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Junk Fees or Junk Economics?

By Ryan Bourne and Sophia Bagley

On September 26, 2022, President Biden announced plans to crack down on hidden and deceptive fees, charges, and add-ons that he said were "weighing down" American families' budgets.[1] He labeled such charges "junk fees" and cited early termination fees for communications services, hotel resort fees, large banking overdraft charges, and airlines charging for seat selection as examples that were "taking money out of the pockets of average Americans."

The White House defines junk fees as charges "designed either to confuse or deceive consumers or to take advantage of lock-in or other forms of situational market power," encompassing fraud, unadvertised mandatory or surprise fees, and exploitative or predatory charges.[2] Economically, the Biden administration deems these bad for consumers because, it says, they complicate comparison shopping, create barriers to switching providers, and rip off vulnerable and poor Americans.

The administration thus began using the threat of legislation to pressure companies to change these pricing structures. The Department of Transportation launched a "family seating dashboard" to shame airlines for charging for seat selection for families with young children.[3] The Consumer Financial Protection Bureau developed standards for banks and credit card companies.[4] The Federal Trade Commission (FTC) announced that it was seeking broader authority to reduce junk fees across various industries, including event ticketing, hotels, funeral homes, and more.

In March 2023, Biden championed the Junk Fee Prevention Act introduced in Congress.[5] The legislation would broaden government regulation over pricing in many sectors by

- mandating that hotels, travel agencies, and online ticketing services "clearly and conspicuously display" the *total* price of their services;
- prohibiting companies from charging ill-defined "excessive or deceptive" mandatory fees;
- giving the Federal Communications Commission and the Transportation Department explicit authority to regulate early termination fees and airline family seating policies; and
- giving the FTC authority to promulgate rules regarding "the disclosure and imposition of mandatory or deceptive fees" in other industries.


RYAN BOURNE is the R. Evan Scharf Chair for the Public Understanding of Economics at the Cato Institute.
SOPHIA BAGLEY is a research associate at the Cato Institute.

The U.S. president and Congress should not be micro-managing businesses' pricing structures in this way. Yet the fact that the president considers this an important issue, even mentioning it in his 2023 State of the Union address, raises obvious economic questions: Would eliminating these charges really save U.S. households substantial money? Are these pricing practices really evidence of uncompetitive markets and exploitation? What other unintended consequences might bans and restrictions on such charges bring?

This brief assesses the big-picture narrative about junk fees before reviewing two case studies: airline seating charges and hotel resort fees.

HUGE EFFECTS ON HOUSEHOLD BUDGETS?

The White House implies that junk fees cost U.S. households billions annually by highlighting that credit card late fees generated $12 billion in revenue for companies in 2020, hotel resort fees generated $2.9 billion in 2018, airline fees generated almost $6 billion in 2021, and hidden cable fees generated $28 billion in 2019.[6] The implicit message of using such figures is clear: junk fees represent massive transfers from consumers to companies that government regulation could prevent.

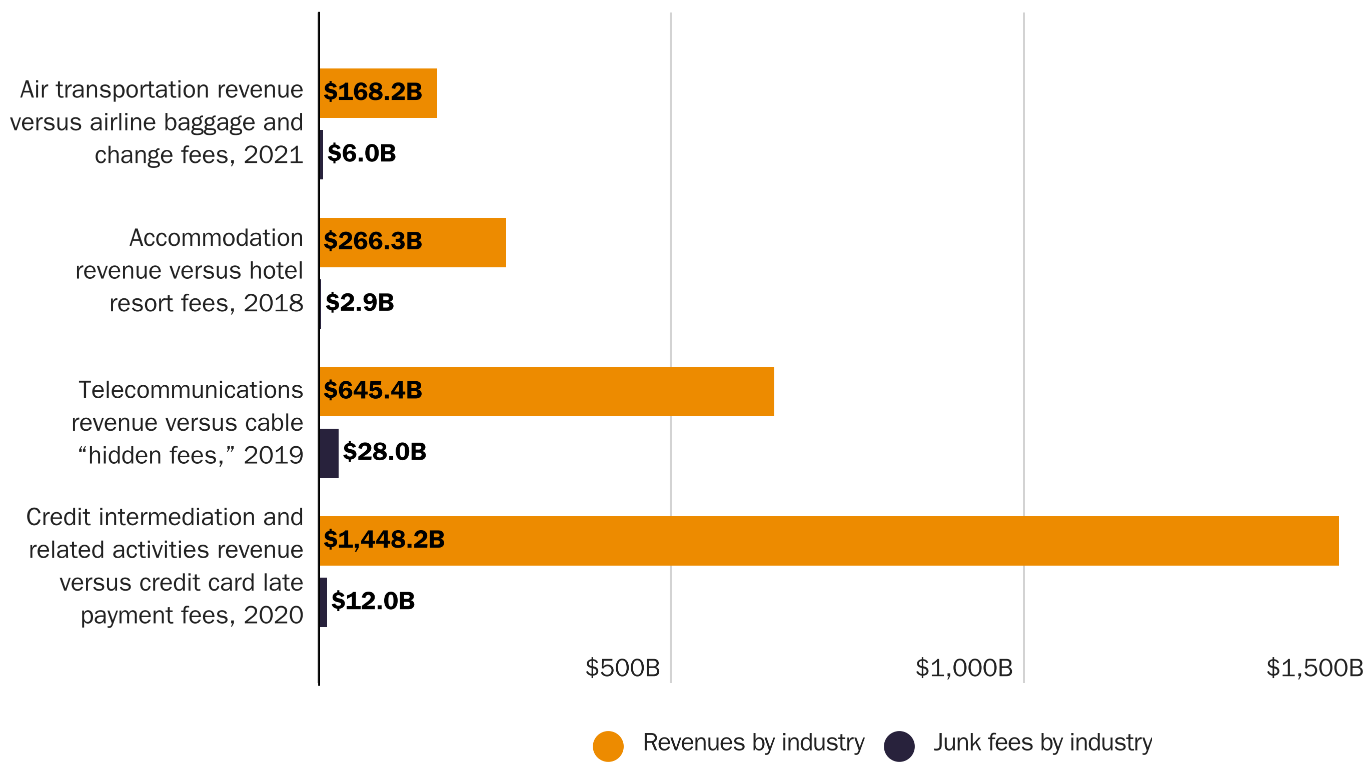
This portrayal is highly misleading. First, though these numbers sound enormous, they are a drop in the ocean compared to the total amount spent in the respective industries (see Figure 1).

Second, the primary effect of banning "fee" revenue in competitive markets would be increases in the headline price of the service. This different pricing structure may redistribute money between different types of customers, but the total amount spent by U.S. households would be largely unchanged. Even in sectors where firms have market power, policing one component of pricing would not massively alter the industry's dynamics, leaving the total price faced by consumers essentially unchanged. There's no pot of gold here for regulation to transfer from businesses to U.S. households.

When pushed, the Biden administration will therefore claim that banning these fees would indirectly benefit

Figure 1

Total versus "junk fee" revenues by industry



Sources: "Service Annual Survey Tables," U.S. Census Bureau, last revised April 29, 2022; and Brian Deese, Neale Mahoney, and Tim Wu, "The President's Initiative on Junk Fees and Related Pricing Practices," White House, October 26, 2022.

consumers by bolstering competition through improving price transparency, making it easier to switch suppliers, and encouraging firms to compete based on cost and quality, rather than innovating around exploitative pricing strategies.[7]

The problem with these more complex arguments is that the White House provides scant evidence that its proposed policies would yield such results. Each market held up as using junk fees is different, so the effects of banning certain charges would vary. Speculation is no basis on which to give extensive new regulatory authority to government agencies. Without clear evidence, the key economic insight remains: banning fees would primarily raise basic prices, providing no significant windfall for customers.

USE OF FEES CAN BRING SIGNIFICANT ECONOMIC BENEFITS

Joe Biden himself appears to see unbundled services (where businesses charge individually for certain services or options), partitioned pricing (where businesses present a bill in price subcomponents), and contract early termination fees as inherently deceptive or undesirable. Yet these are normal pricing practices that, in many circumstances, benefit consumers (see Box 1). Banning or restricting their use could bring significant unintended consequences.

Preventing price unbundling could reduce access to services

Domestic airlines now charge separately for nonessential services such as food or checked bags on short-haul flights. This unbundled pricing has allowed them to explore more profit opportunities while offering cheaper basic ticket prices to the benefit of the poor. This pricing structure has benefited customers with more flight options, lower basic fares, and flight experiences tailored to their individual preferences. Yes, "price discrimination"—charging consumers different amounts for the same product based on their willingness to pay—can often reduce consumer surplus. But banning the ability to unbundle when customers place wildly different valuations on service options could price out poorer consumers and force customers to pay for services that they neither want nor need.

Box 1

How can using fees benefit consumers?

- Can facilitate lower prices and services better tailored to individuals' preferences
- Can provide additional information and context
- Can reduce risks for companies to make investments and provide credit-like services

Banning partitioned pricing could reduce information provided to customers

Whether it's regulations imposed by governments, pricing disputes with suppliers, or other temporary supply shocks, partitioning—breaking a total bill into components—can provide consumers with useful information. For example, restaurants sometimes include surcharges on bills to reflect large local minimum wage rises.[8] This can help consumers understand economic realities and that price rises are not driven by "greed" but by supply and demand. Again, granting broad authority to the FTC over regulating junk fees may stifle this information provision, making markets work less, rather than more, efficiently.

Banning termination fees could hurt credit-constrained consumers

Early termination fees from telecom companies deter customers from ending service agreements early, allowing for discounted upfront prices and more revenue certainty for businesses to support large investments. This price structuring particularly benefits individuals with current liquidity problems but who will enjoy reasonable future credit prospects, allowing them to access products without resorting to bank loans or credit cards with the fee helping to internalize the risk of nonpayment.[9] Banning early termination fees has some theoretical economic benefits, such as removing financial barriers to customers changing services when a novel product clearly better suits their needs. Yet such an approach would lead to higher front-loaded prices, less certain revenue for businesses, and higher net prices in lieu of businesses bearing more risk associated with flaky customers.

MARKETS PROVIDE INCENTIVES AGAINST DECEPTION

Consumers certainly shouldn't be charged for products without their consent, and businesses should disclose mandatory fees before purchases are made. However, the competitive process that distinguishes a market economy already provides incentives for businesses and entrepreneurs to please their customers, mitigating against the use of unpopular or hidden fees.

Online reviews serve as one feedback mechanism for customers to report deceptive practices. A Consumer Reports survey found that 16 percent of consumers in 2019 posted on social media about their experience with "hidden fees."[10] This creates an incentive for businesses to be transparent and honest about any fees that are added to their services, as customers are less likely to return to or recommend a business if they feel mistreated.

Many consumers value transparency, which encourages intermediaries and third-party institutions to provide it. Price comparison websites collate information from businesses, typically trying to provide consumers with side-by-side comparisons of products or services and total prices. Google Flights, for example, allows tailored searches for baggage and ticketing needs, ensuring accurate comparisons, and reducing the likelihood of surprise fees. Such websites may sometimes encourage businesses to "game" the systems, charging more in the way of non-negotiable fees (if not assessed) to appear more favorable by headline price. The point is: there are very strong incentives for price comparison sites to weed this out in the name of accuracy.

More broadly, businesses with repeat customer interactions live or die by their reputations. If a company's pricing is seen as unfair, impractical, or deceptive, the company faces significant risks, including consumer boycotts or opportunities for new entrants to the sector to better serve consumers. We already see this in markets that Biden complains about.

Many banks offer no late fee credit cards, and the nonprofit Cities for Financial Empowerment Fund's BankOn initiative expands access to low-cost transactional products for underbanked users.[11] After concerns about "drip pricing"—where the costs of a product are revealed incrementally throughout the purchasing process rather than being disclosed upfront—StubHub introduced the option for users to view the all-in price at their preferred time.[12]

We already see many instances of firms willing to give up on higher short-term profits because of reputational fears—with major chains refusing to raise prices substantially when natural disasters create shortages, for example.[13] It's unclear, then, why we would expect there to be tons of companies willing to engage in behavior that consumers hate or regard as deceptive. The disciplines and incentives that a market economy creates suggest that unusual charges that endure may have other economic rationales.

THE ECONOMICS OF SPECIFIC FEES

The Biden administration's examples of junk fees cover a diverse range of pricing practices. It is therefore essential to examine each on a case-by-case basis to work out the economics of the practice and the potential impacts of regulation. Here we examine two that have gotten the president's attention.

Airline seating charges

President Biden rails against fees for "sitting next to your child on an air flight."[14] No airline explicitly charges a "sitting with your kid" fee, but if families want to guarantee seats together, they typically must buy tickets allowing advanced seat selection, pay for seat selection separately, or hope adjacent seats are available during or after check-in. Given that the very cheapest fare categories typically do not allow advanced seat selection, Biden's desire to use government power to eliminate this "fee" essentially demands that these customers with kids under age 13 be given preferential treatment for a price of zero dollars.

The president's rhetoric implies that airline fees like this simply extract more money from unwitting customers. Yet seat selection is another form of airline unbundling. As the commentator Matt Yglesias has written, people often have strong seat preferences, with middle seats perceived worse than aisle or window seats. It is logical that those with stronger preferences pay more than those who don't care where they sit.[15]

Structuring fees like this grants airlines more profit opportunities, so it has been a popular means of generating revenue. According to the Bureau of Transportation Statistics, revenue attributable to basic airfares has fallen from 88.5 percent of domestic airline revenue in 1990 to 73.2 percent in 2022 as fees and charges became more important.[16] This pricing flexibility allows airlines to run more routes at lower basic prices, which a 2022 Airlines for America survey confirms is what passengers care about most.[17]

What eliminating airlines' family seating "charges" amounts to, then, is a social mandate compelling other passengers to subsidize families with kids. The federal government initially pressured companies through its Department of Transportation dashboard, and the Junk Fee Prevention Act proposes explicit regulation with the threat of civil penalties.[18] Airlines would have to allocate adults and children under 13 years old adjacent seats within two days of booking, offering a full refund or a week's wait period if no such seats are available. If no seats become available, the airline would have to allow them to rebook or get confirmation that they will waive this new right. For carriers with open seating, airlines would have to alter boarding procedures to ensure children under 13 can sit with adults.

As noted earlier, the main effect of this policy would be higher basic fares for passengers. This would damage ultra-low-cost airlines, which help anchor low fares in the industry by stripping out perks and using fee revenue to "top-up." Quite simply: the ability to unbundle prices improves the opportunity for airlines to make a profit on more flights, which encourages them to run more flights—indirectly encouraging competition.

Apart from the inefficiency of enforcing cross-subsidization for certain passengers, this law would create practical difficulties for airlines' business models. Take Southwest Airlines, known for its family-friendly policies of generous luggage allowances, flexible cancellations, and early boarding for families with children younger than age seven.[19] The airline currently generates revenue through its EarlyBird Check-In and Upgraded Boarding services, which give paying customers access to earlier boarding positions under Southwest's open seating system. A regulation that guarantees all families with children under 13 board earlier could significantly diminish the benefits of these pay-for services, leading to fewer purchases and forcing Southwest to compensate for lost revenue through higher prices or charging for other services, undermining its current business model.

Every airline will face similar boarding and ticketing challenges due to these regulations. Updating reservation systems for new seat assignment rules entails one-off costs, while additional notices for family rebooking or refunds create ongoing burdens. Last-minute bookings for family trips would present difficulties. Airlines would need new systems to reallocate seats for other fee-paying passengers to accommodate families and to allow the latter to waive their seating rights. The ability for families to book certain full flights may be stunted altogether, whereas today, some sensible accommodation is reached in the terminal or on the plane.

In rare cases today where parents and young children are separated after check-in, flight staff and passengers often find solutions, such as trades where families get seats together in exchange for giving up their most desirable seat. Many other passengers are sympathetic and offer help, especially in seating areas where nobody has paid extra fees. Given these existing informal solutions, is this really such a problem that requires federal intervention? Imposing this sort of blanket cross-subsidy would reduce airlines' abilities to tinker with seat allocation, boarding, and ticketing practices, thus reducing their opportunities to make profits. In doing so, it's likely to increase headline ticket prices and reduce the revenue viability of certain ancillary services. And for what? Customers can already book multiple airlines that offer different boarding policies and fee structures to suit their needs on key routes. When parents and young children are separated on the plane, rarely is a workaround not found.

Hotel resort fees

Hotel resort fees, also called "destination" or "amenity" fees, are non-negotiable charges for hotel services and amenities that supplement advertised room rates on bills. President Biden sees them as deceptive junk fees that hinder hotel cost comparison and surprise some customers with additional charges. Following 2017 research critical of the practice, the Junk Fee Prevention Act he's backed would compel hotels to only advertise a "total price" for stays, inclusive of resort fees, to try to reduce their use.[20]

As a fee you can't refuse to pay, some see resort fees as a "total scam."[21] Yet only 6–10 percent of hotels charge them, and usually in tourist regions such as Orlando in Florida, Las Vegas, Hawaii, and major city centers.[22] These hotels do tend to offer significantly more amenities, such as pools, gyms, Wi-Fi, bottled water, tour services, parking, water sport rentals, boarding pass printing, and sometimes unique extras, such as a white noise machine or a cup of clam chowder.[23]

If hotels were banned from using resort fees, it seems obvious that basic room rates would rise near commensurately with any lost revenue, leaving most customers' wallets unaffected. That some hotels still use resort fees suggests that the fees must improve the hotels' profitability somehow, at least compared with either only charging customers who use each amenity (unbundling) or bundling the whole cost into higher nightly room rates.

There are obvious downsides to unbundling services entirely. Monitoring access to pools and gyms can be expensive for hotels and inconvenient for vacationers. When guests have diverse preferences over amenities, bundling them at a lower total price can simply be more profitable for hotels anyway, as not every guest will use every facility.[24]

The real mystery is why hotels don't bundle the charges into nightly room rates for one total price. Biden thinks the failure to do this is a fraudulent attempt to lure customers in with misleadingly low advertised prices. But this explanation seems inadequate in competitive, touristy markets.

The industry itself says that hotels would be worse off financially without resort fees. Online travel agents' commissions are often based on basic room rates, says the American Hotel and Lodging Association.[25] If resort fees were banned and hotels increased basic room rates in response, hotels would thus face larger commission charges from online travel agents, at least some of which would be passed on to customers through higher prices. Since these third-party websites also often rank hotels by their room rate price, there exist clear financial incentives to split resort fees from nightly rates.

Any additional profits from bargaining with travel agents would likely be short-lived, however, as the fundamental bargaining power between hotels and online travel agents is largely independent of resort fees. How hotels structure prices is unlikely to affect their long-run liabilities. For instance, Booking.com began charging commissions on resort fees in 2019, eliminating potential benefits for hotels. At most, we might see some cat-and-mouse game where hotels adjust pricing structures to improve listing positions or exploit commission systems on specific websites for a time before getting found out.

Another financial theory for resort fees is tax arbitrage. A 2018 University of Hawaii analysis found that separately charged amenities were exempt from Hawaii's "transient accommodations tax," meaning that using resort fees, instead of higher room rates, lowered hotels' tax liabilities, creating a shared windfall for hoteliers and consumers.[26] Although Orlando and Las Vegas include resort fees in their hotel tax bases, both New York City and Los Angeles do not, providing a financial explanation for why some hotels might structure prices this way.[27] Yet this explanation clearly cannot explain their use in all tourist spots. What's more, if this tax policy were deemed responsible for resort fees, it would be far better to just broaden the hotel tax base rather than regulate resort fees (still acknowledging, of course, that this would make some combination of hotels and customers worse off).

A less convincing theory proposes that resort fees provide informational value to customers, who like to see their money spent on amenities. According to this idea, resort fees in tourist-heavy areas encourage customers to compare hotels' amenities lists to find the best fit, as long as the total cost is visible. The problem with this theory is that resort fees are seldom advertised prominently, suggesting that hotels aren't actively showcasing their amenities by making these charges transparent.

Behavioral economists have developed a complex consumer shrouding theory to explain why deceptive resort fees might persist even in competitive markets.[28] If two hotels (A and B) charge the same total price, then hotel B educating customers that hotel A uses a lower room rate and later adds a resort fee (whereas B prices transparently) still provides no financial incentive for customers to choose B over A. In fact, if the newly educated customers can negotiate away or use loyalty schemes to avoid some or all of the resort fee (as some hotel chains allow), exposing this information could even harm B's profitability by driving more customers to A.

This might explain why we see resort fees used intensely in highly touristic areas, where vacationers are less knowledgeable about hotel practices. However, online travel agents and third-party booking sites have much stronger incentives to provide transparency, despite being overlooked in this model of competition. ResortFeeChecker.com offers consumers a convenient way to find hotels that charge resort fees in any city they search for.[29] Additionally, popular booking platforms like Expedia, Kayak, and Booking.com have already implemented transparency on resort fees, responding to consumer demands to see the complete cost of their accommodation.

In short, consumers should not be misled by unexpected resort fees, but the economics suggests that banning or restricting the ability to advertise partitioned pricing wouldn't be an obvious boon for customers. Yes, some ill-informed customers would avoid making transactions they'd regret, but price comparison websites and online travel agents increasingly help here anyway. And there's a likelihood some customers would be worse off. Any new tax or commission liabilities would be borne in part by customers, while other groups who can escape resort fees using loyalty points or when canceling stays at late notice may find themselves worse off if hotels don't set up equivalent discount schemes. It's therefore unclear why Biden is expending so much energy on this subject.

CONCLUSION

President Biden has made eliminating junk fees a major part of his consumer protection agenda. He supports a law that would ban certain pricing practices and give the FTC broad authority to police other fees and charges it dislikes. Yet there are all sorts of economic rationales for firms unbundling pricing, charging teaser rates, or using termination fees that the administration ignores.

Banning the pricing structures that Biden complains about could curb pricing innovation that helps grant access to a wider number of consumers, provides information to customers, or guarantees revenues to facilitate investment by companies. Businesses should disclose charges and fees transparently, but heavy-handed regulation to enforce the cross-subsidization of certain consumers or ban firms from listing charges separately could create difficulties for businesses and hurt certain customers. Given that markets and intermediary institutions already have strong incentives to enforce pricing transparency, it is bizarre that junk fees have become a hot-button political issue.

NOTES

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