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This is the first of three articles. It should be our voter "home work" before the November 7 election on issues that can change the future of Oregon (think M41 and M48 which will cut hundreds of millions of dollars from our state budget and make a rainy day fund and other plans nearly impossible).

Please look at the one page PDF with easy to understand charts and graphs that accompany this article at:

http://www.oregonlive.com/cgi-bin/prxy/accessor/nph-repository-cache.cgi/base/pdf_captions/1158989110210730.pdf

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Will their plans solve our problems?
 Sunday, September 24, 2006
 BETSY HAMMOND
 The Oregonian

Step outside the fog of the fall campaign and there is surprising unanimity about how Oregon needs to change.

Wall Street analysts and public finance experts agree that Oregon's money management is among the shakiest in the nation, flooding the state treasury in good times but coming up short in bad.

Oregon habitually spends 99 cents of every available tax dollar. Its savings account is anemic. Class sizes are the nation's second biggest, and universities are losing ground.

But candidates for governor and the Legislature mainly are talking around the edges of these problems. Their solutions won't solve Oregon's long-term fiscal woes.

This week, The Oregonian takes a detailed look at issues crucial to Oregon's future: taxes and spending, education and health care. The newspaper frames the issues not by what the candidates say, but by drawing on facts, statistical comparisons and experts to help voters understand the big-picture realities.

The most recent recession hit Oregon harder than any other state. The lopsided dependence on income taxes left the state no way to maintain public services, triggering chaos in public schools and heartache in public health care.

Today, income taxes are pouring in so fast that the state is set to give back more than \$1 billion in refunds. Yet in these good times, the state has built up only a whiff of savings for any bad times ahead.

Correcting Oregon's No. 1 budget blunder -- having virtually no rainy-day fund to weather tough economic times -- has emerged as a mainstream political issue for the first time this year. Both leading candidates for governor promise to beef up the state savings account.

But their plans so far are too vague or too small to ensure that Oregon would sock away a big enough rainy-day fund to stabilize its boom-and-bust budget cycle.

And other serious money problems continue to dog the state: a tax burden skewed toward household income, spotty efforts to weed out state inefficiency and feeble funding for state universities.

"Oregon's current setup is a recipe for disaster, and we've seen it play out just that way in a recession," says John Tapogna, managing director of the Portland office of EcoNorthwest, a private economic consulting firm that advises several states.

"Volatility undermines the image of the state for people and businesses who are planning to move here," he says.

Oregon voters carry some of the blame for the state's financial turmoil. Through ballot measures, they have locked low property taxes and mandatory income tax rebates into the state constitution while mandating longer prison sentences and directing the state to pay for schools.

Two new tax measures on the fall ballot, Measures 41 and 48, could torpedo promises by politicians to beef up schools, universities, state police and health care -- all state-funded services that many voters want and a healthy economy demands.

Measure 41, which would cut income taxes by about \$140 a person, would leave the state \$400 million less to spend each year. Measure 48 would curb state spending in the next year by about \$1 billion from a projected \$18 billion in all funds.

Even if voters reject both measures, Oregon's tax and spending habits remain out of line and, in some ways, undermine state efforts to generate economic growth, improve quality of life and better manage public money.

Consider:

No other state is as dependent on personal income taxes. More than 85 percent of the state's general fund comes from state income taxes paid by households, compared with 33 percent in a typical state.

In a year when more than half the states socked away money for future downturns -- growing their rainy-day funds to an average of \$1 billion -- Oregon has \$103 million in its savings account for schools.

For its population, Oregon spends less on higher education than all but eight states, prompting public universities to raise tuition and scale back ambitions. Business leaders complain that

leads to a less-educated work force and repels new employers.

Oregon has twice as many workers per capita as the national average performing the core functions of the Department of Human Services, based on the way the Census Bureau categorizes state workers. If the state cut back to the national rate, including trimming the 1,000 central administrative jobs in the department, it could save \$100 million a year.

Oregon pays some of the highest public employee retirement costs in the nation. Reforms enacted under Gov. Ted Kulongoski in 2003 mean costs and benefits will come into line with other states -- but not until about 2025, when retirees who were hired under the new rules outnumber retirees getting more lucrative benefits.

State budget writers blame voters, not a lack of discipline, for their record of spending all the state's money even as revenues soared during the 1990s. When voters enacted Measure 5 property tax caps in 1990, they forced the state to become the primary provider of money for public schools -- without providing a new source of money to draw on.

Comparing the share of state spending devoted to schools before and after the change -- 25 percent in 1990 versus 42 percent today -- lawmakers aren't far off when they claim that schools ate the state budget.

Most volatile

Income taxes are far more volatile than sales or property taxes. That is why all other states use property or sales taxes to a greater degree than Oregon.

When the recession hit in 2001, Oregon's fiscal crisis was the worst in the nation, forcing 90 school districts to lop days off the school year and the state to dump 70,000 low-income people from its government-funded health plan.

Then there is Oregon's "kicker" income tax rebate. No other state has anything like it. Whenever the economy booms and more taxes are collected than was projected two years in advance, the state must return all the unanticipated money to taxpayers.

Many of the state's distinctive tax and spending policies are embraced by Oregonians. Voters have rejected a sales tax nine times, most recently in 1993 when a proposed sales tax for education went down 75 percent to 25 percent. After two decades living with a kicker law, Oregon voters enshrined it in the constitution in 2000.

But those policies also clash with some of the paramount goals that Oregon politicians, public finance experts, business leaders and voters claim to hold -- fostering economic growth and luring good jobs, spending tax dollars efficiently, spreading the tax burden fairly, and avoiding cuts that hurt schoolchildren or seniors.

National financial experts give a thumbs-down to Oregon's approach to taxing and spending.

Governing magazine, which rates states' performance every other year, last year gave Oregon a D for money management -- one of two Ds it issued. The magazine, read primarily by state and local government officials, cites the state's overreliance on income taxes, chronic inability to fund services at previous levels, lack of savings, overblown employee pensions and nationally ridiculed kicker. " 'Mess' is the right word" to describe Oregon's budgetary picture,

the magazine wrote.

Moodys, the influential investment rating firm, withheld its top rating from Oregon this year, despite surging income tax collections. It cited three main reasons: High state debt to pay for unfunded public employee pensions, the Legislature's habit of spending 99 percent of money available to it and the anti-savings-account effect of the kicker.

John Petersen, a public finance specialist at George Mason University's School of Public Policy, says Oregon is "hobbled" by its lack of a rainy-day fund, got "shot in the foot" by its kicker law and "missed the boat" with its lack of a sales tax to balance its revenue sources. The state should immediately work to build a rainy-day fund, he says.

He and other experts say Oregon's voter initiative system is a big part of Oregon's money problem. Tax policy is better set by elected representatives who can spend time carefully considering the rules, they say.

Risa Williams, editor in chief of state tax publications for Tax Analysts, a nonprofit publisher on tax policy, agrees it is crucial for Oregon to create a rainy-day fund.

"In a household budget, when times were better than you expected, you would make sure you have a savings account to be ready for lean times, so in a state budget, why would you put it back in taxpayers' pockets and not be ready for the lean years?" Williams asked. "The kicker system is out of date, and it is essentially kicking your state in the butt."

Reform is long shot

Viewed as a political issue, however, the prospects of changing Oregon's tax and spending practices are dim.

Pollster Tim Hibbitts, who has researched Oregon public opinion for years and does not work for any candidate or political party, says major tax reform is political poison: "It's a waste of hot air. It's dead."

But some smaller changes are possible, Hibbitts says.

Kulongoski, for example, says he will push to divert the entire corporate kicker rebate for 2007 -- an estimated \$200 million that would be sent to corporations, primarily large companies based outside Oregon -- into a rainy-day fund. He'd have to get two-thirds approval from the Legislature. Then, to make the policy permanent, he'd have to get the OK of Oregon voters.

Ron Saxton, his Republican challenger, has made state spending a centerpiece of his campaign.

He wants to eliminate unnecessary functions of state government and privatize others, such as state vehicle emissions testing, some data entry, liquor sales and state vehicle maintenance, he says. He also wants to find efficiencies, such as requiring school districts to pool administrative tasks such as payroll, printing and bus maintenance.

But those functions account for a minuscule share of state spending. Saxton has not specified what he would cut to get to the \$1 billion in savings he says he could achieve so that he can increase spending on state police, the crime lab, universities, Head Start and a rainy-day fund

without raising taxes.

The biggest cost savings Saxton says he would deliver would come from securing agreement from state employees to lower their overall compensation -- pay, health insurance and retirement -- to levels competitive with other states and with the private sector. Courts have said public employees hired before 1996 are entitled to the generous pensions they were promised, so he says he would try to persuade them to forgo raises or pay larger health premiums. Under collective bargaining laws, the state must negotiate these kind of concessions with employee unions.

Saxton says he could sock money into a rainy-day fund in 2007 without taking the corporate kicker. Unless Measure 41 or Measure 48 passes, the state is projected to have \$13.7 billion to spend in 2007-09 -- an increase of about 17 percent, or \$2 billion from 2005-07. Saxton says the state should spend only some of that money and save the rest.

Kulongoski, by contrast, is seeking several new sources of money -- a surcharge on car insurance to pay for more state troopers, a big increase in the \$10 corporate minimum tax to provide Head Start to every poor child who wants in, and keeping the corporate kicker -- so that he can use the surge in state revenues to beef up education, from preschool through college, while maintaining other state services.

Raising taxes on corporations also would help balance Oregon's tax system so that households pay a lower share, he says.

Structural tax reform is unnecessary, the governor says, because the economy will keep pumping enough income taxes into state coffers to offer more services plus build a big rainy-day fund.

House Majority Leader Wayne Scott, R-Canby, the state's chief budget writer in 2005, agrees. Rising revenues will make it easy to balance future budgets -- and possible to sock away savings at the same time, he says. "We have a tendency to spend every dime, and we need to stop doing that."

But Scott and other lawmakers did just that earlier this year, spending all available money on services and schools. Scott says they created a \$75 million general-use state savings account, but in fact, no money was put in it, state fiscal officials say.

Some experts who have studied Oregon's money picture are skeptical the state can stick with its current tax system and avoid another budget train wreck.

Senior citizens are by far the fastest-growing age group in Oregon, and they soon will send the state's bills for nursing home and assisted-living care skyrocketing. With job gains leveling off, state economists project income tax revenues will cool. Oregon reformed its expensive public employee pension program about as far as courts will allow, but the state will continue to pay outsized costs for decades.

Several areas where the state spends a lot of money have price tags expected to rise beyond the rate of inflation -- highway construction materials, prisons, health care for public employees and poor Oregonians, and education for students with disabilities.

People who say Oregon can tinker with taxes and spending and come out fine are "in denial,"

says state Sen. Ben Westlund, who was the state's chief budget writer in 2001. The Bend independent made tax reform a centerpiece of his brief third-party campaign for governor this year.

"When times are good in Oregon, they are very, very good, and when they're bad, they're guaranteed to be very, very bad . . . and you can't run (a state) effectively like that," he says.

Westlund argues that Oregon needs a new tax system that lowers income and capital gains taxes and replaces the lost revenue with a sales tax. And he says the state needs more money -- money from tourists, business travelers, tax cheats and other sources.

"This is going to take a group of courageous and intrepid leaders . . . to propose solutions that address the problem. Regrettably for Oregon, that is not a topic of conversation between the two major gubernatorial candidates or legislative leaders."

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