State Notes

TOPICS OF LEGISLATIVE INTEREST

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Comprehensive Transportation Fund Revenue Reductions
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Overview

The Comprehensive Transportation Fund (CTF) is created in Section 10b of Public Act (P.A.) 51 of 1951 to provide operating and capital funding for various public and freight transportation programs contained in the annual State transportation budget. The Comprehensive Transportation Fund receives State revenue from two principal sources, the Michigan Transportation Fund (MTF) and a portion of the State sales tax on motor vehicle-related sales. The Fund also receives State revenue from licenses, permits, interest earnings, and miscellaneous sources. In fiscal year (FY) 2000-01, total State CTF revenue was $237.5 million. Recent revenue estimates for FY 2004-05 project CTF revenue at $225.2 million. Despite an increase in both total MTF and total State sales tax revenue since FY 2000-01, actual CTF revenue has declined 5.2%. The reason for this decline is directly related to efforts to balance the State's General Fund budget with revenue that traditionally went to the CTF. Specifically, since FY 2000-01, $65.1 million of CTF revenue has been redirected, directly or indirectly, to help support General Fund budget items and/or other transportation priorities.

This article describes how much CTF revenue has been redirected over the past four years to help balance the General Fund budget and support other transportation programs, and the impacts of such reductions.

Two Sources of Revenue

Article IX, Section 9 of the Michigan Constitution allows up to 10% of the 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, after payment of necessary collection expenses, to be used for comprehensive transportation purposes. These transportation taxes are deposited in the MTF under Michigan law. Section 10 of P.A. 51 of 1951 requires that 10% of MTF revenue, after certain statutory earmarks, be transferred to the CTF. The largest earmark of MTF revenue, before the CTF distribution, is four cents of the State gasoline tax, estimated to be $196.8 million in FY 2004-05 which supports State and local road and bridge programs.[1] As a result of these statutory earmarks, the CTF's effective share of MTF revenue in FY 2004-05 is estimated to be 8.5%, about $29.1 million less than the constitutional limit of 10%.

The CTF also receives a share of State sales tax collections on certain purchases of fuel and automotive items. Article IX, Section 9 allows not more than 25.0% of the State sales tax revenue at the 4.0% rate from motor vehicle-related sales, after payment of necessary collection expenses, to be used for comprehensive transportation purposes. Of the total revenue from the 4.0% sales tax on motor vehicle-related sales, 6.0% is distributed to the CTF. This amount is

[1] In addition to earmarking 4 cents of the gasoline tax, Section 10 of P.A. 51 distributes funding for collection and administrative costs ($45.5 million in FY 2004-05), $3.0 million to the rail grade crossing account, not less than $3.0 million for Critical Bridge Fund debt service, and $43.0 million for State Trunkline Fund debt service, prior to the CTF distribution.

substantially less than the 25.0% constitutional ceiling. Table 1 lists State CTF revenue by source for the period FY 2000-01 through FY 2004-05.

Table 1

Comprehensive Transportation Fund Revenue (millions of dollars)

	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	FY 2004-05[a)]
MTF Revenue	$159.2	$159.8	$162.3	$166.3	$168.6
Sales Tax Revenue	73.7	66.1	79.4	65.0	55.3
Other Revenue	4.6	2.2	4.6	4.4	1.3
Total	**$237.5**	**$228.1**	**$246.3**	**$235.7**	**$225.2**

[a)] Estimate as of May 2005

Source: MDOT, Comprehensive Annual Financial Report

Despite the fact that total MTF revenue and total auto-related sales tax revenue have increased over the past five years, total CTF revenue has declined. During the five-year period, total MTF revenue increased from $1,913.5 million to $1,995.8 million, or 4.3%. Table1 shows that the CTF portion of the MTF correspondingly increased by 5.9% during this period.[2] During the same period, total auto-related sales tax revenue increased from $1,053.3 million to $1,088.2 million, or 3.3%. However, as Table 1 displays, sales tax revenue earmarked to the CTF declined by 25.0% over the past five years and as a result total CTF revenue declined 5.2%.

Redirecting CTF Revenue

The reason for the CTF revenue decline during the past five years is directly related to efforts to balance the overall State budget with a portion of the revenue traditionally dedicated for transportation purposes. It is estimated that over $65.1 million in total CTF revenue (a combination of State sales tax and MTF revenue) has been redirected, directly or indirectly, to the General Fund since FY 2000-01. While all motor fuel and vehicle registration tax revenue deposited in the MTF, including the portion earmarked for the CTF, is constitutionally restricted for transportation purposes, the sales tax revenue deposited in the CTF is statutorily earmarked and the entire amount can be redirected to support the General Fund budget.

Since FY 2001-02, $45.5 million of sales tax revenue traditionally earmarked to the CTF has been channeled to the General Fund, by Executive Order and changes to Section 25 of the General Sales Tax Act. Table 2 lists the various CTF revenue changes since FY 2001-02 intended to aid the General Fund budget, either directly or indirectly. First, Executive Order 2001-9 reduced the amount of sales tax revenue deposited in the CTF under Section 25 by $12.75 million and transferred this revenue to the General Fund for FY 2001-02.[3]

[2] The reason for the difference between the two growth rates has to do with the amount of MTF interdepartmental grants appropriated in FY 2000-01 ($50.3 million) and in FY 2004-05 ($29.0 million) and the impact that the P.A. 51 formula has on CTF revenue.

[3] In 2002, the County Road Association of Michigan (CRAM) sued the State of Michigan over the constitutionality of this transfer. In 2002, the trial court enjoined the transfer of CTF funds to the General Fund. In 2003, the Court of Appeals upheld the constitutionality of the transfer. Plaintiffs have filed an Application for Leave to Appeal to the Michigan Supreme Court.

Table 2

Comprehensive Transportation Fund Revenue Reductions (millions of dollars)				
	FY 2001-02	**FY 2002-03**	**FY 2003-04**	**FY 2004-05**
Executive Order 2001-9	($17.6)	($4.8)		
P.A. 139 of 2003			($10.8)	($10.9)
P.A. 151 of 2003			(10.0)	
P.A. 544 of 2004				(10.0)
House Bill 4082[a)]				(1.1)
Total	**($17.6)**	**($4.8)**	**($20.8)**	**($22.0)**

[a)] Based on House-passed version (H-4).

Public Act 139 of 2003 reduced the percentage of revenue from the 4.0% sales tax on auto-related sales that is deposited in the CTF from 7.0% to 6.0% for a two-year period, FY 2003-04 and FY 2004-05. Based on actual sales tax revenue figures for FY 2003-04, P.A. 139 reduced CTF revenue by $10.8 million and increased General Fund revenue by the same amount. For FY 2004-05, the rate reduction is expected to decrease CTF revenue by $10.9 million and increase General Fund revenue by the same amount. It is worth noting that the Governor's FY 2005-06 budget recommendation is based on statutory changes that would continue this revenue redirection.

Public Act 544 of 2004 further reduced the amount of sales tax revenue deposited in the CTF by a flat $10.0 million for FY 2004-05 and increased General Fund revenue by the same amount.

In addition to the changes in the disposition of sales tax revenue, MTF allocations to the CTF have been reduced as a means to help balance the General Fund budget and to support other transportation priorities. First, Executive Order 2001-9 increased the MTF grants to the Departments of State and Treasury by a total of $48.0 million and reduced General Fund appropriations in these Departments by a corresponding amount.[4] This funding shift effectively reduced the amount of MTF revenue deposited in the CTF by $4.8 million in FY 2001-02. This funding shift continued in the next fiscal year, costing the CTF another $4.8 million in MTF revenue in FY 2002-03.[5]

Second, as part of the MTF revenue enhancement package enacted in 2003, Public Acts 151 and 152 changed the registration cycle for trailers from an annual basis to a one-time basis. The package of legislation resulted in a one-time MTF revenue increase of $108.0 million. However, this legislation redirected $10.0 million of the CTF's portion of the revenue increase ($10.8 million) to the State Trunkline Fund for highway capacity improvement projects.

[4] Traditionally, these grants are set in annual appropriation bills. In FY 1996-97, MTF grants to all agencies totaled $90.3 million. These grants were reduced to about $48.0 million annually between FY 1997-98 and FY 2000-01, before being doubled to $95.7 million under Executive Order 2001-9.

[5] The FY 2002-03 MTF grant to the Department of State was $87.9 million. In 2003, the MTF grant to the Department of State was statutorily capped at $20.0 million per fiscal year, beginning in FY 2003-04.

Third, as part of the FY 2004-05 General Fund budget solution, GF/GP appropriations to the Department of State were reduced by $10.6 million under Executive Order 2005-7 and replaced with restricted revenue appropriations under P.A. 11 of 2005. House Bill 4082 would transfer approximately $10.5 from the MTF to satisfy the restricted revenue appropriations contained in P.A. 11. This funding shift would effectively reduce CTF revenue in FY 2004-05 by $1.1 million. The Governor's FY 2005-06 budget assumes that this be a permanent revenue shift, costing the CTF another $1.1 million.

Impacts of CTF Revenue Reductions

State CTF revenue is used to support a variety of public and freight transportation programs, which receive funding through the annual Michigan Department of Transportation (MDOT) budget.[6] The first priority of this revenue, as set forth in P.A. 51 of 1951, is to pay principal and interest on outstanding CTF debt, which is approximately $28.5 million in the current year. The second priority is the payment of MDOT's costs associated with administering the CTF, which are approximately $8.3 million this year. The third priority and the largest use of this revenue by far, is the annual operating assistance grants provided to local public transit agencies. Over two-thirds of the total appropriated CTF revenue, $161.7 million, is budgeted for this purpose in FY 2004-05. The remainder of available CTF revenue is reserved for public transportation purposes as described in P.A. 51. In some cases, P.A. 51 establishes minimum funding levels for select public transportation programs.[7] It is estimated that $194.5 million in CTF revenue in FY 2004-05 is needed to satisfy these three priorities and the minimums set in P.A. 51.

Beginning with Executive Order 2001-9, the series of CTF revenue reductions listed above required appropriation reductions to bring spending in line with revenue availability each year. For the most part, CTF program cuts have focused on discretionary funding, i.e., funding for those programs that are not listed as "priority" or do not have a "funding floor". The FY 2004-05 budget reduced or eliminated funding for many of these programs. Table 3 shows CTF appropriations in FY 2003-04 compared with FY 2004-05 for CTF-funded programs and the changes resulting from recent budget cuts. Continued revenue reductions will force further cuts to or eliminations of discretionary programs in order to meet P.A. 51 priorities and minimums. It is worth noting that, as a result of the CTF revenue decline, the current-year budget does not meet the P.A. 51 funding requirements for the Intercity Passenger and Freight Program, which is 10.0% of the CTF.[8]

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[6] In addition to annual appropriated State CTF revenue, MDOT uses CTF bond proceeds to fund various transportation programs, mostly capital projects. This money, however, is not included in the annual MDOT budget.

[7] For example, P.A. 51 requires that each transit agency annually receive at least the amount of CTF revenue it received in FY 1996-97 for local bus operating assistance grants, which amounts to $121.3 million.

[8] CTF funding for this program totals $16.3 million, about $6.2 million below the P.A. 51 floor.

Table 3

CTF-Funded Programs in MDOT Budget (CTF amount in millions of dollars)			
Program	**FY 2003-04**	**FY 2004-05**	**Change**
Debt Service	$28.7	$28.5	($0.2)
Administration	5.0	5.5	0.5
Grants to Other Agencies	3.0	3.1	0.1
Bus Operating Grants	161.7	161.7	0
Bus Capital	14.5	8.0	(6.5)
Intercity Passenger & Freight Programs	21.0	16.3	(4.7)
Public Transportation Development Programs	12.5	9.2	(3.3)
Total	**$246.3**	**$232.3**[a)]	**($14.0)**

[a)] At this level, the CTF budget is out of balance by approximately $7.0 million. The State Budget Office will reduce appropriation allotments and use prior-year revenue to bring spending into alignment with projected revenue of $225.2 million.

Despite the large share of CTF funding directed to the program, appropriations for local bus operating assistance grants have remained fairly constant the past three fiscal years and have avoided requisite budget cuts. The FY 2004-05 appropriation remains $40.4 million above the P.A. 51 "floor" for these grants. Although protected from hard budget cuts, the CTF revenue reductions have affected the State operating grants indirectly. Stagnant State funding means that local agencies will have to tap other funding sources to maintain budgets or face service reductions. Transit providers will be forced to address the rising operational costs (fuel, health care, etc.) they are facing with revenue from increased local sources or fares. State reimbursement rates, as a percentage of total operating costs, have declined significantly during the period FY 2000-01 to FY 2004-05. During this time, the urban systems' reimbursement rate has gone from 38.1% to 32.4% while the other systems' rate has dropped from 45.5% to 38.4%.[9] Given the current State funding environment, it is unlikely that local agencies will be able to expand local bus service without additional State CTF assistance. Most likely, agencies will focus on providing the status quo service level before considering expanded service.

While State funding for operational grants has not been affected, State support for local bus capital projects has been cut. For example, the FY 2004-05 budget reduced the appropriation used to match Federal funds for local bus capital to the P.A. 51 "floor" of $8.0 million from $14.5 million in FY 2003-04 (Table 3). Traditionally, MDOT has used CTF money to provide the full 20% non-Federal match for local bus capital projects (e.g., bus acquisitions, terminal projects, transit equipment).[10] Continued revenue reductions may prevent the State from being able to provide the entire portion of the non-Federal match for local bus capital projects. This could force local transit agencies, for the first time, to supply a portion of the non-Federal match from local sources of revenue. If local agencies are unable or unwilling to make up the shortfall in requisite matching funds, Federal capital funds could be forfeited.

[9] Public Act 51 requires the CTF to provide urban agencies (with a population greater than 100,000) with a grant of up to 50.0% of operating expenses and other agencies (population less than or equal to 100,000) with a grant of up to 60.0% of operating expenses.

[10] MDOT uses a combination of appropriated CTF revenue and CTF bond proceeds revenue to meet the non-Federal match.

Conclusion

As the Legislature continues to grapple with State revenue issues and the challenges of balancing the General Fund budget, it is likely that some portion of transportation revenue will be redirected to address other State priorities. Because constitutional restrictions prevent State fuel and vehicle registration taxes from being used for nontransportation purposes, the vast majority of State transportation revenue cannot be shifted to address General Fund budget shortfalls. However, sales tax revenue that is used to support various public and freight transportation programs can be redirected to the General Fund. To date, over $65.1 million in traditional CTF revenue has aided the General Fund budget. It is likely that CTF-funded programs will continue to be adversely affected by the State's budget woes. For example, the FY 2005-06 budget recommendation includes a continuation of a reduction in CTF sales tax revenue ($10.8 million), originally scheduled to end after FY 2004-05. Policy-makers will not know immediately what the full impact of these CTF revenue changes will mean to public and freight transportation services provided in Michigan. To date, however, a number of programs have been eliminated and services reduced.