

Creating The Zero-Tax State:

Why Oregon Should replace taxes with user fees

by John A. Charles

I. Summary

Most proposals in Oregon's taxation debate are focused on changing the taxing mechanism, not reducing taxation. This proposal is fundamentally different. It challenges the very premise of taxation, and urges a different method for financing services: **user fees**. Properly designed user fees, if applied broadly, could eliminate most state and local taxes. The shift from *coercive* taxation to *voluntary* user fees would place Oregonians back in control of their own spending, and force government and private service providers to improve the quality and cost-effectiveness of their services.

II. Introduction

There is a widespread perception that certain services must be provided by tax-supported government agencies as "public goods". Economists generally recognize a public good as an activity or service whose very nature is such that everybody in the general area benefits, whether or not they pay for it. Historically, therefore, most elected officials have argued that such services should be funded by taxes imposed on everyone.

However, a closer examination of how most government services function reveals that in many respects, they *are not* public goods. On the contrary, the government offers services with specific, identifiable users who benefit from the service, with nonusers either not benefiting at all or benefiting to a much smaller extent than users. Thus, there is no theoretical case for most services to be funded by compulsory taxation of all residents.

A more appropriate method of financing would be **user fees**. A user fee is a charge imposed for service based on the amount or level of service provided to the user. A user charge is *voluntary*, in contrast to taxes, since payment occurs only when a citizen *chooses* to use a particular service, and the amount is proportional to that person's use.

Analysts have defined two criteria by which to judge when a public service is a good candidate for user-charge funding rather than general tax funding. The service must, first of all, have *readily identifiable users* who must benefit substantially more from the service than nonusers. And second, it must be possible to ensure that *nonusers can be excluded* from the benefits of the service.

III. Advantages of user fees

Robert W. Poole, Jr., president of the Reason Foundation, has identified four reasons why user charges should be enacted in lieu of general taxation:

1. **Fairness.** Taxes are assessed for many services that only few members of the population use, e.g., tennis courts, marinas, and museums. There is no compelling reason why some citizens should have to pay for services used primarily by others.

Those who benefit the most, should pay the most. To the extent that some members of the community may be too poor to afford these charges, it would be more cost-effective to provide discounted passes *only* for them.

2. **Flexibility.** Public services can be much more flexible when they are directly priced on a per-unit basis. Managers of tax-supported programs have only vague ideas of what consumers want, because they don't receive the feedback provided by markets. When services are provided through market-based pricing, managers can quickly provide more of those things consumers want, and discontinue the things they don't want.

3. **Freedom.** A hallmark of the current decade in Oregon has been the growth of people's desire to lower their tax burden. People increasingly wish to make their own decisions and control their

own lives and resources.

The substitution of user charges for taxes fits in well with this desire. User charges reduce the government's coerced "take", returning the spending decisions to the citizen.

5. ***Ensuring that growth pays for itself*** Perhaps no issue has been more hotly debated in Oregon during recent years than growth management. The concern here is that most existing residents want new residents to pay their fair share for public services. However, many suggested solutions in this debate fail to create a link between those who pay and those who benefit. For example, one frequently suggested solution is system development charges (SDCs) levied on the construction of new homes. But there is no way of discerning, in the abstract, how much a new resident is going to use a specific school or library, nor is there any way of guaranteeing that money paid in SDCs will wind up in the hands of the people actually providing the services. Unless carefully calculated, SDCs run the risk of overcharging some people and undercharging others.

User fees, either as a stand-alone mechanism or in combination with SDCs, can solve this problem, because they provide a fiscal connection between the consumer and the provider.¹

IV. Making the change to user fees

User fees can be substituted for taxes in virtually any circumstance where services are provided to an identifiable population. However, in order to maximize the benefits of this change, it's important to also ensure that consumers have choices for these services. Competition in the marketplace ensures that customers will not be held hostage on issues of price or service. Without such competition, user fees may become just another tax.

Thus, the key to a successful transformation is to eliminate ***taxes and monopoly service*** (where possible), and replace them with ***user fees and competitive markets***.

Transportation finance

Oregon's primary means of financing road maintenance and construction is a \$.24 per gallon state gas tax, coupled

with weight-mile taxes for heavy trucks. The state gas tax should be replaced with road user fees by turning Oregon's most heavily traveled highways into electronic tollways². Tolls can be collected easily through automatic vehicle identification systems that rely on transponders. This eliminates the need for old-fashioned toll booths.

Electronic tolling is currently being used on the Dallas North Tollway, the entire Oklahoma Turnpike, and most bridges in New York City. A new, privately-financed tollway opened in Orange County, CA last year (SR 91), and uses both electronic tolling devices and a concept known as variable pricing -- charging different rates during the peak-hour drive time than during the off-peak time. The purpose of variable pricing is to use existing facilities more efficiently by giving drivers with low-value trips an incentive to shift the time, mode, or location of their trip, thereby freeing up more road space for others with higher-value trips who are willing to pay the higher rate. When combined with tax rebates -- such as the elimination of the gas tax -- this leads to a lower-cost system.

Maintenance of local roads, which are not likely to be tolled in the near future, could be financed through county-wide gas taxes. This would give local residents more direct control over their road spending.

Transit

If the state switches to road user fees, the transit industry should be deregulated to allow unlimited competition. Additionally, payroll taxes used to finance municipal transit should be abolished and replaced with market-based pricing of transit service. Transit payroll taxes are based on the number of employees of each business, but this is not related to the level of service provided to the employees. Thus, in some cases, employers pay large sums of money to transit agencies, without receiving any service at all.

Where such private alternatives exist in other cities, operators are able to provide high quality service with no public subsidies. For example, one federal study found that some 400 *unsubsidized* jitneys operating in Miami carried about 49,000 riders each day, equal to the billion dollar heavy rail system.

Libraries and parks

Libraries and parks can easily be paid for through user fees, and such an arrangement would undoubtedly improve the quality of the services as well. For example, many park users already experience the benefits of pricing through the rental of sports facilities. Participants in sports leagues know that paying fees to ensure that certain facilities are available for league games is far better than simply showing up at a field and “hoping” that the facility will be available.

This approach should be extended because it eliminates the problem of the “commons” (too many owners having access to public property at the same time) and gives people choices about the level of service they prefer.

Libraries could be substantially improved through some combination of market-based pricing and privatization. Currently, many libraries charge no fee for cards, no fee for book loans, and allow unlimited loan renewals unless someone else has a “hold” on the book title. Thus, any individual can tie up thousands of dollars of books for months at a time at no personal cost, even though there are significant costs for the library.

Library user fees would also be far more equitable to low-income residents than the current library property tax. According to a 1994 survey conducted by the Oregon Survey Research Laboratory, nearly half of Oregon adults below the poverty level are not regular library users, yet they pay for those services through higher rents. In contrast, fully 80% of adults with incomes over \$100,000 use libraries. Clearly, user fees would be the most progressive way to pay for library services.

Fire services

A great deal of fire protection is inherently a private, rather than a public, responsibility. The risk of fire is related to many factors under the direct control of building owners, such as building design and maintenance. The choice of building materials alone can have a significant impact on the probability of a serious fire occurring. In comparison, the mere property tax value has very little relationship to fire risk.

When fire services are paid for through general taxes, building owners have no incentive to invest in fire prevention, because it will not affect their tax burden for fire services. As a result, several studies have demonstrated that in those communities where fire services are provided through

tax-supported public agencies, the communities have made an overinvestment in fire suppression and an under investment in fire prevention.

Researchers have suggested that fire protection be provided through a user charge in which the fee is based on a formula including the property value, size, number of occupants, and probability of fire. The latter would be based on the building’s structural characteristics, age, and use of protective systems (fire doors, smoke detectors, sprinklers). Under this system owners would have an incentive to invest in improvements that reduce the risk and severity of fire.

In many parts of the state, firefighters now spend more time providing emergency medical services than on fighting fires, yet these services frequently go uncompensated. Allowing fire bureaus to recover costs from patients would create a source of revenue to offset the loss of property taxes, and encourage everyone to carry adequate insurance for such events.

Police protection

Of all services, police protection is perhaps the most difficult to provide on a user fee basis. Yet even here, significant tax savings can be seen through better efforts to differentiate those policing services that are truly public and those that benefit mostly private parties. Where citizens are given the incentive — through variable pricing — to take specific steps to reduce their own risk of crime, they are more likely to do so than if their policing costs are assessed simply on the basis of property ownership.

Citizens in thousands of communities are already taking the initiative through such arrangements as volunteer neighborhood patrols, home security subscriptions, and contracts with private patrol companies. In San Francisco, more than 60 private police beats, “owned” by private police officers, exist on a user fee basis. The “Patrol Specials,” as the officers are called, are provided a complete police academy training, carry guns, and have full arrest powers. But they are private entrepreneurs who receive no tax money.

Some customers desire and pay for 24-hour-a-day foot patrol. Others want only periodic drive-by checks. People on vacation can pay variable fees for such services as rotating house lights, taking in the mail, and making regular on-foot backyard checks.

The San Francisco system thus provides a vast diversity of police services, tailored to the needs of the individual customers who pay for what they want. The San Francisco system has also stood the test of time. The city's private beats date back to the city's founding in the 1850's, and were formalized in its 1899 charter.

Schools

Since public education accounts for more than 58% of all general fund expenditures in Oregon, reforming this system offers the single most significant opportunity to lower the tax burden for Oregonians. Fortunately, the long and successful history of private schools clearly demonstrates that schools can be operated on a user fee basis.

If the approximately \$7,100 that we pay annually per student (k-12) were put back in the hands of taxpayers through the repeal of the state income tax and the elimination of local school property taxes, the average family would have thousands of extra dollars per year. Most of these families would be quite capable of purchasing educational services on the open market, provided that all schools were privatized.

What are now public schools could be turned over to newly formed non-profit foundations, whose mission would be to lease the facilities to teachers. Teachers would organize themselves in whatever fashion they desired — either as for-profit businesses, nonprofit educational centers, neighborhood co-ops, etc. School buildings could become “educational malls”, filled with multiple schools available to all citizens. A version of this concept has been used in East Harlem, New York City, for over 20 years, with substantial success.

For low income residents, scholarships could easily be provided without any taxation through the Common School Fund (CSF). The CSF has assets of some \$328 million in stocks and bonds, and real estate assets of more than \$1.2 billion. Most of the land assets were deeded to the state by the federal government at the time of statehood, for the express purpose of supporting K-12 schools. The portfolio includes the Elliott State Forest near Coos Bay (valued at \$800 million), as well as some 600,000 acres of rangeland in southeastern Oregon.

The average annual return on the stock portfolio is about

7%, but the land resources bring only 0.5%. Since the Oregon Constitution requires that these lands be managed for purposes of maximum revenue for schools, clearly a return of less than 1% violates the Constitution. However, the State Land Board — comprised of the Governor, the Secretary of State, and the State Treasurer — has refused to take any action that would increase the rate of return on these lands.

If the lands were sold and the revenue invested in stocks and bonds, Oregon school children would have approximately \$150 million per year that they don't have now. If coupled with lottery funds, the state would have adequate resources to ensure that all 150,000 school children now on free or reduced-fare lunch programs could receive tuition scholarships.

Conclusion

Taxation coupled with monopoly service from government agencies prevents citizens from controlling their own expenditures. The solution to this problem is ***user fees and markets***. Only through voluntary transactions with free markets can we hope to lower our tax burdens while improving the quality of important services.

Endnotes

1. **Cutting Back City Hall**, Robert W. Poole, Jr. New York: Universe Books, 1980.
2. According to ODOT, approximately 61% of all miles traveled in Oregon take place on about 17% of the existing lane-miles of roads. These are the roads that should be considered for conversion to electronic tollways.