Council Comments

Citizens Research Council of Michigan
500 GUARDIAN BUILDING, SOUTH--DETROIT 48226
834 MICHIGAN NATIONAL TOWER--LANDSING 48933

No. 876 October 2, 1974

ABOUT STATE BALLOT ISSUES

Michigan voters will be asked, at the November 5 general election, to approve or reject four ballot proposals. This *Comment* indicates the wording of each proposal as it will appear on the ballot, and presents a brief discussion of the issues. The proposals are:

A. Limiting Use of Motor Fuel Tax Funds
B. Vietnam Veterans Bonus Bonds
C. Removal of Sales Tax on Food and Prescription Drugs
D. State-Wide Transportation System Bonds

PROPOSAL A: LIMITING USE OF MOTOR FUEL TAX FUNDS

"Proposal A" would amend Article IX, Section 9 of the Michigan Constitution. The proposition was placed on the ballot by provisions of a senate joint resolution which was approved in the 1972 legislative session.

The proposed constitutional amendment would:

1. *Prohibit the use of motor fuel tax funds by law enforcement agencies for highway patrol purposes; and*
2. *Limit the use of motor fuel funds for public transportation to 1/18 of the amount received.*

Should this constitutional amendment be adopted? Yes [ ] No [ ]

<u>The State Constitution and Highway Taxes</u>

The constitution provides that "All specific taxes, except general sales and use taxes and regulatory fees, imposed directly or indirectly on fuels sold or used to propel motor vehicles upon highways and on registered motor vehicles shall, after the payment of necessary collection expenses, be used exclusively for highway purposes as defined by law."

The appearance of Proposal A on the November ballot arises directly from a legislative-executive office compromise formulated during 1972 deliberations concerning the enactment of a package of transportation bills. Voter action on the proposal should resolve long-standing differences between the executive office and the legislature over the use of highway funds.

In recent years the executive office attempted to broaden the meaning of the constitutional phrase "highway purposes."

- Beginning in 1965 the executive office on several occasions has recommended that the cost of patrolling 1,000 miles of state freeways by the state police (estimated $1.5 million annually) be financed from highway user taxes. Proposal A, if approved by the voters, would expressly prohibit the use of highway user taxes for highway patrol purposes.

- More recently the executive office advanced the concept that highway user taxes should be used in part to finance capital and operating costs of public transportation systems. In the closing days of the 1972 legislative session, motor fuel taxes were increased by two cents to nine cents a gallon and one-half (1/18 of 9 cents or about $20 million) was specifically earmarked for a "general transportation fund" to finance public transit programs. The legislature provided that expenditures financed by the earmarked one-half cent through June 30, 1975, "shall be considered as advances from the motor vehicle highway fund to the general transportation fund to be repaid … at such time and in such manner as may be provided by law."

  Proposal A would expressly recognize public transportation programs as within the meaning of "highway purposes" but would limit the amount of motor fuel taxes that could be used for public transportation purposes to 1/18 of the net collection of such taxes.

PROPOSAL B: VIETNAM VETERANS BONUS BONDS

"Proposal B" appears on the November 5 ballot as a result of legislation enacted in the 1974 session. *The ballot proposal would:*

1. *Authorize the state to provide veterans of the Vietnam and other conflicts who served between January 1, 1961 through September 1, 1973 with a service bonus; and*
2. *Authorize the state to borrow the sum of $205 million for this purpose; and*
3. *Authorize the state to issue general obligation bonds therefore; and*
4. *Provide for repayment from the general fund.*

Should this proposal be approved? *Yes [ ] No [ ]*

If Proposal B is approved by a majority vote of the qualified electors the payment of bonus benefits will be made according to the provisions of the enabling legislation—Act 106, Public Acts of 1974. The legislation, in brief, provides:

<u>Eligibility for Bonus</u>
Veterans would be eligible who: a) were residents of Michigan for at least six months prior to entering military, naval, marine or coast guard service and b) completed at least 190 days of honorable service during the period January 1, 1961 to September 1, 1973. Only veterans who received an honorable or general discharge or were separated from service under honorable conditions would be eligible for bonus benefits.

<u>Bonus Benefits</u>
Combat service bonus. A $600 payment would be made to a veteran eligible to wear the Vietnam service medal or Armed Forces expeditionary medal.

Noncombat service bonus. An eligible veteran who had not served in Vietnam expeditionary forces would receive a sum computed at $15 per month for each month of active duty but not to exceed a maximum of $450. An eligible veteran would not be entitled to both a combat service bonus and a noncombat service bonus.

Bonus payment to beneficiary. If the veteran is deceased the bonus for which the veteran would have been eligible would be payable to his beneficiary.

As enacted, the law provides that bonus benefits payable will expire June 30, 1980 and they are not subject to state or municipal income taxes.

Veterans Bonus Bonds
If approved by the voters, the amendment would permit the state to borrow $205 million, pledge its faith and credit and issue general obligation bonds. Under provisions of the enabling act, the state administrative board is directed to sell notes or bonds "at the lowest possible cost." Principal and interest payments would be made by annual appropriation from the general fund.

Cost of Veterans Bonus Program
The eventual cost of the Vietnam veterans bonus is predicated on two sets of factors:

1. The number of veteran applicants. Estimates of the number of potential eligible Michigan veterans range from 400,000 to 465,000. The executive office estimates that 140,000 veterans would qualify for a combat bonus payment of $600, a cost of $84 million, while 312,000 veterans would qualify for noncombat service bonuses of $112 million—a grand total of $196 million.

2. Debt management. The cost of retiring the proposed bonds is dependent on a number of factors including: the length of bond maturity, the interest rate, the method of scheduling principal repayment and the earnings received from the temporary investment of unused bond proceeds. Estimates of total principal and interest costs vary widely, ranging from $320 to $390 million.

PROPOSAL C: REMOVAL OF SALES TAX ON FOOD AND PRESCRIPTION DRUGS

"Proposal C" would amend Article IX, Sections 8, 10 and 11 of the Michigan Constitution. It was placed on the ballot by initiative petition.

The proposed constitutional amendment would:

1. *Remove the sales tax on food and prescription drugs used for human consumption except food prepared for immediate consumption and alcoholic beverages; and*
2. *Compensate units of government, other than the state, for the resulting loss of revenues by increasing each present allocation of sales tax revenue to such units by 1/5th.*

Should this constitutional amendment be adopted? *Yes [ ] No [ ]*

The State Constitution and the Sales Tax
The three pertinent sections of the Constitution relating to the sales tax provide:

Sec. 8 "The legislature shall not impose a sales tax on retailers at a rate of more than four percent of their gross taxable sales of tangible personal property."

Sec. 10 "One eighth of all taxes imposed on retailers on taxable sales at retail of tangible personal property shall be used exclusively for assistance to townships, cities and villages, on a population basis as provided by law…"

Sec. 11 "… One-half of all taxes imposed on taxable sales at retail of tangible personal property, and other tax revenues provided by law, shall be dedicated to this fund." (State school aid fund)

The language of the proposed amendment is fairly definitive and would appear to require very little by way of legislative definition. The intent is clear—to exempt from the sales tax *all* prescription drugs and *all* food for human consumption except prepared foods for immediate consumption. In an advisory opinion, the attorney general states:

> "… Although it would appear that the legislature does not have great leeway in the definition of 'prepared foods', since the term has a well-understood common meaning, it should have reasonable discretion to define the concept of 'immediate consumption'. For example, it should have discretion to determine whether carry-out meals, sandwiches, etc. were 'intended for immediate consumption'."

In the absence of legislative definition of the phrase "immediate consumption" all food for human consumption would be exempted from the sales tax according to the opinion.

Estimated Revenue Loss from Exemptions

Preliminary data indicate that $1.052 billion was collected from the sales tax in fiscal year 1974. According to treasury estimates, the sales tax on "food for human consumption" including prepared food for immediate consumption (e.g. restaurant meals) accounts for 26-29 percent of total collections, or $275 - $306 million annually. Assuming that the legislature acts to insure that "prepared food for immediate consumption" continues to be subject to the four percent sales tax, the revenue loss from exempting all other food for human consumption is variously estimated to be $200 million by the executive office, $200-$225 million by treasury officials, and $300 million by the house fiscal agency. The exemption of prescription drugs would result in a $1.5 - $2.0 million loss in revenues.

Distribution of Sales Tax Revenue—Proposed Changes

If adopted the proposed constitutional amendment would also change the formula for distributing sales tax revenues—increasing shares to both the school aid fund and to local units, but reducing the allocation to the general fund:

	Constitutional Allocation	
	Present	Proposed
School Aid Fund	2 cents	2-4/10 cents
Local Governments	½ cent	6/10 cents
State General Fund	1½ cents	1 cent

However, even with increased allocations, the school aid fund and local units would experience a reduction in revenues—initially in FY 1975 and in future years. Based on estimates of annual sales tax losses of $200 to $300 million, the tabulation following illustrates the range of such potential losses in FY 1975 when the amendment would be partially in effect and for a full year.

	Sales Tax Revenue Loss: Millions	
	Partial Year FY 1975	Full Year
School Aid Fund	$ 3-27	$ 7-67
Local Governments	1-7	1-16
State General Fund	80-91	192-217
Total	$84-125	$200-300

It should be noted that deficiencies in school aid fund revenues are directly offset with supplemental appropriations from the state general fund. In reality, therefore, nearly all the loss in revenue from exempting food and drug sales taxes is borne by the state general fund.

Replacement of Revenue Loss

If the proposed amendment is approved, food and drugs would not be taxed after January 1, 1975. This action would have profound impact on state finances in both fiscal years 1975 and 1976. The effects of a combination of circumstances for practical purposes preclude any possibility of absorbing the sales tax loss in either year: (1) Official revenue estimates for FY 1975 show a *decrease* of $11 million in total GF-GP income from FY 1974 levels as a result of tax relief programs already adopted by the legislature; (2) GF-GP appropriations for FY 1975 exceed estimated current revenues by $195 million—fiscal balance will be achieved only by exhausting the surplus accumulated in recent years. This revenue-expenditure gap will have to be filled in the 1975-76 budget; (3) Official concern is surfacing that continued economic stagnation will result in expanded welfare rolls—increased spending—this winter when several thousand unemployed will exhaust unemployment compensation benefits; and (4) If the legislature approves the mid-year pay boost for state employees recommended by the civil service commission, the $11 million GF-GP cost in the current fiscal year will throw the current budget out of balance.

Nearly all current discussion centers on the personal income tax as the probable source for replacement revenue and there is near unanimity of opinion that any tax increases would be effective January 1, 1975.

According to official estimates, each one percent income tax will yield $300 million in FY 1975. Depending on the sales tax revenue loss, its replacement through the personal income tax would require rate increases in the range of 0.67 percentage points to a full percentage point. The present rate is 3.9 percent.

PROPOSAL D: STATE-WIDE TRANSPORTATION SYSTEMS BONDS

"Proposal D" was placed on the ballot by the legislature (Public Act 245 of 1974) pursuant to the provisions of Article IX, Section 16, which requires voter approval of state bond issues. Proposal D states:

> *The proposal would:*
>
> 1. *Authorize the state to borrow the sum of 1.1 billion dollars to finance the planning, acquiring, constructing, and equipping of various land, air, and water transportation systems, other than operating and maintenance expenses; and*
> 2. *Authorize the state to issue general obligation bonds therefore;*
> 3. *Provide for repayment from the general fund.*
>
> *Should this proposal be approved? Yes [ ] No [ ]*

Proposed bond funds would constitute the state's share of a proposed $6.2 billion 15-year public transportation capital improvement program. It is anticipated that federal legislation will provide $4.6 billion and Michigan local governments $557 million. Specific uses of the bond proceeds would be provided by law after voter approval of the bonds.

The governor, when recommending placement of the bond issue on the ballot, proposed the following allocations:

Urban Transportation. $540 million to be earmarked as the state contribution to a $5.4 billion high-level and intermediate-level transit system proposed by the Southeast Michigan Transportation Authority (SEMTA). The proposal calls for developing 75 miles of high-level service (rapid transit) and 179 miles of intermediate-level service (utilizing buses on reserved lanes of freeways and arterial highways). The SEMTA proposal contemplates that local taxpayers in the counties served would match the state contribution and that the federal government would provide an additional $4.3 billion under proposed legislation.

Inter-City Rail and Bus Systems. $362 million would be used to improve inter-city bus and rail services (passenger and freight) by upgrading existing track, acquiring equipment and improving terminals. It is estimated that the federal government would provide $213 million in federal aid to rail improvements for a total $575 million program.

People Movers. $20 million of the bond proceeds would be used to help finance the estimated $81 million cost of constructing four "people mover" systems in downtown Detroit, at Detroit-Wayne Metropolitan Airport, in Grand Rapids and in Saginaw. It is hoped that the federal government will provide the other $61 million under pending federal legislation.

Airport Development. $100 million to construct and improve aviation facilities and acquire airplanes to improve commuter services.

Port Facilities. $50 million for port improvements and developments matched by $16.7 million in local funds.

Non-Motorized Transportation. $25 million for development of biking, hiking, and riding trails throughout the state.

The governor has recommended that highway construction and improvements and upgrading regular municipal bus system services not be financed from the proposed bond issue. These would continue to be financed from state gas and weight taxes.

If the voters approve the proposed bond issue a series of future legislative actions will be needed to implement the proposed transportation program. Included would be legislation establishing the elements of the program, allocating and appropriating funds, fixing administrative responsibility and procedures, and providing methods of raising funds to provide operating subsidies and to provide local matching funds for capital costs.

Financing the Bond Issue

It is presently planned to sell the $1.1 billion in bonds in issues of various amounts over a 15-year period through 1990. The bond issue would be fully repaid by about the year 2015. It has been estimated that interest costs will total about $1.0 billion. The bonds would be general obligation and pledge the faith and credit of the state. The legislature would be required annually to appropriate an amount sufficient to meet principal and interest payments. The average annual debt service requirements over the approximate 40-year period would be about $57 million annually and the peak requirement would be about $87 million during the early 1990s.

As of June 30, 1974, the state had outstanding $434.5 million in general obligation debt and had authority to issue an additional $69.0 million in bonds previously authorized. Annual debt service requirements on the presently outstanding debt is currently about $50 million annually. This will decrease significantly in 1980 and then will continue to decrease gradually until the present outstanding indebtedness is fully paid off in 1999.