



CMAP Tax Principles May 6, 2009

State and local governments generate revenues through various means to provide services and infrastructure to residents and businesses. Currently this issue stands at the forefront as State leaders weigh the adequacy and fairness of new revenue sources to support the Governor's FY 2010 budget proposal and a proposed capital bill. The components of "good tax policy," while open to interpretation, typically involve questions of adequate revenue generation, the relative burden on different segments of the population, and the resulting impacts on economic growth or development decisions.

The following draft principles are intended to help CMAP judge taxes, user fees, and other revenue generators at the State and local level. These concepts are more applicable for analyzing *systems* of taxes and fees rather than *particular* taxes and fees, because changes to one individual source of revenue should always be judged in relation to the system as a whole, not in isolation.

CMAP should consider these taxation principles at this time because:

- As Illinois finds itself in the middle of one of the worst economic downturns in history, it is becoming more of a challenge for the State and local governments to generate adequate revenue to meet public service demands.
- The proposed \$26 billion capital plan "Illinois Jobs Now" would be funded through increases to the income tax as well as user fees.
- The *GO TO 2040* Plan will recommend policies, programs, and capital projects with their associated potential costs. Implementation of the Plan's recommendations would require State and local leaders to find additional revenues or identify trade-offs with existing programs or policies.

PRINCIPLE 1: Short-term Adequacy and Long Term Sustainability. In the short term, revenues from taxes and fees should adequately provide for the programs and policies demanded by citizens. Furthermore, over the longer term the bundle of taxes and fees should generate stable and predictable revenues which rise at a level consistent with real changes in purchasing power. This requires a mix of different taxes and fees which on the whole generate revenues that can be reasonably predicted even in economic downturns. This principle suggests that State and local governments should avoid a) overreliance on a single or small

subset of revenue sources, and b) allocating only particular revenue sources to particular funds or programs. Overall, this principle suggests that the State and local governments should retain a degree of flexibility regarding which revenue sources are used to provide services. It also suggests a gradual shift from reliance on the main tax types (property, sales, income) toward other sources such as charges and user fees for certain types of services.

PRINCIPLE 2: Broad Tax Base with Low Tax Rates. Residents and businesses prefer low taxes, but also good schools and neighborhoods, quality infrastructure, and access to recreational and cultural opportunities. One strategy for keeping tax rates low while also providing for these critical services is to ensure that the tax base as broad as possible. A broad tax base is one with few exemptions, deductions, and credits. All else equal, a broader tax base typically results in lower rates and a better business climate. While tax breaks to particular individuals and businesses typically seek to influence certain types of behavior, available research indicates mixed conclusions about their effectiveness. One important caveat of this principle is that many local governments lack the capacity to keep property tax rates low in the face of falling home values, retail sales and rising service demands. In these cases, simply expanding the tax base may not be an option; thus other policy solutions are required at all levels of government to improve the plight of distressed communities.

PRINCIPLE 3: Equity. While equity can be defined in different ways, it is generally agreed that taxes and fees should strive for two different principles. The first, "horizontal equity," means that similar people and firms should share similar burdens. Horizontal equity relates to principle 2- keeping the tax base as broad as possible without too many special exemptions to certain entities but not others. The second, "vertical equity," means that the tax system should be based on the entity's ability to pay. Vertical equity is consistent with a tax system that tends toward the progressive rather than the regressive. For example, consumption taxes might be considered to be regressive, since low income households spend a higher percentage of their incomes on taxable goods than high income individuals. Thus, low income households bear more of the burden of a consumption tax. Most "flat taxes," which tax all entities at the same rate, are also considered to be regressive. On the other hand, graduated income taxes, which apply higher marginal rates as incomes rise, are typically considered to be more progressive.

PRINCIPLE 4: Ease of Administration. A tax or fee that is difficult to collect typically leads to noncompliance. As complexity increases, so does tax avoidance, tax evasion, and the cost of monitoring. These costs may increase to the point where the tax is not worth collecting at all. Complex exemptions, deductions, and credits can be complicated and are often difficult to administer. Some proposed user fees based on new technological systems and the like may also fall into this category. This principle suggests that it may be more prudent for State and local governments to adjust existing taxes and fees first before developing new revenue streams that may present administrative hurdles.

PRINCIPLE 5: Transparency and Accountability. State and local tax policy should strive to be as open and transparent as possible. It is vital for all taxpayers to have access to a full accounting of the types of revenues collected, the distribution of the revenue, as well as the entities receiving exemptions or other tax benefits. This principle would also suggest that the State and local governments continually evaluate their tax and expenditure policies to determine whether the needs of their residents are being met. Governments should finance ongoing studies which analyze the efficiency, effectiveness, and equity of the tax system. These studies should also analyze the size of the tax base, tax rates, exemptions and other tax incentives, issues of progressivity/regressivity, and the impact of the tax system on the attraction and retention of businesses and on residential and commercial development decisions.

CMAP Staff Analysis: INCOME TAX May 6, 2009

The personal income tax has increased in importance for State budgets across the country in recent years, aided by their consistency, simple administration, high levels of compliance, and public acceptance. Personal income taxes are somewhat linked to the larger economic health of a state, with a strong economy increasing incomes and thus tax revenue. Illinois' personal income tax is constitutionally mandated as a flat rate tax (3% individual and 4.8% corporate), which has a range of policy implications including the ability to raise adequate revenue as well as concerns regarding inequities across different income groups.

The main findings of this policy brief are as follows:

- Income tax collections in Illinois have generally been on the rise since the early 1990s. Income tax collections made up roughly half of the State's General Revenue Fund budget in 2008. One tenth of this amount (roughly \$1.2 billion) was disbursed to all Counties and municipalities across the State in 2008. This disbursement makes up roughly 6% of municipal budgets in northeastern Illinois.
- Illinois' flat individual and corporate income tax rates are among the lowest rates in the country, which suggests high revenue raising capacity from a rate increase.
- Governor Quinn's proposal to raise the flat income tax rates and reduce corporate tax exemptions has both pros and cons. While the increased rates should raise revenue through a source where some capacity exists, it appears that the proposal may not disburse the increase to local governments. Furthermore, while the revenue will help finance a new capital plan for infrastructure, the increase in the corporate rate may also impact the perception of the State's business climate, insofar as tax rates are concerned.

Background

The Illinois state income tax is authorized by Article IX, Section 3 of the Illinois State Constitution. The Constitution allows for a fixed rate, or "flat," tax on personal and corporate incomes. Different flat rates are assigned to corporations, individuals, and trusts and estates. The rate levied on corporations is not to exceed that levied on individuals according to an 8 to 5

ratio. For individuals, the rate is 3% of net income. The rate for corporations is 4.8% and the rate for trusts and estates is 3%.

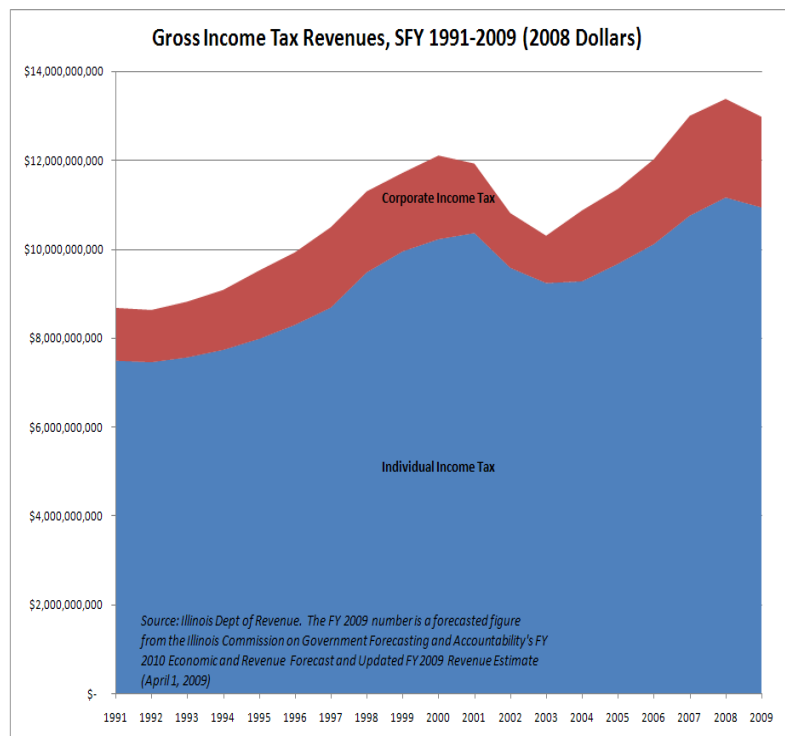
Illinois State Income Tax, Flat Rates

Individual	3%
Corporations	4.8%
Trusts and Estates	3%

Additionally, the state levies the flat Personal Property Replacement Tax (PPRT) on corporate, partnership, and trust incomes to compensate taxing bodies for lost revenues when personal property taxes were forbidden under the current Constitution. Additional flat rates are charged for the Personal Property Replacement Tax. Corporations face an additional 2.5% tax on income for the Personal Property Replacement Tax, meaning the effective corporate income tax rate is 7.3% (2.5% + 4.8%). Local governments, including counties and home rule units, cannot levy an income tax in Illinois.

Collections over Time

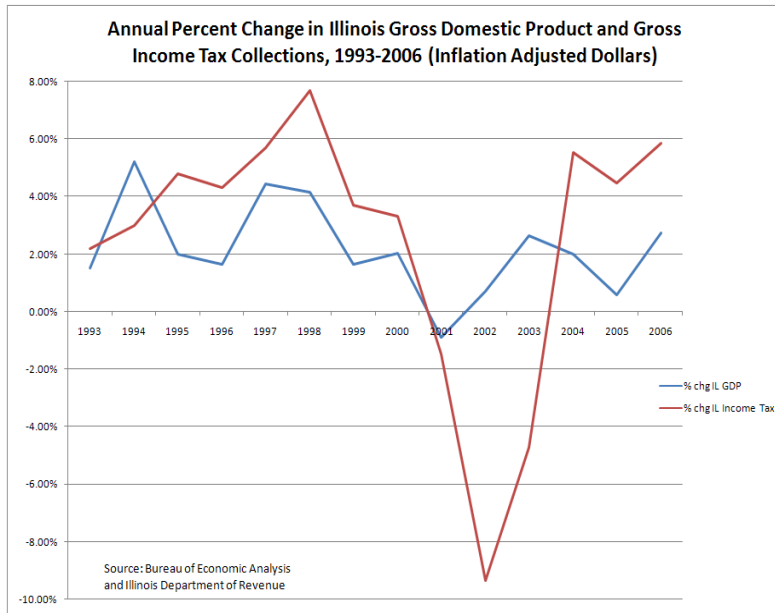
State income tax revenues have generally increased in both nominal and real (inflation-adjusted) terms at a steady rate since 1991. In nominal terms, gross income tax revenues currently bring in over \$13B annually, a nearly \$8B increase since 1991. In real terms, gross revenues have increased roughly \$5B over that same period. The vast majority of income tax revenues come from individuals. The proportion from individuals has fallen slightly over time, from 86% in 1991 to 83% in 2008 (with a high of 90% in 2003 and a low of 83% in 2008)¹.



¹ Illinois Department of Revenue. It should be noted that at the time of this writing, income tax revenues are down roughly 2% over the first eight months of SFY 2009, according to the Commission on Government Forecasting and Accountability, April 1, 2009.

The income tax made up nearly half of Illinois' General Revenue Fund in FY 2008, and revenues have been generally on the rise in both nominal and real terms. Personal income taxes are often thought to be linked to the larger economic health of a state, with a strong economy increasing incomes and thus tax revenue. This view would suggest that revenue streams from the income tax may be inconsistent and decrease in harder economic times when governments need revenues most.

In Illinois, gross income tax revenues have ebbed and flowed somewhat consistently with the state gross domestic product, though the correlation does not appear to be very strong². It is



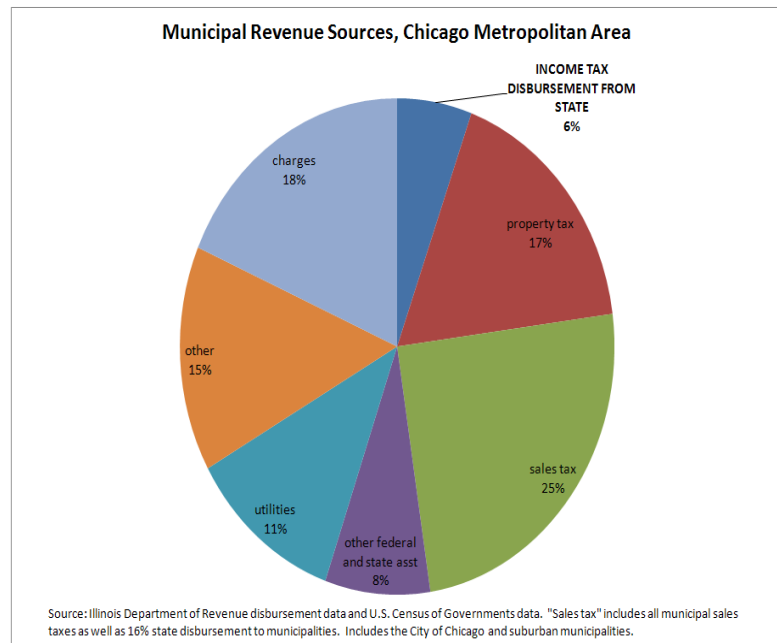
important to note that over the longer term, state income tax revenues have typically been on the rise, in both Illinois and nationwide. For example, between 1980 and 1993 nationwide state income tax grew by 204 percent. It also grew from \$125 billion in 1995 to \$197 billion in 2004. This suggests a consistent performance from the state income tax overall, rather than a performance tied inextricably to the performance of the State economy³.

² A simple univariate correlation analysis between income tax collections and state gross domestic product shows some correlation with an R-squared of approximately .7. However, annual income tax collections are typically reported on a state fiscal year basis while gross state product is reported by calendar year, so this type of analysis is not very appropriate. Quarterly or month by month changes in both GDP and income tax receipts would be more suitable for a correlation analysis.

³ Brunori, David. 2005. *State Tax Policy: A Political Perspective*. Washington D.C.: The Urban Institute Press.

Distribution of Funds

The gross income tax is collected by the Illinois Department of Revenue and deposited by formula into four separate funds: the Income Tax Refund Fund, the Education Assistance Fund, the Protest Fund and the General Revenue Fund (GRF). In 2008, the GRF received about 85% of the gross collections⁴; one tenth of the GRF collection is then disbursed to counties and municipalities, based on population. In FY 2008, \$1.2 billion in income tax revenue was disbursed to counties and municipalities. Local governments in northeastern Illinois received about 60% of this amount, or roughly \$713 billion in revenue. According to CMAP analysis, this disbursement makes up roughly 6% of municipal revenues in northeastern Illinois⁵.



Analysis of the Recent State Income Tax Proposal

To close the budget deficit in FY 2009 and FY 2010, Governor Quinn has proposed a series of revenue enhancements. This includes a 50% increase in the individual income tax rate from 3 to 4.5%. Given the State's 8:5 ratio stipulation, the corporate income tax would also rise from 4.8 to 7.2%. In addition, the proposal would also increase the dependent exemption from \$2,000 to \$6,000. Everyone would receive this benefit, regardless of wealth. The proposal would also eliminate a wide range of corporate tax expenditures, including limiting credits that a corporation can take to 50 percent of the state income tax they owe, allowing the manufacturers' purchase credit to expire, repealing the research and development exemption, as well as seven other corporate tax expenditures.

The State estimates that the increases to the individual and corporate income tax rates will result in a roughly \$3.2 billion increase in revenue over current forecasts. Furthermore, the

⁴ Illinois Comptroller. Revenues by Fund for Fiscal Year 08.

⁵ Disbursement data is from the Illinois Department of Revenue. County and municipal revenue data is from the U.S. Census of Governments.

closing of corporate tax expenditures would net \$287 million a year. The Center for Tax and Budget Accountability estimates that the individual dependent exemption will cost the State \$1.4 billion a year⁶. Thus, without the dependent exemption, the individual income tax increase would likely net over \$4 billion a year.

**Illinois Income Tax Proposal
Annual Revenue Estimates (SFY 09 and SFY 10)⁷**

Individual Income Tax Increase including dependent exemption	\$2.9 B
Corporate Income Tax Increase	\$350 M
Closing of Corporate Tax Expenditures	\$287 M

“Pros” of the Proposal

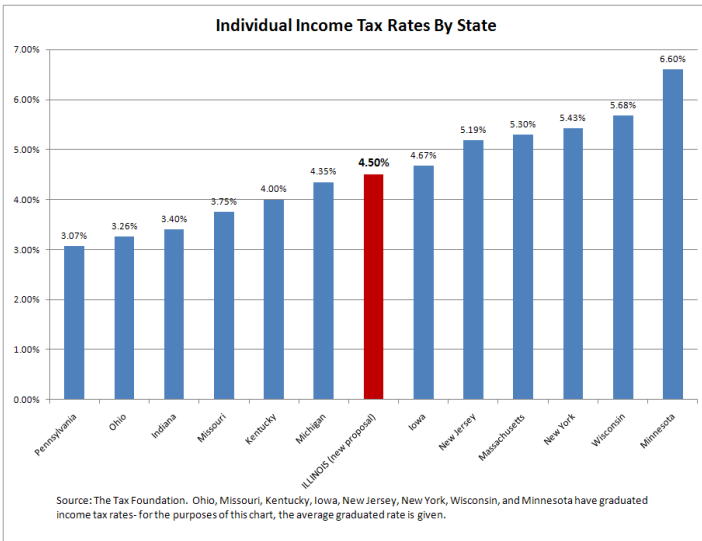
1. The proposal generates revenue from the source with the most capacity.

The State of Illinois has one of the lowest individual income tax rates (3%) in the U.S. Raising the rate to 4.5% places the State more in the middle of the pack especially in comparison to neighboring Midwestern States as well as other eastern, industrialized states with urban centers (Pennsylvania, New York, New Jersey, and Massachusetts).

On the corporate income tax side, the Governor’s proposal would increase the rate to 7.2%. This also places Illinois more in the middle of the pack relative to other states. If the Personal Property Replacement Tax (PPRT) is included in this figure, Illinois’ effective corporate tax rate increases to 9.7%, nearly as high as Minnesota (9.8%) and Pennsylvania (9.99%), and the fourth highest in the country. However, it should also be remembered that S corporations and partnerships do not pay corporate income tax in Illinois.

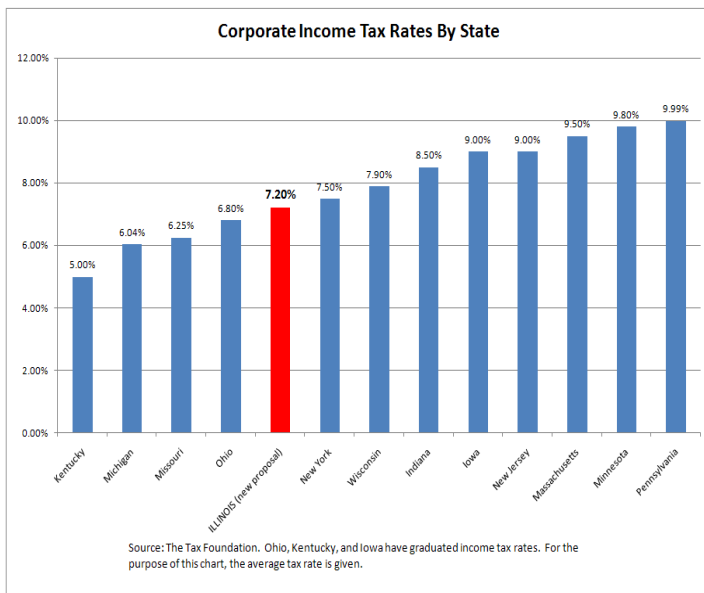
⁶ Center for Tax and Budget Accountability. March 2009. Analysis of the Governor’s Fiscal Year 2010 Illinois General Fund Budget Proposal.

⁷ Governor Quinn’s FY 2010 Budget includes a \$3.207B increase in the income and corporate income tax revenues, over forecasted amounts with the current rates, for FY 2009 and FY 2010. The document states that \$350M of this revenue will come from the increase in the corporate income tax. Thus, \$2.857 would come from the individual portion. The \$287M is linked with tax code changes in terms of eliminating corporate income tax expenditures.



2. The proposal increases the progressivity of the income tax and the State tax system overall.

While the tax increase will undoubtedly cause many Illinoisans to pay more, it should be noted that any increase in the income tax rate will increase the overall progressivity of the Illinois tax system. This is because the income tax remains more progressive relative to other primary State revenue generators, especially the sales tax. The Governor’s proposal to increase the dependent exemption from \$2,000 to \$6,000 would



lower taxes for those making \$14,000 or less as well as families of four making \$56,000 or less⁸.

To illustrate the slight progressivity of the state income tax, the Institute on Taxation and Economic Policy finds that in Illinois, the lowest 20% pays 1% of their income in state income taxes, the middle 20% pays 2.1%, and the top one percent pays 2.6%⁹. However, while the tax is slightly progressive, it is much less so than all but three of all other states levying income taxes. Given the limited progressivity of the Illinois income tax as well as the high

⁸ Center for Tax and Budget Accountability.

⁹ Institute on Taxation and Economic Policy. *Balancing Act: Tax Reform Options for Illinois*. February 2002.

regressivity of the sales tax (the other primary state funding source), Illinois is typically considered to have a more regressive overall tax system than other U.S. states¹⁰. Moving to a greater reliance on the income tax would shift that balance.

3. Ten percent of the increase would be used to fund the State capital plan.

Illinois has not had a capital construction program for ten years. Governor Quinn has proposed a \$26 billion infrastructure proposal- *Illinois Jobs Now!*, which is forecast to create 340,000 jobs. The CMAP Board supports a State capital plan with the additional principle that the plan should be supported with new revenue sources. As currently proposed, the new capital plan would be financed with General Obligation bonds for road, bridge, transit, school construction, economic development, and environmental and conservation projects. Roughly 10% of the income tax increase (\$280 million¹¹) would be used as debt service to pay off bonds financing the non-transportation portion of the bill. The debt service for the transportation portions of the bill would be financed through increases in motor vehicle registrations, driver license fees, certificate of title fees, registration transfer fees, and revenues from the Road Fund¹².

“Cons” of the Proposal

1. The proposal does not address the flat rate structure or the 8:5 ratio.

Few states use a flat rate like the one in place in Illinois, most opting instead for a graduated system. In fact, of the 40 states that collect income taxes, Illinois is one of only seven that charges a flat rate, as opposed to a graduated system. A graduated system could expand tax capacity with marginal rates for different brackets based on ability to pay. Graduated taxes are typically considered to be progressive in nature and thus more equitable, although the increased complexity of the tax complicates its administration. ITEP has argued that replacing Illinois’ flat-rate tax with a 3-tier graduated rate ranging from 2.7 percent to 4.25 percent would

¹⁰ Ibid.

¹¹ The total revenue increase from the income tax is forecast to be \$3.2B. This likely does not include further refunds (12.5% on the individual and 24% on the corporate side). After these refunds, the net revenue is reduced to \$2.776 billion. Roughly 10% of this amount is \$280M. This is similar to the amount identified for capital plan debt service.

¹² Commission on Government Financing and Accountability, April 1, 2009.

cut taxes for 60 percent of Illinoisans and increase Illinois tax receipts by approximately \$1 billion (2002 dollars)¹³.

The untapped tax capacity of the state income tax is significantly restricted by the Illinois Constitution, which stipulates the 8:5 ratio of corporate to individual income tax rates. While increasing the flat tax rate can be accomplished without a Constitutional amendment, the 8:5 ratio must continue to hold. Constitutional amendments (the process for which is described in Article XIV of the Constitution¹⁴) could abolish the 8:5 ratio, allow home rule and other local governments to administer an income tax, or potentially reorganize the entire state income tax.

2. The plan may have a harmful impact on business attraction and retention.

The main policy implication of the 8:5 ratio is that while increased revenue capacity exists primarily in the individual portion of the income tax, raising the individual rate also necessitates raising the corporate rate. Illinois' flat corporate income tax rate is not as low, relative to other states, as the individual income tax. Thus, raising the individual income tax rate will also raise the corporate rate, which may have negative impacts on the perception of the overall State business climate, as least as related to the tax burden on business.

Businesses locate for a variety of reasons, among them the quality of the local labor force, infrastructure, regulatory structures, access to recreational or cultural amenities as well as the overall tax burden. Overall, the question of whether "taxes matter" for interregional or state versus state location decisions leads to mixed conclusions. Available research and surveys indicate that taxation remains a somewhat important driver for interregional or state-to-state location decisions, although the effect seems quite small¹⁵.

¹³ ITEP, February 2002.

¹⁴ Constitution of the State of Illinois, Article XIV – "Constitutional Revision", December 15, 1970. Accessed from <http://www.ilga.gov/commission/lrb/conmain.htm>

¹⁵ See Lynch, Robert. 2004. "Re-thinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development". Economic Policy Institute and McGuire, Therese J, "Do Taxes Matter? Yes, No, Maybe So". State Tax Notes, Vol. 28, No. 10, June 9, 2003. Lynch notes that firms are unlikely to move from one place to another to take advantage of state and local business tax differentials and abatements, since state and local taxes represent such a low (1%) cost of doing business, as opposed to labor costs (20%). McGuire finds it unlikely that taxes are an important factor in explaining differences in business location decisions between states or regions. However, on the intraregional level (e.g. municipality to municipality), it appears that high local property taxes do deter economic growth. In addition, a recent (2008) survey by the Illinois Chamber of Commerce found that commercial and industrial real estate developers believe Illinois should improve its state and local tax burdens as well as its "state reputation/image regarding business". To read the full survey, visit <http://www.ilchamber.org>.

Regardless of the impact, higher taxes do place an added burden on businesses and this may have a harmful effect on the State's economy, all else equal. While Illinois' overall business climate (as it relates to taxes) currently ranks in about the middle of the pack, the income tax increase will undoubtedly shift that index downward¹⁶. Specifically, the state's corporate income tax plus personal property replacement tax rate would move to 9.7%, effectively the fourth highest rate in the country.

3. Counties and municipalities may not receive any disbursement from the increment of the tax increase.

In FY 2008, \$1.2 billion in income tax revenue was disbursed to counties and municipalities. Local governments in northeastern Illinois received about 60% of that amount, or roughly \$713 million in revenue. According to CMAP estimates, this disbursement makes up roughly 6% of municipal revenues in northeastern Illinois¹⁷. At the time of this writing, it appears that local governments would not receive their typical disbursement from the income tax increase. Instead, it appears as though this portion would be allocated to the State's capital plan.¹⁸ As Illinois and the U.S. find themselves in the middle of one of the worst economic downturns in history, it is becoming more of a challenge for local governments to generate the revenue required to meet public service demands. All else equal, it appears that the Governor's proposal will not offer any direct fiscal benefits to local governments. Of course, this potential negative ramification should be weighed against the potential for a new capital plan, which is likely to benefit large portions of the region, including county and local governments.

¹⁶ Tax Foundation, March 18, 2009. "Illinois' 'Business-Friendliness Ranking Would Decline Sharply Under Governor's Plan". The Tax Foundation's "Business Tax Climate Index" is an annual state-by-state ranking, produced annually. The definition of "business climate" is related to taxes only- in this case, the Foundation measures based on the corporate tax, individual income tax, sales tax, unemployment insurance tax and property tax.

¹⁷ Disbursement data from Illinois Department of Revenue. County and municipal revenue data is from the U.S. Census of Governments.

¹⁸ This has not been independently verified by CMAP and there is no statutory language to this effect. The Chicago Sun Times has reported that the Governor's office intends to "withhold the 10 percent stake municipalities would expect to see in additional revenues from an income tax increase." See <http://www.suntimes.com/news/cityhall/1504473,CST-NWS-quinn01web.article>

CMAP Staff Analysis: MOTOR FUEL TAX (MFT)

May 6, 2009

The Motor Fuel Tax (MFT) raises considerable revenue for both the State of Illinois and local governments, and the distribution of these revenues is the primary state-generated source of funding for road maintenance and construction. In inflation-adjusted dollars, the MFT has declined since the early 1990's. This has negatively impacted State and local capacity to address the vital maintenance of the current transportation system against the backdrop of growing deferred maintenance needs.

The main findings of this policy brief are as follows:

- Although the motor fuel tax rate was adjusted five different times between the years 1980-1990, the current rate of 19 cents/gallon remains unchanged since 1990.
- While this revenue source has remained relatively stable in nominal terms, revenue has fallen nearly 20% since 1991 when adjusted for inflation. The median annual change in gross MFT revenues since 1991 stands at **-1.5%**.
- Thirty-one states charge a higher MFT rate than Illinois.
- CMAP estimates that an eight-cent increase in the MFT will result in a short-term annual State-wide increase of \$639 million in revenue collections. Assuming existing allocation formulas, roughly \$287 million of this increase would be spent in the Chicago metropolitan area.

Background

Illinois originated a 3 cent per gallon motor fuel tax in 1929. Since then, the tax rate has been increased nine times, most recently on January 1, 1990 to its current rate of 19 cents per gallon. The rate was raised four additional times throughout the 1980's in response to steadily declining revenues throughout the 1970's. The State collected just over \$1.3B in gross collections in 2008. In nominal terms, this amount is roughly consistent with other MFT revenue collections in this decade.

The current statewide base rates are \$0.19/gallon for gasoline and gasohol, \$0.215/gallon for diesel and \$.215/gallon for combustible gases. In addition, Illinois levies a 0.3 cent/gallon tax for the Illinois Leaking Underground Storage Tank (LUST) fund and 0.8 cent/gallon in an Illinois Environmental Impact Fee. Standard sales tax rates at both the State and local level also apply to motor fuel sales. Like the federal excise tax on gasoline, the State MFT is applied on a *per gallon* rather than a *per dollar* basis. Thus, if total consumption is held constant, MFT collections do not vary with the wholesale price of gasoline. The following example illustrates the total cost to a consumer of one gallon of gasoline with a wholesale price of \$2.50:

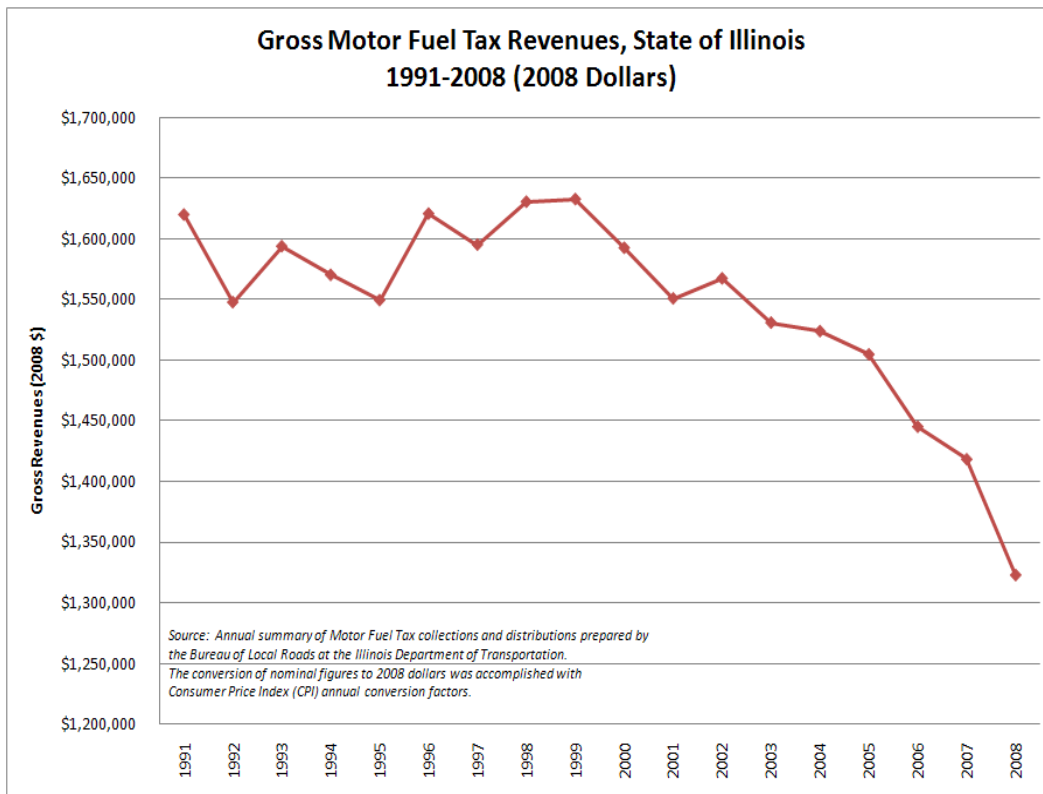
Consumer cost breakdown for one gallon of gasoline

Wholesale Price	\$2.50
State MFT	\$0.19
UST and EPA Impact Fee	\$0.011
Federal Excise Tax	\$.184
State Sales Tax (6.25% of purchase price)	\$.156
TOTAL COST	\$3.04

Collections over Time

When adjusted for inflation, State collections of the motor fuel tax have varied considerably over time. At a level of 7.5 cents per gallon in 1972, the State collected \$376 million in motor fuel tax, which equates to nearly \$2 billion in 2008 purchasing power. By 1983, MFT collections had fallen to \$371,000 in nominal dollars (\$795 million in 2008 dollars). The State raised the MFT per gallon rate five times in the 1980's, beginning with a 3.5 cent increase in 1983. By 1990, MFT collections grew to \$906 million in nominal dollars (nearly \$1.5 billion in 2008 dollars). On January 1, 1990, the General Assembly raised the gas tax to its current rate of 19 cents per gallon, where it stands today. The following chart shows, in 2008 dollars, annual MFT collections by the State since 1991¹.

¹ Much of the historical (pre 1997) revenue figures are from the Chicago Area Transportation Study's *Report to the Regional Transportation Plan Committee on Projected Transportation System Revenues and Expenditures*. October 15, 1997. Gross Revenue Figures for MFT are found in Table C3 of this document. A historical overview of the State of Illinois MFT can be found in Lewis, Darrell, P.E. "Nuts and Bolts of Motor Fuel Tax: MFT History and Distribution". IDOT Bureau of Local Roads and Streets. This document can be accessed at <http://www.iml.org/cnt/files/conference/2007/Darrell-IML%20Conference%2020071020-Nuts%20and%20Bolts%20of%20MFT.ppt>

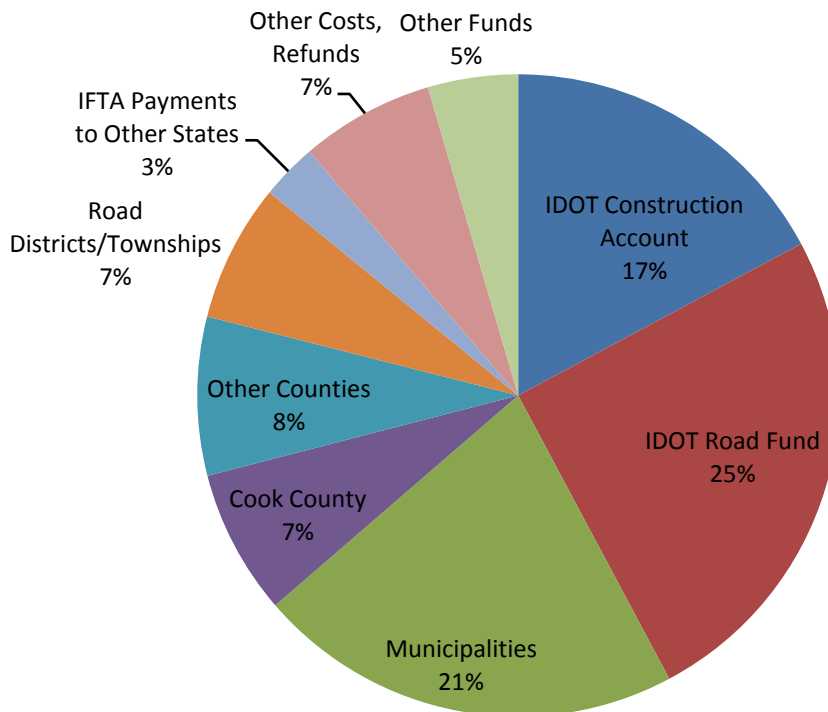


In real terms, gross state MFT revenues have fallen dramatically since 1991. The fall from 1991 (\$1.6B) to 2008 (\$1.3B) equates to a nearly twenty percent drop in revenues. In terms of median annual change, MFT revenue has fallen roughly 1.5% per year between 1991 and 2008.

It is difficult to estimate how much of this revenue is collected from pumps in the Chicago metropolitan area, but regional data on annual vehicle miles traveled (VMT) can be compared to statewide totals to estimate proportions. These proportions can then be applied to the statewide revenues in order to estimate revenues generated by county. Compared to the rest of Illinois, the proportion of annual vehicle miles traveled in the Chicago metropolitan region has been fairly stable- around 55%- between 2003 and 2007². According to these estimates, the Motor Fuel Tax generated \$600M annually in revenues from fuel purchased in the Chicago metropolitan region in 2008. In nominal dollars, revenues have been declining significantly, from an estimated \$800M from 2003-2005 (depending on the estimate) to an estimated \$619M in 2008. The region's share of statewide Motor Fuel Tax revenues has remained more or less constant in this decade (about 55%), although within the region the proportion borne by Cook County and the City of Chicago has generally declined in favor of the collar counties.

² Illinois Department of Transportation, Office of Planning and Programming, "Illinois Travel Statistics 2007", <http://www.dot.state.il.us/travelstats/2007 ITS.pdf>

Distribution of State MFT Revenues



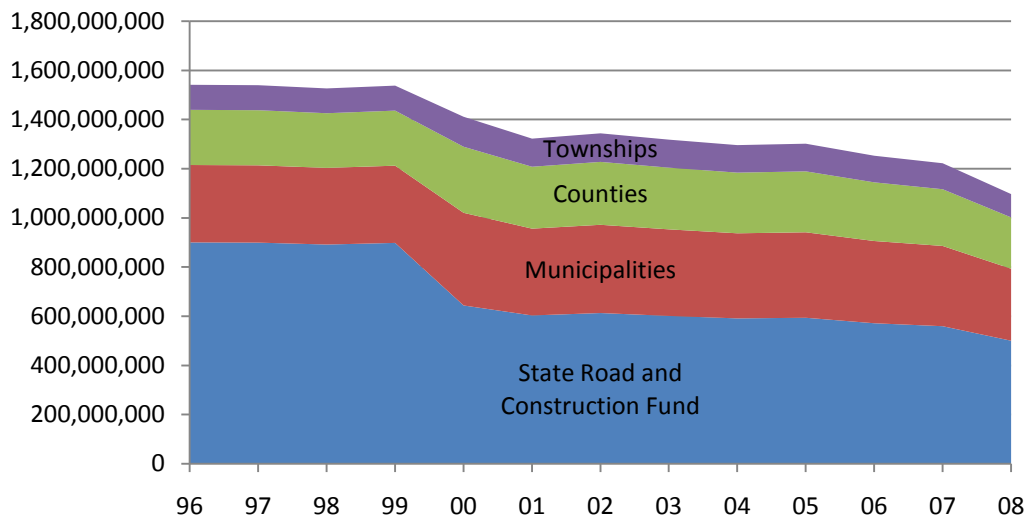
Figures are based on 2008 data provided by the Illinois Department of Transportation

Distribution of Funds

After a variety of deductions, 45.6% of the revenues allocate to the Illinois Department of Transportation's Road Fund and State Construction Fund, and the remaining 54.4% allocate to local governments³. In 2008, roughly \$200M was deducted off the top for various programs and funds, \$341M was distributed the IDOT Road Fund, \$200M to the IDOT Construction Fund, and nearly \$600M was allocated to local governments.

³ Illinois Department of Transportation. Bureau of Local Roads and Streets Manual. January 2006. Chapter 4: "Local Roads and Streets Funding". These figures refer to the percentage allocated to the State and local governments from the Motor Fuel Tax Fund, after a set of distributions including but not limited to the State Boating Act Fund, Grade Crossing Protection Fund, and other administrative costs. The pie chart on this page shows the total allocation of all collections, *including* the other funds, deductions, and costs. The 45.6%/54.4% figure also does not include the Diesel Differential portion, which is allocated to the State Construction Account. Thus, 45.6% may slightly understate the amount of revenue in the "state portion" of the MFT. For reference, in FY 2008 the Diesel Differential deduction amounted to \$33.7 million, less than one percent of the amount allocated to the Road Fund and State Construction Accounts (\$500 million in 2008).

Selected MFT Allocations, 2008 Dollars



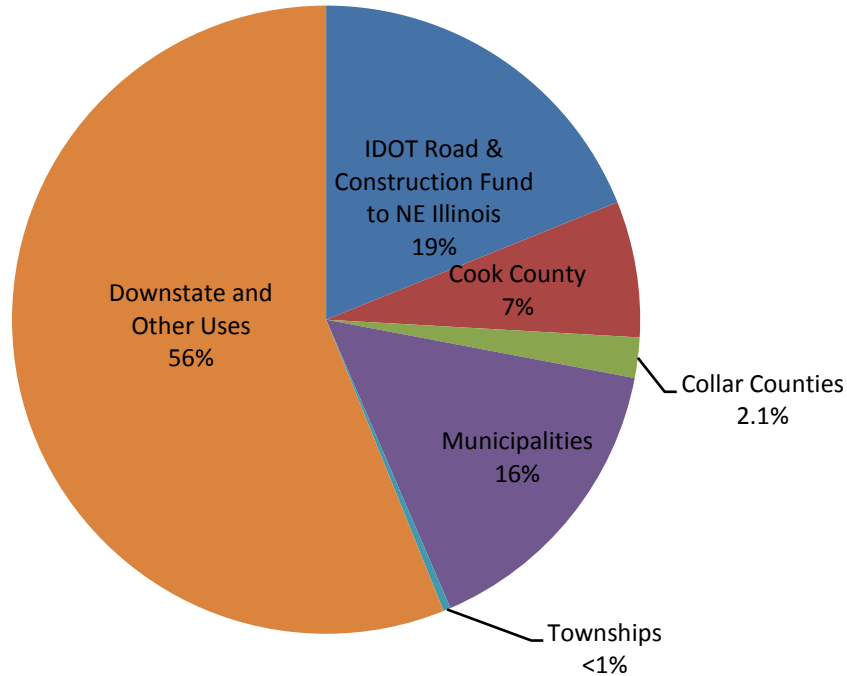
Source: Illinois Department of Transportation, Bureau of Local Roads and Streets

Of the portion allocated to local governments, 49.1% is distributed to municipalities, 16.74% to counties over 1,000,000 in population, 18.27% to counties under 1,000,000 in population, and 15.89% to road districts/townships. The municipality's share of the total MFT allocation is based on population. The county share is based on the amount of motor vehicle license fees received. The road district/township share is based on mileage of township roads.

The IDOT Road Fund and Construction Fund receive revenue from MFT transfers, vehicle registration revenue, and federal highway reimbursement. The Road Fund is used to pay for IDOT's operating expenses, debt service on highway bonds, some other agency operations and highway construction. The Construction Fund receives revenue from the same sources as the Road Fund, but is restricted by law to paying for highway construction expenses on the State system. These two funds are considered as a unit in the planning process because of their similar revenues and because they both support the highway construction program.

Estimated Allocation of State MFT Collections to NE Illinois, 2008

State allocation data is from IDOT Bureau of Local Roads and Streets. The Cook County figure represents an actual allocation. The IDOT Road/Construction fund to NE Illinois number is an estimate based on the assumption of a 45% NE Illinois share of these funds. The other numbers are estimates based on current MFT allocation formulas.



As MFT revenues decline in real dollars, it follows that allocations to the IDOT Road and Construction Funds, as well as to local governments, fall as well. It is important to note that the real decline in these funds occurs against a backdrop of increasing deferred maintenance needs for the State and local governments, due primarily to the increased costs to maintain or reconstruct roads and bridges.

While these MFT allocations have decreased close to 30% (in real terms) between the years 1996 and 2008, one recent estimate suggests that maintenance costs on local roads have grown by 75% since the year 2000⁴. The result is a tremendous drop in MFT purchasing power for local governments who seek to maintain their roads in a state of good repair.

⁴ This number has not been verified by CMAP. It was referenced by Doug Whitley, President of the Illinois Chamber of Commerce, in testimony delivered to the Committee of the Whole Special Session in Springfield, on July 9, 2008.

Forecasts of Future Revenues

State MFT revenues have trended downward at a median average rate of 1.5% per year since 1991. Recent trends can be used to estimate future revenues for the State and the Chicago metropolitan area. This analysis can estimate a forecast of future MFT revenue to the State and the Chicago metropolitan area. It is estimated that the Chicago metropolitan area “receives” (through direct allocation or otherwise) roughly 45% of the funding. The remainder of the revenue is used for downstate roads, other funds, or deductions.

A simple trendline-generated estimation⁵ of MFT revenues at the current rate of 19 cents/gallon predicts that the Chicago metropolitan area will receive \$17.7B (2008 dollars) in MFT funds between CMAP’s long range planning horizon 2009-2040. The breakdown of these funds is predicted as follows:

Forecasted MFT Revenues to NE Illinois with no rate increase, 2009-2040⁶

IDOT Road and Construction Fund to NE Illinois	\$7.6 billion
Counties over 1M (Cook)	\$2.8 billion
Collar Counties	\$840 million
Municipalities	\$6.2 billion
Townships	\$152 million
NE Illinois Total	\$17.7 billion

Analysis of 8-cent State MFT Increase

To date, the CMAP Board has formally supported an Illinois House Bill amending the motor fuel tax law by raising the rate by 8 cents to 27 cents per gallon⁷. A number of transportation policy advocates in northeastern Illinois have also advocated various similar measures for

⁵ The trendline’s coefficient (slope) is -\$11,267,000. In percentage terms, the trendline estimate forecasts less of a decrease in MFT than does applying an median annual growth rate of -1.48%. This estimate was constructed for the purpose of this brief only. As of this date, it is not being used for long range planning purposes by CMAP.

⁶ Numbers are based on a linear trendline estimate, based off revenues from 1991-2008. Revenues to local units of government are estimated based on current funding formulas. The assumption here is that the gas tax remains at 19 cents/gallon through 2040.

⁷ House Bill 1 (Bradley) would amend the Motor Fuel Tax Law in the following way- beginning on July 1, 2009, an additional surcharge of 8 cents per gallon shall be imposed on the privilege of operating motor vehicles upon the public highways and recreational-type watercraft upon the waters of the State. Provides that moneys collected from the additional surcharge shall be deposited into the GROW Illinois Fund, and must be used only for debt service and capital improvements. Amends the State Finance Act to create the GROW Illinois Fund.

raising the State MFT tax, or indexing the rate to inflation. Based on available data regarding historical gross MFT revenues as well as literature on the price sensitivity of consumers to gasoline price increases, estimates can be made regarding the impact of an 8 cent gas tax increase.

Available literature indicates that the demand for motor fuels is inelastic (relatively insensitive to price changes) in the short run, but becomes increasingly sensitive in the long run⁸. The implication is that in the short run, increases in motor fuel taxes will result in a nearly identical increase in gross revenues. However, over the longer term, available research indicates that consumers change their driving behavior as a result of higher fuel prices, leading to less of an increase in government revenue. As this policy brief has demonstrated, revenues from the 19 cent per gallon motor fuel tax have been decreasing in real dollars over recent years. Thus, any forecasting of future revenues due to a tax increase must take into account that while an increased rate is almost certain to raise revenues in the short-term, these revenues will also gradually fall in real terms over time if the rate is not indexed for inflation.

Assuming a current price per gallon of \$2, an 8 cent gas tax increase would raise the price to \$2.08, a 4% increase. Based on short-run (1-2 years) fuel price elasticities, a 4% increase in the price of gasoline will reduce total consumption by roughly -0.6%⁹. Over the long term, a 4% increase in the price should reduce total consumption by roughly three times the number, or -1.8%. If we assume current gross MFT revenues to be \$1,545,493,000 (average of the last seventeen years of revenue), we would expect revenues to change as follows:

⁸ Litman, Todd. November 4, 2008. "Transportation Elasticities: How Prices and Other Factors Affect Travel Behavior", Victoria Transport Policy Institute offers a literature review of elasticity elements related to transportation. While elasticity estimates have certainly varied over the years, it appears that the level of variance in these estimates is beginning to decrease. Recent estimates have pegged the short term price elasticity at roughly -.1-.2 in the short run and possibly 2-4 times higher than that in the long-run. To illustrate what these numbers imply, an elasticity of -0.15 means that a 10% increase in the vehicle fuel price will reduce fuel consumption by 1.5%. Thus, if 1 million gallons of fuel are currently purchased at a market price of \$2 per gallon, increasing the price 10% to \$2.20 a gallon will lead to a decrease in consumption by 1.5% to 985,000 gallons.

⁹ CMAP's assumption is that the short-run fuel price elasticity is -0.15. With a 4% increase in price, the calculation is $4\% \times -0.15 = -0.6\%$ decrease in consumption as a result of the price increase.

Projected Impact of 8-cent MFT Gas Tax Increase for the State and Northeastern Illinois¹⁰

Average Annual State MFT Collections 1991-2008 (2008 dollars)	\$1,545,493,000
Percent Increase of \$2/gallon Fuel Price with an additional 8 cent MFT increase	4%
Short-Run Decrease in Consumption from price increase	-0.6%
Long-Run Decrease in Consumption from price increase	-1.8%
Projected Annual Revenue from 8 cent gas tax increase (First Two Years)	\$2,185,326,000
Projected Annual Revenue from 8 cent gas tax increase (Year 3 and beyond)	\$2,166,780,000
Annual Increase to State MFT Collections from 8 cent gas tax increase (First Two Years)	\$639,833,000
Projected Total State Gross MFT Collections 2009-2040	\$64,472,924,000
Projected NE Illinois MFT Allocation 2009-2040	\$29,012,816,000
Projected Increase in total MFT allocations to NE Illinois with an 8 cent gas tax increase, 2009-2040	\$11.3 billion
Percent Increase in MFT Spending in NE Illinois	63.8%

Policy Implications

CMAAP's analysis estimates a large untapped revenue capacity in the State MFT. Inflation-adjusted revenues from the State MFT have declined sharply since 1991 at a median annual rate of nearly 1.5%. The 19-cent per gallon rate has not been raised since 1990. Additionally, 31 states levy a higher per gallon tax rate than Illinois¹¹. CMAAP estimates that in the short term, an 8 cent per gallon increase will increase State MFT collections by over \$600 million. Over the longer term, these revenues will decrease in relative terms as consumers change their behavior in reaction to the price increase. Over the long range planning horizon of 2009-2040, CMAAP estimates that an 8-cent per gallon increase in the State MFT will deliver roughly \$11.3 billion in additional revenues to northeastern Illinois, above and beyond current trends.

It should be cautioned that these estimates are derived from recent trends in the State MFT over the past 17 years. Due to uncertainty in domestic and international energy markets, the technological push for more fuel efficient vehicles, and the highly politicized nature of gas

¹⁰ Assumptions: short run fuel price elasticity of -0.15. Long run fuel price elasticity of -0.45. Northeastern Illinois "receives" 45% of MFT collections. No further gas tax increases past the 8 cent increase are assumed in the planning horizon of 2009-2040. From 2009-2040, the 8 cent increase is assumed to raise revenues based on elasticity estimates as well as follow the slope of the existing trendline (downward) for the period 1991-2008.

¹¹ Federation of Tax Administrators, "Motor Fuel Excise Tax Rates", January 1, 2008.
http://www.taxadmin.org/fta/rate/motor_fl.html

taxes, it may be unlikely that the above estimate of untapped tax capacity really exists in motor fuel taxes. Additionally, if analyzed as a flat rate regressive tax, the MFT may create a proportionally larger burden for low-income consumers, raising equity concerns. A higher MFT may limit individuals' access to mobility, and limited mobility often translates into limited health care, educational, and employment opportunities.

While an adjusted fuel tax may continue as a viable source for surface transportation, the region should also consider alternative revenue measures. One may be a vehicle miles traveled (VMT) fee, provided that substantial privacy and collection cost issues can be addressed¹². Another would be to reconsider the flat per-gallon nature of the motor fuel tax. The deployment of peak-hour "congestion pricing" could be permitted on Interstate highways in major metropolitan areas. CMAP also supports certain Public-Private Partnerships as a means of attracting additional private investment to the surface transportation system, provided that conditions are included to protect the public interest and the movement of interstate commerce.

¹² CMAP has analyzed the impact of a VMT tax in the *GO TO 2040* Travel Demand Management strategy paper. The report is here: <http://www.goto2040.org/WorkArea/DownloadAsset.aspx?id=14950>