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Oregon's Budget Stabilization Funds – Update

Typically, states build an ending balance into their budget plans by not spending all of the forecasted available resources for the upcoming fiscal period. An ending balance provides a cushion to be used if actual revenues are lower than anticipated at the time the budget was adopted. An ending balance, though, is not the same as a budget stabilization or reserve account, which is typically known as a "rainy day fund." An ending balance reflects revenue that the state expects to receive, but that is not approved to be spent; however, rainy day funds are dedicated accounts made up of dollars specifically set aside for use in the future if needed. While both an ending balance and a rainy day fund can help provide funds if needed, there are typically more requirements that must be met to access rainy day funds than ending balances. Rainy day funds became common during the 1990s and exist in some form in almost every state.

The existence of a budget stabilization fund is desirable for several reasons. During economic downturns, savings can be used to avoid reducing existing programs or raising taxes, thereby reducing uncertainty for citizens concerning program or service availability and quality, as well as their tax liability. By using savings, a state can help "smooth" out revenue or expenditure fluctuations during economic downturns and assist the economy in weathering a recession. The fiscal benefits to states with properly structured reserve funds include:

- Increased economic stability by allowing state officials to avoid budget cuts to deal with a revenue shortfall.
- More in-depth analysis and discussion to ensure informed decision making.
- Reduced need to use numerous one-time revenues and accounting actions to fund ongoing expenditures.[1]
- Assurance to bond-rating agencies that prudent fiscal management practices are in place.
- A "savings" rather than "spend it all" mentality.

A challenge to saving money that is unique to Oregon is the "kicker" law. In several instances, during better than expected economic periods, instead of being able to deposit excess revenues into a reserve account, the extra money has been returned to taxpayers because the kicker threshold was met.[2] Despite the challenge of having a highly volatile revenue system based

[1] Using reserve funds to continue current program and service levels rather than making expenditure reductions during an economic downturn can lead to difficulty in balancing future budgets if revenues are not expected to return to a sufficient level to continue such programs and services on an ongoing basis.

[2] The kicker law requires the return of income tax surpluses to taxpayers in biennia where the actual collections exceed forecasted revenues by two percent or more. During the 1990s, many states reserved such revenue surpluses. Since the creation of the kicker, approximately $3.0 billion in personal income taxes and $0.5 billion in corporate taxes have been returned to taxpayers due to this law.

primarily on income taxes, as well as the existence of the kicker provision, Oregon has established two budget stabilization funds, the Education Stability Fund and the Oregon Rainy Day Fund.

Education Stability Fund (ESF)

The ESF was established in September 2002, when voters amended the Oregon Constitution to convert an existing education endowment fund into a reserve fund.[3] The ESF is composed of 18% of the net proceeds from the state lottery and is capped at 5% of the amount accrued in General Fund revenues during the prior biennium. Once the cap is reached, 15% of net lottery proceeds are deposited into the ESF's school capital matching subaccount. The Legislature is allowed to spend the principal of the fund for public education if there is an economic downturn, as defined by law, and the expenditure is approved by at least three-fifths of the members of each chamber.[4]

Specifically, in order to access the ESF principal, the Legislature must make a finding that one of the following conditions has been met:

- The last quarterly economic and revenue forecast indicates that moneys available to the General Fund for the next biennium will be at least 3% less than appropriations from the General Fund for the current biennium.
- There has been a decline in seasonally adjusted nonfarm payroll employment for two or more consecutive quarter*s* in the last 12 months.
- A quarterly economic and revenue forecast projects that General Fund revenues in the current biennium will be at least 2% below the amount that was projected in the revenue forecast on which the legislatively adopted budget for the current biennium was based.

If none of these conditions are met, the ESF can also be accessed by the Legislature if the Governor declares a state of emergency and the expenditure, which still must be for public education, is approved by a three-fifths majority of each chamber.

Interest earnings from the ESF are retained in the fund and used for the following two purposes:

- Up to 75% are transferred to the Oregon Education Fund to pay for any education lottery bond debt service.[5]
- At least 25% are dedicated to the Higher Education Coordinating Commission for college scholarships.

While the retention of earnings in the fund and the requirement that the earnings be used for public education are constitutional requirements, the actual distribution is outlined in statute.

At the May 2010 primary election, voters approved a constitutional amendment to the ESF that was referred by the Legislature during the 2009 session (HJR 13). This amendment included the repeal of the original school capital matching subaccount that had been established within the ESF and the creation of a new separate school capital matching fund. The new fund received the ending balance from the former subaccount and then receives 15% of lottery proceeds once the ESF cap is reached. The new fund is to be used to provide matching grants to school districts for

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[3] See Oregon Constitution, Article XV, Section 4(4)(d) – Section 4(8) and ORS 348.696 – 348.716.

[4] Three-fifths of the members of the Senate is 18 members and of the House is 36 members.

[5] These earnings were used to pay the debt service on bonds for schools that were approved during the 1997 and 1999 legislative sessions. That debt has been paid off. When there is no education lottery bond debt service or the cost of debt service requires less than 75% of the ESF interest earnings, the earnings dedicated for that purpose become available to the Higher Education Coordinating Commission for opportunity grants.

capital costs and to repay state bonds issued for such costs. Capital costs are defined as costs of land and other assets with a useful life of more than one year including acquisition, construction, improvement, remodeling, furnishing, equipping, maintenance, or repair. Since the ESF cap has never been reached, the capital matching fund provisions have never been used.

The Oregon Growth Account (OGA) is another account established by statute within the ESF. Funds in the OGA are invested by the State Treasurer under the direction of the OGA Board. From the creation of the ESF through June 2009, 10% of the funds transferred from the state lottery to the ESF were deposited in the OGA (1.8% of overall lottery proceeds). During the 2009 session, the Legislature passed a bill that temporarily reduced the dedication of lottery proceeds to the OGA from 10% of the ESF deposits to 5% for the period of July 2009 to June 2013. The measure also specified that declared earnings from the OGA are to be deposited into the ESF instead of the Commercialized Research Fund, another ESF subaccount. The OGA is used primarily to provide seed capital to Oregon venture and emerging growth businesses.

The ESF has been used several times to balance or rebalance a biennial budget. Although the ESF must be used for expenditures on public education, since education (K-12 through post-secondary) comprises a significant portion of the state's budget, expenditure of ESF resources for public education allows General Fund dollars that would otherwise be allocated to the education program area to be redirected to other parts of the budget. Details of allocations from the ESF are provided below.

- The constitutional amendment renaming the endowment fund as the Education Stability Fund (HJR 80) authorized a transfer of $150 million from the ESF to the State School Fund (SSF) to occur on May 1, 2003, during the third special session of 2002. This transfer offset an equivalent General Fund disappropriation to the SSF as part of the 2001-03 budget rebalance plan.
- During the 2003 session, the Legislature transferred an additional $112 million from the ESF to the SSF in May 2003, as part of the final budget rebalance for 2001-03.
- Also during the 2003 session, the Legislature prospectively transferred 90% of the lottery deposits to be made to the ESF between July 2003 and May 2005 to the SSF on May 1, 2005, as part of the balanced budget plan for 2003-05.
- During the 2009 session, the Legislature transferred the balance of the ESF ($394 million) to the SSF as part of the rebalance of the 2007-09 budget.
- To guarantee a commitment made to provide a $6 billion SSF for the 2009-11 biennium, the Legislature made a prospective transfer of $84.3 million from the ESF to the SSF during the February 2010 special session; the transfer of funds occurred in May 2011.[6]
- In order to balance the 2009-11 budget and to address federal post-secondary education maintenance of effort requirements, the Legislature approved the transfer of $96.4 million from the ESF to the SSF.
- As part of the 2011-13 budget, $100 million was transferred from the ESF to the SSF during the 2011 session. The timing of this transfer was approved to occur in October 2011 but was subsequently changed to June 2012.
- During the 2011 session, the Legislature also provided for a transfer of $82.2 million from the ESF to the SSF to occur in May 2013, for several education-related programs in the 2011-13 budget, including an enhancement to the SSF initial funding level.

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[6] The amount of the transfer was determined by the June 2010 economic and revenue forecast and was equal to the difference between $200 million and the combination of the balance in the Rainy Day Fund plus the projected General Fund ending balance for the 2009-11 biennium.

- The Legislature did not authorize any transfer from the ESF during the 2013, 2014, or 2015 sessions. The current projected ESF balance for the end of the 2015-17 biennium is $363.1 million.

Oregon Rainy Day Fund (ORDF)

The ORDF was established by the 2007 Legislature as a general purpose reserve fund. The ORDF was originally capitalized with a deposit of approximately $319 million from the retention of the majority of the corporate income tax "kicker" that was due to be refunded to corporate taxpayers in the fall of 2007. Future deposits into the ORDF are to be taken from the General Fund ending balance in an amount of up to 1% of General Fund appropriations each biennium. If a biennial ending balance is greater than 1% of the General Fund appropriations for that biennium, then an amount equal to 1% is transferred to the ORDF and the remainder is retained as part of the General Fund. If a biennial ending balance is less than 1% of the General Fund appropriations for that biennium, then the entire ending balance amount is transferred to the ORDF. Due to the time needed to make final determinations on biennial expenditures, this transfer from the ending balance normally occurs at the time of the March economic and revenue forecast in the year following the conclusion of a biennium.

During the 2009 session, the Legislature passed a measure providing for the deposit of all revenue collected from corporate income and excise taxes above the 6.6% tax rate into the ORDF beginning with the 2013 corporate tax year. At the time the measure was enacted, the Legislative Revenue Office estimated that $69 million would be collected under the law for deposit on or before June 30, 2015. However, during the 2013 special session, the law was amended by increasing the rate above which revenue flows to the ORDF from 6.6% to 7.5% for tax years 2013 to 2016, and to 7.2% for tax years 2017 and beyond. The amount collected and deposited in 2013 was just under $12 million.

Another condition of the ORDF is that if its balance, at the time of the ending balance transfer, is greater than 7.5% of the General Fund revenue collected during the prior biennium, then the ending balance transfer is not made and the money remains in the General Fund. The full transfer amount is made to the ORDF if its balance does not equal 7.5% of the General Fund revenue collected during the prior biennium, even if the transfer amount results in the ORDF balance being over the cap.

Like the ESF, approval by a three-fifths majority of both chambers of the Legislature is required to authorize expenditures from the ORDF. In addition, the ORDF has the same trigger mechanisms as the ESF as described above, with two exceptions:

- There is no allowance for a declaration of emergency by the Governor.
- The Legislature can change existing triggers by passing a new law since the ORDF is a statutory rather than constitutional creation.

The Legislature is limited each biennium to appropriating no more than two-thirds of the amount that is in the ORDF at the beginning of that biennium; however, if the appropriation is for a future biennium, the Legislature can use the most recent official forecast of the beginning balance of the ORDF for the biennium for which the appropriation is to be made. The ORDF retains all interest earned by the fund, which is calculated and transferred monthly by the Department of Administrative Services.

The ORDF has been used three times to balance or rebalance a budget as described below.

- During the 2009 session, the Legislature transferred two-thirds of the balance of the ORDF ($225.3 million) to the General Fund for general governmental purposes as part of the final 2009-11 balanced budget plan.
- In order to provide a $6 billion SSF for the 2009-11 biennium, the Legislature provided a $200 million trigger in the budget bill for the SSF during the 2009 session. The trigger amount was to come from a combination of the projected General Fund ending balance and the ORDF, with amounts determined at the time of the June 2010 economic and revenue forecast. The amount eventually transferred was $115.726 million.
- As part of the 2009-11 budget rebalance plan crafted during the February 2010 special session, the Legislature transferred $10 million from the ORDF to the General Fund for general governmental purposes.

The Legislature did not authorize any transfers from the ORDF during the 2013, 2014, or 2015 sessions. The balance currently projected to be in the fund at the end of the 2015-17 biennium is $390.6 million.

In summary, Oregon's two budget stabilizations funds have been successfully used to continue programs and services during times of economic downturn, to stabilize and improve the state's bond rating in the credit markets, and to serve as a hedge against cash flow deficits at the state level. The continuing challenge the state will face will be its ability to save cash surpluses when the economy is strong and the capacity to generate revenue is high so that adequate reserves will be available when that capacity is low.