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OREGON EDUCATION ASSOCIATION

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Date: Feb. 21, 2011

To: Senate Finance and Revenue Committee, Chair Burdick and Members

From: Laurie Wimmer, OEA Government Relations Consultant

RE: *SJR 26 and Companion Legislation [Rainy-day Funds and Kicker Reform]*

On behalf of OEA's 45,000 members, we are pleased to address ways to improve the stability and economic stimulus value of our budgeting and revenue systems. This committee's tireless work to search for viable solutions to both is acknowledged and appreciated by our members. Thank you for the opportunity to continue a dialogue about the best way to ensure that services Oregonians most value are prioritized, that key investments contributing to our state's economic health are protected, and that prudent reserving is bolstered in order to shield our most vulnerable in future downturns.

Our understanding is that SJR 26 is just a starting point for this session's conversation about our budget, our revenues, the kicker, our economy's health, and our strategic investments in Oregon and its people. With that in mind, we hope you take as constructive suggestions the comments we'd like to share about the positives and negatives of the resolution as drafted.

SJR 26 AS WRITTEN

The resolution appears to have the following elements:

- Imposes a "popuflation" spending cap, similar to one that Oregonians defeated in 2007's "TABOR" Ballot Measure 48 on a 54%-46% vote.
- Capitalizes Oregon's general "Rainy-day Fund" with a portion of unanticipated personal income tax revenues and 1 percent of General Fund or the biennial ending-fund balance (whichever is less).
- Establishes a new, third, reserve fund for use exclusively on state university budgets.
- Capitalizes this new reserve fund with unanticipated corporate income or excise tax revenues.
- Sends the entire package to the May 2011 primary ballot for a vote of the people.

Additionally, we've heard that other, companion measures may ultimately be linked to this package, such as a permanent capital gains income tax cut. ***We oppose the resolution as written, as well as the link to a fairness-destabilizing tax cut for Oregon's wealthy at a time that we're cutting services to our most vulnerable.***

WHAT WE SUPPORT IN THE RESOLUTION

The Oregon Education Association supports kicker reform that returns stability and fiscal prudence to Oregon's revenue and budgeting processes. We have been calling for economically sustainable and politically viable reform for at least two decades. We also agree that a stronger level of reserving is essential to protect vital services in future economic downturns. We know that this committee has the same goal of modifying our broken system. Thank you for your thoughtful efforts. We stand ready to work with you in any way possible to ensure that the ultimate package produced by this committee meets all tests of pragmatism and good policy.

WHAT WE'D FIX IN THE RESOLUTION

1. ***Delete the "Popuflation" spending cap.*** Oregon's current spending limit on the growth of state expenditures, enacted in 1979 and revised in 2001, works fine. No evidence has been presented to demonstrate that our limit, which is tied to personal income growth in the state, is insufficient to assure fiscal prudence in budgeting to actual need. A population+inflation measure, based on a look backward in order to budget forward, is arbitrary and would straitjacket state efforts to meet critical human needs in financially desperate times and good times alike. Furthermore, it would impose this basis at a historically low point in funding for K-12 – after well over $1 billion has been slashed from the resources our students need to thrive in the global economy.

2. ***Bolster existing reserve accounts, don't enact a third fund.*** According to the best practices of state reserving (see attached article from the *Center on Budget and Policy Priorities*), state reserves should be adequate, accessible when needed, fully utilizable, quickly recapitalized, and flexibly construed to meet the changing needs of a state's people. Adequacy is described as 15-20 percent of a current budget period (not based on the prior biennium). Accessibility is defined as usable once a fiscal emergency is present and without the arbitrary limitation of a supermajority vote requirement (which is really imposition of the anti-democratic principle of "minority rule"). Fully utilizable means that all monies are available when the rainy day is upon us. One of our two reserve pots meets this test; the other does not. Capitalization – sufficiency and speed – are issues that remain central to Oregon's budget instability. OEA supports a focus on this as a central problem to address in any final solution this committee should devise. Flexibility – the final quality of reserving best practices – means that funds should not be earmarked for limited budgetary expenditures only. The more constrained the use of funds, the less ability future lawmakers have to address the economic and human needs of its citizens in the future. This may hurt a state's efforts to recover its economic health and it certainly impairs its ability to deploy funds where they're most needed and desired by our citizens.

3. ***Ensure that the mechanics of the fix makes sense.*** SJR 26 imposes a formula for capturing revenues that institutes a "growth index" based on a prior biennium's actual General Fund appropriations as compared to the future biennium's estimated revenues. This number is a fictional number, which then becomes immortalized in the popuflation spending cap formula and thereby just adds ***more*** uncertainty and instability, not less, to our budget process. The reason the kicker is so destabilizing is that it is based on educated guesses, not actual receipts, and expects the impossible from our talented economists. Kicker reform needs to be based on an understandable method of dealing with unanticipated resources that aligns with our citizens' values of common sense and fairness. The first sum of unanticipated resources ought to go in

the existing reserve pot until it is sufficiently capitalized. We believe that all such resources on the corporate side ought to capitalize reserves, and we believe that the public agrees. A second sum ought to restore services that Oregonians deem essential – such as safety net programs and education. These are the budgetary investments that the state makes that actually increases demand in the state's economy, as Nobel laureates Peter Orszag and Joseph Stiglitz have demonstrated in their economics research. Finally, we believe that any unanticipated revenues beyond these levels ought to be rebated to taxpayers on the personal income tax side.

4. ***Do not trade fiscal stability through kicker reform for permanent fiscal insufficiency through unfair tax policy changes.*** Research has failed to demonstrate that state capital gains tax cuts stimulate investment, stimulate in-state-only investment, or lead to job growth. Indeed, Oregon experimented with an in-state investment-based capital gains tax program in the late 1990s that failed to yield that result, and it was ultimately cancelled. Some experts believe Oregon-only investment requirements may violate federal interstate commerce clause provisions of the US Constitution. In-state only requirements also fail to ensure that the investment will be made in job-creating expansions: more likely, a business will seek to invest in increased mechanization that lowers labor costs and could very likely further eliminate jobs. Finally, a lower rate on capital gains tends to favor those who least need state subsidy: those who've remained prosperous even in these hard economic times. Oregonians have proven with their vote last year to sustain measures 66 and 67 that they value fairness and equity in their revenue system. A capital gains tax cut that does not guarantee economic stimulus and job creation, but only rewards the wealthy while services continue to be devastated, would be an unpopular system change in the eyes of the voters, we believe. We would be happy to provide the committee with extensive research on this point – that cutting capital gains rates would do nothing to guarantee job growth in our state – if you would like those materials and citations.

HOW TO BUILD A WINNING PACKAGE

We believe that we should begin by developing consensus on which "problem" we're trying to solve, and then move to a singular goal fixing it. We suggest that a work group be created to propose the elements of a workable package of research-supported, best-practice-based reserve solutions and kicker reforms that will meet a voter viability test. We would ask that this committee instruct the group to avoid merely political solutions that pull other interests' policy priorities into an untenable policy bargain. Among the work group's goals should be solutions that include proven economic stimulus tools and that align with best budgeting practices. We think this would be the best way to ensure that the package you send to voters balances competing interests without compromising fiscal prudence and revenue sustainability for the long term.

Some elements of such a package, we believe, are:

- RESERVING REFORM: Ensure that Oregon's existing rainy-day reserves are adequately and consistently capitalized. If a portion of our most volatile revenue sources (such as capital gains and corporate income taxes) are put into reserves, we will be able to reach adequate reserving levels. Furthermore, we should amend our current reserving rules to remove unnecessary obstacles for the prudent use of the money in future emergencies. Finally, we should resist the temptation to lock in a percent of General Fund or earmarking to ensure maximum fiscal flexibility.

- BUDGET PRIORITIES: Research shows that the best way to build out of our state's economic woes is to prioritize state investments that have a stimulus effect the economy. Education is the absolute best investment that the state can make with respect to this objective. For every 10 jobs in public schools, nine are supported in the private sector. Investing $1 today in Oregon's number-two employer – K-12 education – is fully reimbursed in five years and yields a positive lifetime return of 14.3 percent. Cutting taxes does not have the same economic stimulus value to the state that education investing at all levels has on Oregon's economic well being.

- KICKER REFORM: Permanently invest unanticipated corporate tax revenues in the general reserve fund, along with the ending balances already dedicated to this fund. Economist Richard Sims told Oregon legislators in 2007 that the corporate kicker has "zero value for informing or affecting business decisions" because it's unpredictable and it does not promote economic growth. In fact, it is the use of the reserved resources, when deployed on vital services, that has a positive stimulus effect. This change therefore keeps faith with the objective of strengthening Oregon's economy. Reform the personal income tax side only if a means to do so is found that aligns with Oregonians' values of fairness and fiscal responsibility, such as "windfall reserving".

- SPENDING LIMIT: Oregon's balanced-budget requirement acts as a *de facto* spending limit; additionally, we have a second limit tied to our citizens' personal income growth; finally, the kicker itself acts as a third spending limit. We do not need a fourth, draconian "TABOR-style" limit that voters have already overwhelmingly rejected just four years ago. To enact such a mechanism would forever end the quest for education funding adequacy, for instance, and would only hurt Oregon's economy in the long run.

Thank you for your consideration of our remarks on these vitally important issues.