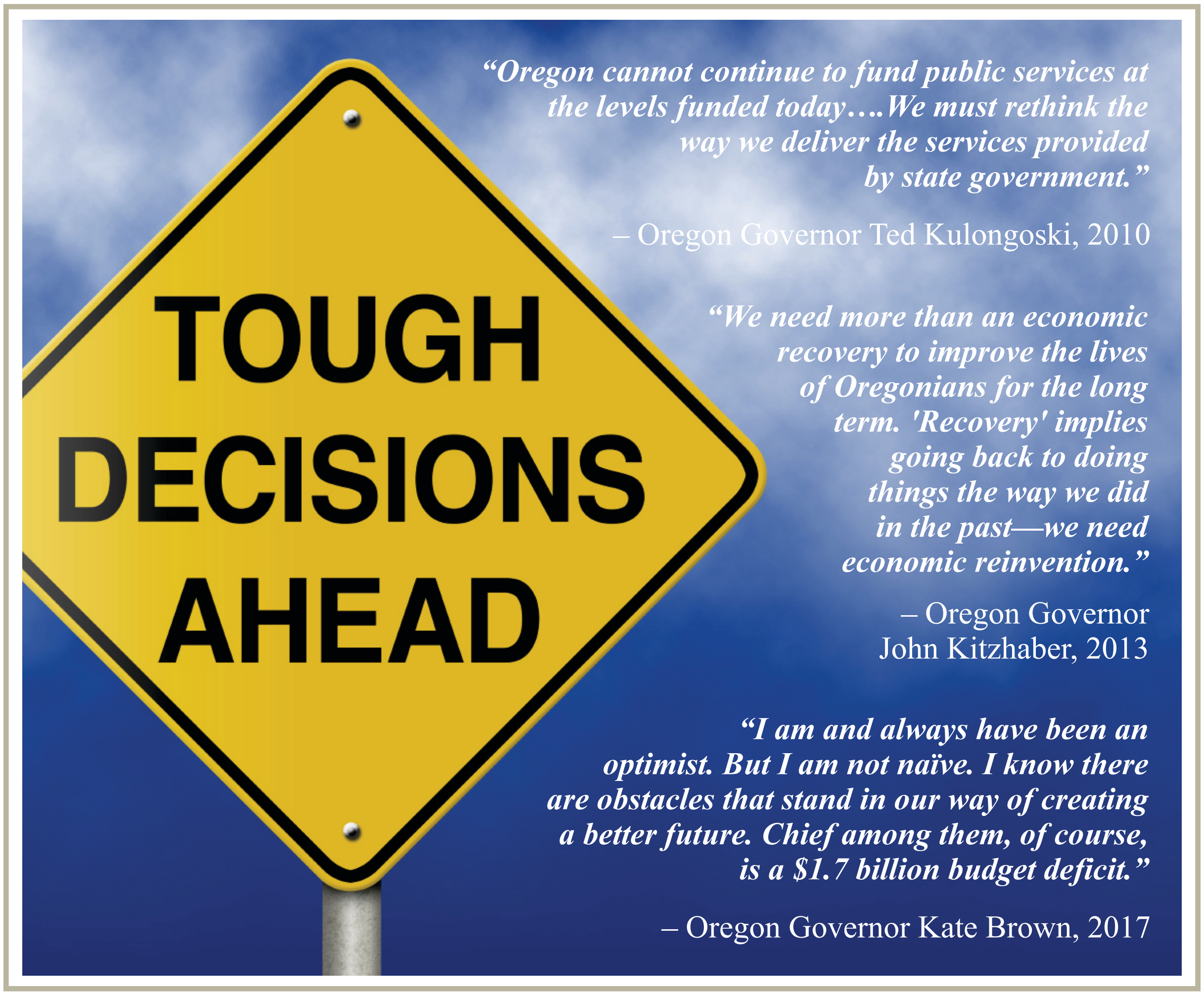
Facing Reality

Suggestions to balance Oregon's budget without raising taxes



Oregon Capitol Watch

Cascade Policy Institute
Oregon

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Introduction

In 2010 and 2013 Cascade Policy Institute and Americans for Prosperity–Oregon published Facing Reality reports, offering state legislators an opportunity to "reset" state government using the time-tested principles of limited government and pro-growth economic policies. We provided a series of proven ideas to balance our state's budget without tax or fee increases, plus policies to stimulate private businesses to "recharge" our economy. We called this approach "Reality Based Budgeting," believing it was time that our leaders face reality, bite the bullet, quit kicking the can down the road, and adopt ideas to lower the cost of government and get the economy going again.

Now in 2017, decades of well-meaning politicians, bureaucrats, and special interests have grown state government spending without regard for long-term consequences, producing an unsustainable budgetary premise that threatens Oregon's financial stability. Long-term debt, unfunded liabilities, inefficient programs, unnecessary spending, and bloated bureaucracies all contribute to this bleak future.

Along with higher tax rates, fee increases, and unfunded mandates that make it harder for businesses to produce a profit, we again face the perfect storm that manifests itself in Oregon's budget and economy today. Without a drastic change in direction, it will only get worse. Governor Kate Brown has proposed a record $20.8 billion state budget that relies on a series of tax and fee increases designed to close what she says is a $1.7 billion budget gap.

Unfortunately, the recommendations in our first two Facing Reality documents were largely ignored, and the state muddled through. Now, in 2017 we propose seven specific ways to reduce spending that, along with reductions of less than three percent in other agency proposed budgets, can balance the state budget without any of the Governor's tax and fee increases. We know that these proposals will be politically hard to achieve, but we believe they are the right things to do and we therefore set them out here. To the extent that they are adopted, Oregon should be a better, more productive and freer state; able to move into the future without the burden of out-of-control government spending holding us back. We look forward to working with any and all policy leaders willing to consider these suggestions.

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Steve Buckstein is Founder and Senior Policy Analyst at Cascade Policy Institute, Oregon's free market public policy research organization. In 2007 Governor Ted Kulongoski appointed Buckstein to the Task Force on Comprehensive Revenue Restructuring where he represented taxpayers. He earned both his B.S. in Physics and M.B.A. from Oregon State University.

Eric Fruits, Ph.D. is an Oregon-based economist and adjunct professor at Portland State University. Fruits has been invited to provide analysis to the Oregon legislature regarding the state's tax and spending policies. His testimony regarding the economics of the Oregon public employee pension reforms was heard by a special session of the Oregon Supreme Court.

About Oregon Capitol Watch Foundation:

Oregon Capitol Watch Foundation (ocwf.org) is a 501(c)(3) charitable educational foundation dedicated to educating Oregon citizens about how state and local governments spend their tax dollars by researching, documenting, and publicizing government spending and developing policy proposals that promote sound fiscal policies and efficient government.

About Cascade Policy Institute:

Founded in 1991, Cascade Policy Institute (cascadepolicy.org) is Oregon's premier policy research center. Cascade's mission is to explore and promote public policy alternatives that foster individual liberty, personal responsibility, and economic opportunity. To that end, the Institute publishes policy studies, provides public speakers, organizes community forums, and sponsors educational programs. Cascade Policy Institute is a tax-exempt educational organization as defined under IRS code 501(c)(3). Cascade neither solicits nor accepts government funding and is supported by individual, foundation, and business contributions.

Facing Reality 2017: Suggestions to balance Oregon's budget without raising taxes

Summary

Despite an eight percent increase in general fund revenues, Governor Kate Brown and some lawmakers say the State of Oregon is facing a $1.7 billion budget shortfall in the 2017-19 biennium to maintain current services, to pay for the state's increased share of the cost of Medicaid expansion, and to fund education ballot measures approved by voters. In addition, Governor Brown has released a budget that increases general fund spending by seven percent over the 2015-17 legislatively approved budget. Her budget expands entitlements and raises taxes, fees, and charges by nearly $275 million for the general fund alone—yet does nothing to address the state's worsening public pension crisis.[1]

While the Oregon economy is improving, the recovery has been uneven, and income for the average Oregonian is still about eight percent lower than the national average.[2] At the same time, the state's high and rising housing costs mean that Oregon's cost of living is 15 percent higher than the national average.[3] In other words, the average Oregonian earns less, but pays more for basic items—like housing, food, and transportation—than the average American.

Oregon legislators and other policy makers must face the reality that the state simply cannot afford costly new programs or costly expansions to existing programs. In reality, Oregon cannot afford to continue some of the existing programs that drain the state's budget year after year.

This report identifies several straightforward solutions to the state's current budget crisis for savings of nearly $1.3 billion in the 2017-19 biennium. Each of these solutions are "doable." In addition, for agencies not listed in this report, reductions equal to across-the-board reductions of about three percent from Governor Brown's budget would eliminate the shortfall she identified. If implemented, none of the tax and fee increases outlined in the Governor's budget would be necessary.

TABLE 1

Solution	Impact
PERS – $100,000 cap	$135 million
Department of Administrative Services – halt additional hiring	$120 million
Medicaid – opt out of ACA expansion	$360 million
Cover All Kids – reject expansion	$55 million
Department of Human Services – targeted reductions	$321 million
Department of Human Services – cash assistance reforms	$160 million
State School Fund – reject Measure 98	$139 million
Total	**$1,290 million**

PERS

The skyrocketing costs of Oregon's Public Employee Retirement System present the biggest challenge to balancing state and local government budgets.

PERS contributions by state government agencies will increase by $260 million for the next biennium.[4] However, the impact on the 2017-19 state budget is approximately $500 million because the state funds two-thirds of the operating costs of school districts, which will also be hit with the steep increase in PERS costs.[5] In addition to the higher costs of PERS padded into the agency costs, the Governor's budget includes $100 million in emergency funds to support the state's increased PERS costs.

Rising PERS costs create a drag on Oregon government and stifle the delivery of services. The costs of PERS are associated with services that have already been delivered by employees and retired employees. That means that Oregonians will get no additional services or better services to go along with the higher costs. There is no "bang" of better government for the millions of "bucks" spent in higher PERS costs.

By design, PERS smooths out and phases in changes in investment returns and changes in how retirement accounts are credited. In this way, PERS is designed to "kick the can down the road" to impose the costs of today's promises on tomorrow's taxpayers. It is for this reason that many potential and necessary PERS reforms would not have immediate impacts on the upcoming 2017-19 biennium.

1. State of Oregon. 2017-2019 Governor's Budget. December 1, 2016. http://www.oregon.gov/das/Financial/Documents/2017-19_gb.pdf.
2. U.S. Bureau of Economic Analysis. Regional data. GDP & Personal income. https://www.bea.gov/iTable/index_regional.cfm. Retrieved December 23, 2016.
3. Missouri Economic Research and Information Center. Cost of Living data series, third quarter 2016. https://www.missourieconomy.org/indicators/cost_of_living/index.stm. Retrieved December 30, 2016.
4. Milliman, Inc. December 31, 2015, Actuarial Valuation: Oregon Public Employees Retirement System. Presented to Public Employees Retirement System Board. July 29, 2016. https://www.oregon.gov/pers/docs/actuarial_valuation-revised_7-29.pdf.
5. Wong, P. "Report lays ground work for higher PERS rates in state." *Portland Tribune*. August 1, 2016. http://portlandtribune.com/pt/9-news/317125-196232-report-lays-groundwork-for-higher-pers-rates

However, the PERS Board has considered a straightforward and easy-to-implement reform that its actuary indicates would immediately and permanently reduce PERS costs. The reform would cap at $100,000 the final average salary used to calculate Tier 1 and Tier 2 retirement benefits. Information provided by the board's actuary shows this reform alone would save the state budget approximately $135 million in the 2017-19 biennium ($78 million from state agencies and $57 million from the state's share of school funding).[6]

State Senator Ted Ferrioli reports findings from the state's Legislative Counsel that:[7]

> PERS reforms focused on future retirement benefits are constitutional; and
>
> The legislature could constitutionally redirect employee contributions to help pay for future retirement benefits.

State Senators Betsy Johnson and Tim Knopp have formed the Bipartisan PERS Solutions Workgroup that is evaluating reforms to reduce or reverse the unsustainable increase in the state's public sector pension costs.

STATE EMPLOYMENT AND COMPENSATION

Oregon has the 12th highest pay in the U.S. for state employees.[8] In addition to the pay received by employees (average of $53,100 in 2015), other payroll expenses such as PERS and health insurance benefits increase the costs to the state by an average of $36,000 per employee, bringing the average cost of a full-time state employee to $89,100 a year.[9]

Research finds that, when worker characteristics and job attributes are controlled for, public sector pay is approximately six percent higher than private sector pay in the United States.[10] This research also finds that job attributes have so little impact on pay differentials that higher pay in the public sector is not because of any compensating differential job attributes or demanded skills. Instead, the research finds that much of the public sector pay premium can be explained by the activities of unions in the public-sector workforce.

The Governor's budget proposes increasing the state government workforce by 675 full-time equivalent employees.[11] Using the cost information from the Legislative Fiscal Office, this 1.7 percent increase would cost the state more than $120 million in compensation costs for the 2017-19 biennium. A halt on adding additional state employees during this biennium would free up resources and ward off some of the pressure to increase taxes, fees, and charges.

MEDICAID EXPANSION

Provisions of the Affordable Care Act were intended to expand Medicaid to all Americans under age 65 whose family income is at or below 133 percent of federal poverty guidelines. The U.S. Supreme Court issued a decision that made Medicaid expansion a voluntary action by states. Oregon elected to participate in the Medicaid expansion.

In the first years of the ACA, the federal government paid all of the costs to the states of expanding Medicaid. Beginning in 2017, federal support will be reduced, decreasing to 97 percent in 2017 and eventually 90 percent in 2020 and thereafter. Although the federal government pays a large portion of the costs of the Medicaid expansion, the huge costs of Medicaid mean even a small increase in costs can have big impacts on state budgets. State Senator Elizabeth Steiner Hayward, incoming co-chair of the Ways and Means Committee for Human Services, noted that about one-third of the deficit at the Oregon Health Authority comes from what she called a "minuscule" change in the federal match.[12]

A 2015 report by the Oregon Health Authority projected Medicaid expansion under the ACA would cost $369 million in the 2017-19 biennium.[13] Janelle Evans, budget director for the Oregon Health Authority, estimates a cost to the state of $353 million to $360 million.[14] With many portions of the ACA likely to be reformed or replaced by the next Congress, Oregon can see immediate budget savings by opting out of the Medicaid expansion in the 2017-19 biennium.

6. Larrabee, M. and Preppermau, S. D. Request number 2016-008: Analysis of potential 2017 legislation: $100,000 final average salary limit. Letter to S. Rodeman. October 28, 2016. http://www.oregon.gov/pers/docs/aa_$100k_fas_limit.pdf.
7. Ferrioli, T. "Act now to make fair, constitutional PERS reforms." *Salem Statesman-Journal*. July 15, 2016. http://www.statesmanjournal.com/story/opinion/readers/2016/07/15/act-now-make-fair-constitutional-pers-reforms/87153118/.
8. CBIZ Human Capital Services. State of Missouri compensation & benefits study report. July 29, 2016. https://oa.mo.gov/sites/default/files/2016-State-of-Missouri-Compensation-Benefits-Report.pdf.
9. Oregon Legislative Fiscal Office. State employee compensation. April 2016. https://www.oregonlegislature.gov/lfo/Documents/2016-4%20State%20Employee%20Compensation.pdf.
10. Gibson, J. (2009). The public sector pay premium, compensating differentials and unions: propensity score matching evidence from Australia, Canada, Great Britain, and the United States. *Economics Bulletin*, 29(3):2325–2332.
11. State of Oregon. 2017-2019 Governor's Budget. December 1, 2016. http://www.oregon.gov/das/Financial/Documents/2017-19_gb.pdf.
12. Wilson, D. J. Sen. Elizabeth Steiner Hayward on Governor Brown's budget. State of Reform. December 22, 2016. http://stateofreform.com/news/states/oregon/2016/12/sen-elizabeth-steiner-hayward-gov-browns-budget/. Retrieved December 23, 2016.
13. Cooper. J. J. "Oregon underestimated Medicaid expansion price tag." *Salem Statesman-Journal*. July 20, 2015. http://www.statesmanjournal.com/story/news/politics/2015/07/20/oregon-underestimated-medicaid-expansion-price-tag/30407741/.
14. Evans, J. voicemail, December 23, 2016.

COVER ALL KIDS

Oregon requires that children receiving medical assistance must be residents of Oregon. The Oregon Health Authority (OHA) provides medical assistance for children with families with incomes at or below 133 percent of the federal poverty level through Medicaid and for children with family incomes below 300 percent of the federal poverty level through the Children's Health Insurance Program.

"Qualified non-citizens" are generally eligible for coverage through Medicaid and CHIP if they meet their state's income and residency rules and satisfy a five-year waiting period.[15] Through the Citizen/Alien Waived Emergency Medical program, residents who are not "lawfully present," such as undocumented immigrants, can get coverage for emergency medical conditions and labor and delivery.[16]

The Governor's 2017-19 budget seeks to expand Medicaid/CHIP insurance to Oregon children who are not "lawfully present" in the United States, under a program she calls "Cover All Kids." Governor Brown estimates the cost of the expanded benefits to be $55 million over the next two years. A similar expansion was considered in the 2015 regular session of the legislature and had a projected cost of $41 million.[17] The estimate provided in the Governor's budget represents a $14 million (34 percent) increase from the last biennium. The steep increase from one session to the next highlights the uncertainty around the projected costs, as well as the likelihood that the costs of the program can escalate rapidly.

Applying the methodology described by proponents of the Cover All Kids expansion to more recent data, Oregon has an estimated 14,300 undocumented children age 18 and under.[18] The Current Population Survey indicates that 25 percent of non-citizens below 300 percent of the federal poverty level in Oregon have no insurance.[19] Thus, fewer than 3,600 individuals would be eligible for coverage under the Cover All Kids expansion. The Center for Medicare and Medicaid Services reports that in Oregon, in 2013, nearly 89 percent of eligible children were enrolled in Medicaid and CHIP programs.[20] Thus, fewer than 3,200 individuals likely would be enrolled under the expansion.

With enrollment of 3,200 under the Cover All Kids expansion, the $55 million cost for the 2017-19 biennium amounts to $17,200 per person, or about $715 a month. By way of comparison, "Bronze" health insurance on the Affordable Care Act exchange is about $120 per child, per month—without subsidies. Among "Gold" ACA plans, the price of covering a child is less than $170 a month. The high costs combined with the low numbers of those who would benefit indicate that the Cover All Kids expansion should be rejected.

DEPARTMENT OF HUMAN SERVICES

The state's Department of Human Services has identified reductions to its budget that would reduce the agency's spending by 10 percent.[21] If all the reductions were enacted—except those reductions that would impact federal funding and/or would reduce expenditures on the state's foster care program—general fund expenditures would be reduced by $321 million in the 2017-19 biennium.

Information from the Census Bureau's report on state and local government finance indicates that, per capita, spending by the State of Oregon on cash assistance (e.g., TANF and SNAP) is approximately double the U.S. average. The Atlantic has described Oregon as a "welfare utopia."[22]

An audit released by Kate Brown when she was Secretary of State in 2014 found that Oregon had a dismal track record shifting people off of welfare and into jobs.[23] As a result, the state hit the cap on the amount the federal government provides for cash assistance. While other states tightened eligibility to trim welfare rolls, Oregon slashed money for related jobs programs, reduced subsidies for child care and transportation, doubled caseloads for program managers, and cut contractors, including those who help recipients with addictions and mental health problems, the audit found.[24]

15. U.S. Centers for Medicare & Medicaid Services. Coverage for lawfully present immigrants. No date. https://www.healthcare.gov/immigrants/lawfully-present-immigrants/. Retrieved December 23, 2016.
16. Oregon Health Authority. *Oregon Health Plan Client Handbook*. March 2014. http://www.careoregon.org/res/documents/he9035.pdf
17. To, K. Fiscal impact of proposed legislation: HB 3517-A. Oregon Legislative Fiscal Office. April 15, 2015. https://olis.leg.state.or.us/liz/2015R1/Downloads/MeasureAnalysisDocument/28565.
18. For methodology, see Bauer, J., Moreno, A, Ordóñez, J. C., and Roman, L. Health care for all children: Oregon thrives when all kids have a chance to grow up healthy. Oregon Latino Health Coalition and Oregon Center for Public Policy. October 21, 2014. http://www.orlhc.org/wp-content/uploads/2014/10/Health-Care-For-All-Children-Report-2014.pdf.
19. Most recent data, for 2014 from Pew Research Center. Unauthorized immigrant population trends for states, birth countries and regions. November 3, 2016. http://www.pewhispanic.org/interactives/unauthorized-trends/. U.S. Census Bureau. Current Population Survey, Annual Social and Economic Supplement. 2016.
20. Rockowitz, Z. Preliminary staff measure summary: HB 3517-A. Senate Committee on Health Care. May 4, 2015. https://olis.leg.state.or.us/liz/2015R1/Downloads/MeasureAnalysisDocument/30161.
21. Oregon Department of Human Services. 2017-19 agency request budget. August 2016. https://www.oregon.gov/DHS/ABOUTDHS/DHSBUDGET/20172019Budget/dhs-2017-19-arb.pdf.
22. Semuels, Alana. "Welfare utopia." *The Atlantic*. May 31, 2016. http://www.theatlantic.com/business/archive/2016/05/welfare-utopia/484607/.
23. Brown, K. and Blackmer, G. Temporary Assistance for Needy Families: High expectations, stronger partnerships, and better data could help more parents find work. Report No. 2014-08A. Published April 2014. Revised August 2014. http://sos.oregon.gov/audits/Documents/2014-08A.pdf.
24. Zheng, Y. "Welfare in Oregon: Audit paints detailed portrait." *The Oregonian*. April 25, 2014. http://www.oregonlive.com/politics/index.ssf/2014/04/welfare_in_oregon_audit_paints.html.

Reforms to reduce cash assistance such that Oregon's per capita rate was 50 percent higher than the U.S. average (instead of 100 percent higher) would reduce General Fund expenditures by $160 million in the 2017-19 biennium.

MEASURE 98

Measure 98 was approved by voters in November 2016.[25] The measure provides $800 for each high school student for technical education, graduation support, and dropout prevention. The measure, however, provides no source for the additional funding, relying instead on growth in General Fund revenue without any concern for offsetting growth in other state expenditures. It provides almost no guidance on how the money is to be spent or how success is to be measured. Measure 98 is a statutory measure, meaning that the legislature does not have to implement any elements of the measure.

Nevertheless, the Governor's budget allocates $139.4 million to the fund established by Measure 98, while at the same time asking for nearly twice that much in additional tax, fee, and other revenue. The weaknesses of the measure itself should cause legislators to reject the guidance offered by Measure 98. In the current fiscal circumstances, the legislature must face reality and reject the Governor's new spending on this risky and costly measure.

SUMMARY

Despite an eight percent increase in general fund revenues, lawmakers say the state budget is facing a $1.7 billion budget shortfall in the 2017-19 biennium. Governor Kate Brown has released a budget that increases general fund spending by seven percent over the 2015-17 legislatively approved budget. Her budget expands entitlements, raises taxes, fees, and charges by nearly $275 million for the general fund alone—yet does nothing to address the state's worsening PERS crisis.

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25. Text of Measure 98. http://oregonvotes.org/irr/2016/065text.pdf
26. State of Oregon. 2017-2019 Governor's Budget. December 1, 2016. http://www.oregon.gov/das/Financial/Documents/2017-19_gb.pdf.

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