REVENUE OPTIONS, SCHOOL FUNDING & ACCOUNTABILITY TASK FORCE

Research Report #2-03

LEGISLATIVE REVENUE OFFICE
COMMITTEE SERVICES

January 22, 2003

Chair
Representative Lane Shetterly

Vice Chair
Senator Joan Dukes

Staff
Paul Warner, Legislative Revenue Officer
Jan McComb, Committee Assistant

71st Legislative Assembly

REVENUE OPTIONS, SCHOOL FUNDING & ACCOUNTABILITY TASK FORCE

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The Honorable Peter Courtney, Senate President
S-203 State Capitol
Salem, OR 97301

The Honorable Karen Minnis, Speaker of the House
269 State Capitol
Salem, OR 97301

Dear Mr. President and Madam. Speaker,

It has been my honor to serve as the Chair for the Revenue Options, School Funding and Accountability Task Force created by HB 4063, enacted in Special Session III of the 2001-03 Legislature. The task force has concluded its work.

As you know, Oregon has one of the most vulnerable revenue systems in the country, with its unparalleled reliance on the income tax. The result of this dependence is a state economy that suffers more than other states when an economic downturn occurs. This loss of revenue severely impacts state funded programs; our task force focused on the impact on K-12 education.

The task force met in each of the five Congressional districts to hear from Oregon citizens on this important topic, and heard many suggestions. The task force also relied heavily on the advisory council created under HB 4063, who developed many recommendations. These recommendations are included in the report.

I hope this report may provide guidance this legislative session as we debate budget issues that face the state. As chair of the House Revenue Committee, I intend to use the report to augment the committee's work.

Sincerely,

Rep. Lane Shetterly, Chair

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Revenue Options,
School Funding &
Accountability Task
Force

Membership:

Rep. Lane Shetterly, Chair

Sen. Bev Clarno
Sen. Joan Dukes
Sen. Gary George
Sen. Frank Shields
Rep. Tom Butler
Rep. Mark Hass
Rep. Mary Nolan

Staff:

Paul Warner, Legislative Revenue Officer

Jan McComb, Committee Services

Introduction

The Revenue Options, School Funding and Accountability Task Force was created by HB 4063 (Appendix A), approved in Special Session III of the 71st Legislative Assembly. The task force consisted of eight members, four from the House of Representatives and four from the Senate. Members were appointed by House and Senate leadership from both parties. Representative Lane Shetterly was elected chair by task force members.

HB 4063 charged the task force with the following:

- Examine alternative tax reform proposals to develop a more stable tax system.
- Evaluate the current property tax system.
- Develop proposals for long-term, stable revenue sources to support kindergarten through grade 12 education.
- Evaluate school finance and accountability alternatives for the management of costs related to education funding.

The task force relied on four primary tools to carry out its charge:

1. Revenue Options, School Funding and Accountability Advisory Council

The Revenue Options, School Funding and Accountability Advisory Council was also established by HB 4063 for the purpose of advising the task force. Complete membership is listed in Appendix B. The council consisted of thirteen citizens and four ex-officio members of the task force. Former Governor Vic Atiyeh served as chair. The council held five meetings in which both public and expert testimony was received, however the council relied most heavily on the expertise of its members to formulate the report to the task force. The council report consisted of key findings followed by consensus guidance. The consensus guidance is divided into those pertaining to revenue options and those related to school accountability. The council also provided “other suggestions” in these two areas. The task force adopted the format of the council report to incorporate into this report. Advisory council members also provided extended public testimony at task force meetings.

2. Research and Previous Proposals

The task force received two new reports during its deliberations. The first was prepared by ECONorthwest under contract with the Oregon School Boards Association, *A Comprehensive Analysis of K-12 Education Finance in Oregon*. The second was a general financial audit of the K-12 system performed by the Secretary of State’s Audits Division, *Oregon Department of Education:*

Kindergarten through 12th Grade Cost Survey. The task force also heard a presentation from Steve Smith, of the National Conference of State Legislatures regarding school funding on a national level (Appendix F). At the request of the advisory council, staff prepared a paper outlining the advantages and disadvantages of various revenue options (Appendix E).

These reports provided valuable insight into the cost structure of the K-12 system. The task force also relied on detailed analysis of the 1985 sales tax proposal and Measure 1 from 1993. Finally, the 1998 *Review of Oregon's Tax System*, under the direction of Governor Kitzhaber, provided a detailed description of the stability risks inherent in Oregon's post-Measure 5 revenue system. A full listing of these publications may be found in Appendix C.

3. Public Testimony

HB 4063 directed the task force to hold public meetings in each of Oregon's five congressional districts. The task force held meetings in Salem, Bend, Hillsboro, Portland and Eugene. Each was well attended with a wide variety of testimony from local public officials and citizens. A summary of the public testimony can be found in Appendix D.

4. Legislative Staff

Individual citizens as well as members of the advisory council recommended specific revenue proposals with varying degrees of detail. The Legislative Revenue Office prepared an assessment of advantages and disadvantages to different revenue restructure approaches. The Revenue Office also prepared revenue impact estimates for a menu of revenue increase/decrease options.

KEY FINDINGS

1. Measures 5 and 50 significantly reduced Oregon's property tax burden thereby reducing Oregon's overall tax burden relative to other states.
2. State and local governments used non-tax revenue (charges, fees, federal funds and lottery) to partially substitute for the reduced property tax revenue.
3. State government also used income tax collections generated by a strong economy and unprecedented run-up in stock prices to offset reduced school property taxes. Revenue from capital gains above long-term trend added $670 million to the General Fund during the 1999-2001 biennium.
4. Income tax revenue from the 1990's economic boom is now gone. Although revenue growth will pick up with economic recovery, revenue from capital gains and corporate profits associated with the late 1990's financial bubble is unlikely to return. This means that the legislatively approved 1999-2001 program level is not sustainable. The Legislature must either scale back this program level or increase revenue.
5. Schools are a critical factor in Oregon's overall quality of life and economic development. Education at all levels should be a high priority for state government.
6. School achievement has improved since the passage of school reform in 1991.
7. Oregon's SAT scores are higher than any other state with the exception of Washington.

8. Oregon's national ranking on K-12 spending per student varies based on the student measure used. For the 2000-2001 school year, Oregon's national rank in spending per student varies from 12th to 21st depending on the student count measure used.
9. Over 80 percent of school spending is on salaries and benefits. This means that rising health care and PERS costs disproportionately affect schools.
10. Federal mandates and a rapidly growing ESL population have significantly affected school costs.
11. Growth in spending on special education significantly outpaced growth in spending on regular programs over the past decade.
12. Accountability links between local school districts and their local communities have been eroded by the shift to a predominantly state financed school system

Task Force Recommendations

School Accountability and Cost Management

1. It is critical that the Governor and the Legislature address the crisis in the Public Employees Retirement system. Rising PERS costs have a significant effect on all public entities. Schools are particularly vulnerable because labor costs exceed 80 percent of total K-12 costs.
2. The Legislature should re-examine its standards and assessment system in response to federal legislation passed this year. The state goals should be either re-affirmed or modified.
3. Government at all levels should make greater efforts to inform the public of the state's education goals and progress towards those goals.
4. Legislative budget committees with assistance from the Department of Education should develop ways to more effectively use data to analyze school budgets and the trade-offs implicit in school budget decisions. Efforts should be made to more fully understand the differences between large and small district costs.
5. Align timing of state education budget process more closely with school's budget processes. Mid-year cuts should be avoided as much as possible because of the limited flexibility schools have once the academic year begins.
6. The Legislature should review state mandates and determine if some should be changed to optional. Mandates that are retained should be aligned with state standards and goals.
7. The Department of Education, in cooperation with the school districts, should establish a statewide student data base.
8. The Legislature, through the appropriate committees, should review the current state school fund distribution formula in light of new information and current statewide policy goals.

Revenue Options

1. Encourage the state's Congressional delegation to increase federal funding for mandates linked to the *Individuals with Disabilities Education Act* and the *No Child Left Behind* initiative.
2. Any proposals to raise additional revenue must be preceded by efforts to clearly define the need (what the revenue will be used for and why) and the development of systems to ensure accountability.
3. Proposals should minimize negative impact on the economy and to the greatest extent possible should encourage economic growth and capital investment. Proposals should be evaluated based on their full economic cost including public and private collection and administrative expense, and consistency with and deductibility under the federal tax code.
4. Major changes in the revenue system should maintain roughly the current distribution of the tax burden.
5. Broad-based public services, including K-12 education as well as public health and safety, should be funded with broad-based taxes such as income, property and/or consumption taxes.

6. The personal income tax base should be broadened by reductions in the use of state credits and subtractions. However, the risk of increased dependence on the personal income tax should be evaluated if significant amounts of additional revenue are generated through elimination of these tax expenditures.
7. The Legislature should examine ways to expand local school funding options. However, if a proposal emerges it should be carefully balanced with the state's school funding equity goals.

OTHER SUGGESTIONS

The task force gathered a large number of suggestions from the advisory council and the general public. Although these suggestions do not warrant the status of recommendations at this time, many do warrant further analysis.

School Accountability and Cost Management

1. Reduce state CIM assessment in any subject areas other than reading/language arts, math, science and social science.
2. Appoint an accountability committee to streamline statutory mandates for curriculum requirements.
3. Use quality education model as a benchmark for determining school adequacy level.
4. Create "re-engineering teams" comprised of business and public sector leaders to investigate ways to improve effectiveness and reduce costs in K-12 system.
5. Examine ways to reduce number of school districts.
6. Change the school funding allocation process to better account for school size, regional distinctions and performance standards. One such action plan to begin this process is spelled out in LC 1143.
7. Re-examine goal that all students achieve to standard.
8. Examine role of ESDs and ascertain whether some should be eliminated or consolidated.
9. Increase use of technology in delivery of education services. Technology should be increased even at the cost of higher student-teacher ratios.
10. Work more cooperatively with private schools and home-schoolers.
11. Develop performance audit process for schools.
12. Limit school board's discretion to buy out administrator's contracts.
13. Expand K-12 services to be year-round through adaptation of new technologies.
14. Encourage the Department of Education and the Department of Human Services to cooperate more thoroughly in order to reduce administrative costs.
15. Require all school districts to use accrual accounting systems.
16. Establish a statewide volunteer program using retirees. This program should be patterned after the Service Corps of Retired Executives (SCORE), a nationwide program used to encourage business development.

Revenue Options

1. Consider a limited value-added tax patterned after New Hampshire's Business Enterprise Tax (BET).
2. Establish a commission to examine tax expenditures and recommend to the Legislature those that should be eliminated or modified. The legislation establishing the commission should be patterned after the federal law used to determine military base closings.
3. Constitutionally amend the 2 percent surplus kicker to dedicate a portion of future refunds to a reserve fund.
4. Examine ways to extend the tax base to generate more revenue from out-of-state visitors.
5. Establish a minimum personal income tax for each filer as a substitute for a consumption tax.
6. Amend Measure 5 to expand potential local option revenue for schools.
7. Establish statewide bonding program to help improve school's infrastructure.
8. Eliminate income tax liability for low-income taxpayers in order to offset the regressive effects of broad-based consumption taxes, if a consumption tax is approved
9. Implement statewide real estate transaction tax.

10. Update and evaluate the 1985 tax reform proposal in view of today's revenue situation.
11. Accompany broad consumption tax proposals by a reduction in income and property taxes.
12. Consider additional funding sources for the newly created Education Stability Fund to better prepare the state for future downturns.
13. Given erosion of the traditional retail sales tax base and the Federal government's deductibility policy, the most logical choice for balancing the tax system is a statewide property tax.
14. Reduce personal income tax on capital gains and replace revenue with higher rate on more stable income source.

Appendix A: House Bill 4063

71st OREGON LEGISLATIVE ASSEMBLY--2002 Third Special Session

Enrolled

House Bill 4063

Sponsored by HOUSE SPECIAL SESSION COMMITTEE ON BUDGET RECONCILIATION

AN ACT

Relating to study of revenue options; appropriating money; and declaring an emergency.

Be It Enacted by the People of the State of Oregon:

SECTION 1. There is created the Revenue Options, School Funding and Accountability Task Force, consisting of eight members appointed as follows:

(a) The Senate Majority Leader, or the designee of the Senate Majority Leader;
(b) The Senate Minority Leader, or the designee of the Senate Minority Leader;
(c) One member of the Senate appointed by the President of the Senate;
(d) One member of the Senate appointed by the Senate Minority Leader;
(e) The House Majority Leader, or the designee of the House Majority Leader;
(f) The House Minority Leader, or the designee of the House Minority Leader;
(g) One member of the House of Representatives appointed by the Speaker of the House; and
(h) One member of the House of Representatives appointed by the House Minority Leader.

(2) The purpose of the task force is to evaluate and prepare legislative options that would lessen Oregon's dependence on income taxes as the predominant source of state revenue.

(3) The task force shall:
(a) Examine alternative tax reform proposals to develop a more stable tax system;
(b) Evaluate the current property tax system;
(c) Develop proposals for long-term, stable revenue sources to support kindergarten through grade 12 education; and
(d) Evaluate school finance and accountability alternatives for the management of costs related to education funding.

(4) In addition to any other meetings scheduled by the task force, the task force shall meet at least once in each congressional district throughout this state between the effective date of this 2002 third special session Act and December 15, 2002.

(5) The task force shall present its findings and recommendations to the committees of the Seventy-second Legislative Assembly having jurisdiction over revenue and school funding matters prior to February 1, 2003.

(6) A majority of the members of the task force constitutes a quorum for the transaction of business. A majority of the members of the task force shall select a chair of the task force from among its members.

(7) Official action by the task force requires the approval of a majority of the members of the task force.

SECTION 2. (1) There is created the Revenue Options, School Funding and Accountability Advisory Council, consisting of 13 members appointed as follows:

(a) The President of the Senate, in consultation with the Senate Majority and Minority Leaders, shall appoint two members representing business, two members representing schools and education labor organizations, and two members of the public;

(b) The Speaker of the House of Representatives, in consultation with the House Majority and Minority Leaders, shall appoint two members representing business, two members representing schools and education labor organizations, and two members of the public; and

(c) The President of the Senate and the Speaker of the House of Representatives shall jointly appoint one member who shall serve as the chair of the advisory council.

(2) Two members of the Revenue Options, School Funding and Accountability Task Force from the majority party of the Legislative Assembly and two members of the task force from the minority party of the Legislative Assembly, appointed by the chair of the task force, shall serve as ex officio members of the advisory council.

(3) The advisory council shall advise the task force and make recommendations to the task force on the subjects described in section 1 (3) of this 2002 third special session Act.

(4) The advisory council shall meet at least five times between the effective date of this 2002 third special session Act and December 15, 2002. The advisory council shall make final recommendations to the task force before December 1, 2002.

SECTION 3. The Legislative Revenue Officer shall provide staff and administrative support to the Revenue Options, School Funding and Accountability Task Force and the Revenue Options, School Funding and Accountability Advisory Council. The Legislative Revenue Officer may request staff or assistance from any other entity having knowledge of business and economic conditions in this state.

(2) All public bodies, as defined in ORS 174.109, are directed to assist the task force and the advisory council in the performance of their duties and, to the extent permitted by laws related to confidentiality, to furnish such information and advice as the members of the task force or members of the advisory council consider necessary to perform their duties.

(3) Members of the Legislative Assembly who serve on the task force are entitled to a per diem payment and an allowance for expenses as authorized by ORS 171.072 from funds appropriated by the Legislative Assembly. Members of the Legislative Assembly who are ex officio members of the advisory council are entitled to a per diem payment and an allowance for expenses, as authorized by ORS 171.072 from funds appropriated by the Legislative Assembly, for any day on which there is an advisory council meeting but not a task force meeting. Other members of the advisory council are not entitled to compensation but may receive actual and necessary travel or other expenses incurred in the performance of their official duties in the manner provided under ORS 292.495.

SECTION 4. In addition to and not in lieu of any other appropriation, there is appropriated to the Legislative Revenue Officer, for the biennium beginning July 1, 2001, out of the General Fund, the amount of $20,000 for the purpose of paying the expenses of the Revenue Options, School Funding and Accountability Task Force and the Revenue Options, School Funding and Accountability Advisory Council created under sections 1 and 2 of this 2002 third special session Act.

SECTION 5. Sections 1 to 3 of this 2002 third special session Act are repealed on June 30, 2003.

SECTION 6. This 2002 third special session Act being necessary for the immediate preservation of the public peace, health and safety, an emergency is declared to exist, and this 2002 third special session Act takes effect on its passage.

Appendix B: Membership: Revenue Options, School Funding & Accountability Advisory Council

Vic Atiyeh
Former Governor of Oregon

Eric Blackledge
President, Blackledge Furniture
Chair, Governor's Small Business Council
Member, 14-member advisory board to the Internal Revenue Service
Delegate, White House Conference on Small Business

Julia Brim-Edwards
Member, Portland School Board

Roger Christensen
President, Columbia River Bank
Member, Western Independent Bankers Assn.

Jeanette Hamby
Former State Senator

James Johnson
Co-chair, New Economy Coalition
Former Vice President and Site Manager, Intel
Member, Oregon's Engineering and Technology Industry Council
Member, Oregon Growth Account Board
Member, Oregon Council on Knowledge and Economic Development

Jean Mater
Vice President, Mater Engineering

Harvey Mathews
Assn. of Oregon Industries representative
Former education policy analyst for the Speaker of the Oregon House of Representatives

Dr. Brian Metke
Superintendent, Glendale School District
Former Member, Database Initiative Committee

Phil Romero
Dean, Lundquist College of Business – University of Oregon Legislative Administration
Former chief economist of California

Jim Scherzinger
Portland Public Schools Superintendent and Chief Financial Officer
Former Legislative Revenue Officer

Al Switzer
Klamath County Commissioner

Jerry Wilson
Hermiston School District Superintendent

Ex-Offio Members

Senator Gary George
Senate District 12

Senator Joan Dukes
Senate District 17

Rep. Tom Butler
House District 60

Rep. Mary Nolan
House District 36

Appendix C: Key Documents Used In Development Of Report

Tapogna, John, Eric Fruits, Anne Fifield, Ted Helvoight. *A Comprehensive Analysis of K-12 Education Finance in Oregon*. ECONorthwest for the Oregon School Boards Association. November 2002. http://www.osba.org/hotopics/funding/2002/analysis/index.htm

Legislative Revenue Office. *1985 Tax Reform and Sales Tax Package*, #5-85 (1985).

Legislative Revenue Office. *Impact of Measure 1: Sales Tax for Schools*, report #3-93 (1993)

Legislative Revenue Office. *The Oregon Tax Incidence Model (OTIM)",* Legislative Revenue Office Research Report 2-01 (2001).

Office of the Governor. *Review of Oregon's Tax System: Technical Advisory Committee. (1998).*

Office of the Governor. *Review of Oregon Tax System: Policy Recommendations*. (1999).

Secretary of State's Audit Division. *Oregon Department of Education: Kindergarten Through Grade 12 Cost Survey*. http://www.sos.state.or.us/audits/audreports/fullreports/2002-45.pdf

Appendix D: Public Testimony

The task force met in each of the five Congressional districts for the purpose of gathering public opinion and recommendations regarding Oregon's tax structure and its school funding methods and level. The task force met in Salem, Bend, Hillsboro, Portland, and Eugene.

The task force heard from teachers, legislators, the state treasurer, school administrators, citizen activists, students, and parents. Opinions were varied and broad-ranging.

Revenue Options

In terms of taxes, many of those testifying before the task force stated that Oregon needed a more diverse tax base to reduce the inherent volatility of heavy income tax reliance, brought into focus by the current depressed economic climate. However, there appeared to be widespread agreement that before Oregonians would vote to increase their taxes, they needed to believe that current revenue was being well spent – on core government services, and in an efficient manner. Voters would need to understand what services would be lost under the current tax system and rates and value those potentially lost services.

One service that was not particularly valued by the public was the existing public employees' retirement system (PERS). Many citizens, school board members, school administrators, and legislators testified that recent PERS rate increases would be critically damaging to school, state, and local budgets. The guaranteed eight percent rate of return and media reports of retirees receiving more money from their retirement than from their job has heightened voter skepticism that government is running a lean operation.

While some witnesses testified that the state didn't have a funding problem, it had a "spending problem" the majority of the testimony heard by the task force was that additional revenue was needed to prevent cuts to critical services, such as schools, public safety, and social services.

Suggested methods of raising revenue were diverse. Among those ideas mentioned: instituting a consumption tax, including a retail sales tax or a value-added tax, increasing the corporate income tax rate, initiating or increasing local system development charges, changing property tax rates, creating a state property tax, and the elimination of certain tax credits and tax exemptions.

Another method of increasing revenue mentioned was increasing the tax base by increasing the number of taxpayers and businesses through economic development.

School Funding

Most of those testifying before the task force concentrated on school funding adequacy, recognizing the funding changes that occurred with passage of Ballot Measure 5 that shifted the majority of funding from the local community to the state.

A majority of those appearing before the task force testified that the state needs additional revenue for schools, that this revenue needs to be stable, and that mid-year cuts are very difficult for schools to make without significantly disrupting functioning schedules and classrooms.

Many made the connection between a good education system and a healthy state economy. Good schools benefit Oregon both in a well-educated workforce and citizenry, as well as attracting and maintaining businesses to the state.

Students and parents testified that reduced education programs put students at a disadvantage for college acceptance. Eliminating sports, arts, music, and other non-core classes may cause marginal students to drop out. Relatively new unfunded mandates such as special education and increasing numbers of students that do not speak English get funding priorities, and those costs are increasing. Others testified that the transportation requirement was very costly and not directly tied to instruction.

More immediately, education cuts that take the form of teacher layoffs negatively impact the local economy. School budgets, made up largely of salaries and benefits, are not flexible without affecting personnel.

A number of funding proposals were made. Some testified that passage of Ballot Measure 5 reduced community connection to their schools, and made taxpayers less likely to support increases in funding. One suggestion was that a mechanism be created that would provide more local control of schools and their funding. Another suggested that the state provide an identified minimum level of funding, with local communities augmenting that level. Some witnesses suggested that the state should use the Quality Education Model for making funding decisions. The state treasurer recommended greater use of the Common School Fund. Another witness suggested that the supermajority requirement for passing tax measures be eliminated. Others recommended changes in the school workforce, by allowing state retirees to work while still collecting their PERS, and to encourage more school volunteers.

Accountability

Witnesses before the task force were divided on the quality and level of accountability of Oregon schools. Most testified that Oregon has an excellent education system, as evidenced by national test results, but that this quality is threatened by the elimination of programs and other cuts that are driving the best teachers into retirement. Declining quality will result in active, involved parents pulling students from public schools, hastening more decline, they stated. Many testified that schools are efficiently run and are accountable to taxpayers through student test scores. Schools are doing their best and should not be punished. Many pointed out that the federal *No Child Left Behind Act* imposed stringent accountability measures, and additional ones would not be necessary.

Others voiced skepticism about the quality of education in schools, citing the inability of third graders to read, for example. They were not convinced that appropriate accountability measures were in place, believed that schools were poor money managers, and suggested performance and financial audits be done on a regular basis.

Recommendations included allowing parents to make education decisions for their children, greater local control, greater state control, and a state salary guide for school personnel.

Appendix F: EVALUATION OF REVENUE OPTIONS

At the direction of the advisory council, the Legislative Revenue Office prepared an evaluation of the major revenue options. Aspects of these approaches were discussed by the advisory council and formed the basis of some of the public testimony received by the task force. These options can be used to evaluate proposals that increase revenue or they can be used in combination to produce revenue neutral proposals. Each proposal is followed by a discussion of advantages and disadvantages.

Revenue Raising Approaches

1. Expand the income tax base by reducing tax expenditures.
The *Tax Expenditure Report* produced on a biennial basis by the Department of Revenue systematically lists all Oregon statutes (or indirectly federal statutes) that reduce Oregon's tax base. For the income tax this includes exclusions, deductions, subtractions and credits. Many exclusions and deductions are the result of connecting to the federal base. Substantial revenue could be raised through elimination or modification of deductions such as the mortgage interest deduction and the expanded medical deduction. Substantial revenue could also be raised through elimination or modification of credits such as the personal exemption credit, the political contribution credit and the pollution control credit.

Advantages

- Uses existing tax structure thereby minimizing administrative costs.
- Increases in state tax burden are partially offset by reductions in federal tax through deductibility for individuals and corporations.
- Increases economic efficiency by broadening base without raising marginal tax rates.

Disadvantages

- Stability may be reduced through increased dependence on the personal income tax.
- Reverses past policy decisions based on equity and economic development goals.
- Likely involves separate political battle for each tax expenditure change.

2. Incrementally Move Toward Consumption Base

Identify individual consumption-based revenue sources when additional revenue can be justified. In some ways, Oregon state and local governments have taken this approach since the passage of Ballot Measure 5. This has been done through increased use of charges such as tuition and systems development charges, fees such as increased parks and recreation fees and indirectly on consumption of gaming entertainment through the establishment of the video poker terminals owned by the Oregon Lottery. Additional revenue could be raised through further expansion in these areas and through increased use of excise taxes such as beverages, meals and entertainment taxes.

Advantages

- Diversifies revenue system through tapping consumption base.
- Can be used to target behavior or certain groups.

- Less disruptive than broad based changes.
- Efficient if linked to benefits.

Disadvantages

- Difficult to raise large amount of revenue.
- Distorts markets if not linked to benefits. Not consistent with goal of using broad revenue sources to fund broad public services.
- Generally not deductible from federal taxes
- Can be regressive depending on tax base selected.

3. Broad-based Consumption Tax

Oregon is one of five states without a retail sales tax. Moreover, many countries have a broad-based consumption tax at the national level, though the U.S. does not. Oregon ranks #50 among the states in consumption tax burden (retail sales plus selective sales taxes/total personal income). Consumption taxes can take three forms:

- Retail sales tax, used by most states. These taxes are designed to tax general retail activity though all states include at least some business intermediate purchases. Retail sales taxes have focused on the sale of tangible personal property excluding most services.
- Value-added taxes. Value-added taxes are based on the incremental value added at each stage of the production process. Most countries use the invoice method to calculate this base. The invoice method starts with the gross receipts from the sale of a good or service and subtracts out the receipts from purchases of intermediate goods or services used to produce the product. Value added can also be calculated by summing the payment to all factors (primarily labor and capital) used to produce the product or service. Michigan and New Hampshire have taxes based on value-added.
- Gross Receipts. The gross receipts of all businesses are summed up to calculate this base. It is potentially much broader than the retail sales tax base. The best current example of this type of tax is Washington's business and occupation tax.

Advantages and disadvantages refer to retail sales taxes unless otherwise noted.

Advantages

- Capable of raising large amounts of revenue, which allows for meeting both adequacy goals and reduced reliance on income taxes.
- More stable than income taxes (in the cyclical sense) if properly designed.
- Discourages consumption rather than productive income generating activity.
- Expands tax base to include non-resident consumers.
- Model legislation developed by states through the National Conference of State Legislatures is available to ease administrative costs.

Disadvantages

- Disruptive to current economic base.

- Retail sales tax is not deductible from federal income taxes. Value added and gross receipts taxes are deductible as business expenses.
- All broad consumption taxes tend to be regressive.
- Sales tax base is eroding over time due to growth of services and remote sellers.
- Gross receipts taxes can distort prices and economic activity.
- Gross receipts and value added taxes are not widely used in the U.S. thereby adding potential administrative costs especially during start-up period.

4. Increase use of Property Taxes
Measure 5 (1990) phased in a reduction in property tax rates over a five year period. Measure 50 (1997) rolled back assessed values and limited assessed value growth on existing property to 3 percent per year regardless of the change in real market value. Between 1989-90 and 1998-99 these measures had the effect of reducing the statewide property tax burden from 5.2 percent to 3 percent of personal income in Oregon. This changed Oregon from the 5th highest property tax burden in the nation in 1988-89 to the 28th highest in 1998-99.

The most direct way to increase property tax revenue for schools would be to raise the Measure 5 limit on property taxes from schools. This could in turn establish a new school permanent rate under Measure 50. Measure 50 limits on assessed value could then be applied to tax base future growth under the new permanent rate.

Advantages

- Relatively stable revenue source.
- Deductible from federal income taxes.
- Land portion of tax base is highly efficient in economic sense.
- Generally less regressive than broad consumption taxes.
- Administrative structure already in place.
- Property taxes are a relatively stable revenue source.

Disadvantages

- Many taxpayers consider property tax base inherently inequitable.
- Increases cost of capital.
- Property tax changes require constitutional amendments.
- Revenue system would remain unbalanced with consumption base largely untapped relative to income and property bases.

Revenue Reduction Options

The advisory council also evaluated options for reducing revenue that are consistent with the overall charge established in HB 4063. These options are meant to serve as areas for consideration, not as an exhaustive list of income tax reduction options.

1. Reduce Marginal Personal Income Tax Rates

Oregon's current income tax rates are set at 5, 7 and 9 percent. The top 9 percent rate applies to joint taxpayer taxable income above $12,500. Oregon's income tax rates are among the highest in the nation. Oregon's personal income tax burden ranks second in the nation.

Advantages

- Increase economic incentives to work and invest. Marginal rates have the most impact on economic behavior.
- Lower rate reduces volatility of income tax.

Disadvantages

- Relatively small rate reductions have a large impact on revenue collections.
- Reduced state taxes are partially offset by lower federal deductions.

2. Reduce Income Tax Rates on Capital Gains Income

Oregon currently imposes taxes on income derived through capital gains as ordinary income. This means that the top 9 % rate applies to most capital gains income.

Advantages

- Reduces reliance on highly volatile component of personal income tax base.
- Provides incentive for movement of capital and labor into the state.

Disadvantages

- Most tax benefits go to high-income taxpayers.
- Does not limit incentive to Oregon specific investments.

3. Expand Oregon's Earned Income Tax Credit

Oregon established a non-refundable earned income tax credit in 1997. This credit is set at 5 percent of the federal credit as long as it does not exceed total state income tax liability. This credit could be expanded by increasing the percentage of the federal credit above 5 percent and/or through making it refundable. Either would have the effect of expanding the earned income credit in Oregon.

Advantages

- Reduces regressivity at lower end of income spectrum.
- Increases supply of labor by increasing the net after-tax return from work.

Disadvantages

- Making tax refundable means credit establishes subsidy for some low-income taxpayers.
- Administration of earned income tax credit has been complex at the federal level.

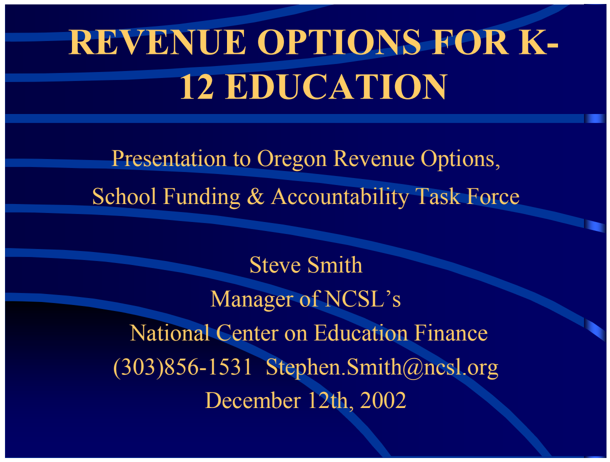
Revenue Impact

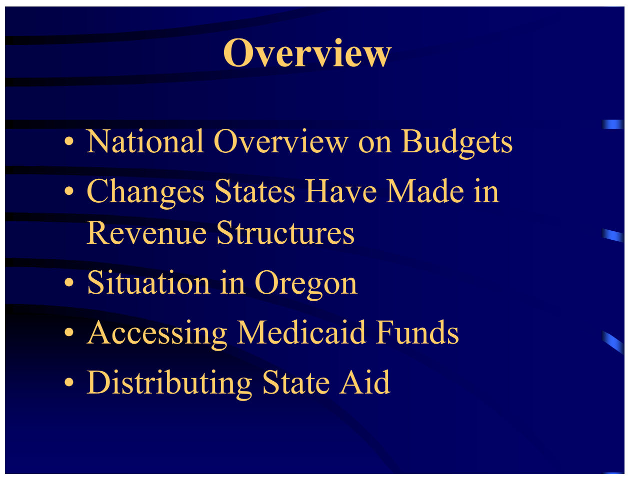
The following table contains estimated revenue impacts for the 2003-05 biennium for a menu of revenue increase and revenue decrease options. These estimates are intended to provide a general sense magnitude for proposed changes. These figures would be refined to meet the specifics of a precise proposal.

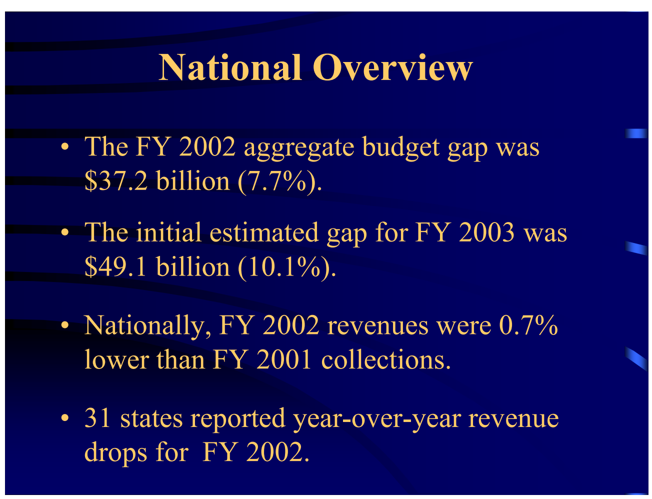
TAX INCREASES/NEW TAXES	Revenue Effect (in millions)		
	FY 2003-04	FY 2004-05	2003-05 Biennium
Statewide Property Tax for School Districts			
Establish an additional tax rate of $1 per $1,000 of assessed value for all school districts statewide that is outside the Measure 5 limit (could need a constitutional change)	$223	$235	$448
Personal Income Tax			
Increase All Rates 5% (5.25, 7.25, 9.45%)	252.9	271.7	524.6
Increase All Rates 7% (5.35, 7.5, 9.63%)	354.9	381.3	736.2
Increase All Rates 10% (5.5, 7.7, 9.9%)	506.0	543.7	1,049.7
Increase All Rates 1 Percentage Point (6, 8,10%)	605.1	648.9	1,254.0
Increase Top Tax Rate to 9.5%	234.4	235.3	469.7
Increase Rate to 10% for Income Above $100,000 Joint (indexed)	117.3	133.0	250.3
Increase Rate to 10% for Income Above $50,000 Joint (indexed)	215.2	238.8	454.0
Increase Rate to 10% for Income Above $30,000 Joint (indexed)	323.5	354.2	677.7
Increase Rate to 10% for Income Above $20,000 Joint (indexed)	402.1	436.8	838.9
Repeal Phase-in of Higher Federal Tax Subtraction (Set Maximum Federal Tax Subtraction at $3,000)	39.1	67.4	106.5
1% Surtax	45.6	49.0	94.6
Reduce Personal Exemption Credit by $10	49.9	50.6	100.5
Limit Interest Deduction on Mortgages to $15,000	30.6	35.3	65.9
Corporate Income Tax			
1% Surtax	3.5	3.8	7.3
Increase Rate One Percentage Point (to 7.6%)	52.2	57.1	109.4
Sales Taxes			
Broad Retail Sales Tax – 1% Rate (exempts shelter)	725	747	1,472
Restricted Retail Sales Tax – 1% Rate (exempts shelter, food, health care, medicines and utilities)	551	568	1,119
Broad Retail Sales Tax – 3% Rate (exempts shelter)	2,176	2,241	4,416
Restricted Retail Sales Tax – 3% Rate (exempts shelter, food, health care, medicines and utilities)	1,654	1,704	3,358
Business Activity Taxes			
Washington Gross Receipts Tax (B&O)– .1% Rate (no income tax credit)	237.7	251.6	489.3
Business Activities Tax (first $25,000 of tax base is exempt) – 1% rate	439.4	471.3	910.7
Excise Taxes			
Washington Real Estate Transfer Tax – 1% Rate	212.5	225.5	438.0
Increase Cigarette Tax by 10¢ per Pack	15.8	16.2	32.0
Increase Other Tobacco Products by 10% of wholesale price	2.5	2.5	5.0
Increase Beer Tax by $1 per barrel	2.5	2.5	5.0
Increase Wine Tax by 25¢ per gallon	2.3	2.3	4.6
Increase OLCC Mark-up by 10% (current = 101%)	10.7	11.6	22.3
Transient Lodging Tax – 1% Rate (no exemption amount)	9.3	9.8	19.0
New Lottery Games			
Line Games	35.0	35.0	70.0

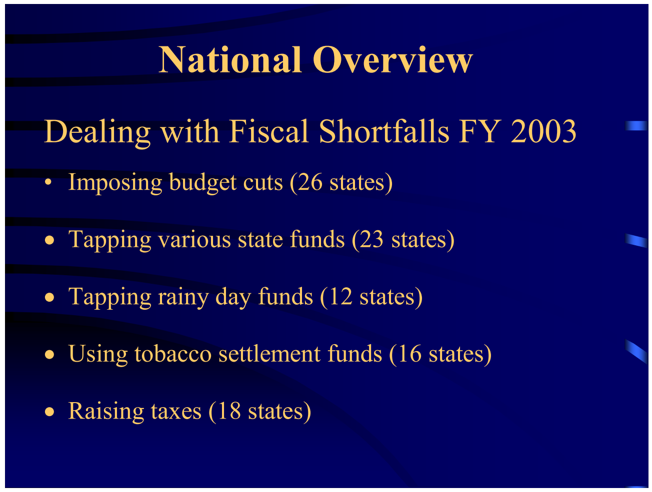
TAX REDUCTIONS	Revenue Effect (in millions)		
	FY 2003-04	FY 2004-05	2003-05 Biennium
Property Tax			
Personal Property Tax Threshold (current law: accounts under $12,500 in Assessed Value are exempt from Taxes) Increase the Tax Exempt Threshold to $20,000 of Assessed Value	-$3.2	-$3.3	-$6.5
Senior Homeowner Property Tax Exemption (current law: no property tax exemption for seniors) Establish a property tax exemption for seniors 70 years or older with annual household incomes less than $20,000 and 100% of property taxes are paid on homes with less than $150,000 in assessed value	-101.5	-105.3	-206.8
Personal Income Tax			
Earned Income Credit (EIC)			
Increase EIC to 10% of federal EIC (non-refundable)	-8.1	-8.2	-16.3
Increase EIC to 15% of federal EIC (non-refundable)	-14.7	-14.9	-29.6
Convert non-refundable 5% EIC to 5% refundable credit	-7.0	-7.3	-14.3
Rate Reductions (current rates 5% – 7% – 9%)			
Reduce rates 1 percentage point (to 4 - 6 - 8%)	-602.4	-646.1	-1,248.5
Reduce rates 1/2 percentage point (to 4.5 - 6.5 - 8.5%)	-301.5	-323.4	-624.9
Reduce rates 1/4 percentage point (to 4.75 - 6.75 – 8.75%)	-150.8	-161.8	-312.6
Reduce rates 0.1 percentage point (to 4.9 - 6.9 - 8.9%)	-60.3	-64.8	-125.1
Tax Bracket Changes			
Double width of 5% and 7% brackets	-224.9	-235.3	-460.2
Widen 5% and 7% brackets by $2,000 ($4,000 on joint returns)	-97.2	-100.4	-197.6
Income Exemptions and Deductions			
$1,000 income exemption ($2,000 on joint returns)	-187.2	-189.8	-377.0
Double standard deduction (currently $1,800 single; $3,000 joint)	-158.6	-161.1	-319.7
Maximum tax subtraction of $5,000 and indexed to inflation (M-88)	-88.5	-48.5	-137.0
Increase maximum subtraction for federal income taxes to $10,000	-271.7	-181.8	-453.5
No limit on maximum subtraction for federal income taxes	-884.9	-676.3	-1,561.2
Credits			
Increase personal exemption credit $10	-46.4	-48.3	-94.7
Capital Gains (currently taxed at 5-7-9% rates)			
Reduce tax rate on capital gains to 5%	-65.2	-107.9	-173.1
Reduce tax rate on capital gains to 4%	-84.7	-133.6	-218.3
Corporate Income Tax			
Reduce corporate tax rate 0.1 percentage point (to 6.5%)	-5.2	-5.7	-10.9
Reduce corporate tax rate 1 percentage point (to 5.6%)	-52.2	-57.2	-109.4

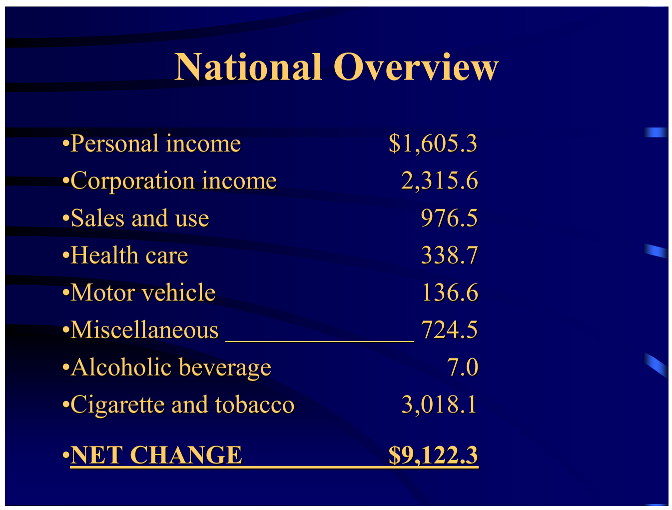
Appendix G: NCSL Presentation

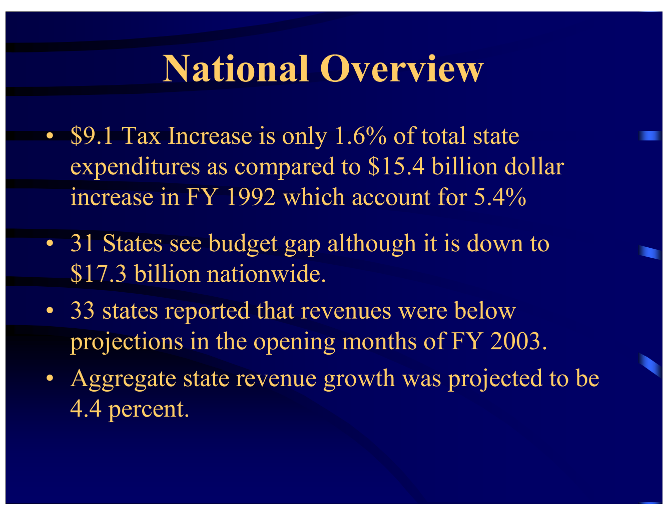


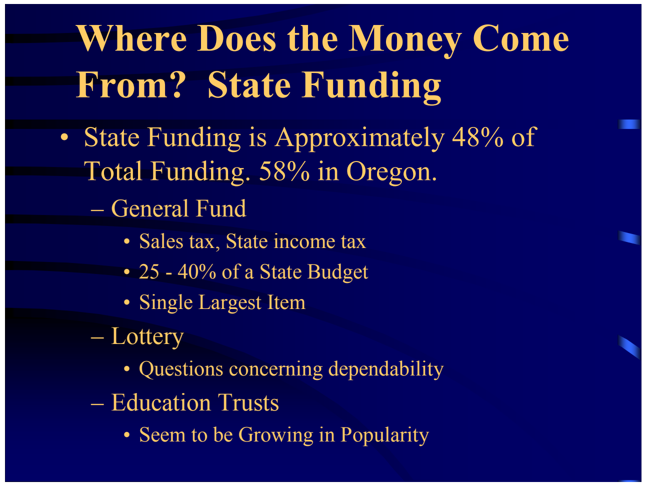





National Overview
Dealing with Fiscal Shortfalls FY 2003
• Imposing budget cuts (26 states)
• Tapping various state funds (23 states)
• Tapping rainy day funds (12 states)
• Using tobacco settlement funds (16 states)
• Raising taxes (18 states)


National Overview
•Personal income $1,605.3
•Corporation income 2,315.6
•Sales and use 976.5
•Health care 338.7
•Motor vehicle 136.6
•Miscellaneous 724.5
•Alcoholic beverage 7.0
•Cigarette and tobacco 3,018.1
•NET CHANGE $9,122.3


National Overview
• $9.1 Tax Increase is only 1.6% of total state expenditures as compared to $15.4 billion dollar increase in FY 1992 which account for 5.4%
• 31 States see budget gap although it is down to $17.3 billion nationwide.
• 33 states reported that revenues were below projections in the opening months of FY 2003.
• Aggregate state revenue growth was projected to be 4.4 percent.


Where Does the Money Come From? State Funding
• State Funding is Approximately 48% of Total Funding. 58% in Oregon.
– General Fund
• Sales tax, State income tax
• 25 - 40% of a State Budget
• Single Largest Item
– Lottery
• Questions concerning dependability
– Education Trusts
• Seem to be Growing in Popularity


Where Does the Money Come From? Local Funding
• Local Funding is Approximately 45% of Total Funding. 35% in Oregon
– Property Tax is Largest Revenue Source
– Other Local Revenue Sources
• Local Sales Tax
• Local Income Tax
• Fees
– Growing Interest in Reducing Dependence on Local Property Taxes


Where Does the Money Come From? Federal Funding
• Federal Funding is Approximately 7% of Total Funding. 7% in Oregon
– Title I is Largest Expenditure
• Over $8 Billion Dollars Targeted for At-Risk Students
– IDEA Grants (Special Education)
• Nearly $8 Billion Dollars Now Allocated, (Only $3 Billion in 1996-97)
• Full Funding?

Michigan Experience

- Prior to 1994-95 School Year Michigan Education was 80% Locally Funded and 20% State Funded
- In July 1993, the Legislature Eliminated Local School Property Taxes, Reducing by Nearly $7 Billion the Annual Funding for Michigan's Public Schools
- Offered Voters Two Solutions to Make up the $7 Billion Dollar Shortfall
- Voters Chose Option that:
  - Increased State Sales Tax from 4% to 6%

Michigan Experience Continued

- Created a 6 mil State Property Tax on Homestead and Non-Homestead Property
  - Prior to Passage Average Homestead Millage Rate in the State was 34
- Created a 12 mil Local Property Tax on Non-Homestead Property
- Reduced State Income Tax from 4.6% to 4.4%
- Increased Tobacco Taxes
  - From 25 cents to 75 cents per pack of cigarettes
  - 16% tax on other non cigarette products
- New System Worked Well Through 1990's, However People are Nervous Now.

Ensuring Equity of Taxation at the Local Level

- If the State is Going to Require a Certain Millage Levy From Districts There is a Need to Ensure that Property Appraisals are Uniform Across the State

State Property Tax

- New Hampshire Prior to 1999-2000 was 85% Locally Funded but in 1999-2000 they Changed to 60% State Funded due to Implementation of State Wide Property Tax.
- Found Unconstitutional Due to Variations in Appraisals
- Florida does not have an Official State Property Tax But Operates in a Similar Manner

Oregon's Situation

- Almost 75% of state revenue comes from personal income tax. (National Average is 37.1%)
- Lack of revenue from sales tax. (National Average is 32.1%)
- Property Taxes are limited due to constitutional amendments.

All of this leads to a very difficult situation!

Accessing Medicaid Funds

- States can access Medicaid funding to pay for services provided to special education students.
- Some states are accessing between $500 and $700 per special education student, which can account for at least 5% of state expenditures for special education.
- Oregon example: $4.5 billion spent on education, 20% of expenditures on special education = $900 million. Let us assume the state can receive additional 3% from Medicaid = $27 million.
- Nationwide states missing out on $2-3 billion.

Accessing Medicaid Funds

Strategies to Increase Medicaid Funding

- Ensuring that educational services are highlighted within Medicaid "contract with the Feds.
- Requiring Health and Human Services Department to inform Department of Education of students covered under Medicaid.
- Training district personnel on what services are covered under Medicaid
- Possibly centralize processing of paperwork or at least obtain statewide bid from private sector

How is the Money Distributed?

- State Aid
  - All States Provide Funding for Education Through Finance Formulas and/or Categorical Funds
  - All but North Carolina and Hawaii Require Local Support in Order to Receive State Funding
    - Hawaii is a State Run System
    - North Carolina Allows Districts to Supplement State Aid but it is not Required

How is the Money Distributed?

- Those States that Require a Certain Local Effort Usually Have a Foundation Program
  - Foundation Program
    - Created to "Equalize" Districts Ability to Pay
    - The Foundation Level is a Minimum Amount the State Feels is Required in Order to Provide an Adequate Education
    - Therefore, the State Requires Each School District to Levy a Certain Millage Rate and the State Will Provide the Difference Between the Generated Local Share and the Foundation Level

Variations Within Foundation Programs

- While Many States Require a Minimum Percentage for Participation, Some States Have Also Set a Limit on the Maximum
- Some States Have Recaptured Local Funding if The Local Required Effort is Greater than the Foundation Level
- What is the Best Foundation Funding System that is Equitable but Also Allows Local Decision Making?

New Ways of Accessing Local Revenues

- One way around the issue of property taxes is to require the local effort to be based off of a different wealth measure than property values. For example, median household income, per capita income etc.
- Then revenue for the required effort could come from a variety of revenue sources, and the state would allow local districts to determine what they would be.
- Political realities of this are questionable???

Example of How New Local Revenue Structure Could Work

- Wealthiest district in Oregon based off of median household income would receive 30% from the state, and would have to provide remaining 70% from local sources.
- Then all other districts are compared to wealthiest district. For a district that is 80% as rich as the wealthiest district, you would multiply 70% (highest local share amount) by .8 = 56% of funding for education would come from local.

Questions and Discussion