PERSPECTIVES ON OREGON GOVERNMENT FINANCE
Prepared by the Oregon State University Extension Service

7 FREQUENTLY ASKED QUESTIONS ABOUT TAXES & SPENDING IN OREGON

As Oregonians engage in a debate about state taxes and spending, they need access to relevant information. Our goal with this publication is to shed light on the state's fiscal situation and to address common questions related to taxation and government spending in Oregon.

Perceptions differ about the facts. Are taxes (and expenditures) higher or lower here than elsewhere? Have they risen or fallen over time? Answering these questions is an important first step toward a constructive dialogue.

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References

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FAQ #1: Are Oregon's taxes high or low compared to other states'?

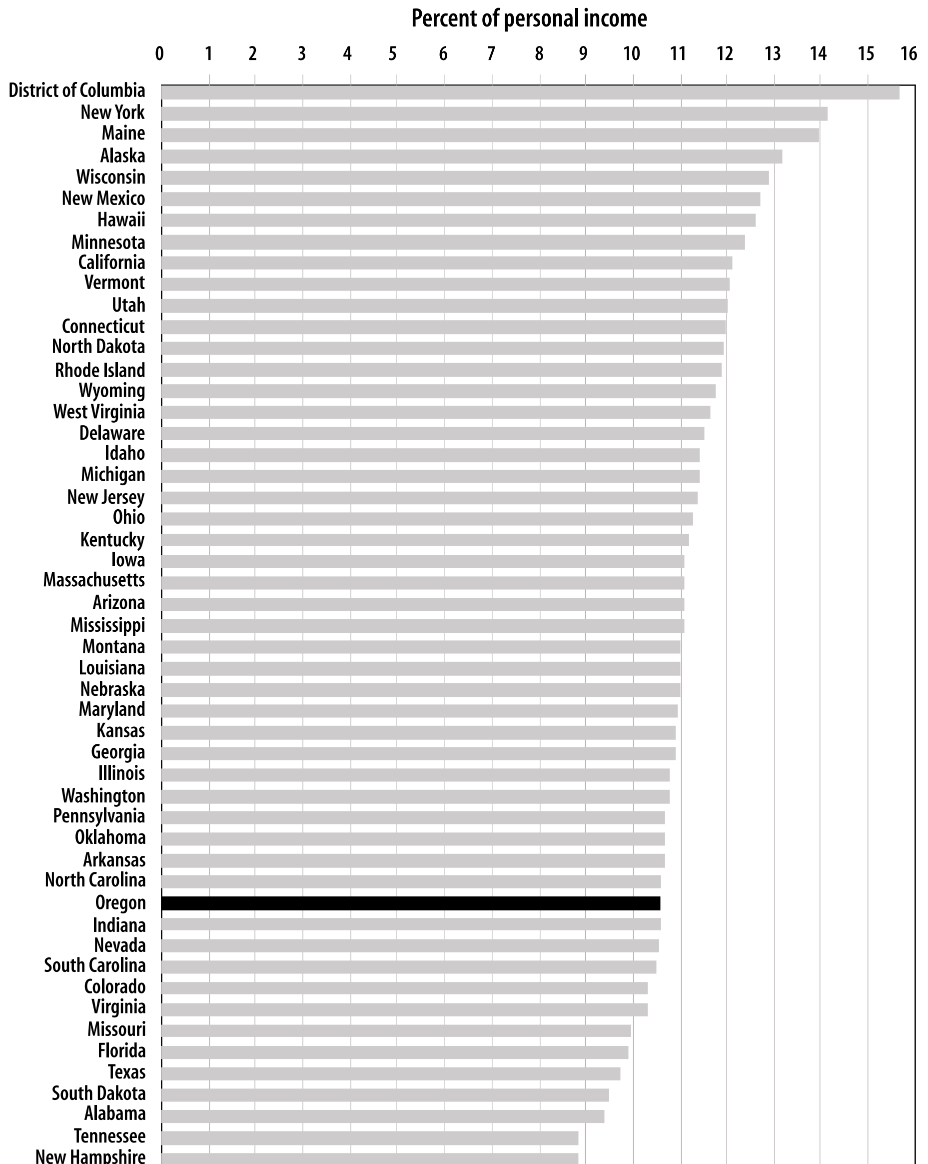
A good way to compare the "tax burden" across states is to look at the share of personal income that goes to state and local taxes. In Oregon, these taxes were 10.6 percent of personal income in 2000, placing Oregon 39th among the 50 states and the District of Columbia (see graph).

These rankings change each year as taxes and incomes rise and fall at different rates in different states. Oregon's rank is lower now than in the past. In 1980, Oregon's taxes as a share of personal income ranked 23rd in the nation. By 1990, Oregon's ranking had risen to 13th, before falling to 39th in 2000.

A low state-local *tax burden* does not necessarily mean low state-local *revenues* as a share of personal income. The reason is that some revenues come from nontax sources, such as federal government payments, licensing and user fees, and lottery receipts. Oregon's general state-local revenue as a share of personal income is 23.5 percent, placing it 10th among the states. (The national average is 19.8 percent.)

Over half the difference between Oregon's general revenues and the national average is due to Oregon's above-average payments from the federal government. These payments amount to 5.9 percent of personal income in Oregon, compared to 3.8 percent nationally.

Ranking by state and local taxes



Note: Rankings based on 2000 data.

Sources

U.S. Bureau of the Census. http://www.census.gov/govs/www/statetax.html

U.S. Department of Commerce, Bureau of Economic Analysis. http://www.bea.gov/

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FAQ #2: Have Oregon's taxes risen or fallen over time?

The dollar value of state and local taxes in Oregon has been rising for decades (top graph). Some of this upward trend is due to inflation and some to increasing population and income.

If we adjust for inflation, population, and income growth, we see a very different pattern. One way to make these adjustments is to look at taxes as a share of personal income. In those terms, Oregon's *state and local tax* revenues declined slightly between the early and late 1990s (bottom graph). As a share of personal income, *state* tax revenues were flat during the 1990s, fluctuating between 5.75 and 6.25 percent from 1992 to 2001.

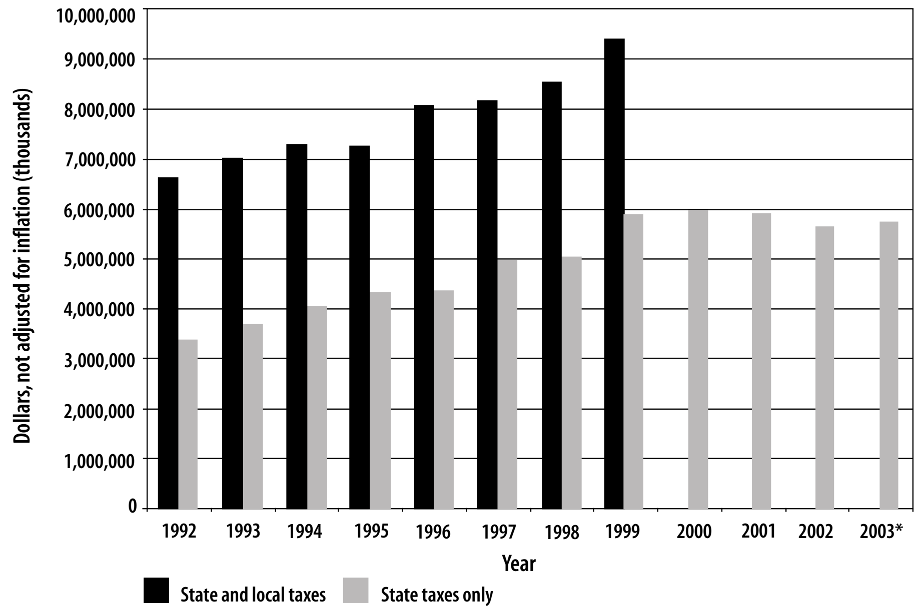
More recent data are available only for state tax revenues. In both unadjusted dollar terms (top graph) and as a share of personal income (bottom graph), revenues declined in Oregon after 2000.

Total state revenues and expenditures represent a greater share of personal income and may exhibit somewhat different patterns. For example, both total revenues and expenditures reflect nontax revenue such as federal funds and lottery receipts.

Sources

U.S. Bureau of the Census. http://www.census.gov/govs/www/statetax.html
U.S. Department of Commerce, Bureau of Economic Analysis. http://www.bea.gov/

Oregon state and local taxes (dollars)



Oregon state and local taxes as a share of personal income

*Combined data for state and local taxes are available only through 1999.
2003 figures for state tax share of personal income based on January–June data.

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FAQ #3: How did a mild recession cause large state budget shortfalls across the nation?

The recent fiscal difficulties faced by nearly all states—including Oregon—were caused by several factors.

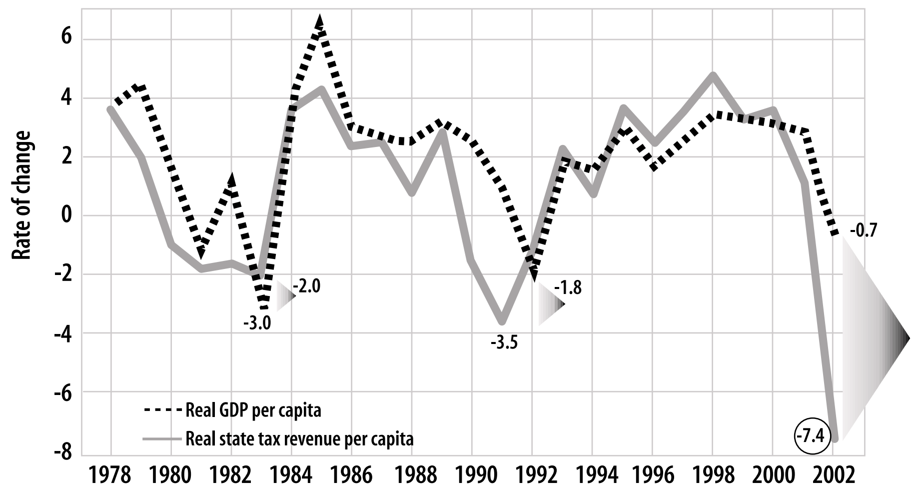
Recession and slow recovery: As incomes declined during the 2001 recession, state revenues fell dramatically. Nationally, in the 2002 fiscal year, state revenues fell an estimated $60 billion below projections based on previous growth rates (Orszag 2003). State tax revenues typically rise by 2 to 3 percent per year (adjusted for inflation) and in line with economic growth. However, they fell by 7.4 percent in 2002 nationally, a much larger decline than during either the 1990–1991 recession or the 1980–1982 recession (top graph).

Stock market decline: In the late 1990s, state revenues increased significantly on the wave of high-tech and stock market growth. The bursting of the stock market bubble resulted in a sudden drop in income from capital gains (bottom graph). This in turn exacerbated the decline in state revenues, especially in states that rely heavily on income taxes (see FAQ #4).

Previous state spending growth: Due to the strong economy, per-capita state and local expenditures grew by about 10 percent in real terms between the early and late 1990s. As a share of personal income, they declined by about 10 percent. Still, expenditure growth made it more difficult for states to respond to revenue shortfalls following the stock market decline.

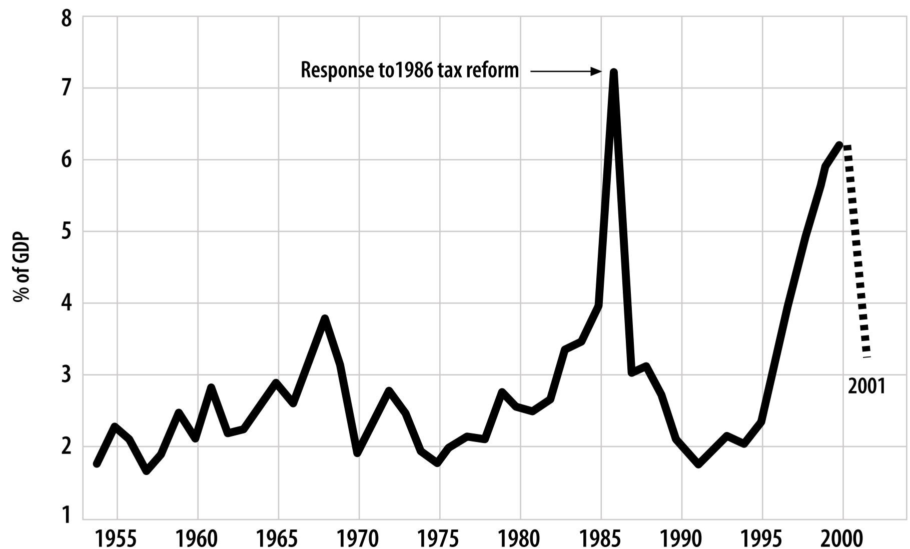
Medicaid expenses: State outlays for Medicaid soared in the late 1990s due to expanded enrollment and rising health care costs. During the 1990s, these costs

State tax revenue has fallen far more sharply relative to the economy than in the 1980–82 and 1990–91 recessions



Source: Boyd 2003a
All figures adjusted for inflation.

Capital gains as % of Gross Domestic Product



Source: Boyd 2003a

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were effectively shifted from the federally financed Medicare program to the partially state-financed Medicaid program, and thus from the federal budget to state budgets (Orszag 2003). State Medicaid expenses rose by almost 12 percent in both 2001 and 2002, twice as fast as in previous years (Orszag 2003).

Lack of reserves: States failed to accumulate reserves during the boom of the 1990s in anticipation of future economic downturns. Although many states had "rainy day funds," none was adequate to protect expenditures during the 2001 recession. Some states set low limits on the size of rainy day funds. Also, it generally is difficult to protect large reserves in the face of pressure to either refund revenues to citizens or spend them.

Sources

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Boyd, Donald. 2003b. The State Fiscal Crisis: How We Got Here, Where We May Be Going. Presented to the National Conference of State Legislatures' Leadership Staff Seminar, Charleston, West Virginia. http://stateandlocalgateway.rockinst.org/fiscal_pub/other/

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Orszag, Peter R. 2003. The State Fiscal Crisis: Why It Happened and What to Do About It. The Milken Institute Review, third quarter.

Western Rural Development Center. 2003. Fiscal Crisis in State Governments: A Focus on 13 Western States. WRDC Public Policy Information Brief No. 1, 2. http://extension.usu.edu/WRDC/

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FAQ #4: Why was Oregon's state budget hit so hard in the recent recession?

All five of the nationwide factors identified in FAQ #3 had strong impacts on Oregon. In addition, several others factors converged to make Oregon's fiscal situation among the worst in the country—a kind of fiscal "perfect storm." Those factors included the following.

Reliance on income tax: Oregon relies more heavily on income taxes than any other state. Income taxes are particularly "procyclical," meaning they rise when the economy is strong and fall when it is weak. Sales taxes also are procyclical, but they are more stable than income taxes. One reason is that individuals tend to save in good years and spend out of their savings in bad years; thus, spending fluctuates less than income. Also, the sales tax is a single flat rate. With income taxes, on the other hand, not only does taxable income drop during a recession, but lower incomes also mean lower tax rates.

On average, states rely on income taxes for 37 percent of state tax collections. Oregon leads the nation in its reliance on income taxes, at 74.4 percent (U.S. Bureau of the Census).

Stock market decline: Because of Oregon's heavy reliance on income taxes, including taxes on capital gains, the burst of the stock market bubble had a particularly large impact on state revenues here. Oregon's state revenues dropped 5.1 percent in 2001 due to reduced capital gains revenues alone. Only California was hit harder than Oregon by this factor.

No rainy day fund: Most states have "rainy day" funds—reserves accumulated during prosperous years or from unanticipated revenues to be used during economic hard times when revenue collections decline. Oregon is one of only five states without a general rainy day fund. (Oregon does have a small reserve fund for education, the Education Stability Fund.) In addition, Oregon has a "2 percent surplus kicker" law, which automatically returns general fund revenues to taxpayers in years when receipts exceed forecasted revenue by more than 2 percent. This law makes it difficult for the state to build up reserves.

Constraints on tax increases: Oregon has a supermajority rule for tax increases; in order to enact a tax increase, three-fifths of each house of the legislature must support the measure. This made it difficult for the legislature to agree on a temporary tax increase as a way to close the budget gap.

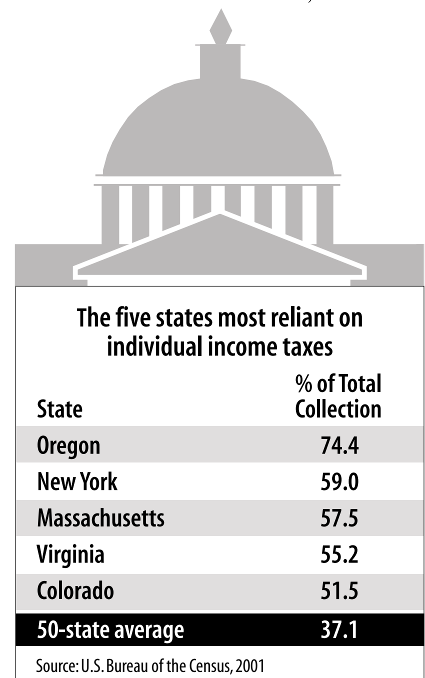
Limitations on property taxes: Measures 5 and 50, passed in the 1990s, limit the growth of property taxes. Prior to their passage, property taxes were the major source of funding for K–12 education and an important source for local government services. As a result of limits on property taxes, the state began to pick up a larger share of education funding, beginning in the early 1990s. During the mid- and late 1990s, the state increased education funding out of increased income tax revenues. As state revenue fell during the 2001 recession, the state was less able to finance education spending.

Due to these five factors, Oregon's public finance system was more vulnerable and less resilient to an economic downturn than many other states'. As a result, Oregon has faced greater fiscal challenges.

Sources

U.S. Bureau of the Census. http://www.census.gov/govs/www/statetax.html

Western Rural Development Center. 2003. Fiscal Crisis in State Governments: A Focus on 13 Western States. WRDC Public Policy Information Brief No. 1, 2.



The five states most reliant on individual income taxes

State	% of Total Collection
Oregon	74.4
New York	59.0
Massachusetts	57.5
Virginia	55.2
Colorado	51.5
50-state average	37.1

Source: U.S. Bureau of the Census, 2001

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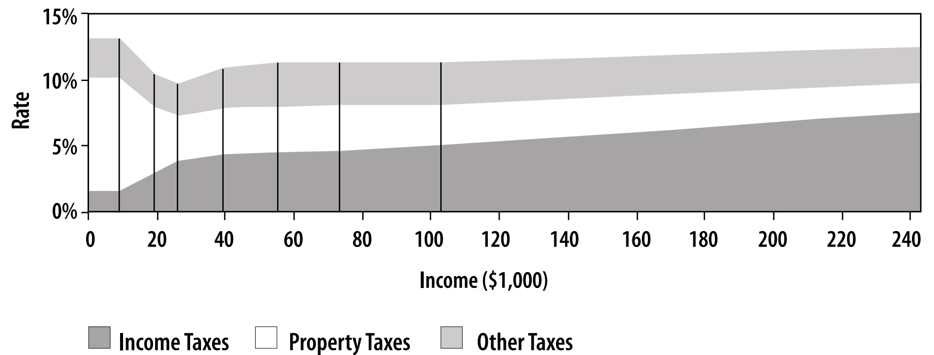
FAQ #5: Is Oregon's tax system fair?

Fairness is, of course, a judgment call, and reasonable people can disagree about what is "fair" in a tax system. One common basis for evaluating "fairness" in a tax system is the relationship of taxes to "ability to pay." This principle has two aspects:

- Those with equal ability to pay should pay the same taxes. In a fair tax system, for example, people with the same income and number of dependents pay the same taxes, other things being equal.
- Those with greater ability to pay should pay more taxes. In a fair tax system, taxpayers who are better off economically pay more taxes. The usual way of measuring this characteristic is to estimate the share of income paid in taxes by various income groups. If the share of income paid in taxes is the same for all income groups, the system is called "proportional." If the rich pay a higher share of their income in taxes than the poor, the system is called "progressive." If the poor pay a higher share of their income in taxes than the rich, the system is "regressive."

Effective tax rates for state income tax, local property tax, and other state and local taxes: Oregon



The "progressivity" of a tax system usually is portrayed by comparing "effective tax rates" for each income group. The effective tax rate is found by adding together the taxes paid directly by households and the business taxes passed on to households (by way of higher prices, lower wages, or reduced shareholder earnings). Then the total is divided by the total income of the households in that income group.

The graph above shows that Oregon's current tax system is roughly proportional overall. The state income tax is the major source of progressivity in the Oregon state-local tax system. The local property tax is highly regressive. Other state and local taxes seem to be distributed roughly proportionally among income groups.

A recent study by the Institute on Taxation and Economic Policy estimated the distribution of state-local tax burdens for all 50 states plus the District of Columbia. Most state-local tax systems are regressive. According to this report, Oregon's roughly proportional tax system is one of the most progressive in the nation.

Sources

Oregon Legislative Revenue Office and Oregon State University. 2001. The Oregon Tax Incidence Mode (OTIM)l, Legislative Revenue Office Research Report 1-01, Salem, Oregon.

McIntyre, Robert S. et al. 2003. "Who Pays": A Distributional Analysis of the Tax Systems in All 50 States, 2nd edition. The Institute on Taxation and Economic Policy, Washington, DC.

FAQ #6: How does Oregon's spending on schools stack up?

Debates over taxes and spending lead to discussion about how government funds are spent. Education is the largest use of state government funds. Oregon's total spending per student in elementary and secondary education—including instruction, capital, interest, and debt—was $8,084 in 2000, almost exactly the national average of $8,032 (see graph). This total breaks down to $4,244 for instruction, $2,653 for student services, and $935 for capital outlays and debt. Oregon spends a bit more than the national average on student services, but less than average on capital outlays.

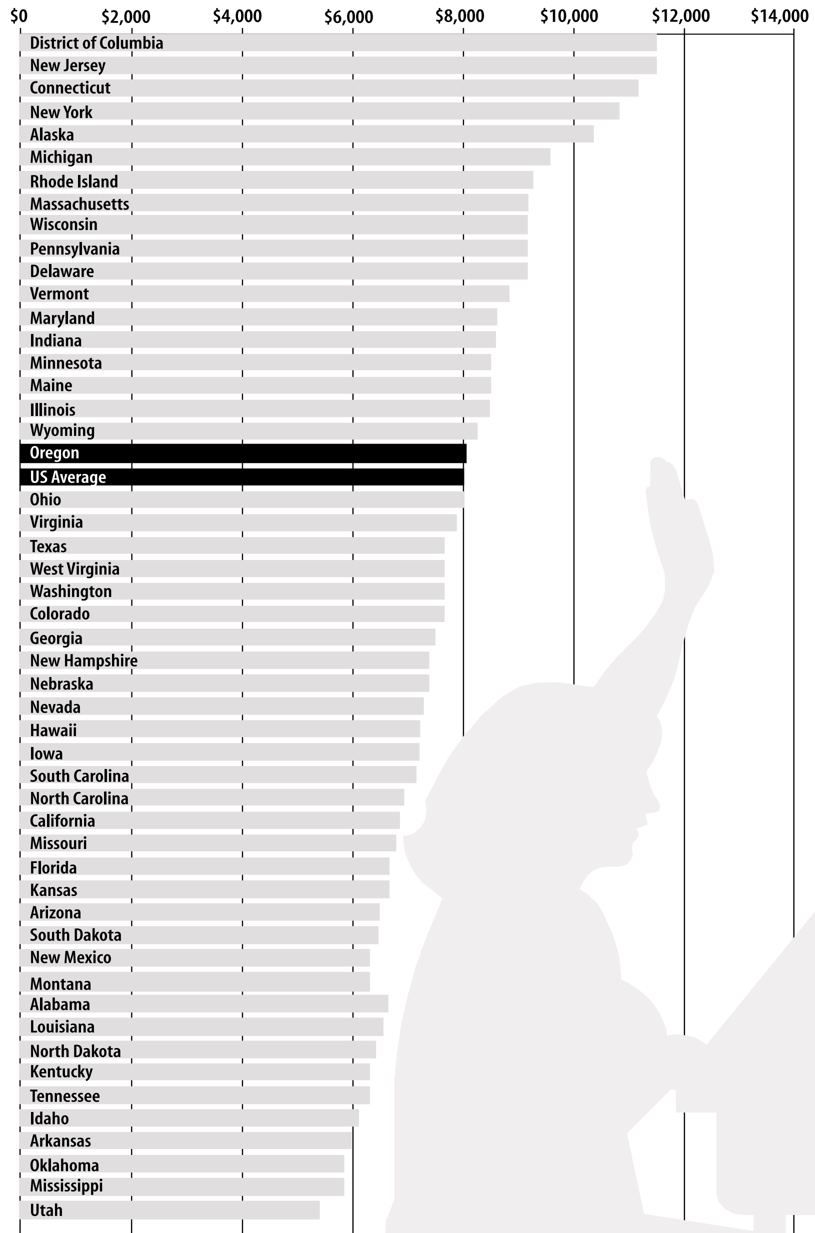
Comparisons based on per-capita spending or spending as a share of personal income may look different.

During the 1990s, Oregon's current spending per student (excluding capital outlays and debt) was very slightly above the national average. Both Oregon's spending and the national average grew about 9 percent in the late 1990s, when adjusted for inflation. In 2003, however, Oregon's spending per student fell by an estimated 8 percent.

Sources

National Center for Educational Statistics. http://nces.ed.gov/
Oregon Department of Education, personal communication.

Total spending per pupil, 1999–2000



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FAQ #7: Do temporary tax increases slow a state's economic recovery?

Because state governments are required to balance their operating budgets,* revenue shortfall must lead to either reduced expenditures or increased taxes. A number of leading economists have concluded that temporary tax increases will not slow a state's economic recovery. Peter Orszag and Joseph Stiglitz (recipient of the 2001 Nobel Prize in Economics) argue that in the short run (the period of concern during a recovery), a tax increase may do less harm to the economy than a government spending reduction of the same amount.

During a recovery, the economy needs stimulation. Both private spending and government spending stimulate the economy. In the short run, however, public spending out of a tax increase generally is higher than the private spending that occurs if money is left in taxpayers' pockets.

If taxes are not increased, taxpayers will save a portion of that income and will spend some of it out of state (e.g., mail-order purchases, out-of-state travel). If taxes are increased, on the other hand, the state government is likely to spend most, if not all, of the increased revenue and to spend more of it in the state.

Which tax is increased also matters. A tax falling more on high-income households—such as a personal income tax—reduces consumer spending less than does a tax falling more on low-income households. The reason is that high-income households are less likely to cut spending if faced with a larger tax bill.

Thus, a temporary surcharge that would affect high-income households most would have less negative short-run impact on the economy than would a tax falling more on low-income taxpayers.

Orszag and Stiglitz conclude that tax increases on higher income families are the least damaging way to close state budget deficits in the short run.

*Like most states, Oregon's constitution requires a balanced budget. This requirement effectively prohibits borrowing as a source of revenue.

Source

Orszag, Peter R. and Joseph Stiglitz. Budget Cuts Versus Tax Increases at the State Level: Is One More Counterproductive Than the Other During a Recession? State Tax Notes (November 12, 2001): 547–548.

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