OREGON'S POST-PANDEMIC FISCAL CHALLENGE:
PROBABLE DEMANDS, CONSTRAINTS, AND TRENDS ARGUE FOR LONG-RANGE BUDGETING

December 2022

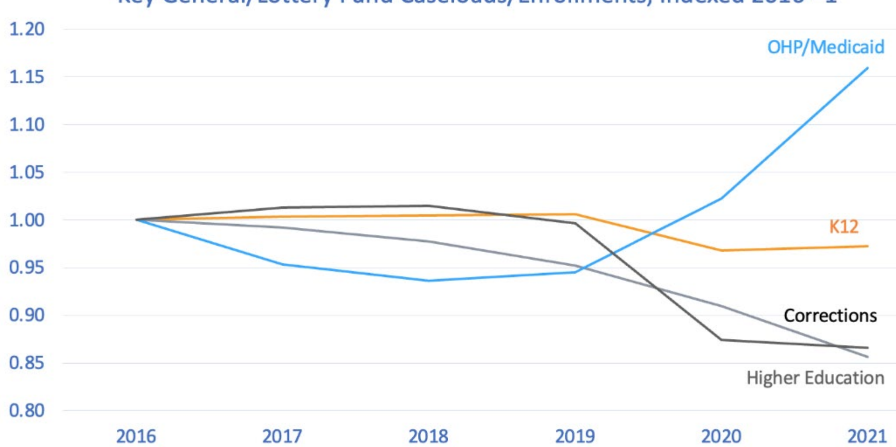
State budgeting has entered a period of considerable complexity. The pandemic upended the delivery and operations of many State-funded programs, and the immediate paths forward are far from clear for the Oregon Health Plan, K12 education, universities, colleges, and the prison system. Meanwhile, longstanding structural trends work in the background. Oregon's natural rate of population growth (births minus deaths) has turned negative. Child and young adult populations, traditionally key drivers of general fund expenditures, are projected to grow slowly through the end of this decade. And the PERS unfunded liability, which has undoubtedly increased during this year's bear market, will challenge budgets into the 2040s.

The State's myopic, two-year budget planning process was never a best practice, and it will fail Oregon in this dynamic policy and demographic environment. To deliver critical needs from housing supports to college aid, Oregon must modernize its budget tools and lengthen its fiscal outlook.

Where We Stand

In some respects, Oregon's fiscal picture has never looked better than in the fourth quarter of 2022. The pandemic economy proved to be a boon to state budgets in Oregon and elsewhere. That's thanks largely to an unprecedented, $5.7 trillion federal fiscal stimulus that more than covered the costs of public response to the Covid crisis. Additionally, many businesses were able to operate through the social distancing period, keeping their employees and maintaining profitability. So, both personal and corporate income taxes beat expectations. The upshot: General Fund revenues for the 2021-23 biennium are on track to exceed the State economist's original forecast by $5 billion, which—if trends hold—would trigger $3.7 billion and $1.3 billion personal and corporate tax kickers, respectively[1].

Key General/Lottery Fund Caseloads/Enrollments, Indexed 2016 =1



Source: OBC analysis of state agency data

While that's good news, the pandemic also disrupted the delivery of State services (see chart). Enrollments in the Oregon Health Plan are up because of the health emergency declaration but down in K12 and colleges as some students look for stable

[1] Oregon Office of Economic Analysis (December 2022) *Oregon Economic and Revenue Forecast.* Oregon Department of Administrative Services. Salem OR.

learning environments outside of public systems. And the number of inmates in state prisons has declined because local courts have been slow in processing criminal cases during 2020-2021. How, when, and whether these programs return to their pre-pandemic service levels is unclear.

Despite the disruption, the 2023-25 General/Lottery Fund budget appears to be roughly in balance—using conventional definitions of current service level and assuming the State's revenue forecast holds. If baseline conditions continue, the State would have roughly $30 billion in resources—after issuing the personal income tax kicker credits—to apply against $30 billion in current service needs. That's a big assumption given the growing likelihood of a recession. But even a recession is unlikely to trigger a fiscal crisis. Sizable reserves—$2 billion in two accounts[2]—could offset an estimated $4.1 billion in revenue losses through fiscal year 2027. In short, strong reserve policy, which operated during the record-long economic expansion of the 2010s, has put Oregon in a much better fiscal position than in the comparable periods before the 2001 and 2007 recessions.

Although resources appear to be in reasonably good shape under baseline assumptions, lawmakers will encounter challenging puzzles in every corner of the budget. Budget-defining activities will include:

- **Implementing a Basic Health Plan and a newly approved Medicaid waiver**. Maintaining pandemic-related health coverage for low-income Oregonians was a top concern in the 2022 legislative session. Many families with incomes between 139 and 200 percent of the Federal Poverty Level secured eligibility for the Oregon Health Plan during the Covid public health emergency (PHE) and, by federal law, could not be removed from coverage while the emergency was in effect. Post-PHE, the State will reinstate the pre-pandemic income eligibility rules, which could result in 300,000 individuals losing health coverage. HB 4035, which passed in the 2022 session, called on the Oregon Health Authority (OHA) to recommend options to approve access to, and lower costs of, health care. The Legislative Fiscal Office estimated a $130 million charge to the General Fund in 2023-25 contingent on the federal government contributing an additional $168 million[3]. The ultimate size of the covered population, and the share of costs picked up by the federal government, will be important drivers of the OHA budget for the next several years.

  Additionally, in September, the federal Center for Medicare and Medicaid Services (CMS) approved an extension of Oregon's Medicaid waiver that will allow the State to provide more seamless Medicaid coverage to children through age six and to cover the costs of evidence-based nutrition and housing supports for adults. Under the waiver, Oregon would spend $500 million through 2027 to secure $1.1 billion in federal matching dollars[4].

- **Addressing profound K12 needs with newly expanded resources**. K12 delivery and funding have appropriately received considerable attention during the pandemic. Remote learning led to historic learning losses just as new resources, including the Fund for Student Success and federal stimulus, filled school budgets. A compelling vision for learning recovery, in a period of growing budgets, has yet to emerge. The State's Quality Education Commission (QEC) published back-to-back, contradictory reports on resource adequacy. A November 2021 report concluded that implementation of the Student Success Act funding had come within six percent of the quality funding level in the 2021-23 biennium—the smallest gap in the two-decade history of the model. But just nine months later, the QEC's August 2022 report, altered the definition of a

---

[2] The December 2022 forecast estimates $0.7 billion and $1.3 billion balances in the Education Stability Fund and Rainy Day Fund, respectively, at the end of the 2021-23 biennium.

[3] See Legislative Fiscal Office Impact Statement assessed at https://olis.oregonlegislature.gov/liz/2022R1/Downloads/MeasureAnalysisDocument/64395

[4] https://oregoncapitalchronicle.com/2022/09/29/under-federal-1-billion-agreement-oregon-will-expand-medicaid-coverage/

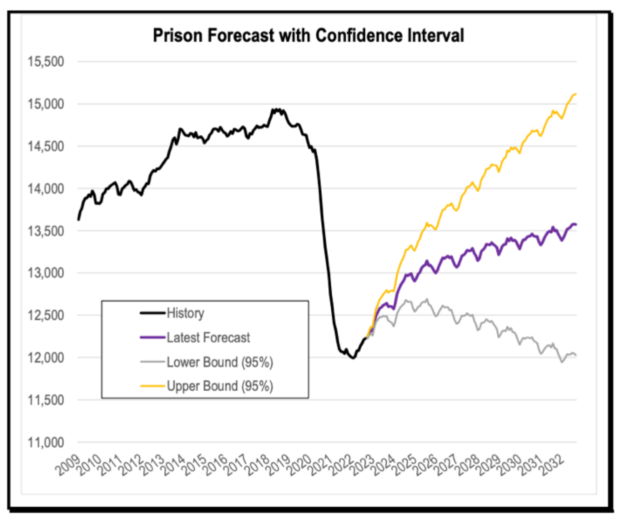
quality education[5], and asserted that the gap had returned to 26.9 percent[6]. In addition to changing the quality definition, the August report advanced a new method for calculating the K12 current service level, which if adopted, would set a higher starting point for K12 in legislative budget writing.

Beyond the adequacy debate, several other issues complicate the K12 budget. First is the future of enrollments, which fell during the pandemic. It's unclear whether public schools will fully recover their pre-pandemic shares of 5- to 17-year-old enrollees in coming years. Next is the timing and use of $1.1 billion in American Rescue Plan Act (ARPA) resources, which can be spent through the end of 2026. State appropriations should consider how and when those dollars will be deployed by school districts. And K12 will almost certainly receive a one-time appropriation through an anticipated corporate income tax kicker. Given its one-time nature, lawmakers will need to ensure that related investment does not trigger an ongoing, service-level obligation.

- **Navigating postsecondary education's cyclical and structural challenges as the 40-40-20 goal comes due**. The pandemic era disrupted the postsecondary system in two ways. First, online learning, with no significant discount on price, proved unattractive to many prospective students. Second, a tight labor market and good wage prospects, beginning in early 2021, raised the opportunity costs of attendance. As a result, college and university enrollments fell by 15 percent or more. The pandemic's cyclical challenges added to an important structural one: growth is slowing among the young, traditional college-age population.

  The enrollments declines come as employers still place a high value on postsecondary experience. Technological progress continues to eliminate routine work, and the jobs that remain consist of increasingly sophisticated tasks. The budget and operational challenges faced by colleges and universities are formidable. Making progress toward the state's ambitious postsecondary goals will require a sustained mix of institutional support and need-based aid in a system with higher rates of retention and shorter paths to completion.

- **Managing a highly uncertain corrections outlook.** Social distancing slowed prosecutions and yielded a sharp reduction in prison intakes during the pandemic. The inmate population fell from a pre-pandemic 14,500 to 12,000 in 2022. Where the population goes from here will be determined by broad, societal trends in criminal activity and changes in policy. Criminal activity has risen in Oregon and elsewhere after the pandemic, but it's unclear whether the increases will hold. On the policy front, forecasters must consider complicated interactions across five major laws[7]. In this complex policy and post-pandemic environment, the Office of Economic Analysis predicts the inmate population will increase gradually to 13,500 during 2022-2032 but suggests the 2032 population could be as low as 12,000 or as high as 15,000 (see



[5] In part by calling for lower class sizes than had been assumed in the original QEM.
[6] Oregon Quality Education Commission (August 2022) *Quality Education Model: Identifying Best Practices and Calculating the Cost of a Quality Education.* Oregon Department of Education. Salem, OR
[7] Measure 11, Measure 57, HB 3508, HB 3194, and HB 3078

chart). Getting a better handle on the rate of growth of the population is a moral and fiscal imperative. A return to 15,000 prisoners would widen the already sizable gap between Oregon's incarceration rate and those of almost every other country in the world. And it would pull resources, mostly from the General Fund, into an activity with lower benefits—relative to costs—than other criminal justice interventions.

- **Weighing the merits of a list of worthy new investments.** While the cost of current services for previously established, State programming may be in rough balance with the resources available to fund them, advocates will likely press a list of strong candidates for new investment. Expanded need-based aid for low-income postsecondary students is a top priority of the business community. Housing advocates will argue that the rate of home production is unlikely to accelerate absent infrastructure investments and other supports. And increased expenditures on childcare will be a priority in many corners. The list is long.

The unusual operating environments of the major State-funded programs, and their uncertain outlooks, will complicate budget building in new ways. Some may argue that a high degree of uncertainty argues for less data-driven decision making. The business community would counter that these kinds of complex environments are commonplace, and now is the time for the State to bolster its fiscal management capabilities and build a two-year budget that keeps the next ten years in mind.

Time to Take the Long View

Oregon's fiscal management generally earns good grades. The Volcker Alliance, a national nonprofit with an aim to strengthen government accountability and effectiveness, evaluates states on five "building blocks" of competent budgeting: budget forecasting, budget maneuvers, legacy costs, reserve funds, and transparency (see chart)[8].

PACIFIC STATES SIDE BY SIDE: Five-Year Average Grades, Fiscal 2015–19

	BUDGET FORECASTING	BUDGET MANEUVERS	LEGACY COSTS	RESERVE FUNDS	TRANSPARENCY
Alaska	B	C	B	A	A
California	B	A	D	A	A
Hawaii	A	A	D-	A	B
Oregon	C	A	B	B	B
Washington	A	B	C	A	B
US AVERAGE	C	B	C	B	B

NOTE States are grouped by US Census Bureau divisions.

Average grades are based on annual numerical scores. For more information, download *Truth and Integrity in State Budgeting: Preparing for the Storm* at VolckerAlliance.org.

Oregon earns a top grade for its lack of budget maneuvers (i.e., the State rarely uses one-time resources to fund on-going operations). The Alliance's research team, a mix of university professors and consultants, also gives the State good marks for keeping up with its legacy costs in pensions and employee health care, establishing two reserve funds, and maintaining reasonably transparent information on operational and capital expenditures.

However, Oregon gets its lowest grade for budget forecasting.

When it comes to long-term fiscal planning, Oregon flies blind. While policymakers keep a close eye on the ten-year outlook for General Fund revenue, expenditure forecasts don't go beyond the upcoming biennium. As a result, policymakers don't understand the relationships between revenue and spending trends and aren't able to forecast the benefits of actions and investments that could increase revenues

[8] The Volcker Alliance (2021) *Truth and Integrity in State Budgeting: Preparing for the Fiscal Storm.* The Volcker Alliance. New York, NY,

or reduce costs in the long term. The State budget is a powerful tool for meeting long-term State objectives. Oregon needs to include that use in the budgeting process.

Long-term budgeting has taken on increased importance in the current demographic and policy environment. Child and young adult populations—key drivers of General Fund spending for at least a quarter century—are projected to grow slowly through the end of this decade and into the next. Meanwhile, the oldest Baby-boomers are approaching 80, and some will need the State's help with assisted living and nursing care. And the State's pension system, despite multiple reforms, will continue to challenge public budgets in foreseeable ways for the next two decades.

In the past, some policymakers may have argued that long-term spending forecasts were unnecessary because, in a middling "tax effort" state, they could propose new taxes to fund unforeseen expenses or new programs. But the passage of the Student Success Act in 2019, and sizable local government ballot measures in the Portland area, have altered the prospects for new taxes. Personal income taxes rates in Portland are second only to New York City, and state-level business taxes are above the U.S. average. Adoption of new taxes, while not impossible, has certainly become less probable. That means that advocates for new investments will have to plan more carefully, and they will need tools to do that--starting with a long-term spending forecast.

When it comes to long-term fiscal planning, Oregon flies blind. While policymakers keep a close eye on the ten-year outlook for General Fund revenue, expenditure forecasts don't go beyond the upcoming biennium.

The Oregon Business Plan has consistently advocated for a stronger expenditure forecasting function in State government and supported the 10-year spending forecast recommendation advanced by the Task Force on Comprehensive Revenue Restructuring in 2009[9]. The State has periodically produced ad hoc forecasts to inform specific policy decisions. The staff capacity is available, and caseload and per capita cost projections exist throughout the executive branch agencies, but no one has assembled, organized, and summarized that collective knowledge.

A long-term expenditure forecast would match the time horizon of the revenue forecast and focus on programs funded by General and Lottery funds. For each major program, the forecasting exercise would ask three questions: 1) how many people will be served by the program over time, 2) what's the per capita cost of service and how will it change, and 3) how will other sources of revenue that are used to fund the program grow over time?

Our illustrative model draws on recent spending data and caseload projections from across State agencies (see chart). With more time and staff engagement, the model could disaggregate populations in Medicaid (adults and children), public postsecondary schools (universities and community colleges), and corrections (prison and community placement).

[9] See Legislative Revenue Office (January 2009) *Task Force on Comprehensive Revenue Restructuring: Final Report.* Oregon State Legislature. Salem, OR.

ILLUSTRATIVE LONG TERM FORECAST: Oregon General and Lottery Fund Expenditures, Actual and Projected, (in Millions of Dollars Unadjusted for Inflation)

Fiscal Year (Ending)	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Administration	124	130	137	143	277	289	210	219	179	186	194	203	211	221	230	240	250
Consumer/Bus. Svcs.	7	7	6	7	8	8	16	17	8	9	9	9	10	10	11	11	12
Econ. & Comm. Dev.	85	88	130	135	337	351	472	492	169	177	184	192	200	209	218	227	237
Education																	
K12	3,729	3,882	4,189	4,360	4,415	4,595	4,458	4,640	4,710	4,779	4,849	4,919	4,988	5,057	5,126	5,195	5,263
HECC	901	938	993	1,034	1,127	1,173	1,281	1,333	1,406	1,464	1,523	1,585	1,649	1,715	1,785	1,857	1,932
Other	161	168	189	197	205	214	229	238	247	257	268	280	292	304	318	331	345
Human Services																	
OHP/Medicaid	706	735	636	662	725	754	1,284	1,337	1,723	1,793	1,916	2,046	2,182	2,326	2,478	2,637	2,806
DHS-IDD	365	380	430	448	460	479	606	631	825	859	901	946	992	1,040	1,091	1,144	1,200
DHS-APD	419	436	491	512	533	555	704	733	829	863	1,017	1,187	1,374	1,580	1,806	2,055	2,328
DHS-CW	110	115	173	180	239	249	436	454	478	498	511	524	538	553	567	582	598
DHS-TANF	214	223	195	203	223	232	248	258	409	426	427	427	428	428	427	426	424
Other	581	604	679	707	869	904	719	748	886	924	964	1,005	1,048	1,094	1,141	1,190	1,241
Judicial Branch	352	366	373	388	427	445	444	462	487	507	529	552	576	601	626	653	681
Legislative Branch	42	44	55	58	80	83	92	96	72	75	79	82	85	89	93	97	101
Natural Resources	205	213	251	262	291	303	376	392	328	342	356	372	388	404	422	440	459
Public Safety																	
Corrections	786	819	857	892	944	982	559	581	1,118	1,166	1,216	1,268	1,323	1,380	1,439	1,501	1,565
Other	374	389	408	425	440	458	549	572	533	555	579	604	630	657	686	715	746
Transportation	63	66	67	70	115	119	78	81	88	91	95	99	104	108	113	118	123
TOTAL	9,226	9,603	10,263	10,682	11,715	12,193	12,763	13,284	14,494	14,972	15,618	16,300	17,018	17,776	18,575	19,419	20,311

What We Propose

Oregon's progress on fiscal management during the past two decades should be applauded. The creation and prudent use of two reserve accounts soften the impact of the next recession whenever it arrives. And increased clarity on the size and dynamics of the State's pension crisis has improved policymaking around it.

Now is the time to add to the State's fiscal toolkit. Oregon is entering a period with fewer revenue raising options available and some well-understood demographic trends on the horizon. Strong fiscal management demands better planning; to do that, we recommend that the State:

- **Consolidate caseload forecasting capabilities in the Office of Economic Analysis (OEA).** State Government's technical forecasting work is uncoordinated and scattered across the executive branch. OEA produces revenue, demographic, and corrections' forecasts while health, human service, and education agencies maintain their own estimates. Forecasting quality and consistency vary across agencies, and ties to the State's official economic forecasts are unclear. Finally, transparency is lacking. Some forecasts are widely shared while others require a public records request.

  The State should consolidate forecasting under the State economist and release forecasts for top programs twice a year. Results should be easily accessible to stakeholders, academics, the press, and the general public.

- **Produce a 10-year General/Lottery Fund budget outlook, projecting revenues and expenditures, in advance of long sessions.** Each biennium, the OEA should develop a consolidated revenue and expenditure forecast for programs financed with general and discretionary lottery fund resources. Expenditure forecasts draw on many more inputs and assumptions than revenue forecasts, and the complexity does not lend itself to a quarterly update schedule. A deep investigation of program trends and outlooks in advance of long legislative sessions would suffice.

For models, Oregon could look to a dozen states identified by the Volcker Alliance as strong performers. Those include three states--Nebraska, Texas, and Utah--that passed long-term budgeting mandates shortly before the pandemic and could share early implementation lessons.