

A large, stylized number '5' is the central graphic. The left side of the '5' is white, and the right side is black. A horizontal rectangular box with a white border is superimposed over the middle of the '5'.

FOCUS ON
M E A S U R E

AN ALTERNATIVE ANALYSIS
OF MEASURE FIVE'S IMPACT
ON STATE AND LOCAL GOVERNMENT

BY VERNON S. WHITE

FOR

CASCADE POLICY INSTITUTE

PORTLAND, OREGON

Does
Oregon
have
a
tax
problem,
or
a
spending
problem
?

\$5.00

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CASCADE POLICY INSTITUTE



July 22, 1992

Why This Report?

Depending on your viewpoint, the property tax limitation passed by Oregon voters in November, 1990, Measure Five, will either devastate government services or restrain runaway government spending. Most discussion to date has been dominated by those inside government and those dependent on government spending.

The need for an outside, reliable analysis compelled Cascade Policy Institute to commission Vernon S. White, former Research Director of Oregon Tax Research, to produce this alternate view of Measure Five's impact on state and local government.

Measure Five phases in over five years, so it is important that everyone interested in its long-term effects have access to the kind of information contained in this report.

But we won't stop here.

CASCADE continues to monitor the fiscal situation in Oregon. **FOCUS ON MEASURE FIVE** will be followed up with a study on the benefits of contracting out government services, scheduled for release this fall.

CASCADE welcomes comments and suggestions on our work. For more information about the Institute and how you can become a supporter, please turn to the last pages of this report.

EXECUTIVE SUMMARY

The Executive Summary of this study is published separately as the eight-page **FISCAL INSIGHT #2**.

The preliminary version of the Executive Summary (Fiscal Insight #1, June 26, 1992) was distributed to media and Legislators before the July 1st special legislative session called to consider the Governor's tax package. It inadvertently compared growth of per capita personal income to total state budgets; not an appropriate comparison. The more relevant relationships between Oregonians' personal income and state budgets are discussed in this study beginning on page 13, and shown in Figure 10 in Appendix B.

Copies of the final Executive Summary are available on request. Copies of this complete **FOCUS ON MEASURE FIVE** report are available for \$5 (including postage and handling).

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Does Oregon Need Tax Reform or Spending Reform?

By Vernon S. White

Section 1

Introduction

Oregon's voters made a significant change in the state's tax structure on November 6, 1990 when they passed Measure Five.

In short, Measure Five reduces property tax rates for school districts (over five years) and caps rates for non-school local governments (effective immediately). The state General Fund is required to replace the taxes school districts would have levied for the first five years only.

Why a property tax limitation? Many who voted for Measure Five were compelled by what they saw as runaway government spending pushing taxes up beyond their ability to pay.

The seeds of Oregon's tax revolt were planted more than a decade ago as tax levies exceeded growth in personal income. Since 1978, there have been six initiatives to limit property taxes to 1 1/2% or less of assessed value. The first

five attempts failed at the polls (usually losing by a narrow margin). The sixth, Measure Five, succeeded with 52.4% of the vote on November 6, 1990.

Why this study? This study examines what Measure Five set out to do and whether further "restructuring" of Oregon's tax system is needed. Two views are explored:

One view is that Oregon has a tax problem -- namely that Measure Five reduces taxes below the level needed to provide adequate government services.

The second view is that Oregon has a spending problem -- namely that Measure Five was an attempt to rein in excessive government spending by limiting the tax revenue government can collect.

The body of this report will document the costs and growth of government in Oregon, indicate areas where costs might be reduced, and explore alternative tax structures. Finally, conclusions will be drawn about the nature of the crisis Oregonians face -- whether we have too few taxes, or too much government spending.

How Did We Get Here?

Measure Five's History

It took six statewide ballots to put a property tax limitation into Oregon's Constitution. Most votes were close. (See Figure 1)

The worst vote property tax limitation ever received (36.9%) at the polls exceeded the best showing by the sales tax (29.3%).

Measure Five has important changes from its predecessors: (1) it phases in over time (five years), (2) it separates school from nonschool tax and places a five-year requirement on the state to replace those property tax revenues it prohibits the schools from levying.

Taxes Exceed Inflation

Property tax levies grew significantly faster than inflation in the decade leading to Measure Five's passage. (Figure 2)

During the 1980s property taxes rose 132% while inflation rose 51%. While some property tax growth was attributable to new construction, most was due to real tax increases on existing property.

Property tax levies consistently outran inflation throughout the 1980s, making tax bills more and more difficult to face, especially for people on fixed incomes, such as the elderly, or those temporarily out of work. For people not interested in selling their homes, an increased assessed value becomes a liability, not an asset. Measure Five alleviates that.

Fund Allocation Problem

The principal historic state support for K-12 schools is known as "Basic School Support". Oregon's Budget & Management Office projects that this will be funded in the future at 30% of school districts' operating expenses. This method of allocating funds forces the state into a corner: the more school districts spend of their own funds, the

Figure 1

Oregon Property Tax Limitation Votes

<u>Date Voted Upon</u>	<u>Yes Votes</u>	<u>% Yes</u>	<u>No Votes</u>	<u>% No</u>
Nov. 7, 1978	424,029	48.3%	453,741	51.7%
Nov. 4, 1980	416,029	36.9	711,617	63.1
Nov. 2, 1982	504,836	49.5	515,626	50.5
Nov. 6, 1984	599,424	49.3	616,252	50.7
Nov. 4, 1986	449,548	42.5	585,396	57.5
Nov. 6, 1990	574,833	52.5	522,022	47.5

Source: 1991-92 Oregon Blue Book, published by the Office of the Secretary of State.

more the state must pay to meet the 30% level.

Throughout the 1980s and long before, most Oregon school districts levied the full annual 6% increase in property tax, legally allowable without a popular vote. A 6% increase per year compounded *doubles* in about 12 years. (It is an option school boards exercise each year). Since 1980, this annual 6% increase has substantially outrun inflation and student attendance increases statewide.

Through the 1970s, most of Oregon's 300+ school districts were unable to operate on their school base tax alone. They increasingly obtained voter approval of supplemental special (temporary) levies in addition. The 6% "automatic up" which applies to tax bases

does not apply to these special "serial levies". But over time, voters approved higher tax bases which are subject to the 6% annual increase. So the dollars levied without voter scrutiny and approval rose dramatically. In "A Dollars and Sense Look at Oregon School Finance" (1990), author T.K. Olson

During the 1980s, property taxes rose 132% while inflation rose 51%.

points out that in 1975 only 28% of school property taxes were subject to the 6% annual increase. By 1990, 82% were under the annual 6% raise. Failure of district boards to restrain this growth helped fuel the property tax revolt.

(T.K. Olson was Executive Director of the Oregon Educational Coordinating Commission for 13 years (now the Office of

Figure 2

Property Tax Levies in the last decade

Year	*Net levy (Millions)	% Change	Inflation (CPI)	% Change
1980	\$1,012.1	--	--	--
1981	1,188.4	17.4%	95.0%	8.9%
1982	1,421.9	19.6	98.1	3.2
1983	1,539.4	8.3	99.1	1.0
1984	1,583.7	2.9	102.8	3.8
1985	1,708.0	7.8	106.7	3.8
1986	1,790.7	4.8	108.2	1.4
1987	1,894.9	5.8	110.9	2.5
1988	2,042.5	7.8	114.8	3.5
1989	2,194.0	7.4	120.5	5.0
1990	2,349.1	7.1	126.8	5.2
1991	2,504.7	6.6	--	--

*Figures do not include urban renewal tax. Levies are in millions of dollars. Inflation is the Portland CPI-U in which 1982-84 = 100. Levy source: Oregon Property Tax Statistics, Oregon Department of Revenue.

Educational Policy and Planning). He also served ten years as a university professor and administrator. In 1990, he authored "A Dollars and Sense Look at Oregon School Finance," published by Oregon Tax Research.)

How Measure Five Works

Two constraints in Measure Five are at work.

- 1) **The five-year requirement that the state government's General Fund must replace funds which schools are prevented from levying in property tax because of Measure Five.**

Beginning with a cap of \$15 per \$1000 of assessed value with the 1991-92 tax year, the cap drops \$2.50 each year until it reaches \$5 in fiscal 1995-96. Thereafter, there is no legal requirement that the state replace lost property tax revenue for schools. Until Measure Five's passage, K-12 schools and community colleges levied about two thirds of all property taxes in Oregon.

Measure Five did not require the state to replace school funds district by district. It only required that the statewide total be replaced.

Here are the figures:

For the 1991-93 biennium, Oregon's General Fund was required to replace about \$452.2 million for schools. The Legislature chose, however, to appropriate \$554 million. The \$102 million extra enabled the State Department of Education to parcel out to each individual district all the money it would have levied had Measure Five not passed, and move substantially toward equalizing per student spending statewide.

When the Legislature opted not to save this \$102 million, it increased the shortfall in the 1993-95 budget. Funding the second year of the 1991-93 biennium was made easier when the Legislature diverted to schools \$185.9 million which would have been owed to taxpayers as a credit against overpayment of their 1991 personal income taxes under the 1979 "2% Kicker" law.

- 2) **The cap on levies by nonschool local governments.**

These include counties, cities and special service districts. This cap remains constant at \$10 per \$1000 of assessed property value. The state is not required to replace any shortfall for nonschool local government. Levy increases must therefore come from growth in property values. Many local governments attempt to elude this cap by reclassifying tax-supported services as "user fees". One such "user fee" (the City of Gresham's drainage fee) was ruled to be a tax and subject to the Measure Five limitations by the Oregon Tax Court.

How Measure Five Creates Savings

Under Measure Five's first biennium, schools did not lose funding. In fact, they gained funds. Only those nonschool local governments (counties, cities and special service districts) which already imposed heavy taxes lost revenue under the \$10 per \$1000 of assessed value tax cap. For Measure Five's first year, this saved property taxpayers about \$51.5 million.

Impact on Taxpayer

For Measure Five's first five years, the Oregon taxpayer's property tax savings on school budgets are technically offset as the state General Fund (primarily income tax) replaces the money schools are prohibited from levying in property tax.

More property taxpayers did not see better savings in Measure Five's first year because assessed values jumped an unexpected 16 + % on average.

Nonschool jurisdictions which kept property taxes reined in tightly to begin with suffered little or no loss from the \$10 nonschool cap.

Added Funding Possible

Any improvement in Oregon's economy will, of course, bring in additional income tax revenue, reducing the state's shortfall. Any drastic surge in property values will also reduce the replacement requirement.

Section 2

Spending Reform

Examples of Questionable Spending

- **Item:** State and local government employees can retire on full pension after 30 years service, regardless of their age. For some, this can be age 50. For police and fire, it is possible to retire by age 40 after 20 years service. Many retire on higher income than they received most of their working years. Most taxpayers, on the other hand, work to age 62 or 65 and retire on smaller pensions -- if any at all beyond Social Security.
- **Item:** In 1970, Oregon's Public Employees Retirement System (PERS) paid out about \$927,000 a month to its retired members. By 1980, this payment climbed to \$7,475,000 and by 1990, \$33,175,000 monthly. PERS' monthly administrative expense rose at an even faster rate -- from \$447,000 in 1970 through \$2,905,000 in 1980 then on to more than \$8,900,000 monthly by 1990. In 1970, there were less than 14,000 retired PERS members; by 1980, more than 32,800; by 1990, more than 55,500. (See Figure 8)
- **Item:** According to the American Legislative Exchange Council (*"America's Protected Class", parts I & II, 1992*), the **public pay premium** (excess cost) of state and local public employee compensation in Oregon is estimated at \$715 million per year *above* private sector standards. Every Oregon household spends \$650 per year just in excess compensation to public employees.

Excess compensation is the increase in the cost of salary, wages and benefits (including retirement benefits) of all state and local public employees in Oregon for the decade of the 1980s over the comparable figures for all private employees in the state. During the 1980s, Oregon's private employees gained 38.1% in salaries and wages alone while public employees gained nearly 59% (not inflation-adjusted).

- **Item:** Many public jobs have too many supervisors in ratio to line workers. Take, for example, the recent case in Oregon's Secretary of State's office where 16 state audit managers reported to eight assistant directors -- one boss for every two workers.

The budget "cuts" blamed on Measure Five generally are not cuts at all. They are simply increases smaller than the increases governmental agencies had hoped to obtain.

- **Item:** Oregon school costs increased a billion dollars during the 1980s (about 75%) while the cost of living went up only 38% and the number of students was static. Salaries went up 60% and employee benefits rose 120%.
- **Item:** Of all the employees of Oregon's public school systems, only 46% teach; 54% do not teach (full time equivalents).
- **Item:** With a budget increase of 18.4% from 1989-91 to 1991-93 and

a slight increase in staffing, Oregon's State System of Higher Education dropped 2,300 students out of the system (after earlier threatening to drop 6,000).

- **Item:** When Portland found its income actually increased in the first year of Measure Five (contrary to the predictions by City officials) the City budgeted \$400,000 for "Regional Arts", \$621,000 for "Future Focus" and \$155,000 to promote growth in an unspecified neighborhood.

Governor Roberts declared: "When Oregonians feel the weight of the ax they wielded in November, they will realize they did far more than give themselves a tax break. They will have cost some Oregonians their lives, and their livelihoods."

The budget "cuts" blamed on Measure Five generally have not been cuts at all. They are simply increases smaller than the increases governmental agencies had hoped to obtain. This is a common misuse of the word "cut" by many public officials and administrators.

State Budget

Cuts and Threats of Cuts

After voters passed Measure Five, the items above were not the areas government officials threatened to cut. Early cutbacks targeted police and fire, libraries and schools.

In presenting her first proposed state budget after passage of Measure Five,

When the 1991-93 Oregon General Fund budget was finalized, however, it showed not an ax whack but a spending increase of \$559 million -- even after deducting the \$452.2 million the Legislature was legally required to appropriate to replace property tax funds which schools could not levy because of Measure Five.

Let's examine state expenditures. As shown in Figure 3, the state will spend

Figure 3

1991-93 State Expenditures Rise

General Fund		% Increase
General Fund Spending 1991-93	\$5,596.7	
Less School Levy Replacement	<u>- 452.2</u>	
Remaining to Spend	5,144.5	
Previous General Fund (1989-91)	<u>- 4,585.5</u>	
Spending Increase for 1991-93	\$ 559.00	12%

(Figures in millions of dollars)

Source: 1989-91 and 1991-93 Oregon State Adopted Budgets of the Legislative Assembly.

12.1% more General Fund dollars in 1991-93 than the previous biennium -- again after fulfilling its Measure Five obligation to schools. The state anticipates a two-year inflation rate of 7.4%.

Government Bookkeeping Explained

A brief explanation of government bookkeeping is in order to evaluate the state budget. Figure 4 shows how fast state spending has grown.

The Legislature has direct, immediate control over General Fund budget expenditures. However, much more state spending is included in the Other Funds budget. There, revenues are generally tied to their use -- for instance, gas tax to highways, and tuition to higher education. While the Legislature cannot constitutionally siphon gas taxes away from highway related uses, it can control the size of the gas tax (up another two cents to 22 cents per gallon as of January 1, 1992), as well as determine how much of its work the Transportation Department may contract out, its staff size, etc. The sum of the General Fund plus Other Funds budgets constitutes the All Funds budget (total state spending). For 1991-93, the General Fund is \$5,596 million and Other Funds (including some federal) \$11,548 million.

The Adopted Budgets

The expenditure levels shown in Figure 4 are for spending authorized by the Oregon Legislature, as published in its legislatively adopted budget.

Figure 4 shows growth of Oregon's General Fund spending and the growth of state government spending overall. With them are Oregon's Executive Department's estimates of General Fund income for 1993-95 and 1995-97 (estimates as of June, 1992). These assume revenue equals expenditure so the state's ending balance (reserve) is unaffected.

The 1993-95 and 1995-97 figures shown are the state economist's estimates of receipts for the General Fund, but actual spending depends on legislative action. The bottom figure shown for 1993-95 is the state Executive Department's estimate of funds necessary to sustain current service levels. If available to spend, this would represent a 32.4% increase over the current 1991-93 biennium, or the rate government aspires to increase spending.

Billion Dollar Shortfall?

What can be concluded from this table then, is that the difference between the 1993-95 \$7.4 billion hoped-for expenditure and the expected income of \$6.058 billion is the source of the "billion dollar shortfall" widely stated by many state officials and employees.

To compensate for this shortfall, Governor Roberts directed agencies to reduce their hoped-for 1993-95 budget targets 20%. Remember that this 20% is not a "cut" below the current 1991-93 legislatively approved budget. It is a reduction from an initially desired target. In actuality, that 20% reduction is precisely "on target" to bring spending into line with anticipated revenue.

Figure 4

General Fund and All Funds spending growth

Biennium	General Fund (000 omitted)	Biennium % Increase	All Funds (000 omitted)	Biennium % Increase
1969-71	\$710,827	-	\$2,210,713	-
1971-73	786,796	8.1	2,798,946	26.6
1973-75	1,036,549	34.8	3,826,903	36.0
1975-77	1,599,313	51.4	5,716,549	49.3
1977-79	2,064,313	29.0	7,360,695	28.7
1979-81	2,889,405	39.9	9,957,371	35.3
1981-83	2,886,219	.2	9,961,286	.4
1983-85	3,102,813	7.7	10,058,358	.9
1985-87	3,343,581	7.7	11,728,993	16.6
1987-89	3,733,830	11.1	13,452,448	14.0
1989-91	4,585,477	22.8	14,360,400	6.7
1991-93	5,596,713	20.5	17,144,800	19.3

Future projected receipts-- (000 omitted)

1993-95	\$6,058,000	8.2%
1995-97	\$6,788,100	12.0%

Future projected "needed" budget--**

1993-95	<u>\$7,412,000</u>	32.4%
		(if government recommended current service level* budget is adopted)

Some quick arithmetic exhibits the projected shortfall:

\$7,412,000	1993-95 projected budget
<u>- \$6,058,000</u>	1993-95 projected receipts
\$1,353,000	

The difference is the projected shortfall -- over \$1.3 billion.

****Projected numbers as of June, 1992.**

***"Current service level" is the amount of spending the state believes will be needed to maintain the level of service provided in a preceding period.**

Current service level budgeting may be thought of as the opposite of zero-based budgeting. Zero-based budgeting assumes a zero starting point for every agency, requiring justification for every dollar in the next budget period. Current service level budgeting, on the other hand, uses today's level of spending as the starting point or given, without requiring any justification of current spending. It then asks how many more dollars are needed to provide the same level of services in the next budget period.

Source: Adopted Budgets of the Legislative Assembly.

Budget writers blame part of this shortfall on Measure Five's required replacement funds for schools. For the current 1991-93 biennium, the replacement requirement equals \$452 million. The 1991 Legislature in fact appropriated \$554 million instead of the

Remember, this 20% is not a "cut" below the current 1991-93 legislatively approved budget. It is a reduction from an initially desired target.

required \$452 million, and raised basic school support on top of that. Oregon's Executive Department estimates that \$1,535 million in required replacement funds will be needed for 1993-95 and \$1,365 million for fiscal 1996.

Replacement "Needs" Shrink

State government's early estimate of replacement funds required by Measure Five for its first biennium (1991-93) was \$791 million. This was calculated in August 1990 -- during the height of the campaign against Measure Five. Later (also before the election) the Legislative Revenue Office estimated \$633 million. The 1991 Legislature based its early calculation on a \$554 million estimate. The true figure came in at a still lower \$452 million, or more than 42% below the early estimate.

This forecasting history calls into question the accuracy both of current estimates for Measure Five's later years and of how much it will actually deprive

nonschool local governments (or save property taxpayers) later.

Oregon's Budget & Management Office reported that Measure Five school replacement would require 8.1% of the 1991-93 budget (the estimate was correct), but will demand 24.3% of the 1993-95 budget and 39.8% of the 1995-97 General Fund. As stated earlier, though, Measure Five does not require the state to continue replacement into the second half of the 1995-97 biennium.

In actuality, that 20% reduction is precisely "on target" to bring spending into line with anticipated revenue.

State officials assume that the General Fund will continue to increase its spending on Basic School Support and community colleges at about a 6% rate per year, matching the 6% increases allowed by law in school tax bases without a vote of the people. Given budget realities, this assumption is doubtful.

Three Perspectives

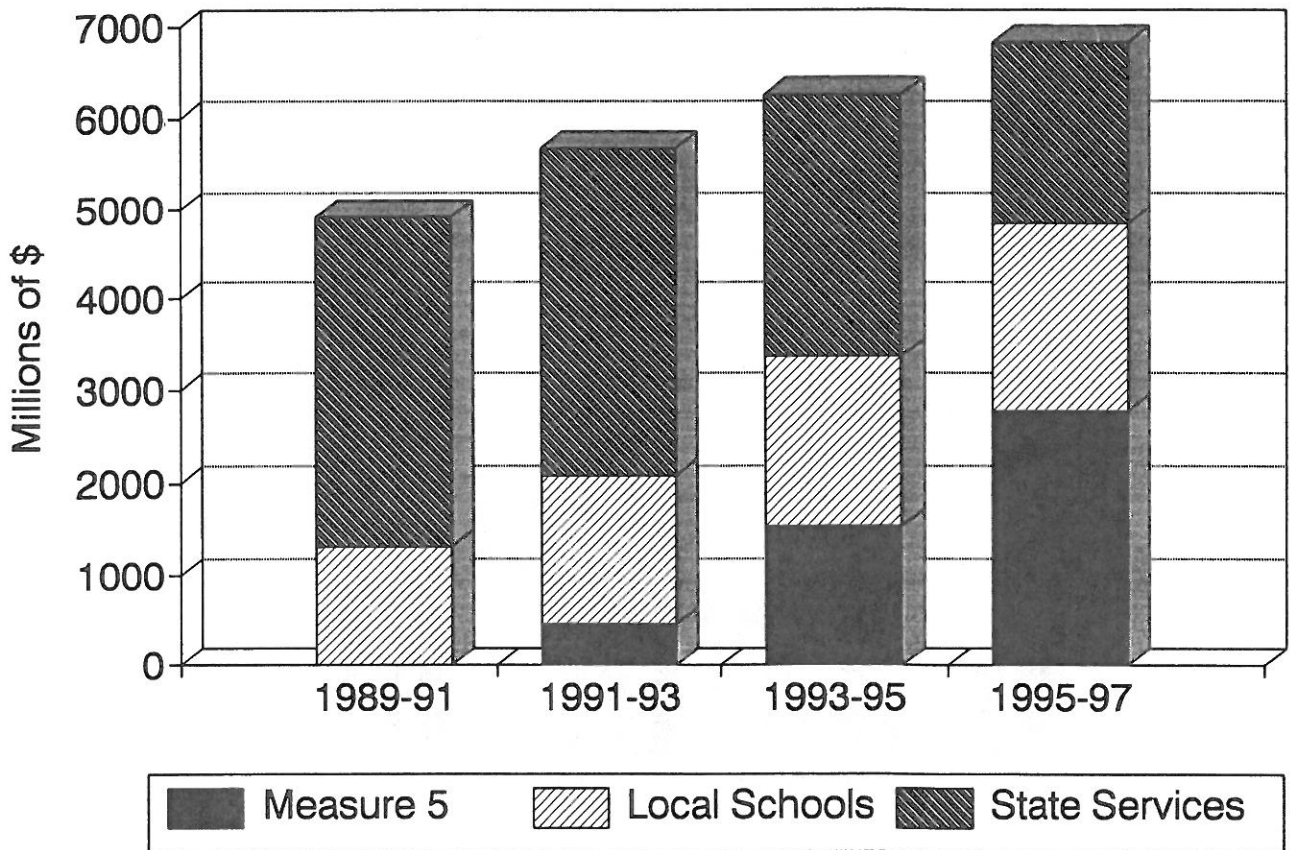
1. The Long and Short of Measure Five's Impact on the General Fund

To fully understand the impact of Measure Five, we need to do what is too rarely done in public policy analysis -- look at both its short and long-term effects.

Figures 5 and 6 show the effects of Measure Five on the State General

Figure 5

Short-Term Effects of Measure Five on General Fund Resources



LEGEND - For both Figure 5 and Figure 6

Measure 5 = State's school tax replacements dictated by Measure 5
(required through 1996, discretionary in 1997 and beyond)

Local Schools = State Basic School Support (discretionary)

State Services = Other state services

Note: Data in this graph is used to represent 1989-1997 data in Figure 6 (next page).

Source: Adopted Budgets of the Legislative Assembly, 1989-93, and assumptions for Figure 6.

Figure 6

Long-Term Effects of Measure Five on General Fund Resources

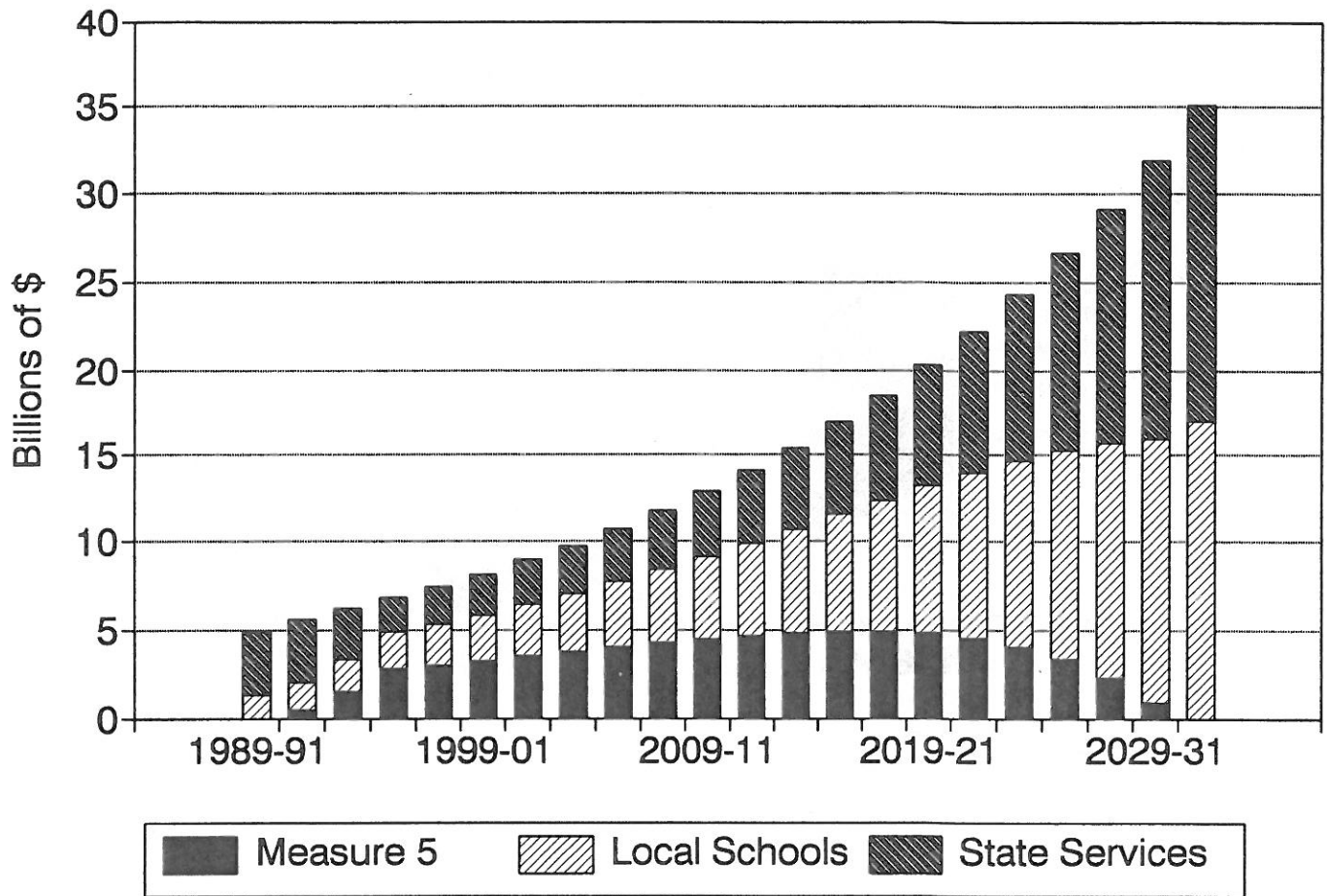


Figure 5 demonstrates the major effect Measure Five has on the state general fund over the short-term. Figure 6, however, demonstrates that even if the state continues replacing lost school revenue after its obligation ends in 1996, the replacement needs begin declining in 1997 and completely disappear by 2031.

Assumptions: State Executive Department assumptions used: Personal income growth: about 6.5% a year; 1993-95 Expenditures: Executive Department Tentative Budget; 1995-97 Expenditures: schools 6%, other inflation + population growth; Inflation: about 3.8% a year; Population growth: about 1.7% a year; Property value growth: 17% in 1991-92, 11% in 1992-93, 9% thereafter.

Fund. Figure 5 shows just the four bienniums between 1989 and 1997. Figure 6 takes a longer term view to put Measure Five into a more revealing perspective. Even if the state continues replacing lost school revenue after its obligation ends in 1996, the replacement needs begin declining in 1997 and completely disappear by 2031.

2. State Budget Growth vs. Growth of Personal Income

Figure 10 in Appendix B shows the growth of the state General Fund and All Funds budgets in relation to the growth in Oregonians' personal income. This table demonstrates that between 1969 and 1990 Oregonians' personal income rose about 515%, while the state General Fund rose 545% and the All Funds budget rose 550%. (The preliminary

June 26th Executive Summary of this study inadvertently compared growth of per capita personal income to total state budgets; not an appropriate comparison.)

Government in Oregon grows as fast or faster than the growth of its citizen's income, but this is a common trend for most state governments. However, we will see that Oregonians are asked to spend more on government than people in most other states. (Figure 7)

3. Oregon vs. the far west and the United States

How does Oregon government spending measure up to that of its counterparts? Figure 7 compares what Oregonians spend for government to what citizens in the far west states and the

Figure 7

Oregon vs. far west states and the United States

Personal Income vs. Government Expenditures, FY 1989

State and Local Government General Expenditures as a Percentage of Personal Income

Oregon	National Rank	Far West States*	United States
21.6%	13	18.9%	18.8%

State and Local Payroll as a Percentage of State Personal Income

Oregon	National Rank	Far West States*	United States
9.1%	12**	8.7%	8.3%

Personal Income Per Capita and Rank

Oregon	National Rank	United States
\$14,601	30	\$16,348

Rank is among all states and the District of Columbia

*Far West States include California, Nevada, Oregon and Washington

**Tied for 12th with Utah

Source: Advisory Commission on Intergovernmental Relations (ACIR), from data supplied by U.S. Department of Commerce, Bureau of the Census, fiscal year 1989.

entire United States spend. Data is for fiscal year 1989 (FY 1990 data should be available by August, 1992). As the chart demonstrates, in 1989 Oregonians spent a higher percentage of our personal income on state and local government expenditures than citizens in all but 12 other states. We spent more on state and local government payrolls than people in all but 11 other states. Compounding this, our per capita personal income is below average, with citizens in 29 states earning more than we do.

In most cases, the higher salary achieved by the manager whose job is abolished will be carried into the lower ranking job.

Comparing the percentage of our personal income we spend on government to the U.S. average, we find that Oregonians spend about 15% more, while we spend nearly 10% more on state and local government payrolls.

The relationships in Figure 7 between Oregon and the United States have not materially changed for the last several decades.

Public Employees

Position Cuts Approved

Most public costs are people costs. The Governor proposes to reduce 4000 positions from the state payroll by the end of the current biennium. These are

on a full time equivalent basis (i.e., two people each working half-time = 1 job).

Gross payroll savings to the General Fund are estimated by Oregon's Executive Department to be \$20 million in the current 1991-93 biennium as reductions "glide down", but should save \$165.8 million in 1993-95. More announcements are promised. Many of these positions are already vacant. The ratio of managers to line workers is to be cut from the current one to six to one to nine. The state payroll now includes an estimated 5800 supervisors. About 72% of them have "bumping rights" or restoration rights to lower level jobs if their present jobs are abolished. In most cases, the higher salary achieved by the manager whose job is abolished will be carried into the lower ranking job. Line workers are entitled to overtime which is not available in the manager's position. Dollar savings will be slow in coming.

Oregon's state government employment rose 19% in the 1980s, while population rose 5.7%. The magazine described this state employee growth as "...the real force behind state budget crises across the nation".

Of the 4000 positions now targeted for abolition, about 2800 are largely supported by the state's General Fund. Three quarters of the drop will come through attrition (not replacing vacated positions). However, not all of the 4000 marked jobs are full time equivalents.

A computer analysis run at the end of April, 1992 showed 34,794 Executive Department positions filled at the end of March compared with 34,291 late in January -- an actual gain of 503 employees in three months.

Confusing People with Positions

Executive Department Director Fred Miller explained that just looking at the apparent gain of 503 state employees in the first three months of 1992 confuses **people with positions**.

One such point of confusion revolves around so-called "double-fills". Double-fills occur when two people, possibly both on full salary, are assigned to a single authorized position. Sometimes this occurs when managers have more funds available than authorized positions.

Total Employment Figure a Puzzle

Nobody seems to know the total number of Oregon state employees. Oregon law limits the number of state employees to 1.5% of Oregon's population for the previous year. There are several exceptions, however.

The Governor's 1991-93 Recommended Budget reported that jobs within the limit for 1991 could total 41,865. She recommended that 40,865 of these be filled. Adding the jobs recommended for the noncovered (exception) areas, brought the recommended total to 46,126 (full time equivalent basis).

According to the Executive Department June report, however, the number of positions filled or temporarily vacant

were **38,352**. In addition, as of June *The Oregonian* reported another **14,271** state employees who are outside the Governor's direct control (Lottery workers, higher education instructors, Judicial branch employees, Legislative employees, etc.) Adding these two figures together yields a total state employment figure of **52,623**. This number is significantly higher than is usually talked about by state officials or the media.

However, 52,623 may be closer to reality, since the U.S. Bureau of the Census reports that Oregon's state government employs 52,180 people (FTE basis). (October 1990 report, latest available). *U.S. News & World Report*, using a 51,000 figure, concluded that Oregon's state government employment rose 19% in the 1980s, while population rose 5.7%. The magazine described this state employee growth as "...the real force behind state budget crises across the nation".

Privatization Sought

The Governor has suggested privatizing four agencies as part of the downsizing. Their support is primarily from Other Funds: Public Broadcasting, State Fair, Resource & Technology Development Corp. and the Travel Information Council. That would reduce state payroll 163 positions.

However, if the Governor proceeds with plans to subsidize Public Broadcasting at 80% of its present draw from the state, much of the benefit to taxpayers will be lost.

Further privatization and contracting out functions to the private sector could lead to additional savings. (Cascade Policy Institute will soon release a report on the benefits of contracting out services for Oregon.)

State Employee Pay and Benefits

PERS Benefits Generous

Oregon's Public Employee Retirement System (PERS) is generally acknowledged to be one of the half dozen most generous state systems in the U.S. It is far more generous than common practice in the private sector. There, slightly less than half of employees have any pension plan (other than Social Security) at all.

Over time, Oregon's legislators and chief administrative officers have become eligible for PERS retirement benefits. This makes those who decide on its benefits also its beneficiaries.

Equal Service to Retirement?

One major saving governments in Oregon could make would be to require public employees to work the same working lifetime as is generally required of the taxpayers who support them. Legal opinions differ as to whether the public employer has power to reduce the benefits under which its already-hired employees work. Preponderant opinion is that it can not. Even so, conditions under which new employees are hired could be changed to require the same working life as private employees must serve. The Governor's Task Force on the budget recommended that this be done. The Governor, however, is opposed.

Figure 8

Growth in Oregon's Public Employee Retirement System (PERS)

	1960	1970	1980	1985	1990
Nonretired membership	53,158	82,847	121,941	127,941	150,733
Retired members	7,092	9,336	13,958	32,832	55,540
Monthly pension payout	\$349,928	\$927,738	\$7,474,402	\$18,083,614	\$33,175,888
Monthly administrative expense	\$200,120	\$447,521	\$1,949,677	\$2,905,072	\$8,901,091

Source: Oregon PERS report for the year ended June 30, 1991

Early retirement creates other problems for the quality of service. With short careers, the agency's institutional memory is also short. With supervisors quitting early, more employees reach top management levels (and more expensive pensions) than is true in the private sector. The will to eliminate deadwood employees is softened. Much more often than in private industry, either the manager or the offending employee is very close to retirement so the faulty personnel situation is "ridden out", never faced.

State employment offers other extra advantages such as the ability to store up sick days and more paid time off than is common in private firms.

Over and Under Pay

The latest state-commissioned wage and benefit survey reports that people in state government toward the bottom of the ladder receive higher salaries than are paid in private employment for comparable work, but that those in the upper and upper middle ranges are worse paid. This apparent savings for the taxpayer may be an illusion because of the excessive number of management positions in public agencies.

The much greater job security enjoyed by public sector employees is another substantial benefit not assigned a dollar value in comparisons.

PERS Earnings Excellent

PERS revenues come from two sources: (1) earnings on invested capital (on which the State Treasurer's office has done extremely well) and (2) the public

employer contribution. Public employees have not paid into their own pension plan since June 30, 1979 when their 6% share was assumed by the employer under the "PERS pickup" labor agreement.

The PERS system covers nearly all permanent state and local government employees in Oregon.

For the taxpayer, ... early retirement has the same effect as paying five employees to do the work of four -- or some such cost -- as extra public employees must be cycled through the system over time.

The average PERS monthly pension benefit for a public worker who retired with 31 or more years service in 1991 was \$1,957.

While Oregon's population grew a little less than 60% between 1960 and 1990, the number of retired public employees receiving PERS benefits grew about 684% -- well over ten times as fast!

PERS Coverage Expands

Put another way, in 1960 about 3.4% of Oregon's population was covered by PERS -- that's public employees either still working or retired. By 1990, this had more than doubled to 7.28% of the population. (Percentages are of Oregon's entire population, not just the working population.)

Employer Funding to Drop

PERS, however, is sufficiently well funded now that it began decreasing employer contributions from 16.22% to 14.59% of payroll July 1, 1992.

State vs. Private Pay and Benefits

Value of Extra Working Years?

The 1989 Legislature enabled public employees in Oregon to retire (without penalty against pension benefits) at any age once 30 years with the agency have been served. The average public employment retirement age has been 58, but is falling. An employee signing in at age 20 could retire at 50. Few private employees who have any pension plan at all are entitled to retire without penalty before 65 -- certainly not before 62. The earning power of those extra years needs to be added to the calculation in figuring PERS benefits. For the taxpayer, that early retirement has the same effect as paying five employees to do the work of four -- or some such cost -- as extra public employees must be cycled through the system over time.

It Pays to Retire

Benefits of the public system are so generous that many public employees retire on pensions which equal or exceed their pay at work -- or are so close that the extra cost of transportation, office style clothing, etc. exceeds any difference. Public employees are often bet-

ter off to retire early even if they do not take a subsequent job.

A public employee, retiring at 62 with 30 years service and an ending salary of \$30,000 (and adding Social Security to the pension) has more disposable income than if he/she continued to work, a 1990 study by PERS' actuary, Milliman and Robertson, found. A result hardly likely in the private sector.

Wage Freeze Suggested

Since public employee wages plus benefits are believed by many to be above the private average, a wage freeze has been suggested. This could save the 1993-95 budget about \$75 million if unionized employees were to forgo wage increases already negotiated for 1993.

However, the public employees' unions have made it clear that they prefer staff reductions to wage/benefit sacrifice.

The Governor's Task Force on the budget problem retained the Seattle firm of Towers Perrin to do a comparative survey which reported (February, 1992), that:

- (1) Too many state employees get both a general raise (average 3 3/4%) + a "step plan" raise (average 4 3/4%) at the same time. The latter is mis-named a "merit plan", as no one is ever found to lack merit. So state annual increases often average 8 1/2% vs. 4.3% to 5.4% in private employment.
- (2) The state could save by basing wages more on the local market, not just on the larger metropolitan areas, and

on a mix of comparisons -- not just comparisons with very large firms.

- (3) Public employer contributions to PERS (the Public Employees Retirement System) need to be reduced over time from the present 16.22% of payroll to a level closer to the 6%-8% common among those large employers who have any retirement plan at all. Slightly less than half of private jobs include a pension plan.

Higher Education

Higher Education Cuts Students

Of particular interest in any cost effectiveness equation is Oregon's System of Higher Education.

There the Governor's Recommended Budget for 1991-93 included an increase of 13 1/4% over the 1989-91 Adopted Budget. Higher Education's Chancellor then recommended that 6000 students be dropped from the system. That was about 9% of the total student bodies. As two-year inflation was less than 8%, this was hard for outsiders to understand.

Average classroom load for faculty who do teach at the University of Oregon and Oregon State (researchers not included) is just over six hours per week. If, for every hour in class one assumes four hours for preparation, grading papers, student conferences, etc., that adds up to a 30-hour work week. Unquestionably, many faculty put in much more time. But many don't.

Higher Education's defenders blame class sizes such as 80 or 200 students. But

the student/teacher ratio at Oregon and Oregon State is actually about 19 to one.

For each employee (professors plus all other staff -- full time equivalents) of Oregon's System of Higher Education, there are slightly more than three students. This is significantly worse than the roughly 4+ ratio in Oregon's private colleges.

Until the recent \$500 tuition increase, Oregon had subsidized about 70% of the cost of each in-state student in the Higher Education system -- the student paying 30%. If that ratio were reversed, the state would save an estimated \$200 million per biennium, even after picking up the tuition difference of students who could not pay.

Oregon ranks third among all states in spending on K-12 public education per \$1000 of Oregonians' income.

Higher Education Employee Load Not Cut

The State System's 1991-93 budget won approval of 15,505 (fte) positions, up slightly from the 15,399 the Legislature approved for the outgoing budget. Publicity, however, has concentrated on staff let go as departments were reorganized.

In the end, the Legislature voted an 18.4% increase for Higher Education (instead of the recommended 13 1/4% -- up to \$2,377 million from \$2,015 million). So, at the insistence of the Legis-

lative Ways & Means Education subcommittee, the reduction in the number of students was cut to 2300 instead of 6000. With 2300 fewer students, the student/faculty ratio will be even less of a load.

Student tuition was raised \$500 per year, among the steepest in the U.S. according to an Associated Press poll conducted in October 1991. Community college enrollments rose 8%, at least partly reflecting admission of those who could no longer afford the state's four-year schools.

Devastation

The President of Portland State University predicted "devastation" for Oregon's System of Higher Education on a television talk show the week before Measure Five passed. Instead, Portland State received an extra \$2.5 million to link its library with other colleges and \$5 million extra for the Engineering Graduate School.

Local Budgets

K-12 Schools

Oregon's School Spending Generous

Oregon ranks third among all states in spending on K-12 public education per \$1000 of Oregonians' income. Oregon also ranks well above average (15th) in its spending on higher education (state system plus community colleges).

K-12 School Districts

During the 1980s, Oregon's K-12 school *enrollment* was static. For the decade, *inflation* rose 38%. School district *budgets*, however, expanded 75% for that same period. Of the added costs, salaries went up 60% and employee benefits 120%. Overall, spending went up a billion dollars in the decade, of which, \$300 million went to employee benefits (T.K. Olson, "A Dollars & Sense Look at Oregon School Finance", December 1990.)

As noted, the formula to allocate Measure Five replacement dollars for the 1993-95 biennium will be decided by the 1993 Legislature. It seems probable that districts with very large property values (such as Portland) will be net

Of all public school employees in Oregon, only 46% teach, 54% don't teach.

losers in favor of districts where per pupil expenditures are less. Federal court rulings have tended to force equal per pupil spending in states where the state itself is the primary funding source.

School Taxes to Rise Again After 1996

After fiscal 1996, when the school tax rate arrives at its final \$5 per thousand of assessed value, school levies will begin to rise again, driven by increases in assessed value. Even if the state intended to continue replacing those funds which schools were prohibited by Measure Five from levying, pressure on the General

Fund would begin to decrease with fiscal 1997.

Portland's school superintendent threatened to hand out "pink slips" wholesale the morning after the November 1990 election if Measure Five passed. By early 1992, however, the Portland

If Oregon reduced its per pupil funding to match California's, we would save about \$450 million per biennium.

school district was well enough off that the same superintendent proposed that the district subsidize college costs for some of its graduates. Instead of pink slips, the district proposed to add 64 employees.

Statewide, school budgets are assured of receiving all the funds that they would have levied in property tax through 1996. District-by-district, however, this will vary as efforts to equalize per student spending statewide continue. As the state assumes a larger share of responsibility for school finance, the option of wide ranges in per pupil spending will narrow. Except for special conditions, such as special education for mentally handicapped and for long travel distances, the courts will likely not permit wide variations in per pupil spending.

Potential Education Savings Plentiful

Since K-12 education consumes a majority of local and state tax revenues in Oregon, no attempt to find significant

savings in government can ignore this area.

There are enormous savings to be made now in anticipation of future curtailment of revenue. Levels of Basic School Support and, eventually, property tax replacement pressures will become compelling. Much more can be done to privatize, particularly in transportation, janitorial and food service.

The expansive list of items which are deemed "bargainable" between public employers and unionized public employees in education drives costs even higher while providing little or no benefit to learning. Pupil/teacher ratio is a major recent addition to labor issues which exerts upward pressure on costs with little return.

Salaries and benefits represent about 80% of school costs. Smaller class size is doubtless a workplace "benefit" to teachers. But the preponderance of evidence from studies shows that there is little or no educational benefit to smaller class size -- certainly not after the early grades. Add in the rights of public education employees to paid time off for illness, bereavement, maternity, jury duty, Sabbatical leave, professional and personal leave, extra pay for extra duty (not listed on published salary schedules), extra holidays not available to employees of private firms, student days off while teachers prepare classwork, plus the summer off and two weeks at Christmas. The cost becomes enormous per student-hour actually spent in a classroom seat. Well-publicized comparisons with achievement of students in other ad-

vanced nations repeatedly demonstrate the problem.

Yet employee benefits (generally tax exempt) have risen at twice the rate of salary increases. Medical/dental benefits, for instance, usually cover 12 months although most unionized school employees work only 8 1/2 or so.

The classroom scene is not the greatest problem, however. Of all public school employees in Oregon, only 46% teach, 54% don't teach (full time equivalents). Supervisory personnel decreased but staff support increased during the 1980s. Oregon school employees now include 169 "psychological personnel". The Portland school district alone has some 81 deputy superintendents, directors of instruction, educational supervisors, etc.

Local school boards have fared poorly in resisting added costs which often fail to reverse the slide in student achievement. Oregon's per pupil costs are about \$487 higher than California's, for example, according to the National Education Association.

If Oregon reduced its per pupil funding to match California's, we would save about \$450 million per biennium.

Compulsory arbitration between districts and teacher's unions has made resistance to cost increases almost impossible. As Measure Five tilts the burden for financing schools toward the state, the state will be forced to confront excessive costs.

Nonschool Local Spending

Property Tax Dependence Varies

Local government's degree of dependence on property tax varies widely. Special service districts, such as rural fire, are often almost wholly dependent on property tax. Others -- especially cities -- have numerous revenue sources besides property taxes.

For instance, only 39% of the city of Portland's General Fund income for 1991-92 is derived from property tax. Multnomah County's General Fund is about 42% dependent on property tax.

The statewide average tax rate on nonschool property was \$8.65 per \$1000 of assessed value in fiscal 1991. Most taxable properties are not now affected by the \$10 nonschool cap.

That the bulk of the revenue supporting these large local governments derives from sources other than property tax was rarely explained to the public during debate over Measure Five. Rather, voters likely believed that the percent of reduction feared in property tax would be the percent that the entire General Fund budget would be shorted. This is simply not the case.

Other Corks for Spending?

What other cost containment efforts can be made to deal with the state's al-

leged \$1.35 billion General Fund budget shortfall?

The Governor's Task Force on Education recommended \$590 million worth of spending reductions including stopping subsidies for the Oregon Historical Society, the Arts Commission, a 28% cut in Basic School Support (\$386 million), and trimming \$11 million from special education.

The Governor proposes cutting state support for cities and counties by 30% to 50% in the 1993-95 budget. State savings could be \$130 million for Oregon's General Fund plus \$535 million for the Other Funds budget, based on support levels in the current budget.

Nonschool Local Effect

Measure Five's first year left a majority of nonschool local government budgets unaffected. It had minimal effect on many others. Local government budgets will be able to grow, however, as assessed values grow.

Taxpayer savings from the \$10 levy cap were generally highest in jurisdictions which had exerted the least effort to control spending. Overall, taxpayer savings in Measure Five's first year were \$246.5 million. Of that, \$51.5 million came from nonschool local governments and was exempt from the Measure Five replacement requirement for schools.

The statewide average tax rate on nonschool property was \$8.65 per \$1000 of assessed value in fiscal 1991. Most taxable properties are not now affected by the \$10 nonschool cap.

Local Spending Continues to Rise

Some jurisdictions subject to the \$10 cap continue to spend as though no limit applied.

By March 1992, despite warnings about Measure Five from Portland's own top officials, the city distributed a 1992-93 General Fund budget whose spending rose to \$213.5 million from the previous year's \$204.3 million -- up 4 1/2%, just a tad more than inflation. Portland's property tax receipts rose \$3.6 million and Multnomah County's were up \$4.4 million more than their budget officers had projected for Measure Five's first tax year.

Portland's Spending Rises

Portland proposed to add a number of police officers but was immediately forced to set aside a half million dollars toward their retirement which will likely occur only 20 years later. In November 1990, Portland's mayor had predicted that police and fire budgets would be cut 15% to 20% if Measure Five passed.

More than a million dollars of Portland's increased receipts also went immediately into "Regional Arts" (\$400,000) and "Future Focus" (\$621,000). "Future Focus" includes such items as "diversity and anti-racism efforts". Some \$75,000 went for unspecified categories; \$40,000 for "first source", that is, promotion of contracts with minority-owned firms and district planning; and \$155,000 to promote growth in a yet-to-be selected neighborhood.

None was squirreled away into a "rainy day" ending balance against the massive layoffs and deteriorating services city officials widely predicted. From an "unencumbered" beginning balance of \$13.8 million, by April 20, 1992 the city had proposed to drop its ending balance to \$9.3 million; in other words, to spend \$4.5 million more than it took in, reducing reserves.

Portland's 1990 tax burden was measured as the heaviest of all 51 cities included in a recent annual study by the District of Columbia, commissioned by Congress.

Portland's 1990 tax burden was measured as the heaviest of all 51 cities included in a recent study by the District of Columbia, commissioned by Congress. It found that a typical Portland family of four with a \$25,000 annual income pays \$3,457 in state and local taxes.

20-Year Careers Costly

Portland has made no effort to require its new hires for police and fire to work longer than 20 years even though their legally binding obligations to the Police & Fire Retirement Fund are a major cost to taxpayers. Modern technology also provides plenty of useful work which does not require strenuous physical effort from police and fire workers who are passing into middle age.

A study by the Portland City Auditor (late 1990) found that, on average, career city workers earned about \$25,000 of annual disposable income while working

for the city, but \$29,000 after retirement (Social Security included). The retirement plan's base of salary at the end of a career (often raised by overtime plus half the value of unused sick leave, plus credit for unused vacation time), makes retirement more attractive than continued work for many city employees. Accumulated vacation and sick leave credits can add up to 25% of a pension check. With that early retiree gone, the city must train a new person, also headed toward a career far shorter than average among the taxpayers who provide their salary and benefits.

"User Fee" Effort

Some cities and other jurisdictions attempted to circumvent the intent of Measure Five by reclassifying various services traditionally part of the regular tax bill as "user fees" -- outside Measure Five.

Measure Five defines a tax as any charge against a property or its owner purely as a result of ownership of the property. Any such charge is subject to

... a typical Portland family of four with a \$25,000 annual income pays \$3,457 in state and local taxes.

the \$10 cap. However, a commodity furnished by the taxing district whose use the owner can control (water, for instance) can be charged for as a user fee, which is not subject to the \$10 cap.

Gresham's Drainage Fee

The City of Gresham imposed a drainage fee on all improved properties under the guise that any impervious surface on the property (roof, driveway, parking lot) caused use of the city's storm drainage system. A charge of \$2.75 per month for residences and \$2.75 for each 2500 square feet of "impervious area" of other properties was set.

A citizen group sued the City of Gresham maintaining that this charge was a tax flowing as a direct consequence of ownership of the property and was not an "incurred charge".

In mid-April, the Oregon tax court agreed, saying the ordinance "does precisely what (Gresham) contends it does not." The court asserted that, by calling the charge a user fee, the city was "engaging in a fiction" and that the city's contention that the fee was not a consequence of property ownership ignored reality. The judge added that it "is not even good sophistry" for the city attorney to maintain that, by building an improvement, the owner was requesting a drainage service. This case is now on appeal.

Numerous similar impositions may die quietly. Others may live because they were not challenged within the time the Legislature set for challenges.

Medford's Street Repairs

The City of Medford attempted to separate street repair from its regular tax base and to charge any household or business which had a water connection a street maintenance "user" fee.

Section 3

Tax Reform

Where do we go from here?

Governor Barbara Roberts' now famous "Conversation with Oregon" was an attempt to find out what services Oregonians want from government, and how they would choose to pay for them. While wants are generally unlimited, once a price tag is placed on services, hard choices need to be made.

In late June, the Governor proposed a package of replacement taxes to offset most of the revenue replacement requirements of Measure Five. The package included a new 3.5% sales tax on goods, a split roll property tax rate on business property of \$20 per thousand of assessed value (instead of the \$15 cap under Measure Five), and a slight reduction in personal income taxes. She asked the Legislature to meet in special session July 1st to pass her package and place it on a special September 15th ballot.

The Legislature refused to refer this tax package to the ballot. The state now has several options to combat the current budget dilemma. These include:

- (1) Change its tax system to capture the \$1.35 billion difference between the \$6.058 billion it expects to collect and the \$7.4 billion officials wish to spend.
- (2) Shift additional costs off the General Fund onto the Other Funds budget

(the \$500 per student college tuition increase was an example).

- (3) Reform unduly expensive procedures.
- (4) Cut programs.
- (5) Reduce personnel costs. (Numbers three, four and five overlap, but not entirely.)
- (6) Begin to control the cost of Oregon's Public Employment Retirement System (PERS) -- particularly early retirement. Even if only new hires were asked to work as long as the average working life of the taxpayers who provide their pay and benefits, that would make a start. Both state and local governments pay into PERS in proportion to their payrolls. Retirement near the private industry average age would cut costs dramatically.

Four Tax Alternatives

1. Cross Off the Sales Tax?

History lends no support to Salem's early hope that a general sales tax would be accepted by Oregonians.

The sales tax has been on Oregon's ballot eight times. It has never received as much as 30% of the popular vote.

Notice in Figure 9 that only three of these eight votes were presented on either a regular May primary or November general election date when voter turnout would be heavier than on special election dates. Five of the eight dates (all "specials") were chosen by Legislatures.

The Governor's proposed tax package included a 3.5% sales tax on goods. She estimated this would raise \$800 million per year. At least one public finance authority was quoted as questioning this figure. Comparing this "narrow based" tax to similar ones in other states, the \$800 million figure seemed too optimistic.

2. Oregon's Income Tax Already #1

What about Oregon's income tax? Traditionally in Oregon, property taxes supported local government (including school districts) while income taxes supported state government. Personal income tax provides about 84% of the state's General Fund revenues.

Resistance to any sharp rise in personal income tax rates could be expected since Oregon's rate is already highest in the nation. (That rank is per thousand dollars of people's income, not per capita. Oregonians have slipped below the national average in per capita income.)

The Legislative Revenue Office has estimated that it would take a 50% increase in personal income tax rates to replace the revenue Measure Five takes from the General Fund.

Substantial sums could be collected through other taxes, fees, licenses, etc., but not nearly \$1.35 billion. Spending cuts become the necessary component in bridging this gap.

3. The Split Roll Idea

A split roll is an effort to shift the burden of property tax from one class of taxpayer to another instead of each paying equally in relation to the value of property taxed. Disproportionately high taxes on business and commercial property will have two effects (1) discourage business initiatives, and (2) encourage those paying an artificially low rate to vote in more expense for others to pay. In the end, it seems self defeating, but only after considerable damage is done.

Figure 9

Oregon's votes on the sales tax

<u>Date Voted</u>	<u>Yes Vote</u>	<u>% Yes</u>	<u>No Vote</u>	<u>% No</u>
July 1, 1933	45,603	21.5%	167,512	78.5%
May 18, 1934	64,677	29.3	156,182	70.7
Jan. 31, 1936	32,106	14.6	187,319	85.4
Nov. 7, 1944	96,697	26.6	269,276	73.4
Oct. 7, 1947	67,514	27.2	180,222	72.8
June 3, 1969	65,077	11.4	504,274	88.6
Sept. 17, 1985	189,733	22.2	664,365	77.8

Contrary to much of the public's impression, the rise in property tax in the first year after passage of Measure Five was almost nil. Homeowners had expected property taxes to drop. The failure to get hoped-for relief for many was fuel for the split roll effort, including a measure advocated for the November 1992 ballot by Fair Share and others.

How Split Roll Works

The Governor's proposed tax package included a split roll property tax rate on business property of \$20 per \$1000 of assessed value. That would have been an increase over the \$15 rate Measure Five mandated on all property. It would not, however, have imposed as much of an increase as the proposed initiative seeks.

The Initiative would retain Measure Five's cuts for owner-occupied homes but cap non-owner occupied homes (mainly rentals) and income-producing property at a constant rate of \$30 (\$20 for schools/\$10 for nonschool local government). Its sponsors estimate this would relieve the state General Fund's replacement requirement by nearly \$900 million in fiscal 1993-95 and by another \$790 million in fiscal 1996.

About 40% of Oregon's real estate value is in owner-occupied housing. Rentals (16%), business properties (40 1/2%) and vacant and second homes (3 1/2%) are lumped together at the higher cap. Renters, however, would be afforded relief equal to about 1/12th of their annual rent.

These figures for government recapture of the tax savings in Measure Five

compare with the Legislative Revenue Office's estimate that the replacement requirement for 1993-95 will be \$1.53 billion and \$1.36 billion for 1996.

The negative effect on nonhomestead property values of such a measure has not been included in this calculation. However, every dollar increase in tax on income-producing property can be expected to decrease its market value by some multiple (a 7 to 1 reduction is not unrealistic). Simply put, for every \$1 increase in property taxes, there could be a corresponding \$7 decrease in the value of that property. This negative effect on property values is known as the tax capitalization effect. (Warren Brookes, "The Tax Capitalization Hypothesis," p.24, *Policy Review Magazine*, Winter 1987, No. 39.)

Tax Reduction Split

Part of the motivation behind the split roll initiative comes from the belief that, over time, business will receive more tax reduction benefit than will homeowners under Measure Five. As noted, about 40% of Oregon's taxable property value is in owner-occupied residential property and 40 1/2% in business property. Apartments and other residential rental makes up about 16%. Without a split roll, the reductions will be in proportion to the levy reductions made within each individual code area (that is, within each group of properties which are levied upon by exactly the same combination of school districts, cities, special service districts, etc.) How that will play out remains to be seen as different properties are affected by the property tax caps.

Oregon's utilities will be required to pass their Measure Five property tax savings back to rate payers as reductions in their bills. By Measure Five's fifth year, this customer saving may amount to \$38 million annually, according to Oregon's Public Utilities Commission. Four of the five largest property tax payers in Multnomah county are utilities.

4. Replacement Tax Too!

Backers of the split roll also assume there will be a replacement tax to make up revenue not levied in property tax and that the likeliest method (income tax surcharge) will fall more heavily on individuals than on business. However, it is up to the Legislature to design how the rate structure falls between corporate and personal income taxes if a surcharge is passed.

Replacement Funds

The Legislature was able to adopt a 1991-93 General Fund budget without major new revenue sources. Even after Measure Five's replacement fund requirement, no undue "devastation" occurred.

Note also, that after fiscal 1996 the state's General Fund will have no obligation to replace funds which Measure Five prevents school districts from collecting.

Conclusion

Oregon does not have a tax problem. Oregon has a spending problem!

The rapid growth of property tax levies during the 1980s and the fact that Oregonians continue to spend more of their personal income on state and local government than most Americans, demonstrates our need to find ways to reduce government spending, not raise taxes.

Measure Five may have been simply a modest attempt by voters to protect themselves against a system that continues to spend more of their income than governments in all but twelve other states.

Measure Five saved property taxpayers \$51.5 million in its first year alone. Lower property tax bills make monthly mortgage payments more affordable for many potential home buyers.

Even if the state continues replacing funds which schools lost to Measure Five after 1996, pressure on the General Fund should begin to decrease with fiscal 1997. As Figures 5 and 6 demonstrate, Measure Five represents only a short-term problem for government planners, not one forcing new and permanent tax revenue sources.

Current service level budgeting is guaranteed to make the problem worse! There is no justification for assuming that the level of government spending today

is a sacrosanct base upon which to grow. If government spending is ever to be brought within our ability to pay, we must have more fiscal accountability and question current spending and priorities.

The "tax reforms" proposed by the Governor and rejected by the Legislature in early July would have allowed Oregon state government to continue spending a higher percentage of Oregonians' income than many believe they can support.

A sales tax, higher income tax rates and the split roll property tax will all reduce the amount of money used by the private sector to increase productivity and create new jobs.

The split roll, in particular, seems especially counterproductive. Higher business taxes will discourage job creation and lead to decreased market values by some multiple of the tax increase. A 7 to 1 reduction is not unrealistic, that is, for every \$1 increase in property taxes, there could be a corresponding \$7 decrease in the value of that property.

Rational spending control would reduce the so-called budget shortfall to a fraction of the \$1.35 billion widely cited by state officials. This huge projected shortfall is a sad reflection of how excessive Oregon state government spending has been.

While it is beyond the scope of this study to make specific recommendations, potential and significant current and/or future savings are apparent. State and local governments need to seriously consider the following prime examples:

- **Reduce the public pay premium of state and local public employees, now estimated at \$715 million per year, or \$1.4 billion per biennium.**

A significant share of this disparity is in generous Public Employee Retirement contributions. Reducing public employer PERS contribution rates from the recent 16.22% level closer to that of large private employers (6-8%) would save the state and local governments \$300 million per year. The state portion alone represents a potential savings of \$100 million per year, or \$200 million per biennium.

- **Reducing the recent level of state support for in-state higher education students from 70% to 30% would save \$200 million per biennium, even after giving need-based help to those students who couldn't afford the tuition increase. While higher education is important, the current subsidy levels primarily benefit upper income families at the expense of all taxpayers.**
- **Oregon would save about \$450 million per biennium if it reduced its K-12 per pupil funding to match California's. There seems to be no correlation between dollars spent and student achievement, and Oregon may not be able to continue spending more on public education than all but two other states in relation to our income.**
- **A Governor's Task Force recommended \$590 million worth of spending reductions including stopping subsidies for the Oregon Historical Society and the Arts**

Commission, a 28% cut in Basic School Support (\$386 million) and trimming \$11 million from special education.

- **The Governor proposed cutting state support for cities and counties by \$130 million from the General Fund and \$535 million from the Other Funds budget in the 1993-95 biennium.**
- **A wage freeze for state employees to help bridge the 1993-95 budget gap would save \$75 million.**

If the Legislature does call for added revenue for the 1993-95 General Fund, public approval of any "tax reform" measure may hinge on an ironclad assurance that any new taxes will be temporary -- a "bridge tax" containing a constitutionally enforceable termination date.

Finally, this study is not so much a criticism of individual government officials and employees as it is a criticism of the noncompetitive system that influences their decisions and activities. Until this system and its warped incentives are changed, no amount of "tinkering" or "waste cutting" will lead to more than temporary respites from excess government spending.

About the Author

Vernon S. White earned a degree in journalism from the University of Oregon and was a reporter for *The Wall Street Journal*. He served as assistant to the publisher of C.C. Chapman's Oregon Voter, a public affairs weekly which concentrated on the Oregon's budget and political affairs. For most of his professional career, White was editor of Western Timber Industry, a lumber and logging trade journal. Until his recent retirement, he was for six years Research Director for Oregon Tax Research and editor of its publication, "Your Taxes", where he remains editor emeritus.

Supporting Materials

Appendix A

What is Ballot Measure Five? Details of its implementation.

Defining a Tax * User Fees * Assessment Appeals

Measure Five defines a tax as "any charge imposed by a governmental unit upon property or upon a property owner as a direct consequence of ownership of that property except for incurred charges and assessments for local improvements".

Measure Five adds "incurred charges include and are specifically limited to those charges which can be controlled and avoided by the property owner."

Voters may incur debt for capital construction bonds outside Measure Five but cannot approve serial levies or other operating cost beyond Measure Five's limits.

Local Improvement District charges for such items as sidewalks also escape provided the property owner is given at least 10 years in which to pay the charge. Charges shall not exceed the cost to design, build and finance the improvement.

Some Bonds Exempt

Existing general obligation bonds for capital construction are exempt as are any bonds issued by the state or others authorized by the Constitution. Urban Renewal bonds, paid for through the scheme called tax increment financing, are subject to Measure Five according to a May 1992 ruling by the Oregon Tax Court.

Implementing Measure Five

Oregon's 1991 Legislature passed a 280-page bill to implement Measure Five -- (that is to provide definitions, questions of timing, etc.) into the state and local tax system. HB 2550 resulted from efforts of some 50 employees of the Department of Revenue plus outside review. Revenue also attempted to insert various matters not directly related to Measure Five. The Legislature deleted

several of Revenue's draft provisions which appeared to hurt taxpayers while maximizing government revenues but which were not required to be dealt with by Measure Five.

600 Laws Amended

All or parts of about 600 Oregon laws are amended by HB 2550.

HB 2550 permits taxing jurisdictions to decide whether an element of its levy is a tax as defined by Measure Five or can be declared a user fee (Section 212). However, the resulting abuse of this privilege by cities has been struck down by the Oregon Tax Court in at least one case. Appeals time for citizen challenges is tightly limited.

Education Group Defined

HB 2550 excludes libraries, community recreation programs, child care, etc. from falling under the education classification (Section 214)-- assuring that they remain defined as nonschool costs.

HB 2550 sets July 1 of the current tax year as the date on which a property's value is set, replacing January 1 of the prior year. It is not clear that this change was required by Measure Five. As values tend to rise rather than to decline, this provision generally results in assessed values being higher than the Jan. 1 date provided.

Early Notice Lost

There is no longer a separate early notice to the property owner of an increase in his/her assessed value. Instead, notification of the value change comes with the tax statement-- again a preference by Revenue-- not a requirement of Measure Five.

Appeals Time Shortened

This shortens appeals time for taxpayers. Appeals petitions must be filed between Oct. 25 (about when tax bills arrive) and Dec. 31. Appeals are actually heard between the second Monday in January and April 15. Equalization boards were swamped with more than 37,000 appeals statewide as valuations (but not levies) went up an average of 16% in Measure Five's first year. Roughly 60% of appeals in the Portland urban (Multnomah,

Clackamas, Washington counties) area have been successful in obtaining an assessment reduction. County assessors have been able to bring their site visitations more closely into line with their six-year cycle requirement as additional funds have been funneled to them, partly through the increase in interest rates on delinquent taxes which rose to 16% from 12% annually.

The exception to the new appeals date requirement is for alleged decreases in value occurring during the tax year (a fire, for example, but also possibly a drastic drop in the real estate market). But the brief window for these will be July 15-31 after the tax year ends June 30. Measure Five requires that the property's lowest value during the year be used to determine its assessed value.

Early Discount Salvaged

Property owners receive a 3% discount if they pay their entire bill early, and a 2% discount if they pay two-thirds of their bill early. While nothing in Measure Five required any change in the discount policy, the State Department of Revenue proposed eliminating all discounts. The effect would have been to punish those who voted for Measure Five, and raise revenues. The discounts were not eliminated in the final version of HB 2550, the legislation implementing Measure Five.

The Department of Revenue's draft would also have permitted Revenue to correct clerical errors, then collect foregone tax for the two previous years-- after the taxpayer's right of appeal had run out. Ways & Means also stopped this. **This provision was not needed to implement Measure Five.**

HB 2550 provides that one jurisdiction can claim that a levy by another district is a user fee-- and should not be levied as a tax. This is useful, of course, to force charges out from under the \$10 per thousand nonschool cap, thus reducing the percent by which the complaining district has to compress its levy. This also provides opportunity for further litigation and legal fees in overcrowded courts. **It is not a consequence of any language in Measure Five.**

User Fee Cases Urgent

Challenges to the decisions of tax levying bodies, as to what is a tax and what is a user fee, go directly to Oregon's Tax Court and thence, if appealed, to the Supreme Court. Hearing them takes precedence over other matters. As written into HB 2550, at least 10 taxpayers in the affected jurisdiction must join in each challenge. Time to challenge is sharply limited by HB 2550 (Section 26). Challenge procedures alone take up four pages of legal fine print (Sections 25-28).

HB 2550 weighs more than two pounds. It contains 280 pages, 44 lines to the page, averaging 17 words to the line.

Appendix B

Figure 10

Oregon Personal Income vs. State Spending

1969 - 71 = Base Period

NOTE:

Per Capita Income measured in dollars.

State Totals measured in millions of dollars.

Cumulative Increases are a percentage of base year.

PERSONAL INCOME vs. STATE SPENDING
1969-71 = Base Period

Year	-----Per Capita-----		State Population	---State Totals---		Biennium	--GENERAL FUND--		---ALL FUNDS---	
	Personal Income	Cumulative Increase		Gross Income	Cumulative Increase		Approp.	Cumulative Increase	Approp.	Cumulative Increase
1969	3573		2081640	7437700						
1970	3705	100.00	2091533	7749130	100.00	1969-71	710827	100.00	2210713	100.00
1971	3959		2143010	8484177						
1972	4287	113.30	2183270	9359678	117.50	1971-73	786796	110.69	2798946	126.61
1973	4833		2222490	10741294						
1974	5284	139.01	2266000	11973544	149.57	1973-75	1036549	145.82	3826903	173.11
1975	5769		2299000	13262931						
1976	6260	165.28	2341750	14659355	183.86	1975-77	1599313	224.99	5716549	258.58
1977	7007		2396100	16789473						
1978	8092	207.46	2521850	20406810	244.92	1977-79	2064313	290.41	7360695	332.96
1979	8938		2584350	23098920						
1980	9817	257.69	2633156	25849692	322.31	1979-81	2889405	406.48	9957371	450.41
1981	10399		2660735	27668983						
1982	10527	287.52	2656185	27961659	366.31	1981-83	2886219	406.04	9961286	450.59
1983	11224		2635000	29575240						
1984	12011	319.25	2660000	31949260	405.12	1983-85	3102813	436.51	10058358	454.98
1985	12622		2675800	33773948						
1986	13217	355.03	2659500	35150612	453.84	1985-87	3343581	470.38	11728993	530.55
1987	14041		2690000	37770290						
1988	14885	397.44	2739000	40770015	517.16	1987-89	3733830	525.28	13452448	608.51
1989	15919		2791000	44429929						
1990	17196	455.00	2828214	48633968	612.79	1989-91	4585477	645.09	14360400	649.58

Sources-- Per capita income figures from U. S. Bureau of the Census.

Population figures from Population Research & Census Center, Portland State University.

State appropriation figures from Legislatively adopted budgets.

Figure 11

Property Tax Savings to Taxpayers in Fiscal 1992 Due to Measure Five's Caps*

County	Savings in School Tax (\$15 cap)	Savings in Nonschool Tax (\$10 cap)	Countywide Average Tax Rate, Fiscal 1991 (properties will vary)
Baker	\$961,270	\$512,515	\$22.69
Benton	5,748,831	102,020	30.98
Clackamas	17,368,802	181,002	25.71
Clatsop	757,401	749,246	20.46
Columbia	3,284,131	78,040	17.86
Coos	7,386,298	113,827	27.78
Crook	-0-	8,565	20.40
Curry	-0-	-0-	13.14
Deschutes	88,233	862	19.99
Douglas	4,076,523	595,126	21.81
Gilliam	811,057	189,701	25.97
Grant	23,383	7,819	18.58
Harney	3,658,547	196,925	26.31
Hood River	178,013	53	20.46
Jackson	830,835	554	21.10
Jefferson	896,234	203,543	22.55
Josephine	-0-	-0-	15.97
Klamath	4,939,197	353,002	19.62
Lake	183,601	387,537	18.97
Lane	32,082,816	111,135	28.51
Lincoln	-0-	404	20.47
Linn	9,976,944	2,245,864	28.00
Malheur	6,639,978	279,859	32.35
Marion	14,250,559	4,963,874	29.75
Morrow	-0-	317,876	19.42
Multnomah	43,950,567	36,322,886	32.20
Polk	3,202,975	53	27.60
Sherman	773,214	129,671	31.68
Tillamook	719,273	375	18.77
Umatilla	11,411,857	1,038,739	31.42
Union	3,368,025	1,202,536	32.14
Wallowa	720,578	11	22.98
Wasco	5,501,920	1,168,766	33.73
Washington	8,846,255	22,326	26.38
Wheeler	155,997	8,186	18.41
Yamhill	2,230,295	8,383	25.74
Total	\$195,021,609	\$51,501,281	26.56

The bottom figure for the tax rate is a weighted statewide average -- not a total.

*Figures from the Oregon Dept. of Revenue are preliminary. Average tax rate taken from the Department of Revenue's "Oregon Property Tax Statistics, Fiscal 1990-91. The 1991 average countywide tax rate is shown because the 1992 rates were not fully developed at the time of this writing.

Constitution of Oregon 1990 Edition

Ballot Measure Five became- Article XI, Section 11b of the Oregon State Constitution

Section 11b. Property tax categories; limitation on categories; exceptions. (1) During and after the fiscal year 1991-92, taxes imposed upon any property shall be separated into two categories: One which dedicates revenues raised specifically to fund the public school system and one which dedicates revenues raised to fund government operations other than the public school system. The taxes in each category shall be limited as set forth in the table which follows and these limits shall apply whether the taxes imposed on property are calculated on the basis of the value of that property or on some other basis:

Maximum Allowable Taxes

For Each \$1000.00 of
Property's Real Market Value

Fiscal Year	School System	Other than Schools
1991-1992	\$15.00	\$10.00
1992-1993	\$12.50	\$10.00
1993-1994	\$10.00	\$10.00
1994-1995	\$ 7.50	\$10.00
1995-1996 and thereafter	\$ 5.00	\$10.00

Property tax revenues are deemed to be dedicated to funding the public school system if the revenues are to be used exclusively for educational services, including support services, provided by some unit of government, at any level from pre-kindergarten through post-graduate training.

(2) The following definitions shall apply to this section:

(a) "Real market value" is the minimum amount in cash which could reasonably be expected by an informed seller acting without compulsion, from an informed buyer acting without compulsion, in an "arms-length" transaction during the period for which the property is taxed.

(b) A "tax" is any charge imposed by a governmental unit upon property or upon a property owner as a direct consequence of ownership of that property except incurred charges and assessments for local improvements.

(c) "Incurred charges" include and are specifically limited to those charges by government which can be controlled or avoided by the property owner.

(i) because the charges are based on the quantity of the goods or services used and the owner has direct control over the quantity; or

(ii) because the goods or services are provided only on the specific request of the property owner; or

(iii) because the goods or services are provided by the governmental unit only after the individual

property owner has failed to meet routine obligations of ownership and such action is deemed necessary to enforce regulations pertaining to health or safety.

Incurred charges shall not exceed the actual costs of providing the goods or services.

(d) A "local improvement" is a capital construction project undertaken by a governmental unit

(i) which provides a special benefit only to specific properties or rectifies a problem caused by specific properties, and

(ii) the costs of which are assessed against those properties in a single assessment upon the completion of the project, and

(iii) for which the payment of the assessment plus appropriate interest may be spread over a period of at least ten years.

The total of all assessments for a local improvement shall not exceed the actual costs incurred by the governmental unit in designing, constructing and financing the project.

(3) The limitations of subsection (1) of this section apply to all taxes imposed on property or property ownership except

(a) Taxes imposed to pay the principal and interest on bonded indebtedness authorized by a specific provision of this Constitution.

(b) Taxes imposed to pay the principal and interest on bonded indebtedness incurred or to be incurred for capital construction or improvements, provided the bonds are offered as general obligations of the issuing governmental unit and provided further that either the bonds were issued not later than November 6, 1990, or the question of the issuance of the specific bonds has been approved by the electors of the issuing governmental unit.

(4) In the event that taxes authorized by any provision of this Constitution to be imposed upon any property should exceed the limitation imposed on either category of taxing units defined in subsection (1) of this section, then, notwithstanding any other provision of this Constitution, the taxes imposed upon such property by the taxing units in that category shall be reduced evenly by the percentage necessary to meet the limitation for that category. The percentages used to reduce the taxes imposed shall be calculated separately for each category and may vary from property to property within the same taxing unit. The limitation imposed by this section shall not affect the tax base of a taxing unit.

(5) The Legislative Assembly shall replace from the State's general fund any revenue lost by the public school system because of the limitations of this section. The Legislative Assembly is authorized, however, to adopt laws which would limit the total of such replacement revenue plus the taxes imposed within the limitations of this section in any year to the corresponding total for the previous year plus 6 percent. This subsection applies only during fiscal years 1991-92 through 1995-96, inclusive. [Created through initiative petition filed May 8, 1990, adopted by people Nov. 6, 1990]

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