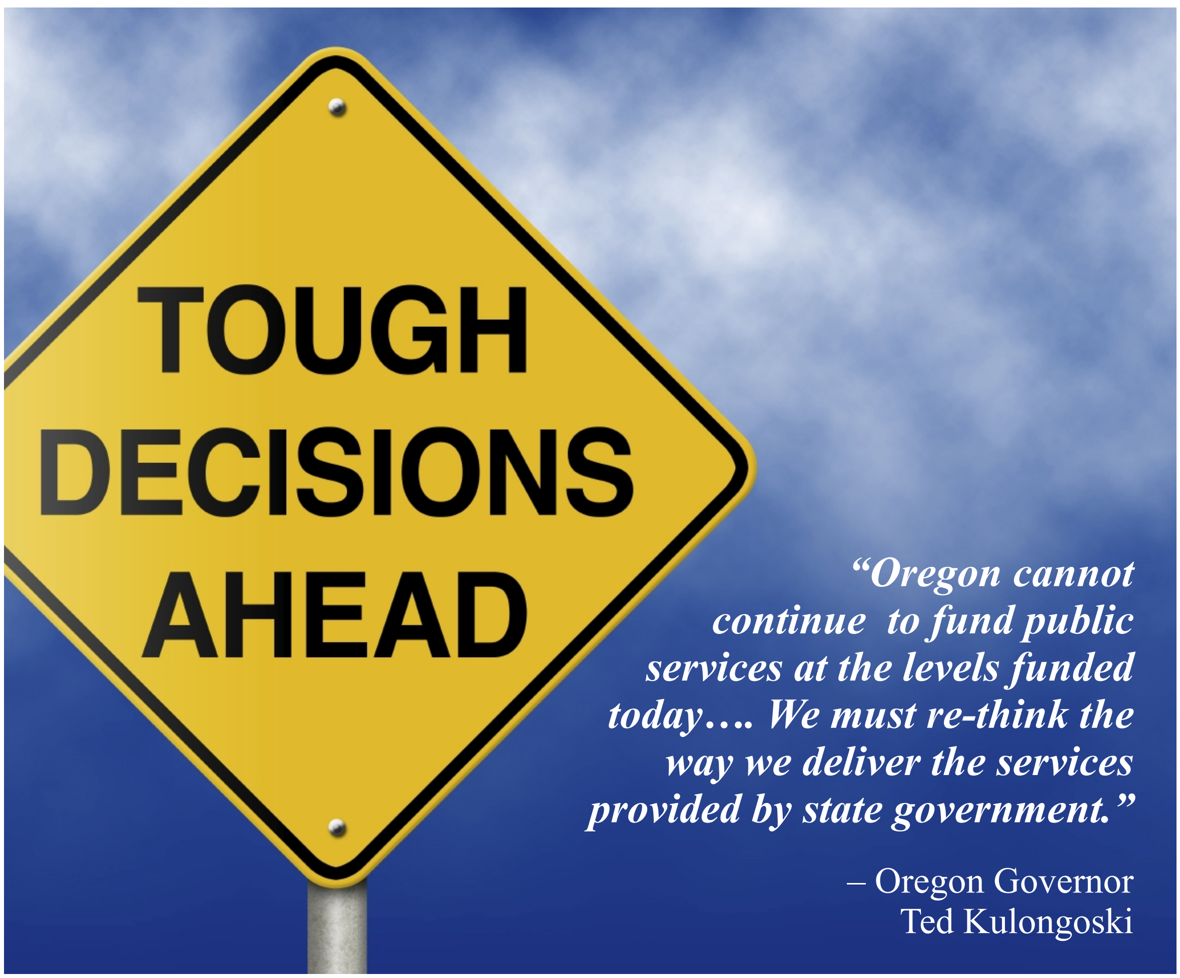
Facing Reality

Ideas to Reset Oregon's Budget and Recharge Its Economy



AMERICANS FOR PROSPERITY FOUNDATION™ OREGON

Cascade Policy Institute OREGON

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Preface

Oregon's fiscal crisis can be more of an opportunity than a crisis if our state government is "reset" using the time-tested principles of limited government and pro-growth economic policies. This document proposes a series of proven ideas that can balance our state's budget without tax or fee increases, plus policies that will stimulate private businesses to "recharge" our economy. We call this "Reality Based Budgeting" because it is high 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.

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 business to produce a profit, we face the perfect storm that manifests itself in Oregon's budget and its economy today. Without a drastic change in direction, it will only get worse.

Governor Ted Kulongoski acknowledged this fiscal reality when he formed his "Reset Cabinet" in 2009. While we agree with some of its recommendations, it does not address ideas for economic growth. Any policy to restructure state spending must be accompanied by proven concepts to grow the private sector economy, as this is the most reliable manner to ensure long-term state budget stability.

Unfortunately, the demonization of corporations and small businesses during the debate over Measures 66 and 67, along with proposed regulations and higher state fees, has reinforced the impression that Oregon is not business-friendly. This must be addressed immediately if long-term investments in expanded business capacity are to occur.

The concepts presented in this document will accomplish this goal by providing certainty to the capital markets, the business community and the taxpayers that government growth will be much slower, tax and fee increases will be unnecessary, public debt will be minimized, the budget will be balanced and a surplus created, all in the coming two-year budget period.

While we recognize the enormity of the politics that surround these concepts, we believe they are essential if we are to "recharge" our economy and ensure Oregon's long-term future. Without them, the future is every bit as dim as the Reset Cabinet acknowledges. With them, the future is as bright as we want it to be.

The choice is ours.

The Honorable Jeff Kropf (Ret.)
State Director
Americans for Prosperity – Oregon

Steve Buckstein
Senior Policy Analyst and Founder
Cascade Policy Institute

Executive Summary

The immediate effects of the most recent recession have hit Oregon especially hard. Declining incomes, diminished job opportunities and depressed property values have stalled spending and shrunk savings. In addition to these immediate effects are the longer-term effects that are just now being projected. State government in Oregon will emerge from the recession with reduced revenues and a reduced potential for economic growth to sustain the rates of state government spending growth enacted prior to the recession. The most recent revenue forecast projects general fund revenues to be $1.27 billion lower than forecast at the end of the 2009 legislative session. Last year, Oregon Governor Kulongoski declared, "Oregon cannot continue to fund public services at the levels funded today."[1] Rather than make minor revisions, Governor Kulongoski argued a "reset" is necessary, charging that "we must re-think the way we deliver the services provided by state government."

We agree with the Governor's statement above. However, we reject the notion that budget deficits are determined by subtracting expected revenue from wished-for state spending. Instead, we propose what we call Reality Based Budgeting, beginning with the concept of a state spending limit such as that proposed through Measure 48 on the ballot in 2006. If that attempt to rein in state spending growth had passed, the 2011-13 general fund budget would be roughly in balance without taking any drastic measures. It did not pass, of course, so we propose a series of cost cutting and revenue enhancing measures that do not include raising income taxes. Together, these measures should close what we believe is a more "realistic" budget gap of about $2 billion in the 2011-13 biennium. Moving forward, the "reset" in state budgeting should include adopting a spending limit similar to Measure 48. Coupled with efforts to recharge the state economy, such as permanently repealing the state's capital gains tax, we see not a decade of deficits, but a decade of growth and prosperity.

Our ideas to cut state government costs or to enhance state revenues fall into four broad categories: privatization, reduced program costs, reduced transfer payments and tax credits, and reforms to public employee compensation. The following table summarizes a number of our ideas.

TABLE 1

Cost savings and enhanced revenue

Privatization and Investment	**Estimated cost savings and/or additional revenue**
Sale or lease of Elliott State Forest	$70 million per biennium
Privatize liquor distribution and sales	$100 million plus $17.2 million per biennium
Privatize motor vehicle registration and emissions inspections	$53 million per biennium
Reduced Corrections Costs	
Reduce cost of housing state corrections inmates down to a national average and privatize the Oregon Youth Authority	$350 million in 2011-13 biennium
Transfer payments and tax credits	
Eliminate Business Energy Tax Credit (BETC) program	$287 million in 2011-13 biennium
Eliminate Building Opportunities for Oregon Small Business Today (BOOST) program	$18 million in 2011-13 biennium
Eliminate Healthy Kids Connect program	$154 million in 2011-13 biennium
Public employee compensation	
Eliminate Public Employee Retirement System pick-up	$700 million in a biennium
Align state employee compensation with private sector compensation	$298 million in a biennium
Remove retirees from general health insurance pool	$21 million in a biennium
Approximate Total Savings and Revenue	**$2 billion in 2011-13 biennium***

*This is an approximation because of the potential for some double counting offset by some additional economic activity

These ideas are only a subset of opportunities for Oregon to face its fiscal challenges and to rethink the core services the state provides, the costs of state services, and the ways in which services are delivered. We view these ideas as a starting point for an ongoing conversation.

Contributors

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Steve Buckstein is Senior Policy Analyst and founder of Cascade Policy Institute. He was appointed in 2007 to Governor Kulongoski's Task Force on Comprehensive Revenue Restructuring. He earned his Bachelor of Science degree in physics and his Master of Business Administration from Oregon State University.

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Matt Evans is a principal with Wagontire Consulting, which provides campaign management services, corporate communications consulting and research services. He is a former Executive Director of Oregon Tax Research, a non-partisan think tank based in Portland. Matt has more than twenty years of experience in politics and public policy formation, including eight and one-half years with former Oregon U.S. Senator Bob Packwood. He is the author of the 2006 Cascade Policy Institute report *Leaving Most Children Behind – Thirty Years of Education Reform at Jefferson*. He is also the Communications Director for Americans for Prosperity – Oregon.

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Eric Fruits, Ph.D. is President of Economics International Corp., an Oregon-based consulting firm specializing in economics, finance and statistics. He is also an adjunct professor at Portland State University. Dr. Fruits has been engaged by private and public sector clients, including state and local governments, to evaluate the economic and fiscal impacts of business activities and government policies. His economic analysis has been widely cited; and he has been published in *The Economist*, *The Wall Street Journal* and *USA Today*.

Jeff Kropf
Former State Representative Jeff Kropf represented Oregon House District 17 (Linn and Marion counties) from 1998 until January 2007. He is a fifth-generation Oregon farmer from the Halsey/Harrisburg area and a small business owner. Kropf hosts a weekday radio talk show on 1360 KUIK in Hillsboro, Oregon from 6-9 a.m.; and he also serves as state Director of the Oregon Chapter of Americans for Prosperity.

About Americans for Prosperity: *Americans for Prosperity (AFP) is a nationwide organization of citizen-leaders committed to advancing every individual's right to economic freedom and opportunity. AFP believes reducing the size and intrusiveness of government is the best way to promote individual productivity and prosperity for all Americans. AFP educates and engages citizens to support restraining state and federal government growth and returning government to its constitutional limits. AFP is more than 1.5 million activists strong, with activists in all 50 states. AFP has 31 state chapters and affiliates.*

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About Cascade Policy Institute: *Founded in 1991, Cascade Policy Institute 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.*

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1 – Introduction

The most recent recession has hit Oregon especially hard. One need not look too far to see the impacts that the recent recession has had on Oregon's families, workers and businesses. Employment in Oregon has declined by 82,000 from its peak; 208,000 Oregonians are unemployed. Declining incomes, diminished job opportunities and depressed property values have stalled spending and shrunk savings. In addition to these immediate effects are the longer-term effects that are just now being projected. Although signs of a national recovery have appeared, economic activity is not expected to return to pre-recession levels for many years. In the wake of past recessions, Oregon has been slower to recover than the rest of the country. As a result, state government in Oregon will emerge from the recession with reduced revenues and a reduced potential for economic growth to sustain the rates of state government spending growth enacted prior to the recession. Declining taxpayer incomes have resulted in a decline in general fund revenues. The most recent revenue forecast projects general fund revenues will be $1.27 billion lower than that forecast at the end of the 2009 legislative session.

Last year, Oregon Governor Ted Kulongoski convened a "Reset Cabinet" to develop options to preserve and improve the services state government provides to Oregonians. In forming the Cabinet, the Governor declared, "Oregon cannot continue to fund public services at the levels funded today." Rather than make minor revisions, the Governor argued a "reset" is necessary: "[W]e must re-think the way we deliver the services provided by state government in order to adequately support our schools, help families in need and keep our communities safe." We agree.

The Reset Cabinet predicts that unchecked state spending will produce a "decade of deficits" that cannot be solved by a rebounding economy or increased federal funding.[2] They recommended reforms to government spending that the governor's office expects to save $1.5 billion.[3]

For the upcoming biennium, Oregon's politicians are focusing on what they call a "shortfall" or "deficit." These terms are misleading. In fact, what politicians call a "shortfall" is simply the difference between how much they want to spend and how much is available to spend. They attempt to short-circuit discussions of state spending by invoking notions such as the "essential budget level" or "current service level" desired to provide "vital services" to the state's residents. These notions dodge the bigger questions:

- What is a vital service? One person's vital service may be another person's pork-barrel project.
- What is an essential budget level? Can the same or better outcomes be produced with a less costly use of resources?
- Why is the current service level the appropriate benchmark?

Democratic candidate for governor John Kitzhaber said his plans for a more efficient government include asking for the resignations of all state agency directors and managers. He would appoint or reappoint those dedicated to increasing productivity and reducing costs. "It's time to look at the budget differently, to spend it differently to get the desired outcomes," he said.[4] Republican candidate for governor Chris Dudley says that the Reset Cabinet's findings make it clear that the "decade of deficits" requires the State of Oregon to find new ways of delivering vital services at less cost to taxpayers.[5] He promises that, if elected, his administration would practice zero-based budgeting, meaning each agency must justify its entire budget, not just the increases over previous spending.

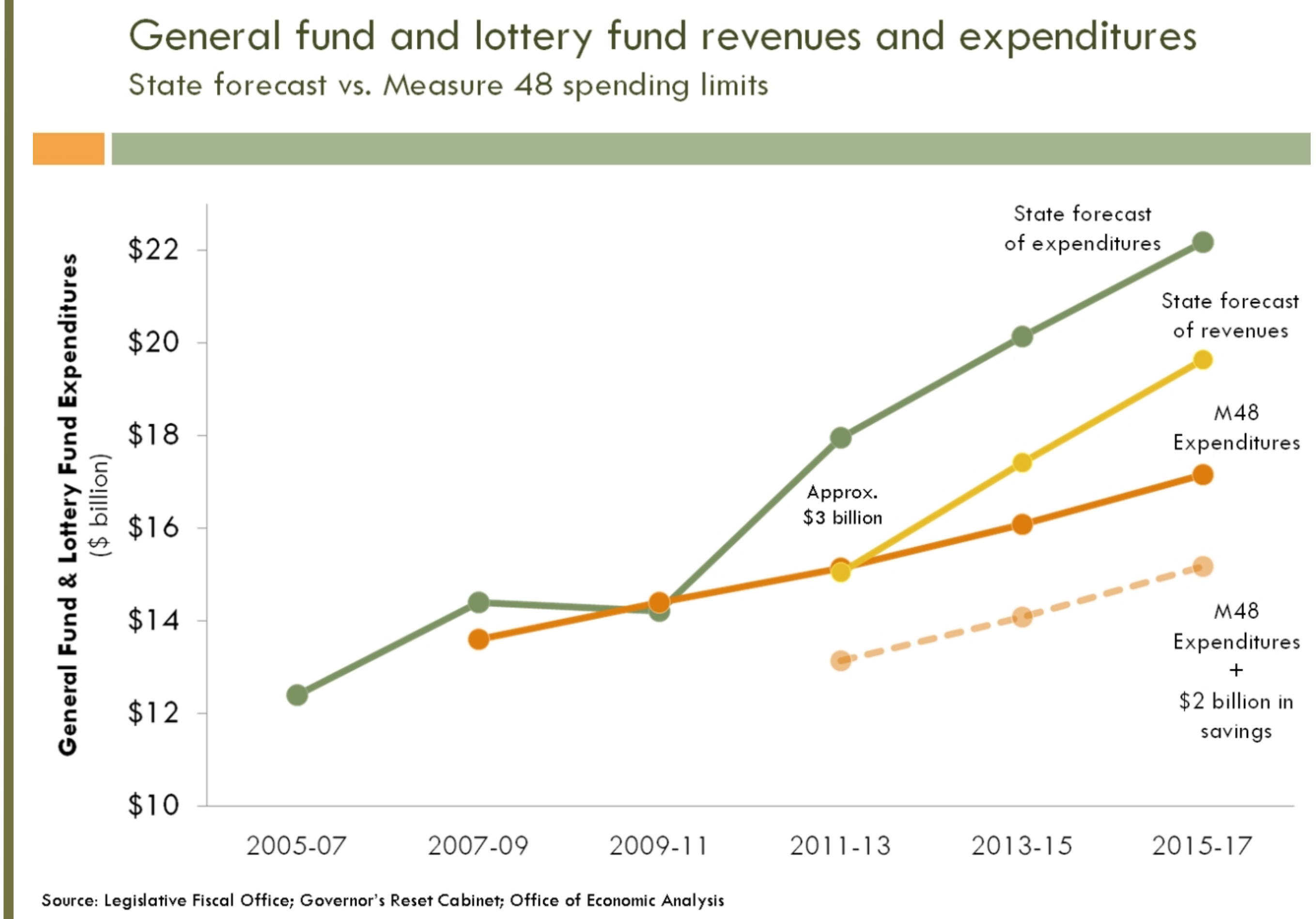
> ***"…[W]e reject the notion that budget deficits are determined by subtracting expected revenue from wished-for state spending."***

Addressing Oregon's future budget challenges demands recognition that they cannot be addressed by raising more money in the form of taxes, fees, charges and federal largesse. Instead, solutions must focus on the spending side of the ledger. Most importantly, Oregon's politicians must understand and accept the state's revenue realities. We propose that Oregon adopt Reality Based Budgeting.[6] The concepts behind our proposed Reality Based Budgeting are straightforward:

- Limit spending increases to identifiable benchmarks, such as the sum of inflation and the percent of population growth or some other reasonable measure.
- State revenues vary widely from year to year. For that reason, revenues in excess of the spending limits are returned to taxpayers and/or placed in a "rainy day" fund that can be drawn down when revenues unexpectedly decline.

In 2006, Ballot Measure 48 proposed such a limit on spending. Exhibit 1 shows that if Measure 48 had passed, spending from the state's general fund and lottery fund would almost exactly match revenues expected in those funds for the 2011-13 biennium. In other words, there would be neither a "shortfall" nor a "surplus." In contrast, "current service level" budgeting shows a "shortfall" of approximately $3.2 billion relative to forecast revenues. Thus, the case can be made that the widely reported expected shortfall is a fiction.

EXHIBIT 1



To further the "reset" conversation, we have identified some areas in which Oregon can cut the costs of state government or enhance the revenues available to state government without increasing income taxes. It has been shown that tax revenues from Measure 66 income tax increases will be substantially less than half the amount originally forecast by the state's Legislative Revenue Office.[7] Oregon has now learned that an ever-growing state government cannot be funded by ever-increasing taxes. We have reviewed independent research, efforts in other states, the Reset Cabinet's reports, and campaign materials and statements from the candidates for Oregon governor, as well as state legislative candidates. As a result, our ideas are not especially original or unique. Rather, they represent reasonable opportunities to reform some elements of state government. It is important, therefore, that the state identify solutions other than simply raising taxes. Our ideas fall into four broad categories:

1. Privatization and outsourcing to the private sector. Oregon state government runs numerous businesses. The State Land Board oversees a timber business. The Oregon Liquor Control Commission is in the wholesale liquor business. The Department of Motor Vehicles and Department of Environmental Quality are in the motor vehicle licensing and inspection business. With limited resources to do the "core" things that government is expected to do, now is the time to scrutinize the state's participation in business enterprises. New Jersey's privatization task force concluded that there is "no question" that privatization can substantially help state government address its fiscal challenges.[8] The task force found that privatization offers many benefits to governments and taxpayers, including lower costs of service delivery, improvements in the quality of public services and access to private sector capital and professional expertise. Indiana has applied the "Yellow Pages" test to public sector activities: If a service can be found in the Yellow Pages, then maybe government should not try to do it itself. Under this approach, Indiana found savings in a wide range of activities, including janitorial services and debt collection of delinquent taxes. Rather than making it easier to foster private sector activity, in the 2009 legislative session, the Service Employees International Union lobbied to make it more difficult to have state work performed by the private sector. In the end, the Legislature approved, and Governor Kulongoski signed, a bill that requires an extensive analysis on any contract job worth more than $250,000 to determine whether it could be done as cheaply in-house.[9]

2. **Reduce corrections costs.** Oregon spends more per prisoner in its adult corrections system than many other states. At a time when some prisons may close, it is time to look seriously at how we might reduce these costs at least down to the national average. We also should privatize the Oregon Youth Authority for additional savings.

3. **Transfer payments and tax credits.** A large portion of state government is dedicated to redistributing income. Some of it comes in the form of transfer payments to support a safety net of public services, such as health insurance and health care. Another large portion comes in the form of subsidies and tax credits to favored businesses, a practice informally known as "picking winners." With dwindling financial resources, the state would benefit from a thorough review of these programs to determine whether taxpayers are getting adequate "bang for the buck."

4. **Public employee pay and benefits.** Years ago, taxpayers and public sector employees developed an understanding. Public employees would be paid less than their private-sector counterparts. In return, they would receive relatively generous benefits and be shielded from many of the risks faced by private sector employees, such as being fired without cause or facing layoffs during economic downturns. Today, the Governor's Reset Cabinet predicts future increases in public sector compensation to exceed increases in the private sector. Both of the current candidates for governor have recognized that public employee compensation is a key area that determines the state's level of spending and changes in the level of spending.

To the extent possible, we have estimated the cost savings or revenue enhancements associated with our ideas. All of these estimates should be considered preliminary and are included to give a "ballpark" estimate based on the limited information available at this time. Moreover, some of the dollar amounts associated with one idea may overlap with another. For example, comprehensive public employee compensation reforms likely would include changes to the Public Employee Retirement System. We would expect more thorough evaluation of these ideas before they are put into action.

2 – Sale or lease of the Elliott State Forest

A large portion (85,000 acres) of the Elliott State Forest is managed by the State Land Board as Common School Fund lands. These Common School Fund lands are known as Trust Lands. A trust is a legal arrangement whereby control over property is transferred to a person or organization (the trustee) for the benefit of someone else (the beneficiary). As trustee, the State Land Board has a fiduciary responsibility to act solely in the interest of the Oregon K-12 schools that are beneficiaries of the Common School Fund.

Department of State Lands management of the Elliott State Forest yields returns of less than one percent. Even "risk free" investments, such as U.S. Treasuries, yield higher returns than the state is earning under its management of the Elliott. Because of the meager returns earned under Department of State Lands management, continued state management of the forest could raise questions about whether the state is neglecting its fiduciary duty to Oregon schools.

2.1. Recommendation

A superior alternative to continued state ownership and management of the forest would be to sell or lease the forest assets and place the proceeds under the management of the Oregon Investment Council. Even accounting for potentially wild swings in investment returns, this alternative would provide 4 to 8 times as much funding to Oregon schools than current management of the forest provides and maintain an investment balance that would provide school funding for future generations.

2.2. Potential savings and other benefits

The Department of State Lands values the Elliott State Forest at $802.7 million. In comparison, research presented to the State Land Board in 2006 valued the Elliott between $359 million and $747 million.[10] If the forest were sold or leased for $750 million and the proceeds placed under management of the Oregon Investment Council, schools would receive an average of $34.6 million per year, or more than five times as much as they currently receive under Department of State Lands management of the forest.[11] More intense utilization of the forest's resources also will provide employment opportunities in areas with some of the highest unemployment in the state. In addition, a sale or lease of the Elliott State Forest has the potential to increase property tax revenues (or fees in lieu of taxes) to local governments.

"More intense utilization of the forest's resources also will provide employment opportunities in areas with some of the highest unemployment in the state."

3 – Privatize liquor distribution and sales

Oregon has a three-tier system of distilled spirits distribution. It is a system for distributing alcoholic beverages set up after the repeal of Prohibition. The three tiers are producers, distributors and retailers. Under a three-tier system, the producer (e.g., distillers) must sell to the distributor who must then sell to the retailer. In Oregon, the Oregon Liquor Control Commission (OLCC) is the monopoly distributor of distilled spirits. The OLCC claims to use its market power as a buyer to negotiate lower prices from distributors and uses its market power as a seller to charge higher prices to retailers and, in turn, to consumers. This "double monopoly mark up" produces net revenues that are distributed to state and local governments.

The wholesale activities of the OLCC are relatively straightforward.[12] The state purchases distilled spirits products from suppliers, warehouses the products and ships them to retail outlets statewide. State employees perform all these activities, except that common carriers are used for delivery to retail outlets. The OLCC spends $9.7 million a year and employs 67 state workers related to its distribution business.[13] A compensation report published by the state compares state compensation with market compensation for two of these positions.[14] The state's analysis indicates that the average compensation for these positions is 12.4 percent higher than the market rate for comparable positions.

Retail prices are determined by the OLCC. Although each liquor retailer in Oregon is privately owned and operated, many aspects of the operation of stores is dictated by the OLCC.

3.1. Recommendation

Eliminate Oregon's three-tiered liquor control system and allow retailers to buy directly from manufacturers. Sell off or close down the state's wholesale distribution business. Liberalize the liquor retail system to provide store operators more freedom to manage their operations, marketing and merchandising. Allow retailers such as Fred Meyer and Safeway to sell distilled spirits. Similar measures are on the November ballot in Washington and appear to be popular. A SurveyUSA/KING5 poll found that a majority of likely voters were certain to vote to approve Washington's privatization measures.[15]

3.2. Potential savings and other benefits

The OLCC says its net revenue is $172 million a year, with $97 million of that amount placed in the state's general fund. The remainder is disbursed to cities, counties and mental health and alcohol services.[16] Research by the Tax Foundation suggests that the same revenues could be achieved with a tax of $24.63 per gallon (or $4.88 per 750 ml bottle) on distilled spirits.[17] If privatization produced a five-percent increase in distilled spirits sales, such a tax would add $8.6 million annually in revenues for state and local governments on top of the $97 million currently going to the state's general fund.

The Washington State Auditor recently released a report showing that the state could increase revenue from liquor sales and distribution by $350 million if it sold the state distribution center and auctioned licenses to private businesses.[18] Virginia's governor estimates the state could generate a short-term windfall of $500 million by privatizing its liquor stores.[19] Mississippi's governor has proposed turning over the distribution of wine to private industry, which could raise an additional $2.5 million annually.[20] Washington and Virginia have much larger populations and, in turn, liquor distribution systems. Applying their estimates to Oregon suggests potential one-time proceeds of $100 million on top of the annual savings mentioned above.

4 – Privatize motor vehicle registration and emissions inspections

The State of Oregon Department of Motor Vehicles (DMV) operates approximately 70 offices throughout the state. The department receives no funding from the general fund; most of the funding is from other funds supported mostly by fees and charges. In addition to the DMV's operations, the state Department of Environmental Quality operates seven vehicle emissions inspection facilities in the Portland and Medford areas.

Many states allow vehicle registration and emissions inspections to be performed by private entities. For example, in California, many DMV vehicle registration transactions can be performed at an American Automobile Association (AAA) branch, including vehicle registration, out-of-state vehicle transfers, lost plates and sticker replacement.[21]

States are required by the U.S. Environmental Protection Agency to oversee an emissions inspection program. There is no obligation, however, for the state itself to perform the inspections. In approximately one third of states, the state itself provides all inspections; another one third of the states oversee a fully private inspection program; and the remaining third have a hybrid program in which both public and private inspections are available.[22] For example, California has some of the strictest emissions regulations in the U.S., yet allows private businesses to perform automobile emissions inspections. There is no reason Oregon cannot adopt a similar system.

4.1. Recommendation

Vehicle registration, emissions inspections, and issuing license plates and tags should be spun off to the private sector, such as automobile associations, co-operatives, insurance companies and vehicle manufacturers, and other private for-profit and nonprofit organizations.

4.2. Potential savings and other benefits

A study published in 1996 calculated savings of $68 million to $86 million per biennium. In current dollars this would amount to $94 million to $119 million per biennium.[23] While most of the savings to the state would be offset by private sector output, privatization would transition approximately 400 individuals from the state payroll to the private sector.

> ***"…California has some of the strictest emissions regulations in the U.S., yet allows private businesses to perform automobile emissions inspections. There is no reason Oregon cannot adopt a similar system."***

5 – Reduce Corrections Costs

Oregon's current costs to house the approximately 14,000 inmates in state custody are well above the national average.[24] This has less to do with the number of inmates and more to do with Oregon's cost structure. The key aspect for cost savings in corrections privatization concerns the number of personnel that can be used to adequately and safely supervise inmates. For example, it would be more difficult and would create less in savings to privatize the State Correctional Facility in Salem than to privatize one of the newer buildings constructed in the past 10 years. Each facility should be evaluated for its privatization potential, and all future state corrections facilities should be designed and built whether privately or by the state including technology and construction to allow for the highest possible corrections officer to inmate ratio.

Corrections privatization should be viewed on a "per-site" basis. Individual correctional institutions will have individual challenges which may make them better or worse candidates for privatization. Studies in Texas have estimated annual savings from "public-private partnerships" to be in the 15 percent range on average from what would need to be spent in a completely public facility. In California, a study found that even a modest privatization effort could save the state $1.8 billion over 5 years, and a more aggressive effort could yield savings of $400 million to $1.2 billion a year.[25]

During the 1990s, Oregon built several new prisons in response to voter-passed initiatives requiring mandatory minimum sentences for some crimes. The Oregonian reports that, including benefits, Oregon's system is one of the best paying on the West Coast. Oregon's annual cost per inmate in 2008 was $36,060, compared with the national average of $24,052. Some states actually spend less than half what Oregon does to house its prisoners.[26] If Oregon could reduce its average cost to just the national average, it would save more than $300 million in the 2011-13 biennium.

One area that could be privatized to realize the greatest savings is the Oregon Youth Authority. Relative to the adult prison population, the Youth Authority is more costly, costing taxpayers $291 per inmate per day. Even a 15 percent savings brought on by privatization, as noted in the Texas study cited above, would save about $50 million in the 2011-13 biennium. However, a massive redesign of service delivery to dramatically reduce the number of personnel needed could elicit much greater savings.

5.1 Recommendation

Reduce the cost per prisoner in Oregon adult correctional facilities down to the national average and privatize the Oregon Youth Authority.

5.2 Potential savings and other benefits

Cost savings of $300 million in the 2011-13 biennium in the adult correctional facilities and cost savings of $50 million in the Oregon Youth Authority.

> ***"A draft study commissioned by Oregon's Department of Energy found that some of the projects that qualify for the tax credits actually reduce employment and income."***

6 – Eliminate Business Energy Tax Credit (BETC) program

Oregon's Business Energy Tax Credit gives businesses a tax credit for investing in energy conservation efforts and renewable energy production. For example, the program has offered renewable energy companies tax credits worth up to $10 million for wind farms and other renewable energy projects and $20 million for plants that produce solar energy components. The cost of the program skyrocketed, however, as hundreds of companies took advantage of loose regulations that allowed some to obtain multiple subsidies and others to claim tax credits without saving any energy. For example, when the program began, the subsidies accounted for only two percent of corporate tax receipts. While the legislature was meeting in 2009, the state predicted it would account for 22 percent.

The program is distinguished by its "pass through" option:

Even entities without any tax liability whatsoever can take advantage of the tax credit. Oregon non-profit organizations, tribes or public entities can "partner" with (i.e., sell the credit to) a business or individual with a tax liability.

A draft study commissioned by Oregon's Department of Energy found that some of the projects that qualify for the tax credits actually reduce employment and income. Commercial renewables projects such as wind and solar projects were associated with fewer jobs and lower income than if the tax credit money were spent on other state-funded programs. Industrial conservation projects – ranging from bus passes to energy efficiency equipment – also had a net negative impact on employment and incomes.

The Oregon Legislature in its 2010 special session capped the Business Energy Tax Credit for renewable energy projects at $300 million but did not impose caps on many other projects.

6.1. Recommendation

Eliminate the Business Energy Tax Credit program.

6.2. Potential savings and other benefits

Senator Chris Telfer (R) estimates that a suspension of Business Energy Tax Credits not yet approved would save approximately $80 million over the remainder of this biennium. The Legislative Revenue Office estimates the program will cost $286.9 million in 2011-13 biennium.[27]

7 – Eliminate Building Opportunities for Oregon Small Business Today (BOOST) program

In February 2010, the Legislature created the Building Opportunities for Oregon Small Business Today (BOOST) program. This program was designed to provide financial assistance to small businesses through both loans and grants. Small businesses eligible for the program include those in a traded sector industry having 100 or fewer employees. The program was to fund grants to eligible employers who expand employment, create full-time positions and fill the positions with employees who had been unemployed for a minimum of 60 days at the time of hire. Employers can apply to the state for a grant and, if approved, receive a $2,500 grant for each eligible employee they hire after the application is approved and keep employed for six months. (However, no employer is eligible to receive more than $50,000 in grants in a calendar year.) The program also provides loans to employers, not to exceed $150,000 or to exceed four years in term.

The BOOST program is funded with "other funds;" it is not funded from the general fund. Funding is to be generated from increased tax enforcement activities at the Department of Revenue. The first $5 million generated by the increased enforcement activities in the 2009-11 biennium are dedicated to the BOOST program. All revenues so generated during the 2011-13 biennium will be dedicated to BOOST, an amount projected to be $18 million. Any funds remaining with the BOOST program must revert to the General Fund on June 30, 2013, when the program is scheduled to sunset.

Despite its objectives, since the program was rolled out, business interest has been muted. Only six loan applications have been submitted, totaling $500,000. For the grant program, only two grants have been made, totaling $75,000 and accounting for only 30 jobs.

7.1. Recommendation

Because of the limited interest and effectiveness, the BOOST program should be eliminated. Funds to be generated from increased tax enforcement activities at the Department of Revenue should be placed in the general fund.

7.2. Potential savings and other benefits

Potential savings of at least $4 million in 2009-11 biennium ($5 million budgeted, less loans and grants already awarded). Potential savings of $18 million in 2011-13 biennium.

8 – Eliminate Healthy Kids Connect program

The 2009 Legislature passed House Bill 2116, which imposes a one percent tax on commercial health insurance premiums. The tax revenues are placed in a dedicated fund called the Health System Fund that, among other things, funds medical insurance coverage for previously uninsured children. Most of the funds are to go toward insurance premium subsidies. Oregon's Department of Human Services (DHS) projects that the health insurance tax would raise $259 million in the 2009-11 and 2011-13 biennia.[28] This level of spending would qualify the program for $590 million in federal funds over the same two biennia.

Proponents of the program and DHS projected that the additional tax revenues would provide health insurance coverage to 80,000 Oregon children by the end of the 2009-11 biennium.[29] However, with only a few months remaining in the biennium, the program has yet to enroll 26,000 more children to reach its projections.[30]

The insurance provided through the program provides generous benefits. For example, the lowest cost plan in Multnomah County has no deductible and has a maximum out-of-pocket cost of $900 per individual and $1,800 per family; generic drugs cost nothing; mental health and chemical dependency treatments cost $100; preventative dental care costs nothing. The premiums, however, are steep. Without any subsidy, the lowest cost plan in Multnomah County costs just over $200 per child per month. For those receiving the biggest subsidy, a family with five or more children would pay no more than $10 per child per month. Such generous benefits, combined with generous subsidies, raise the possibility that the Healthy Kids Connect program will crowd out private insurance. If that occurs, then the costly program will do little to reduce the number of uninsured.

8.1. Recommendation

Eliminate the Healthy Kids Connect program.

8.2. Potential savings and other benefits

If tax revenues are transferred from the Health System Fund to the general fund, eliminating the Healthy Kids Connect program would add $154 million to the general fund in the 2011-13 biennium.

> ***"Such generous benefits, combined with generous subsidies, raise the possibility that the Healthy Kids Connect program will crowd out private insurance."***

9 – Eliminate Public Employee Retirement System pick-up

By law, the Oregon Public Employees Retirement System (PERS) requires state workers to contribute six percent of their income to help fund their pension. At the time, Oregon's state retirement system was a defined benefit program in which retirees' benefits were predetermined by a formula based on the employee's earnings history, tenure of service and age, rather than depending on investment returns. The employees' contribution, it was argued, would provide employees a financial interest in the management of the system's funds.

More than 30 years ago, the state and other public employers crafted a loophole in the employee contribution mandate and began paying that contribution on their employees' behalf, a practice widely known as the "six percent pickup." Over the years, changes to PERS – most notably the 2003 reforms – have unlinked the pickup from the defined benefit system. The six percent is now placed into individual retirement accounts that resemble private sector 401(k) accounts.[31] Even so, the money is still "picked up" by the State of Oregon as the employer.

9.1. Recommendation

Eliminate the six percent pickup. Since the employee contribution no longer goes to fund a defined benefit pension system, the pickup could be phased out or eliminated by getting rid of the requirement that state workers make the contribution. After that, state workers would face the same choice as many private sector workers when it comes to retirement savings. They could choose to have part of their pay placed into the individual accounts, or choose not to.

9.2. Potential savings and other benefits

The Governor's Reset Cabinet estimates that reducing the pickup from six percent to three percent would save $132 million in the next biennium.[32] *The Oregonian* estimates that eliminating the pickup could save Oregon taxpayers $750 million per biennium.[33]

10 – Align state employee compensation with private sector compensation

The Governor's Reset Cabinet calculates that approximately $2.3 billion in state employee payroll expenditures come from the state's general fund.[34] The Reset Cabinet concluded that compensation for state employees is currently "in alignment" with that of comparable jobs in the larger labor market. Even so, the Reset Cabinet predicts future increases in compensation to be expected to exceed increases in the private sector. Despite the Reset Cabinet's reported conclusions, the following table shows that the state's most recent Total Compensation Report indicates that 25 percent of state employees have total compensation that exceeds competitive compensation for comparable services in the public and private sector.[35] Five percent of state employees have total compensation that is more than 20 percent higher than total compensation offered for comparable services in the public and private sector.

The tables below show that across state employees, total compensation exceeds market comparable total compensation by approximately $12 million a year. However, employees receiving total compensation above the state's definition of "competitive compensation" account for $65 million in above-market compensation.[36]

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.[37] 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.

TABLE 2

	Employees				
	Number	Percent of Total	Oregon Average Total Compensation	Market Comparable Average Total Compensation	Oregon Premium
More than 20% lower than market	333	1.1%	$125,640	$162,240	-22.6%
10-20% lower than market	1,041	3.6%	60,480	68,760	-12.0%
5-10% lower than market	4,768	16.3%	70,800	76,320	-7.2%
"Competitive compensation": within 5% of market	15,797	54.1%	69,720	70,080	-0.5%
5-10% higher than market	3,188	10.9%	69,120	64,320	7.5%
10-20% higher than market	2,586	8.9%	70,440	61,920	13.8%
More than 20% higher than market	1,490	5.1%	81,960	63,000	30.1%
Total	29,203	100.0%	$70,820	$70,400	0.6%

TABLE 3

	Employees				
	Number	Percent of Total	Oregon Total Compensation	Market Comparable Total Compensation	Oregon Premium
More than 20% lower than market	333	1.1%	$41,845,000	$54,017,000	($12,172,000)
10-20% lower than market	1,041	3.6%	62,950,000	71,540,000	(8,590,000)
5-10% lower than market	4,768	16.3%	337,728,000	363,931,000	(26,203,000)
"Competitive compensation": within 5% of market	15,797	54.1%	1,101,158,000	1,107,379,000	(6,221,000)
5-10% higher than market	3,188	10.9%	220,316,000	204,952,000	15,364,000
10-20% higher than market	2,586	8.9%	182,143,000	160,179,000	21,964,000
More than 20% higher than market	1,490	5.1%	122,128,000	93,935,000	28,193,000
Total	29,203	100.0%	$2,068,268,000	$2,055,933,000	$12,335,000

10.1. Recommendation

The Governor's Reset Cabinet recommends that state employees' compensation increases be aligned with changes in the costs of pay and benefits projected for comparable jobs in the private and public sectors. The Reset Cabinet also recommends health benefit costs be reduced by establishing upper limits on benefits and managing those limits from year to year: in particular, the establishment of premium cost sharing in the Public Employees Benefit Board (PEBB) in a way that requires greater employee contributions at higher salary levels and offsets such premium costs for employees with rewards for healthy behaviors.[38] In addition, require state employees to make some contribution to their health insurance, as teachers and private sector individuals do.

For example, in 2007, Governor Kulongoski gave 60 state department heads raises of 21 percent to 24 percent. Some had raises of as much as $29,000. In addition, 4,800 state managers received raises of 11 percent to 16 percent.[39] The Legislative Fiscal Office reports that these raises cost a total $248 million. Democratic candidate for governor John Kitzhaber said his plans for a more efficient government include asking for the resignations of all state agency directors and managers. Many of these individuals have compensation in excess of competitive compensation. Any state agency directors and managers that are re-hired should be re-hired at a compensation rate that rolls back these raises to accurately reflect their earning capacity in the private sector.

10.2. Potential savings and other benefits

The Governor's Reset Cabinet estimates that aligning state and school employees' compensation increases with changes in the costs of pay and benefits projected for comparable jobs in the private and public sector would save more than $400 million in general fund payroll costs budgeted for the next biennium. The Reset Cabinet estimates that the establishment of premiums in the PEBB likely would amount to $8 million in savings for PEBB-covered employees in the next biennium. State workers currently pay no part of their taxpayer-provided health insurance premiums. If they paid the same 22 percent share as the average Oregon worker (compared to 27 percent nationwide), this would save approximately $270 million per biennium.[40 41]

11 – Remove state retirees from general insurance pool

State employees who retire before they qualify for Medicare are eligible for health insurance through the Public Employee's Benefit Board (PEBB). Retirees pay the full cost of their PEBB insurance and are charged monthly premiums. On the other hand, state employees who are still working have their premiums paid by the state.

Retirees currently are included in the same health insurance pool as all state workers. Because of the additional medical costs associated with treating older people, the costs of insuring retirees is higher than the pool of non-retired state workers. Because retirees are pooled with non-retired employees, this has the effect of raising the cost of insuring those employees still working. Because the state picks up the costs of the non-retired state workers, the additional costs of insuring retirees is borne in part by taxpayers.

11.1. Recommendation

Remove retirees from the general state health insurance pool and place them in their own pool, with the premium determined separately from those still working for the state. In this way, the premiums paid by the state would more accurately reflect the costs of working state employees.

11.2. Potential savings and other benefits

Consultants to the PEBB estimate savings of $10.5 million a year.[42]

12 – Reduce or eliminate Oregon's capital gains tax

The Tax Foundation reports that Oregon's 11 percent personal income tax is now tied with Hawaii's for the highest rate in the country. Because its capital gains tax rate is linked to the income tax, Oregon's tax on investment gains is also the nation's highest.[43] This has the effect of discouraging investment and hiring activities in the state.

Between 2007 and 2008, income from capital gains declined by 60 percent.[44] The state's economist reports that capital gains and business-related income are highly volatile. Capital gains accounted for 10 percent of income in 2007, dropping to 4 percent in 2008, and may be as little as 2 percent of income for 2009.[45]

12.1. Recommendation

Reduce or eliminate Oregon's capital gains tax. In a reversal from his position when running for U.S. Senate, Steve Novick, lead spokesman advocating for the passage of Measures 66 and 67 declared, "I think we need to think about a capital gains tax break."[46] Both candidates for governor support some reduction in Oregon's capital gains tax. The Oregonian reports that Kitzhaber is open to lowering the capital gains tax as part of a "thoughtful re-evaluation" of the effects of Measures 66 and 67.[47] Dudley has proposed reducing Oregon's capital gains tax from 11 percent to 3 percent.[48]

12.2. Potential savings and other benefits

Previous research by a member of the Governor's Council of Economic Advisers calculates that cutting the capital gains tax rate to 4.5 percent would add approximately 6,000 new jobs a year and increase venture capital activity in the state by approximately $300 million a year.[49] This is consistent with more recent research suggesting that completely eliminating the capital gains tax would add approximately 14,000 more jobs by 2013.[50] Accounting for dynamic reactions to a capital gains reduction, Conerly (2005) finds that short-term revenues would be more than offset by increased economic activity.[51] With capital gains incomes near record lows, state revenues would be virtually unchanged in the early years – especially now, when capital gains revenues are already at record lows. Increased economic activity, on the other hand, would produce greater revenues in later years.

13 – Repeal Little Davis-Bacon

"Prevailing" wage legislation requires that a particular wage rate be paid to laborers working on government construction projects. The rate is determined through government surveys. In most cases, the "prevailing" wage is determined to be substantially higher than the market rate. Politicians and unions who support the prevailing wage rate say it is beneficial and fair because it provides a just wage for hard-working families, results in quality construction and provides a responsible example for construction firms paying lower rates on private projects. On the other hand, a large body of research finds that prevailing wage laws are costly to administer, increase the cost of public works projects, and violate the privacy of workers seeking to freely negotiate wage rates on their own. For example, contractors must create and file statements of compliance and payroll reports. General contractors must make sure that their subcontractors comply with prevailing wage requirements. The cost of this additional administrative work is significant.

> ***"…[A] large body of research finds that prevailing wage laws are costly to administer, increase the cost of public works projects, and violate the privacy of workers seeking to freely negotiate wage rates on their own."***

While prevailing wage proponents argue that the higher wages may lead to increases in tax revenues via higher incomes, it is also generally the case that the higher wages on government-sponsored projects are being paid out of existing tax revenues. In other words, the potential for additional tax revenues is offset by greater government expenditures, which are ultimately drawn from taxpayers.

The federal prevailing wage law is known as the Davis-Bacon Act; state-level prevailing wage laws are known as “Little Davis-Bacon” acts. Oregon's Little Davis-Bacon Act (1959) is the prevailing wage rate law that applies to projects that have no federal funding. The Little Davis-Bacon Act applies only if the project costs more than $50,000 and meets the definition of a public works project. A review of the state's deferred maintenance “stimulus” projects found that 84 percent of the money for the projects was subject to the state's Little Davis-Bacon Act.[52]

Research from Oregon State University, in its study of the effect of the Davis-Bacon Act on construction costs in rural areas, concluded that “a project subject to the Act would cost on average 26.1 percent more than the same project not subject to the Act.”[53] Research by the State of Ohio estimates savings of 5 to 10 percent across all areas (e.g., urban and rural areas).[54] A study by the Fisher Center for Real Estate and Urban Economics at the University of California Berkeley found that project costs increased 13.5 percent to 25.6 percent in selected California cities due to prevailing wages.[55]

13.1. Recommendation

Repeal Oregon's Little Davis-Bacon Act.

13.2. Potential savings and other benefits

Savings of 5 to 25 percent on projects currently subject to Oregon's Little Davis-Bacon Act. Because we do not know what specific projects may go forward in the next biennium, we are unable to quantify specific savings and are not counting these savings in Table 1 above.

14 – Additional savings through privatizing and contracting out state services

In general, privatization refers to ideas that move management or delivery of government services into the private sector. It also can refer to the sale of government-owned assets such as land or buildings – to private concerns. The basic idea is to reduce the cost to taxpayers of delivering services. There are also ways to continue delivering these services using government employees at a lower cost, primarily by sending the services to an open bidding process in which unionized government employees may compete.

On balance, the private sector can deliver services at less cost, both in the short term and especially in the long term. Compared to private sector employees, government employees are expensive. This is primarily due to the very expensive benefit packages available to government employees that are not typical in the private sector. For example, most Oregon state government employees receive a health care benefit that pays 100 percent of their health insurance premium.

This amounts to about $1,200 per month ($14,400 per year) per employee that taxpayers must fund. In addition, taxpayers pick up 100 percent of contributions to the Public Employee Retirement System (PERS) for most government employees in Oregon. This amounts to about 12 percent of each individual employee's salary. For example, for an employee earning $50,000 per year, the state pays another $6,000 per year in taxpayer funds toward retirement benefits.

“On balance, the private sector can deliver services at less cost, both in the short term and especially in the long term.”

Government services delivered by the private sector still must be paid for, so costs are likely to be reduced but not eliminated. One other advantage is that the private sector tends to deliver services more efficiently, so the public gains not only reduced costs but better service.[56] In this way privatization tends to reduce, but not eliminate entirely, the cost of providing services.

This section is not intended to be a comprehensive discussion of privatization of government services for Oregon. Even ideas that have worked well in other states or nations may not be applicable to Oregon. However, many opportunities for privatization of government services in Oregon exist, and it is only the political will to implement these ideas that is missing. Below are some areas ripe for change.

14.1 Transportation

There are several ways Oregon could save significant money on transportation by using privatization ideas. The Oregon Department of Transportation currently employs a large number of project designers and engineers. Frequently, the Department spends money redesigning potential future projects based on changes in federal or state law. For example, new requirements might be handed down from Washington, D.C. having to do with protection of salmon populations. The Department then redesigns every project in its inventory based on the new salmon protection plan.

The easiest answer would be for the Department simply to wait until a project was actually on its way to construction to update the design based on current federal and state law. This would allow a significant reduction of the number of project design engineers employed by the Department.

A second option and the preferable one would be to hire private project design engineers on a per-project basis. When a project is finally ready to be constructed, re-design work to federal and state specifications could be completed as part of the contract.

Another opportunity to privatize road construction projects could involve user fees. Such programs have been in place in the eastern U.S. for years, and many states are adopting similar programs. In exchange for incurring the up-front costs of construction and the ongoing costs of operations and maintenance, the private provider is permitted to charge a fee, or toll, to those who use the road. In addition, dynamic road pricing has been demonstrated to reduce traffic congestion, improve user benefits, and reduce fuel consumption and the resulting emissions.

In Oregon, the most obvious possible candidate for this kind of treatment would be the Newberg-Dundee bypass in Yamhill County. The demand for this bypass has been recognized for decades, but it was not until 2009 that the Legislature moved to make it a funding priority. If a private contractor were allowed to construct the bypass as a toll road, the bypass actually would be built at what could be a significant cost savings to the state.

14.2 State Motor Pool

A 2003 review by the Taxpayer Association of Oregon estimated the state could save up to $20 million per year by selling off the inventory of the State Motor Pool, radically reducing the provision of government-funded vehicles and then using private rental firms when such transportation is necessary. This step was recently recommended for Louisiana by its Commission on Streamlining Government.

14.3 Printing Office

The entire Office of Publishing and Distributing Services should be privatized, and jobs should be outsourced to private printing firms.

14.4 Employment

Privatize the job placement services provided by the Employment Department. Allow private "job search" firms to contract with the state to provide these services.

14.5 Child Support Collections

Collection of delinquent child support payments should be ceded to private entities. These firms could be authorized to collect not only the support payments owed, but also additional money to cover their costs. These firms could be authorized to aggressively take whatever legal means are available, including repossession of assets, to satisfy outstanding child support payments.

14.6 State Park Maintenance

State Park reservations are currently handled by a private firm. Oregon should try privatizing the maintenance of a State Park or two as a test to ensure quality and lowering of costs.

14.7 Other State Privatization Reports

A task force in Arizona recently released its initial report on how that state could save money through privatization.[57] Included were ideas such as consolidating email providers throughout government, contracting with a private firm to collect data on educational progress in public schools and to create a process to encourage privatization initiatives in the state.

As previously noted, New Jersey Governor Chris Christie received the final report of his Privatization Task Force earlier this year.[58] It, too, detailed many areas of state government that are ripe for privatization. Both the New Jersey and Arizona reports should be seen as examples of what the state of Oregon should replicate in its efforts to reset state government.

Conclusion

We agree with the Governor's Reset Cabinet that, without "resetting" state government, Oregon faces a decade of deficits. However, we reject the notion that budget deficits are determined by subtracting expected revenue from wished-for state spending. Instead, we propose what we call Reality Based Budgeting, beginning with the concept of a state spending limit such as that proposed through Measure 48 on the ballot in 2006. If that attempt to rein in state spending growth had passed, we conclude that the 2011-13 budget would be roughly in balance without taking any drastic measures. It did not pass, of course, so we propose a series of cost-cutting and revenue-enhancing measures that do not include raising income taxes. Together, these measures should close what we believe is a more "realistic" budget gap of about $2 billion in the 2011-13 biennium. Moving forward, the "reset" in state budgeting should include adopting a spending limit similar to Measure 48. Coupled with efforts to recharge the state economy, such as permanently repealing the state's capital gains tax, we see not a decade of deficits, but a decade of growth and prosperity. Oregonians deserve no less.

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