

# A Vision For Public Finance In Oregon

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*An Introductory Report From The Oregon Business Council  
Public Finance Task Force  
April 15, 1998*



OREGON BUSINESS COUNCIL

# Introduction

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The Oregon Business Council created the Public Finance Task Force to educate members on Oregon tax and spending trends with an aim to formulate recommendations on public finance matters that come before the Council and provide fiscal context for other task forces. The OBC is vitally interested in the quality and effectiveness of public services in Oregon and in the tax system to pay for those services.

Oregon's system of public finance has been the subject of sustained and vigorous public debate for a number of years, and it is apparent that Oregonians are still not satisfied that the taxes they pay are providing the services they want. The Oregon Business Council enters this debate for a number of reasons: not only are OBC members significant taxpayers in Oregon, but they—and their employees—depend directly and indirectly on effective, well-functioning public services.

Between October, 1997 and April, 1998, the Task Force held six meetings, interviewing a wide range of experts and leaders familiar with all aspects of Oregon's local and state taxing and spending systems.

## A Guide to the Report

This is the first report of the Task Force. It serves three important purposes. First, it provides a guiding vision for how public services and public taxation relate to the economic prosperity and quality of life of Oregon. This vision is perhaps the most important part of the report, for it provides a framework for evaluating all specific tax and spending issues facing Oregon by pointing a path where Oregon can enjoy economic prosperity, relatively low tax rates, and high-quality public services.

The middle sections explore recent trends in public finance and citizen perceptions about the quality of public services.

The final section presents preliminary recommendations of the Oregon Business Council regarding preparation of the 1999-2001 state budget. The Task Force intends to review the budget outlook later in 1998, and offer more specific recommendations on tax and spending policy for the 1999 session. These recommendations will be informed by the work of other task forces that will be examining appropriate budget levels for K - 12, higher education, salmon recovery, and transportation.

We hope that the vision and background sections will inform all policy makers as they reflect on budgetary and fiscal choices facing Oregon.

# I A Vision for Public Finance

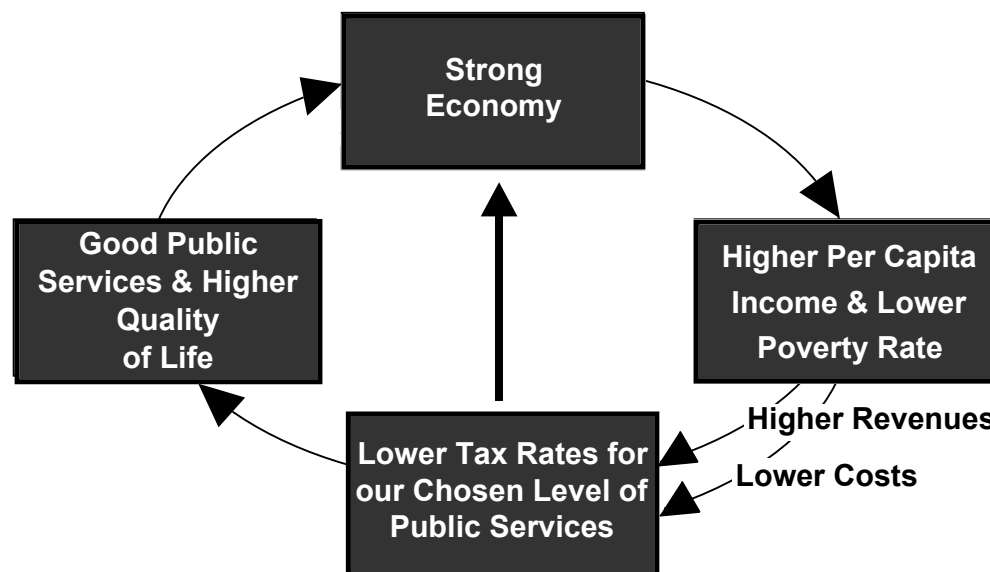
## *Public Services and Oregon's Economic Health*

There is a vital interdependence between a healthy economy and an efficient system for providing and financing needed public services. Our vision is a high skill, high wage economy that enables us to finance needed public services with low tax rates. A healthy economy provides the means to pay for public services. Good public services, including infrastructure, education, public safety, and transportation, are critical to a growing and prosperous economy and a healthy environment.

In effect, the public sector is an important supplier for Oregon-based businesses. As we have learned in so many other facets of our businesses, it is impossible to be a world class firm and compete in global markets if your suppliers are not up to world class standards. Much as we have an interest in getting efficient, cost-competitive, world-class suppliers for the inputs we buy for our businesses, Oregon business depends upon efficient, cost-competitive public services, both for our firms and for our employees.

Government performs a number of functions that influence our ability to compete, including educating the future workers of the state, building and operating the transportation system and other key aspects of infrastructure, and providing a sound environment for commercial transactions and public safety. Government services are also important to our employees: communities with good schools, safe streets, and an exceptional quality of life are important to our ability to recruit (and retain) the best workers.

## Our Vision: Good Public Services and a Strong Economy Reinforce One Another

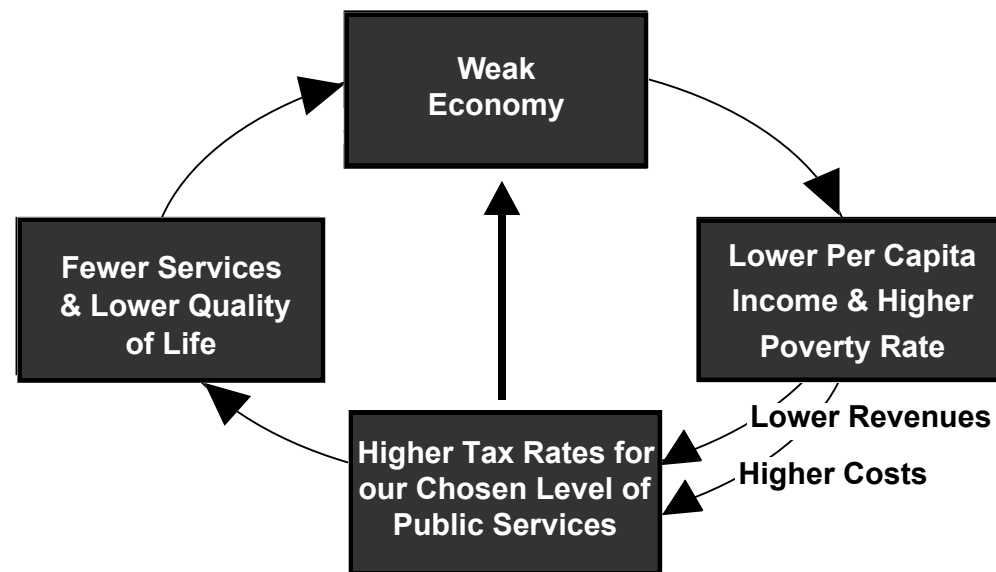


In the decades ahead, Oregon has the opportunity to build an economy that provides both good public services *and* low tax rates, an economy in which efficient and productive public services support a well educated, highly skilled population and an enjoyable quality of life while enabling us to pay relatively low tax rates. And low tax rates, in turn, stimulate the economy, keeping Oregon an attractive place to live, work, and invest. In this vision, public services—in the form of good schools, efficient infrastructure, and effective public safety—are a means to attaining a strong economy and low tax rates, not an obstacle to their attainment.

A healthy economy with rising individual incomes not only can raise any given level of needed revenue with a lower tax rate, but also has a lower need for public expenditure. The cost of many public services, including welfare, the criminal justice system, health care and social services, all decline as household incomes rise. In Oregon, more than half of personal income taxes are paid by the one-fifth of households with incomes of over \$60,000 per year. Most state expenditures for health care, corrections, and social services serve families with incomes below poverty. The more state policies move people out of poverty, and the more they help raise average incomes, the lower will be state costs, and the lighter will be the burden on individual taxpayers as costs decline.

We have sketched out the essential elements of this vision in the diagrams on pages three and four. Taken as a whole, our vision suggests a positive cycle in which a strong economy holds down public costs and provides additional public revenues, supporting quality public services at relatively low tax rates, which in turn benefit the economy. We also understand that this cycle can work in reverse: a declining economy can trigger increased poverty and social problems, lower public sector revenues, and lead to cuts in the quantity and quality of public services, which reduce the attractiveness of the state as a place to do business.

### The Alternative: Failing Services and a Weak Economy Undermine our Well-being



As Stanford economist Paul Romer has pointed out, "As the world becomes more and more closely integrated, the feature that will increasingly differentiate one geographic area from another will be the quality of public institutions. The most successful areas will be the ones with the most competent and effective mechanisms for supporting collective interests, especially in the production of new ideas."

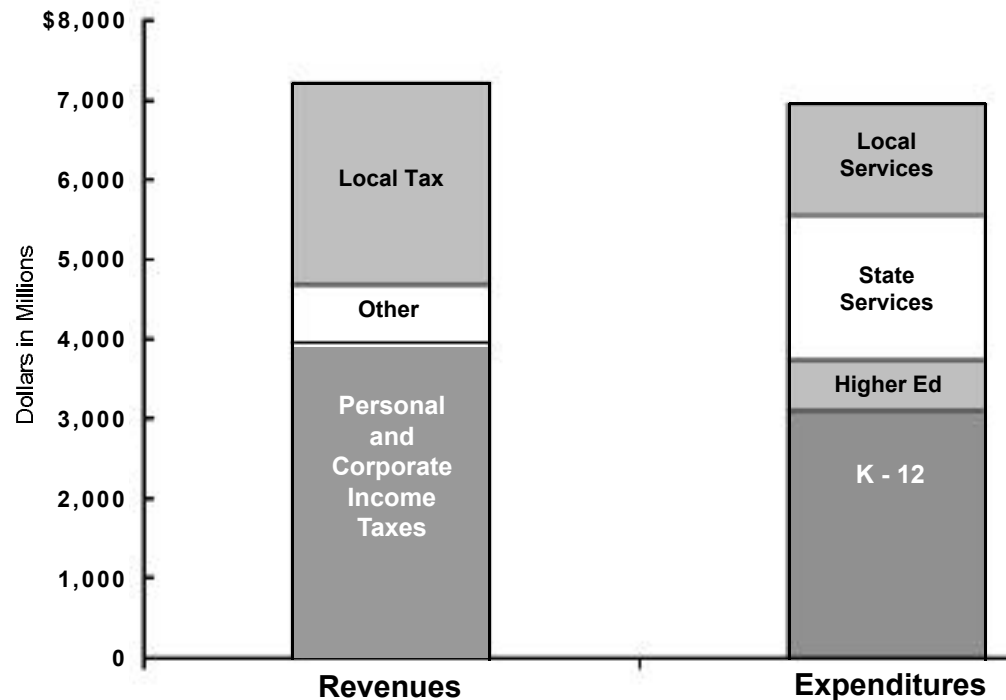
## *We Need a Broad View of Public Finance*

Many of the discussions of Oregon's system of public finance are hobbled by the fact that they look only at one feature of the system (say property taxes or school finance). Oregon's division of responsibilities between local and state entities make it decidedly different from other states. And, over the past decade, voter-approved changes coupled with a rapidly changing economy have dramatically altered the way public finance works in our state. These alterations can best be understood by looking at the system as a whole, and not by focusing on any single component.

Because basic services are financed by a combination of state and local taxes, and because the state government shares revenues and responsibilities with cities, counties and schools, it makes sense that our view should include both the state government and all types of local governments. We should look at all of the general purpose revenues of government, money from personal and corporate income taxes and lottery funds at the state level, and local property tax revenues.

If we look at public finance in this consolidated fashion, public spending for general state and local government is about \$7 billion per year. Revenues come predominantly from local property taxes and state corporate and personal income taxes. Spending falls into three broad categories: education, locally provided services, and state services.

Oregon's \$7 Billion Public Finance System



To clarify the discussion of public finance, OBC has developed a new portrait of state and local taxing and spending that consolidates the general purpose aspects of government. Our consolidated budget includes all of the revenues and expenditures over which the legislature, city councils, and county commissions have broad discretion. We have excluded other revenues (such as federal grants) from these calculations, as well as dedicated income and fees which by constitutional or statutory limit may only be spent for narrowly defined purposes (e.g., the gas tax, unemployment insurance taxes, and user fees).

## Revenues

Oregonians currently pay a little more than \$7 billion each year in taxes to state and local governments. Just two taxes—the personal income tax and the property tax—account for 85 percent of all of the consolidated revenues of state and local governments. All other sources—the lottery, corporate income tax, tobacco taxes and other general fund revenues—account for less than one dollar in six.

One question that Oregonians frequently ask is how the burden of taxation has changed over the past decade. The answer to this question is complicated by the fact that total tax revenues have been pushed up by inflation and population growth. Between 1990 and 1998, overall prices increased about 19 percent, as measured by the chain-weighted Implicit Price Deflator for Personal Consumption Expenditures (the index generally believed to most accurately measure overall price changes in the economy). As a result, much of the increase in spending reflects higher overall prices rather than additional real resources for any particular activity. Over the same period, Oregon population increased by 15.6 percent. We can isolate these effects and examine the true change in tax levels by examining the inflation-adjusted amount of taxes paid annually by each Oregonian.

Our analysis shows that the average Oregonian paid about \$2,076 in state and local taxes in 1990 (expressed in today's dollars)

## Tax Revenues Per Oregonian, 1989-91 to 1997-99

	<u>1989-91</u>	<u>1997-99</u>	<u>Change</u>	
			<u>Dollars</u>	<u>Percent</u>
Personal Income	\$836	\$1,101	\$264	32 %
Corporate Income	64	110	45	71 %
Property	1,107	784	(287)	(27 %)
Lottery	21	98	77	363 %
Measure 44	—	33	33	—
Other	83	94	11	14 %
Total	2,076	2,219	144	7 %

### Inflation-adjusted 1998 Dollars

compared with an estimate of \$2,219 in 1998. Adjusted for inflation and population growth, total taxes in Oregon have increased about \$144, or a total of about 7 percent during this decade. Over the same period, real income per capita has risen by 16 percent.

The composition of state and local revenues has changed dramatically. Overall property taxes have declined by nearly 30 percent, while personal income taxes have increased by a like amount. Corporate income tax revenues have increased 70 percent and lottery revenues have increased three and one-half fold.



### *Our Spending Priorities Have Shifted Dramatically*

Because Oregon's state and local governments are required to run balanced budgets, overall spending is in line with taxation. In the current two-year budget biennium—which runs from July 1, 1997 to June 30, 1999—state and local governments will spend about \$14.6 billion, or about \$7.3 billion per year. (The small difference between spending and revenues comes from unexpended balances carried forward from one budget period to the next, which are not shown in our figures.)

More than half of all this spending goes to education, including K - 12 schools, community colleges and universities. The remainder is divided between local government services (20%), human resources programs (15%), and corrections (5%). All other state services—including the legislature, the courts, natural resource agencies, and community development—account for only 10 percent of the consolidated budget.

When we factor out inflation and population growth, overall state and local spending is up just a total of 6 percent per Oregonian since 1990. In contrast, real per capita income has risen 16 percent during that time.

While total spending has changed only slightly, there have been striking changes in spending priorities. Spending is up sharply for the Oregon Health Plan (+181%), corrections (+59%), and local government (+21%).

### Public Spending per Oregonian, 1989-91 to 1997-99

	<u>1989-91</u>	<u>1997-99</u>	<u>Change</u>	
			<u>Dollars</u>	<u>Percent</u>
K - 12 Education	\$912	\$951	\$39	4%
Community Colleges	78	86	8	11%
Universities	143	108	(35)	(25%)
Corrections	64	102	38	59%
Oregon Health Plan	43	122	79	181%
Other Human Resources	195	205	10	5%
All Other State Services	306	226	(80)	(26%)
Local Government	366	441	75	21%
<b>Total</b>	<b>2,107</b>	<b>2,240</b>	<b>134</b>	<b>6%</b>

#### **Inflation-adjusted 1998 Dollars**

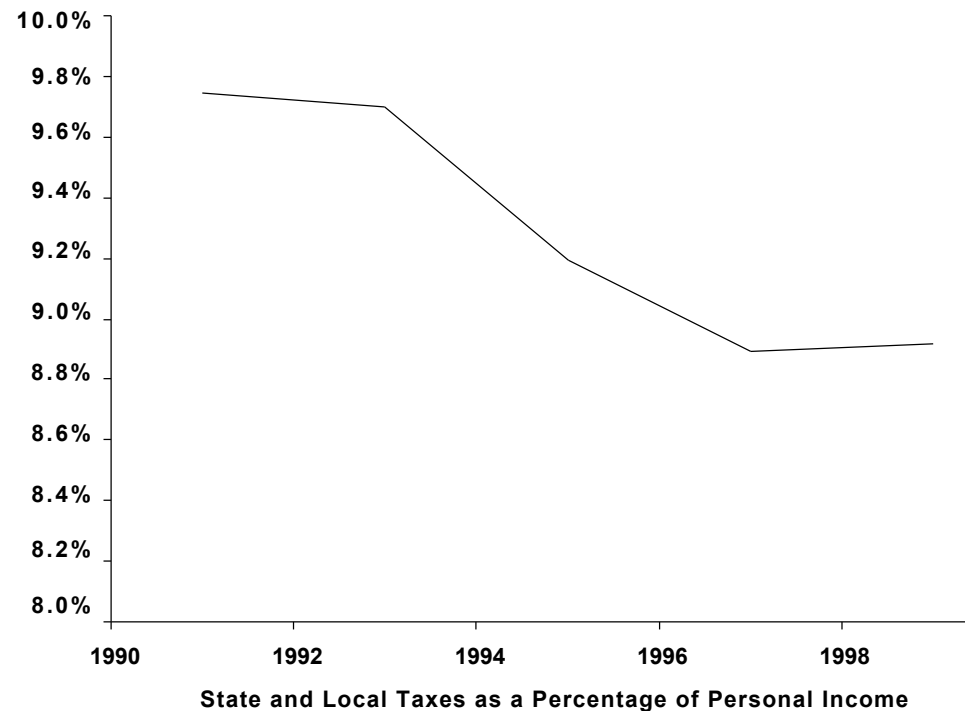
Spending is also up 11 percent for community colleges, but is only 4 percent higher for K - 12 education. (This estimate of the change in spending on K-12 education differs from other estimates which show a slight decrease in per pupil *operating* expenditures because it includes payments to retire bonded debt and because it is calculated on a biennial basis.) Public spending on universities and other state services is 25 percent lower, on a per person, inflation-adjusted basis, compared with 1990. (Some of the decline in support for higher education has been offset by raising tuition rates.)

### *Oregonians Now Spend a Smaller Fraction of Their Income on Government*

Because of changes in prices, incomes, and the number of Oregonians, it is often difficult to make ready comparisons between budgets in one year and the next. The single best way of assessing the size of government spending is to look at what fraction of their total income Oregonians pay in state and local taxes. Since 1990, consolidated state and local spending has declined as a fraction of personal income, from about 9.7 percent of personal income in the 1989-91 biennium to about 8.9 percent of personal income in the 1997-99 biennium.

The decline in state and local taxes as a share of Oregon personal income in the past few years represents a substantial departure from the historical level of taxation in Oregon. Using a slightly different and somewhat broader measure of state and local taxes (which includes license fees and other miscellaneous or constitutionally dedicated taxes like weight-mile taxes and business license fees), the Legislative Revenue Office calculated the trend in overall state and local spending as a fraction of Oregon's personal income over the past three decades. Taxes as a fraction of personal income, as measured by these Census Bureau statistics, rose steadily through the 1960s and 1970s, fluctuated at about 12 percent of state income in the 1980s, and then declined in the 1990s. The share of income we pay in taxes is now at about the same level it was thirty years ago in the mid-1960s.

### Spending a Smaller Fraction of Income on Government



- Tax cuts and strong economic growth have lowered the share of income we pay in state and local taxes
- The share of Oregonians' income going to state and local taxes now is near a thirty-year low



# III Oregon's New Tax System

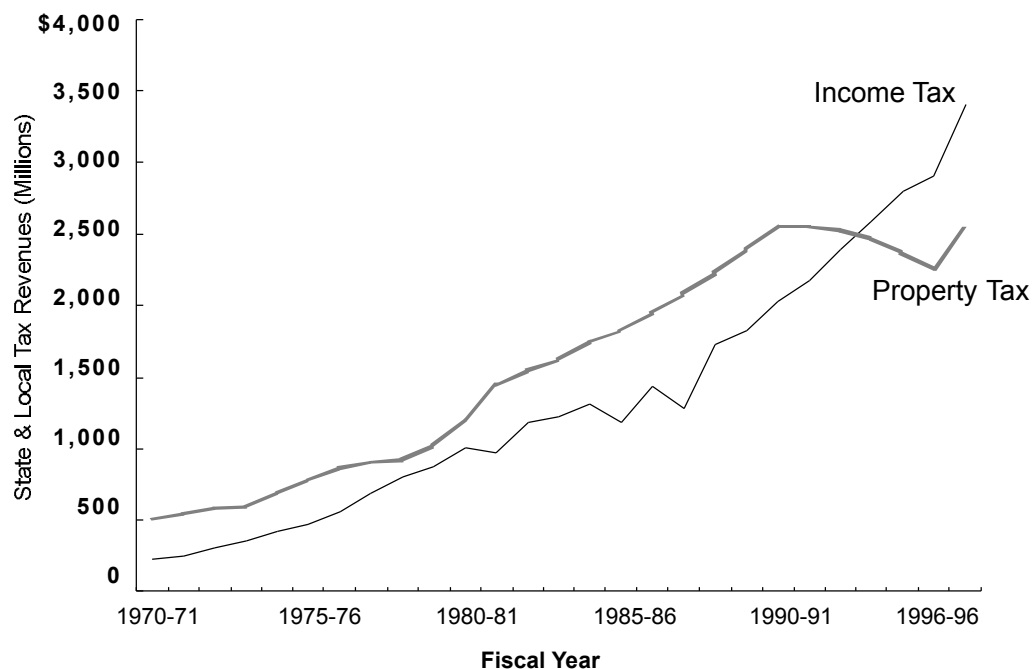
Over the past decade, sweeping changes in the economy and voter-mandated limits on property taxes have fundamentally rewritten the book on the Oregon tax system. In effect, Oregon has a much different system of paying for state and local government than it did in 1990. There are three essential elements in this new tax system:

- Income taxes have displaced property taxes as Oregon's number one revenue source.
- Growing personal and corporate income tax revenues—fueled by Oregon's economic boom—and a surge in lottery revenues have offset the revenue lost to property tax limitations.
- As a result of Measure 5, Oregon property tax payers have a high degree of certainty about their future property tax burdens.

## *Income Taxes have Displaced Property Taxes as Oregon's Number One Revenue Source*

With the passage of Ballot Measure 5 by the voters in 1990, Oregon began the process of greatly restructuring its tax system. Historically, property taxes have been the single largest source of revenue for the combined operations of state and local government in Oregon. Likewise, it is widely recognized that they were the largest source of voter irritation about taxes. When Tom McCall was governor in 1970, property taxes accounted for more than twice as much government revenue as the income tax. Two decades later, Oregonians still paid more property taxes than income taxes.

## Income Tax now Largest Source of Revenue



- Until 1990 the property tax was Oregon's largest source of revenue
- Measure 5 held total property tax revenue in check from 1990 onward
- Income tax receipts are now the largest source of revenue

But Measure 5 produced an absolute decline in property taxes, and a growing economy steadily pushed up income tax receipts. Since 1994, income taxes have been the largest source of revenue for state and local government.



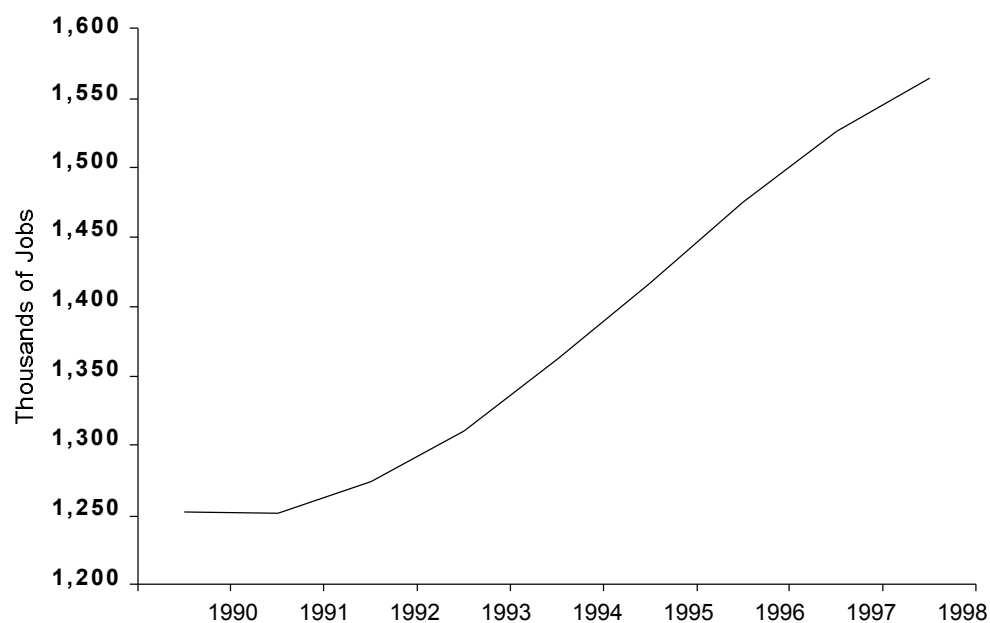
## Oregon's Economic Boom

In retrospect, it is clear that Oregon's choice to shift its reliance from property taxes to income taxes was well timed. Just as Measure 5 started taking effect (it was phased in over the five years after its passage in 1990), the nation recovered from a brief recession and entered into a period of sustained growth. Oregon grew robustly in the late 1980s, and after a slight slowdown during the 1991 national recession, has been one of the states leading the nation's economic boom. Since 1990, Oregon has added more than 300,000 jobs. Oregon wages and per capita income, which had been well below national averages since the late 1970s, grew faster than in the rest of the nation.

New jobs, as well as rising wages and income, translate directly into increased personal income tax revenues for the state. Personal income tax collections have increased from \$2.0 billion in 1990-91 to a predicted \$3.2 billion in 1997-98. This economic cycle also served to boost corporate profits and corporate taxes. Corporate income tax collections more than doubled from \$150 million in 1990-91 to \$379 million in 1997-98.

This track record suggests that Oregon's tax system is very responsive to economic cycles. While this elasticity is a plus in good times, it has a downside, too. In a recession, high elasticity means that tax revenues will likely fall faster than overall economic activity.

## Oregon's Booming Economy Has Produced 300,000 New Jobs



A decade and a half of steady economic growth may have blinded some to the fact that recessions do happen. The shift from primary reliance on taxes on property to taxes on income—corporate and personal—has increased the potential volatility of Oregon's tax system in the event of a recession. The state economist estimates that a medium-depth recession could cost the state as much as \$500 million in revenue in the upcoming biennium, enough to force significant service cuts or tax rate increases.



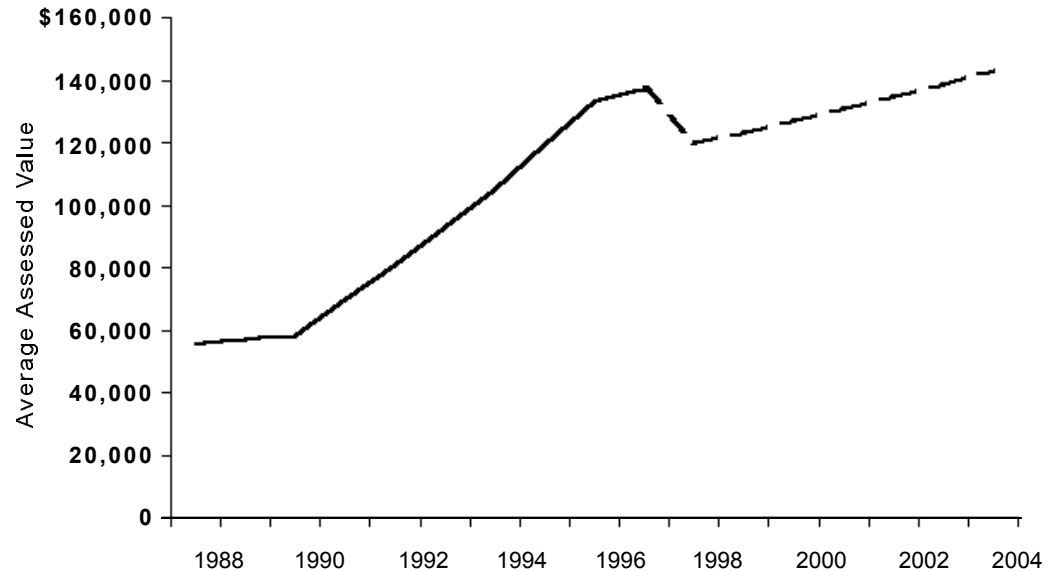
### Cap On Tax Assessments

Voters passed Measure 5 in 1990 with the expectation that it would sharply cut their property taxes. A large part of the projected benefits of Measure 5, however, were offset by an explosive rise in home values. Housing prices, essentially flat throughout much of the 1980s, took off sharply in the 1990s. The problem was compounded somewhat because assessed values lagged behind market values through much of the 1980s. Between 1990 and 1996, the assessed value of the average home in Multnomah County rose 128 percent, from \$58,300 to \$133,100.

Largely out of frustration with soaring assessments, voters in 1996 approved Measure 47, rolling back assessments, freezing tax rates, and limiting future assessment increases. Concerns over the workability of Measure 47 prompted the legislature to draft a re-write of the initiative, which voters approved in May, 1997, as Measure 50.

Under Measure 50, property owners can be assured that the assessed value of their property will increase no more than 3 percent per year. And, unlike California's Proposition 13, property assessments don't increase to market levels when a property is sold. Measure 50 freezes local property tax rates and allows additional local levies for capital and operating costs, but only under specific conditions. Operating levies are limited to five years and must be approved at an election with at least a 50 percent voter turnout. Levies must stay within Measure 5's limits of \$10 per thousand for general government and \$5 per thousand for schools. The net effect should be able to give property owners much greater certainty about their property tax liability.

### Future Assessment Increases will be Limited



Actual and Forecast Data for Multnomah County

- 1990's Measure 5 cut property tax rates
- Assessment increases reduced Measure 5 benefits for homeowners
- Measure 50 now caps future assessment increases at 3% per year



## The Road Ahead

Oregon's strong economy, coupled with a fairly elastic income tax system, has produced strong revenue growth in the state/local tax system. Strong enough, in fact, to provide adequate revenue to offset the costs of replacing revenue lost to the property tax reductions of Measures 5, 47, and 50.

In the coming biennium, state and local combined revenue should be significantly above current levels. Based on current economic projections and assumptions of modest additions of new property to the tax rolls, we anticipate that on a combined basis, state and local governments will have about 13 percent more revenue in the 1999-2001 biennium than in the current biennium. This means total revenue should increase from its current level of \$14.4 billion (an average of \$7.2 billion per year) to \$16.3 billion (an average of \$8.1 billion per year).

While this seems like a substantial increase, about half of the real value of this growth will be offset by a combination of rising prices (up 3.7%) and increasing population (up 2.8%). In addition, the increase in revenues will be divided unevenly between state and local governments. State revenues, driven by corporate and personal income taxes, will rise substantially. But local revenues, due to the Measure 50 assessment cap, will rise more slowly.

This is a generally favorable outlook. There are, however, some shadows. Tobacco taxes and lottery receipts are both predicted to decrease.

## Projected Revenue Picture 1999 - 2001

*Millions of Current Dollars*

	<u>1997-99</u>	<u>1999-01</u>	<u>Change</u>	<u>% Increase</u>
Personal	7,223	8,318	1,095	15%
Corporate	692	959	267	39%
All Other	590	593	3	1%
Measure 44	212	172	(41)	(19%)
Lottery	546	524	(22)	(4%)
Property	5,112	5,672	561	11%
Total	14,374	16,237	1,863	13%

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In addition, this revenue forecast assumes continued healthy growth in the Oregon economy. While corporate taxes are expected to grow 37 percent, this is from an artificially low base reflecting kicker tax refunds; underlying corporate profits are projected to rise just 14 percent over the two year period.

These revenue estimates are based on the Office of Economic Analysis' March 1998 forecast and assume that property tax collections increase at 5 percent per year (the 3 percent assessment cap, plus 2 percent for new construction and levy authority).



## IV How Oregon Compares

One basic, if simple, way to measure whether Oregon's system of taxing and spending is working well is to compare the levels and types of taxes and spending in Oregon with those in other states.

- Overall, tax levels in Oregon compare favorably with other states. Oregon tax levels are projected to decline relative to the national average.
- Oregon's tax system—the combined effect of all taxes—is generally deemed to be less regressive than most states.
- On a per person basis, Oregon spends more than the average state on K - 12 education, and about the same as the average state on higher education.

### *How Much Tax do Oregonians Pay Compared to Other Americans?*

Nationally, Americans pay about 11 to 12 percent of their income in state and local taxes of all forms. Income, sales and property taxes are the largest sources of state and local revenues. States and communities around the nation also levy a variety of other taxes, including payroll taxes, business gross receipt taxes, and a variety of special taxes on tobacco, hotel rooms, car rentals, and liquor. States and communities also collect revenues from government-run enterprises like lotteries, liquor sales, and other sources. Every state uses a different mix of these taxes, and divides the responsibility for taxing (and spending) differently between state government and local governments.

### Oregon Ranks 38th in Tax Burden



The US Census Bureau periodically collects data about the total volume of these taxes; this enables us to make comparisons of state levels of taxation. The data suggest that Oregon's tax ranking, measured as a fraction of personal income, has been among the top twenty states for the past decade or more. Since the adoption of Measure 5, Oregon's ranking has begun to fall, from 10th in 1989-90 to 18th highest in 1993-94. The Legislative Revenue Office forecasts that Oregon taxes as a fraction of personal income will have fallen to 38th place in 1996, if other states remain in their current positions.

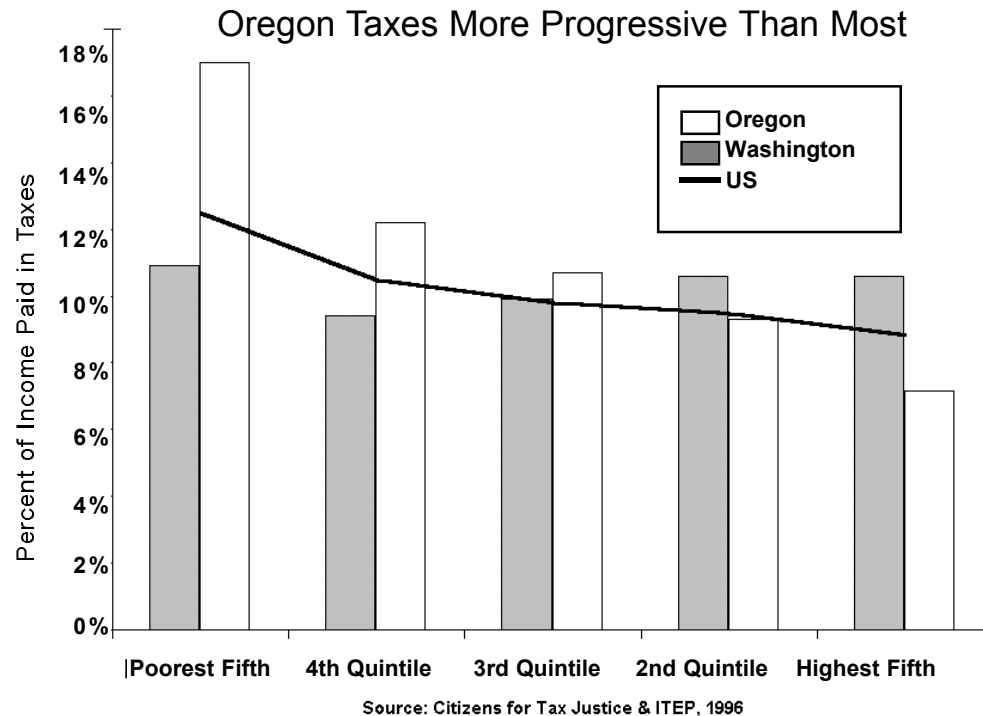
Some comparisons of tax levels imply Oregon ranks higher. One widely quoted set of figures produced by the Tax Foundation claims Oregon taxes increased more than all but three other states, but this data series looks only at state levied taxes and ignores the fact that increased Oregon state taxes were essentially used to pay for cuts in local taxes.

### Is Oregon's Tax System Fair?

One of the most frequent objections to any tax is fairness. Public finance experts generally agree that the only meaningful basis for judging tax fairness is to look at the whole system, and not individual taxes.

National data show that most state systems are, on balance, regressive—poor persons pay a larger fraction of their income than do higher income persons. Nationally, the poorest fifth of all families pays about 12.5 percent of their income in state and local taxes, while the top fifth pays 9.0 percent of their income. Oregon is among the few states with a roughly proportional tax system; families in all income brackets pay roughly the same share of their income in state and local taxes.

Some argue Oregon's tax system is unfair, because it imposes more taxes on individuals than businesses. Tax experts, however, recognize that while businesses may write the check, much of the cost gets passed on: to workers in the form of lower wages, to renters in the form of higher rents, to consumers in the form of higher prices, and to owners in the form of lower profits or dividends. As consumers, workers, and renters, Oregonians end up paying hidden taxes. Businesses that can't pass on tax costs because of competition may ultimately find it unprofitable to do business in a particular location.



States with systems that initially tax business tend to be more regressive, but the bulk of these

- Oregon's tax system, unlike most states, is not regressive
- Taxes on business get passed on to workers, consumers, renters and owners

taxes are passed on, especially to lower income households. Washington State, which ranks fifth in business taxes, has one of the most regressive tax systems in the US. In Oregon, the highest income taxpayers pay almost the same fraction of their income as the poorest fifth. In Washington, the highest income taxpayers pay 60 percent less of their income in taxes than do the poorest fifth.

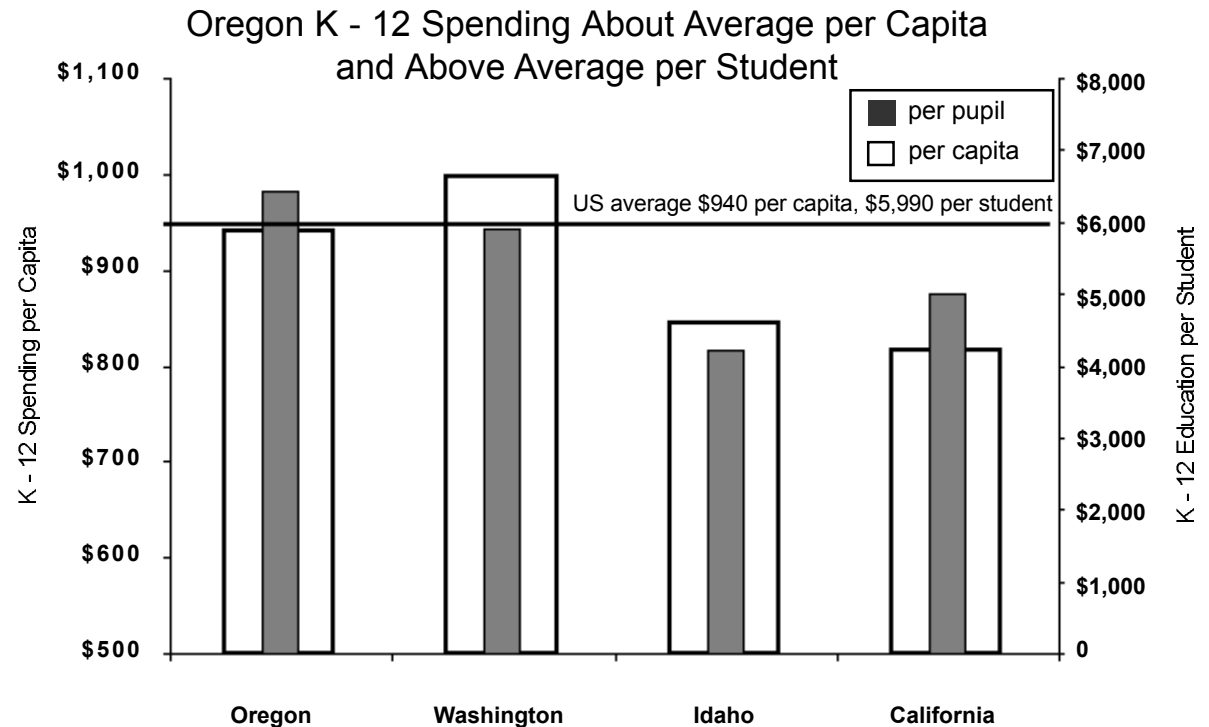


### *How Does Oregon's Spending Compare to Other States?*

We can begin to judge the relative efficiency of Oregon's public spending by comparing spending levels in Oregon with other states. While there are many good reasons why Oregon may spend more or less than other states on specific areas of public endeavor (Oregon may have a higher priority or a special need for added spending in a particular area such as natural resources), we would expect that significant departures from national averages for spending should be explained. Here we examine two major categories of state and local expenditure to identify in a preliminary way the efficiency and priorities of public finance in Oregon.

#### *K - 12 Education*

The largest single expenditure category in Oregon public finance (and indeed in most states) is spending on Kindergarten through 12th grade public education. As of 1994-95, the latest year for which comprehensive national data are available, Oregon spent almost exactly the same as the national average on a per capita basis. Oregon's per capita K - 12 public spending was just equal to the national average, behind Washington State (6 percent above the US average), but ahead of Idaho (10 percent below the US average) and California (13 percent below).



Source: National Center for Education Statistics

These interstate comparisons on spending levels are based on total public support for K - 12 education (from both local property taxes and state funding) divided by the total population of each state. Oregon's per student spending (spending divided by the number of students attending schools) is about 7.5 percent higher than the national average. It differs from spending per capita (spending divided by state population) because students make up a somewhat smaller fraction of the Oregon population than in the average state.

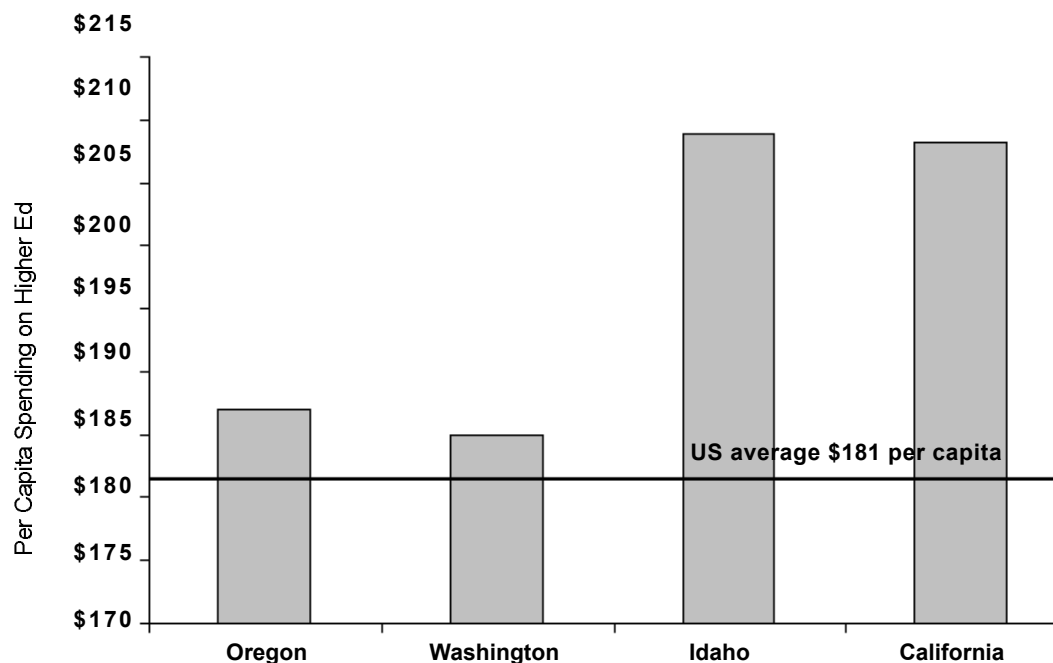
### Higher Education

Oregon's total per capita higher education spending is slightly above the overall US average. In 1995-96, Oregon spent about \$187 in state and local tax dollars per capita on all forms of higher education. Oregon spending was just about the US average of \$181 per capita, ranking Oregon 23rd among all states.

These statistics may appear to some observers to conflict with the widely held view that Oregon spends less on higher education than other states. Data series that look only at state appropriations for direct support for public, four-year colleges and universities do show Oregon is below average in this category. But, unlike other states, Oregon relies on local property taxes to finance part of the higher education system (about one-fifth of community colleges). Oregon also spends proportionately more than other states on two-year schools, and funds higher education through scholarships to students in addition to appropriations to universities. Viewed broadly, Oregon spends somewhat more on higher education than the average state, and within higher education, allocates its funds differently.

These comparisons of education spending levels among states should be just a first step in assessing efficiency. We can—and should—undertake similar comparisons of other major areas of expenditure, including transportation, health care, social services, and the like.

### Oregon Higher Ed Spending Slightly Above Average



Source: National Center for Education Statistics

However, spending comparisons tell only part of the story. Ultimately, we need to ask what we're getting for our money.



## *Restoring Public Confidence in Key Government Functions is Essential*

Efficient, quality public services are vital for maintaining Oregon's quality of life and economic prosperity. Unfortunately, the ability of the public sector to play its vital role is diminished by broad public concern that the public sector is wasteful and inefficient. As we review our basic strategy for public finance in Oregon, we believe that rebuilding confidence that government is providing quality services is our highest priority.

Rebuilding public confidence is much more than a public relations issue. Most OBC members have been forced to rethink their businesses, adopt new management practices, and revamp operations to stay competitive. We believe the public sector requires similar review. While we are aware and impressed by the many initiatives in Oregon to strengthen the quality of public services, we remain unconvinced that a system for continuous review of mission and process improvement is in place throughout Oregon's public institutions. We are in a period when the governance and management practices of all institutions are being questioned and challenged. So must they be with the public sector.

There are two reasons why assuring quality public institutions is so important. First, and foremost, we need quality services provided at a reasonable cost. This is central to our vision for Oregon as we move towards the next century. For example, the quality of education matters more than ever as we look forward to a knowledge-based economy in Oregon. The state needs

responsive, high quality public services.

Second, doubts about the performance of government paralyze public discourse on spending and taxation policy. Oregonians' faith that their state and local governments can carry out basic tasks is at a low ebb. Recent polling confirms that a majority of the public believes that as much as a quarter of state and local spending is wasted. Until Oregonians believe that their tax dollars are spent wisely and well, it is unlikely that there can be any consensus for significant change in our system of public finance.

A 1996-97 poll showed that on average, citizens felt that about 25 percent of state spending, and about 20 percent of local government spending, was waste. Citizens considered waste in K - 12 education to be only 10 percent. While these numbers are distressing, they appear to represent an improvement over previous years. Opinion research suggests that Oregonians who perceive that there is waste are about evenly divided between believing that government is providing the right services but spending more than they really need to, and those who believe that government is offering unnecessary programs.

The dim view that many citizens have about the efficiency of government are fueled by a variety of well-publicized and frequently cited examples of actual or perceived waste or mismanagement. Political debates and media reports on government tend to emphasize such problems, and to some extent are responsible for negative public perceptions. But government frequently fails to measure and report its accomplishments. We believe that frank and careful performance measures are critical to addressing these public concerns.

The average  
Oregonian  
thinks that 25%  
of state tax dollars  
are wasted.  
*From a 1997  
Oregon State  
University survey  
of voter attitudes*

### *Measuring Performance is Key*

One key to improving public services is to clearly focus our efforts on major policy issues that the public wants to see addressed. Establishing clear performance measures related to our goals is a critical step. In addition, the absence of hard information about the measurable outcomes of government programs may allow perceptions of waste to flourish. Our own experience with reorganization and re-engineering in the private sector convinces us that it is difficult to achieve progress unless it is measurable.

We believe that responsible and objective observers in the business community and the media should help take responsibility for providing a balanced assessment of the efficiency of government in Oregon. Such an effort should measure how well state and local governments and schools perform, and highlight both accomplishments and shortcomings.

The OBC believes that there are four opportunity areas for state and local government to tackle the state's most important problems and in the process rebuild credibility with citizens about the effectiveness of government:

- K - 12 Education
- Higher Education
- Transportation
- Salmon Recovery

### Performance Measures for Oregon

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#### **K - 12 Education**

- % Certificate of Initial Mastery (CIM) achievement
  - % Certificate of Advanced Mastery (CAM) achievement
- 

#### **Higher Education**

- Access
  - Quality
  - Cost
- 

#### **Transportation**

- % of roads maintained
  - Congestion
- 

#### **Watersheds/Salmon**

- % of rivers at stable or increasing runs
- 

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As a first step, state agencies could develop benchmarks to show how levels of spending and outcomes in Oregon for each of these services compare with similar states. In addition, the OBC may wish to contract for an outside evaluation of Oregon's efforts in one or more of these areas to determine whether programs and management are efficient, and whether budgets are sufficient, insufficient, or excessive.

## *Management to Improve Efficiency and Effectiveness*

How can public sector management be modified to improve services and increase public satisfaction? Despite the fact that many aspects of government are designed to limit any individual's power and authority and to diffuse responsibility, we believe opportunities abound to change the way we manage: contracting for services, pay-for-performance systems, and modifying public budgeting and accounting to better measure costs and signal managers about the effects of their actions.

While some are tempted to make managers (or workers) scapegoats for poor performance, our experience suggests that poor performance is usually a result of flawed systems. Better performance comes from fixing systems *and* good management.

Increased use of incentives, and regulatory flexibility, can be important ways to improve public service delivery. Particularly where public service delivery is similar to a private market function (vehicle emission testing, vehicle and driver licensing, issuance of many routine permits, etc.), providing employees with incentives for better performance and the flexibility to innovate and improve customer satisfaction could be useful. In addition, for some services, Oregon may want to consider increased use of contracting to the private sector for the provision of selected services.

There are significant opportunities to improve management in the public sector. David

## Improving Public Management

**The Core Strategy** - creating a clarity of purpose

**The Consequences Strategy** - to establish consequences for performance (or the lack thereof)

**The Customer Strategy** - to make public organizations accountable to their customers

**The Control Strategy** - shifting control to front-line workers to empower their innovation

**The Culture Strategy** - to change the habits, hearts and minds of public employees

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Osborne, co-author of *Reinventing Government*, has suggested that improving government efficiency flows from five inter-related strategies, which he calls the "Five Cs." These strategies parallel the lessons learned in improving the performance of private sector organizations, but are adapted to the special needs of public sector efficiency.

We recommend that where clear objectives and performance measures can be established, public sector managers and workers be given increased flexibility to accomplish those objectives, and be given incentives, both positive and negative, to encourage them. Targets for changing the system are many. Rules, regulations, and procedures often hamstring public agencies; public pay systems reward longevity rather than productivity; and there are few incentives for innovating, and little recognition for improving quality.

## VI Next Steps

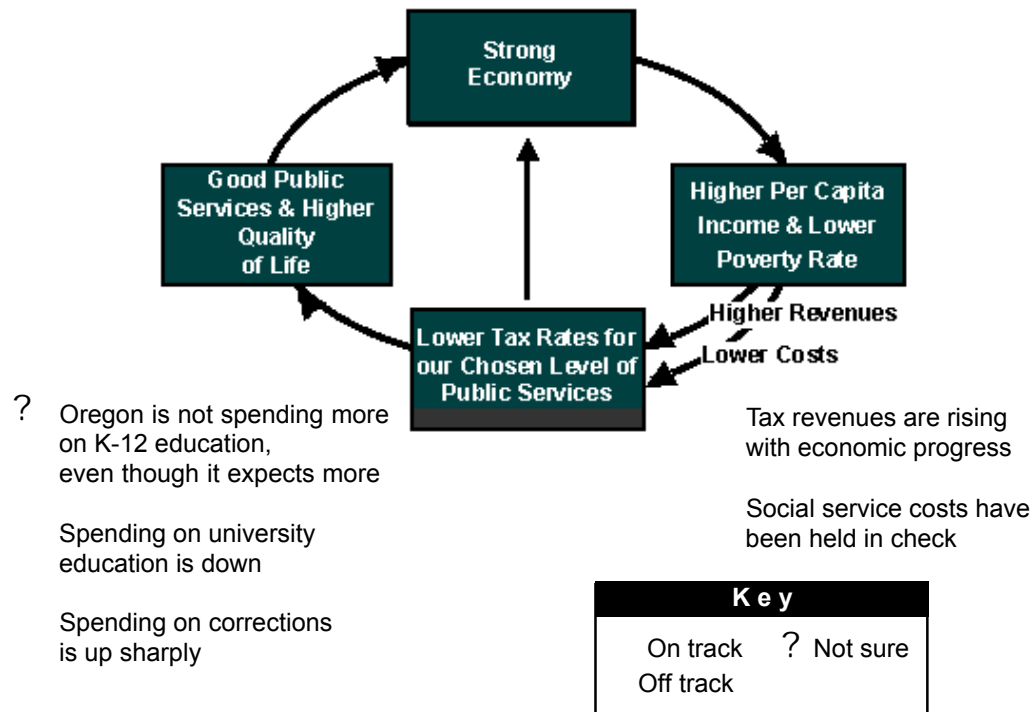
### *Achieving Our Vision*

The record of the past decade is clear in showing that Oregon has performed according to the model we described. Oregon is shifting to the knowledge-based industries of the future, educational attainment of Oregonians has improved, and average incomes have increased. The growing economy and rising incomes have generated healthy increases in tax revenues and enabled an increase in real per capita spending on many types of public services. Most importantly, because of the nature of Oregon's economic growth, we have achieved higher incomes and slightly higher levels of public service spending while paying a lower fraction of our income in the form of state and local taxes.

But have investments in public services contributed to reinforcing the virtuous cycle of a developing economy? The record of the past decade suggests that we may not be investing in the kinds of public services that contribute most to sustaining our economic prosperity. Since 1990, for example, we have increased spending on corrections and social services (expenditures that chiefly serve to remedy rather than prevent or reduce problems). At the same time, we've held in check, if not decreased, the cost of some types of public services. We've dramatically reduced the amount we spend on higher education, and increased spending on K - 12 education only slightly. (Moreover, the 3 percent statewide increase in real per capita spending on K - 12 education obscures the fact that many

### Where are we Relative to our Vision?

A growing, knowledge-based economy  
is raising incomes and cutting poverty



districts have seen their budgets cut as state support has equalized spending across districts, and ignores the fact that we are asking K - 12 education to meet dramatically higher standards of student performance.)

## *Approaching The 1999-2001 Budget Session*

The outlook for 1999-2001 is good. Total funding for state and local government is estimated to rise by nearly \$2 billion, a 13 percent increase. This increase reflects Oregon's strong economic growth and the responsiveness of our public finance system to growth.

With additional dollars, Oregon faces choices in how to use them. We would recommend policy-makers take the following approach.

First, establish what level of public services is critical to sustain and enhance Oregon's quality of life and economic competitiveness. We need to set targets for each of these areas, and decide how much it will cost to achieve them.

Second, decide how many dollars to set aside to guard against the consequences of a future economic downturn. With revenues that are now more volatile and less predictable, we need to explore whether the creation of a rainy day fund is warranted.

Third, we need to look at total expenditures against revenues available, and decide whether to adjust tax levels.

Over the next several months, the Oregon Business Council will use this framework to evaluate these questions, and offer its recommendations. The Council will work with business leaders and business associations throughout Oregon on an agenda to enhance economic health and quality of life in Oregon. The agenda will focus on four areas critical to Oregon's future: K - 12 Education,

## Achieving Our Vision

- Spell out our vision in four key areas:
  - K - 12
  - Higher education
  - Transportation
  - Salmon restoration
- Identify needed changes in governance, management and policy
- Determine efficient funding levels
- Then:
  - Address the fiscal realities
  - Modify the public finance system to meet our objectives

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Higher Education, Transportation, and Salmon Recovery. For each topic, we will:

- Propose a vision and measurable goals for achievement.
- Recommend changes in management, governance, and policy required to achieve the vision and goals.
- Recommend funding levels.

At the same time, the Finance Task Force will review the revenue outlook and expenditure proposals in other areas. Once we have completed these essential steps, we will be in a position to assess the fiscal realities confronting the state: Are tax revenues adequate to meet our needs? Can we afford tax reductions? We anticipate that the results of this work will be useful in providing timely advice for making decisions about the state's 1999-2001 budget.

