



Policy Title: User Fees and Subsidies Policy
Policy Number: CFO010
Report Number: FCS2008-13
Approved by: City Council
Effective Date: 2008 April 28
Business Unit: Chief Financial Officer's Department

BACKGROUND

User fees are fees that The City of Calgary charges in exchange for goods and services. User fee revenues represent a significant portion of The City's total operating budget. A consistent approach to setting user fees is necessary to protect and anticipate this important revenue source, as well as to ensure that the necessary information is available to inform decisions regarding user fees.

This policy replaces the User Fees Policy that was approved by Council in 1995 (FB-83). A review and update of the 1995 policy was requested in Council Priority 3.11 (2006-2008 Council Priorities). The key changes from the 1995 policy are changes in the language, particularly in the classification of goods and services, identification of a pricing methodology to support user fees and explicit identification of societal benefits for some goods and services. Definitions of terms used in this revised policy are included at the end of the policy.

A discussion paper entitled, [Underlying Principles Guiding User Fees & Subsidies Review](#), is available to give more in-depth description and analysis regarding the principles that form the basis of this policy. [Definitions of terms](#) used in this policy are included at the end of the policy.

PURPOSE

The purpose of this policy is to provide a framework for decisions related to the pricing of user fees. It sets out guidelines for the process, rationale and the information needed to support the recommended user fees. This policy applies to goods and services provided by City Business Units for which a user fee is charged.

This policy will lead to consistent and transparent decision-making regarding user fee pricing. This will help to protect this valuable revenue source while also ensuring that user fees accurately represent the value of the goods and services to citizens.



POLICY

Guiding Principles

The following principles underlie the User Fees Policy.

Principle 1 - Benefits Principle: those who receive benefits from a particular municipally provided good or service should pay for that good or services according to the level or value of the benefit received.

The benefits principle indicates that for goods that have an individual private benefit to the consumer, it is appropriate to consider user fees as a way of matching the payments with the benefit received. Properly priced user fees are the most direct means of matching payment with the benefit received.

User fees should only reflect the proportion of the total benefit that is represented by the individual private benefit. Where consumption of a good has a public benefit, broad based tax support reflecting the benefit to all and paid through taxes should be considered. This is discussed further below under the concept of general tax support.

Principle 2 - Cost Recovery Principle: the full cost of providing a good or service, including operating expenses, administrative costs, capital expenses (including depreciation), as well as implicit costs of foregone opportunities or activities that are not being undertaken, environmental costs and social costs, should be the starting point when calculating the appropriate user fee.

The cost recovery principle does not imply that all costs incurred need to be recovered through user fees; rather, it suggests that even if the full costs are not recovered through user fees, understanding the full costs should be the starting point in setting the appropriate user fee. Thereafter, explicit decisions can be made, including decisions regarding the level of subsidization of the good.

Principle 3 - Management of Public Assets Principle: public assets have a value and The City has a responsibility to recognize this value and protect these assets.

When assets are used to provide publicly available goods, then proper management of these assets implies that they will be utilized so that the public receives the greatest total benefit. This principle recognizes that public assets have a value and that this value should be considered when determining rates for user fees. Lifecycle costs should also be considered when determining user fees in order to ensure that the values of the assets are protected.



Principle 4 - Allocation of Resources Principle: in an environment with limited resources available and increasing public demand for goods and services, user fees have value as a mechanism for allocating scarce resources.

Charging a fee can also be used to manage the timing of demand for a service. Many goods offered by The City have higher demand during peak periods. Building capacity to meet peak demand implies there is under-utilized capacity during the off-peak periods. Implementing price differentials can help to balance the demand for goods between peak and off-peak periods. Charging higher prices during peak periods can encourage people to consume during off-peak times while generating greater efficiency in the use of infrastructure.

Principle 5 - General Tax-supported Subsidies Principle: when consumption or use of a good or service benefits society as a whole, all citizens should pay for the societal benefit.

Government is in a unique position to achieve the societal benefits principle through general tax support. If society as a whole benefits from an activity, then society as a whole should pay the proportion of the costs of that activity that reflects the societal benefit. The City collects money from citizens through the tax system and is able to provide subsidies to the activities which benefit society at large.

At times, societal benefits associated with a good, such as transit, come not in the form of benefits per se, but rather as a reduction of social costs. The most equitable means of remedying a social cost is to require individuals to pay for the negative impacts of the activity. This is often done through selective taxation and regulation. However, when the cost is not fully reflected in the price of the good, then encouraging the consumption of substitute goods or services that reduce social costs may be appropriate. This can be achieved through general subsidization of a substitute good, which reduces the price and increases consumption of the substitute good. In turn, this reduces consumption of the activity with the higher social cost and results in reduced social costs.

Principle 6 - Tax-supported Subsidies for Individuals Principle: in cases where individuals may have resources below an acceptable level and are not able to make the choice to consume and pay for City goods and services, The City could provide a subsidy to the individual in order that they are allowed the choice to consume.

In contrast to the general tax support subsidies which are based on the benefits principle, individual tax support subsidies are provided on an individual basis and apply only to those who meet stated criteria.



Policy Statements

General

- 1) Each good or service provided by The City should be classified into one of four categories. Each category identifies different levels of individual and societal benefits received. User Fees are appropriate for goods and services that are classified as either i), ii) or iii) below. The categories for goods and services are:
 - i) **Non Tax-Supported** - A non tax-supported good or service is a good or service for which user fee revenues, in an average year, are expected to recover the full costs of production. A good or service potentially falls within this category if the benefit from consumption accrues only to the user and a user fee can be charged. This category replaces the Private Good category in the 1995 User Fees Policy;
 - ii) **Partially Tax-Supported** - A partially tax-supported good or service is one for which user fee revenues are expected to recover only a portion of the full costs of production. The costs not covered through user fees are subsidized through tax revenues. A good or service potentially falls within this category if the benefit from consumption accrues to both the user as well as to society as a whole and a user fee can be charged. This category replaces the Merit Good category in the 1995 User Fees Policy;
 - iii) **Licenses, Permits and Approvals** – Licenses, permits and approvals constitute permission granted by the municipality allowing property owners to use their property in the specified manner. This category replaces the Regulatory Good category in the 1995 User Fees Policy;
or
 - iv) **Fully Tax-Supported** - A fully tax-supported good or service is one for which the full costs are recovered through taxes, therefore no user fees are charged. A good or service potentially falls within this category if the benefit from consumption cannot be easily ascribed to an individual or a user fee is not practical or desirable. This category replaces the Public Good category in the 1995 User Fees Policy.
- 2) User Fees are only appropriate where The City is willing and able to exclude customers for non-payment in a way that is both legally and administratively feasible, as well as socially desirable.



- 3) No User Fee should be applied without a full consideration and analysis of subsidy options.

Pricing Methodology

- 4) Each user fee should be supported by a pricing methodology for calculating the user fees. The pricing methodology will form the basis for business units to set the user fee for each good or service.
- 5) Pricing of user fees should conform to the Municipal Government Act and any other relevant legislation.

All Goods and Services

- 6) The methodology for calculating prices for all goods and services should consider:
 - a) an estimate of the full cost of producing the good or service. The full cost of producing the good or service will include:
 - i) all direct and indirect operating costs;
 - ii) all capital costs. The capital costs include amortization of any debt, depreciation and lifecycle costs and a return on capital;
 - iii) estimates of environmental and social costs; and
 - iv) corporate overhead costs
 - b) a demand analysis for the good or service;
 - c) an estimation of the value of the good or service to consumers;
 - d) an estimation of the value of the societal benefit associated with the consumption of the good or service;
 - e) identification of whether GST is included in the published price or excluded from the published price. GST should be excluded unless there is a supported business reason for including GST;
 - f) a consideration and analysis of the existing market price, if applicable;
 - g) an analysis of the potential use of convenience pricing for the good or service; and



- h) identification of differential pricing strategies. Differential pricing strategies include:
 - i) peak-load pricing;
 - ii) amenity-based pricing;
 - iii) pricing based on location;
 - iv) pricing based on customer class;
- i) the rationale for differential pricing. Acceptable rationales for differential pricing are cost differentials, demand management practices, standard business practices (e.g. revenue/profit maximization) and differentials in the societal benefit; and
- j) provisions to change prices in the intervening years reflecting impacts such as cost inflation and convenience pricing.

Non Tax-Supported Goods and Services

- 7) In addition to the inclusions in 6) above, the methodology for calculating prices for non tax-supported goods and services should consider:
 - a) full cost recovery, including capital depreciation;
 - b) profit maximization pricing strategy where legally permitted; and
 - c) differential pricing to different customer classes, particularly where these reflect the standard business practice for the good or service. Customer classes may be defined on any discernable characteristic that is legally allowed but should be restricted to those for which the administration costs are relatively low.

General Tax Support for Partially Tax-Supported Goods and Services

- 8) In addition to the inclusions in 6) above, the methodology for calculating prices for partially tax-supported goods and services should consider:
 - a) the societal benefit attributed to the consumption of the good or service as well as a general subsidy that reflects an estimate of the value of the societal benefit. The societal benefit and corresponding tax support should be determined such that:



- i) the societal benefit represents the environmental, social and economic external benefits associated with consumption of the good or service, as defined by the 11 [policy goals for assessing societal benefits](#), approved by Council in report FCS2008-13. These goals are consistent with The City of Calgary's Triple Bottom Line policy LUP003, EM003 CS003.
 - ii) the tax-supported subsidy will be presented as a range to allow flexibility between review periods. Unless otherwise justified, this subsidy should be presented in terms of a percentage of the full cost of producing the good or service;
 - iii) differential general subsidies may be attributed to different customer classes provided they are supported with a detailed analysis; and
- b) differential prices for non-residents. However, an analysis should be provided that considers the administration costs involved in enforcing the differential prices, the potential impact on other partially and fully tax-supported goods and services and any legal considerations associated with the implementation of differential prices for non-residents.

Licenses, Permits and Approvals

- 9) In addition to the inclusions in 6) above, the methodology for calculating prices for licenses, permits and approvals of goods and services should consider:
 - a) deviation from full cost recovery for licences, permits and approvals in situations that involve the explicit encouragement or discouragement of specific activities. A full analysis detailing the impact of price on the encouragement or discouragement of the activity should be included with the pricing methodology, along with a subsidization strategy if less than full cost recovery is used; and
 - b) rationalizing penalties for non-compliance with the price of licences, permits and approvals to ensure they provide a sufficient deterrent for non-compliance.

Tax-Supported Subsidies for Individuals

- 10) User fees should be accompanied by a documented strategy for subsidies to qualified individuals. This strategy should include:
 - a) identification of any individual subsidies which may apply to the goods or service, and whether the subsidy is the result of a City-wide subsidy



- program or specific to the good or service. Individual subsidies should be consistent with The City's Fair Calgary Social Policy CSPA034;
- b) the criteria for receiving an individual subsidy and identification of the application process for receiving an individual subsidy. The criteria and application process should be consistent with The City's Fair Calgary Social Policy; and
 - c) an analysis of implementing a sliding benefit for individual subsidies. Any sliding benefits that are implemented should be consistent with The City's Fair Calgary Social Policy.

Policy Review

- 11) The principles and policy statements should be reviewed every 10 years

PROCEDURES & RESPONSIBILITIES

Council will approve:

- the policy and any updates and amendments to the policy; and
- all user fees as part of the Business Planning and Budget Cycle process.

Administration will be responsible for:

- reviewing the principles and policy statements and recommending any updates and amendments to the policy;
- conducting and maintaining a corporate capital and support service costing study;
- recommending user fees based on the relevant pricing methodology; and
- developing pricing methodologies for user fees for those goods and services that they provide.



DEFINITIONS OF TERMS

Amenity-based pricing	Basing price on the amenities contained within each facility rather than setting a uniform price for all facilities.
Average cost pricing	Setting price equal to the average cost of producing the good.
Capital cost	The cost of buildings and equipment as well as the costs related to the financing of buildings and equipment.
Convenience pricing	Pricing that takes into account the convenience of the monetary units needed to pay for the good (e.g. rounding to the nearest quarter or dollar).
Cost	Any resource required to engage in an activity.
Customer class	A categorization of customers based on an identifiable characteristic common to all customers in the class.
Demand analysis	An analysis of the market demand for a good and service that relates the impact of price changes to changes in total revenues and costs.
Differential pricing/Market segmentation pricing	The practice of setting different prices for different consumers of a good, depending on the characteristics of the consumers.
Direct costs	Costs that can be assigned to individual activities in the production of specific goods and services.
Full cost recovery	Setting price for a good or service such that revenues generated are sufficient to fund all costs related to the production of the good.



Fully tax-supported good	A good or service that is funded entirely through taxes and therefore no user fee is charged. Goods and services that fall into this category are typically equally available to all consumers, non-rivalrous (i.e. consumption by one consumer does not interfere with the availability to other consumers), non-exclusive (i.e. no one can be excluded from consuming it), and the benefits are shared by a large number of consumers.
General subsidy/General tax support	A subsidy that reduces the price of a good or service for all consumers.
Group subsidy	A subsidy that reduces the price of a good or service to all members of an identifiable group.
Incremental cost pricing	Setting the price of a good or service for a secondary market equal to the total the cost of producing it for the entire market less the cost of producing it for the primary market.
Indirect costs	General costs required to operate the Corporation but cannot be assigned to individual activities in the production of specific goods and services (e.g. overhead costs).
Individually targeted subsidy/ Individual tax support	A subsidy that reduces the price of a good or service for individuals that meet specific criteria.
Licenses, Permits and Approvals	Permission granted by the government for an individual to engage in an activity, allowing property owners to use their property in the specified manner.
Lifecycle cost	The costs associated with the maintenance and replacement of physical capital (i.e. buildings and equipment) in order to ensure the maximum life use from the capital.



Market competitive pricing	Charging a rate/fee similar to that charged by suppliers of similar products.
Multi-part tariff	A fee that is comprised of a fixed flat rate plus a variable use-related charge.
Non tax-supported good	A good or service for which user fee revenues, in an average year, are expected to recover the full costs of production. Goods and services that fall into this category typically benefit only the consumer, are rivalrous (i.e. consumption by one consumer impedes the availability to other consumer) and are exclusive (i.e. people can be excluded from using it).
Partially tax-supported good	A good or service for which user fee revenues are expected to recover only a portion of the full costs of production with the balance of the costs funded through taxes. Goods and services that fall into this category are typically rivalrous and exclusive, but the benefit of consumption accrues to both the consumer as well as a larger part of society. Because of the latter benefits, society (usually government), deems the good undervalued by consumers in normal market exchanges.
Peak load pricing	The practice of setting a price higher during periods of high demand and lower during periods of low demand.
Pricing Methodology	The general process and criteria used in determining the price of a good or service.
Profit maximizing price	A price that is set with the goal of generating the highest level of profit (revenues less costs) possible.
Regulatory good	Permission granted by the government for an individual to engage in an activity.



Societal Benefit	A benefit to society at large that is derived from an individual's consumption of a good or service. These benefits can be external economic, environmental or social benefits.
Subsidy	The portion of production costs that is recovered through taxes or other revenue sources rather than by the sale of the good or service in order to keep the price of the good or service at a desired level.
User fee	A payment charged in exchange for a good or service provided by the government.

AMENDMENTS

New Policy is replacing 1995 User Fee Policy (FB95-83).
Policy was approved *in principle* 2007 April 23 while an implementation plan was designed and finally approved by Council 2008 April 28

2010 revision-policy number change from FCS013 to CFO010 due to department reorganization



User Fees and Subsidies Policy CFO010

POLICY GOALS FOR ASSESSING SOCIETAL BENEFITS¹ (Approved by City Council, 2008 April 28)

Reduce community greenhouse emissions, air pollutants, and energy consumption (environmental)

Protect water resources (environmental)

Ensure land stewardship & protection (environmental)

Reduce waste to landfill (environmental)

Provide accessibility/availability (social)

Enable affordability (social)

Promote accommodation/acceptability (social)

Improve adequacy to meet need, suitability and safety (social)

Create a city where citizens want to live and invest (economic)

Encourage sustainable communities (smart growth)

Reduce barriers to participation (smart growth)

Other (from Council-approved environmental, social, economic or smart growth policy)

¹ Source: Council Report FCS2008-13 Attachment 3



**UNDERLYING PRINCIPLES
GUIDING USER FEES & SUBSIDIES REVIEW**

Revised Discussion Paper

March 2007

Table of Contents

1. Introduction	3
2. Types of Goods and Services	5
2.1 Consumption Perspective	5
2.2 Provision Perspective	5
2.3 Combining Perspectives	6
2.4 Licenses, Permits & Approvals	6
2.5 Summary of User Fees Goods and Services	7
3. User Fee Principles	8
3.1 Benefits Principle	8
3.1.1 Policy Implications	8
3.2 Cost Recovery Principle	9
3.2.1 Policy Implications	9
3.3 Management of Public Assets Principle	10
3.3.1 Policy Implications	10
3.4 Allocation of Resources Principle	11
3.4.1 Policy Implications	11
4. Subsidy Principles	13
4.1 General Tax Supported Subsidies Principle	13
4.1.1 Policy Implications	14
4.2 Tax Supported Subsidies for Individuals Principle	14
4.2.1 Policy Implications	15
5.0 Potential Outcomes of Subsidies	16
5.1 Maximize Societal benefit	16
5.2 Encourage Participation in Society	16
6.0 Policy Development	17
7.0 Summary	18

1. Introduction

The User Fees and Subsidies Review (Council Priority 3.11) is being undertaken to update The City's user fee policies and related subsidy strategies. The purpose of the initiative is to establish a consistent approach to user fees and subsidy policies to support corporate economic, social and environmental objectives.

User fee revenues provide a significant portion of The City's operating budget. Any fluctuations can have a major impact on The City's ability to operate within its annual budget in any given year. It is therefore important to review the user fee policy and develop a subsidy policy that will provide a rational basis for determining user fees and subsidies while providing clarity in forecasting City revenues and expenses. This will assist The City in meeting the challenges of rising costs brought on by population growth, new development and inflation.

User fees can be more predictable than other sources of revenue and more closely aligned with changes in the economy. With user fees, The City can directly observe the markets, forecast future demand and make its own pricing choices. Together this yields a much more predictable source of revenue than other sources of funding. In this fashion, user fees can provide The City control over both the price chosen and the amount and quality of service that is delivered. User fees increase the ability of The City to provide more services for a given level of taxes. The City budget for 2006 includes \$550M for user fees (\$260M from tax supported business units and \$290M from utilities).

The user fees and subsidies review is working towards a consistent approach to user fees and subsidy policies across the organization. In reviewing these policies it is recognized it is necessary to consider the current financial constraints and the need for stable sources of revenue to meet Council objectives, while at the same time providing valued goods and services to citizens. If The City chose to fund all its existing services from property taxes instead of collecting user fees, the average residential municipal tax bill in Calgary would increase by over 70% from \$1000 to \$1725 in 2006. In the absence of user fees, the only alternative to tax increases is a significant reduction in the services provided.

The current environment in Calgary indicates stronger citizen support of user fees than tax increases. The most recent Citizen Satisfaction Survey indicated that almost three quarters of those surveyed preferred the introduction of new user fees or expanding existing user fees, rather than increasing property taxes as a means of increasing revenues.

User fees may be politically more acceptable because of a more transparent relationship between cost and price. They may also resonate more clearly as consumers compare relative prices with other products. As well, the ability to choose whether to consume and pay, or not, may increase the attractiveness of user fees as opposed to taxes.

A number of City departments charge user fees today for various products and services they provide to citizens. However, the current user fee policy is more than ten years old and Calgary has changed significantly over these years.

User fees require citizens to make decisions about how to allocate their income amongst various options. In effect, people make judgments regarding what goods they value, whereby price indicates the relative value of different goods.

When goods are fully tax supported, there is no explicit price to guide this decision making process. In effect, there is a disconnect between the cost of providing the good and the price (i.e. tax). This leads to a perception that the service is free, which in turn leads to over-consumption of the good relative to the cost of production. In this way, consumption does not accurately reflect the value that consumers place on the good. By providing consumers a choice to consume (and pay), user fees restore the relationship between consumption and the value placed on the good

This discussion paper has been developed to provide a shared understanding for Council and City Administration of the underlying user fees and subsidies principles being proposed to establish consistent user fee and subsidy policies for The City. Further work will be required during the development of implementation plans to identify legal and other issues that must be addressed.

The User Fees and Subsidies Review is targeted for completion in the 2006 to 2008 timeframe to ensure policies and implementation plans are available for the 2009 to 2011 multi-year business planning and budget cycle.

2. Types of Goods and Services

The City provides a number of different types of goods and services to citizens. In order to understand the applicability of the user fee and subsidy principles discussed later in this paper, it is important to first understand the characteristics of City goods and services eligible for consideration under the user fee and subsidy principles¹.

There are two ways of looking at the characteristics of City goods. One is from the perspective of the consumer. The other is from the perspective of the supplier/provider. The section below identifies the characteristics of goods from both perspectives, beginning with the perspective of the consumer.

2.1 Consumption Perspective

When looked at from the consumption perspective, goods are separated into private and public goods based on who benefits. A pure private good is one in which only the consumer derives an individual or private benefit. By contrast, a pure public good is one in which consumption of the good benefits society at large rather than any particular individual, and therefore, is deemed to have a public or societal benefit.

Between these extremes lies a continuum of goods which have benefits to the individual consumer as well as external benefits to society as a whole. These are referred to by some as merit goods; that is to say, there is a “merit” to society beyond the private benefit.

Most goods fall somewhere along the continuum. Where a particular good falls within the continuum depends on the amount of public benefit generated from consumption of the good compared to the private benefit derived from its consumption.

2.2 Provision Perspective

There are two characteristics that are used in economics to categorize goods from a provider’s perspective. These are: **rivalrous** and **excludability**. It is important to understand City goods in terms of these characteristics as they frame the scope of goods applicable for user fees.

A good is considered **rivalrous** if consumption by one person prevents it from being available to others. For example, when a glass of water is consumed by one person the same glass of water is no longer available for others. By contrast, a good is considered non-rivalrous if one person’s consumption does not reduce the availability for others to consume. An example of a non-rivalrous good is street lighting. Once street lighting is provided, it is available for more than one person to use or “consume” without reducing the availability for others.

The term **excludable** on the other hand, reflects the ability to restrict a person from consuming a good. For example, if a person does not pay their water bill, The City could restrict water service to that person. Street lighting on the other hand, is an example of a non-restricted good, in that once the light is provided people cannot be restricted from using the light.

¹ For simplicity, the word “good” will refer to both the physical goods and the services that The City provides.

These characteristics define private goods and public goods from the provision perspective. A pure private good is one in which, access to the good is restricted and one person's consumption reduces the availability for others. By contrast, a pure public good is a good whose consumption by one person does not reduce availability for others and there is no restriction on access to the good.

Between these two distinct types of goods there are other variations². Some goods for example are restricted, but one person's consumption does not limit availability to others, such as the use of swimming pools (at least up to certain levels of use).

In summary, the degree to which a good is rivalrous, in that one person's consumption reduces the availability of the good for others, will have implications on pricing. However, the key characteristic for consideration of user fees is the ability to restrict access (excludability). The rationale is that it is not practical to levy a user fee on a good for which the ability to restrict access is cost prohibitive, such as restricting access to a public park. Therefore, goods which have unrestricted access, or prohibitive costs associated with restricting access, should not be considered for a user fee.

2.3 Combining Perspectives

When the consumer perspective is combined with the supplier/provider perspective, it results in several types of goods. Because restricted access is the key factor in determining the practicality of charging user fees, goods for which user fees may be considered are those with the following characteristics:

1. Goods with the ability to restrict access, where one person's consumption does not affect the availability for others and, which provide public benefits, private benefits or a combination of public and private benefits.
2. Goods with the ability to restrict access, where one person's consumption does affect the availability for others and, which provide public benefits, private benefits or a combination of public and private benefits.

2.4 Licenses, Permits & Approvals

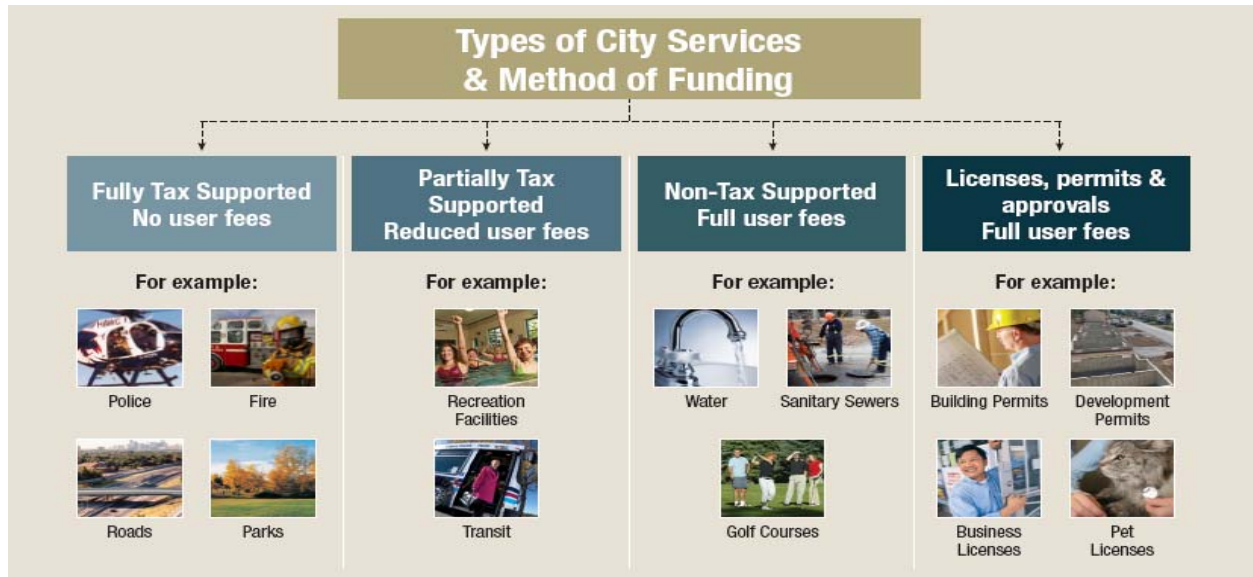
Some of the "goods" that The City provides are not goods or services in the traditional sense, but rather constitute permissions for property owners to engage in certain activities on their property; for example, permits for construction of buildings, business licenses or pet licenses. The City is not selling, renting or leasing City property but rather, allowing private property owners to do something with their own property.

These permissions are granted as a means of regulating certain activities and implicitly recognize that unregulated activities can negatively impact society as a whole. In this way, regulatory fees provide a means to ensure the external costs associated with the regulation and issuance of licenses, permits and approvals for these activities are recovered from the individual generating the costs.

² Many economists will categorize anything other than a pure private good as a public good.

2.5 Summary of User Fees Goods and Services

There are four broad categories of goods that The City provides, as illustrated in Figure 1. Three of them, Partially Tax Supported and Non-Tax Supported services, along with Licenses, Permits & Approvals, are the goods and services for which user fees are appropriate and should be considered.



- Fully tax supported services are funded through property tax and other taxes
- These City services benefit society as a whole and are equally available to all citizens
- Users are not excluded for non-payment

- Partially tax supported services benefits both individuals and society at large
- These City services are funded by both user fees and taxes. User fees do not recover the full cost of providing the service.
- Users can be excluded for non-payment

- Non tax supported services primarily benefit the individual using the service
- These City services are funded through user fees. User fees recover the full cost of providing the service
- Users can be excluded for non-payment

- Licenses, permits and approvals are used to regulate the use of, or changes to, private property
- Users can be fined for non-compliance

3. User Fee Principles

The following sections are guiding principles that have been used in the development of policies for implementation of municipal user fees and subsidies. Although they are interrelated, the principles guiding user fees are outlined separately from principles guiding subsidies. This is done to encourage explicit decisions regarding subsidies while enhancing accountability and transparency in decision making.

The user fee principles outlined below are intended to provide a foundation for deciding whether or not a user fee is appropriate and to establish a basis for calculating user fees.

3.1 Benefits Principle

The benefits principle is based on the idea that those who receive benefits from municipally provided goods are the ones who should pay for those goods. In some cases, the benefit received is derived primarily from the use of the good, as in the purchase of maps or data. In other cases, the benefit is derived more from the availability of the service itself, as in the case of transit services.

The benefits principle indicates that for goods that have an individual private benefit to the consumer, it is appropriate to consider user fees as a way of matching the payments with the benefit received. Properly priced user fees are the most direct means of matching payment with the benefit received.

User fees provide the consumer a choice to benefit from and pay for the good. Broad-based taxes do not provide an option for citizens to choose. In this way, user fees are more efficient than using broad-based taxes, which require all citizens to pay even when they do not consume the good and do not therefore derive a benefit.

The total benefit from consuming a good includes both the private benefit to the consumer and the public benefit to society at large. User fees should only reflect the proportion of the total benefit that is represented by the individual private benefit. Where consumption of a good has a public benefit, broad based tax support reflecting the benefit to all and paid through taxes should be applied. This is discussed further below under the concept of general tax support. It should be noted, this principle also suggests that non-residents could be required to pay a fee in order to access any tax-supported services as they receive a benefit but do not pay the taxes that support the service.

3.1.1 Policy Implications

This principle provides the basis for charging user fees. The principle states that those who benefit from a good should pay for the good. The corollary to this is that those who do not benefit from the good should not pay for it. Goods that are more appropriately funded based on an ability to pay basis should not be subject to user fees.

This principle also has implications for the pricing of goods. The obvious policy implication for pricing is that the good should be priced such that the price of the good captures the full benefit of consuming it. For a good with only private benefits that is provided in a competitive market, the market price serves as the measure of the benefit. Where there is no market competition, and therefore no market price, a different measure of the benefit is required. In this case, the full cost of providing the good should serve as the minimum measure of the benefit.

For goods with a societal benefit, the price of the good should be subsidized through taxes to reflect the value of the societal benefit. This matches the benefit principle in that society as a whole, which benefits from the consumption of the good, will pay for part of the good. This will also lower the price to the consumer, increasing consumption and therefore the benefit to society. The level of subsidy should reflect the societal benefit relative to the private benefit (e.g. if the societal benefit is equal to the private benefit, this implies the subsidy should be 50%). At the extreme, a good that is deemed to have essentially only a public benefit should be subsidized 100%; that is, no user fee (or a user fee of \$0) should be applied. The subsidy should be based on the full cost of production. This will be explored more fully in Section 5, which addresses subsidies. Finally, this principle suggests it may be appropriate to institute higher fees for non-residents that access tax-supported services.

3.2 Cost Recovery Principle

The cost recovery principle suggests that the provider of the good and associated benefits should receive payment. By properly pricing user fees, The City can ensure it receives payment for the goods it provides.

While the market price is often the best estimate of the benefits received, where The City provides goods that do not have market competition, the average cost of production can also serve as a measure of the average benefit. For this reason, cost recovery applies to all costs of production including operating expenses, administrative costs, capital expenses (including depreciation and replacement), as well as implicit costs of foregone opportunities or activities that are not being undertaken.

The cost recovery principle does not imply that all costs incurred need to be recovered through user fees, rather, it suggests that if a price is charged then the money should go to the party that incurred costs. This principle also suggests that even if the full costs are not recovered through user fees, the full costs should be the starting point in setting the appropriate user fee. Thereafter, explicit decisions can also be made regarding the level of subsidization of the good.

3.2.1 Policy Implications

This principle underlines the importance of understanding the full cost of production for each good. For those goods which do not have a competitive market price, the full cost of production represents an estimate of the benefit of the good. Furthermore, for subsidized goods, the full cost is necessary for understanding the financial implications of the subsidy needed to value the subsidy.

The full cost of production includes the direct operating costs, indirect overhead costs and capital costs, as well as environmental costs. Indirect overhead costs encompass costs such as the lease of office space (implicit or explicit), as well as a share of corporate support services such as human resources, finance, information technology and the City Manager's office. The costs of the governance function of The City, for example the costs related to City Council, should be excluded from any calculation of overhead costs. A cost of service study to detail and assign the costs should be done periodically on a corporate wide basis to assist business units in allocating the appropriate costs. The capital costs include amortization of any debt and depreciation/lifecycle as well as a return on capital if permissible. Finally, in order to be consistent with the Triple Bottom Line, the full costs should take environmental costs, such as impacts on air, water and land, into account.

Cost based pricing may deviate from the full costs in the case of goods that are produced as by-products of other corporate activities. Some activities that The City undertakes have a by-product, such as information, that itself has a value. However, regardless of whether The City was to sell the good, The City would still engage in the activity and therefore bear the costs of the activity. In this case, one pricing option may be to take into account only the incremental costs of preparing the good for sale in the market. Careful analysis should be done before implementing this option as this should only be implemented on an exception basis.

3.3 Management of Public Assets Principle

According to the Municipal Government Act, the purposes of a municipality in Alberta are to:

- 1) Provide good government,
- 2) Provide service, facilities or other things that, in the opinion of council, are necessary or desirable for all or part of the municipality,
- 3) Develop and maintain safe and viable communities.

Alberta municipalities hold land and assets to fulfill these purposes.

When assets are used to provide publicly available goods, then proper management of these assets implies that they will be utilized so that the public receives the greatest total benefit. This principle recognizes that public assets have a value and that this value should be considered when determining rates for user fees.

One way to estimate the benefit that the assets provide is to determine the amount of user fees that are collected from use of these assets. It should be noted that if a user fee is not being charged for an asset, it makes it difficult to estimate the value of the benefit.

In this regard, it makes economic sense for The City to charge user fees for municipal assets used by private companies to make private profit. Since The City holds property for municipal purposes, good government implies that it should make a proper return on the assets it manages. If user fees are not charged, then The City would be providing publicly owned assets to private companies for private gain. In this way, not charging user fees distorts the economy and interferes in the free market system by giving an advantage to private companies using municipal property.

3.3.1 Policy Implications

This principle implies that the maximum benefit from The City's assets should be recognized. This benefit can be financial, in terms of the monetary return to citizens, or in other terms by capturing the collective benefit from the efficient use of the asset. This underlines the importance of including a return on capital in the assessment of the costs noted in Section 2.5. This also suggests that revenues from user fees should be weighed against the value of the total societal benefit derived from use of the asset.

In order to address the proper management of assets, user fees should be evaluated relative to the price elasticity of demand. Because higher user fees discourage consumption, lower user fees may stimulate sufficient incremental consumption such that the higher consumption more than offsets the lower price, with the result being higher revenues (the opposite effect is also possible). This also needs to be evaluated against the cost impacts of these changes. However, not only should the revenue impacts be considered, but also the implications on societal

benefits. If properly subsidized, these should be reflected in the impacts on the costs of the subsidies.

In particular, for goods which are non-rivalrous due to excess capacity, lowering the user fees below full cost recovery may stimulate demand and increase revenues. This suggests that the use of congestion pricing (or peak/off-peak pricing) may be warranted. This would entail the implementation of higher prices that reflect the full costs during peak demand times, and lower prices that reflect only operating costs during off-peak demand.

This principle also suggests that the value to the user should be considered, and in particular the use to which the good will be put. If the good that is sold represents an input into a further production process, then the City should ensure that the full value of the good is captured in the user fee. If it is not, this essentially amounts to transferring a benefit from the City (and the citizens) to the producer.

3.4 Allocation of Resources Principle

Municipalities provide a multitude of services. The resources available to provide these services are limited; however, the public's demand for services tends to be unlimited. This implies that there will never be sufficient resources to meet all demands. Charging a fee for service is one means by which The City can allocate limited resources to those who value them the most. Alternate allocation systems include queuing and allocation by a central authority.

Full tax support masks the relationship between demand for a good and the value that citizens place on that good. Demand for a service will drop when a price is charged for something that used to be "free". From a social perspective this may provide an opportunity to direct resources from the areas where there is a decrease in demand to those where there is more demand.

User fees provide one means to measure the strength of demand for each service, particularly relative to the cost of providing the service. This allows The City to determine where to focus its limited resources to provide the services (and associated benefits) that citizens indicate they value through strong demand.

Charging a fee can also be used to manage the timing of demand for a service. Many goods offered by The City have higher demand during peak periods. Building capacity to meet peak demand implies there is under-utilized capacity during the off-peak periods. Implementing price differentials can help to balance the demand for goods between peak and off-peak periods. Charging higher prices during peak periods can encourage people to consume during off-peak times while generating greater efficiency in the use of infrastructure.

3.4.1 Policy Implications

This principle implies that price can be used to allocate the scarce resources the City provides to those who value them the most. As user fees can also be used as a measure of the value that citizens put on some goods, it can inform the City as to which services are sufficiently valuable to warrant continuing to provide them. However, for this signal to be accurate, an understanding of the full cost of each good is necessary, along with an explicit understanding of the full subsidy provided, in order to value the societal benefit of consuming the good. Price should therefore be set such that it indicates the value to the consumer and society as a whole relative to the cost.

This principle also suggests that price can be used to achieve policy goals of managing demand. Higher prices can be used to discourage the consumption of certain goods, particularly during congested periods. This once again suggests that use of congestion pricing (or peak/off-peak pricing) may be warranted. Higher prices during congested periods can push more consumption to the lower-priced off-peak periods. This in turn can lead to more efficient use of existing capital which can lower capital expenditures and thereby reduce prices in both peak and off-peak periods. Business units should therefore consider differential pricing based on the period of use.

4. Subsidy Principles

In addition to the principles that guide user fees, there are principles that provide the foundation for setting subsidies. For the purpose of this paper, a subsidy is needed whenever the full costs of providing a good are not covered by the revenue generated by the users. Because the full costs are not recovered, some level of tax support will be needed.

There are two types of subsidies: general tax support, which reduce the fee to all users, and individual or targeted tax support, which reduce the fee only for selected users.

4.1 General Tax Supported Subsidies Principle

The overarching principle is that those who receive benefits from an activity, whether or not they are the ones actively engaged in that activity should pay. In this way, all who benefit, including the individual and the public at large, pay for the total benefit when the good is consumed. Similarly, all citizens should bear the costs of activities that result in benefits to society at large.

When a good like recreation is provided, it may result in a societal benefit to society as a whole. However, because individuals tend to make decisions based only on the individual benefit they receive, the societal benefits tend not to be taken into account in the individual value decisions. This results in less consumption of the good, which results in less total benefits to society at large.

Government is in a unique position to achieve the societal benefits principle through general tax support. If society as a whole benefits from an activity, then society as a whole should pay some of the costs of that activity. The City collects money from citizens through the tax system and is able to provide subsidies to the activities which benefit society at large.

At times, societal benefits associated with a good such as transit, come not in the form of benefits per se, but rather as a reduction of social costs. In a manner similar to societal benefits, the social costs also tend not to be taken into account in the individual value decisions. This may result in individuals choosing goods that have an individual benefit to them such as individual auto use, but imposing more costs to society as a whole. In these cases, it would be beneficial for the government to encourage the use of other goods, such as transit to reduce the social costs.

The most equitable means of remedying a social cost is to require individuals to pay for the negative impacts of the activity. This is often done through selective taxation and regulation. However, when the cost is not internalized, then encouraging the consumption of substitute goods or services that reduce social costs may be appropriate. This can be achieved through general subsidization of a substitute good, which reduces the price and increases consumption of the substitute good. In turn, this reduces consumption of the activity with the higher social cost and results in reduced social costs.

4.1.1 Policy Implications

This principle states that for goods with a societal benefit, the price of the good should be subsidized through taxes to reflect the value of the societal benefit. This matches the benefit principle in that society as a whole, which benefits from the consumption of the good, will pay for part of the good. This will also lower the price to the consumer, increasing consumption and therefore the benefit to society.

The level of subsidy should reflect the societal benefit relative to the private benefit (e.g. if the societal benefit is equal to the private benefit, this implies the subsidy should be 50%). At the extreme, a good that is deemed to have essentially only a public benefit should be subsidized 100%; that is, no user fee (or a user fee of \$0) should be applied. The subsidy should be based on the full cost of production, including overhead, capital costs and external costs (i.e. environmental costs). Explicit decisions that relate the level of subsidies to the total societal benefit should be included in the decision on user fees. The societal benefit should be consistent for similar types of goods.

This principle suggests that the level of subsidy should vary from good to good if the level of societal benefit varies. This also supports differential pricing of the good to different groups of consumers if the societal benefit derived by one group is different than the societal benefit derived from the consumption of the good by another group. Differential pricing based on other characteristics can also be supported if the societal benefit is deemed to be different due to these characteristics. Again, explicit decisions regarding these differences in societal benefit by group should be made to support differential pricing. Therefore, for goods that will have general tax support, the societal benefit should be identified, as well as the societal benefit for each group which is deemed to have a different benefit.

4.2 Tax Supported Subsidies for Individuals Principle

The second principle guiding tax support for user fees is to provide individual tax support. The user fee principles are based on allowing people to choose whether to consume and pay for goods or services. Some individuals however, may have resources below an acceptable subsistence level and are not able to make the choice to consume and pay for these goods.

In these cases, The City could provide a subsidy to the individual in order that they are allowed the choice to consume. In contrast to the general tax support subsidies which are based on the benefits principle, individual tax support subsidies are provided on an individual basis and apply only to those who meet stated criteria.

One of the primary purposes of user fees is to allow people the choice to consume and pay for goods. This assumes however, that individuals have sufficient income to be able to make this choice. Most households face income constraints and cannot purchase everything they desire. It is their “wants” for which they must make value added decisions. In this way, they choose whether or not to consume (and pay for) government goods and service. However, some households lack sufficient means to even provide the minimum basic needs. As such, they do not have the resources to make a choice of whether or not to consume (and pay for) some goods.

At some point decisions need to be made to identify the point below which people cannot make the choice to pay user fee services to consume City goods. Individuals that fall below this point require assistance and would be eligible for individual subsidy programs. The subsidies would be designed so that the affected individuals meet a basic level of subsistence and participation.

Subsidies attempt to provide economically disadvantaged citizens with an equal opportunity to choose to consume City services by supporting the removal of barriers to entry that exist due to income. It is important to note however, that equal opportunity does not guarantee equal outcome. There is no guarantee that even the highest subsidies will encourage enough subsidized individuals to participate so that the ratio of subsidized participants approximates the ratio of general population participants.

4.2.1 Policy Implications

This principle gives the rationale for offering discounted prices to specific individuals that are deemed to be in need of financial assistance. The implication within this principle is that income should be the consideration in determining need and this should be done on an individual case-by-case basis. The use of differential pricing for groups based on a particular characteristic, such as age, can be aligned with this principle only if the characteristic can be shown to be a proxy for low income and thus an adequate representation of need. If this is done, the circumstances of the group must be monitored in order to ensure that the original reason for identifying the group remains valid.

In order to be consistent with this principle, any program designed to reduce prices for qualified individuals should explicitly state the level of income below which individual subsidies will be permitted, along with the level of subsidy. Differential subsidies on a sliding scale with income would be consistent with both this principle and the Fair Calgary Affordability Filter. However, the income thresholds and the level of subsidy should be consistent for similar types of goods. Targeted subsidies should consider the level of federal and provincial support through income redistribution programs and should only be used where these programs are considered to be insufficient to subsidize the consumption of the good. Other impediments, such as the ease and dignity involved in the application process, should be addressed and overcome to allow the most effective and efficient process, rather than attempting to avoid these issues or eliminate user fees.

5.0 Potential Outcomes of Subsidies

5.1 Maximize Societal benefit

General tax support encourages consumption of a good at a higher level than if the good were provided at full cost recovery. This has the positive effect of increasing the consumption of goods that provide societal benefits.

5.2 Encourage Participation in Society

One of the fundamental reasons why subsidies are provided is to redistribute resources from the more fortunate to the less fortunate.

In some situations, the reason that people have difficulty participating in society is not purely a monetary issue. Language, physical disabilities and mental disabilities are all examples where someone's participation in society may be limited. Offering discounts to address these types of issues likely won't address the problem. Accommodation of the affected individuals is done through design and staff resources, which tends to increase the overall cost of providing the good.

6.0 Policy Development

The User Fees & Subsidies Policy provides a framework to support consistent and transparent decision-making regarding user fee pricing. The rationale for charging user fees and the level of tax support for user fees is set out in the principles. The policy reflects these principles and provides direction for determining user fees and subsidies. Information requirements that will foster consistent application and decision-making across the corporation and over time are identified.

The implementation of user fees meets the benefits principle as long as the consumer derives some individual benefit. The categorization of goods and services within the policy is needed to address the degree to which the benefits are shared by society at large and the individual and thus the degree (if any) to which the final price should be reduced below full cost recovery and subsidized by tax revenues.

In order to achieve the cost recovery principle, it is necessary to have the relevant costs identified. The policy contains a requirement to develop a pricing methodology which identifies the full costs of providing the good or service. This is intended to ensure that decisions are made with an informed understanding of the full cost implications. The inclusion of the identification of a rate of return and all lifecycle costs in the pricing methodology is designed to achieve the management of public assets principle.

The policy will also identify that a demand analysis and market price should be included in the pricing methodology. As well the pricing methodology should identify possible price differentiation strategies. These criteria are included to ensure that pricing decisions reflect the allocation of resources principle.

A significant part of the policy is the identification of societal benefits for partially tax supported goods and services. This criterion is important to ensure explicit and consistent decisions regarding the level of tax support for these goods and services, thereby achieving the general tax supported subsidies principle.

Finally, the policy identifies that all user fees should be accompanied by a strategy for providing subsidies to individuals, in a way that is consistent with the Fair Calgary Social Policy. The inclusion of this strategy is intended to ensure that the tax supported subsidies for individuals principle is achieved.

7.0 Summary

The User Fees and Subsidies Review (Council Priority 3.11) is being undertaken to update The City's user fee policies and related subsidy strategies. The purpose of the initiative is to establish a consistent approach to user fees and subsidy policies to support corporate economic, social and environmental objectives.

The City of Calgary offers a variety of goods and services. These can be separated into 4 broad categories:

- Fully Tax Supported
- Partially Tax Supported
- Non-Tax Supported
- Licenses, Permits & Approvals

Three of these, Partially Tax Supported and Non-Tax Supported services, along with Licenses, Permits & Approvals, are the categories for which user fees are appropriate and should be considered. The policy is needed to enable the consistent pricing of these goods and services.

This discussion paper has been developed to provide a shared understanding for Council and City Administration of the underlying user fees and subsidies principles which have been used in developing the user fee and subsidy policies for The City. The four user fees principles are:

- The Benefits Principle
- The Cost Recovery Principle
- The Management of Public Assets Principle
- The Allocation of Resources Principle

Along with these user fees principles, two subsidy principles have been identified. These are:

- The General Tax Support Principle
- The Tax Support for Individuals Principle

It is recognized that further work will be required during the development of implementation plans to identify legal and other issues that must be addressed.

The User Fees and Subsidies Review is targeted for completion in the 2006 to 2008 timeframe to ensure policies and implementation plans are available for the 2009 to 2011 multi-year business planning and budget cycle.