State Notes

TOPICS OF LEGISLATIVE INTEREST

March/April 2008

Comparison of Projected Transportation Revenue and Expenditures
By Debra Hollon, Fiscal Analyst

Introduction

The winter of 2007-08 produced an overabundance of potholes around Michigan and surrounding states. Drivers are spending more and more at the pump for a gallon of gas while the roads crumble in front of them. Frustration levels are increasing and may not be relieved in the foreseeable future. The purpose of this article is not to advocate for either side in the discussion of a fuel tax increase, but to present information concerning the history and possible future of transportation revenue and costs.

Revenue

Over 95.0% of the revenue in the Michigan Transportation Fund (MTF) comes from motor fuel and vehicle registration taxes. The current Michigan motor fuel tax rates are 19 cents per gallon for gasoline and 15 cents per gallon for diesel fuel. (Comparison information concerning the fuel tax rates of other states can be found on the Senate Fiscal Agency website.) Vehicle registration taxes are based upon the value of the vehicle.

The motor fuel tax rate is a fixed amount per gallon, unlike the sales tax, which is a percentage of the dollar amount sold. As a result, an increase in the price per gallon of fuel does not increase revenue to the MTF. In fact, as the per gallon price rises, consumer usage tends to decrease, which results in a decrease in State revenue from this source. One example of this effect can be seen from the surge in fuel prices after Hurricanes Katrina and Rita in 2005. Motor fuel tax revenue to the MTF dropped by over $20.0 million from fiscal year (FY) 2004-05 to FY 2005-06. Since that time, revenue from fuel taxes has continued to decline as the price of fuel has increased. The FY 2007-08 estimated revenue is another $40.0 million below the FY 2004-05 level.

Revenue from vehicle registrations has increased over the same time frame. This increase offsets the decrease in fuel tax revenue and results in relatively flat overall revenue to the Fund. Growth in MTF revenue over the past 10 years has been only 4.7%. Table 1 reflects revenue to the MTF over the past 10 years.

Expenditures

The revenue received by the MTF is distributed among its various purposes primarily according to statutory formulae. After certain administrative and statutory deductions, 10.0% is transferred into the Comprehensive Transportation Fund to be used for transit purposes (bus, rail, ferry, etc). By statute, the next $40,275,000 is transferred into the Transportation Economic Development Fund for use in road projects related to economic development projects. After some smaller deductions, the balance is divided among the State Trunkline Fund (for Michigan Department of Transportation road projects on interstates and major highways), county road commissions, and cities and villages.

Table 1

Michigan Transportation Fund: Revenue History					
Fiscal Year	**Gasoline Tax Revenue**	**Vehicle Registration Revenue**	**Other Fuel Tax Revenue**	**Other Revenue**	**Total**
1998-99	$931,031,120	$758,527,135	$135,364,353	$19,906,672	$1,844,829,280
1999-2000	921,991,065	802,945,158	144,521,335	23,112,879	1,892,570,437
2000-01	933,494,040	824,746,037	134,165,367	21,134,771	1,913,540,215
2001-02	938,911,784	877,074,423	143,868,807	14,379,470	1,974,234,484
2002-03	935,671,741	892,659,425	157,513,685	14,561,361	2,000,406,212
2003-04	932,139,677	978,527,057	141,139,542	12,776,784	2,064,583,060
2004-05	922,368,211	895,996,513	146,799,386	11,634,283	1,976,798,393
2005-06	906,220,722	898,798,415	149,171,067	13,729,483	1,967,919,687
2006-07	883,687,513	907,808,952	144,174,316	7,764,849	1,943,435,630
2007-08 Est.	867,000,000	911,550,000	146,950,000	6,100,000	1,931,600,000

Notes: The last gas tax increase (4 cents) was passed in 1997. In 2003, legislation changed trailer registrations from annual to one-time (PA 152), creating a spike in revenue from registrations in that year. In 2006, legislation reduced the ethanol and biodiesel fuel tax rates by 7 cents (PA 268). The act required a transfer from the General Fund to the MTF to replace lost revenue, but that transfer has not taken place.

Source: House Fiscal Agency

While revenue for the MTF has remained relatively flat over the past 10 years, the costs of construction have increased dramatically over the same time frame. According to the U.S. Department of Labor, Bureau of Labor Statistics' Producer Price Index, overall prices for highway and street construction increased by 58.1% from 1998 through 2007. Three major contributors to this increase are the prices for iron and steel, cement, and asphalt paving mixtures. From 2002 through 2007, prices increased 76.2% for iron and steel and 36.9% for cement. The Bureau of Labor Statistics did not begin tracking asphalt paving mixture prices until December 2003. From that point until December 2007, the prices for this category increased 51.1%. It should be noted that asphalt prices are directly related to oil prices.

In addition to the rise in the prices of construction components, debt service expenditures have increased as bonds have been issued to finance reconstruction and capacity-building projects as well as to accelerate other projects in an effort to stimulate the economy by creating more construction jobs. For example, $308.2 million in bonds were issued in 2001 for the Build Michigan III Program for capacity-building and reconstruction projects. In 2007, $630.0 million in bonds were issued for the Jobs Today Program to accelerate over 150 projects in order to create jobs in the construction area. Table 2 below outlines appropriations (both operations and debt service) from FY 1998-99 through FY 2007-08 year-to-date and lists the major bond issuances for that period.

Table 2

Michigan Department of Transportation: State Funds Appropriations History			
Fiscal Year	**Operations**	**Debt Service**	**Total**
1998-99	$1,870,991,900	$84,684,700	$1,955,676,600
1999-2000	$1,925,390,600	69,034,100	1,994,424,700
2000-01	$2,044,916,500	69,514,100	2,114,430,600
2001-02	$2,010,125,300	111,616,800	2,121,742,100
2002-03	$2,008,023,200	111,632,100	2,119,655,300
2003-04	$2,052,201,300	108,062,300	2,160,263,600
2004-05	$2,011,937,800	123,750,100	2,135,687,900
2005-06	$2,070,616,400	137,543,500	2,208,159,900
2006-07	$2,039,392,300	152,620,000	2,192,012,300
2007-08 YTD	$1,948,072,800	168,532,200	2,116,605,000
Major bond issuances include: 2001: Build Michigan III - $308.2 million; 2004: Preserve First (first issuance) - $185.7 million; 2005: State Trunkline Fund bonds to refund Federal notes for Build Michigan II - $378.3 million and Refinancing bonds - $223.0 million; 2006: Preserve First (second issuance) - $244.5 million; and 2007: Jobs Today - $630.0 million.			

Source: Senate Fiscal Agency Appropriation Bill Files

Projections

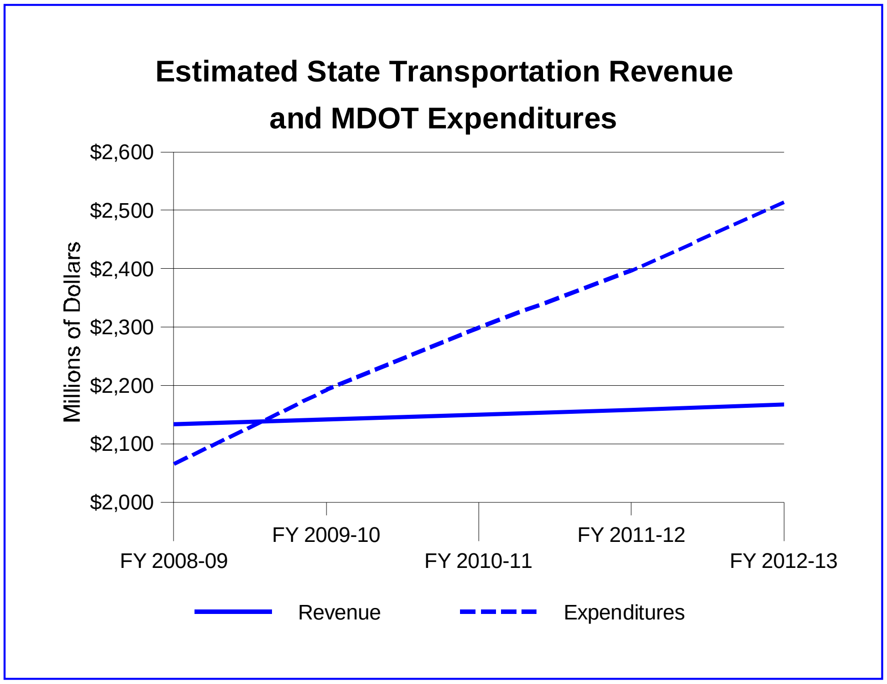
The Michigan Department of Transportation's (MDOT's) stated pavement condition goal is to have 90.0% of State Trunkline roads and bridges in "Good" condition. This goal was surpassed in 2007 when 92.0% of the Trunkline was rated "Good". However, as revenue continues to fall and construction costs continue to escalate, MDOT will not be able to maintain this level of repair. According to the Department, an additional $460.0 million per year will be needed for road and bridge repair beginning in FY 2008-09 to maintain the Trunkline condition at 90.0% "Good".

As noted above, revenue has remained flat while costs have increased over the past 10 years. At this point, there is nothing to indicate that these trends will change. Figure 1 reflects estimated State revenue and expenditures (excluding Federal and local) for FY 2008-09 through FY 2012-13. Several assumptions were made to calculate these projections, including: 1) Motor fuel and vehicle registration tax rates remain the same; 2) construction/maintenance cost increases are calculated using a rate equal to the 2002-2006 average increase in the Producer Price Index for highway and street construction (6.3%); and 3) increases in transit costs are calculated at 4.0% (as directed by the Federal Transit Authority for planning purposes).

As can be seen clearly in the figure, expenditures could exceed revenue as early as FY 2009-10. With that said, appropriations that exceeded revenue to this extent would not be made under any circumstances. As more revenue is used for debt service, less is available for road and bridge repair and construction. State Trunkline Fund debt service payments are expected to peak in FY 2009-10, but there will not be a significant decrease in those obligations until FY 2019-20. Unless new sources of revenue are found, either the condition of the Trunkline will begin to deteriorate or more bond revenue will be needed, resulting in more debt service obligations and even less available funding for road and bridge work.

Under this scenario, construction/maintenance projects most likely will be delayed, transit grants could be reduced or eliminated, and funding to local units could be reduced.

Figure 1



Notes:
Estimates include only State funding sources and do not include any Federal or local revenue.
Debt service includes $14.2 million per year associated with the Economic Stimulus bond package beginning in FY 2009-10.
Revenue estimates: 2008-09 - Consensus Revenue Estimating Conference, January 2008; Remainder – Senate Fiscal Agency, House Fiscal Agency, March 2008.
Salary & Wage increases based on Department of Management and Budget Economic Increase projections - March 2008.
Transit increases based on 4.0% recommended by Federal Transit Authority.
Construction/Maintenance increases based on 2002-2006 average increase in U.S. Dept. of Labor, Bureau of Labor Statistics, PPI-Hwy Construction (6.3%).

Again, the purpose of this article is not to advocate for either side in the discussion of a fuel tax increase, but merely to note that revenue and costs are on different tracks. Choices will have to be made to increase the fuel and registration taxes, find an alternative source of funding, and/or reduce expenditures in the areas of road construction/maintenance and transit.