CITIZENS RESEARCH COUNCIL OF MICHIGAN

Piecing Together the Road Funding Puzzle

Key Takeaways

- Governor Whitmer and the Republican majority in the House of Representatives have both proposed increases in road funding through their respective budget recommendations.
- Governor Whitmer's plan would increase road funding by $1.9 billion a year when fully phased in without requiring budget cuts, but would not exempt fuels from the sales tax.
- The House Republican plan would increase road funding by about $900 million annually once fully phased in, exempt fuels from the sales tax, and cut administrative budgets and information technology spending across all departments in Fiscal Year 2020.

Introduction

When Governor Whitmer put her plan to fix Michigan roads at the center of her Fiscal Year (FY)2020 executive budget, she kicked off the debate over how to address Michigan's deteriorating road conditions. Her proposal has two components: a phased-in 45 cent per gallon fuel tax increase, and a new distribution formula to allocate the additional fuel tax revenue raised.[1]

The Republican majority in the House of Representatives responded to the Governor's proposal by incorporating components of an alternative road funding plan into its version of the FY2020 budget recently approved by the House.[a] The main piece of its plan would exempt motor fuel purchases from the state sales tax and increase fuel taxes by a commensurate amount. While many parts of the Governor's plan are spelled out in a white paper and the fiscal impacts incorporated into her budget recommendation, the exact details of the House Republican plan (hereafter the "House plan") plan are not fully known at this time. However, the broad outline of the House plan, along with its fiscal impacts, are contained in various departmental budgets approved by the House of Representatives.

a For the most part, the FY2020 state budget passed by the Michigan Senate does not address the larger road funding challenge. The Senate has signaled that, for the time being, it will approach the roads issue outside of the budget process.

In anticipation of the debate surrounding highway infrastructure investment, and prior to the release of either plan, the Research Council issued a report, *Evaluating Michigan's Options to Increase Road Funding,*[b] proposing a set of key principles to guide the debate. The report acknowledged the need for additional highway funding, but it also suggested that structural reforms should be considered to address inefficiencies in transportation spending and to make fuel taxation more transparent to the motoring public. Those principles were:

- Disentangle the sales tax and motor fuels to ensure tax transparency and maintain a user fee approach;
- Avoid creating fiscal problems elsewhere in the budget;
- Judicious use of borrowing;
- Distribute new road funding to ensure resources go to the roads most in need;
- Raise funds sufficient to deal with the problem – partial measures or kicking the can down the road will not solve the problem.

b You can read the full report here: https://crcmich.org/evaluating-michigans-options-to-increase-road-funding/

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Disentangle the Sales Tax from Fuels

Michigan drivers currently pay three separate taxes at the pump. All states levy the federal motor fuel tax (18.4 cent per gallon), the proceeds from which are distributed back to states as federal aid. Additionally, Michigan levies a 26.3 cent per gallon excise tax and the 6 percent state sales tax (the per-gallon rate varies based on the wholesale price of fuel). All told, motorists pay just over 60 cents per gallon in taxes on fuel purchases when gasoline prices are $3.00 per gallon.

Several states, including Michigan, include motor fuels in the sales tax base. All except Michigan use some of the revenue generated for roads. Revenue from Michigan's six percent sales tax primarily goes to the School Aid Fund (SAF) and local government revenue sharing through constitutional earmarks. If citizens are being asked to pay for additional highway investment through higher taxes, there should be assurances that all taxes paid at the pump are supporting that investment.

Disentangling the sales tax from motor fuels can be tricky. Of the $840 million in sales tax collected at the pump, $627 million is constitutionally dedicated to the School Aid Fund (SAF), $81.3 million is constitutionally dedicated to cities, villages, and townships for revenue sharing, and the remainder is statutorily earmarked to public transit and statutory revenue sharing payments. Holding local government and school funding harmless from a plan to remove motor fuels from the sales tax base or to redirect the revenue to roads would require finding a considerable amount of additional state dollars.

The Governor's plan does not remove motor fuel purchases from the sales tax base or modify the current earmarking provisions to direct the sales tax on fuels to roads.

The House plan gradually exempts fuel purchases from the sales tax, and replaces it with an additional fuel tax. In FY2020, fuel would be exempt from the 4 percent rate, and a new tax on fuels equal to that amount would be levied. In FY2021, fuel would become exempt from the remaining 2 percent rate, and the new fuel tax would increase by an equivalent amount. While the nature of the replacement tax has yet to be revealed (whether it's an increase in the existing per-gallon excise tax rate or a new price-based tax), tying the tax increase to the sales tax exemption would mean consumers would see little change in the price paid at the pump. It would increase revenue dedicated to the Michigan Transportation Fund (the fund that receives fuel tax revenue) by an estimated $840 million each year.

To make the SAF whole from the sales tax exemption, the FY2020 state budget approved by the House would replace about $500 million in SAF appropriations for higher education with an equal amount of General Fund/General Purpose (General Fund) appropriations. Additional replacement revenue is provided to the SAF by increasing the existing income tax earmark to the fund by $174 million. The House Fiscal Agency projects that the exemption of motor fuel from the sales tax would reduce SAF revenues by $325 million in FY2020 and $627 million in FY2021. The proposed changes to higher education funding ($500 million) and in the income tax earmark ($174 million) would be sufficient to cover the sales tax exemption effects on the SAF in FY2020 and FY2021.[2]

The Michigan Constitution dedicates 15 percent of the 4 percent sales tax rate to revenue sharing payments to cities, villages, and townships on a per-capita basis. The House plan would cause an $81.3 million reduction to these payments in FY2020. Under the FY2020 budget passed by the House, this reduction would be made whole, dollar-for-dollar, via a new appropriation to cities, villages, and townships. While this keeps local government funding whole, it would exchange a constitutionally-dedicated payment for a statutory payment and subject the new payment to future appropriation risk (i.e., the payment could be reduced or eliminated by legislative action).

Avoid Creating Financial Problems Elsewhere

Finding existing and available funding in a $59 billion state budget to redirect to fix the roads would not seem terribly difficult for lawmakers. However, the large amount of state tax revenue dedicated to specific purposes makes redirecting $2 billion or more every year of existing resources towards roads a much more difficult task in practice.[3] General Fund revenue, the state's main source of discretionary funding, is projected at $10.8 billion for FY2020. However, much of the General Fund budget is dedicated to funding priorities such as federal Medicaid matching requirements, paying down state debt, and funding state services (e.g., Michigan State Police or correctional facilities).

Some of the spending out of the General Fund budget is truly discretionary, but much of it is used to keep state services functioning and to generate federal matching dollars that limit state spending elsewhere. One example of this is the Healthy Michigan Plan: the federal government pays a majority of the cost of the program. If the state were to end its support of the program to redirect state dollars, the state would lose the federal matching funds and still have to fully fund certain mental health programs and prisoner health care, which are currently mostly paid for through the program. The Senate Fiscal Agency estimated in 2018 that only about $5.25 billion of the General Fund budget was truly discretionary.[4] Significant spending redirects (for roads) from this limited funding pool could force significant cuts to existing discretionary General Fund programs.

Unlike the 2015 road funding package that relied, in part, on redirecting $600 million in future General Fund revenue to address highway needs, the Governor's proposal does not target existing state resources. Instead her plan relies on all new tax revenue to increase highway investment. Further, the plan backs out the General Fund dollars dedicated to roads from the 2015 package. When that funding was allocated, the rationale was that economic growth would generate sufficient tax revenue (primarily income tax) to finance the increased road spending and avoid the need for budgetary reductions elsewhere in the General Fund. Current revenue estimates suggest that this will be the case; however, uneven revenue growth over the period has created some budgetary stress.

Baseline General Fund revenue[c] is expected to increase by about $1.7 billion from FY2017 to FY2021 (when the 2015 plan is fully implemented)[d] an increase sufficient on its own to cover the $600 million allocation to roads as well as the spending required to expand the Homestead Property Tax Credit, another major piece of the 2015 roads plan[e] (see **Table 1** on page 4).

The majority of revenue growth over the period is projected to have occurred in FY2018 ($1.1 billion of the $1.7 billion total). Because baseline revenue is projected to decline slightly in FY2019, the increase in road funding coupled with the first year of the expanded Homestead Property Tax Credit resulted in the General Fund budget experiencing a $500 million decrease in ongoing revenue growth. This uneven growth means that the 2015 package has had an effect on the year-to-year General Fund budget.

c Baseline revenue does not include the impact of partial-year tax changes or certain recent policy changes, allowing for better year-to-year comparison of revenue relative to economic growth when compared to net revenue. In particular, the 2015 road package and homestead property tax credit increase are subtracted out of net revenue, but the dollars associated with those pieces are included in baseline revenue.

d Based on the May 2019 Consensus Revenue Estimating Conference.

e The Homestead Property Tax Credit was expanded to offset the effects on low-income families arising from the 7.3 cent-per-gallon fuel tax increase that was part of the 2015 plan.

Table 1

Annual General Fund baseline revenue growth relative to prior year and changes in General Fund support for roads and the Homestead Property Tax Credit from prior year, FY2018-2021
(millions of dollars)

	Actual		Projected		
	FY2018	FY2019	FY2020	FY2021	Net Change
General Fund Baseline Growth	$1,118.2	$ (23.1)	$ 321.2	$ 303.8	$ 1,720.1
2015 Road Funding Diversion	$ -	$ (150.0)	$ (175.0)	$ (275.0)	$ (600.0)
Homestead Property Tax Credit Expansion	$ -	$ (205.8)	$ -	$ -	$ (205.8)
Supplemental General Fund Support	$ (195.3)	$ (151.8)	$ 356.8	$ -	$ 9.8
General Fund Baseline Growth Subtracting Roads	$ 923.0	$ (530.7)	$ 503.0	$ 28.8	$ 924.1

Source: January 2019 Consensus Revenue Estimates

To relieve the pressure on the General Fund budget in FY2019, lawmakers used SAF resources to cover some obligations. For example, General Fund support for universities was reduced and replaced with increased SAF appropriations. The SAF appropriations for higher education rose from $238 million in FY2018 to $500 million in FY2019.

As part of her fiscal plan to address roads, Governor Whitmer proposes to eliminate the income tax diversion for highway spending ($468 million in FY2020 and $600 million thereafter). These funds are redirected in the state budget, mostly to replace the SAF appropriations for higher education programs and thus freeing up roughly $500 million in SAF resources.

To the extent that the 2015 road funding plan increased General Fund budget pressure, or shifted the burden of higher education funding to the SAF, the Governor's plan would resolve a portion of the budgetary stress created by the last road funding package.

The House plan would relieve some of the budgetary stress the SAF took on in the form of increased higher education spending in FY2018. The plan would end SAF appropriations for universities, shifting $500 million in higher education spending from the SAF to the General Fund. The plan would also redirect $172 million in income tax revenue back to the SAF that was earmarked to roads in 2018 in order to accelerate the phase-in of the 2015 package. On net, the two changes account for slightly more than the revenue loss that would occur if fuels were exempted from the sales tax, but would not offset the reduction in SAF resources that occurred due to the higher education funding shift in FY2019.

To offset the increase in General Fund spending on higher education, the House plan would require a number of cuts to other General Fund appropriations. First, about $300 million in one-time spending on roads from FY2019 is not renewed under the FY2020 House budget. Additionally, the House budget has made three percent across-the-board appropriation reductions to a number of operational line items amounting to $34 million; these are not tied to specific programs so their impact on state services is unknown at this time. Finally, the House plan includes a 25 percent cut to various information technology spending line items totaling $60 million in the General Fund budget. Again, the information technology cuts are largely nondescript and the final impacts they would have on state services are not identified in the House plan. Generally, state departments rely on technology for everything from processing benefits for assistance programs, maintaining databases and other electronic information, and upgrading state employee computers. Another piece of the House plan replaces $79 million in General Fund appropriations across various departmental budgets with dollar-equivalent restricted fund appropriations. Whether these fund shifts are sustainable long-term or just one-time in nature is not clear.

Borrow Judiciously

Rebuilds of highways and other large-scale projects may require long-term borrowing, but bonding should be used judiciously. Both plans would increase the department's borrowing cap, providing some flexibility if future or planned large-scale projects require significant upfront investment. At the same time, the proposals do not rely on a short-term borrowing that would require a commitment of on-going revenue over the long-term.

Overuse of bonding can limit funding available to maintain roads in the future as debt service payments take up more of the annual revenue available to a road agency. This is precisely the problem Michigan faces. Currently, state borrowing for past highway and bridge projects requires $160 million annually in State Trunkline Fund spending for principle and interest payments. This reduces the amount of ongoing revenue that MDOT has to spend on improving state roads. The majority of those bonds are close to being paid in full, which will free up a majority of that revenue by 2024.

Re-evaluate Funding Distribution Formula

Current road funding is distributed by Public Act 51 of 1951 (Act 51). The Act 51 formula distribution to local agencies is based on road miles, population, and vehicle registration fee revenue attributable to each county; factors such as road usage, number of lanes per road mile, and current infrastructure conditions are not considered. The absence of these key metrics presents two problems; it doesn't allow for effective maintenance, as the multi-lane roads that are used the most are not receiving funding commensurate with their roles, and it does not provide funding to roads currently in the worst condition. If the funding formula is not reexamined as part of a plan to raise additional state funds, new revenue could be allocated inefficiently.

MDOT, and subsequently the local road agencies, has a stated goal of maintaining a system in which 90 percent of the roads are in good or fair condition. Maintaining good and fair condition roads is much more cost effective than rebuilding roads that are in poor condition. MDOT reports that roughly 79 percent of the state trunklines are in good or fair condition.[5] The County Road Association reports that 45 percent of the local federal-aid eligible roads are in good or fair condition and only 36 percent of local non-federal-aid eligible roads meet that goal.[6]

The Act 51 formula distributes Michigan Transportation Fund (MTF) revenue to the agencies responsible for maintaining public roads. The formula allocates39.1 percent to MDOT, 39.1 percent to county road commissions, and 21.8 percent to cities/villages. On the one hand, the goal is to get funding to MDOT and those local road agencies responsible for multi-lane roads carrying high volumes of traffic. On the other hand, an efficient formula should get funding to the local road agencies responsible for roads most in need of repair. The Act 51 formula achieves neither of these goals well.

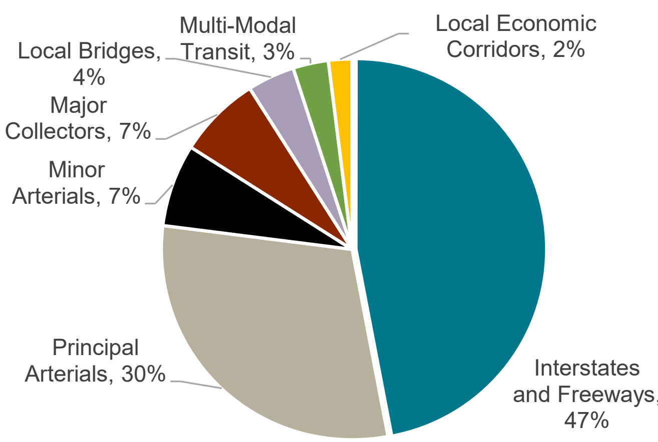
The Governor's plan creates a formula to distribute new revenue with the goal of serving the multi-lane, high traffic volume roads. Unlike the Act 51 formula distribution, the plan would allocate nearly all of the new road funds based on road classification using the federal National Functional Classifications. The proposal directs most of the new funding to interstates, freeways, and principle arterials (non-freeway routes that connect cities and roads that promote transit through an urban area). The remaining revenue would be divided among smaller roads, including minor arterials (shorter and more local roads) and major collectors (roads that funnel traffic to arterials); bridges; non-road transportation infrastructure; and local economic corridors (see **Chart 1**). While the proposed formula gets more money to higher use roads, it fails to direct the funds to those assets in most need of repair.

Changing a funding formula such as Act 51 creates the likelihood of producing winners and losers, especially when there are no new dollars to share across road agencies. However, when additional funds are added to the distribution mix, as is the case with the Governor's tax proposal, any negative funding effects can be moderated.

Based on the Governor's proposed distribution, the state would see the largest increase in funding as MDOT is responsible for the majority of the roads prioritized under the plan. It is estimated that the state would receive about 70 percent ($1.5 billion) of the new revenue. Collectively, all local road agencies

Chart 1

Fixing Michigan Roads Fund Distribution



would receive about 30 percent ($570 million) of the new revenue; this can be compared to the 60.9 percent they would have received if the new revenue was distributed under current Act 51 provisions. The plan does not specify how the dollars would be distributed to individual cities, villages and county road commissions.

The Governor's plan attempts to prevent any road agency from becoming a net-funding loser (i.e. receive less money after the formula change), by employing a "hold harmless" provision of sorts. It does so by allocating $325 million each year from the increased fuel tax collections towards the traditional Act 51 distribution formula.[f] This funding is designed to replace, dollar-for-dollar, the FY2019 General Fund allocation to the Michigan Transportation Fund that is part of the 2015 road funding package. This would ensure that recipients (i.e. county road commissions, cities, and villages) do not receive less funding as a result of the Governor's plan.

While this prevents any road agency from seeing a decrease relative to FY2019, local agencies see significantly less of the new revenue under the Governor's proposal than they would under Act 51. Local governments and road agencies combined would receive about $400 million more under the Governor's proposal than they are currently scheduled to in FY2021 (see **Table 2** on page 7). If the new revenue in the Governor's proposal was distributed through Act 51, local agencies would instead receive $1.26 billion, or nearly a $1.1 billion increase relative to what they are projected to receive under current law.

The Governor's proposal would divide the new revenue among road agencies based on the proportion of lane miles each agency has within a given federal classification. The intent is to target high-use roads; however, the amount of funding received by each agency would be determined by total lane-miles in each classification, not the actual use of those roads. Those agencies responsible for larger proportions of arterials and other major roads will see more funding, regardless of the actual road usage. While a slight improvement over the current Act 51 funding distribution criteria, actual road usage is still lacking as a factor in the Governor's plan. Furthermore, the proposed formula makes no attempt to allocate any dollars (current or new) to those roads currently in the worst physical condition.

The House plan would make no changes to how any revenue was distributed. All new road funding revenue would be distributed using the Act 51 formula.

f This earmarking provision to the Michigan Transportation Fund would be permanent and tied to a percentage of the fuel tax levy. This means that the actual increase would adjust for changes in consumption and inflation beginning in FY2022.

Table 2

Distribution of revenue increase under the current law and the two proposals, FY 2020-2021
(millions of dollars)

		Governor's Plan		House Plan	
FY2020	Current Law	Increase	Change	Total	Change
Michigan Transportation Fund Increase	$143.0	$ -	$(143.0)	$ 610.6	$ 467.6
Fixing Michigan Roads Fund Increase*	$ -	$ 889.9	$ 889.9	$ -	$ -
Net Road Funding Increase	$143.0	$ 889.9	$ 746.9	$ 610.6	$ 467.6
MDOT Funding Increase	$ 55.9	$ 645.6	$ 589.7	$ 238.7	$ 182.8
Local Increase	$ 87.1	$ 244.3	$ 157.2	$ 371.9	$ 284.8
FY2021					
Michigan Transportation Fund Increase	$275.0	$ 2.3	$ (272.7)	$1,187.0	$ 912.0
Fixing Michigan Roads Fund Increase*	$ -	$2,072.9	$2,072.9	$ -	$ -
Net Road Funding Increase	$275.0	$2,075.2	$1,800.2	$1,187.0	$ 912.0
MDOT Funding Increase	$107.5	$1,504.6	$1,397.1	$ 464.1	$ 356.6
Local Increase	$167.5	$ 570.6	$ 403.1	$ 722.9	$ 555.4

*Excludes $64.1 million allocation to multi-modal transit projects

Source: State of Michigan Budget Office and Citizens Research Council calculations

Provide Funding Sufficient to Solve the Problem

The final principle the Research Council outlined was that any plan to improve road funding should be sufficient to improve road conditions, not just slow the rate of decline. If new revenue is insufficient to actually improve conditions, the state will find itself returning to face the problem again in a few years. As the 2015 package has shown, delays and half-measures will only exacerbate the problem by not fixing the roads and requiring repeated requests to taxpayers for more funding.

The scope of the problem is fairly large from a budgetary perspective. Governor Snyder's 21st Century Infrastructure Commission, created in 2016 to evaluate deficiencies in Michigan's infrastructure and estimate funding requirements, found that $2.2 billion would be needed to maintain the state's goals for road conditions in addition to the $1.2 billion from the 2015 package.[7] The Senate Fiscal Agency has said the number is likely higher today than it was in 2016, as roads have degraded further since that estimate.[8] The Governor and the State Budget Office have placed their estimate of road funding needs at an additional $2.5 billion a year.

Ultimately, the dual goals of maintaining the multi-lane, high traffic volume roads and improving the roads in the worst condition can drive the price of road fixes even higher.

The investment goal for state roads is quite clear; Paul Ajegba, MDOT Director, told legislators that the department requires a minimum of $1.5 billion more a year to bring state-operated roads to target conditions.[9] The County Road Association estimates the system-wide need for county roads at an additional $2 billion a year to meet their quality goals (based on FY2019 appropriations).[10]

A similar estimate of investments for city/village roads is lacking. With each city and village having different levels of degradation and ways of measuring the problem, and a lack of centralized reporting for non-federal aid roads, there is no comprehensive estimate for how much revenue municipalities require to reach a similar quality goal. However, given MDOT and the County Road Association estimates, the $2.5 billion estimate commonly cited will likely not be enough, depending on what condition target is set.

The Governor's proposal would raise $2.5 billion in new fuel tax revenue, but road spending would only increase by about $1.9 billion relative to current law. This is because the FY2020 executive budget backs out $600 million in future General Fund dollars that are currently designated for roads. Net new transportation spending (after constitutional deductions) would rise by $775 million in FY2020 and by $1.86 billion in FY2021, when fully implemented (see **Table 3**).[g]

Under the Governor's proposal, MDOT would receive $1.5 billion, but only a $1.4 billion increase over current law, slightly below what MDOT has said is required to meet its 90 percent condition goal. The Governor's proposal provides a significant step towards resolving the problem, but even by MDOT's estimates comes short of the full funding needed.

Counties, cities, and villages would receive $723 million, $555 million more than current law. The counties portion is not close to the $2 billion the County Road Association estimates would be necessary to reach target road conditions. It is uncertain how much would be required to fix city and village roads; the state does not have an estimate for the more than 500 agencies (responsible for more than 20,000 miles of road).

The House plan, which includes a replacement fuel tax for exempting motor fuels from the sales tax and additional revenue from reductions in other MDOT line items to increase road funding, would raise $912 million a year in new revenue once fully implemented in FY2021, about half the new revenue the Governor's plan would raise. County road commissions and MDOT would receive $357 million more than current law each, while cities and villages would receive $199 million more than current law. In total, local governments would receive about $150 million more under the House plan than they would under the Governor's proposal, but MDOT would receive $1.1 billion less (see **Table 2** on page 7).

g The Governor's proposal would also trigger an automatic increase in vehicle registration fees for hybrid and electric vehicles. The 2015 roads package tied the fees for those vehicles to changes in the taxation of motor fuel; for every one cent increase in fuel tax, electric vehicles would be charged an additional $5 in annual registration fees and hybrid vehicles would be charged an additional $2.50. Under the proposed 45 cent per gallon increase, electric vehicle owners would see a $225 dollar increase in registration costs (from $135 right now), while hybrid vehicle owners would see a $112.50 increase (from $47.5 currently) each year. The House plan would trigger an increase under the same formula if it passed as a per gallon fuel tax.

Table 3

Net Change in Road Funding Under the Governor's Plan and House Proposal, FY2020-2021
(millions of dollars)

FY2020	Current Law	Governor's Plan	Change	House Plan	Change
Income Tax Earmark	$ 468.0	$ -	$ (468.0)	$ 325.0	$ (143.0)
Proposed Increases	$ -	$1,242.5	$1,242.5	$ 610.6	$ 610.6
Net Revenue	$ 468.0	$1,242.5	$ 774.5	$ 935.6	$ 467.6
FY2021	Current Law	Governor's Plan	Change	House Plan	Change
Income Tax Earmark	$ 600.0	$ -	$ (600.0)	$ 600.0	$ -
Proposed Increases	$ -	$2,464.3	$2,464.3	$ 912.0	$912.0
Net Revenue	$ 600.0	$2,464.3	$1,864.3	$1,512.0	$912.0

Source: House Fiscal Agency.

The House plan is not close to the $2.5 billion road funding figure that has been cited. Based on recent estimates, the House plan would fund about 24 percent of MDOT's need, while it would fund less than 18 percent of what the County Road Association estimated the county system requires to meet condition goals. Neither plan reaches the estimated road funding level; but the House plan raises much less new revenue than the Governor's plan would.

Considerations Surrounding the Future of the Fuel Tax

Our previous research identified the principles to guide the debate over road funding, and also a few trends and economic effects related to fuel taxes. The current model for fuel taxes raises some concerns about their long-term sustainability and potential for regressive economic impact.

Revenue Sustainability

Long-term fuel tax trends show reason to be concerned with the sustainability of fuel taxes. Over the last four and a half decades, gas tax revenue adjusted for inflation has declined consistently (see **Chart 2**). Collections have been somewhat volatile, but total collections have increased by about $9 million per penny levied, or roughly 25 percent, over the last 47 years.[h] Once adjusted for inflation, revenue on a per penny basis are only 20 percent of what they were in 1970, at $7.2 million dollars per penny levied. If the seven cent per gallon gas tax in 1970 had risen with inflation, we would have a 35 cent gas tax today. Even after the 2015 road funding increase, the 26.3 cent per gallon gas tax is 8.7 cents below that level. A large part of the decline in fuel tax revenue is due to fuel efficiency; since 1975, the average miles-per-gallon for a new vehicle has increased from 13.1 mpg to 25.2 mpg.[11]

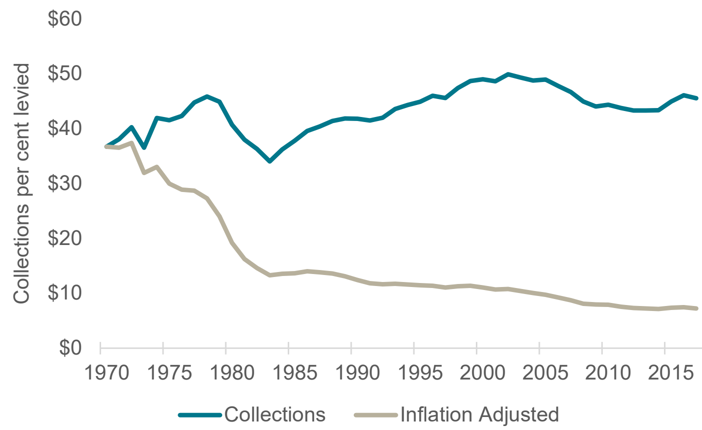
Over the same period, the estimated number of vehicle miles traveled in Michigan nearly doubled, from 53 billion to 102 billion miles per year. On average, vehicles are on the road for nearly two times the number of miles as they were in 1970, yet they are only consuming about 25 percent more fuel.

h The per penny collection is used to better track gas tax collection trends over time, as changes in the total levy have significant effects on the total revenue collected. If per penny levies are flat or declining over time, it means the tax is not keeping up with inflation unless there is a regular rate increase.

Additionally, a larger share of the vehicle fleet will be powered by electricity or alternative fuels.[12] One estimate projects that 33 percent of all vehicles will be electric by 2040.[13] The combination of these factors show a long-term trend – road usage is increasing, while the collections from a one-penny fuel tax levy are declining.

Chart 2

Gasoline Tax revenue per penny levied
FY1970-2017
(millions)



Source: Annual Report of the Treasurer and Citizens Research Council calculations.

The Governor's proposed 45 cent per gallon gas tax increase will do less to maintain Michigan roads over the long run, unless the rate increase is adjusted for both inflation and road usage. The 2015 road funding package tied the gas tax to inflation beginning in FY2022, so the Governor's proposal will be adjusted for inflation, but future increases do not account for downward consumption patterns, which will suppress fuel tax collections over the long-term.

The effects of the House plan could vary, depending on how the sales tax replacement for fuel is structured. If the proposal is a pennies per-gallon fuel tax increase, it would respond to consumption trends the exact same way as the Governor's plan. If a value tax is instead used, collections would be more volatile, and would be tied to gasoline prices instead of an inflation index. A tax on the value of gasoline would move with consumption patterns as well; so if consumption continues to decline, revenue from a value-based tax would as well.

The Regressive Nature of Fuel Taxes

Fuel taxes are regressive, meaning the relative tax burden on an individual goes down as their income increases. Much of the driving people do, whether for work or for other purposes, is unavoidable. The sparsity of public transit in many parts of the state further increases reliance on automobile use for low income people. Lower income families typically pay a significantly higher share of their income in fuel taxes, as the rate is based on consumption.

Providing some form of tax relief paired with an increase in fuel taxes may be a notable consideration. The expansion of the Homestead Property Tax Credit was tied to the 2015 road funding package to provide relief to lower income families. In her plan, the Governor proposed an increase to the Earned Income Tax Credit (EITC) to offset the household budget effects arising from the fuel tax increases. The EITC is linked to the federal credit of the same name and is designed to incentivize work in lower-income households. As an eligible taxpayer's wages go up, so does the EITC benefit (to a point).

The Governor's proposal to increase the Michigan credit from 6 to 12 percent of the federal credit would provide greater benefits to lower income families with children than those without. At the maximum EITC range, the credit would increase anywhere from a maximum of $31 (for a filer with no children) to $386 (for a filer with three or more children) per year. Families with children are likely to drive more. One concern with the credit is that the benefit accrues when people file their taxes (usually in April) as opposed to seeing it in their regular paycheck. It might not help lower-income households as well as intended, as families living paycheck to paycheck will be put under more strain by the significant fuel tax increase during the course of the year. Their relief will not come until they file their annual tax.

The House plan would not increase the price at the pump, and thus does create an increased economic burden on low-income households (or increase the EITC to address them).

Conclusion

Neither the Governor's proposal, nor the current details of the House proposal, check all the boxes in our guidelines for a road funding proposal.

The Governor's road funding proposal would provide a significant funding boost that would address a larger share of the problem than the House plan, but ultimately falls short of the Governor's target of a $2.5 billion road funding increase (and even a full $2.5 billion increase could fail to meet all state and local funding needs). The Governor's proposal uses a significant tax increase to avoid creating budget problems down the road; it would relieve some pressure on the SAF budget without creating pressure on the General Fund. The tradeoff to this is that the plan fails to exempt fuels from the sales tax.

On the other hand, the House alternative provides a more modest funding increase for Michigan roads (raising about half the revenue the Governor's plan would), but ends the collection of the sales tax on motor fuel to make fuel taxation more transparent and reduce the economic impact of the funding increase. The cost of doing so is a three percent cut to administrative budgets across the board, a 25 percent cut to information technology programs and projects across state government, and maintaining some of the existing pressure on the School Aid Fund.

Both plans avoid the short-sighted approach of relying on borrowing to increase road investment. Yet at the same time, both plans raise a question of long-term sustainability; as fuel efficiency increases over time, the yield from the per-gallon fuel tax will struggle to keep up with funding demands.

Given the Legislature and Governor are not bound to the initial proposals, the final agreement could end up significantly different from either. With the number of moving, interlocking pieces in the process, it is likely road funding talks will drive the discussion of the final FY2020 budget agreement.

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