

Task Force on Comprehensive Revenue Restructuring

Final Report

January 2009

TASK FORCE ON COMPREHENSIVE REVENUE RESTRUCTURING

FINAL REPORT

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EXECUTIVE SUMMARY

Introduction

The Task Force on Comprehensive Revenue Restructuring was established by the 2007 Legislature (House Bill 2530). Membership of the Task Force included eight legislators and 22 members representing different regions and interests appointed by the Governor. The Chair of the Task Force, appointed by the Governor, was former State Representative Lane Shetterly. The Task Force was assisted by a 7-member Advisory Council made up of technical experts. Staff for the Task Force was provided by the non-partisan Legislative Revenue Office.

The Task Force was charged with developing a blue print for a state and local government tax system that provides stable revenue, creates positive economic benefits for the state and provides for a financial foundation that enhances the state's global competitiveness. The Task Force began meeting in November, 2007, and developed a draft report for review and comment by the public. After a series of public meetings and opportunity for the public to comment on the draft report, this final report is presented to the Governor and 2009 Legislative Assembly.

This report is organized into three major components: Findings, Short-term recommendations and Long-term options. The Findings are the key determinations about our state and local revenue systems on which the Task Force has developed its Short-term recommendations, in particular, and by which it has framed its Long-term options. The Short-term recommendations are recommendations that the Task Force intends be enacted or adopted by the 2009 legislature. The Long-term options fall into two general categories. The first category addresses changes in the local government revenue system, which, while not recommended for enactment in the 2009 legislative session, is nevertheless of a more urgent nature and merit active review and consideration. The second category of Long-term options deals with the possible scenarios for more fundamental restructuring of the state and (in some cases) local revenue

systems. The Task Force presents these scenarios in this report for consideration by future policy-makers, but does not make any recommendations for enactment at this time.

Findings

- The state revenue system, dominated by the personal income tax, remains highly volatile over the short-term. This makes it difficult for the state to maintain an adequate level of public services during economic downturns. State policy-makers have taken major strides to offset revenue instability by the creation of the Education Stability Fund (2002) and the Rainy Day Fund (2007) but risks to major programs remain substantial in the event of future recessions. With the state economy now in recession, the adequacy of the state's reserve funds takes on added relevance and urgency.
- Oregon's General Fund budget has been forced out of balance in the past by passage of voter initiatives that either mandate new program expenditures without new revenue or reduce revenue without specifying offsetting revenue increases or desired program reductions.
- Because state revenue makes up roughly two-thirds of K-12 operating revenue, school finance remains especially vulnerable to the volatility of the personal income tax. The state's dominant role in financing K-12 education is a direct result of Measure 5 (1990), which reduced local property tax revenue for schools and required the state to replace the lost property tax dollars.
- Many decisions made by state government have long-term fiscal implications that are not properly accounted for in the current budget process. The state has a well-developed system of short-term expenditure and revenue analysis but does not systematically factor long-term trends such as demographic changes and structural revenue changes into the planning process.
- The state faces immediate revenue needs in transportation and health care due to developments in dedicated revenue sources that put those critical program areas at risk.
- Local government revenue (cities, counties and special districts) remains closely tied to the property tax. Assessed property values are restricted to 3% annual growth for existing property and the average assessment ratio in the county for new construction. This means that local revenue generally falls behind the growth in the cost of providing services.
- Property tax revenue is largely set by Measure 50 and property tax revenue growth is not closely linked to the rate of inflation. This means that local governments are put under significant stress when the inflation rate rises above 5% such as it has over the 2006-08 period.
- Property tax rates for local taxing districts (permanent rates) were determined when Measure 50 was enacted in 1997. Although many local governments can raise short-term option levies, a constitutional amendment would be required to raise these permanent rates (and to establish permanent rates for those local governments that did not have them in 1997) making it difficult for local governments to respond to institutional changes such as the phase out of federal timber payments to counties. However, Measure 50 does allow counties, with the approval of their voters to establish new taxing districts for services such as sheriff's patrols, libraries and agricultural programs.
- Measure 50 creates inequities in the property tax system by separating assessed property value from market value. Homeowners pay taxes based on their assessed value, not the market value of their property. This means that homeowners in high-growth real estate markets will tend to pay a lower percentage of the value of their home in taxes than those in low-growth real estate markets.
- Many government services are jointly provided by state and county governments. This means that fiscal stress at one level of government affects the other.

Short-Term Recommendations

The Task Force recognizes that the state is likely to be facing a deteriorating revenue situation in the immediate future because of the emerging recession and the instability of the revenue system. The Task Force recommends the following actions that can be adopted in the 2009 legislative session to help state and local governments manage the cyclical downturn and help stabilize the revenue system for the long-term.

- Establish a method for more reliable state revenue forecasting and more prudent budgeting; direct ending balances into the Rainy Day Fund. This proposal involves a change in how the state treats surplus revenue and will require a constitutional amendment that must be approved by voters.
- Apply a balanced budget rule to ballot initiatives. This recommendation calls for additional information about the fiscal consequences of initiatives to be included in the ballot title of initiatives that have a significant cost or significantly reduce revenues for other programs and services.
- Provide greater public access and input to the initiative process through increased legislative involvement.
- Reduce restrictions on local government's ability to raise revenue and refrain from new property tax exemptions or state mandates on local governments. This recommendation is directed at the Legislature and essentially says "do no harm" that will make local government's fiscal situation worse.
- Develop a systematic long-term budgeting process including long-term infrastructure plan. This proposal involves the development of 10-year projections of state government spending and revenue by the staffs of the Governor and the Legislature.
- Develop adequate revenue sources to meet the state's immediate needs in health care and transportation. The Task Force is recommending that the Legislature give high priority to consideration of revenue raising proposals from the task forces that the Governor has appointed to develop recommendations in these critical areas.
- Develop a process that engages the public in a discussion of options for changing the structure of Oregon's revenue system. The link between public services and revenues needs to be clearly understood by the public before proceeding to a discussion of revenue options. Without public engagement and acceptance any major proposal is unlikely to be successful.

Long-Term Recommendations

The Task Force recognizes that state and local governments will be focused on managing the challenges of an economic downturn in the coming months. However, revenue restructuring is a longer term proposition and long-run considerations are the key to evaluating options. A major initial consideration is the adequacy of the revenue system. The Task Force expressed concern about the adequacy of the current revenue system to fund needed services such as high quality education, infrastructure and the needs of an aging population over the long term both now and in the future. The Task Force did not have sufficient information to settle on an overall level of adequacy, but did acknowledge its critical role in any long-term revenue restructuring plan. The long-term recommendations are:

- Develop ways to increase the adequacy and flexibility of the local revenue system. The current local revenue system is inadequate to meet current and future needs. The Task Force's recommendations involve the following :
 - Options for diversifying local revenue away from the property tax.
 - Modifications of property tax limits (Measure 50) to better reflect real estate market conditions.
 - Options to replace declining federal forest payments.
 - Proposals to share state and local revenue sources.
- Evaluate the results of the public engagement process included in this report as a short-term recommendation. Use those results to determine what constitutes an adequate level of public services and the public's view toward any potential revenue that may be needed to fund that level.
- Continue to analyze tax restructure proposals based on their impact on the distribution of the tax burden, the state economy, the stability of the revenue system and administrative costs. The Task Force has a number of scenarios in the report that show how various combinations can be analyzed using these criteria. While the Task Force does not make a consensus recommendation for any of the combinations presented, it encourages the Legislature to continue evaluating and working with the various options and combinations to improve the revenue system for the long term.

This is a critical time for Oregon. Our ability to continue to provide the level of services and programs from high quality education kindergarten through university, to a transportation system that is adequate to support economic growth across the state, to a health care system that is ready to meet the demands of an aging population, to police and safety services that keep our communities safe and beyond, is stressed. At the state level, it is challenged by an unstable source of revenue that lacks adequate reserves to maintain services during economic downturns and is subject to significant influences through the initiative process. At the local level, the cost of providing basic services, including police, fire, streets and public health, is already challenged by a structural imbalance between revenues and the rising cost of doing business. The Task Force offers this report and these recommendations to provide information to the public and the legislature as well as to suggest actions that we can take now and in the future to preserve the ability of the state and local government to meet the needs of all Oregonians and provide for a brighter future for our communities, our families and our economy.

Chapter 1

Introduction

House Bill 2530

HB 2530 (2007) established the Task Force on Comprehensive Revenue Restructuring. The bill directed the Governor to appoint the Chair of the Task Force along with four members from the general public representing the major regions of the state, a member representing small business, a member representing large business and two members from organized labor. The Speaker was responsible for appointing four members from the House while the Senate President appointed four members from the Senate. These seventeen Task Force members constitute the voting members of the Task Force. The bill also designates the State Treasurer* and twelve members appointed by the Governor representing various groups and interests in the state as non-voting Task Force members. The bill directed the Chair of the Task Force to appoint a seven-member Advisory Council to provide technical analysis. Finally, the Legislative Revenue Office was assigned staffing responsibilities for the overall Task Force. The complete text of HB 2530 can be found in Appendix A.

HB 2530 directs the Task Force to develop a “blueprint for comprehensive revenue restructuring for local and state government.” The blueprint is to provide ways to promote a stable state and local government revenue flow, create positive economic benefits for the state and provide for a financial foundation that enhances the state’s global competitiveness. Within the blueprint the bill calls for a plan for revenue and economic competitiveness that includes tax restructuring that leads to a more stable revenue system, promotes agreements among different levels of government and that stimulates economic growth.

Following appointments by the Governor and Legislative Leadership the Task Force first met on November 29, 2007. The Task Force convened a total of 12 meetings, at the conclusion of which the Task Force issued its draft report. This was followed by five public meetings** around the state to discuss the draft report. A summary of the public meetings can be found in Appendix B.

*State Treasurer Randall Edwards served on the Task Force until his term expired January 5, 2009, just prior to the release of the final report. The Task Force appreciates Treasurer Edwards’s contributions.

**A 6th public meeting was scheduled for Tigard but was canceled due to inclement weather

Previous Tax Reform Efforts & Studies

By the end of the 1960s, the majority of states had revenue systems that had evolved into systems characterized by three major tax sources. Most states imposed a general sales tax and an income tax while reducing their reliance on the property tax. Property taxes became the primary tax source for local governments. After passing an income tax in 1929 to provide property tax relief, Oregon chose not to adopt a general sales tax as most states did in the 1930s. That left Oregon's revenue system dependent on comparatively high income and property taxes.

Prior to 1990, most major tax restructuring proposals were directed at the adoption of a sales tax, coupled with substantial property tax relief. The two most prominent proposals along these lines were Governor McCall's plan (defeated 59% to 41% by voters in 1973) and Governor Atiyeh's plan (defeated 78% to 22% by voters in 1986). In 1990, voters approved Measure 5 (52% to 48%) which limited property tax operating levies to \$15 per \$1,000 of market value. In an effort to restore revenue to the system the Legislature, working in conjunction with Governor Roberts, and after an extensive set of public meetings statewide developed yet another sales tax plan that also contained additional property tax relief. This proposal was referred to voters as Measure 1 in 1993 and defeated 75% to 25%.

In 1996, voters approved Measure 47 (52% to 48%), a constitutional amendment that limited assessed property value growth in addition to setting property tax rates. The language of the measure proved unworkable prompting the 1997 Legislature to refer Measure 50 to voters as an alternative. Measure 50 was designed to capture the key provisions that voters had adopted in Measure 47. Voters approved Measure 50 (56% to 44%) in the May 1997 primary election. Measure 50 reduced assessed values by 10% from their 1995-96 levels and limited future growth on existing property to 3% annually. It also established permanent rates for all taxing districts.

The approval of Measures 5 and 50 (explained in Chapter 2) moved Oregon from a relatively high property tax state to one near the middle of the states in property tax burden. This has had the effect of substantially muting public concerns over the property tax burden. It also made the state's revenue system even more dependent on the personal income tax. Concerns over the implications of this dependence and the consequences of a limited property tax system have dominated tax reform discussions since 1997.

The first thorough analysis of the post Measures 5 and 50 revenue system was Governor Kitzhaber's Review of Oregon's Tax System completed in 1998. The Governor appointed a technical committee and a policy committee consisting of citizens and experts to evaluate how the revenue system had changed in the wake of Measures 5 and 50. The policy committee's report emphasized the dangers of the state's over-reliance on the traditionally unstable personal income tax, especially to fund the state's kindergarten through 12th grade (K-12) education program. The report also noted the consequences for the local revenue system of dependence on a slow growing, initiative-constrained property tax. The policy committee recommended the establishment of a substantial reserve fund to counter the instability in the state revenue system and a series of steps such as abstaining from additional local revenue preemptions, state reimbursement for new property tax exemptions and increased revenue diversification in response to the stable but inflexible local revenue system.

Governor Kitzhaber's policy committee's warning of the dangers of revenue instability proved prescient as the 2001 recession and the bursting of the 1990s stock market bubble triggered the largest percentage reduction in state General Fund revenue since the 1930s. The effects of the recession also shifted the tax reform discussion toward a means of stabilizing the revenue system. The Legislature responded with formal tax reform committees following both the 2001 regular session and the 2003 regular session.

The “Revenue Options, School Funding & Accountability Task Force” issued a report in 2002 emphasizing broad principles for tax reform efforts to stabilize school funding. In 2004, the “Joint Interim Committee on Tax Reform” conducted a series of public meetings around the state to gather input on ways to make the tax system more stable and more equitable.

The Legislature also took substantive fiscal reform actions in response to the severe 2001-03 revenue contraction. In 2002 the Legislature referred Measure 19 to voters Measure 19, amending the constitution to transform the previously adopted Education Trust Fund into the Education Stability Fund. This fund was tapped to provide immediate revenue for schools and established as an ongoing reserve to which 18% of Lottery earnings (estimated at \$241 million in the current 2007-09 biennium) are directed. The 2007 Legislature further strengthened the state’s reserve position by establishing a new statutory Rainy Day Fund. The new fund received \$319 million from revenue that would have been returned to corporations through the 2% surplus kicker credit mechanism (discussed in Chapter 2) and will receive up to 1% of General Fund appropriations from the ending balance in future biennia. For a description of the reserve funds see Appendix C.

Report Outline

The Task Force on Comprehensive Revenue Restructuring began its analysis of Oregon’s revenue system by thoroughly reviewing these previous tax reform discussions and recommendations. The Task Force found these previous efforts useful in framing the problems associated with the current revenue system. In particular, the Task Force concluded that two findings from Governor Kitzhaber’s “Review of Oregon’s Tax System: Policy Recommendations” report released in January 1999 remain very much true today:

“Oregon is more reliant on the personal income tax for its tax revenue than any other state in the country. This tax is very sensitive to changes in economic conditions. Public finance experts consider it the most volatile of the major state-local revenue sources.” (1999 Report, p 3)

“Oregon’s local government revenue system remains highly dependent on the property tax. The property tax has been significantly altered by Measure 50. By limiting growth in individual property tax bills to 3 percent per year, overall property tax revenue is likely to grow slower than the economy over time. Moreover, property tax revenue will not keep up with increases in the inflation rate.” (1999 Report, p 30)

The Task Force found strong evidence supporting these concerns when analyzing recent fiscal trends in the state. In addition, other related findings were identified. These findings and supporting evidence can be found in Chapter 2. Chapter 3 discusses a series of short-term recommendations to address some of the problems caused by the findings. These recommendations are intended to be implemented in the 2009 Legislative session. Chapter 4 reviews broader long-term options for addressing the more fundamental structural problems embedded in Oregon’s revenue system.

CHAPTER 2

FINDINGS

Summary

Based on previous studies, updated analytical work and recent fiscal experience of state and local government in Oregon, the Task Force identified the following key findings:

- The state revenue system, dominated by the personal income tax, remains highly volatile over the short-term. This makes it difficult for the state to maintain an adequate level of public services during economic downturns. State policy-makers have taken major strides to offset revenue instability by the creation of the Education Stability Fund (2002) and the Rainy Day Fund (2007) but risks to major programs remain substantial in the event of future recessions. With the state economy now in recession, the adequacy of the state's reserve funds takes on added relevance and urgency.
- Oregon's General Fund budget has been forced out of balance in the past by passage of voter initiatives that either mandate new program expenditures without new revenue or reduce revenue without specifying offsetting revenue increases or desired program reductions.
- Because state revenue makes up roughly two-thirds of K-12 operating revenue, school finance remains especially vulnerable to the volatility of the personal income tax. The state's dominant role in financing K-12 education is a direct result of Measure 5 (1990), which reduced local property tax revenue for schools and required the state to replace the lost property tax dollars.
- Many decisions made by state government have long-term fiscal implications that are not properly accounted for in the current budget process. The state has a well-developed system of short-term expenditure and revenue analysis but does not systematically factor long-term trends such as demographic changes and structural revenue changes into the planning process.
- The state faces immediate revenue needs in transportation and health care due to developments in dedicated revenue sources that put those critical program areas at risk.
- Local government revenue (cities, counties and special districts) remains closely tied to the property tax. Assessed property values are restricted to 3% annual growth for existing property and the average assessment ratio in the county for new construction. This means that local revenue generally falls behind the growth in the cost of providing services.
- Property tax revenue is largely set by Measure 50 and property tax revenue growth is not closely linked to the rate of inflation. This means that local governments are put under significant stress when the inflation rate rises above 5% as it has over the 2006-08 period.
- Property tax rates for local taxing districts (permanent rates) were determined when Measure 50 was enacted in 1997. Although many local governments can raise short-term option levies, a constitutional amendment would be required to raise these permanent rates and to establish permanent rates for those local governments that did not have them in 1997. This makes it difficult for local governments to respond to institutional changes such as the phase out of federal timber payments to counties. However, Measure 50 does allow counties with the approval of voters, to establish new taxing districts for services such as sheriff's patrols, libraries and agricultural programs.

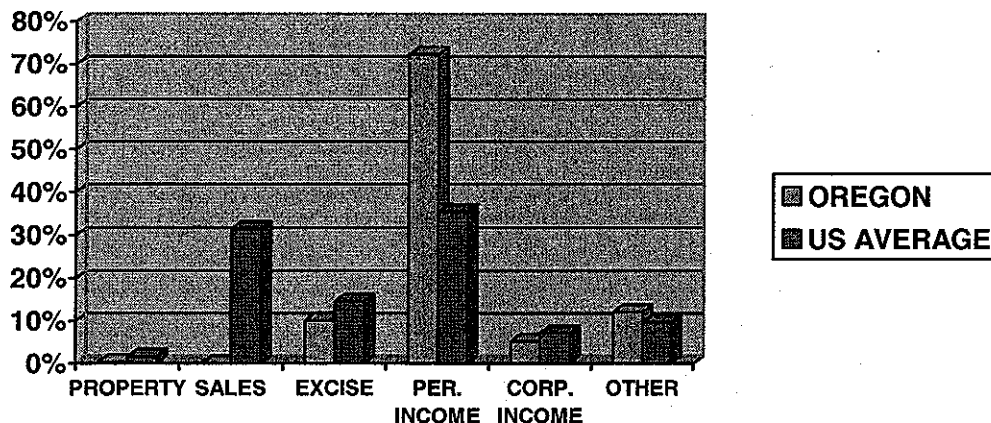
- Measure 50 creates inequities in the property tax system by separating assessed property value from market value. Homeowners pay taxes based on their assessed value, not the market value of their property. This means that homeowners in high-growth real estate markets will tend to pay a lower percentage of the value of their homes in taxes than those in low-growth real estate markets.
- Many government services are jointly provided by state and county governments. This means that fiscal stress at one level of government affects the other.

Key Finding: State revenue system is volatile.

Since the Kitzhaber Policy Committee report was released in January of 1999, state personal income tax revenue peaked along with the state economy and the stock market in 2000. Income tax revenue then experienced its largest decline since the 1930s in the 2001-03 recessionary period, before recovering sharply in the 2003-07 period. Now as the Legislature enters the 2009 session, income tax revenue is once again dropping sharply as the nation and the state fall deeper into another recession.

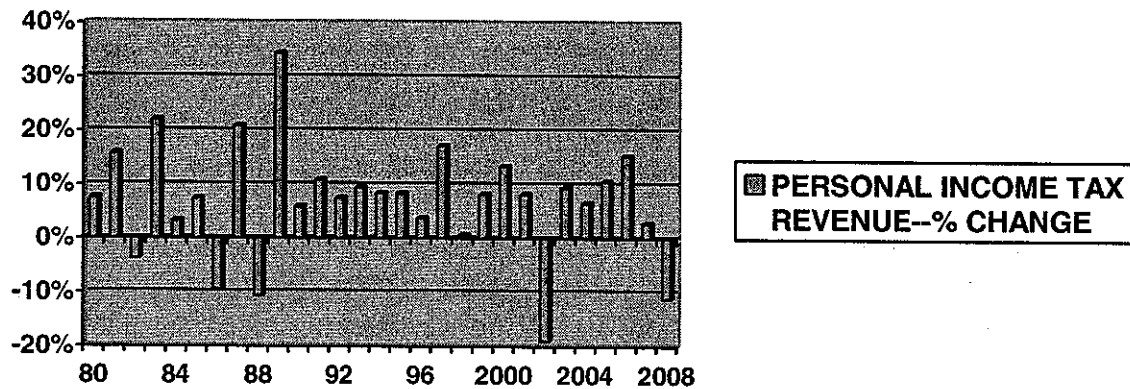
The state's dependence on the personal income tax becomes apparent when state taxes are broken down by source. Chart 2.1 shows Oregon state taxes by source compared to the national averages. Personal income taxes make up 72.3% of tax revenue for state government in Oregon. This is the highest percentage reliance on any single tax source among the 50 states.

Chart 2.1: State Tax Sources (percent of taxes from each source in 2006-07 fiscal year)



Historically the personal income tax has shown the greatest volatility compared to other major state and local tax sources (See Appendix H for comparison of the volatility of the major revenue sources over the past 20 years.) Chart 2.2 shows the annual volatility of personal income tax revenue in Oregon. The volatility of the personal income tax is due to its sensitivity to changes in the rate of growth of personal income. When the economy is expanding and personal income is growing rapidly under a graduated income tax system, a larger proportion of income is being taxed at the top rate (9% in Oregon), while the reverse is true during downturns in the economy when income is falling or growing slowly. Another factor contributing to volatility in state revenue is the 2% surplus kicker. The kicker requires that an income tax refund be mailed to taxpayers following any biennium in which revenue has exceeded the state's two-year budget forecast by 2% or more. These refunds reduce personal income tax revenue for the year in which they are sent out. A separate credit is calculated for corporate income tax revenue.

Chart 2.2: Annual Change in Personal Income Tax Collections



Fluctuations in personal income taxes have a major impact on the state's General Fund. Chart 2.3 breaks out General Fund revenue sources. Personal income taxes comprise 86% of General Fund revenue with corporate income taxes making up another 7%.

Chart 2.3: Sources of General Fund Revenue (2007-09 Biennium)

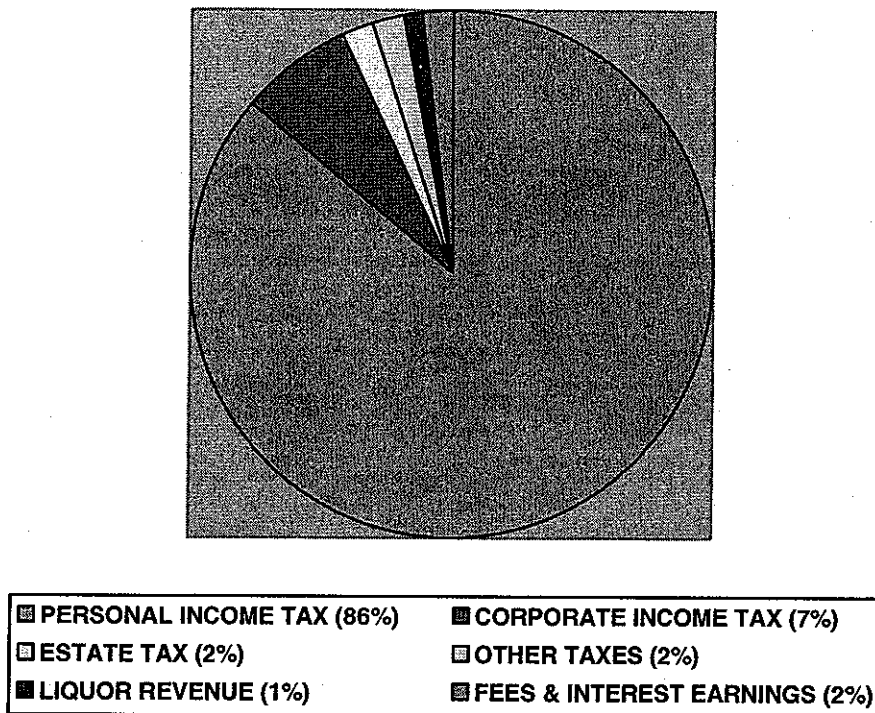


Chart 2.4: Breakdown of General Fund Expenditures (2007-09 Biennium)

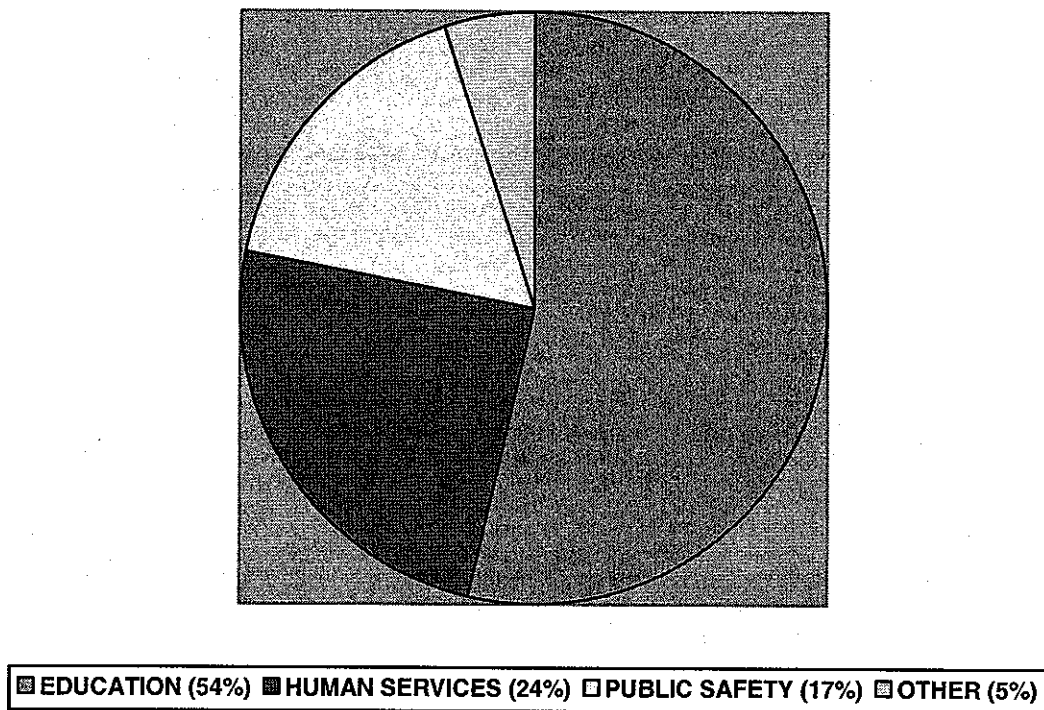


Chart 2.4 shows the allocation of General Fund revenue by major program area. Over one-half of General Fund revenue is devoted to education, including K-12, community colleges and higher education. Human services and public safety (including the state court system) are the other major program areas within the General Fund budget. Less than 5% of General Fund revenue went to all other programs outside these three areas in the 2007-09 budget.

The overwhelming importance of the volatile personal income tax to the General Fund translates into instability for General Fund revenue, and for the critical programs and services the General Fund supports. Chart 2.5 traces biennium-to-biennium fluctuations in General Fund revenue over the past 20 years. It is important to note that the 7.5% decline in revenue during the 2001-03 biennium incorporates \$450 million the state borrowed through the issuance of revenue bonds to balance the General Fund budget. Without this infusion of one-time revenue, scheduled to be paid back from Master Settlement Agreement tobacco funds through 2013, General Fund revenue during the biennium would have declined 12.0%.

Chart 2.5: General Fund Revenue Growth

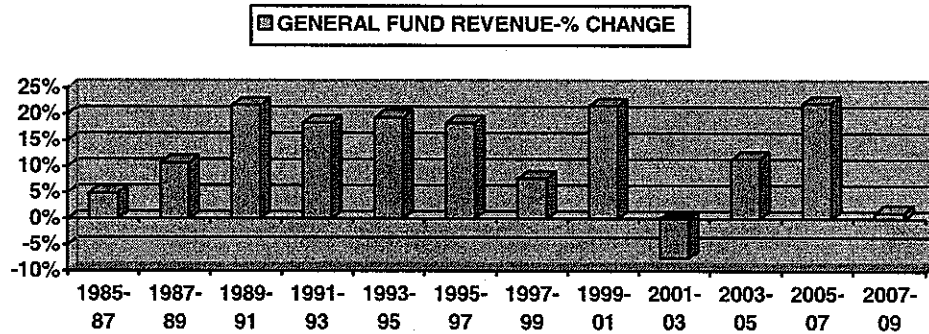
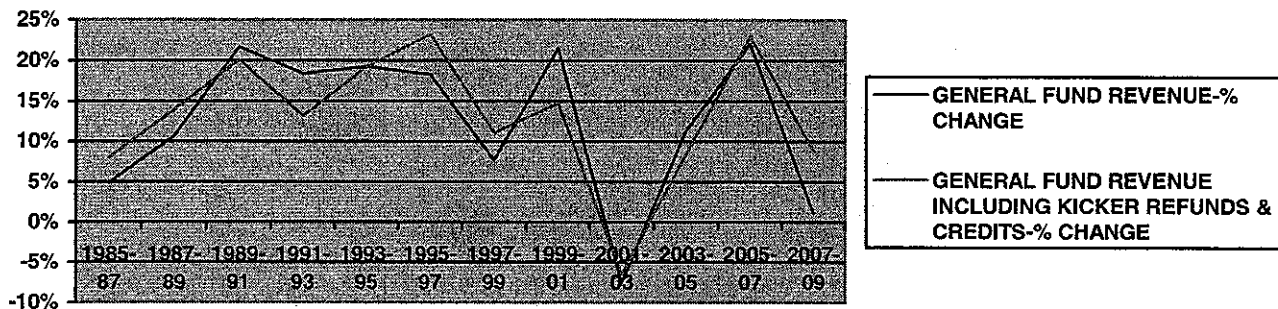


Chart 2.6: General Fund Revenue—Impact of Kicker Refunds/Credits on Volatility



As can be seen in Chart 2.6, the surplus kicker revenue limit does slow revenue growth during periods of high growth such as the 1990s but it also tends to reduce revenue further during recessionary periods such as the 2001-03 biennium and the current 2007-09 biennium, thereby exacerbating the impacts of recessions on the state General Fund. On average kicker refunds and credits have reduced General Fund revenue by \$222 million per biennium or 2.8% since the kicker was put into statute in 1979.

It was the combination of the sharp 2001 downturn and a 2% surplus kicker refund that left the Legislature in crisis management to rebalance the General Fund budget in 2002. Table 2.1 shows the relative impact of the downturn on Oregon tax revenue compared to other states. Only Alaska—almost totally dependent on oil and gas revenue—was harder hit on a percentage basis in the 2002 fiscal year. Both California and Massachusetts have relatively high personal income tax rates in addition to a sales tax.

Table 2.1: Oregon among Hardest Hit by 2001-02 Recession

FY 2002 COMPARED TO FY 2001	% CHANGE IN TAX REVENUE	RANK AMONG THE STATES
ALL STATES	-5.6%	--
ALASKA	-28.1%	50
OREGON	-20.3%	49
CALIFORNIA	-17.6%	48
MASSACHUSETTS	-14.6%	47

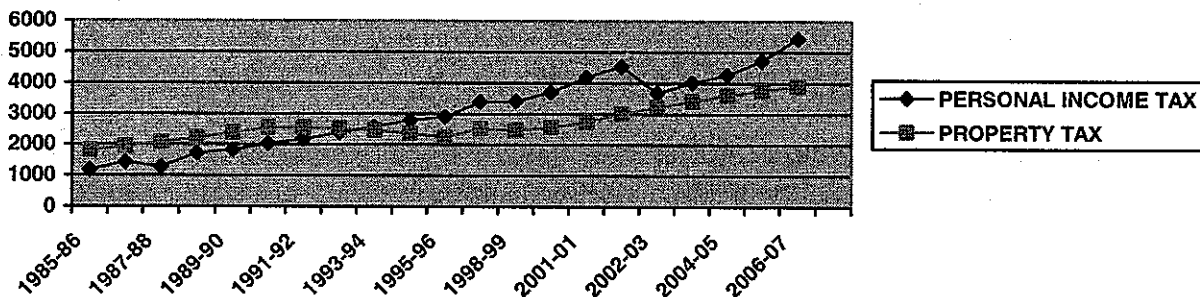
In summary, the state revenue system is highly dependent on the personal income tax. The personal income tax has grown rapidly during periods of strong economic performance such as the 1990s but has also turned down sharply when the economy weakens. It is this pattern of instability that prompted the Legislature to adopt the Education Stability Fund (2002) and the Rainy Day Fund (2007). For a description of these funds see Appendix C. The question of the adequacy of these reserve funds to protect programs during future downturns was discussed at length by the Task Force and the Advisory Council. The Task Force response to this issue is addressed in Chapter 3.

Key Finding: State's General Fund budget has been forced out of balance by voter initiatives

Voters approved a series of initiatives in the 1990's that have had a major impact on the state-local fiscal system. Most prominent of these for the state budget was Measure 5, approved in 1990. Measure 5 limited property tax operating levies to \$15 per \$1,000 of market value. K-12 schools and community colleges were limited to \$5 per \$1,000 under the constitutional measure. Most importantly for the state budget, the state was required to "replace" the property tax revenue lost by the schools.

Chart 2.7 shows how Measure 5 fundamentally changed Oregon's revenue system. Throughout the state's history, property taxes had been the largest tax in the state-local revenue system. Measure 5 changed that by reducing property tax levies over a 5-year period (1991-96). During this period property tax collections fell by 12%. It was also during this period that personal income tax collections first exceeded property tax collections in the state.

Chart 2.7—Personal Taxes vs. Property Taxes (Millions of \$)

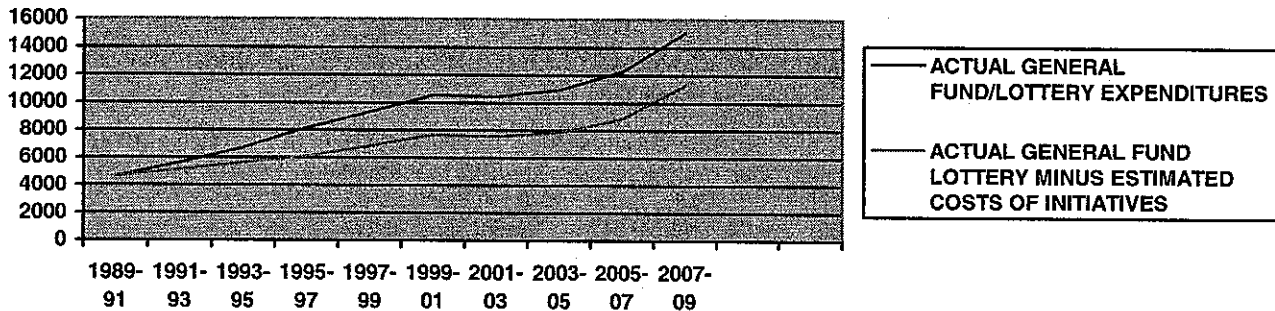


Although Measure 5 has had the largest impact of the voter approve initiatives on the General Fund budget, a series of other initiatives have also had, to differing degrees, the effect of mandating a portion of the state budget. These are:

- Measure 11 (1995)—requiring mandatory prison sentences for certain crimes.
- Measure 47 (1996) and Measure 50 (1997)—limiting property assessed value growth and establishing permanent tax rates for schools and other taxing districts. Expanded state mandate to replace reduced school property tax revenue.
- Measure 66 (1998)—dedicating 15% of Lottery revenue to parks and natural resources.
- Measure 99 (2000)—ensuring quality home care providers for elderly.

The cumulative effect of these initiatives on state discretionary spending—General Fund plus Lottery revenue—has been dramatic and can be seen in Chart 2.8. *Since 1990, roughly 50% of new General Fund/Lottery spending has been determined by the voter initiatives listed above.* The bulk of the additional spending directed by initiatives is associated with the mandate to support school operating budgets required by Measure 5 and reinforced by Measure 50.

Chart 2.8: Impact of Voter Initiatives on State General Fund/Lottery Spending



Key Finding: The state's increased role in funding schools has exposed school finance to the volatility of the state revenue system.

This finding is the logical consequence of the first three. Measures 5 and 50 shifted the predominant responsibility for funding local school operations from local property taxpayers to the state General Fund, which has left school funding subject to the volatile personal income tax. This shift can be seen in Chart 2.8. Prior to the passage of Measure 5, local property taxes funded roughly 70% of school operating budgets. The phase-in of Measure 5 completely reversed these proportions, leaving the state with roughly 70% of funding responsibility. Measure 50 locked in this relationship with permanent tax rates and limits on value growth.

Chart 2.9: Proportion of School Operating Revenue Funded by State

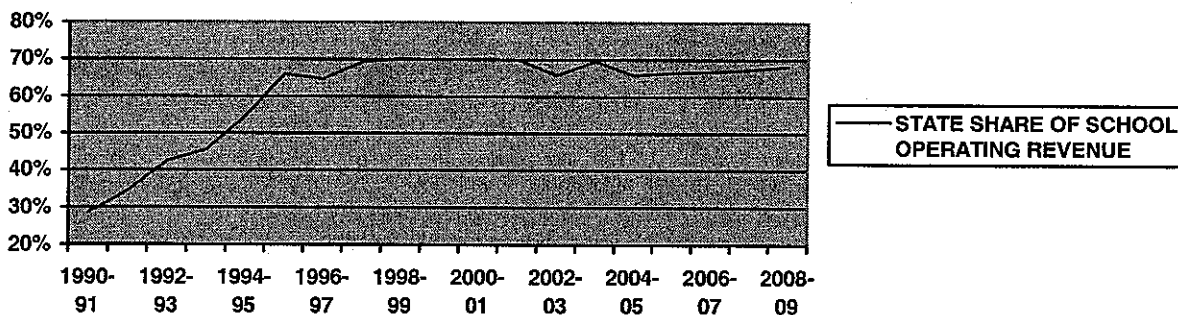
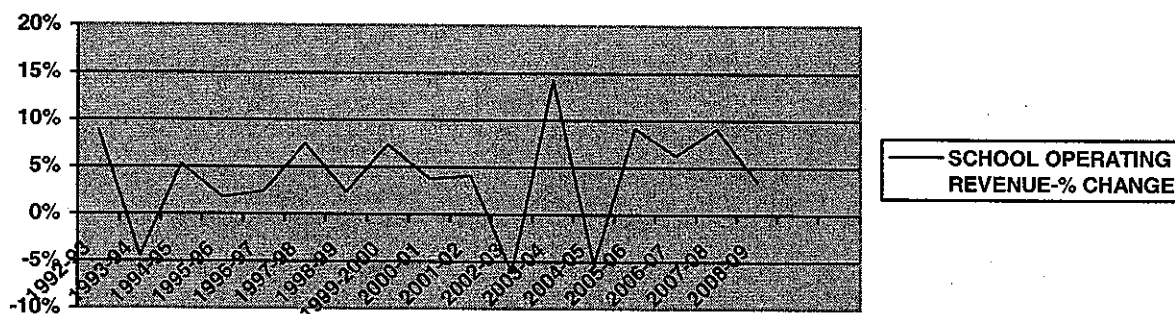


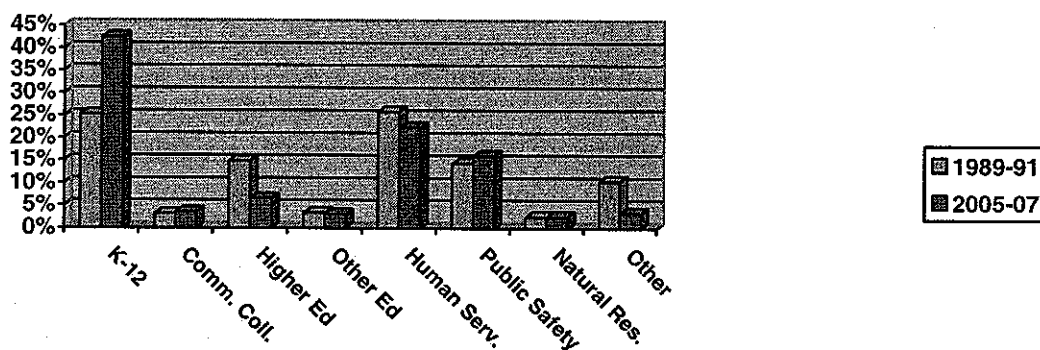
Chart 2.10 illustrates the volatility of school operating revenue on an annual basis since the state was assigned primary responsibility for school funding can be seen in Chart 2.10. The sharp declines in the 2002-03 and 2004-05 school years are directly attributed to the fiscal crisis brought on by the 2001 recession and the defeat of revenue packages to restore balance by voters (Measures 28 and 30).

Chart 2.10: Percentage Annual Change in School Operating Revenue



The shift in the uses of discretionary revenue (General Fund plus Lottery) triggered by the passage of Measure 5 has led to a corresponding decrease in the discretionary budget shares for other programs. Chart 2.11 shows how the budget changed between 1989-91 and 2005-07.

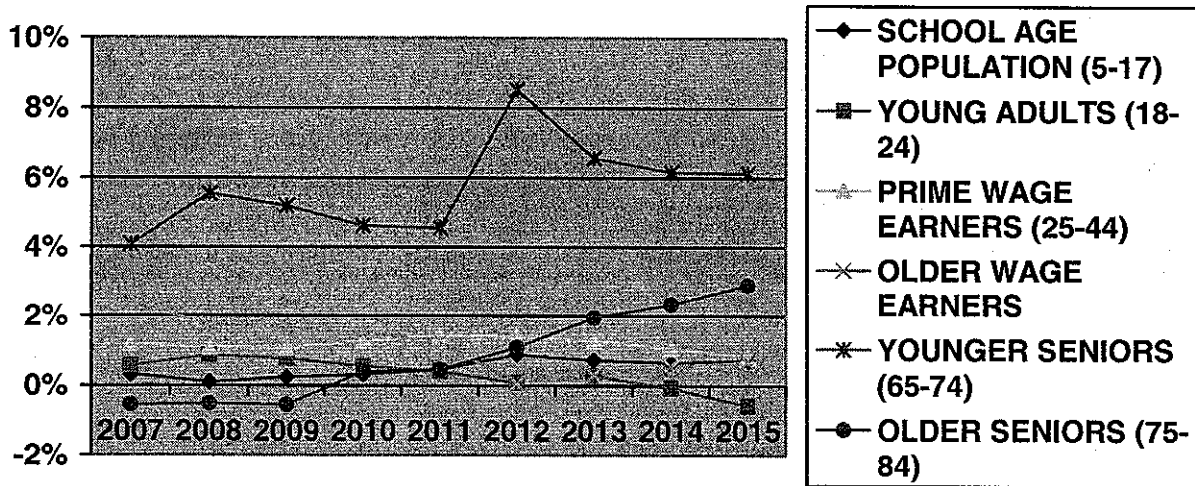
Chart 2.11: Shifts in Share of General Fund/Lottery Budget



Key Finding: The state's budget environment is influenced by long-term predictable forces. In addition, state fiscal decisions often have long-term spending & revenue implications.

The state's budget and spending process carried out by the Governor and the Legislature has tended to focus on short-term implications. While the volatility of the revenue system forces this short-term focus at times, longer term forces interact with these policies in broadly predictable ways. For example Chart 2.12 shows the current projections for the changing age composition of Oregon's population. The growth in the 65-74 year-old population has major implications for the state fiscal system. This group does not tend to be heavy users of state services but the 75+ population is far more important for the state human services budget, as they tend to require more state services. On the revenue side, many state tax expenditures such as exclusion of social security income from taxation and the elderly medical subtraction kick in when adults near 65.

Chart 2.12: Projected Annual Growth Rates for Various Age Groups in Oregon

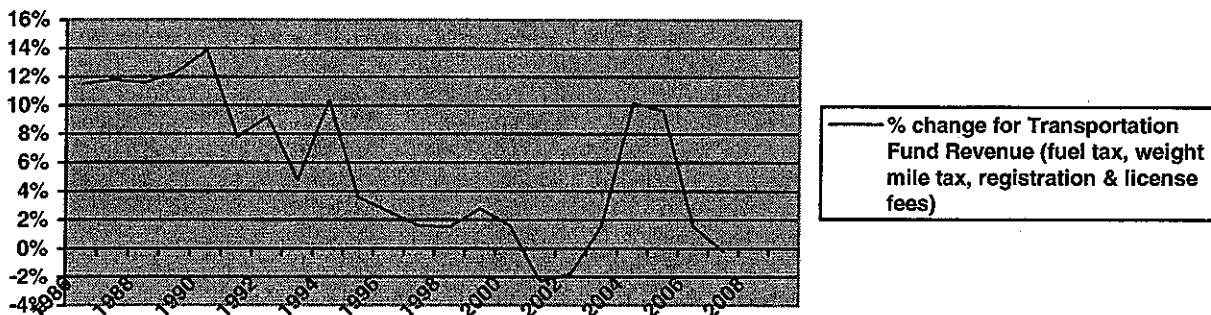


Key Finding: Funding for transportation and health care appear to be inadequate for the upcoming 2009-11 biennium due to developments in dedicated revenue sources.

As the state braces for the revenue impact of a recession on income tax revenue, two non-General Fund revenue sources are under severe strain for unrelated reasons.

Oregon's transportation system is funded separately with dedicated revenue sources. These sources are the fuel tax, the weight-mile tax on heavy vehicles and registration and license fees for vehicles. The history of these revenue sources over the past 20 years can be seen in Chart 2.13. These revenue sources tend to grow only when tax rates or fees are increased. A series of gas tax increases were implemented in the late 1980s and early 1990s followed by years of relatively flat revenue until 2003-04 when registration fee increases triggered revenue growth. Although vehicle miles traveled have increased with the state's population, cars and trucks are becoming more fuel efficient and the recent surge in gas prices limited revenue growth from fuel taxes. The weight-mile tax is more sensitive to vehicle miles traveled but the state constitution requires that the share of revenue coming from heavy vehicles must be consistent with the state's most recent cost allocation study. The flat-to-down trajectory of highway fund revenue is in sharp contrast to the trends in the cost of maintaining and expanding the state's transportation system. If the trend lines between revenue and expenditures continue to diverge, maintaining and expanding the state's transportation system will be increasingly problematic.

Chart 2.13: Transportation Fund Revenue Sources (Annual % Change)

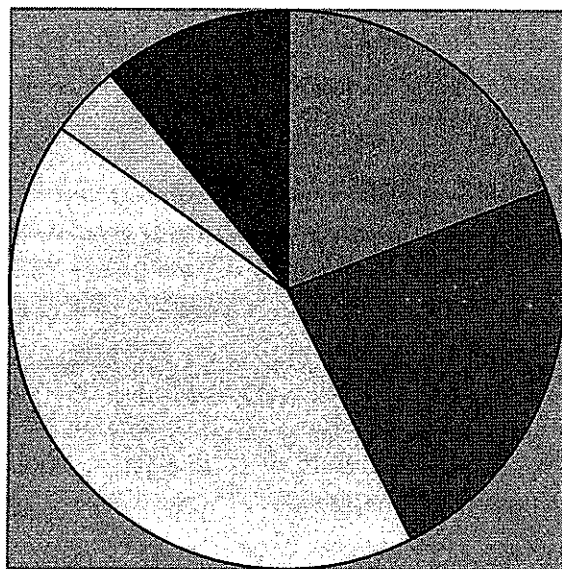


Oregon's existing medical provider taxes will expire at the end of the current federal fiscal year (October 2009). This revenue source generates roughly \$300 million per biennium and the current tax paid by Medicaid providers will no longer be eligible for federal matching revenue due to federal rule changes. This revenue plays a critical role in funding health care for the state's low income residents, and the loss of it would have major impacts on the provision of health care services.

Key Finding: Local government revenue remains closely tied to the property tax which is strictly limited by Measure 50.

Property taxes remain by far the largest tax source in the local revenue system. The distribution of property tax revenue can be seen in Chart 2.14. Slightly less than 50% of property tax revenue still goes to education, despite Measure 5 limits, while the remainder goes to cities, counties and other districts. Other districts include special districts such as fire and irrigation districts, and urban renewal districts.

Chart 2.14: Distribution of Property Tax Revenue (2006-07 Fiscal Year).



■ COUNTIES (19%)	■ CITIES (23%)	■ SCHOOLS & ESDs (42%)
■ COMMUNITY COLLEGES (4%)	■ OTHER DISTRICTS (11%)	

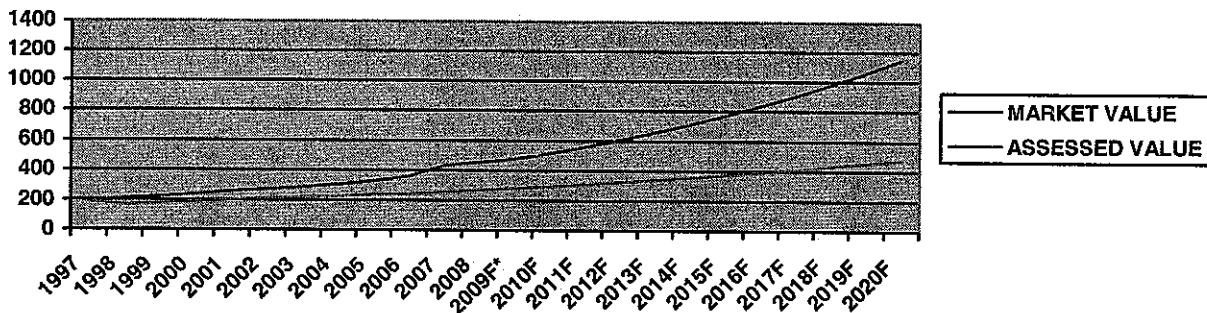
Voters, many of whom were disappointed in the degree of tax relief provided by Measure 5, approved Measure 47 in 1996. The key to voter dissatisfaction was the use of market value to determine the assessed value of property that had been retained by Measure 5. As market values increased, after the property tax reductions of Measure 5 had been fully implemented, property owners saw their property taxes increase as well. Measure 47 tied property taxes to a newly created "maximum assessed value," and limited assessed value growth to 3% annually, thereby divorcing assessed value from market value. When the language of Measure 47 proved unworkable, the Legislature referred Measure 50 as a replacement. Measure 50 established a new property tax system based on the principles approved by voters in Measure 47.

The key elements of Measure 50 are:

- Assessed value growth limited to 3% annually for existing property.
- When property is changed in a fundamental way such as the construction of a new building or a subdivision, the property comes on the tax roll as “exception value” equal to the “changed property ratio.” The “changed property ratio” is equal to the average assessment ratio (assessed value/market value) in the county for a class of property.
- Permanent rates based on existing tax levies in 1995-96 are set for all taxing districts.
- Voters can approve local options above the permanent rate for up to 5 years but cannot exceed the Measure 5 limits for any property.
- Local options above the Measure 50 permanent rates must be approved by a double majority (>50% approval in an election with >50% turnout) with the exception of the biennial November election. The number of elections in which the double majority does not apply was expanded to May and November of each year by voters in November 2008 (Measure 56).

Chart 2.15 illustrates the impact of separating assessed value from market value. Projections are based on the average annual change in market value since Measure 50 was approved (8.3%) and the average annual change in assessed value (4.9%).

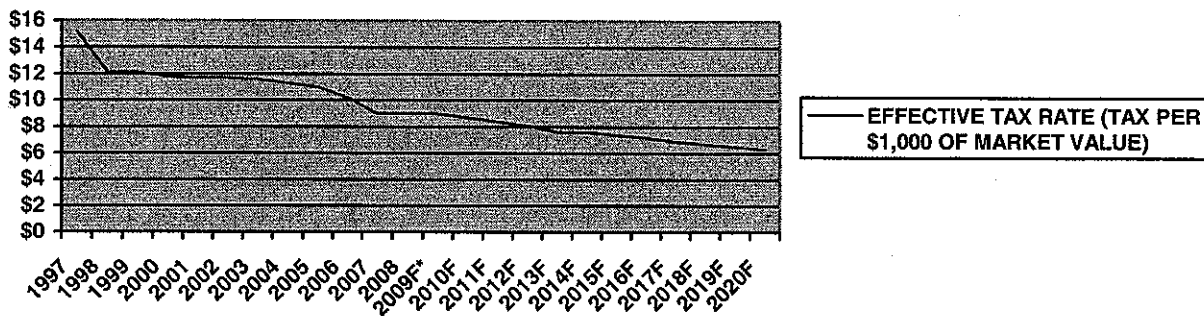
Chart 2.15: Historical and Projected Growth of Market and Assessed Property Value since Passage of Measure 50



*F denotes forecast value

By separating assessed property value from market value, Measure 50 is expected to lead to lower effective property tax rates over time. (Effective rate is defined as the property tax amount divided by the property's market value.) This will generally be the case as long as market value growth exceeds 3%. Chart 2.16 shows how effective tax rates are expected to fall based on the projections for market and assessed value in Chart 2.15. The effective tax rate fell sharply with the introduction of Measure 50, dropping from \$15.20 per \$1,000 of market value in 1997 to \$12.10 per thousand in 1998. The rate of decline since that time has been determined by the difference between market value growth and assessed value growth. By 2007, the effective tax rate had fallen to \$9.00 per \$1,000 of market value. It is projected to fall to \$6.30 per \$1,000 in 2020.

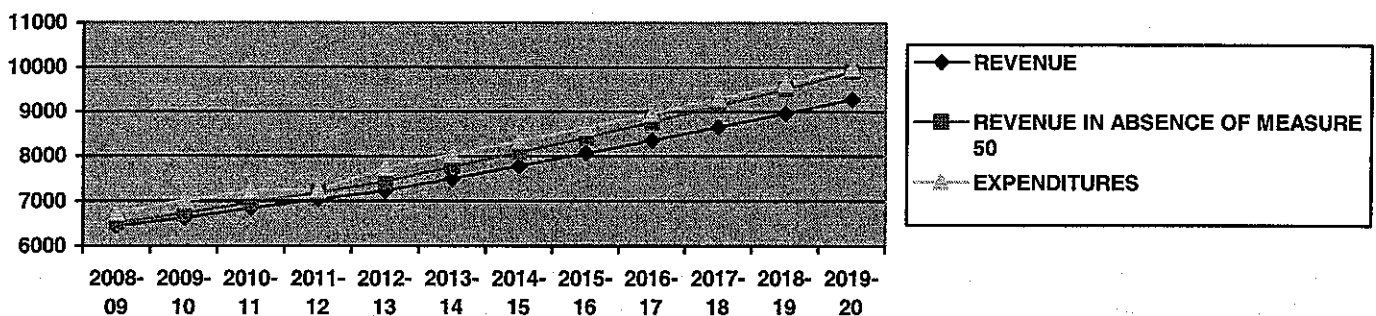
Chart 2.16: Measure 50 Means Falling Effective Property Tax (\$ per \$1,000 of market value)



*F denotes forecast

The downward drift of the effective property tax rate has put continuous fiscal pressure on city and county governments. To get an understanding of how counties and cities have been affected by this trend, the Task Force requested a long-term fiscal projection for cities and counties as a whole. Using audited data from all 36 counties and cities accounting for 88% of total city population, the Association of Oregon Counties and the League of Oregon Cities tabulated revenue and expenditure data for the most recent period available. These data served as the base year (2005-06 for counties and 2006-07 for cities). Projections for revenue and expenditures were then developed by the Legislative Revenue Office. These data are projected forward using known inflation rates and estimated revenue to the 2007-08 base year. Chart 2.17 shows that current service expenditures, largely driven by population growth and inflation, are expected to grow faster than revenue. By 2019-20 current service expenditures are expected to exceed current law revenue by \$702.2 million. An alternative revenue projection is also calculated assuming that Measure 50 is not in place and property tax levies grow 6% annually. This alternative shows that the gap between revenue and expenditures shrinks considerably in the absence of the limiting effects of Measure 50 on property tax revenue.

Chart 2.17: Long-Term City & County Fiscal Position under Trend Projections (in millions of \$)



Key Finding: The local fiscal system is put under significant stress when the inflation rate rises.

In order to develop long-term fiscal projections for city and county governments as a whole, each of the revenue and expenditure categories in Table 2.2 is projected forward using variables from the state economic and demographic forecast (September 2008). The projections rely heavily on inflation forecasts using various deflators for specific GDP components from the national economic forecast upon which the state forecast is based. The most common inflation measure used is the state and local government deflator. Overall state population projections are also used extensively to estimate growth in demand for services and growth of the revenue base. For a complete list of the variables used to project each of the categories see Appendix D.

Table 2.2: Base Year Revenue and Expenditure Estimates for Cities and Counties

	2007-08 FISCAL YEAR (\$ IN MILLIONS)
<i>REVENUE</i>	
PROPERTY TAX	\$1,740.5
HOTEL/MOTEL	54.3
OTHER TAXES & ASSESSMENTS	427.4
LICENSE, PERMITS & FINES	407.0
CHARGES FOR SERVICES	595.0
SYSTEM DEVELOPMENT CHARGES	85.5
FRANCHISE FEES	172.7
INTERGOVERNMENTAL REVENUE	1,685.3
FEDERAL FOREST PAYMENTS	203.1
INTEREST EARNINGS	130.3
MISCELLANEOUS	324.7
BOND PROCEEDS	368.4
TOTAL REVENUE	6,190.3
<i>EXPENDITURES</i>	
GENERAL GOVERNMENT	859.9
PUBLIC SAFETY	1,849.1
TRANSPORTATION	752.6
HEALTH	942.2
COMMUNITY DEVELOPMENT	420.8
CULTURAL & EDUCATION SERVICES	236.2
PARKS & NATURAL RESOURCES	180.4
CAPITAL OUTLAY	589.9
DEBT SERVICE	409.5
MISCELLANEOUS	55
TOTAL EXPENDITURES	6,295.7
NET FISCAL POSITION	-100.7

The baseline data shows that property taxes and intergovernmental revenue (primarily from the state), are the two major sources of revenue for cities and counties. On the expenditure side, public safety and public health are the largest categories. The extrapolations show that the cities and counties have a negative \$100.7 million fiscal position in the 2007-08 base year. This means that cities and counties as a whole were required to go into reserves or reduce expenditures by cutting or eliminating programs and services--or both--in order to balance their budgets for the base year. The primary reason for the current fiscal pressure is that costs are rising faster than local government revenues. The state and local

government deflator, designed to measure inflation for the market basket of goods and services purchased by governments, increased 5.1% in 2007 and is projected to increase 6.4% in 2008. It is important to note that the future fiscal position for cities and counties is highly dependent on the assumed inflation rate. The baseline forecast assumes that the recent resurgence of inflation is temporary and that overall inflation will return to the 2 to 2.5% range. The baseline forecast for the state and local government deflator (used extensively in the projections) is forecast to drop from 6.4% in 2008 to 2.7% in 2009 and average between 2 and 2.5% annually through the remainder of the forecast. This would tend to keep property tax revenue growth relatively close to the increasing cost of services. To see the importance of this assumption, the Task Force examined an alternative scenario in which inflation, as measured by the state and local government deflator drops back to 5.1% (the rate for both 2006 and 2007) and remains there through 2019-20. Chart 2.18 shows the impact of the alternative inflation assumption on the city/county fiscal position.

Chart 2.18: Long-Term City and County Fiscal Position under Higher Inflation Assumptions
(in millions of \$)

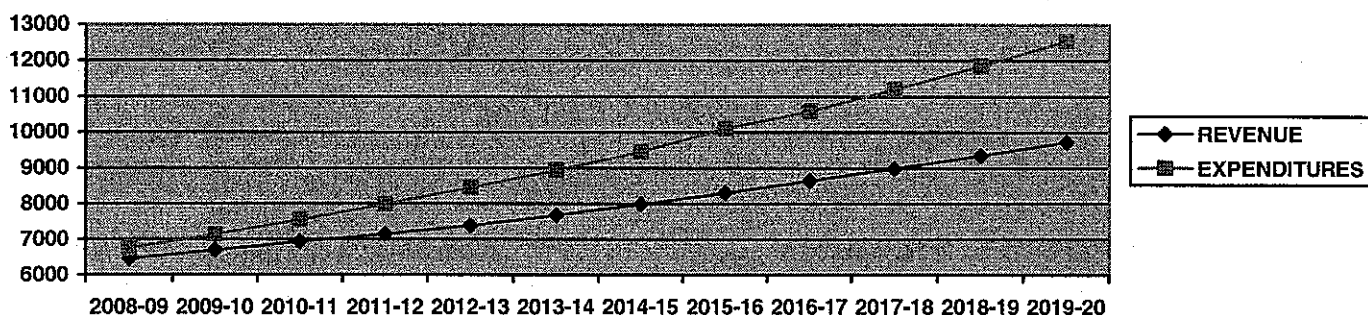
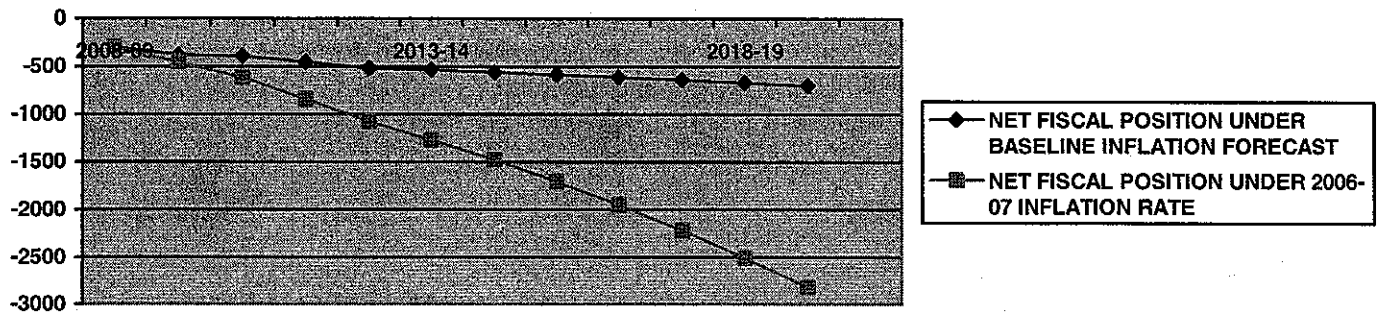


Chart 2.18 compares the city and county net fiscal position for the baseline projections with the alternative scenario based on the higher 5.1% inflation assumption. Under this scenario, current service expenditures continually outpace revenue. The net fiscal position of the county-city system deteriorates annually reaching *minus* \$2.8 billion by the 2019-20 fiscal year. This is because assessed property values do not respond to the higher inflation environment—property tax revenue growth remains locked in at 4.5% per year regardless of the inflation rate. This scenario shows the risk that higher inflation poses for the relatively inflexible county and city revenue system.

Chart 2.19 compares the local government fiscal gap estimates under the two inflation scenarios.

Chart 2.19: Fiscal Gap Estimates under the Baseline Inflation Assumptions and the Higher 2006-07 Inflation Rates (in millions of \$)



Key Finding: Permanent property tax rates were locked into the constitution based on the fiscal realities of 1997 and do not reflect changes since then.

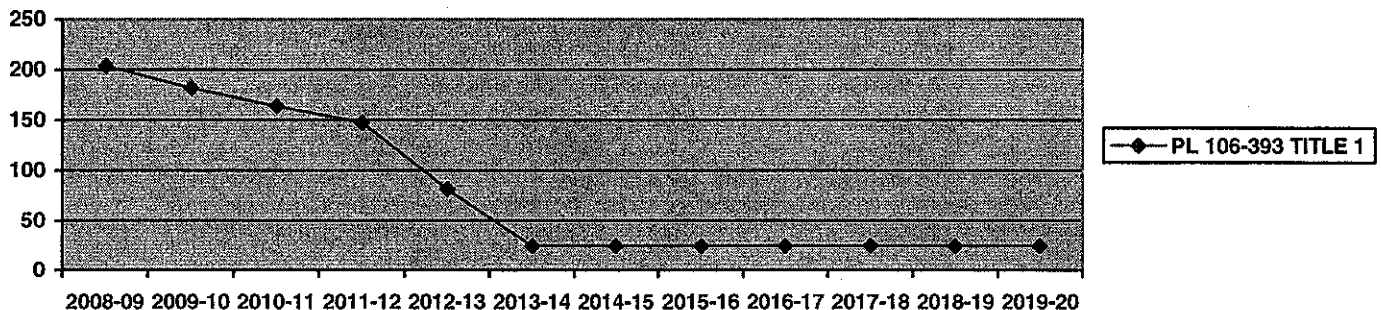
When Measure 50 was approved by voters in 1997 it contained permanent property tax rates for all taxing districts. The permanent rates for counties were based on the rates in existence at the time. This meant that the wide variation in existence at the time was locked into the constitution. Historically, one factor causing divergent county property tax rates has been the amount of federal timber receipts available for individual counties. Table 2.3 shows the variation across the state in county permanent tax rates. Counties with relatively low permanent tax rates do have greater room for raising 5-year local option levies, but subject to voter approval. On a statewide basis, counties could roughly double their property tax revenue if all approved local option levies. Counties have used their authority under Measure 50 to establish special taxing districts in recent years. Examples of newly established districts include a public safety district in Deschutes County, an agricultural extension district in Douglas County and a library district in Clackamas County.

Table 2.3: Permanent Tax Rates by County

COUNTY	RATE PER \$1,000 OF ASSESSED VALUE
BAKER	\$3.7286
BENTON	2.2052
CLACKAMAS (RURAL)	2.9766
CLACKAMAS (CITY)	2.4042
CLATSOP	1.5338
COLUMBIA	1.3956
COOS	1.0799
CROOK	3.8702
CURRY	0.5996
DESCHUTES	1.2783
DOUGLAS	1.1124
GILLIAM	3.845
GRANT	2.8819
HARNEY	4.5016
HOOD RIVER	1.4171
JACKSON	2.0099
JEFFERSON	3.5662
JOSEPHINE	0.5867
KLAMATH	1.7326
LAKE	3.7619
LANE	1.2793
LINCOLN	2.8202
LINN	1.2736
MALHEUR	2.5823
MARION	3.0252
MORROW	4.1347
MULTNOMAH	4.3434
POLK	1.716
SHERMAN	8.7141
TILLAMOOK	1.4986
UMATILLA	2.8487
UNION	2.8515
WALLOWA	2.5366
WASCO	4.2523
WASHINGTON	2.2484
WHEELER	8.5266
YAMHILL	2.5775

Federal timber payments are clearly a factor influencing permanent county tax rates. For example, two of the most dependent on federal revenue: Curry and Josephine Counties, have the lowest permanent rates in the state at roughly 60 cents per \$1,000 of assessed value. Following a great deal of uncertainty, Congress recently approved (in October 2008) a 4-year extension of the federal timber payment program. The extension calls for a decline in county payments with no guarantee of an extension following the 4-year period. Title 1 timber payments (from both Forest Service Lands and O & C Lands) are projected to drop from \$203.8 million in 2007-08 to \$182.1 million in 08-09, \$163.8 million in 09-10, \$147.7 million in 11-12 and \$81.5 million in 12-13 before dropping off to the residual level of \$24.5 million through the remainder of the forecast horizon. In effect, the extension moves the county fiscal crisis out into the future but does not avoid it. Chart 2.20 traces the projections for federal timber payments to counties through 2020.

Chart 2.20: Projected Federal Timber Revenue for Counties (in millions of \$)



The expected phase-out of Federal timber payments will have a major impact on a number of counties especially those with low permanent property tax rates. The inflexibility created by Measure 50 makes it difficult for these counties to respond to a new fiscal environment without severe cuts in programs and services—and it is questionable whether some counties will be able to make large enough cuts to balance their budgets and remain viable.

Key Finding: Measure 50 creates inequities among taxpayers by separating assessed value from market value.

Prior to 1997, residential property was assessed at market value. After a decade under Measure 50, residential property is now assessed at 57% of real market value (2007-08) on average across the state. However, the assessment ratio varies widely both within and across districts. Some homeowners are assessed much closer to market value than the statewide average while others are well below the 57 percent statewide average. This creates situations where taxpayers with equally valued homes (market value) pay different tax amounts or taxpayers with higher valued homes pay an equal or lesser amount than nearby homeowners with lesser valued homes. Treating taxpayers in equal financial circumstances equally is a basic principle of taxation called horizontal equity. Measure 50 creates a system where this principle will be increasingly violated

Key Finding: Because of the linkage in service provision between state government and the counties, fiscal stress at one level of government affects the other.

The funding of schools and transportation are two key areas where state and local government revenue systems overlap. But there are many other areas as well. Table 2.4 shows areas where the state and counties jointly provide services. The table is based on results of the 5520 project directed by the 2005 Legislature in a budget note that accompanied passage of SB 5520. The budget note directed the counties and the Legislative Fiscal Office to gather information about the eight shared services listed in the table. The results of the study highlight the interconnection between the state and local fiscal system and the importance of considering the state-local revenue system as a whole. Stress in the state revenue system causes fiscal stress for local governments, and the reverse is true as well.

Table 2.4: Source of Funding for State and County Shared Services

SERVICE—2003-05 BIENNIUM	COUNTY	STATE	OTHER REVENUE*
PROPERTY TAX ASSESSEMENT & COLLECTION (\$80 million)	55%	34%	11%
COMMUNITY CORRECTIONS (\$297 million)	20%	60%	20%
DISTRICT ATTORNEY (\$144 million)	70%	7%	23%
ECONOMIC DEVELOPMENT (\$212 million)	51%	12%	37%
JUVENILE SERVICES (\$219 million)	68%	17%	15%
MENTAL HEALTH (\$545 million)	11%	29%	60%
PUBLIC HEALTH (\$404 million)	27%	11%	62%
VETERANS SERVICES (\$8 million)	63%	10%	27%

*Other revenue includes federal grants & contracts and fees.

CHAPTER 3

SHORT TERM RECOMMENDATIONS

The Task Force developed a series of short-term recommendations based on the findings detailed in Chapter 2. Throughout its discussions, the Task Force remained focused on the two fundamental weaknesses of the revenue system: instability at the state level and inflexibility at the local level. The following recommendations are intended to serve as guidance for the Governor and Legislature for the 2009 session. These short-term recommendations do not entail fundamental reform of the revenue system but they do address critical ways to strengthen and further stabilize our current system. The first recommendation regarding reserve funds is particularly relevant as the state finds itself in another recession, facing the prospect of a significant revenue shortfall. Several options for more fundamental long-term changes in the system are addressed in Chapter 4.

Summary

The short-term recommendations are:

- **Establish a methodology for more reliable forecasting and more prudent budgeting; direct ending balances into the Rainy Day Fund.**
- **Apply a balanced budget rule to ballot initiatives.**
- **Provide greater public access and input to the initiative process through increased legislative involvement.**
- **Reduce restrictions on local government's ability to raise revenue and refrain from approving any new property tax expenditures or state level mandates on local governments.**
- **Develop a systematic long-term budgeting process including long-term capital spending plan.**
- **Develop adequate revenue sources to meet state's immediate critical needs in health care and transportation.**
- **Establish an ongoing process to systematically engage the public in determining the desired level of public services and the best way to pay for providing these services.**

Recommendations: Discussion and Explanation

Establish a methodology for more reliable forecasting and more prudent budgeting; direct ending balances into the Rainy Day Fund.

The Task Force recommends that the Legislature prepare a joint resolution to amend the state constitution for consideration by voters. The constitutional amendment should contain the following elements:

- Place the new 2007 Rainy Day Fund in the constitution
- Require the Governor to develop a point estimate for corporate income tax revenue and all other General Fund revenue and a range for both estimates.
- Specify that the range is based on historic forecasts compared to actual revenue.
- Require all revenue above the top of the forecast range to be returned to taxpayers
- Require revenue that exceeds the point estimate up to the top of the range to go into the Rainy Day Fund unless fund is full.
- Increase the cap on the Rainy Day Fund from 7.5% to 10% of General Fund revenue in the prior biennium.
- Specify that when the Rainy Day Fund cap is reached, revenue above the cap is returned to taxpayers. When making deposits into the fund, corporate income tax revenue above the point estimate is calculated first, then all other General Fund revenue.
- Put the current statutory Rainy Day Fund triggers in the constitution.
- Put the 2/3 limit for the amount that can be withdrawn in a single biennium in the constitution but change the date from the beginning of the biennium to the beginning of the fiscal year.*
- Put the statutory ending balance calculation (up to 1% of prior biennium appropriations) into the constitution.

Explanation: The Task Force spent considerable time examining the consequences of the 2001 recession. There was agreement that the state should avoid the disruptive program cuts that occurred in the 2001-03 and 2003-05 biennia, particularly the cuts in school budgets. The Task Force also recognized the need to avoid a recurrence of the situation that occurred in 2003, when the state issued \$450 million in appropriation credit bonds in order to balance the 2001-03 budget. These bonds will not be fully paid off until 2013.

The Task Force reviewed the details of the state's two reserve funds (see Appendix C) created in response to the 2001 downturn and asked the Advisory Council to analyze the adequacy of these funds to protect state programs in future recessions. The Advisory Council responded with the following recommendations:

- The target for the reserve funds (the Education Stability Fund plus the Rainy Day Fund) saving rate should be to maintain *average* growth in spending during the *average* recession.
- Meeting the foregoing target would require a savings rate between 3% and 4% of General Fund revenue during expansions.
- The maximum for the reserve funds, taken together, should be 12% to 15% of the biennial budget.
- The current policy of adding the General Fund ending balance up to 1% of General Fund appropriations should be continued. However, historical analysis shows that this method would not be sufficient to fully fund the current Rainy Day Fund.
- Sources should be identified that would provide an additional 0.5% to 1.5% of General Fund revenue on average during periods of economic expansion.

- One proposal is to change the forecast method to allow for any revenue up to one standard deviation above the current forecast method to be allocated to the current Rainy Day Fund. Historical analysis shows that this change would have restored the Rainy Day Fund within two biennia of recent recessions, and it is recommended as the most promising method of additional funding.

For the complete text of the Advisory Council recommendations see Appendix E.

*Some Task Force members expressed concern that putting the 2/3 withdrawal limit into the constitution along with the 3/5 vote requirement could be too restrictive on access to the Rainy Day Fund; others felt it was important to substantially retain the negotiated elements of the 2007 Rainy Day Fund legislation. The Task Force recommends further legislative discussion of this issue

Table 3.1 shows the historical simulation of how the proposed changed in forecast methodology would affect reserve funds referred to by the Advisory Council:

Table 3.1: HISTORICAL SIMULATION BASED ON PROPOSED FORECAST METHODOLOGY CHANGE: RAINY DAY FUND DEPOSITS IN MILLIONS OF \$

BIENNIUM	81-83	83-85	85-87	87-89	89-91	91-93	93-95	95-97	97-99	99-01	01-03	03-05	05-07
<i>GENERAL FUND EXCEPT CORP</i>													
BUDGET EST	2,704	2,887	2,915	3,302	4,145	5,063	5,797	6,533	7,567	9,113	10,195	10,199	10,827
ACTUAL	\$2,641	2,976	3,139	3,477	4,331	5,123	5,960	7,047	7,736	9,367	8,946	9,797	11,898
%DIFFERENCE	-2.3	+3.1	+7.7	+5.3	+4.5	+1.2	+2.8	+7.9	+2.2	+2.8	-12.3	-3.9	+9.9
RDF DEPOSIT	0	89	163	175	186	60	164	366	168	255	0	0	606
<i>CORPORATE REV</i>													
BUDGET EST.	348	285	291	288	320	337	409	428	658	799	860	540	500
ACTUAL	249	299	298	325	297	355	576	684	589	755	420	641	844
%DIFFERENCE	-28.9	+4.7	+2.3	+12.6	-7.2	+5.3	+40.9	+59.8	-10.4	-5.5	-51.1	+18.7	+68.8
RDF DEPOSIT	0	13	7	36	0	18	130	137	0	0	0	101	160
<i>RDF CALC</i>													
TRIGGERS MET?	YES*	NO	NO	NO	YES*	NO	NO	NO	NO	NO	YES*	YES*	NO
1% ENDING BALANCE DEPOSIT	0	28.6	27	0	37.4	45.3	55	0	0	0	101	96.7	102.2
RDF BALANCE**	0	130.7	334.2	373.9	135.7	265.7	628.1	742.7	878.5	1,010	366	153	1,028
% OF GENERAL FUND	0	4.2	10.0	10.0	3.0	4.8	9.8	10.0	10.0	10.0	3.8	1.5	8.8
PERSONAL KICKER REFUNDS	0	0	61	0	0	0	149	0	0	0	0	0	465
CORPORATE KICKER CREDITS	0	0	0	0	0	0	37	119	0	0	0	0	185

*No deposits are assumed to be made when triggers are met.

** Assumes 10% cap.

The historical simulation covers the 1981-83 biennium through the 2005-07 biennium. Deposits to the Rainy Day Fund are up to one standard deviation of the forecast error for the General Fund. The calculation is done separately for corporate income tax revenue just as is current done for the 2% surplus kicker calculation. The standard deviation, a measurement of the difference between actual revenue and forecast revenue, is based on the forecast error for the 13 biennia covered in the simulation. One standard deviation for all non-corporate General Fund revenue is 5.6%. For the corporate income tax forecast, one standard deviation is equal to 35.6% of the forecast. Revenue above the forecast but less than one standard deviation is assumed to be deposited into the Rainy Day Fund.

The simulation shows that the 10% cap is consistently reached within two biennia of when one of the triggers has been met for withdrawing funds from the Rainy Day Fund balance.

The Task Force believes that approval of this recommendation would substantially improve the state's reserve fund position, both with regard to the adequacy of the combined funds as well as the viability of the method for rebuilding the reserve funds (particularly the Rainy Day Fund) in the event of a withdrawal. This recommendation, if adopted, would significantly mitigate the downward volatility of the state revenue system, thereby making the state better able to maintain a more consistent level of critical programs and services without resorting to borrowing or increases in taxes and fees in the event of future economic downturns.

Apply a balanced budget rule to ballot initiatives.

The Task Force recommends that the 2009 Legislature enact legislation amending current statutes to do the following:

- Require the ballot titles of initiative measures to include a declaration of significant fiscal or revenue impact when they, if enacted, will have a significant unbudgeted fiscal or revenue impact that will require eliminating or reducing funding for current programs and services.
- Incorporate financial impact statement into ballot title where appropriate.
- Establish a dollar amount (indexed for inflation) establishing what constitutes a "significant unbudgeted fiscal or revenue impact."

Explanation: The Task Force applauds recent legislation (2005) that increased the latitude given to the Financial Impact Committee (consisting of the State Treasurer, Secretary of State, Director of the Department of Revenue and the Director of the Department of Administrative Services) that examines the revenue and fiscal impacts of initiative measures to include secondary fiscal and economic effects in their voter's pamphlet statement. However, the Task Force recommends that further efforts need to be made that highlight for voters the fiscal consequences of ballot measures. The November 2008 ballot had Measures (58, 59, 60, 61 and 62) that had a potential combined fiscal impact of \$2.165 billion (13%) on the 2009-11 General Fund-Lottery budget. The impact of any of these measures on the state budget, if adopted, would have been significant. The cumulative effect of more than one would have been substantially more so. The fiscal or revenue impact of a ballot measure is important information that should be called to voters' attention when they are asked to vote on it.

In developing its recommendation the Task Force reviewed the work of a National Conference of State Legislatures committee which issued a report in 2002. The report emphasized the potential budget disruptions caused by initiatives that either mandate new spending without a revenue source or reduce revenue without identified alternative revenue or spending reductions. The study cited 11 states with various laws designed to establish restrictions on imposing fiscal policies through the initiative process. See Appendix F for the list of states with restrictions.

Provide greater public access and input to the initiative process through increased legislative involvement.

Explanation: In its 2002 report on the legislative and referendum process, the National Conference on State Legislatures found that "further integrating the legislature into the initiative process would result in improved policymaking" and that "increasing legislative involvement in the initiative process enhances the debate that surrounds initiative proposals and provides more opportunity for public access and input to the initiative." ("Initiative and Referendum in the 21st Century: Final Report of the NCSL I&R Task Force," 2002).

The NCSL report recommends increasing legislative involvement through the “indirect initiative” (by which voter initiatives are referred first to the Legislature for review and adoption, or to place alternative measure on the ballot with the initiative) or through public hearings on initiatives. The NCSL report found that public hearings can help voters make more fully-informed decisions by providing a forum for expert testimony, staff analysis, and public debate by opposing sides.

The Task Force did not recommend one approach over the other, but encourages the Legislature to enact measures to provide access and input to the initiative process through increased legislative involvement.

Reduce restrictions on local government’s ability to raise revenue and refrain from approving any new property tax expenditures or state level mandates on local governments.

The Task Force does not have a recommendation for new legislation in this area for 2009 but does have some recommended guidance for the major legislative fiscal policy committees:

- Revenue Committees
 - No new property tax expenditures unless offsetting revenue is included.
 - No new preemptions of potential local revenue sources.
 - Review existing local preemptions for possible modification or repeal.
- Ways & Means Committee
 - No new expenditure mandates for local governments.
 - Fully fund (at 100% of estimated impact) any new property tax expenditures with appropriations to the Property Tax Expenditure Account.
- All Legislative Committees
 - Refrain from new legislation that requires local spending mandates.

Explanation: Led by its local government representatives, the Task Force had lengthy discussions concerning the fiscal situation of local governments around the state. Given the long-term fiscal analysis of local fiscal trends discussed in Chapter 2 and the report from the Governor’s Task Force on Federal Forest Payments and County Services, the Task Force recommends that the Legislature take no action in the short-term that will worsen the fiscal strains on the local fiscal system. This means a moratorium on new expenditure mandates and on additional preemptions of potential revenue sources.

The Task Force reviewed existing preemptions such as real estate transfer taxes, hotel-motel taxes and construction excise taxes. The Task Force also heard a formal presentation from the League of Oregon Cities recommending consideration of substituting a more responsive tax based on gross revenue of telecommunications providers for the existing franchise fee for city rights-of-way. Franchise revenue has been declining and is expected to continue its downward trend in the future. The Task Force does not endorse any single revenue diversification suggestion for the short-term but does recommend that the Legislature thoroughly explore these options for diversifying local revenue and continue to work with local officials and other interests to find the best approaches to increase the diversity and adequacy of the local revenue base.

The Task Force recommends that the Legislature appropriate enough funds for the Property Tax Expenditure Account to fully reimburse local governments for any new property tax expenditures that would be enacted. Tax expenditures are laws that fully or partially exempt certain property from taxation thereby reducing revenue to local governments. The Account established by the 1999

Legislature, is designed to reimburse local governments for 50% of the cost of new tax expenditures though only a nominal amount has ever been appropriated to the account. The Task Force feels that the current fiscal situation for local governments in Oregon warrants full reimbursement if new tax expenditures are approved.

Develop systematic long-term budgeting process including long-term capital spending plan.

The Task Force recommends that legislation requiring a 10-year forecast for state discretionary expenditures and revenue be developed as a regular part of the budget development and reporting process. Specifically the new legislation should contain the following:

- A 5-biennia projection for General Fund-Lottery expenditures and revenue under current law to be included with the Governor's budget report at the close of the regular legislative session. These forecasts should include a range of economic scenarios.
- The Governor's budget report should also include a 5-biennia plan implementing programs to meet benchmark goals established by the Oregon Progress Board and adopted by the Legislature.
- Requirement for the Legislative Fiscal Officer to prepare a 5-biennia estimate in all fiscal impact statements.
- Requirement for the Legislative Revenue Officer to prepare a 5-biennia estimate in all revenue impact statements.
- Require the Governor, the Treasurer and the Legislature to develop a 10-year capital spending plan.

Explanation: The Task Force received a presentation from the Department of Administrative Services based on projections for current spending programs and revenues. Given the long-run consequences of many fiscal decisions and the changing economic and demographic background, the Task Force recognizes the need for including long-run fiscal projections at regular intervals as part of the budget planning process. The Task Force also heard testimony from the Metro regional government outlining the long-term infrastructure needs of the Portland Metropolitan area and the likely capital needs of other parts of the state over the long-term. Given the long life of these assets and the large cost of maintaining and replacing them, the Task Force recommends inclusion of a capital spending plan based on infrastructure needs as a formal part of the long-term budget planning process.

Develop adequate revenue sources to meet state's immediate critical needs in health care and transportation.

Explanation: The Task Force does not have a recommendation for a specific revenue plan to meet the short-term needs in these two important areas. However, the Task Force, based on reports given by the Governor's Transportation Task Force and the Health Fund Board recognizes the need for action in the 2009 session to develop additional sources of revenue for the state's transportation system and to replace expiring provider tax revenue to use in combination with federal matching funds to maintain health care programs.

Establish process to engage the public in determining the desired level of public services and the best way to pay for them.

Explanation: The Task Force recognizes the critical need to engage the public in any discussion of options for changing the structure of Oregon's revenue system to meet the state's needs. The link between public services and revenues needs to be clearly understood by the public before proceeding to a discussion of more fundamental and far reaching options to change Oregon's state and local revenue systems. Without a broad and concerted effort of public engagement, any major proposal is unlikely to be successful. Further, such a program of public engagement should not begin with a recommended outcome; rather, the outcome should be determined through the process of public involvement. The Task Force received a presentation on the successful Virginia experience with revenue reform, which involved both public and private leadership, and recommends that the Virginia process be examined as a possible model for engaging the public in future tax restructure efforts.

Chapter 4

LONG-TERM OPTIONS

Summary

The Task Force recognizes the challenge the current recession poses for state and local governments in Oregon. Steps will have to be taken in the coming months to manage through the cyclical downturn, including implementation of the recommendations in Chapter 3. However, more fundamental and substantial revenue restructuring must be preceded by an in-depth process of public engagement and information. This process is necessary to provide guidance for determining an adequate level of public services that the overall state and local revenue system should fund.

In addition to the concerns about the volatility of the state revenue system and the inflexibility of the local revenue system, the Task Force expressed serious concerns about the adequacy of both the state and local revenue systems to fund currently needed programs and services as well as the adequacy of the revenue system to provide for needed services over the long-term. These concerns include the impact of an aging population, that will require an increase in expenditures while contributing less revenue, adequate funding to meet the infrastructure needs of a growing population, sufficient funding to meet the state's adopted education goals of a high quality K-12 education system expressed through the Quality Education Model as well as a high quality work force that can compete on a global level. For the purposes of this report the Task Force considers "long-term" to be a period beyond the 2009 legislative session. With federal timber payments in the process of being phased out and the damaging fiscal effects of another economic downturn becoming more visible, the Task Force emphasizes the urgency of addressing both the adequacy and the stability of the revenue system with all due speed following the legislative session.

The Task Force recommends the following direction for development of a comprehensive revenue restructuring plan:

- Initiate and evaluate the results of the public engagement process included in this report as a short-term recommendation. Use those results to determine what constitutes an adequate level of public services and the public's view toward any potential revenue that may be needed to fund that level.
- Develop ways to increase the flexibility of the local revenue system to allow local governments to better respond to growth in demand for services, inflation and changing fiscal conditions. This involves considering:
 - Potential modifications to Measure 50
 - Options for diversifying local revenue away from the property tax.
 - Options to replace declining federal forest payments.
 - Proposals to share state and local revenue sources.

- Continue to analyze different tax restructure options and combinations of options. The Task Force examined 5 scenarios presented below but did not reach a consensus on an optimal option or combination. The Task Force encourages the Legislature to continue developing and evaluating the various options using the following criteria:
 - Distribution of the tax burden.
 - Ability to pay for individuals and businesses.
 - Impact on the state economy.
 - Impact on the stability of the revenue system over the course of the business cycle.
 - Administrative cost for both tax collection agencies and taxpayers.

Develop Ways to Increase Flexibility and Adequacy of Local Revenue System

The Task Force expressed serious concern about the inability of the current local revenue system to provide and maintain an adequate level of programs and services to meet local needs, both immediately and into the future. (See Charts 2.16, 2.17 and 2.18, and the accompanying discussion). Public testimony from local government officials during the Task Force hearings supported these concerns.

There is a structural gap between revenues and the cost of providing essential services that is only going to become pronounced and urgent in the years ahead. Many local governments have so far been able to accommodate this gap by spending down reserves, cutting programs and services, and raising revenue through bond measures, local option levies, fees and other strategies. However, those options will become less viable as the gap continues to grow. In most counties this trend is made worse by the loss of federal forest funds in four years.

The Task Force discussed long-term options designed to make the local revenue system more responsive to economic, demographic and institutional changes or give more options to local policy makers to respond to these inevitable changes. The Task Force considered three general approaches:

- Local revenue diversification discussed in Chapter 3.
- Modifications to Measure 50.
- Reassignment of tax revenues between state and local governments.

While it was the consensus of the Task Force that there is not sufficient public support to move forward with any of these options in the short-term, efforts should continue to engage the public on the structural deficit in the local revenue system, and to develop support for one or more viable options.

Local Revenue Diversification

The Task Force heard a series of suggestions from local governments regarding ways to diversify local revenue. The Task Force recommends that local revenue diversification continue to be explored as a viable option for restoring balance to the local fiscal system. See Chapter 3 for further discussion of these local revenue diversification proposals. Given that most changes in the property tax system would require a constitutional amendment, changes in the local revenue system that do not require a constitutional amendment would be easier to implement and, once enacted, easier to adjust according to changing circumstances.

Modifications to Measure 50

The Task Force examined a series of proposals to modify the property tax system as defined by Measure 50 and enumerated the pros and cons of each option.

- Reset assessed value to market value at the time of transactions, including the sale of property and new construction.
 - Pro
 - Slows long-term revenue loss for local governments.
 - Preserves certainty for taxpayers when not buying or selling property.
 - Minimizes cash flow disruptions for taxpayers.
 - Con
 - Exacerbates horizontal inequities—taxpayers with equally valued homes paying widely different taxes.
 - Creates incentive to lock-in residential property investments leading to dislocations in the state economy.
 - Would sharply increase the amount of compression under Measure 5.
- Establish a ceiling and floor for the changed property ratio (the assessment to market value ratio at which new property comes onto the tax roles).
 - Pro
 - Slows long-term revenue loss for local governments.
 - Constrains the degree of horizontal inequities.
 - Maintains certainty for those taxpayers above the minimum property change ratio.
 - Con
 - Creates uncertainty over annual tax change once the property change ratio floor is reached.
 - Could result in considerable horizontal inequities if property change ratio limits are set widely apart.
 - Revenue gains for local governments would be minimal if the floor is set at low levels.
- Adjust the 3% annual assessed value change with a 5-year moving average change tied to the consumer price index.
 - Pro
 - Allows property tax revenue growth to more closely match service cost increases for local governments.
 - Maintains some certainty for taxpayers by limiting unexpected annual jumps in assessed values.
 - Con
 - If inflation is high, taxpayers will receive higher annual property tax bills.
 - Does not address horizontal equity issues.
- Provide voters a one time option to change permanent tax rates within Measure 5 limits.
 - Pro
 - Allows for response to significant change in fiscal circumstances, such as the loss of federal timber payments.
 - Retains taxpayer certainty over value growth after change in permanent rate.

- Con
 - Does not correct variations in assessment ratios.
 - Does not prevent erosion of revenue over the long-term.
- Repeal Measure 50/ Reset Measure 5 limits at \$10 per \$1,000 of market value (\$6.67 local governments, \$3.33 schools)
 - Pro
 - Resolves inequities caused by variations in assessment ratios
 - Restores the link between market value growth and revenue growth
 - Con
 - Reduces taxpayer certainty over year-to-year variations in tax bills
 - Will initially create “winners and losers” as assessed values are returned to market value

Analysis: While supporting further discussion of ways to modify Measure 50 as being critical to address the shortfall in revenue for local governments and schools, the Task Force voiced concern that even small changes are likely to require a constitutional amendment and could easily result in a major political effort for a relatively small gain in terms of addressing the fundamental problems of the local revenue system. This underscores the need for an active public engagement in advance of putting forward any particular proposal for property tax reform.

Reassignment of major tax sources between state and local governments

The Task Force discussed the instability of the state revenue system and the inflexibility of the local revenue system at length. The root of these fundamental problems at the two levels is the major tax source each relies on. The Task Force considered a proposal developed in the last legislative interim that would swap a portion of the state personal income tax with local governments in exchange for a statewide property tax.

As demonstrated elsewhere in this report, the local government revenue system dominated by the property tax is characterized by relatively slow but stable growth. The state’s system, highly dependent on income taxes, is much more responsive to growth over time but is highly unstable over the course of the business cycle. The cities are projected to raise \$843.5 million in the 2007-08 fiscal year on permanent rates averaging \$4.87 per \$1,000 of assessed value. The counties are projected to raise \$668 million on a permanent rate of \$2.49 per \$1,000 of assessed value. The proposal calls for cutting the rates of the cities and counties in half on a statewide basis and imposing a \$3 per \$1,000 state property tax. This would have the effect of shifting about \$1.7 billion dollars from the cities and counties to the state in the 2009-11 biennium. The cities and counties would then receive a portion of personal income tax revenue to hold them harmless in the aggregate. For the cities this translates into 7% of personal income tax collections. For the counties the proportion of income tax revenue is 5.6%.

The net fiscal impact of the proposal is roughly neutral for cities and counties with a short-term gain for the state. However, the net fiscal position for cities and counties will turn positive over time because the personal income tax is expected to grow more rapidly than property tax revenue. This would generate stronger revenue growth allowing cities and counties to respond better to growing service demands. However, cities and counties are likely to experience more revenue volatility because of the cyclical nature of the personal income tax. The state would experience slower revenue growth but more stability over time.

Analysis: The approach offers the prospect of addressing the fundamental weakness of the state revenue system and the fundamental weakness of the local revenue system simultaneously. The biggest roadblock is the uniformity requirement for a statewide property tax. If implemented across the board, the statewide property tax would lead to major tax increases for low property tax jurisdictions. In addition, the issue of how to distribute personal income tax revenue back to individual counties and cities would have to be carefully considered.

Tax Restructure Options

The Task Force considered a number of options and spent considerable time analyzing their impact. There was no consensus among Task Force members regarding a particular approach (or that any of the approaches reviewed by the Task Force was necessarily appropriate for the state) but the options reviewed by the Task Force represent a broad range of potential approaches to fundamental revenue restructuring. The Task Force considered various revenue packages, some of which raise revenue, others that are revenue neutral, and evaluated their net effect on the distribution of the tax burden, the economy, stability of revenue and administration. The Task Force encourages the Legislature to continue to evaluate the prospects for an improved revenue system by mixing and matching the elements of the scenarios discussed below.

Based on prior proposals and the suggestions of individual members, The Task Force considered five major approaches to restructure the tax system. These approaches were designed to highlight the effects and trade-offs of the overall approaches rather than represent a final proposal or recommendation.

- Eliminate the personal income tax and establish an equal yielding general retail sales tax
- Reduce personal income and property taxes and establish a broad gross receipts tax.
- Eliminate residential property taxes for most residences, reduce personal income taxes and establish retail sales tax
- Eliminate corporate income tax and replace with higher yielding corporate franchise tax
- Eliminate corporate income tax and replace with equal yielding value added tax on all business.

There is a limitless number of ways in which the elements of the major approaches examined by the Task Force can be combined; the identification of particular combinations for the purpose of analysis in this report does not indicate a specific recommendation by the Task Force. Rather, the combinations are shown to assist in a general evaluation of each proposal, for further consideration.

The Task Force relied on a number of tools to consider the impact of major tax restructure proposals.

Economic and distribution effects

To gage the long-term economic and distribution effects the Task Force requested simulations using the Oregon Tax Incidence Model (OTIM). OTIM is a computable general equilibrium model of the Oregon economy. It is designed to show how tax changes affect wages and prices and how these changes ultimately affect the overall level of economic activity as measured by total personal income and employment. The OTIM simulation compares the current economy (baseline) to how it will look after wages, prices and income have adjusted to the tax change. This is assumed to reflect a 5-year adjustment period. After accounting for these changes OTIM computes new estimates for the distribution of after-tax income and state-local revenue. For the OTIM results of the individual scenarios see Appendix G.

Stability

OTIM compares the economy at two points in time and is therefore not a useful guide to the impact of tax changes on the stability of the revenue system. In order to examine how different state and local taxes move up and down over the course of the business cycle, a series of stability simulations were run. These simulations are based on historic U.S. Census data for quarterly state and local government tax collections. The data are based on collections for the 12-month period ending in March, June, September and December of each year. The quarterly series begins in December 1988 and runs through March of 2008. From these data, a base case is developed that starts with the national tax source proportions in December 1988 and applies the historic growth rate to each source, in effect replicating history. This allows for a comparison of hypothetical tax combinations with the actual national averages in terms of average growth, standard deviation (a measure of stability) and the minimum and maximum quarterly change. For the results of the stability simulations see Appendix H.

Administration

In order to consider the potential administrative issues posed by the various tax restructure proposals, the Task Force requested comments from the Department of Revenue. Those comments are included in the analysis of the proposals.

SCENARIO 1

Description

- Eliminate state personal income tax.
- Impose 8.5% retail sales tax with exemptions for in-home food, shelter, insurance, utilities, manufacturing, agriculture inputs, private education, already taxed items (gas, tobacco).

Static Revenue Impact

Sales tax rate set to make net revenue estimate neutral for 2011 calendar year. Over time the net revenue impact will be negative because the long-term income elasticity for the retail sales tax is less than the personal income tax.

Long-Term Economic Impact

Dramatic changes in a state's tax structure causes significant short-term dislocations as businesses and individuals adapt to the new system. In this case Oregon's retail trade sector would shrink particularly along the border. Gains could be expected in high wage sectors as the income tax burden falls. Over the long-term, the overall economy would be expected to benefit from the switch to a sales tax. Employment is expected to rise by over 5%. This triggers a 1% increase in the population as net in-migration picks up. The return to capital is expected to increase leading to a 0.7% increase in business investment. Elimination of the personal income tax results in higher after-tax wages. This causes an increase in the supply of labor leading to lower gross (before-tax) wages. In the simulation, net household income rises by \$550 million (0.4%).

Dynamic Revenue Impact

An increase in employment and population is expected to generate additional consumption above the baseline thereby triggering a positive revenue feedback for sales tax collections. The increase in investment and in-migration would also be expected to increase property tax collections driving up local government revenue. On net, the \$6.837 billion sales tax (at 2011 levels) would be expected to generate an additional \$29 million in sales taxes through feedback effects, \$55 million in state other funds revenue and \$167.5 million in local revenue for a total revenue feedback of \$252 million.

These estimates are all at 2011 levels after the assumed 5-year adjustment period has taken place in the state economy.

Distribution Effects

The shift to the sales tax reduces net income for the majority of households. Net income is expected to decline on average for all household income groups below \$117,067. The primary beneficiary of the shift is high income households. Households above \$185,879 are expected to see a 9.2% increase in net household income. Overall the swap of the personal income tax for a retail sales tax would change the distribution of Oregon's tax burden from largely proportional (with a slightly regressive lower end and slightly progressive higher end) to regressive throughout the income spectrum. This effect could be mitigated by providing additional tax relief in the revenue system to low income taxpayers, but such changes would reduce net revenues to the General Fund that would have to be offset by increases elsewhere, such as a higher sales tax rate or fewer exemptions, or by reduced spending.

Revenue Stability

Historically, the retail sales tax has exhibited less volatility than the personal income tax. This is particularly true for the last business cycle (1991 to 2002). Stability is influenced by the definition of the base and tax rate structure. In general, the broader the sales tax base, the more stable the revenue stream will be. For the personal income tax, more progressive rate structures tend to increase volatility. In practice, the sales tax has shown greater stability at the national level. Based on historic revenue stability calculations switching from a personal income tax dominated revenue system to a sales tax dominated system reduces the standard deviation of quarterly revenue collections from 1.06% to 0.68%. However, in the current recession consumer spending appears to be particularly weak putting downward pressure on sales tax revenue in many states.

Administrative Issues

The Department of Revenue would experience budget savings due to the elimination of the personal income tax however it would continue to enforce the corporate income tax under this scenario. The DOR would also have to gear up to ensure compliance with the new sales tax. A potential administrative complication is the fact that the state works in cooperation with the Internal Revenue Service to gather data for enforcement efforts. Under a sales tax system that partnership would no longer be applicable. Administrative costs for the sales tax are expected to be between 1 and 1.5% of total collections depending on the number and complexity of exemptions. More complexity generally leads to higher administrative costs. A sales tax also imposes administrative costs on businesses that collect them. Generally, businesses are allowed to retain a portion of sales tax collections to offset their administrative costs, but this reduces net tax revenue to the state.

Analysis: Despite the positive job creation and stability effects (based on 20 years of historical data) of moving to a Washington type sales tax dominated revenue system, this option would need to incorporate significant additional measures to offset the negative equity effects to avoid a dramatic shift in the tax burden from high income to low income families. Further development of this approach should begin with the consideration of these additional measures.

SCENARIO 2

Description

- Reduce personal income tax rates to 2,4,6,8% (8% rate starts at \$75,000 single)
- Increase earned income tax credit to 50% of federal
- Establish \$50,000 homestead exemption
- Establish low income renter relief program
- Impose 1.31 % tax on business gross receipts.

Static Revenue Impact

This proposal is expected to generate a net revenue increase of \$150 million in 2011 calendar year. Over time, revenue would likely be expected to grow slightly slower due to the lower elasticity of the gross receipts tax.

Long-Term Economic Impact

Imposition of a gross receipts tax could cause short-term dislocations for businesses that operate with low margins relative to total sales (receipts). Consumers are likely to face higher prices for goods and services that involve a substantial amount of intermediate purchases (business-to-business purchases) because the gross receipts tax would be built at each stage of production. However, the strength of the gross receipts tax is its broad base and relatively low rates. This tends to limit distortions in the long-run. Significant reductions in personal income tax rates and expansion of the earned income tax credit are expected to stimulate labor force growth. On net, employment would be expected to increase 120,588 or 5.1 %. The state's population is expected to rise 51,857 as in-migration picks up in response to the stronger labor market. Lower personal income tax rates increase the after-tax return for workers. This leads to an increase in the labor supply and a lower gross (before-tax) wage rate. This process pushes the wage index down 4.5%. Net household income is expected to rise by \$1.7 billion despite the increase in state revenue. Imposition of the gross receipts tax is expected to push up the state price level by 0.4%.

Dynamic Revenue Impact

Despite the increase in net static revenue from the combination of changes, the dynamic revenue impact is also positive. The net increase of \$150 million would be expected to generate an additional \$255 million in state and local revenue after the economy has fully adjusted.

Distribution Effects

Net household income rises for all household income groups under this scenario due to the increase in population across the income spectrum. However, average household income within the groups falls for all groups with the exception of those groups with incomes between \$117,067 and \$185,879 and above. The gross receipts tax works through the price system to lower average net after tax income for most income groups.

Revenue Stability

Switching from a personal income tax dominated revenue system to a balanced consumption tax/personal income tax system would be expected to significantly increase overall stability. Historically (1988 to 2008), a personal income tax dominated system has a quarterly standard deviation of 1.06%. A balanced consumption tax/personal income tax system, such as the national average for all state and local revenue systems, has a quarterly standard deviation of 0.78% based on the past 20 years.

Administrative Issues

Administrative costs can be expected to rise under this scenario. The Department of Revenue would continue to administer the personal income tax system, though the incentives for non-compliance would decline due to the lower overall rates. The DOR would have to gear up to ensure compliance with the new gross receipts tax. Businesses would have to be educated on how to calculate and remit the new tax. However, there is the experience of other states that would serve as an initial guide. Washington has a business and occupation tax based on gross receipts and Ohio recently enacted a commercial activity tax based on gross receipts. Over the long term the administrative costs for the gross receipts tax would be expected to average between 1 and 1.5% of gross collections similar to the retail sales tax. More complexity from exemptions or special treatment generally adds to administrative costs. In addition the DOR would work through the county assessor to establish the new homestead exemption and the renter relief program. A gross receipts tax also imposes administrative costs on businesses that pay them.

Analysis: This approach offers reduced reliance on the personal income tax and the property tax while shifting the tax burden to consumption through a gross receipts tax. The plan produces positive economic and stability effects that are consistent with the Task Force's goals for the revenue system. However, it disproportionately reduces the tax burden on high income households. The gross receipts tax has the advantage of relatively low rates and a broad base but does impact different industries differently. Appendix G shows how the gross receipts tax would be distributed among different industries. Task Force members also remain concerned about the administrative costs and equity implications of a new major consumption tax.

SCENARIO 3

Description

- Create property tax homestead exemption up to \$750,000 of assessed value for owner occupied residences.
- Double personal income tax brackets to \$6,400 and \$16,100 for single taxpayers
- Impose 2.7% retail sales tax with exemptions for in-home food, shelter, insurance, utilities, manufacturing, agriculture inputs, private education, already taxed items (gas, tobacco).

Static Revenue Impact

This combination of changes generates a projected static revenue impact of +\$170 million in the 2011 calendar year. Over time, net revenue impact will likely be slightly positive as sales tax revenue is expected to grow faster than the initiative-constrained property tax.

Long-Term Economic Impact

Imposition of a sales tax would cause significant short-term dislocations as businesses and individuals adapt to the new system. In this case Oregon's retail trade sector would shrink particularly along the border. The relative cost of housing would fall significantly as the residential property tax is removed for most home owners. This would lead to a jump in jobs (77,633 or 3.3%), population (35,951 or 0.9%) and investment (\$129 million or 0.7%). Net household income is expected to be \$1.4 billion or 1.1% higher after all adjustments have taken place.

Dynamic Revenue Impact

An increase in employment and population is expected to generate additional taxable activity at the state level. However, the feedback effect on local government revenue is expected to be negative as capital shifts from taxable commercial and industrial property to non-taxable residential property. The net effect is a positive dynamic revenue impact of \$162 million (2011 levels) resulting from the positive economic effects of the change.

Distribution Effects

In general middle income households benefit under this scenario, with income groups between \$16,579 and \$86,675 experiencing net income gains largely because they receive full property tax relief through the homestead exemption. Households above \$117,067 experience a net loss because they are likely to have residences above the \$750,000 homestead exemption cap.

Revenue Stability

At the national level, the property tax has historically shown slightly less stability than the retail sales tax with a quarterly standard deviation of 1.2% compared to 1.0% for the sales tax. However, in Oregon's case the property tax is likely to be more stable because of the effects of Measure 50. A simulation with a sales tax dominated revenue system and lower property tax (1/2 the national average) exhibits slightly less stability than the base case.

Administrative Issues

Under this scenario the Department of Revenue would maintain oversight of the property tax assessment function. The DOR would administer the homestead exemption tracking eligibility. County assessors would also continue to determine market and assessed values though property tax collections would fall sharply. The DOR would also have to gear up to ensure compliance with the new sales tax. Administrative costs for the sales tax are expected to be between 1 and 1.5% of total collections depending on the number and complexity of exemptions. More complexity generally leads to higher administrative costs. A sales tax also imposes administrative costs on businesses that collect them. Generally, businesses are allowed to retain a portion of sales tax collections to offset their administrative costs, but this reduces net tax revenue to the state.

Analysis: Similar to the evaluation for Scenario 2, this simulation leads to compelling gains in employment, household income and revenue stability. Another positive feature is that it targets middle household income groups for tax relief more effectively. However, the proposal raises a series of institutional and administrative questions around such a dramatic reduction in reliance on the property tax. Among these issues is the fate of existing bonds backed by the property tax base, the impact of the scenario on tax-increment financing (such as Urban Renewal), and administrative issues, such as the administration of a large homestead exemption program. A further complication of this scenario would be the need to establish some method for the state to distribute state sales tax revenue to local governments (including counties, cities and special districts) to replace property taxes lost by local governments. Finally, even with a plan to replace local revenue in an equitable way, Task Force members expressed concern about breaking the traditional benefit link between property taxes and local services. The Task Force recommends that further development of this approach must address these concerns before further refinement.

SCENARIO 4

Description

- Eliminate corporate income tax
- Impose .3% tax on value added

Static Revenue Impact

Static revenue impact is set to be revenue neutral for 2011 calendar year. Over time revenue is likely to grow slightly faster than the current system because the value added base has demonstrated greater long-term income elasticity than has the corporate income tax base.

Long-Term Economic Impact

Employment and population decline slightly but investment increases in response to elimination of the corporate income tax. The return to capital rises 0.22%. Net household income falls \$101 million in the simulation because the burden of the corporate income tax is born partially by non-state residents while the value added tax falls predominantly on state residents.

Dynamic Revenue Impact

The dynamic revenue impact from this simulation is very small (<\$5 million).

Distribution Effects

The lower household income is spread roughly proportionately across the income spectrum. The highest income group (with incomes greater than \$185,879) essentially breaks even after wage, price and economic activity changes.

Revenue Stability

Replacing the corporate income tax with a value added tax has the unusual result of increasing both stability and long-run revenue growth. This is because the corporate income tax demonstrates the greatest short-term instability (highest quarterly standard deviation) of the major state and local revenue sources and the lowest long-term quarterly growth rate (tied with excise taxes). The stability and long run growth characteristics of the value added tax are similar to the retail sales tax. Simulating the switch from a system with an average corporate income tax to one with no corporate income tax and higher consumption taxes leads to less volatility (the quarterly standard deviation drops from 0.78% to 0.74%) and a higher long-term growth rate (average quarterly growth in revenue of 1.41% compared to 1.39%).

Administrative Issues

The corporate income tax is highly complex with substantial enforcement and compliance issues at the state level. Its elimination would reduce Department of Revenue costs significantly. This would be offset by the costs of implementing and administering a new value added tax. Only Michigan and New Hampshire have imposed a tax on the value added base at the state level. However, value added taxes are used extensively in other countries around the world, at the national level.

Analysis: The value added tax base is generally considered superior to other widely used business taxes on a theoretical basis. However, there is little experience at implementing a value added tax at the state level and there would likely be considerable uncertainty, particularly among business taxpayers regarding implementation issues and the impact of the base on their operations.

SCENARIO 5

Description

- Eliminate corporate income tax
- Impose a franchise tax based on gross business investment

Static Revenue Impact

Static revenue impact is set to raise revenue of \$500 million for the 2011 calendar year. Over time revenue is likely to grow slightly faster because the gross investment base has historically grown faster than the net corporate income base over the long-term.

Long-Term Economic Impact

Employment and population increases slightly as investment increases marginally in response to the elimination of the corporate income tax. The return to capital rises 0.28%. Net household income falls \$278 million in the simulation primarily because of the increase in the overall tax burden.

Dynamic Revenue Impact

The dynamic revenue impact from this simulation is projected to be very small (\$3 million).

Distribution Effects

The higher tax burden is spread roughly evenly across the household income spectrum.

Revenue Stability

The impact on stability is expected to be slightly less than Scenario 4. Gross investment consists of net investment which adds to the capital stock and replacement investment due to depreciation. Net investment is volatile over the business cycle, but overall gross investment is considerably less volatile than the net corporate income base. However, gross investment is likely to be more volatile than a consumption oriented base such as value added or gross receipts.

Administrative Issues

This scenario represents a relatively new tax base. Clearly the Department of Revenue administrative costs would drop with the elimination of the highly complex corporate income tax, but a number of detailed decisions regarding the exact definition of the investment base would have to be made to implement the franchise tax. In general, the more understandable these definitions are for corporate taxpayers, the lower the ratio of administrative costs to collections is likely to be.

Analysis: This proposal generates a significant amount of revenue but does have some negative economic effects. Similar to the analysis for scenario 4, this proposal involves a relatively new tax base meaning that definitional and administration issues would have to be addressed very carefully before implementation.

Voting Members
Lane Shetterly, Chair
Rep. Phil Barnhart
Joe Benetti
Rep. Scott Bruun
Sen. Ginny Burdick
Jerry Caruthers
Jim Diegel
Rep. Sal Esquivel
Leslie Frane
Jennifer Geller
Henry Lorenzen
Sen. Rod Monroe
Sen. Frank Morse
Rep. Tobias Read
John Russell
Sen. Kurt Schrader
Malia Wasson

Staff
Paul Warner, Legislative
Revenue Officer
Tim Nesbitt, Governor's
Office
Anna Grimes, Task Force
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Task Force on Comprehensive Revenue Restructuring

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Chuck Sheketoff
Bob Shiprack
Alan Unger
Advisory Council
Milo Ormseth
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Philip Romero
Anthony Rufolo
Carol Samuels
Karey Schoenfeld
John Tapogna
Adjunct Members:
Linda Ludwig
Gil Riddell
Hasina Squires
David Williams

FINAL REPORT APPENDICES

- A. Text of House Bill 2530
- B. Summary of Public Meetings
- C. Summary of Stability Funds
- D. Variables Used for City/County Fiscal Projections
- E. Advisory Council Recommendations for Managing Reserve Funds
- F. States with Limitations on Initiatives with Fiscal and Revenue Impacts
- G. Oregon Tax Incidence Model—Summary of Simulation Results
- H. Stability Study Results
- I. Summary of Poll on Public Attitudes toward Revenue Restructuring
- J. Glossary of Terms

Appendix A

Text of House Bill 2530

Enrolled
House Bill 2530

Sponsored by Representatives JENSON, BURLEY, ESQUIVEL, BERGER, BRUUN, Senators
SCHRADER, MORSE, DECKERT, WESTLUND

CHAPTER

AN ACT

Relating to taxation; appropriating money; and declaring an emergency.

Whereas Oregon needs a revenue system that is stable, predictable and adequate; and

Whereas Oregon needs a revenue system that stimulates the economy to create and retain family wage jobs; and

Whereas Oregon's financial support for critical services, including education, human services, public safety and the judiciary is stressed; and

Whereas the cumulative impact from initiatives coupled with a highly volatile revenue system has created the stress; and

Whereas Oregon's local units of government are experiencing a diminished ability to provide services vital to the well-being of Oregonians; and

Whereas the decline of Oregon's public-land-dependent timber economy and the effects of that decline are now finally being realized with the loss of federal rural payments; and

Whereas increases in property values are causing unsustainable increases in property taxes that threaten the financial security of Oregon homeowners, owners of small businesses and farm owners; and

Whereas Oregonians deserve a tax structure that is shared equitably by all for the benefit of all; now, therefore,

Be It Enacted by the People of the State of Oregon:

SECTION 1. (1) There is created the Task Force on Comprehensive Revenue Restructuring consisting of 30 members.

(2) The task force shall consist of the following voting members:

(a) The Governor or the Governor's designated representative, who shall be chairperson of the task force;

(b) Four members from the general public appointed by the Governor who shall represent different geographic regions of Oregon;

(c) One member appointed by the Governor who is a representative of an Oregon-based small business;

(d) One member appointed by the Governor who is a representative of an Oregon-based large corporation;

(e) Two members appointed by the Governor who represent organized labor;

(f) Four members from among members of the House of Representatives appointed by the Speaker of the House of Representatives; and

(g) Four members from among members of the Senate appointed by the President of the Senate.

(3) The following members shall be nonvoting members of the task force:

- (a) The State Treasurer or the State Treasurer's designated representative;
- (b) Two members from Oregon's business trade associations appointed by the Governor;
- (c) Two members from Oregon's labor associations appointed by the Governor;
- (d) Two members from associations representing taxpayers appointed by the Governor;
- (e) Two members from chambers of commerce appointed by the Governor;
- (f) Two members from the League of Oregon Cities appointed by the Governor; and
- (g) Two members from the Association of Oregon Counties appointed by the Governor.

(4) The task force shall:

(a) Provide advice to the Governor and the Legislative Assembly that may be used for drafting legislation for presession filing, by means of a blueprint for comprehensive revenue restructuring for local and state government. The blueprint shall provide a means for:

- (A) Promoting a stable revenue flow to fund all levels of state and local government;
- (B) Creating positive economic benefits for Oregon; and
- (C) Creating a financial foundation that will increase Oregon's ability to compete in a global economy.

(b) Develop a state plan for revenue and economic competitiveness. The plan shall include policy and program recommendations to:

- (A) Restructure the tax code to provide stable state, county and city funding;
- (B) Promote agreements among cities, counties and the state regarding funding; and
- (C) Stimulate economic growth in Oregon.

(5) A majority of the voting members of the task force constitutes a quorum for the transaction of business.

(6) Official action by the task force requires the approval of a majority of the voting members of the task force.

(7) The task force may adopt rules necessary for the operation of the task force.

(8) The task force may establish committees and delegate to the committees duties as the task force considers desirable.

(9) The Legislative Revenue Officer shall provide staff to the task force.

(10)(a) Members of the task force who are not members of the Legislative Assembly are entitled to compensation and expenses incurred by them in the performance of their official duties in the manner and amounts provided for in ORS 292.495. Claims for compensation and expenses of these members of the task force shall be paid out of funds appropriated to the Legislative Revenue Officer for that purpose.

(b) Claims for compensation and expenses of members of the task force who are public officers shall be paid by the public bodies that employ the members.

(11) All agencies of state government, as defined in ORS 174.111, are directed to assist the task force in the performance of its duties and, to the extent permitted by laws relating to confidentiality, to furnish such information and advice as the members of the task force consider necessary to perform their duties.

(12) The task force shall complete the initial state plan required by subsection (4)(b) of this section on or before November 1, 2008.

SECTION 2. (1) There is created the Oregon Revenue Advisory Council consisting of seven members appointed by the chairperson of the Task Force on Comprehensive Revenue Restructuring created under section 1 of this 2007 Act. The members shall represent accountants, economists and tax attorneys who are professionally involved in tax issues.

(2) The advisory council shall:

- (a) Provide technical analysis for the task force; and
- (b) Make recommendations for consideration by the task force.

Appendix B

Summary of Public Meetings

Voting Members
Lane Shetterly, Chair
Rep. Phil Barnhart
Joe Benetti
Rep. Scott Bruun
Sen. Ginny Burdick
Jerry Caruthers
Jim Diegel
Rep. Sal Esquivel
Leslie Frane
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Karey Schoenfeld
John Tapogna
Adjunct Members:
Linda Ludwig
Gil Riddell
Hasina Squires
David Williams

PUBLIC MEETINGS

Meetings:

November 13, 2008: Jackson County Library, Medford
November 19, 2008: Vert Auditorium, Pendleton
November 20, 2008: Deschutes County Fair and Expo Center, Redmond
December 8, 2008, Hatfield Marine Science Center, Newport
December 12, 2008: Eugene School District Education Center, Eugene
December 17, 2008: Tigard Public Library, Tigard—Canceled due to inclement weather

Summary of Meetings*

Key Themes:

- Need for urgency in reforming state and local revenue system
- Local government fiscal pressures including:
 - Erosion of reserves and build-up of debt
 - Growing infrastructure needs
 - Fragmentation of local service provision
 - Inflexibility of Measure 50 system
 - Difficulty in passing local property tax option levies
 - Damage caused by state preemption of local revenue options and need for greater flexibility in diversifying revenue sources
 - Need to develop adequate response to phase-out of federal timber payments

- School funding concerns
 - Need for greater and more stable school funding
 - Need to diversify state revenue sources
 - Fear of repeating damaging impact of state cuts during 2001-03 recession
 - Inadequate work force training programs
- Changing fiscal environment
 - Falling property values
 - Emergence of deflation
 - Growing economic hardship
- Growing taxpayer inequities caused by Measure 50
- Pros and Cons of moving to state consumption tax
 - Benefits of expanding tax base to include underground economy and tourists
 - Economic benefits of reducing dependence on high marginal income tax rates
 - Concerns over regressive nature of traditional consumption taxes
 - Public reaction to previous sales tax proposals
- Need to emphasize public engagement and education on tax and budget issues as a short-term recommendation

*For a complete record of the public testimony contact the Legislative Revenue Office.

Appendix C

Summary of Stability Funds

EDUCATION STABILITY FUND

- STATUS: CONSTITUTIONAL
- REVENUE: 18% OF LOTTERY UNTIL CAP REACHED THEN 15% INTO CAPITAL MATCHING FUND
- TRIGGERS: (DECLINING EMPLOYMENT OR REVENUE 2% BELOW FORECAST OR EMERGENCY)+ 3/5 VOTE
- USES: PUBLIC EDUCATION
- CAP: 5% OF GF REVENUE

RAINY DAY FUND

- STATUS: STATUTORY
- REVENUE: ONE-TIME CORP KICKER CREDIT + UP TO 1% OF GF APPROPRIATIONS IN PRIOR BIENNIIUM (ENDING BALANCE)+INTEREST
- TRIGGERS: SAME AS ESF EXCEPT EMERGENCY DECLARATION
- WITHDRAWALS CANNOT EXCEED 2/3 PER BIENNIIUM
- USES: GENERAL PURPOSE
- CAP: 7.5% OF GF REVENUE

Appendix D

Variables Used for City/County Fiscal Projections

LOCAL GOVERNMENT LONG-TERM PROJECTIONS
SCENARIO 1: BASELINE PROJECTIONS

GOVERNMENT	CITY	CITY	CITY
	05-06	06-07	06-07
REVENUE (IN MILLIONS OF \$)			
PROPERTY TAX	713	920.5	4.5% ANNUALLY
HOTEL/MOTEL		52.1	CONSUMPTION DEFLATOR/OREGON POPULATION
OTHER TAXES & ASSESSMENTS	320.2	75.9	CONSUMPTION DEFLATOR/OREGON POPULATION
LICENSE/PERMITS & FINES	109.1	290.1	OREGON POPULATION
CHARGES FOR SERVICES	302.7	255.2	CONSUMPTION DEFLATOR/OREGON POPULATION
SYSTEM DEVELOPMENT CHARGES		82.1	CONSUMPTION DEFLATOR/OREGON POPULATION
FRANCHISE FEES		170.2	OREGON POPULATION
INTERGOVERNMENTAL	1153.3	413.6	CONSUMPTION DEFLATOR/OREGON POPULATION
PL 106-393 TITLE 1	199.1		12% OF HISTORIC LEVEL AFTER PHASE OUT
INTEREST EARNINGS	57.5	67.9	CONSUMPTION DEFLATOR
MISCELLANEOUS	211.6	90.8	CONSUMPTION DEFLATOR/OREGON POPULATION
BOND PROCEEDS	29.5	323	CONSUMPTION DEFLATOR/OREGON POPULATION
TOTAL	3096	2741.4	
EXPENDITURES (IN MILLIONS OF \$)			
GENERAL GOVERNMENT	441.7	334.4	OREGON POPULATION/STATE & LOCAL GOV DEFLATOR
PUBLIC SAFETY	820.5	886.3	OREGON POPULATION/STATE & LOCAL GOV WAGES
TRANSPORTATION	407.7	236.6	STATE & LOCAL GOV CONSTRUCTION DEFLATOR/OREGON POPULATION
HEALTH	857.7		MEDICAL CARE CPI/OREGON POPULATION
COMMUNITY DEVELOPMENT	131.2	254.4	OREGON POPULATION/STATE & LOCAL GOV DEFLATOR
CULTURAL & EDUCATION SERVICES	153.6	57.4	OREGON POPULATION/STATE & LOCAL GOV DEFLATOR
PARKS & NATURAL RESOURCES	5.7	163	OREGON POPULATION/STATE & LOCAL GOV DEFLATOR
CAPITAL OUTLAY	158	384.3	OREGON POPULATION/STATE & LOCAL GOV DEFLATOR
DEBT SERVICE	66.4	299.3	GDP CONSTRUCTION DEFLATOR/OREGON POPULATION
MISCELLANEOUS	18.3	32	OREGON POPULATION/STATE & LOCAL GOV DEFLATOR
TOTAL	3060.8	2627.7	

VARIABLES USED FOR PROJECTION

Appendix E

Advisory Council Recommendations for Managing Reserve Funds

Advisory Council Recommendations for "Rainy Day" Funds

August 21, 2008

The Advisory Council recommends the following:

- The target for the Rainy Day Funds saving rate should be to maintain average growth in spending during the average recession. Both the Education Stability Fund (ESF) and the Rainy Day fund are expected to serve the stabilizing function and should be considered together. The saving rate should be based on achieving a 50% to 75% probability of having sufficient resources in the funds.
- From the information presented, this would require a saving rate of between 3% and 4% of general fund revenue during expansions. The funding for the Education Stability Fund is variable, but it amounts to about 1.5% of the general fund revenue. Thus, the revenue target for the Rainy Day Fund itself should be 1.5% to 2.5% of general fund revenue during periods of expansion.
- The maximum for the Rainy Day funds should be 12% to 15% of the biennial budget. This is projected to be sufficient to maintain spending through 90% of all recessions. Current maximums for the two funds would achieve the lower end of this range when both are fully funded.
- The current policy of adding the general fund ending balance, up to 1% of the general fund revenue, should be continued. Both the Governor's budget and the Co-chairs' budget should show an ending balance of at least 1% during periods of expansion. However, historical analysis shows that this method would not have been sufficient to fully fund the Rainy Day fund.
- Sources should be identified that would provide the additional 0.5% to 1.5% of general fund revenue on average during periods of expansion. More money should be set aside in periods of above average growth allowing for a lower rate of savings during expansion periods of below average growth.
- One proposal is to change the forecast method to allow for any revenue up to one standard deviation above the current forecast method to be allocated to the Rainy Day fund. Historical analysis shows that this change would have restored the Rainy Day fund within two biennia of recent recessions, and it is recommended as the most promising method of funding. If this is not adopted or does not generate enough revenue, then another source of additional money for the Rainy Day fund should be found.
- Other possible sources include the following:
 - Use corporate income tax kicker amounts

- Use personal income tax kicker amounts
 - Share of capital gains revenue
 - State interest earnings not otherwise earmarked
 - Corporate minimum
-
- Utilization of the funds during a recession should take account of future prospects for replenishing the funds. With current funding methods, the ESF should be utilized first during periods of recession since it has a relatively stable source of replacement funding.
 - We do not recommend any changes to current policies for using the funds.
 - These recommendations are based on the current revenue system. Significant changes in the revenue sources could affect the volatility of state revenues and the desired level of the Rainy Day fund.

Appendix F

States with Limitations on Initiatives with Fiscal and Revenue Impacts

STATE RESTRICTIONS ON INITIATIVES WITH FISCAL IMPACTS	
STATE	RESTRICTION
Alaska	No dedication of revenues or making or repealing appropriations.
Florida	Tax or fee increase requires 2/3 vote.
Maine	Expenditures above available state funds remain inoperative until 45 days after legislative session, unless the measure provides for adequate new revenues.
Massachusetts	May not be used to make specific appropriations unless Legislature raises sufficient revenue to fund appropriation.
Mississippi	Sponsor must identify in the text of the initiative the amount and the source of revenue required to implement the initiative.
Missouri	May not appropriate money other than new revenues created by the initiative.
Montana	May not appropriate money.
Nebraska	No measure that interferes with the Legislature's ability to raise necessary revenues.
Nevada	No additional expenditures unless measure also raises sufficient revenue.
North Dakota	No appropriations.
Wyoming	No dedication of revenues or making or repealing appropriations.

Source: National Conference of State Legislatures

Appendix G

Oregon Tax Incidence Model Summary of Simulation Results

Scenario 1 (effective 1-1-2011):

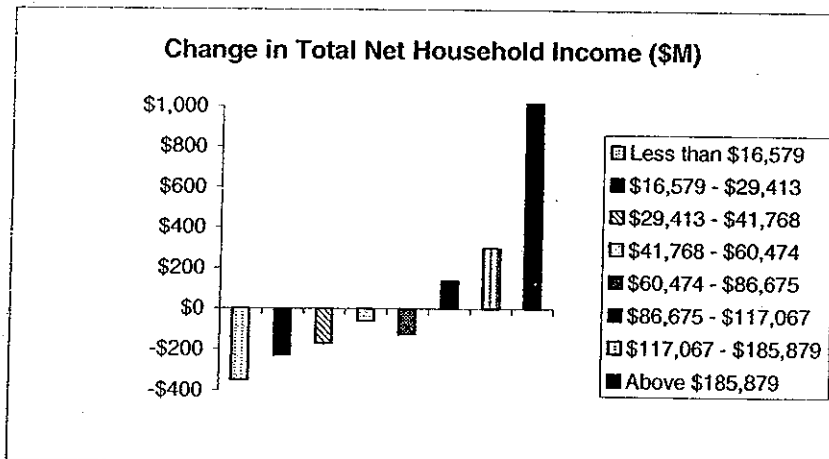
- (1) 8.5% sales tax rate, with exemptions
- (2) Eliminate the personal income tax (\$6,837 million in 2011)
- (3) Estimated sales taxes of \$6,837 million (2011)

Sales Tax and Personal Income Tax Swap				
2011 Levels				
	Baseline	New Equilibrium	Change From Baseline	Percent Change
Private Sector				
Personal Income (\$M)	160,400	157,940	-2,460.2	-1.5%
Employment	2,383,753	2,507,368	123,616	5.2%
Population	3,957,000	3,996,772	39,772	1.0%
Investment (\$M)	17,754	17,886	132.8	0.7%
Wage Index	100.0	94.2	-5.8	-5.8%
Return to Capital	100.0	100.8	0.8	0.8%
Price Levels	100.0	101.6	1.6	1.6%
Private Sector				
State Spending (\$M)	22,084.7	22,168.9	84.2	0.4%
GF Revenue (\$M)	7,098.4	7,127.7	29.2	0.4%
OF Revenue (\$M)	14,986.3	15,041.3	55.0	0.4%
Local Govt Revenue (\$M)	12,015.2	12,182.7	167.5	1.4%
Federal Tax Paid by Oregonians (\$M)	32,145.8	33,214.4	1,068.6	3.3%

Static Revenue Impact (\$ Millions)	\$0
Dynamic Revenue Impact (\$ Millions)	\$252
Net Revenue Impact (\$ Millions)	\$252
General Fund Change (\$ Millions)	\$29
Other Funds Change (\$ Millions)	\$55
Local Revenue Change (\$ Millions)	\$168

Total Net Household Income

	Baseline (\$M)	New Equilibrium (\$M)	Difference (\$M)	% Difference	Change in Number of Hholds	Mean HH Income Change (\$)
Less than \$16,579	\$4,414	\$4,063	-\$351	-7.9%	-782	-\$1,661
\$16,579 - \$29,413	\$9,876	\$9,646	-\$230	-2.3%	905	-\$1,463
\$29,413 - \$41,768	\$14,142	\$13,970	-\$172	-1.2%	1,547	-\$1,626
\$41,768 - \$60,474	\$20,577	\$20,517	-\$60	-0.3%	4,299	-\$1,533
\$60,474 - \$86,675	\$33,115	\$32,988	-\$127	-0.4%	3,358	-\$2,009
\$86,675 - \$117,067	\$17,876	\$18,013	\$138	0.8%	2,587	-\$756
\$117,067 - \$185,879	\$14,947	\$15,246	\$299	2.0%	1,805	\$783
Above \$185,879	\$11,423	\$12,476	\$1,053	9.2%	2,118	\$11,677
TOTAL	\$126,371	\$126,921	\$550	0.4%	15,837	



Scenario 2 (effective 1-1-2011):

- (1) Reduce personal income tax rates to 2-4-6-8% (8% starts at \$75,000 if single)
- (2) Increase earned income credit to 50% of federal EIC
- (3) Eliminate corporate income tax
- (4) Create 1.31% gross receipts tax
- (5) Create a \$50,000 homestead property tax exemption

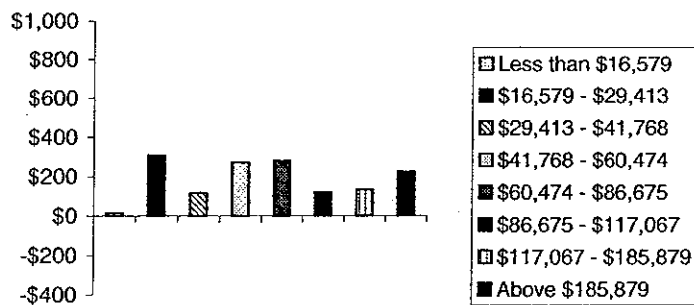
Reduce PIT, Increase EIC, Add Homestead Exemption, Swap CIT for GRT				
2011 Levels				
	Baseline	New Equilibrium	Change From Baseline	Percent Change
Private Sector				
Personal Income (\$M)	\$160,400	\$160,531	\$131	0.1%
Employment	2,383,753	2,477,008	93,256	3.9%
Population	3,957,000	3,997,462	40,462	1.0%
Investment (\$M)	\$17,754	\$17,903	\$150	0.8%
Wage Index	100.0	96.2	-3.8	-3.8%
Return to Capital	100.0	100.9	0.9	0.9%
Price Levels	100.0	100.4	0.4	0.4%
Public Sector				
State Spending (\$M)	\$22,085	\$22,785	\$701	3.2%
GF Revenue (\$M)	\$7,098	\$7,728	\$630	8.9%
OF Revenue (\$M)	\$14,986	\$15,057	\$71	0.5%
Local Govt Revenue (\$M)	\$12,015	\$11,732	-\$283	-2.4%
Federal Tax Paid by Oregonians (\$M)	\$32,146	\$32,716	\$570	1.8%

Static Revenue Impact (\$ Millions)	\$150
Dynamic Revenue Impact (\$ Millions)	\$267
Net Revenue Impact (\$ Millions)	\$417
General Fund Change (\$ Millions)	\$630
Other Funds Change (\$ Millions)	\$71
Local Revenue Change (\$ Millions)	-\$283

Total Net Household Income

	Baseline (\$M)	New Equilibrium (\$M)	Difference (\$M)	% Difference	Change in Number of Hholds	Mean HH Income Change (\$)
Less than \$16,579	\$4,414	\$4,429	\$15	0.3%	480	\$27
\$16,579 - \$29,413	\$9,876	\$10,185	\$309	3.1%	5,156	\$359
\$29,413 - \$41,768	\$14,142	\$14,261	\$119	0.8%	1,913	-\$107
\$41,768 - \$60,474	\$20,577	\$20,849	\$272	1.3%	3,670	-\$2
\$60,474 - \$86,675	\$33,115	\$33,397	\$281	0.8%	2,659	-\$97
\$86,675 - \$117,067	\$17,876	\$17,995	\$119	0.7%	1,118	\$49
\$117,067 - \$185,879	\$14,947	\$15,080	\$134	0.9%	688	\$475
Above \$185,879	\$11,423	\$11,647	\$224	2.0%	429	\$2,621
TOTAL	\$126,371	\$127,843	\$1,473	1.2%	16,113	

Change in Total Net Household Income (\$M)



Scenario 2
Gross Receipts Tax by Industry
(1.31% rate), tax year 2011

Industry	Total (\$M)	Share
Livestock	\$28	0.8%
Crops	\$22	0.6%
Nurseries and greenhouses	\$5	0.1%
Other agriculture and natural resources	\$119	3.5%
Construction	\$140	4.1%
Agricultural processing	\$111	3.2%
Tobacco and alcohol	\$23	0.7%
Apparel	\$41	1.2%
Wood and construction products	\$135	3.9%
Pulp, paper printing and publishing	\$112	3.3%
Chemical products	\$137	4.0%
Petroleum products	\$24	0.7%
Hi-tech manufacturing	\$120	3.5%
Motor vehicles	\$111	3.2%
Other manufacturing	\$179	5.2%
Transportation	\$115	3.3%
Communication	\$113	3.3%
Utilities	\$9	0.3%
Wholesale trade	\$193	5.6%
Retail trade except restaurants	\$226	6.6%
Eating, drinking and lodging	\$121	3.5%
Banking	\$116	3.4%
Insurance	\$70	2.1%
Real estate	\$152	4.4%
Other financial insurance	\$97	2.8%
Business services	\$255	7.4%
Health services	\$279	8.1%
Entertainment	\$49	1.4%
Other services	\$330	9.6%
Total	\$3,431	100.0%

Scenario 3 (effective 1-1-2011):

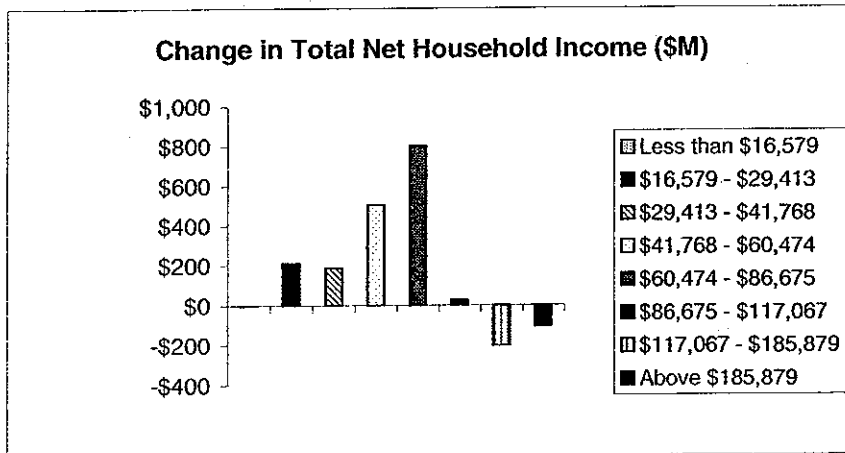
- (1) Double the personal income tax brackets (to \$6,400 & \$16,100 if single)
- (2) Create a \$750,000 homestead exemption
- (3) Create a 2.7% sales tax, with exemptions

Reduce PIT, Add Sales Tax & Homestead Exemption				
2011 Levels				
	Baseline	New Equilibrium	Change From Baseline	Percent Change
Private Sector				
Personal Income (\$M)	\$160,400	\$160,854	\$454	0.3%
Employment	2,383,753	2,461,386	77,633	3.3%
Population	3,957,000	3,992,951	35,951	0.9%
Investment (\$M)	\$17,754	\$17,882	\$129	0.7%
Wage Index	100.0	97.3	-2.7	-2.7%
Return to Capital	100.0	100.8	0.8	0.8%
Price Levels	100.0	100.6	0.6	0.6%
Public Sector				
State Spending (\$M)	\$22,085	\$24,041	\$1,956	8.9%
GF Revenue (\$M)	\$7,098	\$8,980	\$1,882	26.5%
OF Revenue (\$M)	\$14,986	\$15,061	\$75	0.5%
Local Govt Revenue (\$M)	\$12,015	\$10,561	-\$1,454	-12.1%
Federal Tax Paid by Oregonians (\$M)	\$32,146	\$32,537	\$391	1.2%

Static Revenue Impact (\$ Millions)	\$170
Dynamic Revenue Impact (\$ Millions)	\$332
Net Revenue Impact (\$ Millions)	\$502
General Fund Change (\$ Millions)	\$1,882
Other Funds Change (\$ Millions)	\$75
Local Revenue Change (\$ Millions)	-\$1,454

Total Net Household Income

	Baseline (\$M)	New Equilibrium (\$M)	Difference (\$M)	% Difference	Change in Number of Hholds	Mean HH Income Change (\$)
Less than \$16,579	\$4,414	\$4,413	-\$1	0.0%	299	-\$35
\$16,579 - \$29,413	\$9,876	\$10,088	\$212	2.1%	3,280	\$312
\$29,413 - \$41,768	\$14,142	\$14,330	\$188	1.3%	2,003	\$253
\$41,768 - \$60,474	\$20,577	\$21,082	\$505	2.5%	4,749	\$616
\$60,474 - \$86,675	\$33,115	\$33,917	\$802	2.4%	4,445	\$1,133
\$86,675 - \$117,067	\$17,876	\$17,903	\$28	0.2%	369	-\$58
\$117,067 - \$185,879	\$14,947	\$14,743	-\$203	-1.4%	-569	-\$1,219
Above \$185,879	\$11,423	\$11,316	-\$107	-0.9%	-260	-\$1,092
TOTAL	\$126,371	\$127,793	\$1,423	1.1%	14,317	



Scenario 4 (effective 1-1-2011):

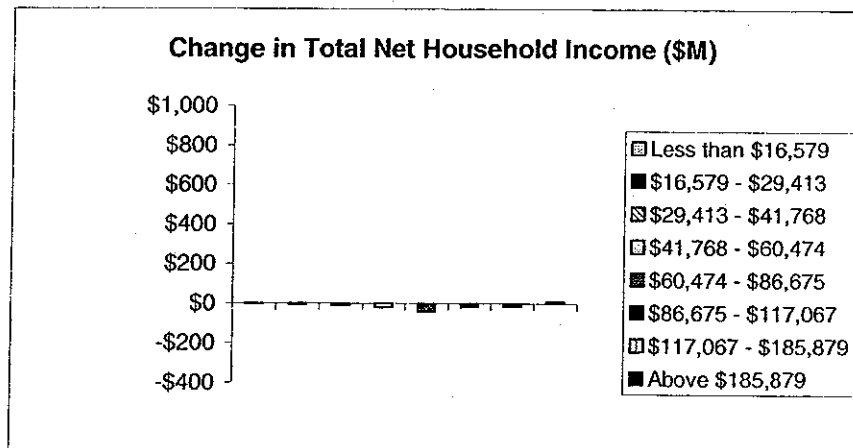
- (1) Eliminate corporate income tax (\$487 million in 2011)
- (2) Create a 0.3% value added tax (\$487 million in 2011)

Value Added Tax and Corporate Income Tax Swap				
2011 Levels				
	Baseline	New Equilibrium	Change From Baseline	Percent Change
Private Sector				
Personal Income (\$M)	\$160,400	\$160,332	-\$68	0.0%
Employment	2,383,753	2,382,936	-817	0.0%
Population	3,957,000	3,956,605	-395	0.0%
Investment (\$M)	\$17,754	\$17,795	\$42	0.2%
Wage Index	100.0	99.8	-0.22	-0.2%
Return to Capital	100.0	100.2	0.22	0.2%
Price Levels	100.0	99.95	-0.05	0.0%
Public Sector				
State Spending (\$M)	\$22,085	\$22,071	-\$14	-0.06%
GF Revenue (\$M)	\$7,098	\$7,087	-\$11	-0.16%
OF Revenue (\$M)	\$14,986	\$14,984	-\$3	-0.02%
Local Govt Revenue (\$M)	\$12,015	\$12,026	\$11	0.09%
Federal Tax Paid by Oregonians (\$M)	\$32,146	\$32,172	\$26	0.08%

Static Revenue Impact (\$ Millions)	\$0
Dynamic Revenue Impact (\$ Millions)	-\$3
Net Revenue Impact (\$ Millions)	-\$3
General Fund Change (\$ Millions)	-\$11
Other Funds Change (\$ Millions)	-\$3
Local Revenue Change (\$ Millions)	\$11

Total Net Household Income

	Baseline (\$M)	New Equilibrium (\$M)	Difference (\$M)	% Difference	Change in Number of Hholds	Mean HH Income Change (\$)
Less than \$16,579	\$4,414	\$4,411	-\$3	-0.1%	8	-\$14
\$16,579 - \$29,413	\$9,876	\$9,870	-\$6	-0.1%	-3	-\$31
\$29,413 - \$41,768	\$14,142	\$14,132	-\$10	-0.1%	-10	-\$52
\$41,768 - \$60,474	\$20,577	\$20,558	-\$19	-0.1%	-44	-\$66
\$60,474 - \$86,675	\$33,115	\$33,074	-\$41	-0.1%	-75	-\$129
\$86,675 - \$117,067	\$17,876	\$17,859	-\$17	-0.1%	-25	-\$92
\$117,067 - \$185,879	\$14,947	\$14,932	-\$15	-0.1%	-24	-\$109
Above \$185,879	\$11,423	\$11,433	\$10	0.1%	18	\$116
TOTAL	\$126,371	\$126,269	-\$101	-0.1%	-156	



Scenario 5 (effective 1-1-2011):

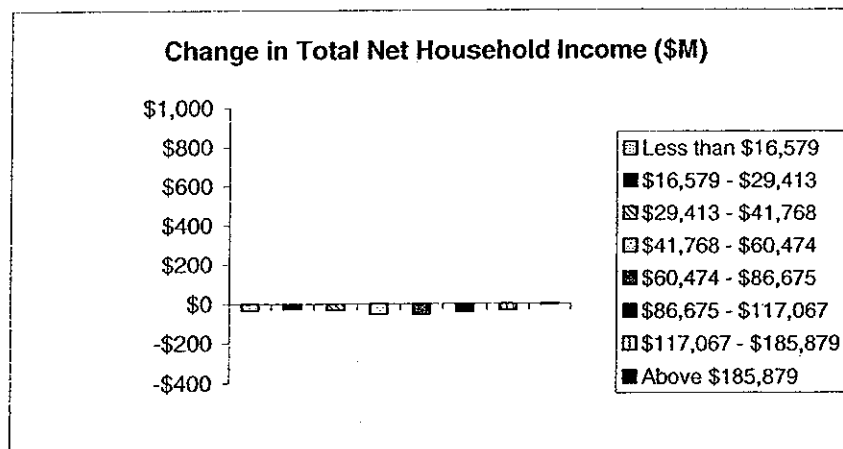
- (1) Eliminate corporate income tax (\$487 million in 2011)
- (2) Create a franchise tax (\$987 million in 2011)

Franchise Tax and Corporate Income Tax Swap				
2011 Levels				
	Baseline	New Equilibrium	Change From Baseline	Percent Change
Private Sector				
Personal Income (\$M)	\$160,400	\$160,729	\$329	0.2%
Employment	2,383,753	2,385,593	1,840	0.1%
Population	3,957,000	3,958,895	1,895	0.0%
Investment (\$M)	\$17,754	\$17,818	\$64	0.4%
Wage Index	100.0	100.0	0.02	0.0%
Return to Capital	100.0	100.3	0.28	0.3%
Price Levels	100.0	99.92	-0.08	-0.1%
Public Sector				
State Spending (\$M)	\$22,085	\$22,555	\$470	2.13%
GF Revenue (\$M)	\$7,098	\$7,570	\$471	6.64%
OF Revenue (\$M)	\$14,986	\$14,985	-\$1	-0.01%
Local Govt Revenue (\$M)	\$12,015	\$12,048	\$33	0.27%
Federal Tax Paid by Oregonians (\$M)	\$32,146	\$32,266	\$120	0.37%

Static Revenue Impact (\$ Millions)	\$500
Dynamic Revenue Impact (\$ Millions)	\$3
Net Revenue Impact (\$ Millions)	\$503
General Fund Change (\$ Millions)	\$471
Other Funds Change (\$ Millions)	-\$1
Local Revenue Change (\$ Millions)	\$33

Total Net Household Income

	Baseline (\$M)	New Equilibrium (\$M)	Difference (\$M)	% Difference	Change in Number of Hholds	Mean HH Income Change (\$)
Less than \$16,579	\$4,414	\$4,381	-\$33	-0.7%	42	-\$166
\$16,579 - \$29,413	\$9,876	\$9,849	-\$26	-0.3%	66	-\$159
\$29,413 - \$41,768	\$14,142	\$14,111	-\$31	-0.2%	76	-\$214
\$41,768 - \$60,474	\$20,577	\$20,525	-\$53	-0.3%	142	-\$260
\$60,474 - \$86,675	\$33,115	\$33,060	-\$55	-0.2%	172	-\$296
\$86,675 - \$117,067	\$17,876	\$17,834	-\$41	-0.2%	112	-\$334
\$117,067 - \$185,879	\$14,947	\$14,913	-\$34	-0.2%	81	-\$381
Above \$185,879	\$11,423	\$11,419	-\$5	0.0%	63	-\$287
TOTAL	\$126,371	\$126,092	-\$278	-0.2%	755	



Appendix H

Stability Study Results

REVENUE STABILITY SIMULATIONS

Description

The stability simulations are based on historic U.S. Census data for quarterly state and local government tax collections. The data are based on collections for the 12-month period ending in March, June, September and December of each year. The quarterly series begins in December 1988 and runs through March of 2008. The Base Case starts with the national tax source proportions in December 1988 and applies the historic growth rate to each source, in effect replicating history. Sims 2 through 5 alter the initial proportions (for example double sales tax and eliminate personal income tax) and then apply the historic growth rate to each of the tax sources. This allows for a comparison of the hypothetical tax combinations with the actual national averages in terms of average growth, standard deviation (a measure of stability) and the minimum and maximum quarterly change.

Simulations

Sim 1

Base Case (Based on actual December 1988 national data)

Personal Income Tax = 20.5%

Corporate Income Tax = 5.6%

Property Tax = 29.6%

General Sales Tax = 24.9%

Excise Taxes = 19.4%

Total Collections = 100%

Sim 2

Sales Tax/ No Personal Income Tax

Personal Income Tax = 0%

Corporate Income Tax = 5.6%

Property Tax = 29.6%

General Sales Tax = 45.4%

Excise Taxes = 19.4%

Total Collections = 100%

Sim 3

Personal Income Tax/ No Sales Tax

Personal Income Tax = 45.4%

Corporate Income Tax = 5.6%

Property Tax = 29.6%

General Sales Tax = 0%

Excise Taxes = 19.4%

Total Collections = 100%

Sim 4

No Residential Property/ Higher Sales Tax

Personal Income Tax = 20%

Corporate Income Tax = 5.6%

Property Tax = 15%

General Sales Tax = 40%

Excise Taxes = 19.4%

Total Collections = 100%

Sim 5

No Corporate Income Tax/ Higher Sales/Gross Receipts Tax

Personal Income Tax = 20%

Corporate Income Tax = 0%

Property Tax = 29.9%

General Sales Tax = 30.6%

Excise Taxes = 19.4%

Total Collections = 100%

Simulation Results

SUMMARY MEASURES	SIM 1	SIM 2	SIM3	SIM 4	SIM 5
AVERAGE QUARTERLY CHANGE	1.39%	1.3%	1.45%	1.37%	1.41%
STANDARD DEVIATION	0.78%	0.68%	1.06%	0.83%	0.74%
MAX	3.4%	2.8%	4.3%	3.5%	3.2%
MIN	-0.6%	-0.1%	-2.6%	-1.1%	-0.4%

SIM 1 = Base Case (Based on actual December 1988 national data)

SIM 2 = Sales Tax/ No Personal Income Tax

SIM 3 = Personal Income Tax/ No Sales Tax

SIM 4 = No Residential Property/ Higher Sales Tax

SIM 5 = No Corporate Income Tax/ Higher Sales/Gross Receipts Tax

LRO: 9-5-08

Appendix I

Summary of Poll Results On Public Attitudes Toward Revenue Restructuring

November 17, 2008

To: Senator Morse and Senator Nelson
From: Davis, Hibbitts, & Midghall, Inc
Re: Tax Reform Survey Results

I. Introduction

This memo highlights the results of a statewide telephone survey conducted for Senator Frank Morse. The overall purposes of the research were to examine voter opinions about tax reform, their support for a potential ballot measure reforming Oregon's tax system, and to test arguments for supporting and opposing tax reform.

Research Methodology: Between November 6 and 10, 2008, DHM, Inc. conducted a telephone survey of 600 registered voters in Oregon that lasted an average of 20 minutes. This is a sufficient sample size to assess voter opinions generally and to review findings by multiple subgroups including gender, age, area of state, and political affiliation.

In gathering responses, DHM employed quality control measures, including questionnaire pre-testing, callbacks, and validations. In addition, quotas were established for age, gender, and area of state based on the total population of voters in Oregon to ensure a representative sample. Computer abstracts for the survey accompany and are referenced throughout this report. They present a number of cross-tab variables based on demographic groupings. Combined percentages in the report may not always equal the sum of individual percentages because of rounding.

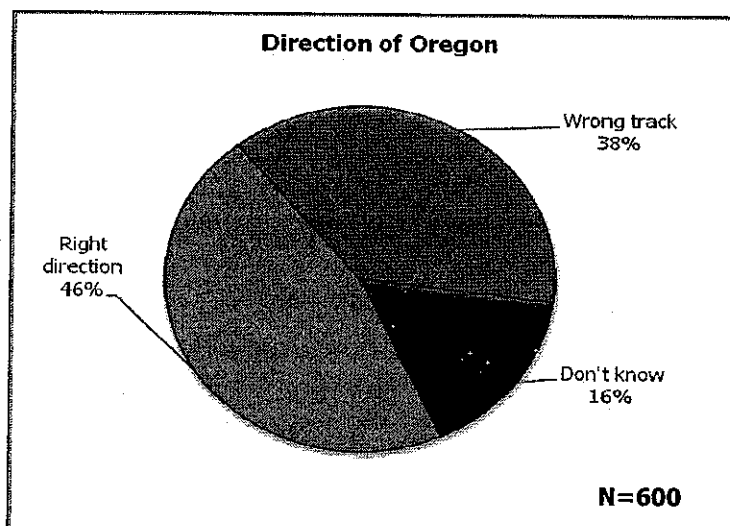
Statement of Limitations: Any sampling of opinions or attitudes is subject to a margin of error, which represents the difference between a sample of a given population and the total population (here, voters in Oregon). For a sample size of 600, the maximum margin of error would be +/- 4.1%.

These plus-minus error margins represent differences between the sample and total population at a confidence interval, or probability, calculated to be 95%. This means that there is a 95% probability that the sample taken for this study would fall within the stated margins of error if compared with the results achieved from surveying the entire target population.

Findings

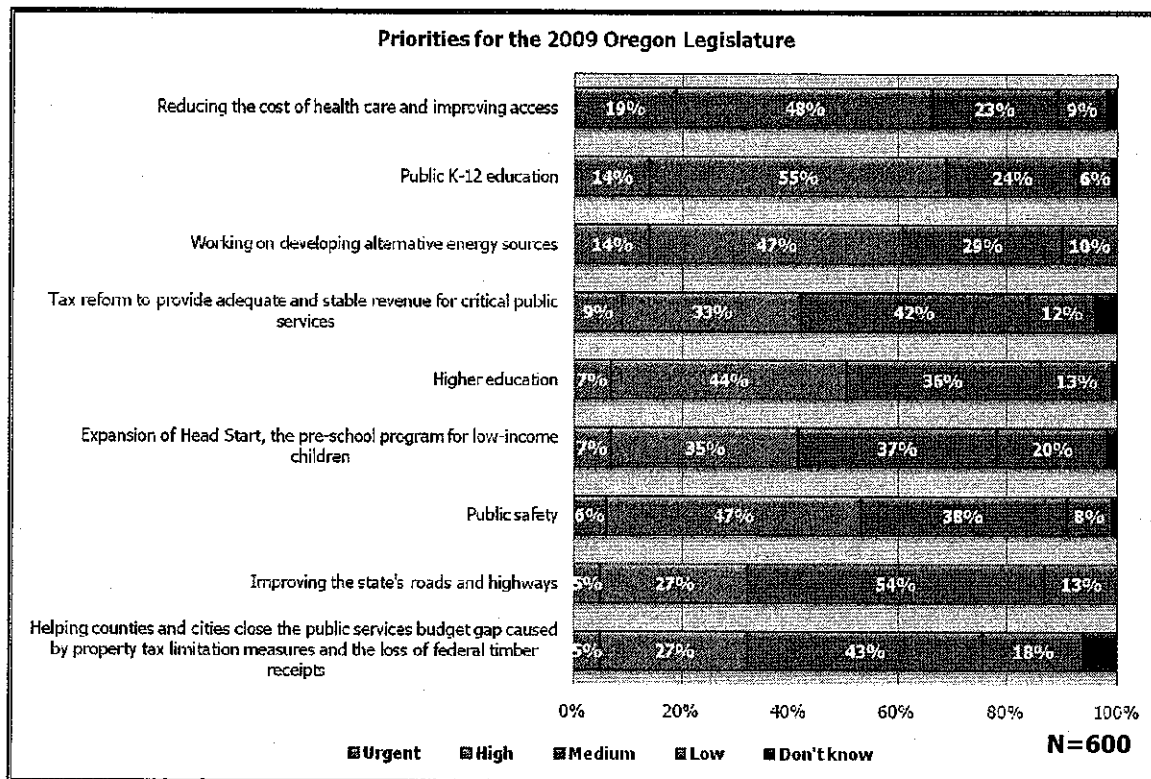
II. Priorities for the 2009 Oregon Legislature

A narrow plurality of 46% said the state was headed in the right direction, 38% felt things were off on the wrong track, and the remaining balance were undecided (Q1). Perhaps the key differences were found by party and ideology, with Democrats, Independents and liberals who said things in the state are headed in the right direction, while Republicans and conservatives were pessimistic. An observation that we would make here is that field work for the survey was completed immediately following the election, which produced substantial victories for the Democrats both nationally and in Oregon. The election results probably lifted up the Democrats and depressed the Republicans regarding the direction of the state. This is a pattern we have seen in other elections, and we would caution the reader that external events may well bring the upbeat numbers for Democrats down in the coming months, or even weeks.



Source: Davis, Hibbitts, & Midghall, Inc, November 2008

Voters were read a list of items and asked if the 2009 Oregon legislature should give each a low, medium, high, and urgent priority, knowing that financial resources are limited (Q2-Q10). The following chart highlights the order of priorities for voters:



Source: Davis, Hibbitts, & Midghall, Inc, November 2008

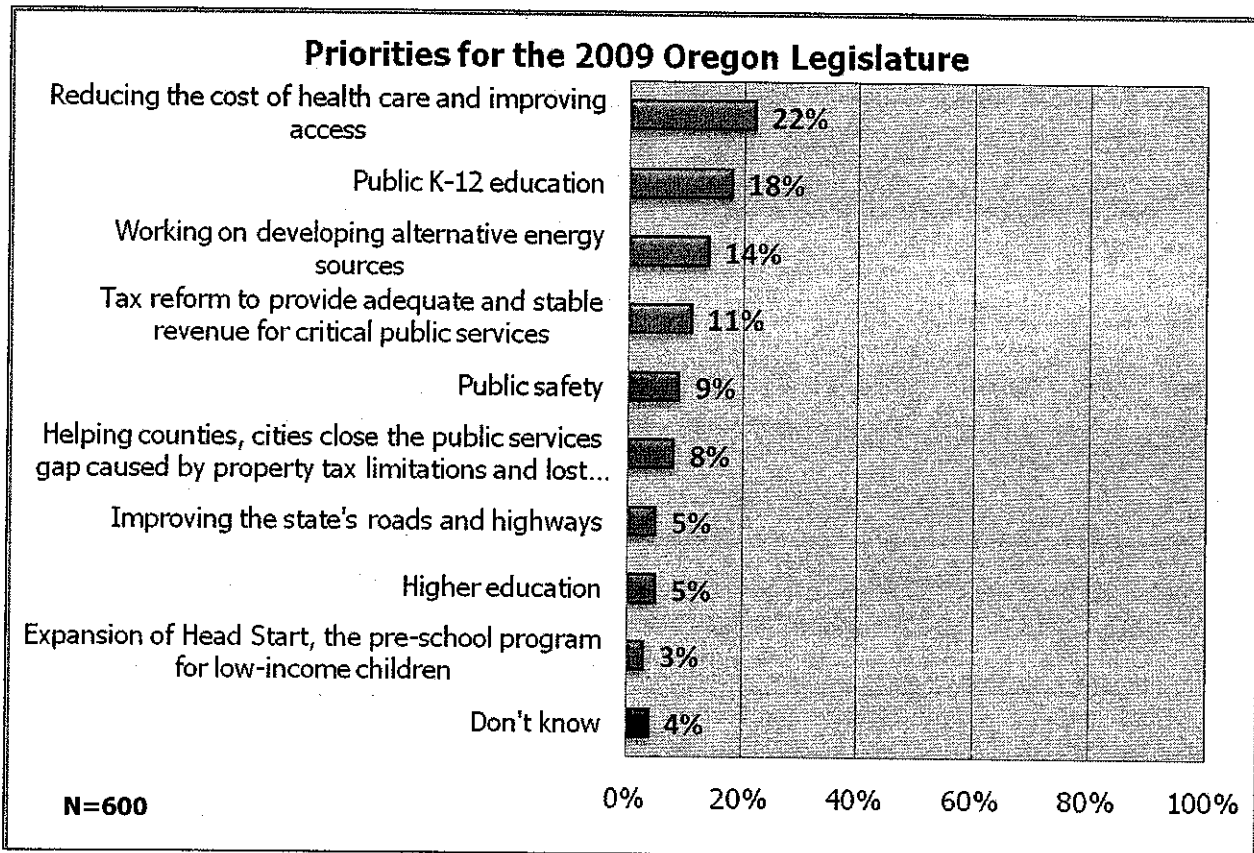
When looking at these priorities for the next session of the Legislature, three stood out (with more than 60% rating it a high or urgent priority). These included public K-12 education (69% high/urgent priority), reducing the cost and increasing access of health care (67% high/urgent priority), and working on developing alternative energy sources (61%). All other priorities were seen as urgent or high by less than six in ten respondents.

Around one-half of voters viewed public safety (53% high/urgent) and higher education (51% high/urgent) as urgent or high priorities, followed by expansion of Head Start (42% high/urgent). Slightly over four in ten respondents (42% high/urgent) viewed tax reform to provide adequate and stable revenue for critical public services as an urgent or high priority, 42% said it was a medium priority, and 12% reported it was a low priority.

At the bottom, 32% of voters reported improving the state's roads and highways as an urgent or high priority, followed by helping counties and cities close the public services budget gap caused by property tax limitation measures and the loss of timber receipts (32% high/urgent).

One point we would make is that there was a partisan coloring to these priorities, as Democrats and Independent voters had a noticeably higher level of focus on the top issues than Republicans. In fact, the number one priority issue for Republicans was public safety (59% high/urgent priority), followed closely by K-12 education (58% high/urgent priority).

When asked to pick the top priority for the 2009 Legislature from the same list of issues, we received no decisive direction from voters, though the top priorities tended to match what we found in the previous question (Q11).



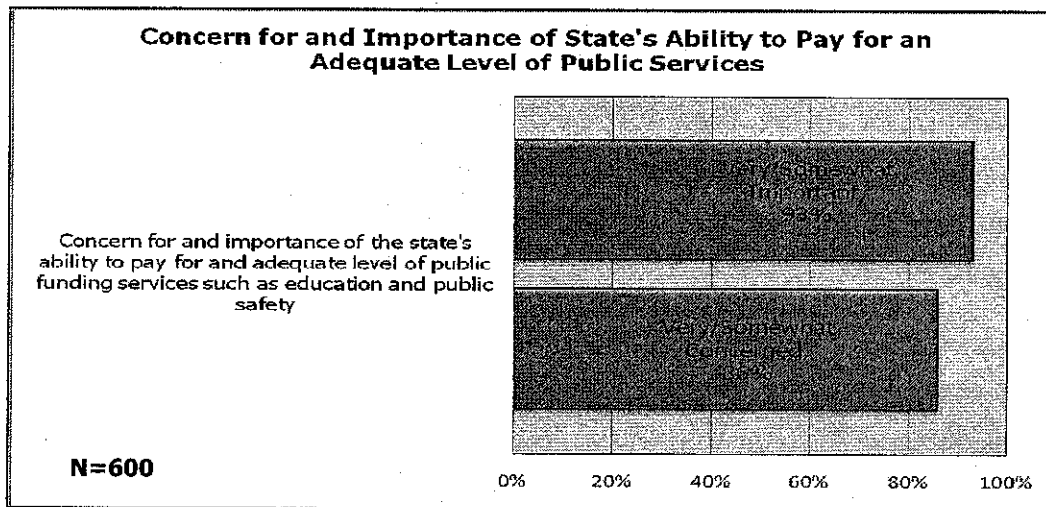
Leading the list at 22% was improving the cost and access to health care, followed by 18% who selected public K-12 education. In the second tier, 14% rated working on alternative energy sources as the top priority, and 11% said tax reform. Last, 9% ranked public safety as a top priority, 8% said helping cities and counties close the budget gap from property tax limitations and the loss of timber receipts, 5% each picked improving roads and highways or higher education, and 3% selected expanding Head Start.

It is worth noting that the timber receipts issue is viewed as one that Oregonians say needs to be addressed (80% felt it was very or somewhat important that the Legislature help cities and counties close the budget gap caused by the loss of timber receipts: Q15), but it is not viewed as a front rank issue at this time.

It is clear that voters are concerned about the state's ability to pay for an adequate level of public services for things like education and public safety (Q12), as fully 86% said they were very or somewhat concerned (50% somewhat, 36% very).

This was a consensus finding, though Democrats (42%) and liberals (41%) were noticeably more likely to say they were very concerned about this than either Republicans (32%) or Independents (30%). Further, fully 93% of those polled said it was very (57%) or somewhat (36%) important for the Legislature to address the problem of the state's ability to fund adequate levels of public services.

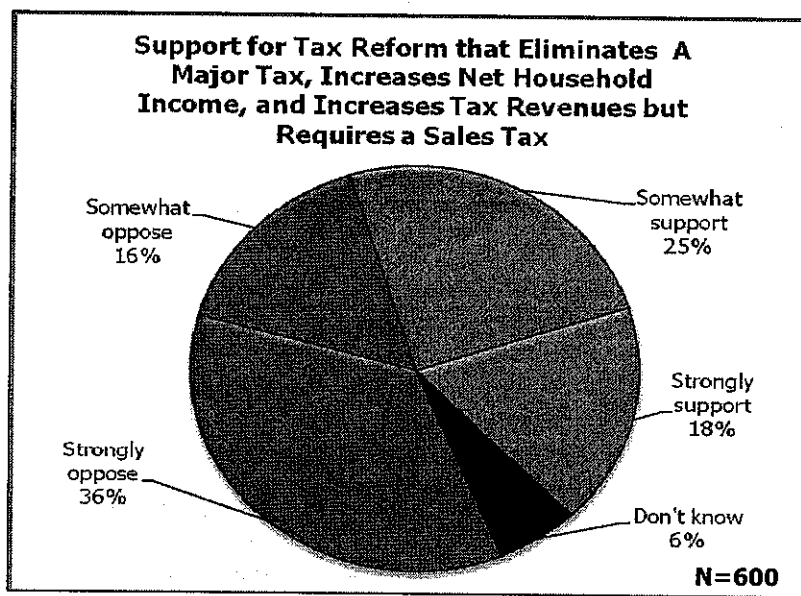
This was a consensus finding with huge majorities in all subgroups saying that it was very or somewhat important that the issue be addressed by the Legislature. It is worth noting that 64% of Democrats and 46% of Republicans described this as very important, indicating a somewhat heightened sense of urgency about the problem from Democrats.



Source: Davis, Hibbitts, & Midghall, Inc, November 2008

III. Tax Reform Options

We asked respondents if they would strongly or somewhat support, or strongly or somewhat oppose a tax reform plan that eliminates a major tax, increases revenues for state programs, but requires a sales tax (Q14). Given this construct, 52% would oppose the idea (36% strongly, 16% somewhat), while 43% would favor it (25% somewhat, 18% strongly).

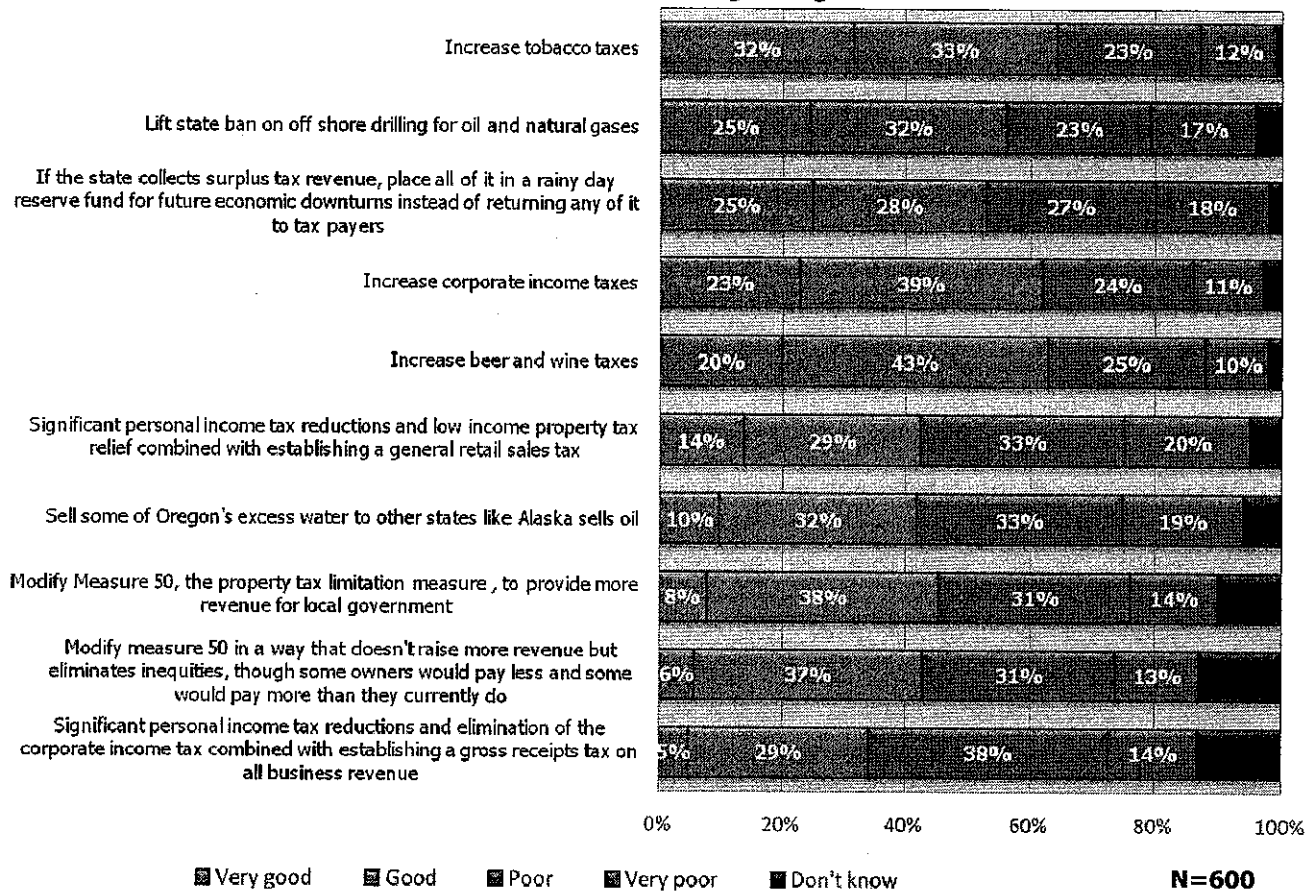


Source: Davis, Hibbitts, & Midghall, Inc, November 2008

There was little in the way of subgroup difference here with two exceptions. First, those over the age of 55 were more resistant to this idea, as 56% opposed it and only 38% were in favor. By contrast, those 18-34 years of age split 48% in favor and 45% opposed. Additionally, there was a noticeable difference by ideology (but not by political party), with conservatives opposing this idea by 60% to 33%, compared to moderates (51% oppose and 45% in support), and liberals (53% support and 41% opposition).

Voters were given a series of ten general proposals for restructuring the state's tax system, and asked for each if the respondent thought it was a very good, good, poor, or very poor idea (Q17-Q26). The following table reflects responses by subgroup:

Priorities for the 2009 Oregon Legislature



Source: Davis, Hibbitts, & Midghall, Inc, November 2008

As the table indicates, there is substantial majority support for increasing tobacco taxes (65% good/very good idea), increasing beer and wine taxes (63% good/very good), increasing corporate income taxes (62% good/very good), and lifting the ban on offshore drilling for oil and natural gas (57% good/very good). Republicans are willing to support increasing beer and wine and tobacco taxes, but not increasing corporate income taxes (a proposal that is very popular among Democrats and Independents). Republicans and conservatives also overwhelmingly support lifting the ban on offshore drilling, while Democrats and liberals oppose this idea.

No other proposal garnered a huge majority of support among voters, though a narrow majority of 53% favored the idea of placing surplus tax revenues in a rainy day fund rather than return any of it to taxpayers. Some 53% of those surveyed thought this was a good or very good idea, while 45% thought it was a poor/very poor idea. Again, subgroup differences were driven by party and ideology. In short, Democrats and liberals strongly endorsed the idea, Republicans and conservatives strongly opposed it. Independent voters split about evenly (53% good, 47% poor), and the large bloc of moderate voters gave a 57 to 41% endorsement to the idea of using surplus tax revenue for a rainy day fund, rather than return it to the taxpayers.

Other proposals fared less well with voters. Voters split about evenly on the idea of modifying Measure 50 to provide more revenue to local governments. Some 46% thought it was a good idea, 45% said it was a bad idea. Ideological divisions were not as great on this proposal, though they still existed. In short, liberals favored this idea by 50% to 38%, conservatives opposed it by 51% to 40%.

A similar idea to modify Measure 50 in a way that does not increase revenues but eliminates inequities also divided voters. Some 44% said this was a poor idea, 43% thought it was a good idea. Again, the only notable subgroup difference here was ideology, with liberals marginally supportive (48% good idea, 37% poor idea), and conservatives in opposition (52% poor idea, 36% good idea).

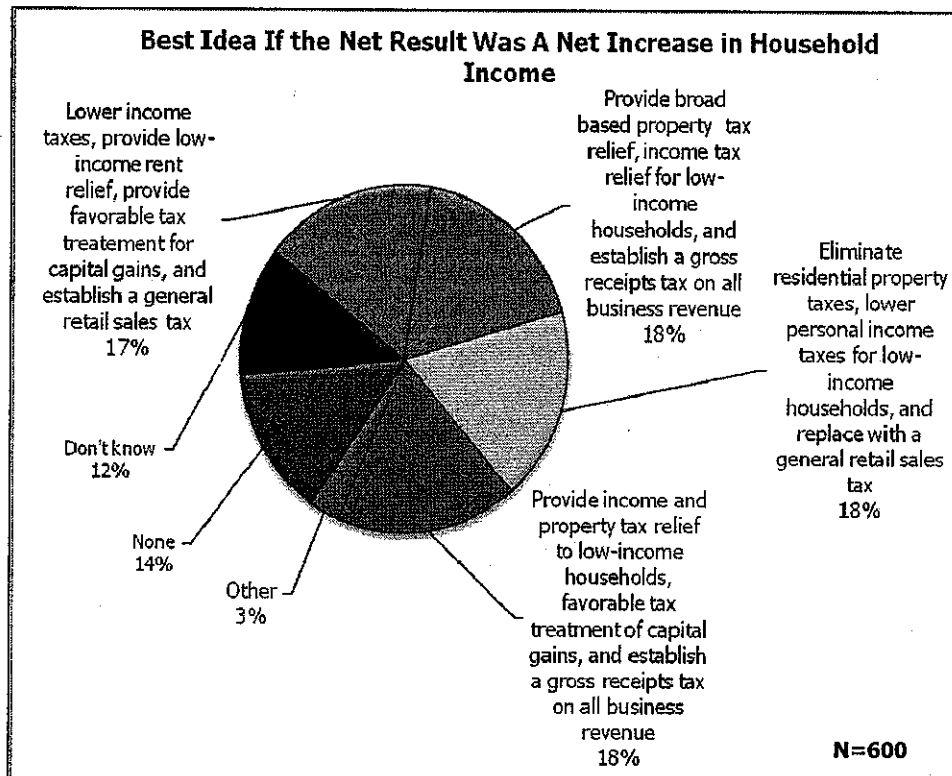
The remaining proposals were even less popular. Some 52% thought it was a poor/very poor idea to sell excess water to other states like Alaska sells oil, while 42% thought this was a good or very good idea. Opposition to this idea was centered among those outside the Tri-County area, among voters over age 55 (where it was thought to be a poor idea by 65 to 28%), and among liberals and Democrats (63% poor idea and 61% poor idea respectively). Republicans (52% good idea), and conservatives (49% good idea) were the most supportive.

A sales or gross receipts tax did not fare well with voters, as 52% said it was a poor idea, and 34% felt it was a good idea. The results were very consistent among subgroups, with nearly all subgroups clustered around the overall average of opposition (52%).

The proposal of a significant personal income tax reduction and low income property tax relief in exchange for a general retail sales tax was viewed as a poor idea by 53% of those polled, 43% thought it was a good idea. There are a group of potentially persuadable voters, as only 20% described this as a very poor idea and 14% thought it was a very good idea. Subgroup differences were not that great, with Democrats and conservatives slightly more inclined than average to say this proposal is a poor idea. Men also were more resistant than women, as 57% of the former and 49% of the latter saw this as a poor idea.

Lastly, the idea of eliminating property taxes for nearly all residential property owners combined with the establishment of a general sales tax was not viewed favorably by voters. Overall, 62% said this was a poor idea (26% very poor, 36% poor), while just 34% saw it as a good idea (13% very good, 21% poor). This proposal was turned down by a large majority of respondents in all subgroups, but it was especially unpopular among Democrats (72% poor idea) and liberals (70% poor idea).

When asked which (of four) ideas was best for the respondent if it led to a net increase in household income (Q27), we received no clear direction.



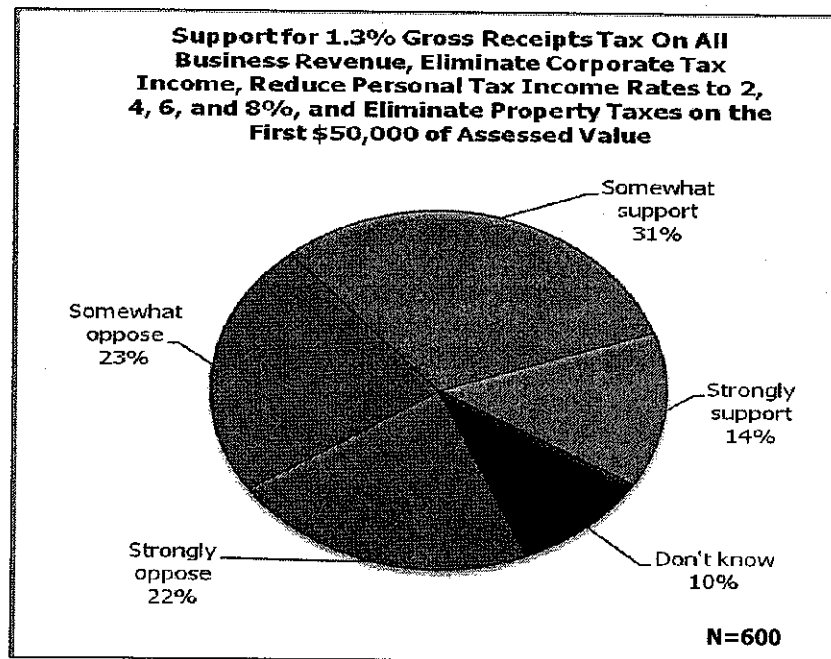
Source: Davis, Hibbitts, & Midghall, Inc, November 2008

Some 18% said providing income and property tax relief to low income households, favorable tax treatment for capital gains, and establishing a gross receipts tax on all business revenue would be the best, the same percentage (18%) said that broad based property tax relief, income tax relief for low-income households and a gross receipts tax on all business revenue would be the best for them, a further 18% said eliminating residential property taxes, lower personal income taxes for low-income households, and a general sales tax would be best. Seventeen percent (17%) of voters reported that lower income taxes, low income rent relief, providing favorable treatment for capital gains, and establishing a general retail sales tax would be best, while 14% said that none of these options would be the best idea for them, and 12% were unsure. In short, there is absolutely no consensus among voters (nor anything approaching a consensus) out of these options.

IV. Sales Tax/Gross Receipts Options

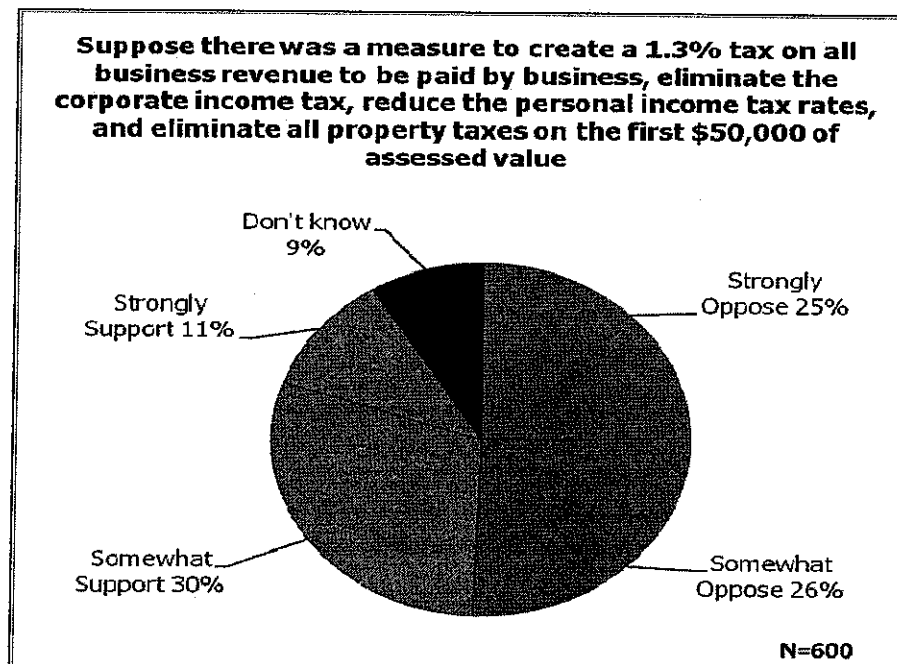
We posited a number of possible changes in the state's tax system to respondents, and asked for their opinion about the options. In short, none of the proposals garnered majority support from voters, though all had substantial support from voters.

Marginally, the strongest proposal was to create a 1.3% gross receipts tax on all business revenue, while eliminating the corporate income tax, reducing personal income tax rates, and eliminating property taxes on the first \$50,000 of assessed value (Q31).



Source: Davis, Hibbitts, & Midghall, Inc, November 2008

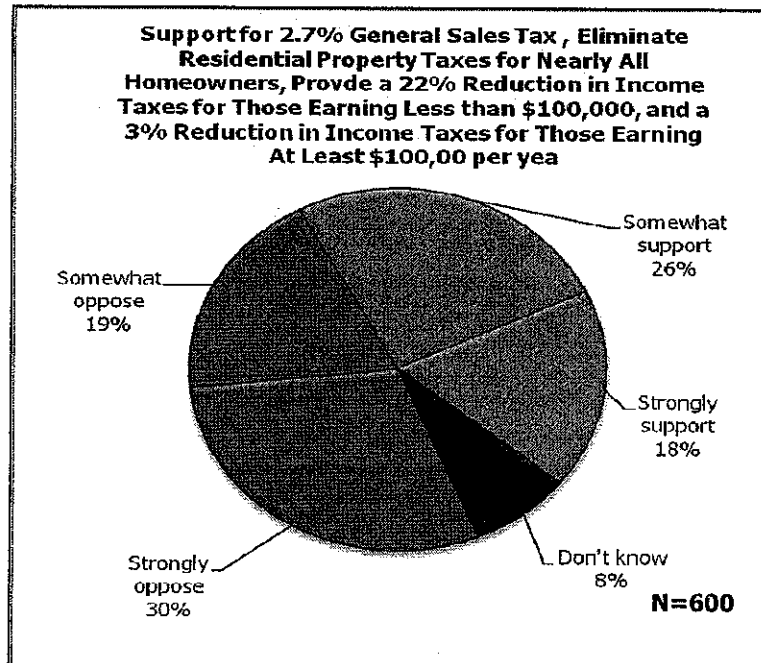
Some 45% of those polled would support this idea, 45% would oppose it, and the balance was unsure. It is worth noting that 22% strongly opposed this idea, while a smaller 14% strongly supported it. We found virtually no subgroup variations on this proposal, with the modest exception that conservatives opposed the idea by 50% to 42%. We then retested this proposal near the end of the survey, and received somewhat more negative results (Q37). In the second test vote, 51% opposed the proposal, 41% supported it. Strong opposition increased slightly from 22 to 25%, strong support decreased slightly from 14 to 11%.



Source: Davis, Hibbitts, & Midghall, Inc, November 2008

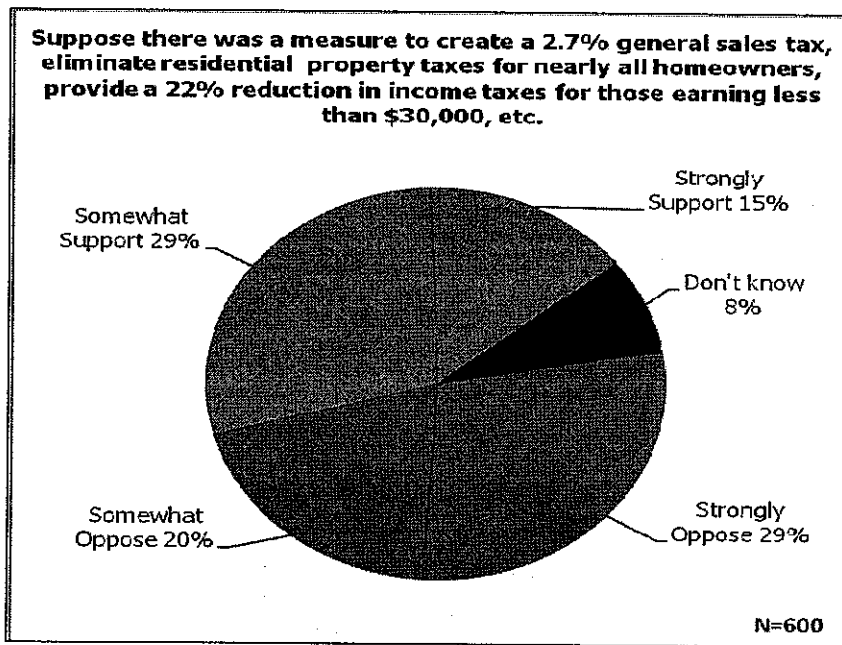
Opposition to the idea increased modestly across the board in subgroups, with conservatives again opposing the idea by the largest margin (57 to 37%).

We also tested a proposal to create a 2.7% general sales tax, with the elimination of residential property taxes for most homeowners, and income tax reductions also included. In the first 'ask' about this proposal, it was rejected by a 49% to 44% margin, with 30% strongly opposed to the idea and 18% strongly supportive (Q32).



Source: Davis, Hibbitts, & Midghall, Inc, November 2008

This proposal creates some slightly different coalitions. Opposition to this proposal was greatest among Democrats (53%), liberals (52%), and conservatives (52%). We retested this proposal later in the survey (Q39) and got the same outcome (49% opposition, and 44% support). Strong support was at 15%, strong opposition was at 29%. Subgroups were effectively unchanged from the first test vote.



Source: Davis, Hibbitts, & Midghall, Inc, November 2008

V. Kicker and Measure 50 Options

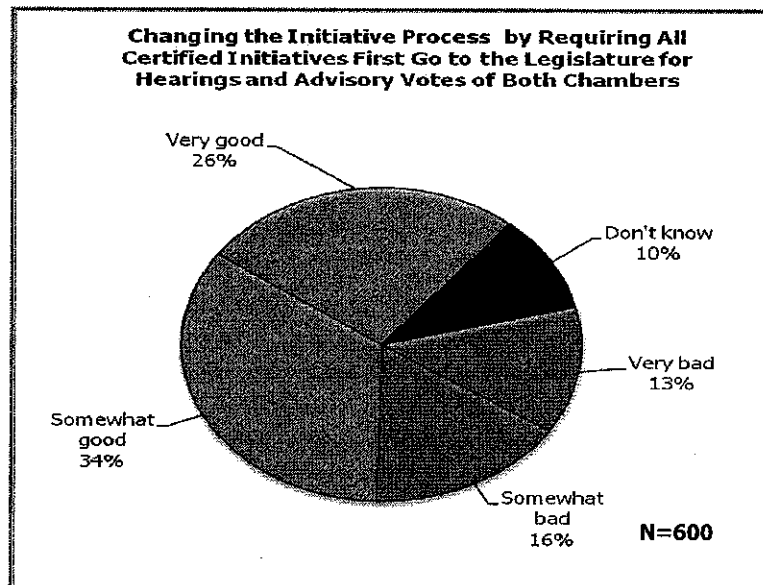
By a 68% to 29% margin, voters were supportive of the idea of keeping the kicker in a rainy day fund to sustain programs when the economy is down, with the understanding that any excess above 10% of the previous general fund budget would be returned to taxpayers (Q28).

Fully 38% of those polled strongly supported this idea; just 18% strongly opposed it. This was a consensus finding, with a large majority in every subgroup indicating support for this idea, including conservatives, who favored it by a narrower 55% to 42%.

Voters were evenly split on the notion of changing the maximum fixed rate of property taxes from \$15 to \$10 per thousand, but basing the tax on market value of the property rather than assessed value (Q29). Forty four percent (44%) supported this idea, 43% opposed it. Again, the key differences were by party and ideology. Democrats and liberals favored this idea, Republicans and conservatives were opposed, especially the latter (55 to 32%).

VI. Changing the Initiative Process

Voters indicated support (61%) for an idea that would change the initiative process to require all certified initiatives to go to the Legislature for hearings and advisory votes, with the option of the Legislature offering an alternative for voters to consider (Q30). Some 30% thought it was a bad idea.



Source: Davis, Hibbitts, & Midghall, Inc, November 2008

While there was majority support for the idea in all subgroups, Republicans and conservatives offered less support for the idea (54% and 51% respectively thought this was a good idea).

VII. Summary and Observations

1. Key priorities for the upcoming legislature are public education, reducing the cost and improving access to health care, and working on alternative energy sources. Had we added economic concerns to the list we believe that they also would have been a high priority item, given current economic conditions. One point we would make is that tax reform was fairly low on the list of priorities, ranking in a tie for sixth of the nine issues we asked about. It did finish fourth when we asked voters to pick the single most important priority for the next legislature to work on, but was selected by only 11% as the highest priority.
2. There is a high level of concern about the state's ability to pay for public services, but a definite lack of consensus about what to do about it. This is a pattern that we have seen for the past several decades when asking about this issue; voters tend to express a fairly high level of concern about the issue of funding state services, but no policy consensus about what to do about it.

3. Revenue options that were broadly acceptable to voters were increasing the tobacco tax, increasing beer and wine taxes, and increasing corporate income taxes (no specific amount was suggested). Voters also supported changing the initiative process to require all certified initiatives to go to the Legislature for hearings and advisory votes, with an option of offering an alternative, by more than a 2:1 margin (61% to 30%).

A variety of other proposals provoked a fairly narrow split among respondents, including modifying Measure 50, and taking surplus tax revenues and placing them into a rainy day fund instead of returning the money to taxpayers. A narrow majority of 53% supported this idea, 45% opposed it.

Voters did not warm up to the concept of replacement tax in the form of a gross receipts or sales tax. A gross receipts tax, with elimination of corporate income taxes and significant personal income tax reductions was thought to be a poor idea by 52 to 34%. Likewise, elimination of property taxes for nearly all residential homeowners combined with a general retail sales tax was seen as a poor idea by 62% of those surveyed.

4. Some general thoughts on a sales tax are appropriate here. This is an issue we have polled repeatedly over the past three decades. We have never seen a sales tax (either conceptually or a specific proposal) start with majority support in a survey. We have often seen a sales tax proposal start in the 40-45% range, with similar numbers or slightly larger ones in opposition. In those circumstances where a measure has gone to the ballot, it has inevitably lost support over the course of the campaign, and wound up in the mid 20's percentage.

None of this means that voters would absolutely reject another sales tax proposal, but given the fact that it has been voted down nine times and never received more than 29% of the vote, and given the fact that nothing in this survey suggests that voters are more favorably disposed toward a sales tax now than they were the last time we looked at it two years ago, the odds of passage of any kind of sales tax or gross receipts tax measure seem slim at best, even when proposed as a replacement for the income or property tax.

Appendix J

Glossary of Terms Used in Report

GLOSSARY OF TERMS USED IN REPORT

2% Surplus Kicker

State revenue limit that was put into statute in 1979 and amended into constitution by voters in 2000 election. Limit goes into effect when General Fund revenue exceeds revenue forecast at time Legislature approves biennial budget by 2% or more. When 2% threshold is exceeded, entire amount of revenue above the forecast (including the 2%) is returned to taxpayers in following biennium. Kicker is calculated separately for personal income taxpayers and corporate income taxpayers. If corporate income taxes exceed revenue forecast by 2% or more, corporate income taxpayers receive a credit equal to the entire amount above the forecast. When all other General Fund revenue exceeds the forecast by 2% or more, personal income taxpayers receive a refund equal to the total amount of non-corporate General Fund revenue above the forecast.

Changed Property Ratio

The ratio of average maximum assessed value under Measure 50 to the average real market value. This ratio is used in calculating the assessed value of new property that comes on the tax rolls.

Dynamic Revenue Impact

Indirect revenue change resulting from impact of tax change on economic activity. The Oregon Tax Incidence Model (OTIM) is used to calculate the change in economic activity resulting from a tax change and estimating how much that will affect tax revenue. The dynamic revenue impact is added or subtracted from the static revenue impact to get the total long-term revenue impact of a proposed change.

Earned Income Tax Credit

Income tax credit for low-income working taxpayers. Amount of credit depends on income and number of dependents. Oregon's credit is set at a percentage of the Federal credit and is refundable, meaning the credit can exceed the total amount of tax liability.

Effective Property Tax Rate

Defined as the total taxes collected divided by the market value of property. Since the market value of property is greater than the assessed value on a statewide basis under Measure 50, the effective tax rate is less than the tax rate applied to assessed value.

General Fund Budget

The state's discretionary budget decided every two years by the Legislature. Over 90% of General Fund revenue comes from income taxes. Over 90% of General Fund expenditures go to education, human services and public safety. Sometimes the General Fund budget is combined with the discretionary (non-dedicated) portion of the Lottery fund to get a broader measure of discretionary spending.

Gross Receipts Tax

Tax paid by businesses based on the total dollar amount of receipts from sales. Broad tax base allows for large revenue collections from relatively low rate. Current state examples of gross receipts taxes are Ohio's recently enacted Commercial Activities Tax (CAT) and Washington's Business & Occupation Tax (B & O tax).

Homestead Exemption

Form of property tax relief used in many states though not currently in Oregon. A homestead exemption exempts a set amount of assessed value from property taxes on owner occupied residential property.

Local Preemptions

In most cases, Oregon cities and counties are free to impose taxes on income and sales, including specific types of sales. However, the Legislature can "preempt" local governments from taxing certain things by passing a law prohibiting them from doing so. Over the years, the Legislature has preempted a number potential revenue sources for local governments including real estate transfer taxes (Washington County has a real estate transfer tax because of a grandfather clause), cigarette taxes and construction excise taxes.

Measure 5

Constitutional property tax limitation approved by voters in 1990. Measure 5 limits property taxes for schools (including K-12, education service districts and community colleges) to \$5 per \$1,000 of market value. The sum of nonschool property taxes is limited to \$10 per \$1,000 of market value. Levies to pay bond principle and interest for capital construction projects are outside the limits if approved by local voters.

Measure 50

Constitutional property tax limitation referred to voters by the 1997 Legislature to replace Measure 47 which was approved by voters in November 1996. Measure 47 was deemed to have technical problems making it difficult to implement. Measure 50, reduced the assessed value of every property to 90% of its 1995-96 assessed value, and limited assessed value on existing property to 3% annual growth. New construction and other exceptions are brought on the tax rolls at the average assessed to market value ratio for properties of that class in that county (see changed property ratio). Measure 50 established permanent property tax rates for all taxing districts that had a tax rate at the time of implementation.

Oregon Tax Incidence Model (OTIM)

OTIM was developed by the Legislative Revenue Office in conjunction with Oregon State University at the direction of the 1999 Legislature. OTIM is a computable general equilibrium model of the state economy designed to show how tax changes affect wages and prices and how these changes ultimately affect the overall level of economic activity as measured by total personal income and employment. OTIM compares the current economy (baseline) to how it would look after wages and prices have adjusted to the tax change. This is assumed to reflect a 5-year adjustment period. After accounting for these changes, OTIM produces a new set of estimates for the distribution of income and state revenue.