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Abstract

At the end of a biennial session Oregon legislators realized their just approved, \$15 billion two-year budget depended on very fragile and optimistic forecasts for the revenue needed to balance. If the economy didn't improve, they faced a billion dollar plus shortfall. There was a glimmer of hope in the federal stimulus and the promise of a billion dollars from increases in the personal income tax. Legislators hoped that both would materialize, and in the end the budget would be balanced for the entire two-year cycle. It was known at the time that these new taxes would probably be challenged by tax payers through a referendum, so hurriedly before leaving Salem; they set February 2, 2010 for the opening date of a special session that would address budget shortfalls should the new taxes be struck down.

Keywords: Oregon budget, state budgets, fiscal policy, state taxes

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Avoiding Hard Choices: Oregon's Special Session to Amend the 2009-2011 Budget

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Mid-Point Budgeting in Oregon: An Overview

At the end of the biennial session last June 29th legislators realized the \$15 billion two-year budget they had just approved was dependent on very fragile and optimistic forecasts for the revenue necessary to balance that budget. At the time, a more than billion dollar shortfall was anticipated unless the economy improved. But there was a glimmer of hope because of federal stimulus money, and the promise of a billion dollar increase that would come from increases in the personal income tax. Legislators were hopeful that both would materialize, and in the end the budget would be balanced for the entire two-year cycle. However, it was also known at the time that these new taxes would probably be challenged by tax payers through a referendum, so hurriedly before leaving Salem; they set February 2, 2010, for the opening date of a special session that would be able to address budget shortfalls should the new taxes be struck down by a possible referendum. An editorial in *The Oregonian* the day after the session ended summed up the mood of that session, "It was a year of governing dangerously. Democrats picked a fight with business (Increased corporate income taxes), recklessly spent reserves (money from surplus accounts), and risked their majorities, but in these tough times, they shielded kids and schools) *The Oregonian*, June 30, 2009.

In the last two quarters of 2009 and in the first quarter of 2010, Oregon has had a somewhat better economy, but it has not improved to the point of anticipating pre recession revenues in taxes on corporate and personal income. Two referenda to challenge the increases in personal income and corporate taxes did materialize, but they were unsuccessful in turning back the proposed increase in the income taxes—the first time Oregonians have voted for an increase in taxes in 80 years.

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Federal stimulus monies have had a positive effect on the state's economy through an additional billion dollars in new money that has been spent on a wide variety of state services as well as a few infrastructure projects. So when the special session convened on February 2, 2010, legislators did not have the pressure to immediately find additional revenues to address the potential shortfall everyone worried about six months earlier. Lawmakers spent most of the special session on issues that were less directly associated with the immediate need to address revenue shortfalls. One of those issues was to dismantle the Kicker Law (The provision that when revenues exceed 2% of the projected revenue the budget has approved, those surplus funds are returned to taxpayers.) and in its place increase the very modest rainy day fund that was instituted three years ago. However, partisan politics made that goal impossible, and in the end, this special session actually ended earlier than planned. They did manage to pass legislation providing for a permanent special session in the years when there were no scheduled sessions that will have to be referred to voters, and motorists using cell phones while driving. Legislators may have dodged the major issue of funding state services in the short run, but the next biennial process that will begin in less than a year is hardly encouraging.

Politics in the State

Similar to the lack of bipartisanship at the federal level, Oregon's politicians have likewise demonstrated the same uncivil and uncooperative manners that have become so distasteful to the electorate. Within such a partisan atmosphere, the Oregon state legislature appears to be as dysfunctional as Congress. An expectation of addressing serious problems in the state is nonexistent. In particular a restructuring of taxes so as to correct the over dependence on the personal income tax that is so closely affected by unemployment gets nowhere when Democrats and Republicans even suggest the topic. This overdependence on the personal income tax in times of recession is extremely problematic for the state because personal income taxes suffer severely with high unemployment rates. With this present lack of confidence that legislators cannot govern the coming November elections may prove very interesting. In November Oregonians will not only elect the legislature, but it will also be electing a governor, and there are already signs of change afoot

In a state that has had divided government for most of the past two decades, it would appear that the overall political makeup of state government would not be that different. However, the last Republican elected governor of the state was in 1982, and despite having elected four Democratic governors since then, the House of Representatives, in six of the past eight elections has been able to hold on to Republican majorities. The Senate has held a Republican majority only once during this period, and has had an evenly split chamber in 2002-04. Table 1 indicates the

Table 1. Political Makeup of the Oregon Legislature 1994-2008

Year	House of Representatives		Senate	
	Democrats	Republicans	Democrats	Republicans
1994	26	34	11	19
1996	29	31	16	14
1998	26	34	17	13
2000	25	35	18	12
2002	27	33	15	15
2004	25	35	18	12
2006	31	29	18	11 + 1*
2008	36	24	18	12

*Independent

makeup of the Oregon Legislature from the elections of 1993 to 2008, within the context of continually electing Democratic governors and mostly Democratic Senators through this entire period.

After the November 2009 elections, Democrats were convinced that having maintained a Democratic House and Senate since 2006, and with a second term Democratic governor, the party would be in a position to do most anything it would like within reason. However, what it did not anticipate was the impending difficulties that the economic recession of 2008-09 would have on what appeared to be a very promising majority. Republicans dug in, not all the Democrats were united with the governor's agenda, and the Democrat's hope of using what appeared to be a supermajority was so diminished when faced with financing public education and other services in tough economic times.

The divisiveness between the two parties reared its ugly and disconcerting self most visibly in any attempt to address projected revenue declines that the state has now experienced for two years. Democrats not wanting to face an angry citizenry when told of cutting support for K-12 education, and not wanting to push their luck with any additional tax increases, dug deeply into every reserve fund the state had in place. The single most "hit" fund was that of the Oregon Public Utilities Commission. Making up for the needed revenues and with their backs against the wall, Democratic lawmakers managed to raid ratepayers funds to the tune of approximately 20 million dollars (Esteve, *The Oregonian*, February 20, 2010, A1).

The race for governor of Oregon could prove to be the most interesting election in recent history given the sour mood of voters. Democrats have two major candi-

dates who will run in the May primary for its nomination, former governor, John Kitzhaber who held two terms from 1995 until 2003, and Robert Bradbury who was former secretary of state. Both men are popular and well known in the state. The Republicans have seven or eight candidates for the May primary depending on what day you look at the party's options, but the most encouraging is Chris Dudley, a former professional basketball player for the Portland Trailblazers, and politically an unknown. However, Dudley could become a serious challenger to the Democrats should he win his party's nomination. His lack of political experience in his own words is "his best advantage" in a period when voters so distrust major politicians.

As the state moves into the fall elections, it could be a very interesting period in which the Democratic hold on the governor's role quite possible could change, and the majority of incumbents are challenged by much less experienced law makers. The makeup of the state's administration could look very different a year from now.

The Economy

Oregon occupies a very difficult position in funding its budget because of its overdependence on the corporate and personal income taxes. Both forms of the income tax have traditionally been around 9%, but with the passage of two bills in last year's session, lawmakers approved increases in both forms of the income tax that would increase corporate income taxes, and as well increase the personal income tax for couples earning more than \$250,000 annually. Legislators knew that some Oregonians were not pleased with the proposed increases and managed to get sufficient support to have these increases referred to voters. As a result, Measures 66 and 67 were put before Oregonians on January 26, 2010, and for the first time in eighty years, Oregonians were asked to support an increase in its major form of taxation. Measure 66 addressed the increase in corporate taxes, and Measure 67 addressed the personal income tax for couples earning more than \$250,000 per family. Oregonians voted down both measures by a 56-44 ratio, and Democratic lawmakers were convinced they would not have sufficient revenues to fund the present budget for both years.

However, what Democrats did not consider carefully is that the slightest variation in failure to produce these increased taxes jeopardizes any revenue forecasts that are supposed to guarantee funding. Oregon has a long history of witnessing how the unemployment rate has seriously affected revenue forecasts, and an examining of unemployment figures for the just the past decade illustrates those years in which it has been difficult to support the budget with sufficient revenue. Table 2 illustrates shifts in unemployment in the state which results in millions of dollars lost as unemployment increases. In years when unemployment rates spike quickly,

Table 2. Oregon's Unemployment Rate, 2000-2010

Year	Unemployment Rate
2000	4.3%
2001	6.4%
2002	7.8%
2003	8.2%
2004	7.9%
2005	6.1%
2006	4.3%
2007	5.1%
2008	7.3%
2009	12.1%
2010	10.5%*

*As of March 1, 2010

legislators have been faced with two problems: first, having sufficient revenues to cover shortfalls; and second, and the drastic need to look for new sources of revenue that would make up for overly optimistic economic forecasts. As experienced from past downturns in the economy, for every ½ percent of the unemployment rate, the state loses approximately \$300 million in revenue. In a state that has depended so heavily on the nine percent income tax, Oregon experiences recession even more so than states that have more varied sources for producing revenues.

The state's economy has improved somewhat since the summer of 2009. But it is still not strong, and with a 10.5 percent unemployment rate presently, it has come nowhere near replacing the tens of thousands of jobs lost in the last two years. Tom Potiowsky, from the state Office of Economic Development, has predicted a slow, long recovery every bit as bad as the 1980s when it took Oregon seven years to come back to pre-recession employment rates (Esteve, Feb 9, 2010, A1-6). Most state economists agree with Potiowsky, and warn that the next biennial budget's shortfalls could even be more severe given that the state has spent most of its reserved funds to get through the present budgetary cycle. In the six months since June 2009, voters approved two tax measures, the state added more than 2,900 jobs in December—the most since June, 2008, and third best in the nation, legislators hoped for the best and acted as if the state was beginning to pull out of the recession. However, because of unanticipated dramatic increases in the cost of Business Ener-

gy Tax Credits that resulted in a significant source of revenue, the reality became clear: Oregon was still not out of the woods (Buckley).

A further concern regarding the actual effect the increases in income taxes would have on overall revenue is uncertain. Critics have warned Democrats that Oregon has one of the highest corporate income taxes in the nation, and this will serve as a disincentive to attract new businesses, and worse yet, it may cause business to move from Oregon. As for the personal income taxes affecting couples making more than \$250,000 annually, there has been a growing movement for wealthy Oregonians—most of whom live within a short distance of Portland—to move across the Columbia River to Washington where they would pay much less in personal income taxes.

The 2009-11 Biennial Budget

Twenty years ago, Oregonians approved Measure 5 that basically put restrictions on the amount of money home owners could be assessed, and specifically limited the amount local school districts could raise to support K-12 public education. Over the next decade then, the state assumed the major responsibility of funding K-12 public education and managed to do so given the increases in a well educated and well paid workforce that came into the state to feed the high tech industries. The resultant increases in revenues nearly doubled over the last fifteen years, and despite some minor setbacks, the state managed to fund the usual level of expectations Oregonians enjoyed. However, as that high tech bubble burst and as population growth slowed, unemployment rates increased, and the major item in General Fund Revenues would no longer be able to fund state expenditures at the level the state had come to expect.

With the failure to approve Measures 66 and 67, which would have provided additional revenue from the increased taxes, the legislature was forced to find other sources of revenue and make adjustments to the budget they approved in June, 2009. Table 3 indicates the growth of General Fund Revenue from 1995 to 2010. However, the anticipated revenue from the personal income tax and as well the corporate income tax are predictions, and they may be a bit too optimistic given the slow growth in employment, and interestingly not knowing what effect Measure 66 will have on corporations and wealthier taxpayers leaving Oregon for more tax-friendly states.

What has been presented as the 2009-11 Budget is not as rosy or concrete as one would be lead to believe. Most lawmakers—even Democrats—left Salem at the end of February knowing full well that the Personal and Corporate Income taxes even with the anticipated increases would probably not produce the almost \$14 billion dollars they actually put in the budget. Several indications from both Demo-

Table 3. General Fund Revenues, 1995-2009

	1995-1997	1997-1999	1999-2001	2001-2003
Personal	\$6.22	\$7.20	\$8.40	\$9.00
Income Tax				
Corporate Income	\$520	\$726	\$841	\$900
Tax				
Lottery Income	\$730	\$537	\$517	\$532
Cigarette Taxes	\$180	\$100	**	**
Other Taxes	\$3.40	\$437	\$621	\$621
Insurance				
Beginning Balance	\$140	\$536	\$359	\$465
Total	\$8.60	\$9.60	\$10.743	\$11.5

	2003-2005	2005-2007	2007-2009	2009-2011
Personal	\$9.78	\$9.95	\$11.174	\$13.100
Income Tax				
Corporate Income	\$410	\$456	\$648	\$878
Tax				
Lottery Income	\$673	\$772	\$1.113	\$1.148*
Cigarette Taxes	\$112	\$107	\$88	\$107
Other Taxes	\$580	\$580	\$551	\$562
Insurance	\$110.8	\$124	\$161	\$186
Beginning Balance	0	0	\$1,364	*
Total	\$11.666	\$11.989	\$15.099	\$15,981

*Figures in Table 2 are in millions.

crats and Republicans have stated that the figure is more likely to produce one or as much as two billion less from that category. In short, the anticipated revenues for 2009-11 will probably not even match the previous biennial revenues.

Based on the shaky belief that the state could realize the anticipated revenue shown above, the amended budget that the legislature approved in the special session was not very different from had been approved in June, 2009. With a further \$30 million in cuts, and some changes in the Business Energy Tax Credit Program and more use of the remaining reserve funds, the final budget for 2009-11 was approved on February 22, 2010. Table 4 illustrates the major expenditures in the 2009-11 biennial budget. There persists a realistic sense that this amended budget will not be balanced at year's end, and the first task of the next legislature will be to address that shortfall before they will be able to begin work on the 2011-13 Budget.

Table 4. Oregon's Biennial Budget for 2009-11

	2007-2009	2009-2011	% of Increase
Schools K-12	\$6,600	\$6,899	9.5 %
Higher Education	\$800	\$949.5	8%
Other Education	\$500	\$673.2	7%
Public Safety	\$2,500	\$2,721.8	9%
Human Services	\$3,500	\$3,618.9	9.6%
Natural Resources	\$377	\$364.2	-.5%
All Other	\$500	\$452.8	-1%
Total	\$15.099	\$15,848	

What this special session actually accomplished in addressing revenue shortfalls was very short termed, and as the state moves toward the next budgetary cycle, lawmakers will have to face not only the difficulty of funding the last months of the present budget, but also trying to come up with ways of increasing new revenues to pay for the next budget.

Table 4 represents the actual amended budget at this point in the two-year cycle. Of the six major expenditures, only one—Natural Resources—indicates about a one percent loss from the previous budget. However, what is not illustrated are the savings that have been imposed on every segment of state government through mandated furloughs. Beginning in 2009, and through this year, state personnel have been given furlough days as method of “inflating” actual costs. This has affected every office from the Attorney General, to State Courts, to Human Services, and also to public education. Interestingly, when offices have had furloughs, it has been made very evident to clientele so that there is complaining, and perhaps even more frustrating has been the awareness that personnel cuts are real.

What the final budget does not indicate are cuts that have been indirectly made in every area of the state budget, and these have been primarily through mandating furloughs for personnel throughout the next two years. From higher education to public safety to human resources, state workers have taken days off work to help balance the present budget. Interestingly, the more closely related state personnel are to state residents asking for services, the more effective and clear they have become in illustrating these “savings.” In phoning offices, messages frequently remind Oregonians that there will be somewhat of a wait because some of the regular staff has been furloughed that day. After six months of furloughing, though, those agencies who have twenty-four hour services—human services, corrections, and employment—have actually increased their budgets because of additional overtime pay necessitated to keep fewer people working. This cost-saving measure thus far

has not amounted to the savings originally intended when furloughs were mandated (Cole, *The Oregonian*, March 31, 2010, A1-4).

Dealing with the Kicker

Even before the special session began on February 2, the governor made it clear to the legislature that creating a rainy day fund for the state should be a priority. The modest rainy day fund that had been developed three years earlier had already been used to get through this round of budgeting, and it was obvious to the governor, and many others, that the Kicker was highly questionable when the state all too frequently cannot find sufficient revenues for its budget. Governor Kulongoski closely tied this reform to public education and argued that “Rather than rebating higher than expected tax revenue back to taxpayers . . . the money should first go into a state savings account as a hedge against the withering effects that future recessions would have on public schools and state services” (Esteve, January 28, 2010, A1).

The difficulty with the Kicker Law is that its unusual method of determining the size of the rebate is not closely connected to the actual state’s economy at the time it is rebated. David Sarashon, a political analyst for the *Oregonian* put it well, “the Kicker needs to be fixed. There’s a reason no other state has anything like it, because to cut state services and then mail hundreds of millions in revenue back to taxpayers because the state economist couldn’t predict the state’s receipts—within two percent—two years in advance makes absolutely no sense” (Sarashon, the *Oregonian*, February 28, 2010, D1). Despite the missed predictions of recent years when the state returned as much as a billion dollars followed by a year when the state faced a billion dollar deficit isn’t very responsible in an economic downturn. When Oregonians were asked in 2000 to repeal the Kicker, the proposal suffered defeat by 62 percentage points. A decade late there still exists a strong distaste for repealing the Kicker, so any hope of change seems impossible. So even though the session began with the thought that the Kicker might possibly be repealed, it ended with the reality that this would not happen now, or in the foreseeable future.

Conclusion

When the session ended on February 25, three days earlier than scheduled, and when all was said and done, very little changed regarding the present budget. However, in anticipating the next budget session, there are major concerns that it will be as difficult, if not more difficult, than the present year in putting together the budget. By avoiding further cuts and hopefully increasing state revenues with an increase in employment, state economists project a \$2.5 billion shortfall for the

2011-13 budget and a \$1.7 billion hole in 2013-15 (an editorial in the *Oregonian* February 28, 2010, A10).

As Democrats left Salem, their opportunity to amend the present budget in any responsible or significant way was lost. Instead of trimming spending and socking away more money for the future, they took from the state's meager reserves in order to protect popular and important public services, including K-12 schools and an overwhelmed college grant program. So in an recessional atmosphere when revenue forecasts have shown declines, the Democratic majority proceeded to ignore the future and make it through this session. The next budgetary cycle, to say the least will be very interesting.

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