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Paul Warner, Legislative
Revenue Officer
Tim Nesbitt, Governor's
Office
Anna Grimes, Task Force
Coordinator



**Task Force on Comprehensive Revenue
Restructuring**

900 Court Street NE
H-197 State Capitol Building
Salem, Oregon 97301
Phone (503) 986-1266 — Fax (503) 986-1770

Non-Voting Members

Bernie Bottomly
Steve Buckstein
Jon Chandler
Hon. Randall Edwards
Ben Fetherston
Ralph Groener
Brad Hicks
Tom Hughes
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DRAFT FINAL REPORT 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, are 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 independent of 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.
- 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 :
 - Modifications of property tax limits (Measure 50) to better reflect real estate market conditions.
 - Options for diversifying local revenue away from the property tax.
 - Proposals to share state and local revenue sources.
- 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.
- 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.