Michigan Transportation Funding Recommendation

11/21/2022

EXECUTIVE SUMMARY

This recommended approach will modernize the transportation funding system in Michigan, while increasing state transportation revenues by $2.4 billion in FY 2025. The approach relies on a baseline of general taxes to support the entire transportation network and adds user-fees for premium assets such as the freeway system. The recommendation will **provide a higher level of customer service** for the freeway system while **eliminating the 28-cent motor fuel tax** and **reducing the state income tax by 0.5% to 3.7%**.

USER FEES AND GENERAL TAXES

The construct of a user fee is a "user pays, user benefits" system, whereby the user is charged for their proportional use of the facility. Since the early 20th century, motor fuel taxes have been used as a proxy for user fees. The first paved roads were funded by taxes on motor fuel, which was seen at the time as a luxury tax on a small portion of the population that benefitted from paved roads (as opposed to dirt or log roads).

Today's transportation network is the backbone of the economy and serves everyone who participates in that economy. The benefits of a transportation network are felt further and wider than the direct users, benefitting everyone that uses the economy.

In addition to the obvious declining revenues of the motor fuel tax due to electric vehicle adoption, the current system is not truly proportional to use or consumption. Heavy vehicles account for approximately 10% of the traffic on the roadways, 20-40% of the user fees, but greater than 95% of the wear and tear on our roadways. Adjusting user fees to align with this consumption would cripple the trucking industry and the economy.

A modern funding system will employ a mix of revenue streams, largely ambiguous to the fuel type used to propel vehicles. Basic and broad transportation needs should be funded by dedicated general fund taxes, with high-cost/high-value facilities (like the Interstate and remaining freeway network) funded by mileage-based user-fees as a self-sustaining system.

Several states have deployed Road User Charging (RUC) or Vehicle Miles Traveled (VMT) systems in pilot form, or in production form. However, all deployments so far have been voluntary and collected fees are capped at what the user would have paid in the previous system. In other words, current deployments of RUC and VMT are <u>not</u> generating additional revenue at this time.

CURRENT SYSTEM FUNDING

Michigan's current state-level funding system relies "trips to the gas pump" for 41% of revenues. Motor fuel taxes are 27.2-cents per gallon (for both gasoline and diesel), and vehicle registration fees are charged annually. Additionally, a $600M annual general fund subsidy is provided to the Michigan Transportation Fund (MTF) based on the 2015 transportation funding package. MTF revenue distributions are very complicated, but roughly end up as a 40-40-20 split between state, county and city governments.

Recent estimates show that current state funding is approximately 50% of the current need for state of good repair, or $3.7 billion short (combining state, local and multimodal needs).

Current STATE Funding (Approximate)				
		Distribution (millions)		
Revenue Sources	Total	Michigan DOT	Counties	Cities
Motor Fuel Tax (27.2-cents, diesel & gasoline)	$ 1,400	$ 560.0	$ 560.0	$ 280.0
Registration Fees	$ 1,400	$ 560.0	$ 560.0	$ 280.0
General Fund Transfer	$ 600	$ 240.0	$ 240.0	$ 120.0
TOTAL	**$ 3,400**	**$ 1,360**	**$ 1,360**	**$ 680**
Splits		40%	40%	20%
Notes				
Motor Fuel Tax = 27.2-cents, indexed to inflation, max 5% annual				
Registration fees (incl. additional $120 for EVs, $80 for Hybrid enacted 2015)				
$600M GF transfer per 2015 Funding Package				

PHASE 1 RECOMMENDATION (2023-2024)

To immediately impact the transportation program in a sustainable way, it is recommended that two statutory steps be undertaken in 2023 to impact the FY 23/24 Budget.

1. After delivery of the Statewide Tolling Study, **pass legislation allowing for the creation and enforcement of a Michigan Statewide Tolling Authority**, separate from the Michigan DOT and Michigan Transportation Fund. Tier 1 of the Statewide Implementation Plan calls for tolling of 6- to 7-cents/mile on 550 miles of freeway in Michigan, creating a self-sustaining system at enhanced levels of customer service. **This will allow for the creation of a $8.5 billion capital improvement program**, delivered between 2024 and 2032, and allows for future phases to be added to the toll system.

   Additionally, the tolling program creates $8.5 billion in "tolling credits" which can be used as soft federal match to provide greater flexibility to MDOT, or potentially sold to other states not having state funds for federal match.

2. Modify the 2015 transportation funding package to **allocate an additional $1 billion of general funds to transportation, funded from the statewide budget surplus.** To allocate more of these funds to local roadways, the distribution of the general fund transfer would need to change to a 25-45-30 split between state, county, and city allocations.

Proposed STATE Funding Sources - Short Term				
		Distribution (millions)		
Revenue (millions)	Total	Michigan DOT	Counties	Cities
Motor Fuel Tax (~28.5-cents, diesel & gasoline)	$ 1,400	$ 560	$ 560	$ 280
Registration Fees	$ 1,400	$ 560	$ 560	$ 280
General Fund Transfer (25/45/30)	$ 1,600	$ 400	$ 720	$ 480
NEW Toll System Development (GF)	$ 30	$ 30	$ -	$ -
TOTAL	**$ 4,430**	**$ 1,550**	**$ 1,840**	**$ 1,040**
Splits		35%	42%	23%
Notes				
Keep Motor Fuel Tax				
Keep registration fees (incl. additional $120 for EVs, $80 for Hybrid enacted 2015)				
INCREASE GF transfer by $1 billion to $1,600M				
Requires statutory change				
Implement Tolling System. Tier 1 deploy by 2032, creates $8.5B capital program				
Requires statutory change				

PHASE 2 RECOMMENDATION (2024-2025)

As a follow-up to the phase 1 actions, Michigan policy leaders have an opportunity to modernize Michigan's transportation funding system while constitutionally dedicating revenues to transportation.

In 2024, a 2/3 majority vote by both houses would be required to advance a ballot proposal to do the following:

1. **Increase the Sales Tax by 2% (from 6% to 8%) on tangible goods and dedicate those revenues to the Michigan Transportation Fund**, split 25-45-30 between state, county and cities allocations.

2. **Allow municipal localities to adopt a Local Sales Tax (capped at 0.5%)** dedicated to transportation and infrastructure purposes, after a majority vote of the people in the taxing jurisdiction.

3. **Repeal the state motor fuel tax on diesel and gasoline** (28.5-cents per gallon, diesel & gasoline).

4. **Reduce the State Personal Income Tax** by 0.5% to 3.7%.

Proposed STATE Funding Sources - Long Term				
		Distribution (millions)		
Revenue (millions)	Total	Michigan DOT	Counties	Cities
Motor Fuel Tax (~28.5-cents, diesel & gasoline)	$ -	$ -	$ -	$ -
Registration Fees	$ 1,400	$ 560	$ 560	$ 280
General Fund Transfer	$ -	$ -	$ -	$ -
NEW 2% Sales Tax (25/45/30)	$ 3,600	$ 900	$ 1,620	$ 1,080
Toll System Bonding Revenue (Tier 1, 2032)	$ 1,000	$ 1,000	$ -	$ -
TOTAL	**$ 6,000**	**$ 2,460**	**$ 2,180**	**$ 1,360**
Splits		41%	36%	23%
Notes				
Repeal Motor Fuel Tax				
Keep registration fees (incl. additional $120 for EVs, $80 for Hybrid enacted 2015)				
Eliminate GF Transfer and Reduce State Income Tax				
Add 2% sales tax on goods, dedicated to transportation. Split 25/45/30 (State/County/City)				
Requires constitutional amendment				
Keep Tolling System. Tier 1 deploy by 2032, creates $8.5B capital program				
Tier 1 followed by Tier 2 and Tier 3. Total Revenue potential = $1.5 billion (2020$) annually				