those who do not pay, and (4) there are few unacceptable inequalities.\footnote{1}

Many human service programs meet some or all of these criteria. For example, medical care and education have clearly identifiable individual benefits, and policies that exclude nonpayers can be initiated. Questions of spill-over benefits and inequalities are more complex. Both are difficult to define and measure, and as values change, the acceptance of these concepts changes. For example, most citizens may agree that public education benefits society as well as the student; however, there may be less than universal agreement over the benefits to the community of a tax-subsidized mental health center. Equity objectives often prevent "efficient prices" in the economic sense. Many human services are targeted for people who can't afford the private-sector alternative. A battered women's center would be self-defeating if it accepted only those women who could afford to pay for child care, food, lodging, or counseling.

**ADVANTAGES OF PRICING**

The three major advantages associated with the use of public pricing are (1) its allocative efficiency, (2) its equity, and (3) its usefulness as a revenue source.

**Allocative Efficiency**

Efficiency is the most important and least controversial advantage of pricing. A fee represents a direct and explicit link between revenue and expenditure. Through the direct exchange of service for a fee, citizens are able to connect costs and benefits. Costs are more tangible and visible. Furthermore, a demand function for the public service can be observed. People demonstrate their support for a service through their willingness to pay for it, and this provides management with useful signals which indicate the quality and quantity of services people desire.\footnote{2} Using this information, public managers are then better able to expand or contract services as well as make investment decisions.

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Indeed, even a small charge may have unexpected payoffs. Community mental health centers, for example, often provide therapy free of charge. In an experiment wherein fee and nonfee clients were randomly assigned to different groups, McRae found that a fee had a therapeutic effect. Clients who paid even a small fee took therapy more seriously, and there was a significant reduction in premature termination compared to the nonfee clients.\footnote{3}

The painful questions of the 1980s concerning where to cut programs will outnumber expansion decisions. User charges could make this task easier. Bird concludes that prices tend to reduce the quantity demanded rather than to encourage expansion. By making costs meaningful, residents will reduce their consumption and give managers useful cut-back signals.\footnote{4}

**Equity**

There is little disagreement in the literature that pricing public products encourages an "appropriate" allocation of resources. On the other hand, there is less than universal agreement over whether user fees result in an equitable distribution of services. Authors who support pricing as fair or equitable employ the "benefit principle" of taxation. Pricing is fair because those who use the services pay and those who do not use the services do not pay. In addition, nonresidents who are not subject to the local property tax are forced to pay for the services they use. Bird maintains that the benefit notion of equity is most appropriate at the local level. The concern over distributive questions, however, is that it may result in unacceptable levels of inefficiency.\footnote{5}

**Revenue Source**

Public managers at the local level are faced with an unprecedented fiscal squeeze. A decade of inflation, declining federal grants, and a weakened or declining property tax base have all contributed to the problem. Hence, managers are looking more closely at fees as a viable revenue source. The property tax, the mainstay of local government, has been weakened by taxpayer revolts (or the threat thereof) and by growth in tax concessions, such as property tax relief for the elderly. Fees, in contrast, are a revenue source directly under the control of local government.

Because of these advantages, pricing mechanisms undoubtedly will continue to serve public managers. User fees, however, must be applied carefully, for they are subject to several constraints.

**DISADVANTAGES OF PRICING**

There are five potential problems of which a public manager should be aware. These limitations are (1) political problems, (2) technical and administrative problems, (3) legal constraints, (4) externalities, and (5) regressive taxation features.

**Political Problems**

Meltzer, in his classic The Politics of City Revenue, notes that user fees like taxes are bounded by political parameters. Officials must be sensitive to the community's attitude about what is appropriately provided by local government, and what should be free and what should be subject to a charge.\footnote{5} For the most part, the public does not trust an increase in fees, feeling that it is simply an increase in cost without either a corresponding decrease in taxes or increase in benefits. Moreover, interest groups
who are currently enjoying a free or subsidized service will resist the increase.

Several authors stress the importance of using proper pricing principles. Politically, however, an efficient pricing structure may be impossible to obtain. For example, when the city of Oakland finally approved a sewer use fee, it had little to do with classic cost or usage information. Major industries of the area had conditioned their support for user fees on the guarantee that the fee would be less than or equal to an alternative increase in property taxes. As a result, Oakland implemented a sliding scale system whereby big users paid lower rates. Political realities prevailed over an economically efficient pricing structure.7

Technical and Administrative Problems

Although technical problems associated with pricing mechanisms are very real, they comprise an area which, unlike political problems, is to some extent under the control of a manager. A key technical problem is management's lack of training in price and costing methods. Managers and city staff, particularly at the local level, often do not understand the value of or know how to apply key principles, such as price elasticity or marginal cost. Given the widespread lack of expertise, the need for training is a recurring theme in the literature.

A pricing mechanism is particularly suited to human services that are provided at the local level.

Administrators of community mental health centers have learned that the timing of payment is a critical aspect to consider. When a sliding scale is used, the cost of mail billings may be unreasonable. Typical mailing costs are a dollar, and it is not uncommon for monthly bills to be as low as four dollars. A three-quarter cost-recovery norm suggests the need for a new collection system. Furthermore, many low-income clients don't pay their monthly bill, but therapy often continues to be provided. Mental health administrators in central Texas have found that charging at the time the service is rendered alleviates many of these problems.

Managers should be aware of resistance within the bureaucracy. People who make organizational budget decisions, such as city managers, agency executive directors, and finance officers, take the larger picture into account. But often administrative heads and employees see themselves merely as spenders and providers and pay little attention to the cost-recovery norm. Melsner maintains that the service orientation of an agency is critical in determining the extent of its concern with revenue. The more staff members view themselves as service providers the less their concern with revenue.8 In fact, fees are often seen as obstacles to the goal of providing service. By definition, human service programs are service oriented. Hence, administrators should pay close attention to the potential roadblock of bureaucratic resistance. One way to reduce resistance is to keep staff members informed. Tell them why fees are initiated or changed. Keep in mind that cut-back management often implies the loss of positions. If employees perceive increases in fees as a potential substitute for lost grant dollars, they are apt to be more receptive to fee changes.

When developing pricing structures, management needs solid cost information. It is also crucial to understand how costs can be controlled. If a service is highly labor intensive and service oriented (therapy in a mental health center, for example), employee productivity becomes critical. Employees' motivation, their morale, and their concern over the cost-recovery norm are other key factors. Greater productivity could lead to a lower average cost and, therefore, potentially to a reduced fee schedule or lower subsidy.

Legal Constraints

Administrators have more control over pricing mechanisms than taxes as a revenue source. There may, however, exist legal constraints which reduce the administrator's flexibility in determining an optimal fee structure. For example, a legislature or granting agency may mandate that charges cannot be above cost, and there is often legal confusion over the definition of cost. In other instances, an administrator may be bound to a zero fee. For example, when President Lyndon Johnson donated family land for a public park, he specified that there should be no fee charged for its use. Finally, cities may be reluctant to rely too heavily on fees because citizens cannot deduct fees from their income tax, whereas property taxes are legitimate deductions.

Externalities

Externalities, or benefits that accrue to nonusers, are a particularly thorny problem. To the extent that benefits are diffuse and are enjoyed by users and nonusers, appropriate pricing methodology becomes less clear. Summer youth recreation programs are often supported for their benefits to the community. It is argued that by keeping youth busy and off the streets, vandalism and petty crime is reduced. Price no longer works as a true link between those who benefit and those who pay. Furthermore, externalities are difficult to measure, and elements of the classic public-good problem are evident. Therefore, a service characterized by externality does not lend itself to pricing.

Regressive Taxation Features

A common and perplexing criticism of public pricing is that it imposes a hardship on the poor. Under a strict pricing mechanism, the needy may simply not have access to public facilities because they don't have the money. Hence, certain publicly provided services will effectively be denied the poor. By employing the ability-to-pay approach of taxation, critics show that user charges are similar to a regressive tax. (As income decreases, the tax bite of a regressive tax increases.)
Few authors deny the regressive nature of user fees. Pricing, however, may be fairer than sales and property taxes because of their perhaps even more regressive economic effects. Furthermore, the poor can avoid user charges by not consuming the product. They are less able to shift the tax burden.

Economists have long advocated separating allocation and distribution policy. Income should be distributed directly, perhaps through a negative income tax. In theory, after a “fair” income distribution is established, the poor can then choose what market basket of public and private goods they want to purchase.

Given this reasoning, Bird, an economist, feels that the ability-to-pay norm should not be a concern of local administrators. The distribution of income is a national question. A local public manager should not sacrifice efficiency at the expense of equity. Furthermore, policies that take into account the ability to pay necessarily have a high tax burden; the middle- and upper-income classes must subsidize the poor. At the local level, individuals (and firms) have the option to move and escape the tax. If the tax burden is high enough to motivate relocation or to slow middle-income growth, the property tax base will be seriously eroded. In the long run, the city and the poor are worse off. Although Bird’s analysis may be correct, it does not address the problem now faced by local governments—major cutbacks in the federal budget for social programs.

**THE EQUITY-EFFICIENCY DILEMMA**

The efficiency-equity trade-off facing a local administrator is a difficult problem. How can an administrator reconcile the seeming conflict between fair treatment for the poor and the notion that “there’s no free lunch”? Over the last few decades, many programs were initiated that rejected the benefit principle and targeted aid to those with low incomes. Often these programs were financed, in large part, through federal grants, yet were administered at the local level. Public housing, mass transportation, and community mental health centers are a few examples. Given the prospects of significant federal cutbacks, the financial responsibility for service delivery at the local level will grow. Although there is sound theoretical justification for distributive policies resting with the federal government, that is small comfort to a local administrator who must deal with providing community services fairly and efficiently.

Many human services are targeted for people who can’t afford the private-sector alternative.

It should be noted that if a fee does not cover costs, a tax-supported subsidy is necessary. Administrators and policy makers must ask these questions about a subsidy:

1. What services should be subsidized?
2. What is an appropriate subsidy? (Perhaps more pragmatically, what is the current subsidy, and how should it be changed?)
3. Who should be subsidized? (Should allowances be made for differences in income?)

Externalties, uncertain federal funding, and local politics cloud the subsidy issue. Externalities complicate the question since fees for activities with substantial spillovers should be below cost for all. Uncertain federal funding may make the local share of the subsidy change from year to year. Finally, these questions are tightly wedded to the political process since an “appropriate” subsidy is a value-laden concept. Because price changes create new sets of losers and gainers, political battles will almost surely be unavoidable.

**POTENTIAL PRICING MECHANISMS**

Citizens and city officials are well aware of the uniqueness of their community. Indeed, the geography, institutional arrangements, demographic characteristics, and industrial base of each community differs. Furthermore, citizens of different communities may be interested in different levels and qualities of public services. For example, a town with many young families may emphasize schools and recreation for children. Hence, the fair pricing scheme of one community may seem inappropriate in another area. The following discussion can serve as a guide for choosing a pricing mechanism that takes income differences into account. Only through continued experiment, however, will officials find a workable fair pricing structure for their community. The fee structures reviewed here are (1) sliding scale, (2) free to all, (3) uniform charge with slide subsidy, (4) structural arrangements (price differentiation), (5) two-part tariff and compulsory charges, (6) minimum service level, (7) community support, (8) payment in kind, (9) credit card, (10) insurance system, and (11) payment over time.

**Sliding Scale.** The sliding scale is a traditional method used by programs such as public housing authorities and mental health centers. Information concerning income, assets, number of dependents, and so on, is collected, and a fee adjusted for income differences is set. Care must be taken to ensure that the fee does not represent undue hardship.

There are several technical problems associated with obtaining reliable income information. It is important that the form that is used is understandable to people of fairly low educational levels and that the information it provides is easy for agencies to verify. Individual circumstances often change (new job, promotion), hence, an updating process must be regular and simple. It should be noted that there is an incentive for people to hide their true income level, since a lower income results in a lower
fee. Agencies that provide health care face yet another factor. The working poor may have insurance that would cover more than the minimum fee, but they often forget this or hide the information from the agency. Finally, the fee should be collected at the time service is rendered to reduce collection costs.

Traditionally, sliding scales are employed when the agency has substantial federal support. Indeed, a sliding-fee system is often mandated by legislation or grant. In addition, a record-keeping system usually already exists. A housing authority, for example, maintains occupancy records, so income information can easily be added to the existing records. On the other hand, administrators of recreation facilities or mass transportation networks would have to develop costly record and identification systems.

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There are several problems associated with such systems aside from administrative costs. First, there may be a stigma attached to the ID owner. (Food stamp programs have this problem.) The possessor of the card is automatically labeled as poor. Second, the identification card would be difficult to control and update. Would a black market in low-income IDs spring up? Third, an ID system that updated information regularly would be cumbersome and expensive.

Free to All. Because of the administrative problems and potential stigma associated with a sliding scale, some services might be provided free to all. In this case, however, the allocative advantages of user charges would be foregone. For example, pressures might develop to expand service to and subsidization of the middle- and upper-income classes. Nevertheless, the free-to-all method seems most reasonable when externalities are high.

Uniform Charge with Sliding Subsidy. This method is the reverse of the sliding scale. All consumers are charged the same fee, then later, perhaps on a quarterly basis, some portion of the original charge is returned to low-income users. This system might be viewed as a sliding low-income rebate. The G.I. education benefits program is a type of uniform charge with sliding subsidy. G.I.s pay tuition like other students. Their monthly benefit check, however, is computed by taking into account course load and number of dependents. Since initially all users pay the same price, the stigma problems of the sliding-scale method are overcome. The administrative costs associated with monitoring, mailing, updating, and record keeping, however, remain.

Structural Arrangements (Price Differentiation). The administrative problems of the sliding-scale method are overcome through this system. Instead of directly classifying people by income, substitute groupings are used. Howard and Crompton have employed four criteria by which clientele may be classified: participant, product, place, and time.

A common method, for example, is to charge different fees for children, the handicapped, or the elderly. These people are typically among groups with low incomes, although it should be noted that many upper- and middle-income children, elderly, and handicapped will be subsidized if this method is used.

Price could also be differentiated by time. Recreation centers or pools may designate days when all may enter free. In this way, the poor receive the opportunity to enjoy the service. However, because of congestion, they may be receiving a service inferior to that provided on nonfree days. Finally, an example of differentiating price by place would be lowering charges for recreation services in low-income neighborhoods.

Howard and Crompton note that charging different fees for the same program may result in loss of community support and good will and caution that price differentiating must not cause resentment among a majority of citizens.11

Two-Part Tariff and Compulsory Charges. Noted public utility economists argue that in some cases, for reasons of efficiency, charges should be divided into two components. All users pay a common fee for the first part of the charge. It is designed to cover fixed costs and is compulsory. The second half of the charge is based on use. The greater the use the larger the total fee. A water bill, for example, may have fixed and variable components. The two-part system was developed to increase efficiency; however, a similar mechanism could be developed to meet equity objectives.

Each household could be sent a bill for a given set of city services (social or otherwise). The bill would be compulsory and could not be escaped. The second part of the charge then would be collected at the time of use. Thus, frequent users of specific services, mass transit, say, or therapy, or recreation facilities, would pay more. Officials could take differences of income into account through either the compulsory component or the user fee. The fixed fee might vary by income, health, age, or neighborhood, or conversely, everyone could pay the same fixed charge and sliding or differentiated user fees could be employed.

It should be noted that the two-point tariff is most easily used if a city billing system (as for water) already exists. Some cities might find compulsory charges to be an attractive new revenue source. If income differences (either by family or neighborhood) are considered, a regular updating system is important.

Minimum Service Level. Willcox and Mushkin advocate a system whereby a minimum level of basic services is provided free to all, then a fee is charged for additional service. They cite trash collection as an example. Each week a certain amount of trash would be collected free. Additional pickups or additional bags would incur a charge. This system could result in a kind of self-administered sliding charge nearly in proportion to the citizen's
standard of living.\textsuperscript{12}

Community Support. Members of a community can supplement taxes and fees by other fund-raising or cost-saving activities. The benefits of many services, such as neighborhood swimming pools and recreation centers, accrue mainly to residents in a rather small geographic area. Neighborhood identification and support may be possible. For example, in the city of Austin, Texas, recreation centers throughout the city offer classes in subjects as varied as guitar, ceramics, and yoga, but the fees for the classes are not uniform across recreation centers. Each facility has the power to set its own fees, so those in low-income areas often are lower. At these centers, instructors are more likely to donate their time, fund-raising activities like bake sales are frequent, and some classes, such as those in dance, give performances to raise money. A staff that can generate internal and outside support is essential, and decentralized decision making is also important.

Payment in Kind. Fees and taxes usually are collected in dollars, but some low-income individuals may be better able (and willing) to pay in kind. Goldberg and Kane discuss a successful payment-in-kind program at a community mental health center. Day care and cleaning were mentioned as payment-in-kind activities.\textsuperscript{13} This method seems appropriate either for relatively small decentralized community-oriented services or for services that use volunteers extensively. Where it seems reasonable, clients may be encouraged to pay for the service by volunteering aid to the agency at a later date. Administrators of battered women’s centers often discover that former residents are among their best volunteers.

A combination of community support and payment in kind would complement each other. For example, a dance instructor might trade her services as instructor for swimming lessons for her children. This is an area ripe for innovation.

Credit Card. Mushkin suggests an innovative credit card experiment. She uses a school lunch program as an example. A machine-readable credit card would be issued to each child. Children then would be admitted to the lunch room after inserting the card in the computer card reader. Fraud could be guarded against by built-in computer-checking systems. The number of monthly meals consumed would be recorded and parents billed, with the bill adjusted for family income on a sliding scale.\textsuperscript{14} Since all children would be issued a card, there would be no low-income stigma associated with its use. On the other hand, the school would have to engage in the costly task of maintaining, verifying, and updating income records. Furthermore, given the experiences of mental health centers with sliding-scale billings (the billing process is costly and there is a high delinquent-payment rate), the credit card system might be viewed as unnecessarily high in administrative costs.

This method merges modern technology and the ability-to-pay approach and could be expanded beyond the school lunch program. For example, a city service credit card might be issued to each citizen. Individuals could use the card to pay for swimming, golfing, ambulance services, subway use, and so on. Billing would occur at the end of the month. Aside from the obvious high administrative and implementation costs, citizens might object to this system on the grounds that the government was invading their privacy.

Insurance System. Clearly, all of us want fire protection yet we hope we never have to use its services. Some services are used infrequently, and there is risk or uncertainty associated with them. Fire protection, mental health services, and police protection are a few examples. This type of service might be a candidate for a system of public insurance. Differences in income could be taken into account through a sliding-premium feature.

Payment over Time. If people can pay for private goods such as refrigerators or TV sets over a period of time, why not social services? The time dimension associated with certain human services can be fairly accurately estimated. Family therapy, for example, is often concluded in ten sessions or less. Frequently, families who are unable to pay the total cost in a lump sum can handle payments over several months.

For payment over time to work, a clear, easily understood, contractual agreement needs to be worked out ahead of time. An optional renegotiation feature would also be necessary, and a sliding scale could be applied to the final negotiated figure. It should be noted that this method works well only with individuals who have stable credit histories. Payment over time might appeal to the middle class who can’t quite afford private counseling, but would be willing to commit a portion of future income. Care must be taken to ensure that billing costs do not undermine the revenue source.

CONCLUSION

Several of the pricing mechanisms discussed above could prove useful to human service administrators. The sliding scale is perhaps the most viable method, since client records are generally maintained. Indeed, the sliding scale has been employed widely for years. When a graduated-fee structure is used, it should be regularly reviewed and updated, and flaws in the existing system, when possible, should be eliminated. Prior to initiating procedural changes, staff suggestions and support should be obtained, for a resistant staff can undermine the most elegant pricing mechanism.

Although as yet untested in human services, the compulsory charge may offer some fiscal relief in the future. If this is to happen, however, social service agencies need to convince citizens and community leaders that their “product” benefits the community as a whole. This persuasion works best for services like battered women’s centers or emergency psychiatric units.

Often citizens feel they have little say in how their taxes are spent. Perhaps a “general” monthly compulsory charge could be initiated (either a flat fee or a fee based
on percentage of utility consumption). Citizens could choose to support the services they felt most worthy by designating annually how they want their money distributed. This is an area ripe for investigation.

Community support and payment in kind are two other methods with potential. The community involvement and volunteer aspects of these methods can be employed as evidence of local support by an agency trying to capture part of a city's budget.

Adoption of the insurance system seems unlikely, given the present political climate. It should be noted, however, that a large segment of society is already insured. Families with very low disposable incomes will nevertheless often have insurance coverage. Health and mental health agencies should be aggressive in pursuing this source. It may be advisable to provide clients with assistance in filing for insurance.

Finally, payment over time would seem a likely option for mental health centers.

Some of these ideas admittedly are untested and give rise to a number of unanswered questions. For example, what is the best way to collect accurate income information? Will people accept a compulsory charge? More research is clearly necessary. In the long run, making the right choice among alternatives goes hand in hand with learning more about their repercussions.

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**Notes**

5. Ibid., p. 11.
7. Ibid., p. 148.
8. Ibid., p. 80.
13. Carl Goldberg and Joyce Kane, "Services-In-Kind: A Form of Compensation for Mental Health Services," *Hospital and Community Psychiatry* 25, no. 3 (1974).