User-Fee Financing of USDA Meat and Poultry Inspection. By James MacDonald, Fred Kuchler, Jean Buzby, Fitzroy Lee, and Lorna Aldrich. Economic Research Service, U.S. Department of Agriculture. Agricultural Economic Report No. 775.

Abstract

USDA's Food Safety and Inspection Service (FSIS) finances about 13.5 percent of its budget outlays through user fees for overtime and unscheduled meat and poultry inspections. User fees play an increasingly important role in financing government programs, and FSIS has frequently requested expanded authority to charge user fees for more of its operations. Congress has consistently rejected the FSIS requests and has placed important restrictions on fees and the uses of fee revenue at those agencies that have been granted more extensive user fee authority. This report surveys the application of user-fees for financing meat and poultry inspection programs in other countries; reviews user-fee systems in other Federal agencies, particularly those with food and agricultural missions or regulatory responsibilities; and discusses the relevant economics literature on the use and design of user fees. Finally, we suggest several elements that should underlie the structure of user fees for meat and poultry inspection, should such a program be introduced.

Keywords: user fees, meat inspection, public finance

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Executive Summary

User fees play an increasingly important role in financing government programs. Federal user fees accounted for 12 percent of all Federal revenues collected in fiscal year 1996. USDA's Food Safety and Inspection Service (FSIS) raised $85 million through user fees for overtime meat inspections and unscheduled meat and poultry inspections in FY 1996, about 13.5 percent of total FSIS outlays.

FSIS has frequently requested expanded authority to charge user fees for its operations, but Congress has consistently rejected the requests, despite approving expanded user-fee authority for other Federal agencies. Agencies that do have more extensive user-fee authority, nevertheless, have important restrictions placed on fees and on the uses to which fee revenue can be put. In this environment, the Economic Research Service (ERS) investigated the use of user fees for the finance of meat and poultry inspection. In particular, ERS aimed to do the following: survey the application of user fees for financing meat and poultry inspection programs in other countries; survey user-fee systems in other Federal agencies, particularly those with food and agricultural missions or regulatory responsibilities; and review the relevant economics literature on the use and design of user fees.

ERS obtained information on 22 countries—the 15 members of the European Community (EC) as well as Argentina, Australia, Canada, Japan, Korea, Mexico, and New Zealand—concerning the financing of meat and poultry inspection in each. Twenty-one rely on user fees for at least some funding for government meat inspection. Some rely on a combination of public funds and user fees, systems that resemble the current system in the United States. Others, including all EC member states, finance all of the costs of live animal and meat inspections through user fees paid by inspected establishments.

Many Federal agencies now rely on user fees for at least some funding, and new or revised user fees now finance USDA inspections of imported food and agricultural products and exported grain and rice shipments, FDA review of new drug applications, and most activities of the U.S. Customs Service, the Federal Communications Commission, and the Nuclear Regulatory Commission.

Some inspection agencies base their user fees on hourly charges for inspectors' time. The hourly charges can vary with the skills required for a task and according to the time of inspection and the volume of inspection services to which a firm commits. Charges can also be based on measurable outputs, rather than inputs. In some EC countries, fees for slaughter inspection are assessed not on the basis of inspector hours, but on the basis of inspected carcasses. U.S. inspection agencies also often perform lab tests and other analytical services in addition to inspections, and they charge specific fees for each of those services.

Agencies can match charges to actual costs of providing services. Higher weekend and overtime rates reflect the wages paid to inspectors for overtime and weekend work. Some types of services may require more skilled, and therefore more highly paid, inspectors. Firms that can commit to the use of full-time inspector services impose lower costs of travel and inspector downtime on agencies. By offering rates that reflect costs, agencies provide firms with incentives to choose lower cost services; thus the fee structure can provide agencies with ways to manage costs.

Agencies may have significant components of overhead costs that arise from developing standards, performing research, managing inspection and review, and using Departmental support. Overhead may be paid for out of general tax revenues, but it is frequently recovered through user fees. Firms may be charged for overhead in direct proportion to their use of inspection hours, but overhead may also be recovered through volume charges, assessed in direct proportion to the firms' volume of output, rather than to their use of inspection services.

Advantages and Disadvantages of Financing Through User Fees

Before choosing a structure for user fees, the FSIS should consider four issues to decide if user fees are an appropriate option for financing government activities.

1. Programs should be easy to administer. User fees generate administrative costs for tracking detailed program costs, managing revenue flows, and adjusting fees over time. Fees also create policy issues, and managers frequently devote considerable time to fee issues as they are raised by Congress and by fee payers. The process of collecting fees also creates compliance costs for direct users, as each must now make, record, and review payment. Compliance and administrative costs will substantially exceed any administrative savings realized through reduced support from general revenues because the system for administering and paying for general revenues remains in place. Administrative and compliance costs will be larger the more complex is the regulatory environment and the more diverse are the regulated entities.

2. User fees can lead to more effective agency management. Administration of a fee system can generate new information relating detailed program costs to regulatory activities and to program outcomes. Improved information can allow program managers to operate more effectively by allocating resources to their most productive uses and by identifying reasons for unusual cost overruns. Moreover, if firms have some choice among inspection alternatives (such as overtime vs. regular time, or contract vs. intermittent service), then fees that reflect an agency's true cost of services can provide firms with incentives to use agency resources carefully, thus indirectly conserving those resources. Fees are more likely to improve agency effectiveness if fee collection generates new sources of information, if agencies carry out a wide variety of activities on a diverse mix of plants, if fees are based on costs, if fee revenues actually fund agency programs, and if firms can choose among a variety of services or regulatory options.

3. Fees can lead to more stable financing of essential services. Interest in user-fee financing frequently arises from concerns that general revenue financing can lead to underfunding of some activities whose benefits clearly exceed costs. User fees on regulated entities are often seen as a feasible alternative because the regulated firms are easily identified, they may have limited opportunities to avoid paying fees, and they may prefer paying fees to the alternative of receiving poorly funded and poorly delivered services. But user-fee financing will not always be more stable. As a technical matter, financial stability requires fees whose bases vary with inspection costs. For example, Animal and Plant Health Inspection Service (APHIS) revenues from cattle inspection can vary sharply with transborder cattle flows, even while inspection costs do not. As a practical matter, fees can create coalitions among fee payers, who may work to shift fee payments to other payers.

4. Fees can ensure that the right amounts of inspection services are used. Users compare a fee to the benefits that they receive and use a government service only as long as benefits to them exceed the fees. The fees then provide a market test for government services—agencies will provide the services only as long as the benefits to society outweigh costs.

Fees provide an accurate market test only if they actually do reflect the costs of providing services and if the benefits flow largely to those paying the fees. In the case of meat and poultry inspection, processors would pay the fees, but most of the food safety benefits flow to ultimate consumers. Consequently, processors would compare the costs to only their part of the benefits (ignoring benefits to the public at large) and generally would be expected to purchase too little of the inspection service. Fees would, therefore, lead to underprovision of inspection services.

However, this primary economic criterion for evaluating user fees may be irrelevant for meat and poultry inspection. Because inspection is mandated, the demand for inspection is unlikely to be affected by its price (the fee), and the imposition of fees would not affect the level of inspection provided. If fees do not affect the demand for the service, then charging fees can have no positive or negative impact on the appropriate level of service.

User-Fee Design: Financial Management

Three issues of financial management arise when agencies try to design user fees. Each can be negotiated at the time a program is designed, and each can affect program performance.

1. Fee systems operate under a variety of spending authorities. Agencies need to be aware of the ways in which Congress, Office of Management and Budget (OMB), the Treasury, and an agency's Department can constrain how an agency collects and spends fee revenues.

2. Agencies must allow for reserve funds because revenues may not match expenditures through the year. Fees may all be paid during a statutorily designated payment month, while costs are incurred throughout a year. Agencies may also need start-up funds because initial revenue flows are modest or because fee systems are introduced gradually. Moreover, agencies shifting to user fees frequently retain significant accrued liabilities (such as employee benefits) from earlier periods. Finally, revenue flows may fall short of expectations because of recessions or other shortfalls in activity. In each case, agencies will need to build reserve balances, either through a fee schedule that provides an excess of revenues over costs in some periods or via appropriations from Congress. The latter option is probably more desirable in those cases in which agencies retain significant accrued liabilities when they shift to user fees.

3. Agencies need to design ways to adjust fee schedules to account for inflation, productivity growth, and changes in workload. Some statutes mandate fees that can be adjusted only through Acts of Congress. In other cases fee adjustments are designed into the statute. Some adjustments are based on the rulemaking process. Because some methods are far more difficult than others, agencies should seek authorizing legislation that establishes effective and flexible fee adjustment mechanisms.

Designing Structures for User-Fee Programs

European Community directives require member states to base user fees on the costs incurred at inspected establishments, and the basic U.S. statutes underlying user fees oblige agencies to base fees on costs. Costs can be difficult to measure, particularly at the level of specific regulatory activities, and the attribution of overhead costs to activities can be arbitrary. ERS believes that three strong reasons support establishing fees that are based on costs.

1. Agencies can better balance revenues and expenses through time if fees are based on costs. Agency workloads can change, as some tasks take on greater importance. If fees do not reflect costs, then as underpriced tasks grow in importance, the agency will find that the costs associated with those tasks grow more rapidly than the resources available for doing them. The result will be poor agency performance, a drawdown of financial reserves, or a request to Congress for an emergency appropriation. Most likely, all three will result.

2. Fees based on costs provide more efficient use of agency resources. Improved information can allow program managers to operate agencies more effectively; but the system will generate useful new cost information only if fees are based on costs. Cost-based fees can also affect agency efficiency indirectly by leading users to reorganize their consumption of inspection resources in ways that reduce inspection costs.

3. Cost-based user fees may limit political gaming by regulated firms. If agencies establish fee systems based on costs, they can more easily rebut charges of arbitrary decisionmaking made by regulated entities. They can also force interest groups to offer cost-based justification for their own alternative proposals. Such a rule will allow the agency to limit its own expenditure of management resources in debates over fee structures.