Budgeting for Now *and* the Future

OBC PROPOSAL TO OREGON STATE LEADERSHIP
SUPPORTING A LONG-TERM, STRATEGIC APPROACH
TO THE CURRENT BUDGET SHORTFALL

OREGON BUSINESS COUNCIL

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Introduction

As Oregon's declining economy pulls down state revenues, elected officials face painful choices over the next few weeks in reallocating diminished resources. Reflecting on business experience in dealing with similar fiscal challenges, this paper suggests an approach for how to address it for consideration by our elected leaders. We recognize that government is not the same as business. Yet the guidelines presented here may be useful as our elected leaders work together to address a very serious fiscal challenge.

This proposal covers three interrelated issues, 1) the status of the Oregon economy, 2) the state's fiscal challenges now and in coming biennia, and 3) guidelines for how Oregon can address the current shortfall while keeping an eye towards the future.

We commit to work with public leaders to shape and implement a strategy consistent with the guidelines in this report. By taking this approach, Oregon can do away with a pattern of budget planning that leaves it ill prepared for cyclical economic downturns, revenue shortfalls, and other contingencies.

Suggested Guidelines

1. Start with Oregon's future in mind.
2. Make budget choices within a multi-year framework.
3. Build a healthy economy (it's the best source of public revenue).
4. Take the opportunity to save money and improve service by redesigning programs.
5. Cut budgets selectively.
6. Raise new revenue as a last resort with the least impact on economic growth

The State Of The Oregon Economy

The current budget shortfall reminds us how important the Oregon economy is to revenue for public service. The magnitude of Oregon's public fiscal crisis is directly related to the depth and length of the current recession – and the rate of growth in jobs and incomes as the recession ends.

After a decade of stellar growth, Oregon's recent economic performance has been disappointing. The economy is down not because Oregon businesses aren't competitive, but because our industrial mix leaves us more exposed to this down cycle than other places. With appropriate policy, we should be able to again out-perform the nation when the economy expands.

Statewide employment in September 2001 was about 1.3 percent less than in the previous September. Through August, Oregon's 12-month employment growth rate ranked 49th of the 50 states. This represents a dramatic turnaround from the performance in the 1990s, when Oregon was among the nation's fastest growing, averaging 2.5 percent more jobs per year compared to a national rate of 1.9 percent.

Analysis of economic data suggests that Oregon's particular industrial mix underpins our weak showing, not the performance of Oregon companies against their peers in other states. The structure of the Oregon economy, with proportionally greater dependence on durable goods manufacturing, makes it more sensitive to this economic cycle than the nation as a whole. Durable goods manufacturing accounted for about 14 percent of the growth in earnings in Oregon during the 1990s compared to about 7 percent nationally. As durables have declined nationwide, Oregon's fall has been steeper than elsewhere.

A sector-by-sector analysis, presented in Table 1 of Appendix A, illustrates that our current downturn isn't due to a systematic weakness of Oregon firms when compared with similar firms nationally. In fact, Oregon industries are still outperforming their counterparts nationally in high tech and wood products – and are performing on a par with their counterparts in metals. Only the food processing and transportation equipment industries are performing noticeably worse. And in the case of transportation, this is due to the products produced here (heavy trucks and recreation vehicles), which have suffered more than the sector as a whole.

The Outlook

It is difficult to estimate the length of this recession. It will almost certainly be more serious than the 1990-91 recession (which Oregon essentially dodged) but far less severe than the 1980-82 recession (unless the national economy goes into a depression.) The 1980-82 recession was far more severe in Oregon than nationally, lasting three years and costing the state nearly 10 percent of its total employment due mainly to the huge impact high interest rates had on forest products and the subsequent restructuring of that industry.

As the national economy rebounds, we could well outperform the rest of the nation over the next decade if we continue to build on the strengths in our key sectors. This may not provide much comfort to businesses and public agencies facing painful choices, and especially not to people losing their jobs. But it does remind us that even now we need to be planning for better days ahead.

To support a healthy economy, OBC has suggested that Oregon stay focused over the long haul on five key issues. We must not lose sight of these priorities even during an economic downturn.

Workforce and Education. Great education is a powerful magnet for knowledge-intensive industry because knowledge workers value education (making them easier to attract and retain) and because talented graduates fuel the economy. In addition, a quality education system can help segments of the Oregon population and communities throughout the state that have had the greatest difficulty connecting with opportunities in the new economy.

Business Costs and Business Climate. The cost and availability of a range of public and private services influences the competitiveness of Oregon businesses in national and international markets. Environmental regulations and natural resources policies designed to sustain quality of life and a healthy economy build a climate for business expansion. Competitive rates for quality health care, energy, and worker compensation encourage investment and expansion, as do fiscal policies that keep business taxes competitive with other states.

A Culture of Innovation and Entrepreneurship. Increasingly, the bulk of the growth in the Oregon economy is being propelled by knowledge-based industries such as high technology, software, and electronic commerce – and through innovation and new products from all industries. Prosperity will grow out of our work to hone our collective capability to continuously learn and adapt in an ever-changing economic world. Necessary infrastructure for knowledge-based growth includes strong public and private sector research activities, a good entrepreneurial climate, and the availability of investment capital for new ventures.

Oregon's Quality of Life. Oregon is a special place to live, and Oregon's quality of life helps attract and retain talented people who drive our economy.

Business/Government Partnerships. State and local governments are, in effect, critical suppliers to Oregon businesses – largely responsible for providing a well-educated workforce, building and operating a well-functioning infrastructure, and clearly and fairly regulating business activity. The ability of business and public leaders to anticipate each other’s critical challenges is an important ingredient for economic prosperity in an era of rapid change. It is also important that communities across the state understand one and other's needs and identify opportunities to be mutually supportive.

Current economic conditions highlight the need for a review of strategies to strengthen the economy in the short and longer terms. Under the auspices of a Governor’s Task Force, the Oregon Economic and Community Development Department (OECDD) is identifying steps to spark immediate growth. Longer term, OBC is prepared to support a broad-based effort to engage business and public leaders statewide to refine strategies for economic growth.

The State’s Fiscal Condition

Although the latest forecast rivets attention on the current deficit, Oregon actually faces three interrelated fiscal challenges – short, intermediate, and long term. Oregon’s system of budgeting, which focuses on balancing resources and expenditures here and now, ignores longer-term challenges and opportunities. Oregon must pay attention to all three.

Immediate Challenge: 2001-2003 Budget

In early December the State Economist predicted that state General Fund and lottery revenue would fall $720 million below the forecast used for the 2001-03 budget adopted by the Legislature earlier this year. (Using the ending balance, the deficit drops to about $623 million.) This shortfall represents a deficit of about six percent this biennium, triggering the need for a special legislative session next year, probably in February.

Table 1 summarizes the budget adopted by the 2001 session, and presents the expected deficit created by the latest forecast. Since the Oregon state budget must balance, some action will have to be taken.

Unfortunately, it will be difficult to cut budgets by this magnitude without jeopardizing some of Oregon's important investments in education and other services that insure a healthy economic future. A six percent deficit may not sound like much. However, demand for public services typically does not decline during downturns. In the case of social services, the need for assistance increases. Students will remain in school. Prisoners are still locked up. As the table makes clear, education, social services, and public safety combined compose over 90 percent of general fund expenditures. All other agencies – the legislature, executive departments, natural resources agencies, economic and community development – would have to be severely cut or eliminated completely to spare the big three from cuts of the magnitude required by the latest forecast.

Table 1: Summary of Budget and Current Estimated Shortfall

	Close of Session	December Revenue Forecast	% of Total Budget
	REVENUE		
General Fund	11467.7	10747.5	
Lottery Fund	676.2	687.5	
Less Ed. Endowment	-99.0	-101.5	
Total	12044.9	11333.5	
	EXPENDITURES		
Education	6733.8	6733.8	56%
Human Resources	2620.7	2620.7	22%
Public Safety	1351.0	1351.0	15%
Other	675.1	675.1	6%
Emergency Fund	180.3	180.3	2%
Total	11973.9	11973.9	100%
Net Position	**70.9**	**-640.4**	

Note: OBC staff are working with the state budget office to determine why the -$640 million net fiscal position does not match the -$623 million deficit that they presented to the Legislature earlier this month.

Intermediate Challenge: 2003-2007 Budget

OBC believes that the state should consider its budget choices beyond the current biennium. *The Oregon Agenda Policy Playbook,* which set out our policy positions for the 2001 session, illustrates how such a framework might look by providing historic data on revenue, expenditures, and trends for the future. Table 2 updates that forecast with more recent trends on revenue and expenditures.

The numbers in Table 2 represent a simple trending of current service level by the state budget office and show a growing budget deficit as illustrated in yellow. Under the December revenue forecast, the budget office expects the budget will be out of balance in the 2003-05 and 2005-07 biennia by amounts considerably greater than the current shortfall.

[1] This figure is slightly higher than the projected $623 million deficit because we are awaiting the detailed close of session expenditure figures for the 2001-03 biennium.

Table 2. LONG-TERM GENERAL FUND-LOTTERY BUDGET OUTLOOK
(Millions of Dollars)

	1989-91	1991-93	1993-95	1995-97	1997-99	LAB 1999-01	LAB 2001-03	CSL 2003-05	CSL 2005-07	Est. 2007-09
RESOURCES										
General Fund (+ beginning balance)	4,926.2	5,869.7	6,902.5	8,227.9	9,124.8	10,460.0	10,747.5	11,944.8	13,585.5	14,669.2
Lottery	97.2	217.6	471.7	669.5	578.1	595.2	687.5	675.4	672.4	694.4
Total State Resources	5,023.4	6,087.3	7,374.2	8,897.4	9,702.9	11,055.3	11,435.0	12,620.2	14,257.9	15,363.5
Less Transfer to Ed. Endowment Fund					91.2	87.1	101.5	96.8	96.9	96.9
Net State Resources						10,968.2	11,333.5	12,523.4	14,161.0	15,266.6
School Property Tax	3,249.0	3,224.0	2,710.0	2,141.0	2,236.0	2,567.0	2,892.1	3,196.0	3,523.6	3,884.7
State + Local Resources	**8,272.4**	**9,311.3**	**10,084.2**	**11,038.4**	**11,938.9**	**13,535.2**	**14,225.7**	**15,719.4**	**17,684.5**	**19,151.3**
EXPENDITURES										
Education	5,383	6,209	6,410	6,829	7,746	8,665.8	9,625.9	10,621.5	11,772.6	13,078.3
School Fund	4,201	4,904	5,075	5,526	6,204	6,905.5				
Community Colleges	357	424	381	502	574	630.9				
Higher Education	649	707	668	523	590	741.7				
Other Education	176	174	286	278	378	387.7				
Human Resources	1,097	1,403	1,735	1,899	1,899	2,279.7	2,620.7	3,164.5	3,693.2	4,310.1
Medicaid/OHP	127	270	454	673	611					
Other Human Resources	970	1,133	1,281	1,226	1,288					
Public Safety	631	710	770	991	1,282	1,538.5	1,764.0	1,997.4	2,178.9	2,401.3
Corrections	295	324	355	445	630					
Judicial	198	231	256	269	308					
Other Public Safety	138	155	159	277	344					
Other	530	455	461	460	457	572.5	675.1	714.5	748.9	800.3
Natural Resources	85	95	135	125	148		275.9	269.4	284.4	300.2
Economic Development	191	162	118	144	118		131.7	161.2	165.3	169.5
Other Remaining	254	198	208	191	191		267.4	283.9	299.2	330.6
Total Expenditures	**7,641**	**8,777**	**9,376**	**10,179**	**11,384**	**13,057**	**14,686**	**16,498**	**18,394**	**20,590**
Less:										
Emergency Fund	141	114	52	88	86	81.9	180.3	30.0	30.0	30.0
Special Purpose Appropriations	134	42	28	76	116	64.3				
Target Ending Balance							86.4	133.0	149.0	149.0
Net Fiscal Position	**356.4**	**378.3**	**628.2**	**695.4**	**352.9**	**332.5**	**-726.8**	**-941.5**	**-888.0**	**-1,617.8**

However, this projection is very sensitive to the underlying assumptions on revenue and expenditure growth. For example, Table 3 assumes that Oregon returns to the revenue trend we were on just a little over a year ago and assumes slower growth in education and human services expenditures. Under this scenario, we can expect to see a very small deficit in the 2003-05 biennium and a surplus by the 2005-07 biennium and beyond. The changes from Table 2 are highlighted in yellow.

We are not arguing that Table 3 represents a better forecast of the future than Table 2. We present it to illustrate how relatively small changes in assumptions about revenues and expenditures can dramatically influence the size of projected deficits. It highlights how hard work in stimulating the economy and improving public services (or a more optimistic economic forecast) can make a big difference for Oregon's future. It also illustrates the uncertainty of the budget environment that we are operating in. Having the intermediate analysis is very important because it will more fully frame the scope of our budget problem. For example, if we face multi-year budget deficits, then use of one-time sources of money to address the immediate shortfall may simply delay difficult choices until the next session of the Legislature. We need to understand that there are uncertainties within any forecast, and think about contingency plans for different economic conditions.

Table 3. LONG-TERM GENERAL FUND-LOTTERY BUDGET OUTLOOK
(Millions of Dollars)

						LAB	LAB	CSL	CSL	Est.
	1989-91	**1991-93**	**1993-95**	**1995-97**	**1997-99**	**1999-01**	**2001-03**	**2003-05**	**2005-07**	**2007-09**
					RESOURCES					
General Fund (+ beginning balance)	4,926.2	5,869.7	6,902.5	8,227.9	9,124.8	10,460.0	10,747.5	12,524.7	14,301.8	16,079.0
Lottery	97.2	217.6	471.7	669.5	578.1	595.2	687.5	675.4	672.4	694.4
Total State Resources	5,023.4	6,087.3	7,374.2	8,897.4	9,702.9	11,055.3	11,435.0	13,200.1	14,974.2	16,773.4
Less Transfer to Ed. Endowment Fund					91.2	87.1	101.5	96.8	96.9	96.9
Net State Resources						10,968.2	11,333.5	13,103.3	14,877.3	16,676.4
School Property Tax	3,249.0	3,224.0	2,710.0	2,141.0	2,236.0	2,567.0	2,892.1	3,196.0	3,523.6	3,884.7
State + Local Resources	**8,272.4**	**9,311.3**	**10,084.2**	**11,038.4**	**11,938.9**	**13,535.2**	**14,225.7**	**16,299.3**	**18,400.9**	**20,561.2**
					EXPENDITURES					
Education	5,383	6,209	6,410	6,829	7,746	8,665.8	9,625.9	10,396.0	11,227.7	12,125.9
School Fund	4,201	4,904	5,075	5,526	6,204	6,905.5				
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Less:										
Emergency Fund	141	114	52	88	86	81.9	180.3	30.0	30.0	30.0
Special Purpose	134	42	28	76	116	64.3				
Target Ending Balance							86.4	133.0	149.0	149.0
Net Fiscal Position	**356.4**	**378.3**	**628.2**	**695.4**	**352.9**	**332.5**	**-726.8**	**-136.2**	**427.3**	**1,051.6**

Long-Term Challenge: 2005-07 Budget and Beyond

The analysis above shows how important the assumptions are for the long-term forecast. Under one scenario we have a significant deficit by the end of the decade, however if economic growth is strong and expenditures are contained we could have a substantial surplus.

Even with a rosy scenario, however, we have to consider the dark cloud represented by the growing liabilities of the PERS system. An analysis by Randy Pozdena prepared for OBC estimates that the net present value of the retirement liabilities associated with PERS (the retirement programs for state government, local government, and public school employees) is up to $10 *billion* greater than the assets in the PERS fund. While some progress has been made, unless we can come to grips with this contentious issue, Oregon's ability to provide quality services could be jeopardized for decades.

The PERS analysis emphasizes the importance not only of providing a long-term forecast of General Fund revenues and expenditures, but also of assessing the assets and obligations associated with the various funds managed by state government. Along with PERS, the Legislature should review the condition of all funds, including the Common School Fund, the Unemployment Insurance Fund, the Transportation Fund, the State Accident Insurance Fund and Tobacco Settlement Funds as part of its response to addressing the current budget shortfall.

To summarize, Oregon has a short-term budget problem. It also may have an intermediate- and long-term problem. As we look towards a special session, it will be important to understand more fully the nature of all three.

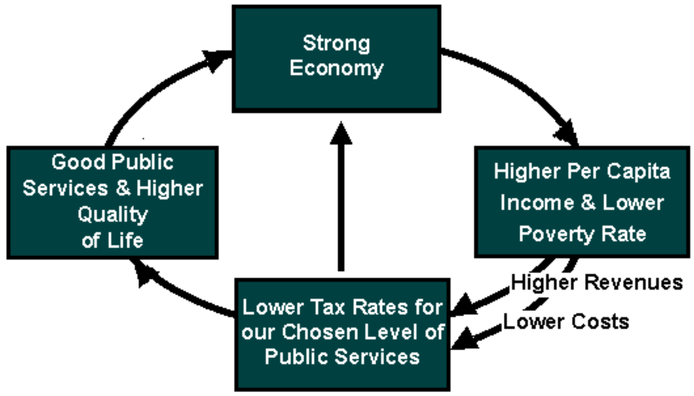
Guidelines For Addressing the Budget Shortfall

Oregon public leaders face difficult choices as they wrestle with how to address the current budget shortfall and plan for Oregon's future. The Oregon Business Council offers these guidelines on how to approach the challenge and pledges to work with public leaders to develop these ideas into specific proposals in the weeks ahead.

1. Start with Oregon's future in mind. Oregon's response to the fiscal deficit should be guided by the vision and strategies of *Oregon Shines*, our state strategic plan. The plan envisions a vital, prosperous Oregon that excels in all spheres of life.

> Oregon has diverse businesses providing quality jobs and a talented workforce able to perform those jobs well. It has communities that are safe, caring, and engaging places to live. It has quality public infrastructure and services. It has healthy and sustainable natural surroundings. **— Oregon Shines II, January 1997**

OBC recognizes that a strong economy and quality public services are interdependent. *Oregon Shines* calls this the Circle of Prosperity. The public sector needs a healthy economy, which creates jobs, boosts tax receipts, reduces poverty, and shrinks demand for poverty-related services. The private sector needs high-quality public services in the form of good schools, and other public amenities to attract and retain the talent business needs to be competitive. And it needs transportation, telecommunications, energy, and other infrastructure to produce and move products and services.



Oregon's Circle of Prosperity. A strong economy and quality public services are interdependent.

The perspective that this provides takes off the table some of the more simplistic responses to the current deficit challenge. Because public services are vital for long-term economic health, thoughtless service cuts in education and other areas would fracture the Circle of Prosperity. On the other hand, across-the-board tax hikes may dampen long-term growth and risk prolonging the current recession.

As part of its work on addressing the budget shortfall, the Legislature should keep our future vision clearly in mind and look for proposals that reduce costs, improve service quality and stimulate economic growth.

2. Make budget choices within a multi-year framework. Fiscal choices made one year affect choices in the years that follow. The state should prepare a budget forecast for the next five biennia and explicitly connect current decisions with the longer-term outlook. It should also produce a status report on the condition of all funds and an identification of one-time revenue sources that might be applied to this current challenge – and obligations that may come due in the future. This analysis should test different assumptions about revenue and expenditure growth.

To date, we have not seen an analysis of the kind and quality we are suggesting. Simple extrapolations of current economic trends and current services levels do not constitute a long-term budget. A long-term budget imagines alternatives, and drives plans for making a preferred future happen.

This analysis is critical in the current environment, for it drives the perception about whether the current shortfall is temporary (driven by the current downturn) or permanent (driven by need for services greater than the capacity of the current tax system). And a comprehensive summary of our funds will help determine resources that might be available to responsibly address the current shortfall.

3. Build a healthy economy (its the best source of public revenue). The best source of revenue for public services is a healthy economy, not increased taxes. The enormous growth in revenue during the 1990s beyond that originally anticipated is an excellent illustration of the importance of economic growth.

Unfortunately, state policy and action can do relatively little to offset the impact of a national recession, but it is important to do everything that can be done on short-term stimulus. We applaud both the Governor and the Legislature for focusing on this issue. Short-term stimulus should aim to:

- Spark new public and private investment.
- Retain existing businesses as they downsize.
- Stimulate consumer demand, including tourism.

A short-list of ideas is being developed. The public and private sectors need to work together to implement them. As was discussed in an earlier section, this is a good time to look at longer-term economic strategy.

4. Take the opportunity to save money and improve service by redesigning programs. In business revenue shortfalls often spark improvements that might be neglected in ordinary times. So it should be for the public sector. The Governor and Legislature should develop a short list of opportunities for possible implementation soon. The focus should be on big-ticket areas that can save dollars and improve service short and long-term, such as:

- Revamp PERS to limit future liabilities while providing a fair retirement program for public employees.
- Apply the tools created for the Quality Education Model to selectively review the K-12 budget and to identify opportunities for savings and to set priorities.
- Employ the new funding model for post-secondary education to make adjustments to budgets. Consider accelerating decentralization of responsibility and authority to the campus level to reduce overhead an enable more flexible responses to shortfalls.

5. Cut budgets selectively. Budget cuts should be coupled with the opportunity to rethink services, as described above. And priorities should be set to avoid cuts that damage critical priorities for now and the future. In particular, we must take care to:

- Ensure that Oregon maintains excellence in core education services.
- Build programs in engineering and technical education that support economic growth.
- Provide assistance to those most in need.
- Protect early childhood investments that will forgo the need for remedial services (special education, corrections and other social services) in the future.

6. Raise new revenue as a last resort with the least impact on economic growth. Additional revenues may ultimately be needed to fill the current budget deficit and possibly to meet long term needs. However, tax increases should be considered as the last resort. If additional revenues are required, sources should be prioritized. Oregon is already overly reliant on taxes related to work and investment. Increases in income taxes should fall to the bottom of the list because they discourage economic growth. Revenue opportunities include the application of cost-based fees for services, taxes on consumption of items such as beer, wine, cigarettes, and gaming or the expansion of the lottery.

While Oregon does not have a formal rainy day fund, there are one-time sources such as tobacco settlement dollars and federal funds associated with Medicaid Upper Payment Limit that should be considered. As described earlier we need a full accounting of all the various funds and an assessment of future obligations before we can decide how much of these funds can be responsibly used.

For some time OBC has recommended the creation of a rainy day fund. While now is not the time to fill such a fund it is a good time to create and to identify a revenue source to build it up as the economy improves so that future downturns are not as painful as this one.

These guidelines are intended to assist in the framing of choices and for the development of specific proposals. For its part, members of the Oregon Business Council are eager to work with elected leaders to develop more specific proposals to address Oregon's long-term interests.

APPENDIX A

Oregon Economic Situation
November 2001

J. Cortright, Impresa, Inc.

The current situation

The nation's longest peacetime expansion is clearly over. Oregon employment in September 2001 was about 1.3% less than in the previous September. This represents a dramatic turnaround from the state's average performance in the 1990s, when the state was among the nation's fastest growing, averaging 2.5% more jobs per year compared to a national rate of 1.9%.

In contrast to the last national recession—1990 to 1991—Oregon is leading the nation into the downturn. Through September, US employment growth had slowed to 0.1%, but had not gone negative. It will clearly be negative the in 4th Quarter of 2001. Through August, Oregon's 12-month employment growth rate ranked 49th of the 50 states.

How does this compare to previous recessions?

The current recession will likely be more serious than the 1990-91 recession but far less severe than the 1980-82 recession. Oregon was spared most of the brunt of the 1990-91 recession, recording just seven months of negative growth. In contrast, the 1980-82 recession was far more severe in Oregon than nationally, lasting three years and costing the state nearly 10% of its total employment.

This recession is unlikely to be as severe as the 1980-82 recession for several reasons: First, economic policy is far more favorable now than twenty years ago. The Federal Reserve Board purposely engineered the 1980 recession with tight money policies; today the Fed is pursuing a very loose monetary policy, with interest rates at 40 year lows. Fiscal policy is rapidly shifting to an expansionary mode as well. Second, Oregon's economy is far less dependent on the interest rate sensitive lumber industry than in 1980. The 1980-82 recession coincided with a permanent structural change in wood products and the loss of 30,000 jobs. No such large structural changes appear likely for any of Oregon's principal economic sectors.

Why is Oregon leading the nation into recession?

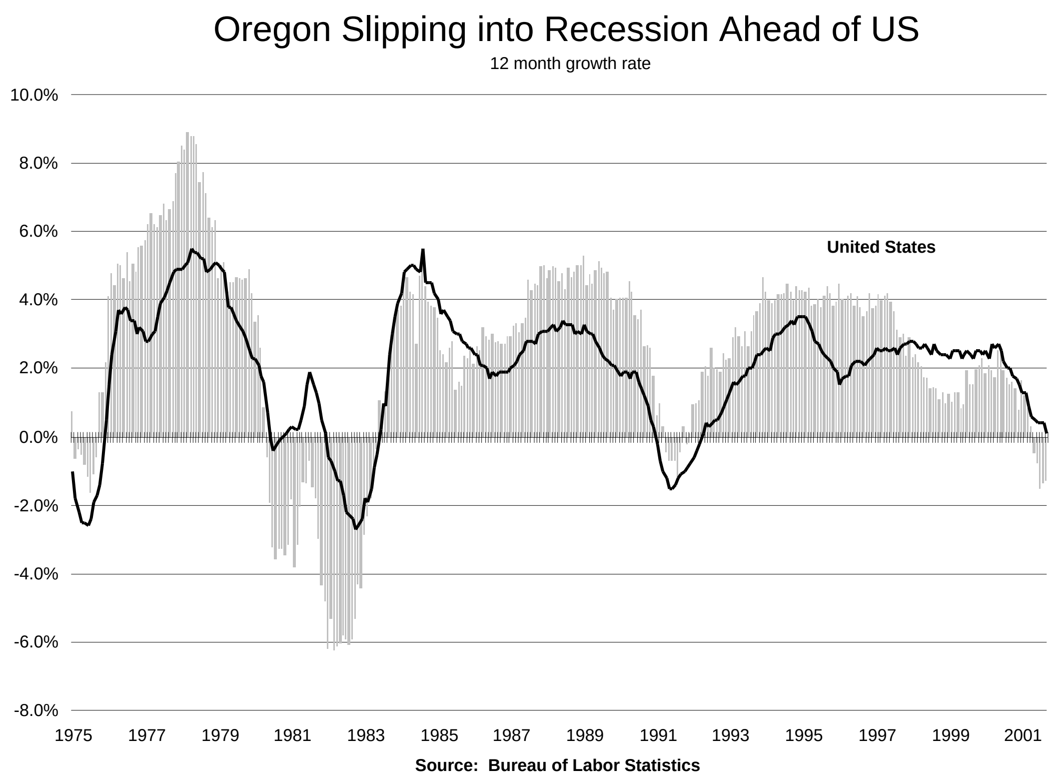
The structure of the Oregon economy, with proportionally greater dependence on durable goods manufacturing sectors, makes us more sensitive to economic cycles than the nation as a whole. Durable goods manufacturing accounted for about 14% of the growth in earnings in Oregon during the 1990s compared to about 7% nationally. Oregon's economic performance varies dramatically by industry sector.

The decline in the growth rate of high tech employment from 6% per year in the 1990s, to 1% over the last twelve months has been the most dramatic factor in lowering Oregon's growth rate. Over the past decade, high tech job growth was twice as important to the

Oregon economy as the US economy; consequently the decline in high tech growth to one-sixth of its previous level has affected Oregon far more than the US. Despite the slowdown, Oregon high tech continues to outperform the nation, growing 1% while the national high tech sector declined by 3%.

In addition, employment has declined in all of the other principal manufacturing sectors in the Oregon economy. Transportation equipment manufacturing, which grew significantly faster than the US in the 1990s, is down sharply (due to layoffs at Freightliner and recreational vehicle makers); the decline in metals manufacturing parallels the trends in the industry nationally, and paper, food processing and wood products, which were all declining during the 1990s, have dropped further in the past 12 months.

In addition, employment declines in two other sectors have amplified the cyclical downturn. Construction employment and personnel supply services firms act as "accelerators" boosting the economy during times of growth and contracting rapidly during recessions. Construction employment, which grew almost twice as fast in Oregon as nationally during the 1990s, is down 7% over the past twelve months. In contrast, construction employment nationwide is up about 3%. Oregon's weakness in construction reflects slower statewide growth over the past few years. This is also reflected in Portland area housing prices, which are down about 1% from a year ago.



Does this recession reveal a fundamental weakness in the Oregon economy?

Oregon is less dependent on any single economic sector than it was 20 years ago. While the state has diversified, it still depends more heavily on cyclically sensitive non-durable manufacturing sectors than the nation as whole. This suggests that Oregon will grow faster in expansions and grow more slowly (or contract more) in recessions than the nation.

The sector-by-sector analysis makes it clear that our current downturn isn't due to the systematic inability of Oregon firms to do as well as other similar firms nationally in this economic environment. Oregon industries are still outperforming their counterparts nationally in high tech, and a performing on a par with their national counterparts in metals. Surprisingly, Oregon wood products and paper manufacturers are outperforming the nation (contracting less than the US industry), suggesting that they have become less cyclically sensitive than before. Only food processing and transportation equipment industries are performing noticeably worse than the same industry sectors nationally in the current recession.

During the 1990s, the state's economic growth was propelled by the rapid expansion of high technology employment, which grew an average of 6% annually, more than double the national rate. The growth in high tech, coupled with a relatively strong performance in metals and transportation equipment, masked the weakness in employment growth in paper and food processing and the continuing decline in wood products employment.

Table 1: Sectoral Analysis, Oregon Employment Growth, 1990-2000 & 2000-2001

Sector	**2000 Employment (thousands)**		**Share of Employment (2000)**		**Annual Growth Rate, 1990-2000**		**Annual Growth Rate** August 2000 to August 2001	
	Oregon	US	Oregon	US	Oregon	US	Oregon	US
High Tech	78.0	5,027.4	4.9%	3.8%	6.3%	2.6%	0.9%	-2.9%
Wood Products	49.0	831.8	3.1%	0.6%	-2.7%	1.3%	-3.0%	-4.5%
Metals	26.6	2,234.7	1.7%	1.7%	1.6%	0.3%	-5.9%	-5.6%
Transportation Equipment	20.2	1,849.0	1.3%	1.4%	4.1%	-0.7%	-14.1%	-4.9%
Food Processing	24.3	1,683.8	1.5%	1.3%	-0.2%	0.1%	-2.4%	0.2%
Paper	7.9	656.7	0.5%	0.5%	-1.5%	-0.6%	-2.5%	-3.9%
Six Key Export Sectors	206.0	12,283.5	12.8%	9.3%	1.6%	1.0%	-2.3%	-3.0%
Total Employment	1,603.3	131,759.0	100%	100%	2.5%	1.9%	-1.3%	0.4%
Key Cyclical Sectors								
Construction	85.7	6,698.0	5.3%	5.1%	4.9%	2.7%	-6.6%	2.3%
Personnel Supply	44.5	3,887.0	2.8%	3.0%	10.4%	9.3%	-18.0%	-10.2%