Executive Summary

OREGON CENTER FOR PUBLIC POLICY
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May 21, 2001

Dim and Dimmer:
Forecasts of State Revenues and Federal Discretionary Spending in Oregon

By Charles Sheketoff and Jeff Thompson

The future of state General Fund revenues and federal discretionary spending in Oregon is not bright. The May *Oregon Economic and Revenue Forecast* projects state General Fund and lottery revenues for the next biennium will fall some $600 million below current spending needs, and over the next two biennia the resources available will be less than the Legislature anticipated at the beginning of the legislative session. Adding insult to injury, a new analysis of President Bush's proposed budget by the Economic Policy Institute shows that federal discretionary spending in grants-in-aid to the State and to local governments in Oregon will fall short of current needs both next year and 10 years from now, when the Bush-proposed tax cuts are fully implemented.

The forecasts show:

- Oregon's real, per-capita General Fund revenue is expected to decline by 2.7 percent between 1999-01 and 2001-03.
- The May General Fund and lottery forecast for the 2001-03 biennium anticipates that the state will collect $593.2 million less than is necessary to provide the same level of services provided this biennium (1999-01).
- Available general fund revenues for the 2003-05 biennium will be $340 million, or 2.7 percent, less than what was forecasted last December. Revenue for the 2005-07 biennium will be down by $435.7 million, or 3 percent from the December 2000 forecast.
- Federal domestic discretionary spending in Oregon is estimated to be $1.3 billion in federal fiscal year (FFY) 2001.
- Relative to the FFY 2001 baseline, FFY 2002 federal aid to the State and to local Oregon governments will decline by nearly $102 million, or 7.2 percent. Ten from now projected federal discretionary spending in Oregon will be nearly $224 million, or 11.8 percent, less than the current services spending.

Needed (and Possible) Corrections

- Reclassify the state receipt of federal Medicaid Upper-payment Limit (MUL) payments.
- Pay the debt this biennium that Oregon owes to federal retirees as the result of a lawsuit the retirees won against the state years ago.
- Suspend the kicker completely with a three-fifths vote.
- Use tobacco settlement funds wisely, not unsustainably.
- Avoid making significant or back-loaded large tax cuts.
- Scale back the size of the proposed federal tax cuts.

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The future of state General Fund revenues and federal discretionary spending in Oregon is not bright. The May *Oregon Economic and Revenue Forecast* projects state General Fund and lottery revenues for the next biennium will fall some $600 million below current spending needs. Over the next two biennia the resources available will be less than the Legislature anticipated at the beginning of the 2001 legislative session. Adding insult to injury, a new analysis of President Bush's proposed budget by the Economic Policy Institute (EPI)[1] shows that federal discretionary spending in grants-in-aid to the State and to local governments in Oregon will fall short of current needs both next year and 10 years from now, when the Bush-proposed tax cuts are fully implemented. Both of these mid-May analyses cast a shadow on Oregon's revenue outlook and point to reductions in programs and services important to Oregonians, in the months and years ahead, unless federal and state policies are corrected.

Oregon's Fiscal Forecast is Dim

Recent media attention on the May 2001 revenue forecast focused on the fact that the May projection was $20 million higher than the previous forecast in March. While more money will be available in sheer dollars, population growth and inflation will overwhelm the State's ability to provide the level of services that taxpayers currently need and expect. Oregon's real, per-capita General Fund revenue is expected to decline by 2.7 percent between 1999-01 and 2001-03.[2]

The small improvement in the forecast since March, due solely to an increase in the projected revenues from lottery funds, does not restore funding to levels used to create the Governor's proposed balanced budget, which included program and service cuts across government programs. The forecast also falls short of providing the resources necessary to meet a continuing level of services from the current biennium. The May General Fund and lottery forecast for the 2001-03 biennium still anticipates that the state will collect $593.2 million less than is necessary to provide the same level of services as in the current (1999-01) biennium.[3] Schools, human services, corrections and public safety are all slated for service cuts because the forecasted revenue is less than continuing service level needs.

Future Biennia Won't Be Flush

The May outlook for future biennia (2003-05 and 2005-07) gives lawmakers further cause for concern about Oregon's fiscal condition. As lawmakers consider the cost of starting programs or of tax reductions next biennium, and as they examine the ability of the state to maintain those programs in the future, they must anticipate fewer available funds than they did at the beginning of the 2001 legislative session. The most recent revenue forecast shows that available General Fund revenues for the 2003-05 biennium will be $340 million, or 2.7 percent, less than what was forecast in December 2000. It gets worse. The projection for the 2005-07 biennium is $435.7 million, or 3 percent, less than the December 2000 forecast. The revised revenue forecasts for the future reflect a number of factors related to the slowing economy.[4]

Because of insufficient current revenues, legislators sometimes propose to delay to future biennia implementation of tax cuts. In other words, they defer making hard budget decisions to some later date in the hope that financial conditions will improve, or in order to pass fiscal problems off to future legislatures.[5] The revised outlook for future biennia should dampen those efforts to back-load significant tax cutting measures.

President Bush's Federal Budget for Oregon is Dimmer

Federal domestic discretionary spending in Oregon is estimated to be $1.3 billion in federal fiscal year (FFY) 2001. While considerably smaller than the $5.3 billion Oregon is likely to collect in General Fund revenues in state fiscal year (FY) 2000-01, these federal dollars play an important role in Oregon's economy and in its ability to provide necessary state and local government services. The Bush Administration's budget proposes changes to the budget authority (hereafter referred to as "spending") for federal aid to Oregon and to its local governments. Relative to current services spending, FFY 2002 federal aid to the State and to local Oregon governments will decline by nearly $102 million, or 7.2 percent. In ten years (FFY 2011) projected federal discretionary spending in Oregon will be nearly $224 million, or 11.8 percent, less than the current level of spending.

This analysis of federal spending, by the Economic Policy Institute, is based on Federal Funds Information for the States (FFIS) estimates of the Bush budget's spending, by program and by state, in FFY 2002. The EPI examined 192 programs constituting 87 percent of federal discretionary spending for state and local governments (or 38 percent of all non-defense discretionary spending) and about one-tenth of all spending by state and local governments.[6]

The reductions in federal aid are likely to have significant repercussions at the state and local level in terms of changes in services or in the need for tax reform. For example, total federal domestic discretionary spending in Oregon on education, training, employment, and social services will fall $8 million, or 1.4 percent, below the current service level by FFY 2002. By 2011, federal spending will be $29.2 million, or 4 percent, below the level necessary to maintain current services. Head Start, School Renovation Grants, Youth Opportunity Grants, and Class Size and Teacher Financing Programs all receive real cuts in the administration's budget. While some programs receive increases, including Drug Free Schools and Child Care and Development Block Grant programs, some programs, such as federal funding for class size reduction and for increasing the number of teachers, receive no federal funding at all. The net result is reduced funding.

The cuts impact all segments of Oregon. For example, spending on agriculture will fall $3.2 million, or 24 percent, below current service levels in 2002, and $5.2 million, or 28.6 percent, below current service levels in 2011. Oregon's agricultural sector faces drought, energy, and commodity price problems; the prospect of reduced federal assistance is likely to have significant consequences for Oregon's agricultural and rural communities.

A summary of the changes in federal discretionary spending in Oregon follows on page 4.[7]

Needed (and Possible) Corrections

Unless federal and state tax and spending policies are corrected to avert these cuts, a wide range of federal and state programs, including education, health care, environmental protection, and public safety, will face difficult reductions in services. State and federal spending will rise more slowly than inflation and population growth, leaving Oregon with unmet needs.

Avoid Getting Kicked

When state tax collections for the biennium from either corporate income or excise taxes or from personal income taxes and other General Fund revenues exceed their estimates by two percent or more, current law requires that the amount above 100 percent of the estimates be refunded or "kicked back" to taxpayers.[8] The May revenue forecast estimates that corporations will receive $22.5 million in kicker credits. Personal income tax payers may receive $355 million, the second largest kicker in history.[9] The typical Oregonian will receive about $106 if the legislature does nothing.[10]

The most immediate and feasible approach for alleviating significant program cuts in Oregon's state budget requires keeping funds from the projected kicker. Legislators could take two simple steps to decrease revenue lost to the kicker:

- Reclassify the receipt of federal "Medicaid Upper-payment Limit" (MUL) payments that the state receives. Some legislators are beginning to acknowledge that these federal dollars should not be refunded to Oregon taxpayers as part of the kicker; they are federal dollars and not General Fund revenues from Oregon personal income taxes. With a simple majority vote, these payments

Oregon

Changes in federal discretionary grant-in-aid spending, fiscal years 2001-11

(Budget authority in thousands of dollars)

Function and program	Actual FY2001 ($000)	Change in spending under Bush budget compared to baseline: FY2002 Change ($000)	FY2002 Change (%)	FY2011 Change ($000)	FY2011 Change (%)
State Total	$1,333,808	-$101,792	-7.2%	-$223,989	-11.8%
National Defense	$1,988	-$129	-6.2%	-$320	-11.4%
Energy	$2,396	$1,340	52.5%	$2,500	76.6%
Natural Resources and Environment	$70,650	-$11,948	-16.2%	-$27,537	-27.3%
EPA - Drinking Water SRF Grants	$11,559	-$509	-4.2%	-$2,786	-16.9%
Environmental Protection Agency	$28,697	-$7,871	-26.3%	-$14,774	-36.0%
Agriculture	$12,600	-$3,158	-24.0%	-$5,170	-28.6%
Transportation	$454,007	-$44,077	-9.3%	-$110,291	-16.8%
Airport Improvement Program	$40,729	-$509	-1.2%	-$5,515	-9.3%
FTA - Section 3 Discretionary Grants	$19,381	-$43	-0.2%	-$2,371	-8.4%
FTA - Section 9 Formula Grants	$27,016	$1,289	4.6%	-$1,591	-4.1%
Highways Aid	$360,712	-$44,917	-11.9%	-$100,207	-19.2%
Community and Regional Development	$43,935	-$1,735	-3.8%	-$3,601	-6.1%
Appalachian Regional Commission	$0				
Community Development Block Grant	$39,958	-$1,359	-3.3%	-$2,997	-5.6%
FEMA - Disaster Relief	$0				
Education, Training, Employment and Social Services	$528,689	-$8,042	-1.4%	-$29,226	-4.0%
Adult Education Basic Grant	$4,125	-$255	-5.8%	-$469	-8.3%
Child Care & Development Block Grant	$20,602	$783	3.6%	$237	0.8%
Class Size & Teacher Financing	$15,642	-$16,612	-100.0%	-$21,414	-100.0%
College Work-Study	$13,142	-$815	-5.8%	-$1,498	-8.3%
Community Services Block Grant	$4,756	-$295	-5.8%	-$542	-8.3%
Comprehensive Education -- Title I	$95,650	-$1,720	-1.7%	-$5,620	-4.3%
Dislocated Workers	$28,812	-$5,537	-18.1%	-$7,992	-20.3%
Drug-Free Schools & Communities State Grants	$4,205	$948	21.2%	$1,038	18.0%
Employment Services Administration	$9,600	-$595	-5.8%	-$1,094	-8.3%
Head Start	$53,329	-$2,231	-3.9%	-$4,730	-6.5%
Impact Aid	$2,713	-$322	-11.2%	-$503	-13.5%
Job Training Partnership Act	$13,461	-$1,543	-10.8%	-$2,424	-13.2%
Pell Grants	$87,300	-$1,713	-1.8%	-$5,309	-4.4%
School Renovation Grants	$9,020	-$9,580	-100.0%	-$12,349	-100.0%
Special Education	$80,414	$6,858	8.0%	$5,696	5.2%
Supplemental Educ. Opportunity Grants	$10,035	-$622	-5.8%	-$1,144	-8.3%
Vocational Education	$14,491	-$896	-5.8%	-$1,649	-8.3%
WIA Youth Opportunity Grants	$14,551	-$2,765	-17.9%	-$3,997	-20.1%
Health	$60,172	-$503	-0.8%	$3,873	4.7%
AIDS Comprehensive Care - Title II	$4,836	-$174	-3.5%	$126	1.9%
AIDS Emergency Assistance - Title I	$3,513	-$126	-3.5%	$91	1.9%
Consolidated Health Centers	$14,889	$984	6.4%	$2,497	12.3%
Maternal & Child Health Block Grant	$6,377	-$230	-3.5%	$166	1.9%
Mental Health Block Grant	$4,273	-$154	-3.5%	$111	1.9%
Substance Abuse Prevention & Treatment	$15,478	-$557	-3.5%	$403	1.9%
Income Security	$129,121	-$22,464	-15.2%	-$35,772	-17.6%
Home Investment	$20,435	-$4,695	-20.0%	-$7,183	-22.3%
Low-Income Home Energy Assistance	$17,086	-$2,512	-12.8%	-$4,118	-15.3%
Operation of Low-Income Housing	$13,962	-$1,404	-8.8%	-$2,499	-11.4%
Public Housing Capital Fund	$14,182	-$5,403	-33.2%	-$7,851	-35.1%
WIC/Supplemental Feeding Program	$49,141	-$6,439	-11.4%	-$10,794	-13.9%
Administration of Justice	$23,517	-$9,042	-36.5%	-$14,525	-41.8%
E. Byrne Drug Control System Improvement Grants	$6,253	-$171	-2.6%	-$995	-10.8%
State Criminal Alien Assistance Program	$4,894	-$2,854	-55.4%	-$4,271	-59.1%
General Government	$6,734	-$2,034	-28.7%	-$3,919	-38.6%

Notes: The Bush spending proposal is compared with the baseline spending level for FY2002 and 2011. The baseline employed is a per capita real baseline, meaning spending is adjusted for inflation (which varies by function) and population growth. A positive number is an increase over the baseline. A negative number is a "cut," or a reduction relative to the baseline. The inflation estimates are from the Congressional Budget Office. The population growth estimates are from the Census Bureau.

Source: EPI analysis of FISS data.

should be separated from the General Fund before calculating the occurrence and size of the kicker. The federal government is phasing out this funding source.[11]

- Pay the debt that Oregon owes to federal retirees resulting from a lawsuit the retirees won against the state this biennium. By paying this debt in the current biennium the legislature would save interest payments and would reduce the revenue used in the calculation that determines the size and the occurrence of the kicker.

These efforts will reduce the kicker refund. The Legislature is empowered to suspend the kicker completely with a three-fifths vote. While fiscally responsible and authorized by law, this action requires political leadership that has yet to materialize, despite the public's call for better funding for education, human services, public safety, and corrections.

Addicted to Tobacco . . . Money

The Governor's budget proposes using a backlog of multiple years' tobacco settlement funds to cover some of the shortfall for the next biennium. The proposed budget even directs some of the funds into non-health programs and services and specifically directs some of these funds to education. Moreover, by using the past years' payments, the Governor's proposed budget spends more tobacco settlement money in one biennium than Oregon will normally receive in a two-year period, making this use of the tobacco funds unsustainable in future biennia. The Governor's proposed budget also leaves $100 million in tobacco settlement funds unspent and proposes to place them in a trust fund.

To offset the forecasted reduced revenues, the legislature may choose to spend even more of the unspent money than the Governor proposes.[12] Health advocates, principally those wanting to direct the tobacco settlement funds to tobacco prevention programs, and others have criticized the Governor's spending plan. They oppose efforts to use the funds for non-health related programs or to spend these funds in excess of expected future biennial payment levels.[13]

The Legislature should avoid spending the tobacco settlement funds in an unsustainable manner that will only exacerbate the revenue shortfall in future biennia.

Additional Tax Cuts Only Make it Worse

Despite looming cuts to a broad range of state services, some members of Oregon's business community are backing tax cuts that will overwhelmingly benefit high-income individuals and a few large companies. Senate Bill 67 would reduce Oregon's capital gains taxes by nearly $440 million per biennium. The richest one percent of Oregonians would receive 55 percent of the benefit from SB 67, while the bottom 60 percent get only three percent of the cut.[14]

Another proposal, House Bill 2281, would cut corporate income taxes by nearly $136 million per biennium. To help understand the impact of the changes contemplated by this bill, the Legislative Revenue Office calculated the impact on corporations if the measure had been in place in 1998. The 17 largest companies in Oregon, with taxable incomes over $1 billion annually, would have received almost 65 percent of the benefit and average $3.2 million in annual tax savings.

Under this legislation, 2,400 corporations would have averaged less than $200 a year in tax savings, with 1,700 of them receiving nothing or next to nothing. On the other hand, 5,700 corporations that do business in the state would have faced tax increases.[15]

These proposals and others under consideration will further reduce Oregon's ability to address public needs, whether they are implemented immediately or phased in slowly. Legislators should resist passing large tax cuts that will significantly exacerbate the revenue shortfall in the upcoming or future biennia.

Oregon's Congressional Delegation Needs to Work for Oregon

Federal domestic spending in Oregon is expected to decline if the Bush Administration's budget proposals are implemented. Outright program cuts and funding that lags behind inflation and population growth will adversely affect Oregon communities. Oregon's congressional delegation must take these impacts into consideration when they vote on President Bush's budget and tax proposals.

Federal spending in Oregon and other states is being reduced to make room for large tax cuts that primarily benefit the well-off. When fully phased in, the administration's tax cuts will deliver average cuts of $38,000 to the top one-percent of Oregonians, higher than the state's median income.[16] The typical Oregonian would receive just $600 from the Bush tax cut when fully implemented. If the size of the Bush tax cut is scaled back, cuts to important federal programs in Oregon and other states can be avoided.

Endnotes.

[1] Mishel, Lawrence, *Changes in Federal Aid to State and Local Governments, as Proposed by the Bush Administration FY 2002 Budget*, Economic Policy Institute, Washington, D.C., May 16, 2001. Available at www.epinet.org/briefingpapers/stateimpact-full.pdf.

[2] Change in Oregon's real per-capita General Fund revenue is calculated by OCPP. Figures for projected General Fund revenues for 1999-01 are compared to projections for 2001-03. The calculation uses Department of Administrative Services projections for the Portland-area Consumer Price Index and total state population for 2000 and 2002.

[3] The current service level (CSL) figure is from State of Oregon 2001-03 Governor's Budget, page S-1. It is the total CSL for general funds and lottery funds. The shortfall is calculated by comparing the CSL with the May *Oregon Economic and Revenue Forecast* , available at www.oea.das.state.or.us/economic/forecast051501.pdf.

[4] The state revenue forecast does not include the impacts of President Bush's tax cut package on state revenues. Some elements of the Bush proposal, principally the elimination of the wealth or estate and gift tax, would further reduce state revenues. Other elements of the Bush tax cuts may result in increased state revenues, as some people will not be able to subtract as much federal income tax from their income when determining state taxable income. Neither the Legislative Revenue Office nor the Office of Economic Analysis in the Department of Administrative Services has calculated the impact of the Bush tax package on state revenues.

[5] The problem is exacerbated by term limits. Because of term limits many legislators will never have to address the consequences of significant tax cuts.

[6] A more complete description of what programs are included and which programs are excluded is provided in the full report by EPI (see note 1).

[7] The data is available online at www.epinet.org/datazone/0501/.

[8] The 1999 Legislative Assembly referred a measure to the voters to put the kicker provisions in the state constitution with a slightly higher threshold necessary for legislative overrides. The voters approved the measure in November 2000. By its own terms, however, the constitutional provisions do not go into effect until July 1, 2001.

[9] The corporate kicker is based solely on whether corporate income and excise taxes exceed the projected level by two percent or more. The personal kicker is based on other General Fund revenues in addition to personal income tax revenues, but the refund goes only to personal income tax taxpayers. The Medicaid Upper-payment Limit funds are an example of General Fund revenues that impact the personal kicker calculation and that do not come from the personal income tax (see note 9).

[10] For a distributional analysis of the kicker, see www.ocpp.org/2001/2001kicker.htm.

[11] Under this financing mechanism, a state pays selected nursing homes, hospitals, or other institutions more than the actual costs incurred for the medical services provided. The state then requires these health care providers to transfer most of the extra payments back to the state. The state draws down federal Medicaid matching funds based on the inflated payments it temporarily made to the providers. New federal rules will phase out this apparently legally permissible but questionable practice. For more information, see Ku, Leighton, *Limiting Abuses of Medicaid Financing" HCFA's Plan to Regulate the Medicaid Upper Payment Limit*, Center on Budget and Policy Priorities, Washington, D.C., September 27, 2000. Available at www.cbpp.org/9-27-00health.pdf.

[12] The Governor proposed placing $100 million of past years' funds into a trust fund. As of this date, no legislative action has occurred to implement that suggestion, leaving the money available for use.

[13] The critics include the Oregon Health Leadership Against Tobacco coalition and the Coalition for a Healthy Future.

[14] Thompson, Jeff, *Empty Promises and False Hopes: The Reality of Capital Gains Tax Cuts in Oregon*, Oregon Center for Public Policy, April 9, 2001. Available at www.ocpp.org/2001/es010409.htm.

[15] OCPP analysis of Legislative Revenue Office data.

[16] Institute for Taxation and Economic Policy, April 2001.