Section 8: Surface Transportation Funding Alternatives

Funding for all surface transportation modes, including highways, roads, bridges, transit, passenger rail, freight rail, and others, are distributed through the MTF. Revenue to the MTF currently comes from user fees such as motor fuel taxes and vehicle registration fees. The Task Force considered alternatives involving both user fees and non-user fees, as directed by P.A. 221. A combination of alternatives would be required to achieve a "good" level of investment.

ALTERNATIVE: Increase vehicle registration fees.
Vehicle registration fees remain a reliable mechanism for funding transportation, but need to be increased in light of the pressing need for greater investment in roads, bridges, and transit systems. The Task Force considered several means of accomplishing this over time:

> <u>Increase registration fees by an *ad valorem*, or value-based rate.</u> Increasing registration fees by a set percentage at the existing value-based rate would yield additional revenue. A 10 percent increase would be expected to provide about $86 million in additional revenue per year.
>
> <u>Increase registration fees by a flat rate.</u> Each dollar increase in the annual registration fee generates an estimated $8 million in additional revenue for investment.

Either of these changes could be accomplished with legislative amendment to the Motor Vehicle Code (MCL 257.801).

ALTERNATIVE: Eliminate registration discounts.
One of the guiding principles endorsed by the Task Force was the notion that everyone who benefits from the transportation system needs to contribute to the transportation system. At a time when funding for transportation is so urgently needed, it makes sense to close all the loopholes in current law that have offered registration discounts to some users under certain circumstances. The Task Force recommended these discounts be eliminated:

> <u>Eliminate the three 10 percent reductions in the registration fee.</u>
> Autos and light trucks pay an annual registration tax of $8.00 plus half of one percent of the base price in the first full year of registration. This tax is reduced by 10 percent per year in each of the next three years, and then remains at $8.00 plus 0.3645 percent of the base price. Since the registration fee is a road user fee and not a property tax, there is no reason why the fee should decline with the value of the vehicle.
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> The three step discount might be abolished on newly purchased vehicles only, to spare owners of existing vehicles from an unanticipated increase in registration fees. This increase would require over 13 years for full effect, as the vehicle fleet is replaced and ages over four years, and would yield an estimated $51 million per year after the third year. Another alternative would be that all auto and light truck registration taxes might revert back to the half percent rate that owners paid in the vehicles' first year. This would be equivalent to about a 27 percent increase in registration taxes on four year

and older cars and would yield an estimated $135 million per year upon enactment.

Eliminate registration discounts for specific industry groups. Trucks hauling agricultural goods, milk, and logs may be registered at a fraction of the usual fee charged for trucks by elected gross weight. This discount was originally intended for farm trucks used only during harvest season, but has been extended to all unprocessed agricultural commodities, milk, and logs. While the foregone revenue is not large, probably under $2 million per year, the discounts are a precedent for extension to other users. It is unfair to charge higher road-use fees to some industries than others.

Collect increased registration fee upon plate transfer to a higher value vehicle. When vehicle buyers transfer license plates from an old car to a new one, they pay only an $8.00 plate-transfer fee that does not benefit the MTF. Michigan's registration fee on the value of the new vehicle - which is typically higher than on the old vehicle - is not collected until the first renewal after purchase. This delay in collecting the increased fee reduces transportation revenues by $24 million per year.

To accomplish these changes would require an amendment to the Motor Vehicle Code (MCL 257.801).

ALTERNATIVE: Adjust motor fuel taxes.

Michigan's per gallon motor fuel taxes (19 cents per gallon for gasoline and 15 cents per gallon for diesel fuel) currently provide about half the revenue to the MTF. Michigan's per gallon motor fuel taxes have not increased in ten years, and were not increased for ten years prior. However, the cost of providing transportation infrastructure and service increases every year. This helps explain why underinvestment in transportation is an ongoing problem in Michigan. Transportation systems are too important to the economy and the general quality of life to allow this trend to continue.

While the motor fuels tax has become a less reliable source of revenue in recent years, and is not expected to be viable as a source of revenue over the long term, it is currently the most efficient means of raising much needed revenue for transportation. The Task Force considered several options for increasing motor fuel taxes over time.

Convert the cents per gallon motor fuel tax to a percent of sales price.
Motor fuels are taxed at cents per gallon rates that do not adjust with inflation or price. Converting the tax to a percentage of sale price would allow revenues to rise or fall with changing fuel prices. At October 2008 prices, if 4.5 billion gallons per year of gasoline at $2.30 (before the tax) and 0.9 billion gallons of diesel fuel at $3.20 per gallon were taxed at a percentage of price, each one percent would yield $103 and $29 million per year, respectively. This could be accomplished with amendments to the Motor Fuel Tax Act (MCL 207.1008) and the Motor Carrier Tax Act (MCL 207.211). An amendment to P.A. 51 [MCL 247.660(1)(d)] would also be required to remove reference to per gallon revenues from the MTF distribution formula.

Enact a flat cents per gallon increase. Each penny increase in the motor fuel tax would raise $46.5 million from gasoline and $9.8 million from diesel for investment in transportation systems, including highways, roads, bridges, and transit systems.

Take phased-in approach to increases.
Increasing the cents per gallon motor fuel tax could also occur over time, in a pennies per year arrangement that would provide additional revenue to keep pace with rising cost.

Any of these changes could be accomplished with an amendment to the Motor Fuel Tax Act (MCL 207.1008).

ALTERNATIVE: Equalize diesel and propane tax rates with gasoline.
As previously noted, the tax rate for diesel fuel is 15 cents per gallon, as is the tax rate for propane. Increasing these tax rates to 19 cents per gallon, as is the rate for gasoline, improves the equity of contribution by users of the transportation system, in keeping with the guiding principles of the Task Force.

Each penny increase in diesel and propane tax rates would yield $10 million annually. It would require an amendment to the Motor Fuel Tax Act (MCL 207.1008).

ALTERNATIVE: Abolish 1.5 percent cost of collection allowance on gasoline.
One and one-half percent of Michigan's 19 cent gasoline tax is left uncollected. This formerly covered cost was incurred by retailers when fuel tax was collected at the retail level, but these payments are now made automatically by fuel wholesalers at a negligible cost. The discount leaves only 18.715 cents per gallon available for investment in transportation for every 19 cents per gallon of gasoline taxes paid by motorists (no discount exists for diesel fuel). Abolishing this discount is the equivalent of a 1.5 percent gasoline tax increase, yielding an additional $13 million per year.

Eliminating the 1.5 percent cost of collection allowance on gasoline would require and amendment to the Motor Fuel Tax Act (MCL 207.1014).

ALTERNATIVE: Enact measures to control costs that are paid for with transportation funding through Inter-Departmental Grants (IDGs).
Currently, there are transfers of road user fees to departments of state government that cover the costs of collecting vehicle registration fees and fuel taxes, environmental permits, motor-carrier registration enforcement, State Police operations, and personnel and other routine services provided to MDOT. Some funds are credited automatically, with no legislative oversight over costs; others are made in yearly interdepartmental grants (IDGs). The Task Force recommends reducing interdepartmental transfers of transportation funds by 10 percent per year over the next five years, by pursuing alternative business models for these administrative functions.

ALTERNATIVE: Increase sales and use tax one percent and dedicate that additional revenue to transportation.
Transportation, as noted previously, enhances the quality of all our lives and provides enormous benefits to residents, businesses, and visitors. A modest increase in the sales and use tax, dedicated to transportation, would accomplish several important things. First, it would provide a reliable revenue stream that could, in time, help replace the gas tax, as

sales tax revenue has increased every year except 2003 when it was stagnant. Next it expands the concept of "users pay" to "beneficiaries pay," recognizing the breadth of benefits transportation brings to all aspects of our lives. Finally, it utilizes an administrative mechanism that is already in place, which has the advantages of efficiency and relatively quick implementation.

Another option would be to increase the sales and use tax, but give Michigan residents a credit on their income tax, to ensure that the revenue captured comes from non-residents.

Increasing the sales and use tax by one percent and dedicating those funds to transportation would provide an estimated $1.3 billion in additional funds, although this amount would be reduced if an income tax credit were created.

Changes to sales and use tax would require an amendment to the State Constitution as well as accompanying statutory changes to the General Sales Tax Act (MCL 205.52 and 205.75) and giving residents an income tax credit would require an amendment to the Income Tax Act of 1967.

ALTERNATIVE: Direct all or a portion of the sales tax on fuel to the MTF.
The Michigan Constitution spells out that revenue generated by motor fuel taxes should be used for transportation. One of the guiding principles of the Task Force has been that all revenue generated by transportation should be reinvested in the transportation system. This year Michigan has seen record increases in the price of gasoline, causing the public to travel less, thereby reducing motor fuel tax revenues. However, the sales tax on motor fuel is based on a percentage of the fuel price per gallon, which increases as the price of gasoline goes up.

The sales tax on motor fuels is estimated to generate more than $800 million in FY 2008. This revenue is generated by transportation users and should be reinvested in transportation systems.

Redirecting all of the sales tax collected on motor fuel sales (or any portion that is currently constitutionally allocated) would require an amendment to the State Constitution and accompanying statutory changes. Redirecting only the portion that is not constitutionally restricted would require an amendment to the General Sales Tax Act (MCL 205.75).

ALTERNATIVE: Redirect all or a portion of the Natural Resources Trust Fund to transportation.
The Natural Resources Trust Fund was established in 1984 and governs rents and royalties from private oil, gas, and mineral exploration on state owned lands. These changes are embodied in Article IX, Section 35 of the Michigan Constitution. Over time, voters have approved other changes to Section 35, consistently in the direction of adding more revenue (or stopping diversions) and making the use of funds more restrictive.

During FY 2007, just over $43 million was generated from mineral royalties levied largely on oil and gas. After appropriation of $14 million for state and local grants (as permitted by law), and transfer of $10 million to the State Parks Endowment Fund, the remaining $19 million was deposited into the Natural Resources Trust Fund, bringing its total balance to $345 million. The balance will continue to grow to $500 million (as approved by voters), at which point direct appropriations cease and all grants are made from interest earnings on the $500 million total balance.

The Task Force recommends that a portion of this revenue be used for transportation purposes, particularly for improvements related to recreational transportation such as development of multi-use trails or bikeways. Depending on the amount of revenue to be redistributed, a Constitutional amendment would likely be called for to accomplish this.

ALTERNATIVE: Encourage local investment in transportation by enabling a broad spectrum of local revenue options statewide.

Local transportation agencies already make a significant contribution to transportation investment, but as state and federal partners increase their participation, local governments must be prepared to do the same. The legislature needs to enact enabling legislation that provides local transportation providers with a full array of financial tools to stimulate this investment. The Task Force considered the revenue potential of county registration fees and county driver's license fees, and concluded these are reasonable options to generate transportation revenue at the local level.

Other local options, such as local fuel taxes, need to be enacted on a regional level, rather than county-by-county. One public comment suggested allowing a region-wide, seasonal local fuel tax to provide additional revenue for winter maintenance. There is also a need to enable corridor authorities to raise revenue along a certain alignment for a particular project that may span multiple counties or municipalities.

ALTERNATIVE: Enable Public-Private Partnerships (P3s) for toll-financed reconstruction, expansion or new construction of freeways or other transportation systems.

Major projects may be procured from consortia of private firms who finance, design, build, operate, and maintain the roads or transit systems for decades into the future. Tolls and fares might cover much or all of life-cycle costs now paid for from user fees and taxes, and private debt or equity might replace public funds. Enabling P3s could preclude the need for several billion dollars worth of expenditure from MDOT's user fee funded program.

A new act would be needed to establish clear authority for procurement through agreement with public-private partners. This would be in addition to the amendment needed to enable tolls.

ALTERNATIVE: Enable toll-financed reconstruction, expansion, or new construction of freeways.

Michigan needs to reconstruct aging urban freeways and add lanes to commuter and intercity routes. This will require multiple projects costing over $1 billion each. The possibility of paying for these projects with existing revenues does not exist. Conversion of some freeway segments to toll roads can make these projects affordable by dedicating a stream of user fees to the roads on which the fees are collected. The additional option of dynamic pricing can price traffic jams out of existence by offering discounted travel in off-peak hours.

Toll finance requires an amendment to Michigan highway law enabling MDOT to collect tolls, and to Act 51 crediting tolls to a fund for roads. Amendments to the Vehicle Code enforcing tolls are also needed.