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The Federal Budget: Surplus to Deficit, A Five-Year Journey

by Gary S. Olson, Director

On September 30, 2000, the Federal government closed the fiscal year (FY) 2000 with a $236 billion budget surplus. This surplus marked the largest Federal budget surplus ever recorded in the nation's history. Five years later, the Congressional Budget Office (CBO) is currently estimating that when the accounting of FY 2004 Federal receipts and outlays is complete, the Federal budget will close with a $477 billion deficit. This deficit will mark the largest Federal budget deficit in the nation's history. This article attempts to analyze the factors that have led to this remarkable five-fiscal year change in the condition of the Federal budget.

Table 1 provides a summary of Federal receipts and outlays for the period FY 2000 through January 2004, when the CBO issued its estimates for FY 2004. The $236 billion budget surplus recorded in FY 2000 was quickly reduced to a $127 billion surplus in FY 2001. Beginning in FY 2002, the Federal budget fell into deficit and has remained in deficit through the current fiscal year, with an expected shortfall of $477 billion. This change in the fiscal condition of the Federal budget primarily can be attributed to three principal factors: the performance of the national economy, reductions in Federal taxes, and Federal spending increases largely driven by increases in defense spending.

Table 1

**Federal Government Budget
Receipts, Outlays, and Year-End Balance
(billions of dollars)**

Fiscal Year	Receipts	Outlays	Surplus/(Deficit)
2000	$2,025	$1,789	$236
2001	1,991	1,864	127
2002	1,853	2,011	(158)
2003	1,782	2,158	(376)
2004	1,817	2,294	(477)
Change FY 2004 from FY 2000	$(208)	$505	$(713)

Source: Congressional Budget Office, January 2004

Perhaps the most accurate way to analyze the condition of the Federal budget is to review Federal receipts, outlays, and the year-end budget balance as a percentage of Gross Domestic Product (GDP). This analysis provides a historical review of the budget adjusted for the size of the United States economy. Table 2 provides a summary of Federal receipts, outlays, and the year-end budget balance as a percentage of GDP for the period FY 2000 through FY 2004. Several important points can be taken from the data. First, Federal receipts totaled 20.9% of GDP in FY 2000, but fell to 15.8% of GDP by FY 2004. The 20.9 % of GDP that Federal receipts totaled in FY 2000 represented the highest level of Federal receipts as a percentage of GDP since FY 1944, when spending on World War II pushed Federal receipts to 20.9% of GDP. On the other hand, the 15.8% of GDP that Federal receipts will total in FY 2004 marks the lowest level of Federal receipts as a percentage of GDP since FY 1950, when Federal receipts equaled 14.4% of GDP. The combination of an economic slowdown, which had a major impact on Federal personal income tax receipts, and enacted tax reductions has led to this large decline in the level of Federal receipts over the past five fiscal years.

Table 2

Federal Government Receipts, Outlays and Surplus/(Deficit) as a Percentage of Gross Domestic Product			
Fiscal Year	**Receipts**	**Outlays**	**Surplus/(Deficit)**
2000	20.9%	18.4%	2.4%
2001	19.8%	18.6%	1.3%
2002	17.9%	19.4%	-1.5%
2003	16.5%	19.9%	-3.5%
2004	15.8%	20.0%	-4.2%

Source: Congressional Budget Office, January 2004

Federal outlays, which equaled 18.4% of GDP in FY 2000, have grown to 20.0% of GDP in FY 2004. Most of this increase can be attributed to increased defense spending, but other Federal expenditure categories also have grown significantly over the last five fiscal years. Since the end of World War II, the peak level of Federal outlays as a percentage of GDP occurred in FY 1983 when Federal outlays equaled 23.5% of GDP. During FY 2000, the Federal budget surplus equaled 2.4% of GDP. The projected Federal budget deficit in FY 2004 will equal 4.2% of GDP. The 2.4% of GDP that the Federal budget surplus equaled in FY 2000 was the largest percentage ever recorded in the history of the Federal budget. The previous high was during FY 1951, when the Federal budget surplus equaled 1.9% of GDP. The 4.2% of GDP that the Federal budget deficit will equal in FY 2004 is the largest Federal budget deficit in relation to the size of the economy since FY 1983, when the Federal budget deficit equaled 6.0% of GDP.

The change in Federal receipts for the period FY 2000 through FY 2004 is summarized in Table 3. Over this five-fiscal year period total Federal receipts declined by $208 billion or 10.3%. Federal individual income tax receipts declined by $243 billion or 24.2%, and corporate income tax receipts fell by $46 billion or 22.2%. These declines in individual income and corporate income tax receipts were partially offset by an increase in social insurance taxes, which grew by $94 billion or 14.4%. Another striking feature of this sharp decline in Federal receipts is that the consecutive three-year decline in Federal receipts that occurred in FY 2001, FY 2002, and FY 2003 marks the first consecutive three-year decline in Federal receipts since FY 1921, FY 1922, and FY 1923.

Table 3

Five-Year Change in Federal Government Receipts		
	Billions	**Percentage Change**
Individual Income Tax	-243	-24.2%
Corporate Income Tax	-46	-22.2%
Social Insurance Taxes....................	94	14.4%
All Other Receipts	-13	-8.1%
Total Receipts	-208	-10.3%

Source: Congressional Budget Office, January 2004

The change in Federal outlays for the period FY 2000 through FY 2004 is summarized in Table 4. Over this five-fiscal year period total Federal outlays have increased by $505 billion or 28.2%. Defense outlays have grown $156 billion or 52.9%. While the defense spending increases have been the major factor behind the recent growth in Federal outlays, other areas of Federal spending also have grown considerably over the past four fiscal years. Nondefense discretionary spending has increased $125 billion or 31.4%, Social Security spending has increased $86 billion or 21.2%, Medicare spending is up $78 billion or 36.1%, Medicaid spending is up $43 billion or 36.6%, and other income support program spending is up $59 billion or 43.8%. The only area of Federal outlays that has declined in recent years is net interest payments. The spending to service the Federal debt has declined by $67 billion or 30.0%. The 28.2% overall growth in Federal outlays over the past four fiscal years compares with an 18.1% growth in GDP over the same time period and a 9.9% growth in the United States Consumer Price Index over the same period.

Table 4

Five-Year Growth in Federal Government Outlays
FY 2000 to FY 2004

	Billions	Percentage Growth
Defense	$156	52.9%
Nondefense Discretionary	125	31.4%
Social Security	86	21.2%
Medicare	78	36.1%
Medicaid	43	36.6%
Income Support	59	43.8%
Net Interest	(67)	-30.0%
All Other Outlays	25	32.7%
Total Change in Outlays	$505	28.2%
Addendum:		
United States CPI	---	9.9%
Gross Domestic Product	---	18.1%

Source: Congressional Budget Office, January 2004

What is clear from a review of the recent history of the Federal budget is that remarkable changes have taken place over the past four Federal fiscal years. Instead of the debates that took place in the United States Congress in 2000 about what to do with a large Federal budget surplus, the United States Congress is now focused on eliminating a large Federal budget deficit. It will be very interesting to see if the changes in the Federal budget that occur over the next few years are as major as the changes that have occurred over the past few years.

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Where Are The Jobs?
by Jay Wortley, Senior Economist

The number one problem for both the U.S. and Michigan economies is the lack of growth in the number of people with jobs. While a number of key economic indicators are reflecting a pickup in economic activity – including an acceleration in quarterly growth in real Gross Domestic Product, a decline in initial unemployment claims, a sharp increase in corporate profits, increased activity in the manufacturing and nonmanufacturing sectors, and a sustained increase in the stock market – employment remains weak. Nationally, employment has increased slightly during the past seven months, but the pace of the increase has been very weak. In Michigan, a three-year downward trend in employment has not yet been reversed. This article provides an overview of the job market situation in both the U.S. and Michigan economies.

Weak National Employment

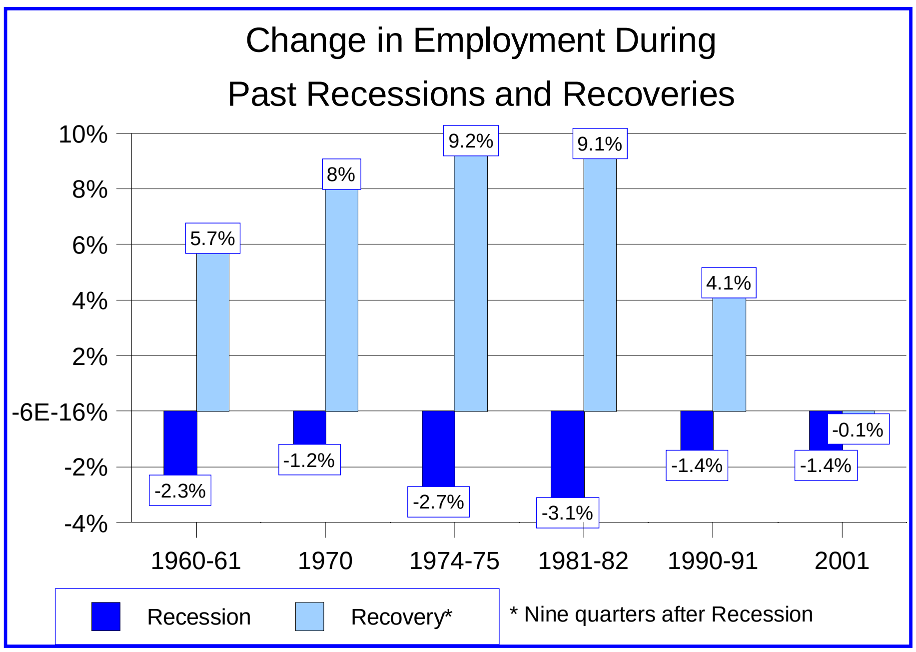
The good news is that payroll employment in the U.S. has increased for seven consecutive months from September 2003 to March 2004, as shown in Figure 1. During this time, employment is up 759,000 workers or 0.6%. The bad news is that this increase in employment did not begin until 22 months after the recession officially ended, which was at the end of 2001.

Figure 1

Source: U.S. Department of Labor, Bureau of Labor Statistics.

This weakness in the U.S. labor market is further illustrated in Figure 2, which compares the change in payroll employment during the previous six recessions and the first nine quarters of the economic recovery that followed each of these recessions. In the 2001 recession, U.S. payroll employment declined 1.4%, which was equivalent to the rate of job loss experienced during the 1970 and 1990-91 recessions, but the decline was not as severe as those experienced in the other three recessions. However, in terms of the job growth experienced during the first nine quarters of economic growth following the end of the recessions, the comparison between the current recovery and the previous five recoveries is very different. During the first nine quarters of economic recovery following the five recessions that occurred between 1960 and 1991, the percentage increase in the number of people employed ranged from 4.1% following the 1990-91 recession to 9.2% following the 1974-75 recession. During the first nine quarters since the 2001 recession, employment has shown no improvement. In fact, despite the recent improvement in employment since September 2003, the employment level in March 2004 was still 0.1% below the employment level at the end of the 2001 recession. As a result, it is clear that the labor market situation is much weaker currently than it was during any of the previous five economic expansions since 1960.

Figure 2



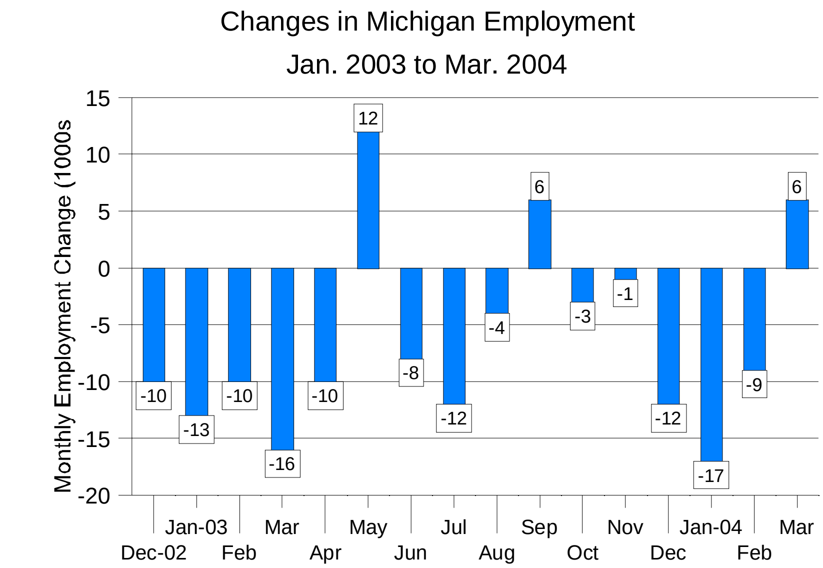
Even Weaker Michigan Employment

While the national employment situation has been very weak, the employment situation in Michigan has been even weaker. Michigan's employment level peaked in June 2000, at 4,689,600. Since then it has maintained a fairly steady downward trend. In March 2004, payroll employment totaled 4,372,000, which is down 318,000 workers or 6.8% from June 2000. Even from September 2003 to March 2004, when U.S. employment was finally increasing by a modest 0.6%, employment in Michigan declined 30,000 workers or 0.7%. This continuing downward trend in Michigan's employment level is illustrated in Figure 3, which shows the monthly change in payroll employment in Michigan from December 2002 through March 2004.

Manufacturing Employment

While the decline in employment has occurred in most sectors of the economy, the largest declines have occurred in the manufacturing sector. Nationally, from July 2000 to February 2004, manufacturing employment decreased every month. This 43-month decline resulted in a loss in manufacturing employment of 3.0 million workers, a decline of 17.4%. In March 2004, the consecutive-month decline was finally broken as manufacturing employment remained unchanged from the February level.

Figure 3



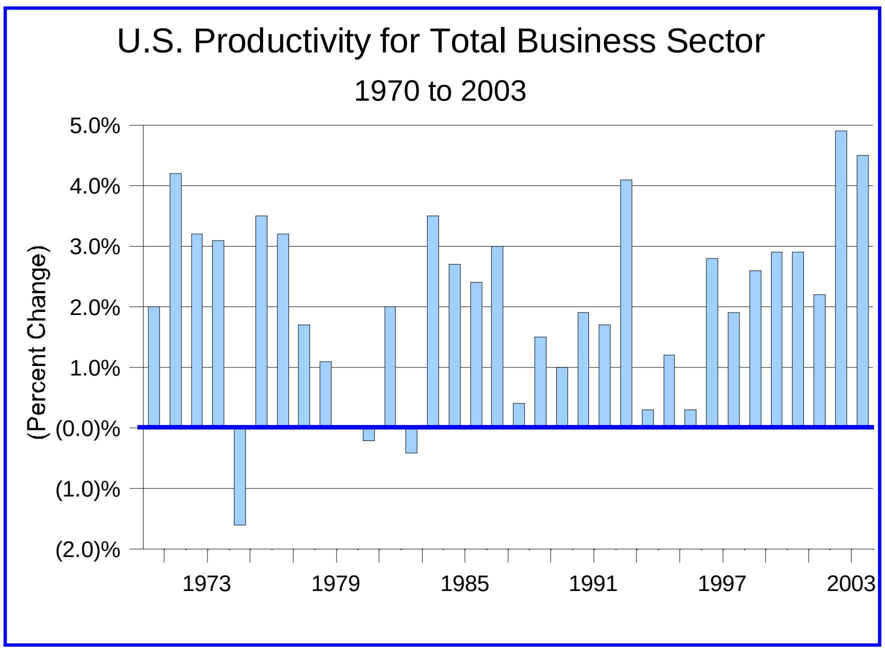
Source: U.S. Department of Labor, Bureau of Labor Statistics.

Manufacturing employment in Michigan also has fallen dramatically since 2000. In June 2000, manufacturing employment totaled 906,500 workers, but by March 2004 it had fallen to 712,000 jobs. This equates to a 21.5% decline or the loss of one in five jobs.

What Is Keeping Employment From Increasing?

The major reason why employment has been so slow to rebound since the end of the 2001 recession is that productivity has been extremely strong. Productivity measures the amount the economy can produce per hour worked. Over the past few years, productivity has been growing at a fairly strong and steady rate. As shown in Figure 4, productivity grew at a fairly good pace of between two and three percent during the last part of the 1990s, and it did not slow down much during the 2001 recession. Then in 2002 and 2003, productivity grew at historically robust rates of 4.9% and 4.4%, respectively. The improvement in productivity has occurred because businesses invested in new equipment to help keep production costs down and stay competitive in the marketplace. It is also believed that some of this recent strong growth is due to the lingering effects of the investment in computers and software that occurred leading up to Y2K. As a result of these historically strong increases in productivity, businesses have been able to achieve increasing levels of output while still reducing the number of people they employ. It is predicted that the recent strong pace of productivity growth is not sustainable and the pace of growth will likely slow down during 2004 and 2005; however, the demand for goods and services is expected to continue to improve. In order to meet the increasing demand for goods and services while productivity growth slows, businesses will have to hire new workers. As a result, it is forecasted that employment will finally experience some meaningful increases during the remainder of 2004, both nationally and in Michigan, and that these increases in employment will gain momentum in 2005.

Figure 4



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Streamlined Sales Tax Revisited

by J.P. Finet, Legislative Analyst

The State of Michigan has required its residents to pay a use tax on out-of-State purchases, not subject to the state sales tax, since 1937, yet the use tax is rarely collected from individuals because purchasers are unaware of the requirement or simply do not pay the tax. While Michigan retailers are required to collect and pay the sales tax, the State cannot require out-of-State (remote) sellers to collect Michigan's use tax. Few mail-order and internet retailers currently collect Michigan's and other states' sales and use taxes voluntarily because, they claim, conflicting terms in the various state tax statutes make it virtually impossible to determine how much tax is owed, and to which jurisdictions it is payable. In 2001, Michigan joined a growing number of states seeking to increase their tax collections on out-of-state purchases, by enacting the "Equitable Sales and Use Tax Administration Act". The Act entered Michigan into a multistate sales and use tax agreement to work with other states in developing a more uniform and simplified system for remote sellers to collect and remit the taxes.

While Michigan and 35 other states ratified the multistate streamlined sales and use tax agreement in November 2002, Michigan's Act contained a sunset provision that caused Michigan's membership in this multistate group to end on December 31, 2002. Further, the Act did not make any of the amendments to the State's Use Tax Act and the General Sales Tax Act that would be necessary for the State to be in compliance with the agreement. Recently, a series of bills was introduced in the Michigan House of Representatives to enact the "Streamlined Sales and Use Tax Administration Act" as well as make the numerous amendments to the use and sales tax codes necessary for Michigan to implement the agreement. This article summarizes the history of the streamlined sales and use tax issue, describes the proposed amendments to the Use Tax Act and the General Sales Tax Act, and looks at their possible impact on the collection of Michigan's use and sales taxes.

Background

The sales tax is an important source of revenue for the 45 states, along with the District of Columbia, that collect the tax. Since a number of these states also permit local units of government to levy the tax, the National Conference of State Legislatures (NCSL) has reported that there are roughly 7,200 state and local taxing jurisdictions that collect a sales tax. Nationwide, sales taxes generate about one-third of state and local government revenue, according to the NCSL.

What is commonly thought of as the sales tax includes both sales and use taxes. In a state that levies a sales tax, the tax applies to all taxable retail transactions that take place in that state; however, if the state's residents purchase goods outside their state, then the use tax may apply. Each state that has a sales tax has a similar use tax, which must be paid by buyers who use, consume, or store in-state items that were purchased out-of-state. The use tax is a necessary companion to the sales tax, because without it, residents could avoid much of the sales tax by making as many purchases as possible in states that do not collect a sales tax.

In Michigan, the sales tax is levied on retailers who make a sale on taxable items to a customer from an in-State location. Most retailers pass the amount of the tax levy on to their customers. The sales tax is levied regardless of whether the purchaser is a resident or a nonresident if the purchaser takes possession of the product at the time of the purchase. In general, if products are shipped to nonresident purchasers, the seller is not required to collect the sales tax, but the purchasers are required to pay the use tax in their home state.

If the out-of-state transaction is not for an item, like a car, that must be registered in Michigan, then it is unlikely that the Michigan Department of Treasury will have a record of the purchase, and it will not collect the use tax unless it is voluntarily remitted by the purchaser. Historically, this voluntary compliance by individuals has been very low because people are unaware the tax exists or they ignore it.

The ability of states to require remote sellers to collect and remit use tax on merchandise sold to a state's residents have been restricted since 1967 by two key U.S. Supreme Court decisions. In 1967, the Court ruled that an Illinois statute requiring an out-of-state mail-order business to collect and pay use tax on goods purchased for use in Illinois violated the Due Process Clause of the U.S. Constitution and created an unconstitutional burden on interstate commerce (*National Bellas Hess, Inc.* v *Department of Revenue of Ill,* 386 U.S. 753). In a subsequent use tax collection case, North Dakota filed an action in state court to require an out-of-state mail-order house to collect and pay use tax on goods purchased from it for use in North Dakota. The case eventually went to the U.S. Supreme Court, which affirmed its earlier ruling in *Bellas Hess*; holding that, for a state to require a business to collect sales or use taxes, the business must have a physical presence (nexus) in the state. The Court found that Congress could legislate a solution because it has the constitutional authority to regulate commerce among the states (*Quill Corp.* v *Heitkemp,* 504 U.S. 298 (1992)).

Originally, the use tax collection problem concerning remote sales dealt primarily with mail order catalog sales. The inability to collect the use tax was troublesome, but was not critical to state budgets. In recent years, however, the growth of transactions made over the internet has substantially increased the incidence of remote sales. There is concern among many of the 45 states (and the District of Columbia) that levy sales and use taxes that the ever-increasing volume of purchases over the internet and by mail is seriously eroding sales and use tax revenue and that this erosion will increase dramatically over time.

In Michigan alone, the Department of Treasury has estimated that the inability to collect the use tax from out-of-state purchases costs the General Fund and School Aid Fund between $200 million and $300 million annually. With the State attempting to address a $1 billion shortfall for the 2004-05 budget, the collection of the use tax on out-of-state sales potentially could help address this problem by adding to the State's revenue.

Streamlined Sales Tax Project

Organized in 2000, the Streamlined Sales Tax Project is an effort by state governments, with input from local governments and the private sector, to simplify and modernize sales and use tax collection and administration. According to an Executive Summary of the Project, 42 states and the District of Columbia are involved in it.

The mission of the Project is to develop and implement a uniform and simplified sales and use tax system that will encourage sellers' voluntary compliance with the tax laws. The Project's mission has proven quite daunting, as 34 of the 45 states with sales taxes allow local sales taxes and 30 states have multiple tax rates. Further, states often treat the same products differently and have different kinds of exemptions and definitions in their tax laws.

The Project proposes that states change their sales and use tax laws to conform with simplifications that would apply to all sellers. The simplifications pertain to rates, exemptions, definitions, and administration, and provide for uniform rules regarding the "sourcing" of transactions.

The legislation necessary for a state to participate in the Streamlined Sales Tax Project has two components. The first is the state's adoption of enabling legislation that allows the state to enter into an agreement with one or more states to simplify and modernize sales and use tax administration. The second legislative component is amendment of the state's sales and use tax laws to achieve conformity with the simplifications and uniformity required of the participating states. The Project refers to this legislation as the "Streamlined Sales and Use Tax Agreement".

According to the Streamlined Sales Tax Project, on November 12, 2002, 35 states and the District of Columbia approved the interstate Agreement provisions. As of April 2004, 20 states have enacted all or part of the conforming legislation.

In May 2004, the states participating in the Streamlined Sales Tax Project are expected to meet and establish a process to certify states that are in compliance with the agreement. If a certification process is established this spring, participating states could start collecting the streamlined sales and use taxes on a voluntary basis as early as fall 2004, according to the NCSL.

In addition to setting up a certification procedure at the meeting, the states are expected to address administrative issues such as how individual states will determine which agencies would have the responsibility for collecting the streamlined tax, and to put together requests for proposals for software packages that could be used by multistate vendors to track their use tax obligations.

Congressional Implementation

Collection of the sales and use tax on interstate transactions will remain on a strictly voluntary basis unless and until the U.S. Congress enacts legislation permitting states to require remote sellers to collect the taxes. The Streamlined Sales and Use Tax Act (S. 1736 and HR 3184) has been introduced in Congress to give those states that comply with the agreement the authority to require out-of-state sellers to collect their sales and use taxes.

The Federal Act would be consistent with the *Bella Hess* and *Quill* decisions, which state that Congress is the only body with the authority under the U.S. Constitution to determine the extent to which states can burden interstate commerce by imposing a duty to collect use taxes.

While the collection of state streamlined sales and use taxes will be voluntary until Congress acts, the agreement provides an incentive for businesses to start collecting the tax when it goes into effect. The agreement contains an amnesty provision under which a seller that has been voluntarily collecting the tax will not face litigation by a state for unpaid back sales taxes in the future should the state find that a nexus existed between the seller and the state, which required the seller to collect the state sales tax.

Michigan's Streamlined Sales Tax Proposals

In October 2001, then-Governor Engler signed into law the Equitable Sales and Use Tax Administration Act, which permitted Michigan to enter into the streamlined sales and use tax agreement. In November 2002, Michigan joined the other states in ratifying the multistate agreement. Following the repeal of the Equitable Sales and Use Tax Administration Act on December 31, 2002, Michigan has not been an active participant in the Streamlined Sales Tax Project, and has not enacted the sales and use tax amendments that would be necessary to comply with the agreement.

The language of the newly proposed Streamlined Sales and Use Tax Administration Act, House Bill 5504, appears to mirror closely that of the 2001 Act. According to the bill, "This act simplifies the sales tax and use tax administration in order to substantially reduce the burden of tax compliance for all sellers and for all types of commerce." The bill would allow the State Treasurer to enter into the streamlined sales and use tax agreement with one or more states, certify the State's compliance with the agreement, and take any other action necessary to participate in the agreement. The Department of Treasury also would be able to take action reasonably required to implement the Act, including promulgating rules and procuring goods and services with other states.

The bill would require the appointment of four people to the governing board of the agreement. The State delegation would include a member or former member of the Senate or an employee of the Senate or the Senate Fiscal Agency; a member or former member of the House of Representatives or an employee of the House or the House Fiscal Agency; the State Treasurer or a designee; and the Governor or a designee. Legislative appointments would be jointly made by the legislative leaders of both parties.

The delegation would represent the State at all meetings of the board and would vote on the State's behalf in certifying service providers (agents performing sellers' sales and use tax functions); certifying automated systems (computer software that calculates the tax imposed by each jurisdiction on a transaction and determines the amount to remit to the appropriate state); establishing performance standards for multistate sellers; participating in the issue resolution process; determining compliance of petitioning states; and taking other actions necessary under the agreement. The delegation would report on a quarterly basis to the appropriate legislative standing committees on the board's activities and would recommend amendments to State statutes necessary to comply with the agreement. In addition, the delegation would appoint a business advisory council of up to eight members to consult with it on streamlined sales and use tax matters.

A seller could participate under the agreement only by registering in the central registration system provided for by the streamlined sales and use tax agreement. A seller registered under the agreement would be registered in each of the member states, but sellers also could register individually with other states. A seller could cancel its registration under the agreement at any time, but would remain liable for remitting taxes collected to the appropriate states. By registering, a seller would agree to collect and remit sales and use taxes for all taxable sales into this State.

A registered seller would have to agree to one of the following models for purposes of collecting and remitting sales and use taxes under the agreement:

Model 1: The seller uses a certified service provider to act as its agent to perform all of the seller's sales and use tax collection functions, other than its obligation to remit sales or use tax on its own purchases.
Model 2: The seller uses a certified automated system to perform part of the seller's sales and use tax collection functions, but retains responsibility for remitting the tax.
Model 3: The seller has sales in at least five member states, has annual sales of $500 million or more, has a proprietary system that calculates the amount of tax due in each taxing jurisdiction, and has entered into a performance agreement with the member states establishing a tax performance standard for the seller. For this model, "seller" includes an affiliated group of sellers using the same proprietary system.
Model 4: Any other system approved by the Department of Treasury.

The bill also would provide for the confidentiality of personally identifiable information.

Proposed Use Tax Amendments

To bring Michigan's Use Tax Act into compliance with the agreement, House Bill 5502 would make numerous changes to the Act. Many of the changes would be definitional, but the bill also would eliminate some exemptions, create new exemptions, and make other changes to the use tax.

Among the definitional changes would be the simplification of such terms as "purchase price" and "tangible personal property". The bill also would define "sale", "alcoholic beverage", "computer software", and "dietary supplement", along with 13 other new terms.

To comply with the agreement, the bill would add the following to the list of items to be taxed in the same manner as tangible personal property:

-- The transmission and distribution of water and electricity if the sale is made for consumption rather than resale.
-- The production costs and indirect costs of a product affixed to real estate that are incident and necessary for production or manufacturing operations or processes, for a

manufacturer that affixes its product to real estate and maintains an inventory of its product that is available for sale to others by publication or price list.

-- The production costs and indirect costs of a product affixed to real estate that are incident and necessary for production or manufacturing operations or processes, for a manufacturer that affixes its product to real estate but does not maintain an inventory of its product that is available for sale to others or make its product available for sale by publication or price list.

Generally speaking, the bill would allow the sale of telecommunications that are sold on a call-by-call basis to be sourced to each level of the taxing jurisdiction in which the call originates or terminates and in which the service address is located. Also, the sale of telecommunications services on a basis other than a call-by-call basis could be sourced to the customer's place of primary use with an option to include the location associated with the mobile telephone number if the service is for a mobile phone.

The bill would exempt the following from the use tax:

-- Rental receipts from tangible personal property upon which a sales or use tax already has been paid by the owner in Michigan or if the owner has paid one of the taxes at a 6% rate in another state.
-- Specific charges for technical support or for adapting or modifying prewritten computer software programs to a purchaser's needs or equipment if those charges are separately stated and identified.
-- The sale of computer software originally designed for the exclusive use and special needs of the purchaser.
-- The sale of oxygen and insulin for human use as dispensed pursuant to a prescription.
-- A meal provided free of charge or at a reduced rate to an employee during work hours by a food service establishment.
-- The sale of diesel fuel to a person who is an interstate motor carrier for use in a qualified commercial motor vehicle.

The bill would lay out timetables for when the tax should be paid to the Treasury Department each month, and when a cause of action by a buyer against a seller would accrue; and would establish record-keeping requirements for sellers subject to the use tax.

Proposed Sales Tax Amendments

The amendments to the General Sales Tax Act proposed by House Bill 5503 begin with a dramatic simplification of the definition of "sale at retail". In most ways, however, the proposed changes to this Act mirror the proposed amendments to the Use Tax Act. The bill would add the same new terms to the General Sales Tax Act and would modify the sales tax exemptions to match those in the proposed amendments to the use tax. Additionally, the bill would amend the definitions of "food and food ingredients", "prepared food", and "prepared food intended for immediate consumption".

Tax Revenue Equalization Act

In addition to amending the General Sales Tax and Use Tax Acts, the State must enact a "Streamlined Sales and Use Tax Revenue Equalization Act" in order to comply with the multistate streamlined sales and use tax agreement. House Bill 5505 proposes to do that.

The bill is designed to ensure that some exemptions currently enjoyed by some Michigan businesses and residents would not be eliminated by the proposed definitional changes in the sales and use tax laws. The taxes and credits are related to interstate motor carriers, some motor vehicles, and aircraft. The bill also would provide a credit for assessments added to hotel and motel charges for convention and tourism marketing and development.

The Cost of the Streamlined Sales Tax

According to the Michigan Department of Treasury, if the streamlined sales tax took effect on July 1, 2004, as proposed in the House bills, the definitional changes and other amendments to the sales and use tax laws would have two results. The first would be an $18.5 million decrease in sales tax revenue for the 2004-05 fiscal year. The second would be an increase in use tax collection that would more than offset the sales tax loss.

The Department estimates that the use tax owed for 2005 will total roughly $264 million, meaning that the State would need to collect only 7% of the residents' use tax obligations to break even. Departmental analysts believe that a 7% collection rate would be reasonable because Treasury expects that a number of out-of-State vendors would come forward and voluntarily collect the use tax due to the simplifications and the amnesty provision incorporated into the multistate streamlined sales tax agreement.

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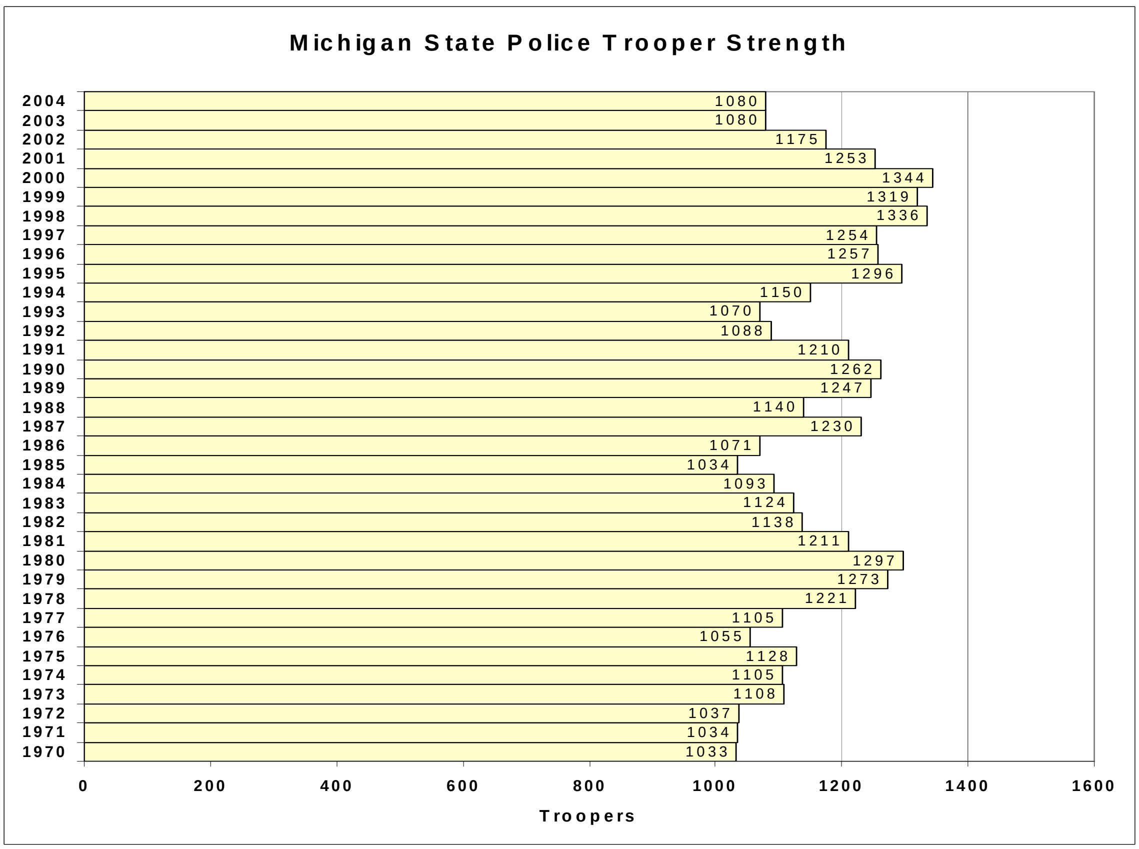
STATE POLICE TROOPER COUNT UPDATE: DECLINE CONTINUES
by Bruce R. Baker, Fiscal Analyst

The number of "at-post troopers", those Michigan State Police troopers who are assigned to highway patrol and general law enforcement in the State, continues to follow a trend downward. The strength level of troopers, measured by those who serve at the 63 State Police posts and other sites throughout the State, has reached a multiyear low of 1,027 troopers as of this writing. (See Figure A.)

Figure A



Note: Trooper strength numbers reflect totals at the first full pay period in October of each year. The numbers include those troopers at-post and those who are currently enrolled in trooper school. The fiscal year (FY) 2003-04 projection is based on starting FY 2003-04 with 1,080, losing 100 troopers to attrition, and gaining 100 by 2005. The trooper school is to begin in July 2004. School attrition factors would place the expected number of graduates at 85.

A drop in trooper strength is a natural result of the State's not holding a sufficient number of trooper candidate schools to replenish the expected annual attrition of officers from the rank of trooper. (The expected attrition for FY 2004-05 is 80.) There have been no trooper school graduates since 2001. (See Table 1.) Attrition from the rank of trooper mostly occurs from promotions out of the trooper rank to other functions within the Department, and retirements. (Full retirement for a uniformed member of the State Police is earned after 25 years of service.) The recent 25th anniversaries of trooper schools that graduated 360 candidates back in 1978 have contributed to the reduction in trooper numbers. The State has taken two steps to help bolster the trooper count: the budgeting for a trooper candidate school planned to begin July 18, 2004, and graduate an estimated 85 troopers in December, and the establishment of a Deferred Retirement Option Plan (DROP), created by Public Act 83 of 2004. The candidate school, the 120th to be held by the Department, has $2.5 million appropriated in FY 2003-04 and $7.0 million proposed for FY 2004-5 to cover its cost, which primarily consists of salaries of the candidates, who begin receiving pay on day one of the school. The DROP is a program aimed at retirement-eligible officers (currently numbering 144) containing incentives to encourage them to continue serving the State, thereby helping to keep the number of troopers at a higher number than it would be otherwise.

Table 1

Trooper Recruit School Graduations							
Year	**Graduates**	**Year**	**Graduates**	**Year**	**Graduates**	**Year**	**Graduates**
2005*	85	1996	140	1987	145	1978	360
2004	0	1995	256	1986	155	1977	109
2003	0	1994	69	1985	0	1976	36
2002	0	1993	88	1984	44	1975	46
2001	142	1992	0	1983	0	1974	144
2000	0	1991	0	1982	55	1973	99
1999	212	1990	119	1981	0	1972	180
1998	94	1989	130	1980	0	1971	86
1997	78	1988	95	1979	83	1970	59

* Proposed recruit school to begin July 18, 2004.