

Testimony for Matt Blinkilde, Policy Advisor, Senate Majority Policy Office

Good Morning Chairman Kahn and members of the Task Force on Transportation Infrastructure. Over the past several weeks, we have walked through many of the aspects of the current status of transportation assets and agencies. Beginning with how funds are currently being expended, moving through what those funds are purchasing us and what they aren't, discussing what not meeting maintenance costs the state and its residents, and finally settling in to a conversation of revenue sources and what is required to maintain Michigan's road network.

A great deal of the conversation has been focused on the funding shortfall and what level of funding is appropriate. While that remains an open question and a policy decision, there are several different options currently introduced or proposed by staff, Senators, Representatives, and the Governor.

Fuel Tax and Registration Tax Bills Currently Before the Legislature

One package of bills before both the House and Senate reflect the Governor's Special Message on Infrastructure and funding roads through current mechanisms.

The fuel tax bills create a percentage tax based upon the price of fuel, with the percentage tax on gasoline and diesel being the same. The bills permit the tax to increase or decrease on a cents-per-gallon basis, only allowing the tax to increase one cent per year, with an overall cap of 40 cents per gallon. Exemptions for schools, local government, state agencies, community action agencies, and other political subdivisions are also eliminated. A 1.5 percent deduction from fuel tax revenue for suppliers to allow for the cost of collecting and remitting the taxes would also be eliminated, along with several sections providing for refunds to those types of agencies. Upon enactment, this is estimated to raise the gasoline tax and the diesel tax by roughly 9.3 cents and 13.3 cent-per-gallon respectively.

The registration tax increases vehicle registrations by a little more than 66 percent for passenger vehicles and 68 percent for vehicle models from pre-1984 (which are subject to a weight-based tax). Municipal registrations are increased from \$5 to \$25, nonprofit registrations from \$10 to \$25, and truck registrations are raised between 23 and 30 percent depending upon their weight. A \$15 fee assessed on commercial trucks for the Truck Safety Fund which funds Michigan State Police commercial motor vehicle enforcement and education operations is eliminated and a \$2.25 fee assessed on some registrations for the Traffic Law Enforcement and Safety fund is also eliminated.

Currently, the gas tax brings in roughly \$844 million, and the diesel tax (in conjunction with the International Fuel Tax Agreement which implements a use fee on international and interstate commercial motor vehicle traffic) brings in \$124 million. Current registration fees garner roughly \$868 million. The bill package would bring in an additional \$413 million in gasoline taxes initially, as well as \$109.9 million in diesel taxes, and roughly \$590 million in vehicle registration taxes for a total of roughly \$1.12 billion initially upon enactment. This is shy of the \$1.4-\$1.5 billion increase calculated by the House Transportation Work Group, but represents a significant increase in revenues.

There would be some debatable shifts in policy if these bills are implemented. Taxing government and education fuel consumption will add to the cost of them carrying out their responsibilities. A little more than half of the revenue raised is off of registrations, which is currently based upon the list price of a given vehicle. This may have a slight chilling effect on new vehicle purchases, though the extent of this is unclear. These revenue bills will also continue to rely on fossil fuel sales as well, which, even if a percentage tax rather than an excise tax is used, as fuel efficiency and price of fuel increase, consumption does diminish, which might lead to continuing diminishing returns moving forward. This is dependent on the extent of fuel price increases and mileage standards.

While this is a "percentage tax" based on the price of fuel, it is a hybrid type system, still relying in part on a pennies-per-gallon tax, with increases tied to the price of fuel. In the past, it has been suggested that the flat-tax be tied to the Consumer Price Index, and these bills represent a variation on that theme. It is unclear whether or not this system will in fact keep up with commodity price increases and network need over time. Tax revenue will be able to fluctuate with the price of fuel, which would appear to keep up with inflation; however, caps on increases, the overall cap, and variance between fuel increases and general inflation, the efficacy remains unclear.

On the positive end, as with any revenue enhancement legislation, these bills do raise substantial additional revenue. Arguably, the increase in cost to Michigan residents will be offset by a decrease in maintenance costs, wasted time, and crashes. Additionally, this tax structure would certainly have the ability to grow over time, something the current system lacks.

Sales Tax for Transportation Infrastructure

Sales and use tax have been revenue sources researched by SMPO staff extensively as a source of revenue for the transportation infrastructure of Michigan. As testimony has reiterated numerous times and indicated by the data provided by the House and Senate Fiscal Agencies, a flat excise tax on fossil fuels is a revenue source that increases upon enactment of an increase, remaining either flat or declining in every subsequent year.

The examination of an alternate, stable revenue source led to a recommended 2 percent sales and use tax increase, partnered with the elimination of the gasoline and diesel fuel taxes. To many, this deviates from the "user fee" traditionally discussed for road funding. However, I would assert that one, a user fee situation doesn't take into account people benefitting from good roads who don't do a lot of driving; second, user fees have not truly existed since vehicle mileage has begun to vary through more efficient engines.

To begin with a basic description, the sales and use taxes are a very stable source of revenue. Even just after the financial crisis sucked hundreds of millions of dollars out of state, local, and the national economies, the Michigan sales tax lost just \$600 million – just barely more than 10 percent. This is remarkable considering the size and damaging effects of the event. The economic downturn in the early 2000s hardly impacted sales tax revenue at all.

Economically speaking, "utility," or benefit, from a particular product is not necessarily related to direct use of that product. For instance, electric bills contain a base charge that is not related to the cost of electricity itself, but is assessed on a monthly basis to all customers to keep the power grid infrastructure in good repair. Similarly, on water bills there is a base waste rate as well as a minimum water service charge to maintain water and sewer networks. Everyone in a community benefits from having a water system or power grid that are in good condition everywhere, not just on blocks that consumer a great deal of energy or water.

Utility of roads is similar. The utility, the benefit, exists whether you drive a lot or none at all. Take for example someone who stays at home all the time and orders products through a catalog or the internet. They may never use the roads themselves, but they are directly benefitting because their products can be delivered, utility trucks can move around easily to maintain electricity to the dwelling, etc. Another perspective is a person purchasing products at a local retail store. When a product is purchased, inventory must be restocked, and people benefit from being able to purchase products at a store on demand.

This consumer behaviour drives the use of roads because those products are restocked using a heavy truck. Additionally, employees must be able to get to the store to serve customers, and customers must be able to get to the store to purchase products. Under this scenario, it isn't necessarily unreasonable to charge the fee for benefiting from good roads at the cash register. Using sales and use taxes as a way to associate benefit, rather than direct use, is intended to establish a more appropriate tax-system for road network maintenance. Sales and use taxes are far arguably more appropriate than gas taxes and registration fees in assessing benefit from a good road system.

Other Sales and Use Tax points:

- Sales and use taxes broaden the base, requiring a smaller increase for achieving a large revenue increase. A 2 percent sales tax increase would cost roughly \$225 per person annually. Currently, gas tax revenue is in that realm per driver.
- Sales and use tax is arguably less regressive than a gas tax due to the ability to not purchase retail items, there are exemptions for food and medicine, and lower income individuals are more likely to drive older model vehicles with worse mileage than new vehicles.
- Sales tax impact is much more moderate, in terms of an impact on the auto industry, than registration fees, and should not impact vehicle sales to any sizable degree.
- Under the theory that good infrastructure leads to a better economy and a more attractive state, as the economy improves and businesses establish themselves here, more people will have more money to spend, thus benefitting the roads, leading to increased investment, and so the cycle would continue.
- Sales tax ensures that out of state drivers pay into the system through their tourist behaviour without increasing registration fees that only Michigan residents pay.
- With respect to retail, there is evidence through Federal Reserve studies that the border counties may benefit economically if Michigan's gas prices were lower than surrounding states much more than a sales tax rate barely higher than our neighbors. While this isn't as large a

benefit as maintaining the investment in roads made over the last several decades, it is something that has been an issue for border counties in the past.

Current Proposal and Other Scenarios

Senator Walker introduced Senate Joint Resolution N along with Senate Bills 711 and 712 in October last year. The SJR dedicates the proceeds of a 1 percent increase in the state sales tax to the Michigan Transportation Fund (MTF), and the Senate Bills tie-barred to it abolish the Motor Fuel Tax and Motor Carrier Tax Acts. This would result in a net increase in MTF revenues of an estimated \$47 million - \$162 million, with \$4.7-\$16.2 million going to the Comprehensive Transportation Fund (CTF) and \$42.3-145.8 million for roads.

This does not achieve a substantial increase in road revenues, but could, in time, solve the issue of matching available federal funds and benefits from all of the points I have outlined.

I have provided a spread sheet that details a 1, 1.5, and 2 percent straight increase in the sales and use taxes. The 1 percent proposal will differ slightly from Senator Walker's Joint Resolution, as SJR N does not increase the use tax along with the sales tax.

One important note to make considering the sales tax, it cannot be done statutorily. Michigan's constitution provides a cap for the amount of sales tax the state levies, and that would require an amendment.

Rather than only opting for a ballot initiative, a Proposal A style legislative package has been discussed which would ensure that the status quo does not continue, but also puts this option on the table for the voters and for the state to achieve a different fashion of funding our infrastructure. This would be implemented by raising taxes through statutory mechanisms first, then having a Joint Resolution passed allowing voters to decide the source of increased revenues.

Another Alternative

A third alternative fashion of funding roads has been pitched by several interest groups and a few legislators – exempting gasoline and diesel sales from the sales tax and raising the excise taxes (either flat tax or percentage based on price) the difference (at \$4 per gallon, this is roughly 21 cents).

This option would provide, depending upon the price, quite a bit of revenue without increasing overall state taxes. At \$3.50 and \$4.00 per gallon both gasoline and diesel, revenue would be between \$960 million - \$1.1 billion by itself; if coupled with a 50 percent increase in registration taxes, this would achieve \$1.53 billion overall.

The negative consequences of this effective sales tax shift would be a \$700-\$800 million hit to the School Aid Fund, \$95-\$110 million to local revenue sharing, and \$106-\$123 million to the General Fund (assuming \$3.50-\$4.00 per gallon for gas and diesel respectively). This would demonstrate a significant shift in priorities if a subsequent revenue increase did not occur.

Conclusion

Transportation funding is an expensive endeavor in the current environment, largely due to the current degradation of the system. Accurate comparisons to 1997 road conditions are difficult due to the lack of asset evaluation prior to the introduction of asset management. Another aggravating factor is that Michigan has been in the bottom ten states in terms of road funding for the past 50-60 years (U.S. Census Bureau, per capita), leading to the state always playing "catch-up." Additionally, as has been discussed at length, commodity prices are substantially higher now than they were even just 5 years ago.

Not maintaining infrastructure is similar to carry debt or running a deficit. If you consider not having revenue that is sufficient as an unfunded liability and delayed maintenance as interest, the cost of not achieving adequate funding is very clear. As testimony and data indicate, Michigan is approaching -and has arguably passed in some areas – unsustainability of its road network.

Whatever level and from what source or sources the Legislature and Executive decide upon, the data suggests that action sooner will cost less annually and waiting will cost more. These proposed fixes to that unsustainability are flexible, and different increases and decreases can be done to come to a definitive revenue solution. That being said, there are short and long term positives and negatives to any given revenue source, and in my opinion, these should be considered in addition to just funding levels.

With that, if there are any questions, I will be happy to address them.

3 Proposals for Sales Tax for Transportation

2 Cent Increase for Transportation; Elimination of Fuel Excise Taxes	
2 cent increase in the Sales and Use Tax (Effective rate of 8 percent)	\$2,458,000,000.00
Elimination of the Gas and Diesel Taxes	(\$934,947,700.00)
Net Revenue Increase	\$1,784,052,300.00
1.5 Cent increase for Transportation; Elimination of Fuel Excise Taxes	
1.5 cent increase in the Sales and Use Tax (Effective Rate of 7.5)	\$1,843,500,000.00
Elimination of the Gas and Diesel Taxes	(\$934,947,700.00)
Net Revenue Increase	\$908,552,300.00
1.5 Cent increase for Transportation; Elimination of Fuel Excise Taxes	
1 cent increase in the Sales and Use Tax for Roads	\$1,229,000,000.00
Alter Gas and Diesel Taxes to 10 cent Wholesale Tax	(\$934,947,700.00)
Net Revenue Increase	\$294,052,300.00
Loss of Road Asset Value (Daily, Annual)	
Loss of Road Asset Value (Daily) (Source: Jim Shea)	(\$3,000,000.00)
Loss of Road Asset Value (Annual) (Source: Jim Shea)	(\$1,092,000,000.00)
Cost of rebuilding these Assets	(\$5,460,000,000.00)

Sales Tax on Fuel at Different Pump Prices

Taxable Gallons of Gasoline	4,347,368.421		
Taxable Gallons of Diesel	766,666.667		
Base for Sales Tax on Gasoline (assuming \$3.50 and \$4.00 per gallon)	\$ 3.123	\$ 3.594	
Base for Sales Tax on Diesel (assuming \$3.50 and \$4.00 per gallon)	\$ 3.160	\$ 3.632	
Sales Tax Rate	\$ 0.060		
Estimated Sales Tax Revenue from Gasoline	\$ 814,609,894.73	\$ 937,466,526.30	
Estimated Sales Tax Revenue from Diesel	\$ 145,360,000.06	\$ 167,072,000.07	
Total Sales Tax Revenue on Gasoline and Diesel Purchases	\$ 959,969,894.79	\$ 1,104,538,526.38	

Breakdown of How Current Sales Tax on Fuel is Distributed

School Aid Fund 2 percent Sales Tax	\$ 319,989,964.93	\$ 368,179,508.79
General Sales Tax at 4 percent	\$ 639,979,929.86	\$ 736,359,017.58
School Aid Fund Revenue Sharing (60 percent, constitutional)	\$ 383,987,957.92	\$ 441,815,410.55
Total School Aid Fund Revenue	\$ 703,977,922.85	\$ 809,994,919.34
Local Revenue Sharing (15 percent, constitutional)	\$ 95,996,989.48	\$ 110,453,852.64
Comprehensive Transportation Fund (27.9 percent of 25 percent of the 4 percent General Sales Tax on fuel)	\$ 44,638,600.11	\$ 51,361,041.48
Health Initiative Fund	\$ 9,000,000.00	\$ 9,000,000.00
Remaining General Fund Revenue	\$ 106,356,382.36	\$ 123,728,712.92

How Pump Price is Determined

Gasoline at \$3.50 per gallon		Diesel at \$3.50 per gallon	
Base retail price	\$ 2.939	Base retail price	\$ 2.916
Federal excise tax	\$ 0.184	Federal excise tax	\$ 0.244
Base for Sales Tax	\$ 3.123	Base for Sales Tax	\$ 3.160
Sales Tax at 6%	\$ 0.187	Sales Tax at 6%	\$ 0.190
Subtotal	\$ 3.310	Subtotal	\$ 3.550
State Excise Tax	\$ 0.190	State Excise Tax	\$ 0.150
Pump Price	\$ 3.500	Pump Price	\$ 3.500
Gasoline at \$4.00 per gallon		Diesel at \$4.00 per gallon	
Base retail price	\$ 3.410	Base retail price	\$ 3.388
Federal excise tax	\$ 0.184	Federal excise tax	\$ 0.244
Base for Sales Tax	\$ 3.594	Base for Sales Tax	\$ 3.632
Sales Tax at 6%	\$ 0.216	Sales Tax at 6%	\$ 0.218
Subtotal	\$ 3.810	Subtotal	\$ 3.850
State Excise Tax	\$ 0.190	State Excise Tax	\$ 0.150
Pump Price	\$ 4.000	Pump Price	\$ 4.000