LEGISLATIVE REVENUE OFFICE
State Capitol Building
900 Court St. NE, Room H-197
Salem, Oregon 97301

Research Brief

(503) 986-1266
FAX (503) 986-1770
http://www.leg.state.or.us/comm/lro/home.htm

Number 6-02 March 8, 2002

EDUCATION STABILITY FUND

Overview

House Joint Resolution 76 (HJR 76) is a constitutional amendment referred to the May 2002 primary ballot by the second special legislative session. HJR 76 converts the current Education Endowment Fund into a new Education Stability Fund. The new fund will receive the 15% of lottery proceeds that are currently flowing to the endowment fund. The measure sets up criteria, reflective of an economic recession, allowing the Legislature to access the fund in the future. If these criteria are met, a 3/5 vote from each house of the Legislature is required to spend principal from the stability fund. Moneys from the fund can only be spent on public education. Spending from the fund balance can also take place if the Governor declares an emergency and it is approved by 3/5 vote in each chamber of the Legislature.

HJR 76 transfers $220 million from the new stability fund to the State School Fund on May 1, 2003. The State School Fund is allocated to all the school districts in the state through the school distribution formula. These dollars would be used as part of the final state school payment for the 2001-03 budget period. This transfer would offset a $200 million reduction in the State School Fund approved by the second special legislative session. The Education Stability Fund balance on July 1, 2003, following the $220 million transfer, is estimated at $58 million.

With one exception, HJR 76 is identical to Senate Joint Resolution 50, approved by the first legislative special session. The difference is an increase in the initial transfer from the new fund to the State School Fund of $220 million instead of the $120 million transfer in the original SJR 50.

HJR 76 will not take effect unless it is approved by a majority of statewide voters in the May 21 primary election. HJR 76 states that SJR 50 should not appear on the ballot. If both do appear, language in HJR 76 specifies that it takes precedence over SJR 50 if voters approve both.

Current Law: The Education Endowment Fund

The Education Endowment Fund was established as a constitutional amendment by the voters in May of 1995. The measure was referred to the voters by the 1995 Legislature. 15% of Lottery earnings are dedicated to the fund. Earnings from the fund are dedicated to public education. The constitution is silent on use of the fund principal. However, the 1995 Legislature clearly indicated in material for the 1995 primary election voter's pamphlet that the principal would not be allocated. This is why converting the fund to a stability fund requires a constitutional amendment approved by voters.

Lottery revenue began flowing into the fund in the 1997-99 biennium. The fund had a balance of $91.4 million on July 1, 1999. At the beginning of the 2001-03 biennium (July 1, 2001) the fund balance was $171.6 million. The March 2002 revenue forecast projects 2001-03 revenue for the fund at $106.5 million. This would leave the fund balance at $278.1 million on July 1, 2003.

Under current law, 10% of endowment fund principal is invested in the Oregon Growth Account. This account is restricted to Oregon based investments.

Earnings from the fund are used for two purposes:

- 75% of earnings are dedicated to the Oregon Education Fund. Dollars from this fund are then used to pay debt service on lottery backed bonds for schools approved by both the 1997 and 1999 Legislatures. These bonds have debt service costs estimated at $ 60 million for both the 2001-03 and 2003-05 biennia.

- 25% of earnings are dedicated to the State Scholarship Commission. These funds are used for college scholarships.

Total earnings for the fund are estimated to be $15.1 million (December 2001 estimate). The Education Fund will receive an estimated $11.3 million while the Scholarship Commission receives $3.8 million.

Stabilization Funds

Oregon is one of 5 states that do not have a formal stabilization fund. The other four states are Kansas, Montana, Illinois and Arkansas. However, this distinction does tell not the entire story. California, Colorado, North Dakota and Wisconsin have formal stabilization funds but they have a zero balance in the fund as of January 2002. On the other hand, Kansas does not have a formal fund, but it does have a statute requiring 7.5% of its General Fund should be left as a projected ending balance. Applying this percentage to Oregon's General Fund estimate for the Legislatively approved budget would have left a projected ending balance of $829 million going into the 2001-03 budget period. Oregon has neither a formal fund nor a statute requiring a certain ending balance.

The Center on Budget and Policy Priorities estimates stabilization fund balances totaled $17.4 billion for all the states in January of 2002. This total fund balance is 3.3% of general fund expenditures for all the states. 16 states have a stabilization fund balance equal to 5% or more of general operating expenditures.

Formal stabilization funds typically have four features. These are:

- Revenue Source(s)

Some funds have a dedicated revenue source that flows into the fund during good economic times. This allows the fund to be replenished after use during a recession. However, some states rely on direct appropriations. These appropriations tend to occur during good economic times when the states are running surpluses. The fact that a number of states have stabilization funds without any money in them indicates that an ongoing revenue source can be an important feature.

- Triggers

All formal funds have triggers specifying the conditions under which withdrawals can be made. Triggers can take three forms: economic, budgetary or political. Economic triggers are indicators demonstrating that the state economy is in recession. These triggers are usually based on objective economic data that is available on a regular basis with limited reporting lags. Budgetary triggers are designed to measure fiscal stress. They usually involve a projected deficit in the current general operating budget for the state. Political triggers specify necessary actions by the governor and/or legislative vote requirements. Many stabilization funds have multiple triggers that fall into two or three of the categories. If there are multiple triggers state law must say if any one trigger allows access to the fund ("or") or they must all be met ("and").

- Uses of Fund

Once the triggers have been met, their use must be determined. Many states allow funds to be spent as ordinary general operating revenue. They can then be used to fill gaps in the general operating budget. Another option is to dedicate funds to high priority expenditures such as education. Another issue concerning fund use is interest earnings from the fund balance. These earnings can be reinvested back into the fund thereby accelerating fund growth or they can be dedicated to other purposes.

- Size of Fund

Most states set a limit on the size of the fund. This limit is usually tied to the overall size of the state's operating budget.

Characteristics of the Proposed Education Stability Fund

By creating a formal stabilization fund and specifying an ongoing revenue source, HJR 76 represents a significant change in Oregon fiscal policy. The constitutional referral spells out many of the fund's features. Other detailed features will be determined by accompanying statute if voters approve HJR 76.

- Revenue Sources

The Education Stability Fund will receive the 15% of Lottery revenue now going to the Education Endowment Fund. This revenue is projected to be $98.9 million in the 2003-05 biennium and $100.5 million in the 2005-07 biennium. This forecast is based on the assumption that there is no significant change in the mix of games offered by the Lottery Commission or a change in the market share of gaming activities held by the Tribal casinos. New game introductions could boost revenue above forecast while a further shift in the gaming market toward the tribes would reduce state revenue. Lottery revenue, 80% of which is video poker, has shown a great deal of stability in the current recession. This suggests that lottery revenue, in the absence of one of the mentioned structural changes, is likely to grow at a slow steady rate over time.

- Triggers

HJR 76 contains all three types of triggers. It has one economic trigger and two budgetary triggers. It also has separate political triggers. The fund cannot be accessed unless the political conditions are met.

> **Economic trigger:** A two consecutive quarter decline in seasonally adjusted non-farm payroll employment within the last 12 months. Non-farm payroll employment is based on a monthly survey conducted by the Oregon Employment Department. The methodology for the survey is set by the federal government and carried out in all states. A two-quarter decline is indicative of a recession. This trigger would currently be met. Employment has declined four quarters in a row beginning in the first quarter of 2001. Prior to the current recession, such a decline last occurred in the 1989-91 biennium during the 1990-91 national recession. It also occurred in the 1981-83 and 1979-81 biennia, a time of severe recession in Oregon.

> **Budgetary triggers:** (1) The final forecast of the biennium indicates that General Fund revenue will be at least 3% less than General Fund appropriations in the current budget or (2) the quarterly General Fund revenue forecast for the current biennium projects that revenue will be at least 2% below the forecast used for the Legislatively adopted budget. The first trigger would be indicative of an anticipated severe recession at the time the budget is being developed by the Legislature. This has not happened in the history of Oregon's modern forecasting system, which began in 1981. The second trigger would apply to the current (March 2002) revenue forecast. This forecast is $813.9 million or 7.4% below the one used for the legislatively approved budget, exceeding the 2% trigger by a wide margin. This is the first time this condition has been met since the 1981-83 biennium. It would also have been met in the 1979-81 biennium.

> **Political Triggers:** A 3/5 vote in both houses of the Legislative assembly. A vote can be taken if the economic trigger or one of the budgetary triggers is met. The 3/5 vote is an additional requirement, it must be met after one or more of the economic/budgetary triggers have been met. The fund can also be accessed in the absence of the non-political triggers if the Governor declares an emergency and 3/5 of the legislature in each chamber approve.

- Use of the fund

Once the triggers have been met, allocations from the fund must be used for “expenditure on public education.” Public education is broadly defined to include all levels.

- Size of the Fund

HJR 76 does not specify a size limit for the fund. A key issue is the use of fund earnings. If earnings are invested back into the stability fund it will grow faster. If earnings continue to be allocated as they are under current statute (75% to debt repayment and 25% to scholarships) the fund will grow more slowly. Under current projections the fund will grow to $600 million over the next ten years. This assumes earnings are not re-invested and there is no intervening withdrawal after May 1, 2003. Re-invested earnings could add $150 to $300 million to the fund balance after 10 years depending on rate of return. If voters approve HJR 76, fund size is likely to be addressed by the 2003 Legislature.

If approved by voters, the Educational Stability Fund becomes operational on April 30, 2003.

Initial Fund Transfer

HJR 76 directs an initial $220 million transfer from the new stability fund to the State School Fund on May 1, 2003. SJR 50 sets this transfer at $120 million. A $220 million transfer will reduce the fund balance to $58 million for the beginning of the 2003-05 biennium. The initial transfer to the State School Fund offsets a $200 million disappropriation from the State School Fund contained in Senate Bill 5575 from the second special session. Unless further action is taken by the Legislature, the State School Fund reduction will take place regardless of voter's decision on HJR 76.

The initial transfer will reduce interest earnings from the fund in the final two months of the current biennium and next biennium. Earnings can be expected to decline by roughly $2 million with the Education Fund absorbing 75% of the decline and the remaining 25% reduction accruing to the State Scholarship Commission.