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## **2002 SPECIAL SESSION III**

### **REVENUE PACKAGE**

Following release of the June revenue forecast, the Legislature faced a General Fund shortfall of \$859 million compared to the budget adopted by the second special legislative session in March. This shortfall left the State School Fund at the level approved by the 2001 regular legislative session. However it did not offset any of the \$112 million reduction caused by elimination of second year funding for the School Improvement Fund. Ultimately, the Legislature offset \$30 million of this previous reduction leaving a total rebalance package of \$889 million.

The table below displays the components of the rebalance package.

<b>SPECIAL SESSION III REBALANCE PLAN</b>	<b>REVENUE IMPACT (\$ Million)</b>	<b>BILL NUMBER</b>
Allow School Districts to Accrue Early 2003-2005 State School Fund Payment	211	SB 1022
Education Stability Fund Transfer*	150	HJR 80, HB 4052
Phase-In of Higher Federal Income Tax Subtraction (Measure 88)	108	HB 4054
Transfer Tobacco Settlement Revenue from Health Care Trust Fund	85	HB 5091
Cigarette Tax Increase ( 60 cents per pack effective November 1, 2002)*	65	HB 4051
Reduction of Projected General Fund Ending Balance	61	HB 5091
Delay Payment of Portion of Community College Support Payment	56	SB 1022
Issue Revenue Bonds Based on Future Cigarette Tax Revenue	50	HB 4056
Distribute Statutory Balance from Common School Fund	18	HB 4055
Reduce General Purpose Emergency Fund Balance	12	HB 5091
Re-Allocate Light Rail Bond Reserves	10	HB 5091
Transfer Portion of 9-1-1 Balance	9	HB 4055
Budget Reductions	54	HB 5091
<b>Total Rebalance Solutions</b>	<b>889</b>	

\*Referred to special election on September 17, 2002.

### **The Estimated Shortfall Compared to Special Session II**

Going into Special Session III the General Fund budget was \$859 million out of balance compared to the budget approved by the Legislature in Special Session II. This gap was caused by a declining revenue forecast, federal tax legislation, voter rejection of Measure 13, the Governor's vetoes and rising human service costs. Specifically, the factors causing the short fall were:

- \$545 million reduction in the General Fund revenue forecast. This includes a \$124 million reduction in corporate and personal income taxes due to the passage of a bonus depreciation provision by the federal government. Oregon automatically connects to changes in the federal tax base unless the Legislature votes to override.
- Failure of Measure 13 in the May primary election. Special Session II disappropriated \$200 million from the State School Fund in anticipation of replacing the loss with a transfer from the newly created Education Stability Fund. However, voters rejected the proposal creating the fund. Measure 13 called for a \$220 million transfer from what is now the Education Endowment Fund after it had been constitutionally transformed into the Education Stability Fund. This transfer would have left the State School Fund \$20 million higher than the level adopted at the end of the 2001 regular session. This infusion was to be used to partially offset a \$112 million reduction in the School Improvement Fund approved by Special Session II.
- An \$81 million reduction in revenue caused by the Governor's vetoes following Special Session II. The Governor vetoed a portion of SB 5575 following Special Session II that contained a \$67 million transfer of revenue received from the Master Settlement Agreement between the states and the major tobacco companies. The 2001 Legislature had targeted \$82 million of this revenue for a newly established Health Care Trust Fund and the other \$5 million for tobacco cessation. Special Session II transferred a portion of these funds to general purposes. The Governor also vetoed HB 4030, a bill that transferred \$14 million from the 9-1-1 emergency fund account and sub accounts to the General Fund.
- \$33 million in expenditures required to rebalance the Department of Human Services budget.

### **The Estimated Shortfall Compared to the 2001 Regular Session**

The General Fund shortfall prior to Special Session III was \$1,587 million compared to the close of regular legislative session estimates. Existing law General Fund resources (including the beginning balance) were \$1,413 million less than projected in July of 2001. This includes the effects of federal legislation but excludes any actions (legislative or administrative) taken by the Legislature since the end of the regular session. Demands on the General Fund were increased \$144 million due to caseloads and other rebalance factors since the end of the regular session. Finally, the Legislature opted to increase the State School Fund by \$30 million (including an \$18 million distribution from the Common School Fund) relative to the Close of Session. However, projected local property tax revenue for schools is now \$20 million less than anticipated when the regular session ended.

The table below displays the cumulative actions taken by the Legislature to rebalance the General Fund budget since the close of the regular 2001 session.

<b>CUMULATIVE REBALANCE PLAN SINCE CLOSE OF REGULAR SESSION</b>	<b>REVENUE IMPACT (\$ Million)</b>	<b>BILL NUMBER</b>
Income Tax Collections Process	16	ADM
MUPL Account	131	SB 5575 SS II
Senior Deferral Balance Transfer	20	ADM
Sale of Boardman Property	4	HB 4035 SS II
Increased Lottery Forecast	34	--
Sunday OLCC Sales	3	HB 4028 SS II
Allow School Districts to Accrue Early 2003-2005 State School Fund Payment	211	SB 1022 SSIII
Education Stability Fund Transfer*	150	HJR 80, HB 4052 SS III
Phase-In of Higher Federal Income Tax Subtraction (Measure 88)	108	HB 4054 SS III
Transfer Tobacco Settlement Revenue from Health Care Trust Fund	85	HB 5091 SS III
Cigarette Tax Increase ( 60 cents per pack effective November 1, 2002)*	65	HB 4051 SS III
Reduction of Projected General Fund Ending Balance	81	SB 5575, SSII HB 5091,SSIII
Delay Payment of Portion of Community College Support Payment	56	SB 1022 SS III
Issue Revenue Bonds Based on Future Cigarette Tax Revenue	50	HB 4056 SS III
Distribute Statutory Balance from Common School Fund	18	HB 4055 SS III
Reduce General Purpose Emergency Fund Balance	17	HB 5091 SS III
Re-Allocate Light Rail Bond Reserves	10	HB 5091 SS III
Transfer Portion of 9-1-1 Balance	9	HB 4055 SS III
Budget Reductions	520	SB 5575, SSII HB 5091,SSIII
<b>Total Rebalance Solutions Since 2001 Regular Session</b>	<b>1,587</b>	

\*Referred to special election on September 17, 2002.

The net result of the actions taken by the Legislature since the close of the regular session leaves a projected General Fund ending balance of \$15 million.

## **Components of the Special Session III Rebalance Plan**

### *Accrual of 2003-05 Initial State School Fund Payment*

Senate Bill 1022 modifies the timing of State School Fund payments and allows school districts to accrue a portion of their initial 2003-04 payment back into the 2002-03 fiscal year for purposes of balancing their budgets. State School Fund payments are to be distributed as if there was no reduction in the State School Fund since the 2001 session until the final payment on May 15. The May payment, 25% of the annual allocation, will be reduced by \$211 million as part of the rebalance plan. School districts will receive a payment equal to 16 2/3 % of their annual 2003-04 payment on July 15, 2003. They are allowed to accrue up to 9.1% (\$211 million for all districts) of their 2002-03 State School Fund payment out of this initial 2003-04 distribution as revenue for the 2002-03 fiscal year. Accrual of a portion of the initial payment of each fiscal year will continue into future biennia.

The net effect of the accounting change combined with the budget reduction from the State School Fund is to help rebalance the state General Fund budget that is measured on a cash basis without forcing reductions in accrual based school district budgets. Districts that operate on a cash basis will be allowed to have a negative end-of-the-year fund balance for a 3-year period.

### *Education Stability Fund Transfer*

HJR 80 is conceptually similar to Measure 13, rejected by voters in May, but it also has a number of distinguishing features. HJR 80, like Measure 13, amends the constitution and converts the Education Endowment Fund into a new Education Stability Fund. It also initially transfers money into the State School Fund and specifies under what conditions future transfers can take place. Both measures restricted use of the new stability fund to public education purposes.

The features that distinguish HJR 80 from Measure 13 are:

- Starting July 1, 2003, 18% of lottery revenue will be diverted to the stability fund. Measure 13 retained the 15% dedication currently used for the Education Endowment Fund.
- Initially transfers \$150 million to the State School Fund. Measure 13 called for a \$220 million transfer.
- HJR 80 is accompanied by implementing statutory language (HB 4052) making the fund operational 30 days after voter approval. Measure 13 would not have been operational until May 1, 2003 pending regular session action on implementing statutes.
- HJR 80 caps the stability fund at 5% of General Fund revenue in the previous biennium. Measure 13 had no cap.
- HJR 80 creates a new school capital matching sub account within the stability fund. Once the cap is reached, 15% of lottery revenue is diverted into the sub account.

The new stability fund is projected to have an ending balance of \$128 million on July 1, 2003, \$246 million on July 1, 2005 and \$366 million on July 1, 2007. These figures

assume that there are no further intervening withdrawals beyond the initial transfer contained in HJR 80.

### *Phase-In of Higher Income Federal Income Tax Subtraction*

The 1999 Legislature referred Measure 88 to voters for the November 2000 election. Following approval by voters the measure was scheduled to take effect in the 2002 tax year. Measure 88 increased the maximum amount of federal taxes that can be subtracted from Oregon taxable income from \$3,000 to \$5,000. For taxpayers paying federal taxes in excess of \$5,000, this measure reduced Oregon tax liability by \$180  $((\$5,000 - \$3,000) \times .09)$ .

Special Session III action (HB 4054) phases in the subtraction cap over a 5-year period. This has the effect of increasing projected personal income tax revenue by \$108 million in the 2001-03 biennium and \$119 million in the 2003-05 biennium. Under the new statute, the federal subtraction cap is:

- \$3,250 in tax year 2002.
- \$3,500 in tax year 2003.
- \$4,000 in tax year 2004.
- \$4,500 in tax year 2005
- \$5,000 in tax year 2006.
- \$5,500 in tax year 2007.

For the 2008 tax year and beyond the subtraction cap is indexed to changes in the Consumer Price Index. Measure 88 contained similar indexing language.

### *Tobacco Settlement Revenue*

The Legislature allocated an additional \$85 million of Master Tobacco Settlement revenue toward the General Fund gap in Special Session III. These dollars had previously been allocated to the Health Care Trust Fund and tobacco cessation programs. This leaves a projected \$2 million remaining for the Health Care Trust Fund.

Payments from the Master Tobacco Settlement Agreement began flowing in during the 1999-2001 biennium. This revenue was not allocated until the 2001 legislative session. Settlement revenue through the end of the 2001-03 biennium is expected to total \$335.2 million. The 2001 Legislature allocated \$99.2 million of this revenue for the General Fund. The Legislature also allocated a projected \$82 million for the Health Care Trust Fund and \$5 million for tobacco cessation.

The second special session re-allocated \$62 million from the Health Care Trust Fund and \$5 million from tobacco cessation programs to general health plan expenditures. The Governor vetoed this transfer following Special Session II.

### *Cigarette Tax Increase*

HB 4051 increases Oregon's current \$.68 per pack cigarette excise tax to \$1.28 per pack. HB 4065 refers the enrolled bill to the voters for a special election on September 17,

2002. Upon approval by voters, the \$.60 increase goes into effect November 1, 2002. HB 4051 also imposes a \$.60 floor tax on distributor's inventories as of the effective date of the increase.

The excise tax increase is projected to generate a net increase of \$67 million to the state for the 2001-03 biennium. A one-time transfer of \$2 million to the Tobacco Use Reduction Account leaves \$65 million available for balancing the General Fund shortfall. Net additional state tax collections are projected to total \$207 million for the full 2003-05 biennium.

With the exception of the one-time 2001-03 transfer, the \$.60 increase is dedicated to the Oregon Health Plan. The bill also adjusts payments to local governments and tobacco use reduction to ensure that revenue is not reduced due to lower consumption associated with a 60-cent increase in the price of cigarettes. However, General Fund revenue from the cigarette tax, fixed at \$.22 per pack, is reduced by \$3.1 million in 2001-03 and \$12 million in 2003-05 due to lower cigarette sales volume.

#### *Reduced General Fund Ending Balance*

The revenue estimate used for the Legislatively Approved Budget showed a projected ending balance of \$96 million. This was reduced to \$76 million by Special Session II. At the end of Special Session III the Legislature reduced the projected ending balance to \$15 million, freeing up \$61 million relative to Special Session II to use to rebalance the budget.

#### *Allow Community Colleges to Accrue Early 2003-05 Payment*

In addition to schools and ESDs, SB 1022 also allows community colleges to accrue early 2003-05 state support payments as revenue for the 2001-03 biennium. SB 1022 was accompanied by a \$56 million (equal to the 2002-03 quarterly payment) reduction in the 2001-03 community college support fund for state budgetary purposes.

#### *Revenue Bonds Backed by Future Cigarette Tax Receipts*

HB 4056 authorizes the State Treasurer to issue \$50 million in revenue bonds secured by future cigarette revenue. The measure directs the Treasurer to deposit the net proceeds from the bond sale in the State School Fund.

The debt repayment period is limited to 6 years. Debt service costs are estimated at \$25.4 million for both the 2003-05 and 2005-07 biennia.

HB 4056 also contains language authorizing the Treasurer to issue additional cigarette backed revenue bonds up to \$175 million under certain conditions. The additional authorization is contingent on a future quarterly revenue forecast projecting a General Fund deficit in excess of \$50 million. This contingency applies only to the remainder of the 2001-03 biennium. The maximum amount of additional debt that can be issued is either the size of the deficit or \$175 million whichever is less. Debt service payments are estimated to be \$64 million in the 2003-05 biennium if the full \$175 million contingency authorization is issued. This would be in addition to the \$25 million in debt for the \$50 million revenue bond issue.

Future cigarette tax revenue would be obligated to pay the debt service regardless of the voter's decisions on the cigarette tax increase.

#### *Statutory Balance Distribution from the Common School Fund*

The Legislature required the Division of State Lands to transfer at least \$17.7 million above its planned distribution to schools in 2002-03 from the Common School Fund. The \$17.7 million distribution is in addition to a \$15 million planned distribution for 2002-03. The measure directs the Division of State Lands to use statutory revenue sources to make the extraordinary distribution.

If the Division of State Lands cannot meet its planned distribution, it is directed to report to the Legislature prior to March 1, 2003.

#### *Other Budget Rebalancing Actions*

- \$12 million reduction in the general-purpose emergency fund. The reduction leaves \$20 million in the general-purpose emergency fund.
- \$10 million from re-allocation of light rail bond reserves. Refunding of lottery backed West Side light rail bonds freed up bond reserves from the Department of Transportation's budget. No longer needed for bond reserve purposes, these funds became unallocated lottery revenue available for general purposes.
- \$9 million transferred from the emergency communications accounts and sub-accounts. Revenue generated from a tax on 9-1-1 phone service is deposited in these accounts. Revenue from 9-1-1 tax revenue is used for emergency management services and equipment. HB 4055 makes a one-time exception by allowing a portion of the balance in these accounts to be transferred to the General Fund.
- \$54 million in budget reductions. These reductions are a combination of selective cuts (\$31 million) and general reductions through withholding a portion (\$23 million) of special purpose emergency fund dollars targeted for previously negotiated state employee salary increases.