CITIZENS RESEARCH COUNCIL OF MICHIGAN

"The right to criticize government is also an obligation to know what you're talking about."

Lent Upson, First Director of the Citizens Research Council

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Budget Implications of the House Republican Road Funding Plan

In a Nutshell

- Michigan House Minority Leader Matt Hall has proposed a plan to shift over $2.7 billion in existing tax revenues to road infrastructure to boost ongoing funding for road repairs and maintenance.
- However, the plan will likely require major reductions in state General Fund/General Purpose appropriations of up to 17 percent to accommodate the loss of that redirected revenue.
- As deliberations advance on the plan, lawmakers should also thoroughly examine reforms to Michigan's road funding distribution formula and our decentralized system of state and local road agencies to ensure any new funding is being used to address the state's most critical needs.

Michigan House Minority Leader and Speaker-Elect Matt Hall put a jolt into Michigan's typically quiet November legislative recess with a major new proposal to reallocate revenue to address the state's crumbling road infrastructure. The proposal seeks to dedicate over $2.7 billion in annual revenue for road repairs without a tax increase by redirecting existing state revenues. This huge redirection of currently appropriated state revenue may be creating angst for K-12 school groups, public universities, local governments, and other interests that receive support from the state's two major revenue funds – the General Fund and the School Aid Fund.

Their question: who's going to pay for this?

The plan has three major components:

- Shifting $1.2 billion of Michigan's Corporate Income Tax (CIT) revenue to road infrastructure; that revenue is currently deposited in the state's discretionary General Fund.
- Redirecting another $600 million in CIT revenue currently earmarked for business attraction incentives, placemaking grants, and housing and community development to roads upon the expiration of those existing earmarks in Fiscal Year 2026.
- Exempting motor fuel purchases from the state's six percent sales tax while simultaneously boosting the state's motor fuel tax by a revenue-neutral amount, effectively shifting about $950 million to road infrastructure.
- To its credit, the proposal represents the first serious plan to generate a permanent and genuinely impactful boost in road funding since Governor Whitmer's proposal for a phased-in 45-cent per gallon increase in the motor fuel tax in 2019.

Notably, two years ago, the Research Council recommended precisely what is being proposed in the third component of the House Republican plan: eliminating the sales tax on fuel and approving a revenue-neutral increase in the motor fuel tax rate. The proposal was also discussed in 2015 when the state eventually raised motor fuel tax and registration fee revenue to boost road funding. In our 2022 article, we discussed what has perennially been the barrier to enacting such a policy shift: the significant revenue loss to the School Aid Fund, the General Fund, the Comprehensive Transportation Fund (which finances public transit programs), and constitutional revenue sharing allocations to local units of government – all of which receive earmarks from sales tax collections.

Back in 2022, however, the timing could not have been better. The unexpected revenue boom following the COVID-19 pandemic meant that ongoing state revenues in the General Fund and School Aid Funds exceeded budgeted spending by around $2.5 billion. That meant excess revenue was available to compensate for any revenue losses from eliminating the sales tax on gasoline. Unfortunately, that is no longer the case. This means all three components of the proposal will also present state budget writers with significant challenges next spring while formulating the state's FY2026 budget, if not sooner. This article will assess the impact of the revenue shift and outline key issues that are still unknown.

The Sales Tax and K-12 Schools: Why are School Officials Worried?

The state's K-12 budget is primarily funded by revenue from Michigan's School Aid Fund (SAF), and the sales tax is the largest source of revenue for the SAF. Roughly 73 percent of sales tax revenue is distributed to the SAF, which means – without some counteracting revenue increase – the fund stands to lose around $690 million in annual revenue from the elimination of the sales tax on fuel. For this reason, Speaker-Elect Hall's announcement immediately raised anxiety among K-12 school officials.

In fairness, though, Representative Hall's press release made clear his intention to "hold school funding harmless" from the reduced sales tax revenue – a practice that has been relatively common over the last two decades when major state tax reforms have been implemented.

However, it's important to note that "holding school funding harmless" can be interpreted in more than one way. The most obvious interpretation would be that lawmakers boost revenue to the SAF from other sources in an amount that offsets any revenue losses related to eliminating the sales tax on fuel. Most likely, the state's General Fund/General Purpose (GF/GP) revenue would be the primary, if not the only, source of that revenue.

But even if the School Aid Fund itself is held entirely harmless from the sales tax change, there is another matter of concern for school groups. In 2012, the state's 15 public universities saw their operating budgets cut by 15 percent as part of a separate effort to conserve state GF/GP revenue to facilitate the elimination of the Michigan Business Tax, replacing that tax with a new Corporate Income Tax with a narrower base of business taxpayers. To help mitigate the need for more extensive higher education cuts, lawmakers tapped the School Aid Fund to help make up for some of the GF/GP reductions to universities. That, of course, reduced the amount of SAF revenue available for K-12 schools.

As we explain below, significant reductions to higher education funding may be needed again on the GF/GP side of the budget to bring appropriations in line with the reduced revenues that will come with this road funding proposal. School groups are likely equally concerned about whether they will be held harmless from this kind of SAF revenue shift. For this analysis, we will assume the strict definition of "hold school fund harmless" – that any revenue loss to the SAF from reduced sales tax collections will be backfilled with other revenue (very likely discretionary GF/GP revenue) and that the SAF won't be used to offset potential budget cuts to universities or community colleges.

The GF/GP Budget May Need to Be Reduced by $2.4 Billion

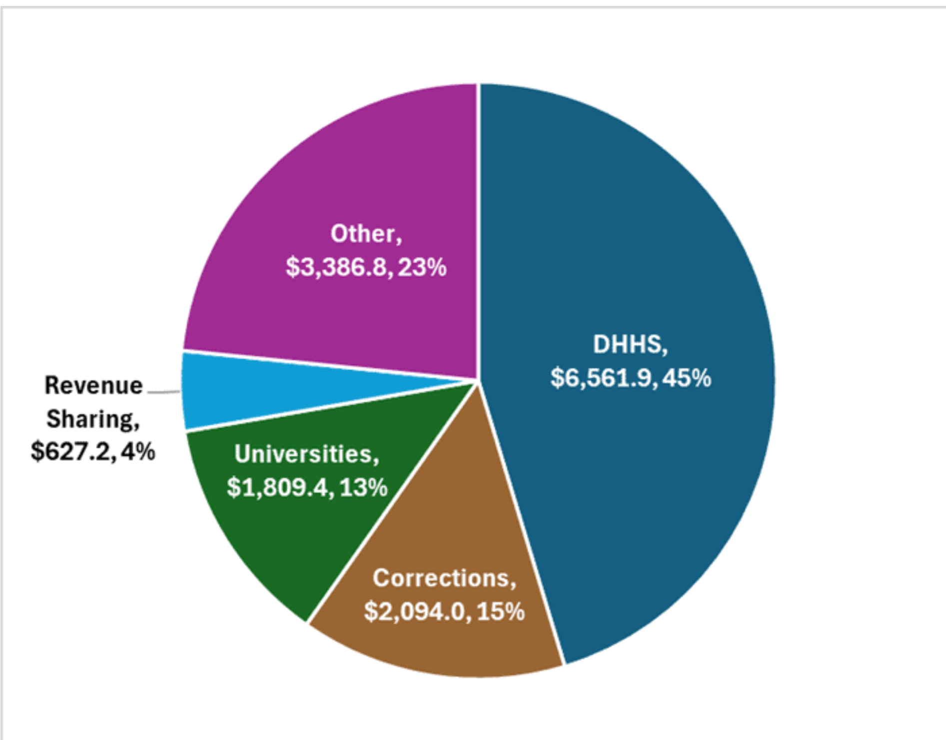
If that's the case, what does it mean for the state's General Fund budget?

The good news is that the state is expected to have a modest GF/GP revenue surplus if current revenue forecasts hold when FY2026 budget deliberations begin. House Fiscal Agency and Senate Fiscal Agency documents show that the state should have roughly $14.7 billion in available GF/GP revenue in FY2026.

On the spending side, the recently enacted FY2025 budget contains ongoing GF/GP appropriations of around $14.4 billion. That means if the legislature passed a purely continuation budget for FY2026 (one that simply maintains FY2025 GF/GP-funded appropriations with no increases and no cuts), about $300 million in GF/GP would remain on the table to help cover the $2.7 billion in revenue redirected out of the General Fund under the road funding plan.

However, even with the $300 million surplus, that still leaves a significant structural budget deficit of $2.4 billion. Addressing that deficit would require the legislature to reduce GF/GP appropriations (or generate new GF/GP revenues) by that amount to bring the budget into balance. A solution that relies solely on budget reductions would equate to a nearly 17 percent cut in overall GF/GP appropriations. Can the legislature cut $2.4 billion out of the current GF/GP budget? With sufficient votes, they sure can. But lawmakers should be fully aware of the kind of major budget reductions that would be necessary to accomplish that goal. Over 75 percent of ongoing GF/GP appropriations are focused in just four areas: health and human services (i.e., Medicaid, child welfare, social services programming), corrections, public universities, and local government revenue sharing. Cuts to programming in these areas would have to be prominent in any budget reduction plan, and recent Research Council analyses have highlighted the fiscal challenges facing both public universities and local governments.

Ongoing FY2025 GF/GP Appropriations by Function (in millions)



Notes: Statutory revenue sharing is not directly appropriated from GF/GP revenue, but it does draw from GF/GP revenue resources, so it is included in this chart. Ongoing appropriations do not include one-time appropriations.

Fixing the Damn Roads Goes Beyond Money

Finally, if this plan goes forward, the legislature should keep in mind that Michigan's revenue struggles are only part of the story regarding Michigan's poor road conditions. A recent series of Research Council analyses helped document what everyone already knows about Michigan's roads: they're generally in poor shape. Using a multi-factor index created by the Research Council, Michigan ranks 40th nationally among states in road system conditions.

However, our research also revealed something that is less known. Regarding road revenues and expenditures across key metrics, Michigan ranks 30th among states and 7th among 11 peer states. That's still below average, but Michigan ranks better in terms of available road funding than it does in terms of its road conditions. That suggests that at least some similarly situated states are getting more bang for the buck with the road funding that they do have.

Finally, our research also suggests that Michigan's complex "Act 51" distribution formula, which allocates road funding to the state and to 614 different county and municipal road agencies, is not very effective at sending funding to the areas with the highest maintenance and repair needs.

In short, a permanent increase in transportation will likely help move the needle on fixing the damn roads. But, as debate on the House Republican plan moves forward, lawmakers should proceed with the understanding that this revenue shift will require a substantial restructuring of the services that state government can provide. In recognition of that trade-off, they should also devote serious time to studying and making appropriate reforms to how we distribute and utilize our existing road funding, and any new revenue shifted to road infrastructure from other areas of the budget.

That dual focus will not only help fix the damn roads but will fix them more efficiently and could minimize the budget sacrifice that comes with any revenue shift.

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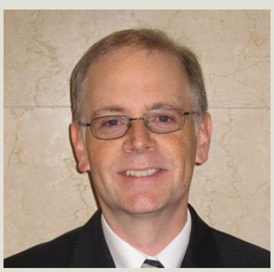

Bob is in his second stint with the Citizens Research Council, having worked for the organization from 2013 to 2015. He has spent most of his time in state government, having worked in the Office of Health and Human Services – State Budget Office and as Associate Director for the non-partisan Michigan House Fiscal Agency (HFA). He has extensive expertise and has provided non-partisan advice and analysis on state policy and budget matters in areas including corrections, human services, and transportation. Prior to joining HFA, he was a research assistant and project manager from 1994 to 1996 for Public Policy Associates, a Lansing-based policy research and consulting firm. He also served for two years within the Michigan Department of State working on department budget and financial issues.

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