

II. REVENUE FORECAST

Summary

The growing pessimism and uncertainty felt among economic forecasters has yet to be reflected in Oregon's personal income tax collections. Personal income tax revenues have grown at double-digit rates for more than a year, and have shown few signs of slowing down so far this fall. Strength in personal income tax collections is more than making up for weakness in corporate income tax collections and lottery transfers. Overall, Oregon's recent growth in tax revenues ranks among the top handful of states, with only energy producing regions faring better.

Heading into 2012, many of the factors supporting Oregon's strong revenue gains will go away. Not only has growth in employment and wages slowed, many nonwage forms of taxable income are weakening as well. The declines in stock prices and business income seen at the end of the summer will lead to less growth in taxable capital gains and bonuses this year. Also, households have depended on a wide range of alternative taxable income sources in recent years to help replace lost labor income. Some of these sources, including unemployment insurance payments and tax-deferred savings accounts such as IRAs, have been heavily tapped, and will weaken going forward.

Given these challenges, revenue growth is expected to be cut in half in the months ahead. Income tax collections are expected to increase by roughly \$600 million over the current biennium, matching the growth seen in fiscal year 2011 alone.

Such a slowdown in collections has been assumed in the outlook for several months. The current outlook is only marginally more pessimistic than was the September forecast. However, the risks to the outlook are clearly skewed to the downside. There is at least a one in three chance that the U.S. economy will slip back into recession, which would certainly drag Oregon's regional economy down with it. In such a scenario, the forecast for tax revenues would fall on the order of \$1 billion.

After the smoke clears, revenue growth in Oregon and other states will face considerable downward pressure over the 10-year extended forecast horizon. As the baby boom population cohort works less and spends less, traditional state tax instruments such as personal income taxes and general sales taxes will become less effective, and revenue growth will fail to match the pace seen during recent periods of economic expansion.

A. 2011-13 General Fund Revenues

Led by personal income tax collections, general fund revenues are posting large gains entering the 2011-13 biennium. Temporary factors will help support healthy growth in personal income tax collections in the near term, but growth in collections will lose a steam in the second half of the biennium. Corporate tax collections are now falling rapidly, with the boom in underlying corporate profits having come to an end.

Largely due to a weaker outlook for global demand, expected revenues for the 2011-13 biennium are somewhat weaker than what was predicted in the September 2011 forecast. The forecast for General Fund revenues for 2011-13 is now \$13,732 million. This represents a decrease of \$84.3 million (-0.6%) from the September 2011 forecast.

Table R.1

2011-13 General Fund Forecast Summary					
(Millions)	2011 COS Forecast	September 2011 Forecast	December 2011 Forecast	Change from Prior Forecast	Change from COS Forecast
Structural Revenues					
Personal Income Tax	\$12,193.6	\$12,035.1	\$12,001.4	-\$33.7	-\$192.2
Corporate Income Tax	\$894.2	\$875.5	\$821.4	-\$54.2	-\$72.9
All Other Revenues	\$944.2	\$928.8	\$932.3	\$3.6	-\$11.9
Gross GF Revenues	\$14,032.0	\$13,839.4	\$13,755.1	-\$84.3	-\$276.9
Administrative Actions ¹	-\$23.1	-\$23.1	-\$23.1	\$0.0	\$0.0
Legislative Actions	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Net Available Resources	\$14,008.9	\$13,816.3	\$13,731.9	-\$84.3	-\$276.9
Confidence Intervals					
67% Confidence	+/- 7.8%		\$1,068.0	\$12.69B to \$14.82B	
95% Confidence	+/- 15.5%		\$2,136.0	\$11.62B to \$15.89B	
1 Reflects cost of cashflow management actions, exclusive of internal borrowing.					

The forecast for the 2011-13 biennium is now \$277 million below the Close of Session forecast. Given the strong employment gains seen at the time, the Close of Session forecast was somewhat more optimistic than other recent forecasts produced before or since.

Personal Income Tax

Personal income tax collections were \$1,236 million for the first quarter of fiscal year 2012, \$28.9 million (2.0%) above the latest forecast. Compared to the year-ago level, total personal income tax collections were up 12.0% relative to a forecast of 9.8% growth. Table B.8 in Appendix B presents a comparison of actual and projected personal income tax revenues for the fourth quarter of fiscal year 2011.

Although personal income tax collections have been tracking ahead of projections for several months, the forecast for total personal income tax receipts during the current biennium was reduced by \$34 million from the September forecast. This small revision can be traced to weaker expectations for growth, and disappointing recent job counts.

Corporate Income Tax

Corporate income taxes equaled \$121 million for the first quarter of fiscal year 2012, \$12.0 million below the September forecast. Quarterly corporate receipts were 7.9% lower than figures from a year ago. Table B.8 in Appendix B presents a comparison of actual and projected corporate income tax revenues for the fourth quarter of fiscal year 2011.

Corporate profits, and associated tax collections, are cooling off rapidly after reaching record highs. Profits and corporate tax collections are notoriously volatile, with collections often cut in half in the year immediately following profit booms. The expectation for a sharp correction in corporate income tax collections over the coming year has been built into recent forecasts. With collections tracking behind the forecast, and a weaker profit outlook, particularly among financial

institutions, the decline in corporate income taxes is now expected to be more pronounced. As a result, the September outlook for 2011-13 was revised downward by \$54 million (6.2%).

Non-income Tax Sources of Revenue

All other revenues will total \$932 million for the biennium, an increase of \$4 million (0.4%) from the prior forecast. Downward revisions to the outlook for cigarette taxes and criminal fines and assessments were offset by a stronger outlook for court fees and a recently enacted bottle surcharge for alcohol.

B. Extended General Fund Revenue Outlook

Table R.2 exhibits the long-run forecast for General Fund revenues through the 2019-21 biennium. Users should note that the potential for error in the forecast increases substantially the further ahead we look.

Table R.2

General Fund Revenue Forecast Summary (Millions of Dollars, Current Law)												
Revenue Source	Forecast 2009-11		Forecast 2011-13		Forecast 2013-15		Forecast 2015-17		Forecast 2017-19		Forecast 2019-21	
	Biennium	% Chg	Biennium	% Chg	Biennium	% Chg	Biennium	% Chg	Biennium	% Chg	Biennium	% Chg
Personal Income Taxes	10,467.2	3.7%	12,001.4	14.7%	13,689.5	14.1%	15,526.3	13.4%	17,306.3	11.5%	19,137.9	10.6%
Corporate Income Taxes	827.6	20.9%	821.4	-0.8%	1,070.0	30.3%	1,079.8	0.9%	1,092.3	1.2%	1,164.2	6.6%
All Others	318.2	-63.1%	932.3	193.0%	907.8	-2.6%	953.6	5.0%	1,011.7	6.1%	1,087.2	7.5%
Total General Fund	11,613.1	-0.2%	13,755.1	18.4%	15,667.3	13.9%	17,559.7	12.1%	19,410.3	10.5%	21,389.3	10.2%
<i>Kicker Distributions</i>	-		-		-		-		-		-	
Total Revenue	11,613.1	-8.7%	13,755.1	18.4%	15,667.3	13.9%	17,559.7	12.1%	19,410.3	10.5%	21,389.3	10.2%

Other taxes include General Fund portions of the Eastern Oregon Severance Tax, Western Oregon Severance Tax and Amusement Device Tax.
Commercial Fish Licenses & Fees and Pari-mutual Receipts are included in Other Revenues

General Fund revenues will total \$15,667 million in 2013-15, an increase of 13.9% percent from the prior period, and \$265 million (1.7%) below the September forecast. In 2015-17, revenue growth will moderate to 12.1%, followed by 10.5% growth in 2017-19 and slower rates of around 10% to in subsequent biennia. The slowdown in long-run revenue growth is largely due to the impact of demographic changes. Revenues in 2015-17 and beyond are expected to be smaller than in the September forecast, largely due to the downgraded outlook for global demand. Table B.2 in Appendix presents a more detailed look at the long-term General Fund revenue forecast

C. Tax Law Assumptions

The revenue forecast is based on existing law, including actions signed into law during the 2011 Oregon Legislative Session. OEA makes routine adjustments to the forecast to account for legislative and other actions not factored into the personal and corporate income tax models. These adjustments can include expected kicker refunds, when applicable, as well as any tax law changes not yet present in the historical data. A summary of actions taken during the 2011 Legislative Session can be found in Appendix B Table B.3.

Although based on current law, many of the tax policies that impact the revenue forecast are not set in stone. In particular, sunset dates for many large tax credits have been scheduled. As credits are allowed to disappear, considerable support is lent to the revenue outlook in the outer years of the forecast. To the extent that tax credits are extended and not allowed to expire when their sunset dates arrive, the outlook for revenue growth will be reduced.

D. Forecast Risks

The latest revenue forecast for the current biennium represents the most probable outcome given available information. OEA feels that it is important that anyone using this forecast for decision-making purposes recognize the potential for actual revenues to depart significantly from this projection.

Currently, the overwhelming risk facing the revenue outlook is the threat that the U.S. economy will slip back into recession in the near term. Such a scenario, however it played out, would result in drastic revenue losses.

In our recessionary scenario, job cuts and income losses begin across a range of industries this fall. Over the next year, all 30,000 jobs Oregon gained since the previous trough in 2009 would be lost. A recession of this magnitude would not be a severe one, with job losses around half the size of what were seen in 2001-03. The working assumption is that there are few excesses to be wrung out, with auto sales, construction activity, business inventories and the like all fairly lean. Job losses would be most concentrated among manufacturing, leisure/hospitality, retailing and government enterprises.

Should a recession of this nature ensue, FY2011-13 biennial income tax revenues would be reduced on the order \$833 million. In addition to income taxes, which we can formally model under alternative scenarios, other general fund taxes would also decline, lowering the general fund by an additional \$100 to \$200 million in 2013-15.

Table R.2a

R.2a Alternative Scenarios for Major General Fund Revenues

	Baseline	Compared to Baseline				Growth Rates		
		Pessimistic	Losses	Optimistic	Gains	Baseline	Pessimistic	Optimistic
Personal Income Taxes								
(\$ thousands)								
FY 2011	5,524,015	5,524,015	0	5,524,015	0			
FY 2012	5,865,021	5,502,507	-362,514	6,276,716	411,695	6.2%	-0.4%	13.6%
FY 2013	6,136,362	5,765,279	-371,083	6,579,265	442,902	4.6%	4.8%	4.8%
FY 2014	6,590,976	6,214,558	-376,417	7,099,645	508,670	7.4%	7.8%	7.9%
FY 2015	7,098,476	6,713,093	-385,383	7,674,707	576,231	7.7%	8.0%	8.1%
Corporate Excise Taxes								
(\$ thousands)								
FY 2011	468,606	468,606	0	468,606	0			
FY 2012	404,323	355,998	-48,325	444,594	40,271	-13.7%	-24.0%	-5.1%
FY 2013	417,028	366,015	-51,013	458,118	41,089	3.1%	2.8%	3.0%
FY 2014	517,102	464,838	-52,265	561,461	44,359	24.0%	27.0%	22.6%
FY 2015	552,912	498,679	-54,232	597,373	44,461	6.9%	7.3%	6.4%

Note: Optimistic and Pessimistic alternatives do not reflect statistical ranges, but rather likely scenarios for near term business cycles that are stronger/weaker than the baseline.

E. Lottery Earnings Forecast

Table R.3 presents a summary of lottery earnings and distribution for the 2011-13 biennium. Projected lottery earnings will total \$1,099.2 million, a decrease of \$25.4 million from the prior forecast. Overall lackluster collections stem from video lottery sales, which dominate overall lottery earnings. Although growth has been relatively slow, lottery revenues have stabilized and returned to continued growth in fiscal year 2011. Revenue fell sharply in the wake of the recession and enactment of the smoking ban. Including the beginning balance and other earnings, total available resources equal \$1,101.9 million. After adjusting for programs that receive a strict percentage of lottery transfers and incorporating changes to distributions made during the 2011 session, the current forecast for the ending balance is \$8.0 million.

Table R.3
2011-13 Lottery Fund Forecast Summary

	Close of 2011 Session	Sept 2011 Forecast	Dec 2011 Forecast	Changes from:	
				Sept 2011 Forecast	Close of 2011 Session
Transfers of Lottery Earnings					
Traditional Games	\$128.5	\$128.7	\$120.1	-\$8.6	-\$8.4
Video Lottery	\$991.8	\$987.9	\$971.1	-\$16.8	-\$20.7
Administrative Savings	\$8.0	\$8.0	\$8.0	\$0.0	\$0.0
Total Transfers	\$1,128.3	\$1,124.6	\$1,099.2	-\$25.4	-\$29.1
Economic Development Fund					
Beginning Balance	\$0.2	\$0.2	\$0.2	\$0.0	\$0.0
Transfers from Lottery	\$1,128.3	\$1,124.6	\$1,099.2	-\$25.4	-\$29.1
Other earnings ¹	\$2.5	\$2.5	\$2.5	\$0.0	\$0.0
Total Available Resources	\$1,131.0	\$1,127.3	\$1,101.9	-\$25.4	-\$29.1
Dedicated Distributions ²	\$432.9	\$427.8	\$423.3	-\$4.6	-\$9.6
Other Legislatively Adopted Allocations	\$670.6	\$670.6	\$670.6	\$0.0	\$0.0
Total Distributions	\$1,103.5	\$1,098.4	\$1,093.9	-\$4.6	-\$9.6
Ending Balance	\$27.5	\$28.8	\$8.0	-\$20.8	-\$19.5

Footnotes:

1. Includes interest earnings and reversions.

2. Includes Education Stability Fund (18%), Parks and Natural Resources Fund (15%), Sports Lottery (1%), Gambling Addiction (1%), and County Distributions

In the current biennium, video lottery sales are forecasted to grow slowly as employment and income grow is likewise relatively slow. Over the extended forecast horizon, video lottery sales are expected to grow at rates similar to overall consumer spending. This has not been the case in past years, with gains in video lottery having outstripped spending on other items throughout their history. Eventually as video games lose some of their novelty, sales growth will slow to more

sustainable levels. The extended outlook for lottery earnings can be found in Table B.9 in Appendix B.

F. Overview of Budgetary Reserves

The state currently administers two general reserve accounts, the Oregon Rainy Day Fund (ORDF) and the Education Stability Fund (ESF). This section updates balances and recalculates the outlook for these funds based on the December revenue forecast.

Established by the 2007 Legislature, the ORDF is funded from ending balances each biennium, up to one percent of appropriations. The Legislature can deposit additional funds, as it did in first populating the ORDF with surplus corporate income tax revenues from the 2005-07 biennium. The ORDF also retains interest earnings. Withdrawals from the ORDF require one of three triggers, including a decline in employment, a projected budgetary shortfall, or declaration of a state of emergency, plus a three-fifths vote. Withdrawals are capped at two-thirds of the balance as of the beginning of the biennium in question. Fund balances are capped at 7.5 percent of General Fund revenues in the prior biennium.

The ESF gained its current reserve structure and mechanics via constitutional amendment in 2002. The ESF receives 18 percent of lottery earnings⁴, deposited on a quarterly basis. The ESF does not retain interest earnings. The ESF has similar triggers as the ORDF (in fact, the ORDF was modeled on the ESF), but does not have the two-thirds cap on withdrawals. The ESF balance is capped at five percent of General Fund revenues collected in the prior biennium.

Budgetary Reserve Outlook

Table R.4 presents projected balances for the ORDF and ESF. In 2009-11, \$115.7 million from the ORDF and \$84.3 million from the ESF were transferred to the State School Fund. The ORDF ended 2009-11 with a balance of \$10.4 million, while the ESF ended the biennium with a balance of \$5.1 million. The General Fund ending balance for 2009-11, \$35.2 million, was deposited into the ORDF at the beginning of the 2011-13 BN.

In 2011-13, the ESF is expected to see deposits of \$188.0 million based on Lottery sales, while scheduled withdrawals this biennium total \$182.7 million. The projected ending balances for both the ORDF and ESF total \$56.7 million this biennium.

B.10 in Appendix B provides detailed information for Oregon's budgetary reserves.

Table R.4
Oregon's Budgetary Reserves

(Millions)	2009-11 Biennium	2011-13 Biennium	2013-15 Biennium
Rainy Day Fund			
Beginning Balance	\$112.5	\$10.4	\$45.9
Net Deposits ³	-\$103.4	\$35.2	\$197.5
Interest	\$1.3	\$0.3	\$6.5
Ending Balance¹	\$10.4	\$45.9	\$249.9
Education Stability Fund			
Beginning Balance	\$0.0	\$5.1	\$10.7
Net Deposits	\$101.4	\$188.0	\$203.5
Interest ²	\$1.0	\$0.5	\$4.6
Withdrawals	-\$97.4	-\$182.7	-\$4.6
Ending Balance	\$5.1	\$10.7	\$214.3
Total Reserves	\$15.5	\$56.7	\$464.2

Footnotes:

1. Under current law, only 2/3rds of the beginning balance is available for withdrawal. Withdrawal subject to economic and financial triggers.
2. Education Stability Fund interest is distributed to the Oregon Education Fund (75%) and the State Scholarship Commission (25%).
3. Includes transfer of ending General Fund balances, up to 1% of budgeted appropriations, as well as private donations.

⁴ Five percent of these transfers are deposited to the Oregon Growth sub-account. Due to the illiquid nature of this sub-account, only funds in the main account are included in the figures presented here.