

II. REVENUE FORECAST

Summary

Similar to the outlook for economic growth, the near-term revenue forecast has stabilized in recent months. Expectations call for slow growth over the next two fiscal years. Growth in personal income tax collections is expected to moderate, but remain strong enough to offset losses in corporate income tax collections and flat lottery transfers.

Since the December forecast, combined general fund and lottery resources have been revised lower by \$35.1 million for the 2011-13 biennium, and lower by \$15.8 million for the 2013-15 biennium.

Most of the reduction in the near-term revenue forecast can be traced to personal income tax returns from 2010 that were submitted by filers who requested extensions. Such filers include many high-income households with complicated tax returns. On average, filers who take advantage of extensions tend to pay more than they owe in April in order to avoid late payment penalties. Last April, such filers overshot their tax liability by an unusually large amount, and drained state coffers when they asked for it back in the fall.

Encouragingly, 2010 personal income tax returns have now been largely processed, and cannot do any further damage to collections. Excluding 2010 tax reconciliations, fiscal year 2012 has started off well, with the vast majority of revenue line items tracking above the forecast. In particular, withholdings out of wages and salaries have held up surprisingly well in recent weeks. However, given Oregon's dependence on personal income taxes, the 2012 outlook for collections will remain highly uncertain until the April tax season passes.

During fiscal year 2011, personal income tax collections grew at a 12% rate, which was more than double the growth seen in underlying personal income. Heading into 2012, many of the factors supporting Oregon's strong personal income tax revenue gains will go away. As a result, revenue growth is expected to be cut in half in the months ahead. Income tax collections are expected to increase by roughly \$600 million over fiscal years 2012 and 2013, matching the growth seen in fiscal year 2011 alone.

Such a slowdown in collections has been assumed in the outlook for several months. The current outlook is only marginally more pessimistic than was the December forecast. However, the risks to the outlook remain skewed to the downside. If the U.S. economy slips back into recession, it would certainly drag Oregon's regional economy and state tax revenues down with it. In such a scenario, the forecast for tax revenues would fall on the order of \$1 billion for the current biennium.

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

A. 2011-13 General Fund Revenues

Led by personal income tax collections, general fund revenues have expanded at their long-run average pace through the first seven months of fiscal year 2012. Corporate tax collections are now falling rapidly, with the boom in underlying corporate profits having come to an end. Lottery sales have grown at only a snail's pace since the recession began.

Growth in collections will lose steam over the remainder of the biennium. Many of the factors supporting Oregon's strong revenue gains in fiscal year 2011 are now going away. Growth in personal income taxes will face downward pressure from policy changes, including revisions to the tax withholding tables in 2011 and a reduced 2012 income tax rate on high-income filers. Moreover, the declines in stock prices and business income seen at the end of the summer will lead to less growth in taxable capital gains and bonuses this year. Also, households have depended on a wide range of alternative taxable income sources in recent years to help replace lost labor income. Some of these sources, including unemployment insurance payments and tax-deferred savings accounts such as IRAs, have been heavily tapped, and will weaken going forward.

Largely due to reconciliations of 2010 tax returns, expected revenues for the 2011-13 biennium are somewhat weaker than what was predicted in the December 2011 forecast. The forecast for General Fund revenues for 2011-13 is now \$13,703 million. This represents a decrease of \$28.63 million (-0.2%) from the December 2011 forecast.

Table R.1

2011-13 General Fund Forecast Summary					
(Millions)	2011 COS Forecast	December 2011 Forecast	March 2012 Forecast	Change from Prior Forecast	Change from COS Forecast
Structural Revenues					
Personal Income Tax	\$12,193.6	\$12,001.4	\$11,969.2	-\$32.2	-\$224.3
Corporate Income Tax	\$894.2	\$821.4	\$812.6	-\$8.7	-\$81.6
All Other Revenues	\$944.2	\$932.3	\$944.6	\$12.3	\$0.4
Gross GF Revenues	\$14,032.0	\$13,755.1	\$13,726.5	-\$28.6	-\$305.5
Administrative Actions ¹	-\$23.1	-\$23.1	-\$23.1	\$0.0	\$0.0
Legislative Actions	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Net Available Resources	\$14,008.9	\$13,731.9	\$13,703.3	-\$28.6	-\$305.5
Confidence Intervals					
67% Confidence	+/- 7.8%		\$1,065.8	\$12.66B to \$14.79B	
95% Confidence	+/- 15.5%		\$2,131.6	\$11.59B to \$15.86B	
¹ Reflects cost of cashflow management actions, exclusive of internal borrowing.					

The forecast for the 2011-13 biennium is now \$305.5 million below the Close of Session forecast. Given the strong employment gains seen in early 2011, the Close of Session forecast is somewhat more optimistic than other versions produced before or since. Nevertheless, given lackluster near-term expectations for revenue growth, a strong April tax season of collections would put us back on track with the Close of Session's optimistic outlook. If we see two unexpectedly strong April seasons in 2011-13, the personal income tax kicker will come into play.

Personal Income Tax

Personal income tax collections were \$1,403 million for the second quarter of fiscal year 2012, \$35.3 million (2.5%) below the latest forecast. Compared to the year-ago level, total personal income tax collections were up 10.1% relative to a forecast of 12.8% growth. Table B.8 in Appendix B presents a comparison of actual and projected personal income tax revenues for the second quarter of fiscal year 2012.

Although personal income tax collections tied to current economic conditions remain healthy, the forecast for total personal income tax receipts during the current biennium was reduced by \$32 million from the December forecast. This revision can largely be traced to disappointing reconciliations of 2010 tax returns.

Corporate Taxes

Corporate excise taxes equaled \$90 million for the second quarter of fiscal year 2012, \$0.9 million above the December forecast. Compared to the year-ago level, total corporate receipts were down 15.9% relative to a forecast of a 16.8% decline. Table B.8 in Appendix B presents a comparison of actual and projected corporate income tax revenues for the fourth quarter of fiscal year 2011.

Corporate profits, and associated tax collections, are cooling off rapidly after reaching record highs. Profits and corporate tax collections are notoriously volatile, with collections often cut in half in the year immediately following profit booms. The expectation for a sharp correction in corporate income tax collections over the coming year has been built into recent forecasts. The December outlook for 2011-13 was revised downward by \$8.7 million (1.1%).

Non-income Tax Sources of Revenue

All other revenues will total \$944 million for the biennium, an increase of \$12.3 million (1.3%) from the prior forecast. Most small revenue line items are now performing better than expectations. Revisions were largest for state court fees and criminal fines, where the impacts of 2009-11 legislation are now appearing in the revenue data.

B. Extended General Fund Revenue Outlook

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

Table R.2

General Fund Revenue Forecast Summary (Millions of Dollars, Current Law)												
Revenue Source	Forecast		Forecast		Forecast		Forecast		Forecast		Forecast	
	2009-11	%	2011-13	%	2013-15	%	2015-17	%	2017-19	%	2019-21	%
	Biennium	Chg	Biennium	Chg	Biennium	Chg	Biennium	Chg	Biennium	Chg	Biennium	Chg
Personal Income Taxes	10,467.2	3.7%	11,969.2	14.3%	13,657.7	14.1%	15,464.2	13.2%	17,163.8	11.0%	19,001.8	10.7%
Corporate Income Taxes	827.6	20.9%	812.6	-1.8%	1,097.3	35.0%	1,097.9	0.1%	1,082.7	-1.4%	1,140.6	5.3%
All Others	1,230.9	29.2%	944.6	-23.3%	921.1	-2.5%	978.2	6.2%	1,046.9	7.0%	1,132.5	8.2%
Total General Fund	12,525.8	6.8%	13,726.5	9.6%	15,676.1	14.2%	17,540.3	11.9%	19,293.4	10.0%	21,274.9	10.3%
<i>Kicker Distributions</i>	-		-		-		-		-		-	
Total Revenue	12,525.8	6.8%	13,726.5	9.6%	15,676.1	14.2%	17,540.3	11.9%	19,293.4	10.0%	21,274.9	10.3%

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

General Fund revenues will total \$15,676 million in 2013-15, an increase of 14.2% percent from the prior period, and \$9 million (0.1%) above the December forecast. In 2015-17, revenue growth will moderate to 11.9%, followed by slower rates of around 10% in subsequent biennia. The slowdown in long-run revenue growth is largely due to the impact of demographic changes. Revenues in 2015-17 and beyond are expected to be smaller than in the December forecast, largely due to a downgraded outlook for retirement income. An unexpectedly large amount of assets have been pulled from retirement accounts in recent years, leading to smaller nest eggs. Table B.2 in Appendix presents a more detailed look at the long-term General Fund revenue forecast.

C. Tax Law Assumptions

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

The treatment of the corporate minimum tax represents an important current area of policy uncertainty. Proposed legislation and the courts are both currently determining whether or not Oregon tax credits can be used to offset liability from the corporate minimum tax. Should the credits be allowed, the forecast for corporate excise taxes will be reduced. In this event, OEA will use estimates from the Legislative Revenue Office to determine the impact on collections. Preliminary back-of-the-envelope estimates suggest that corporate tax collections will take an initial hit of around \$20 million as businesses amend old tax returns, followed by a loss of \$6 million to \$12 million per fiscal year going forward.

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

D. Forecast Risks

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

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

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

Should a recession of this nature ensue, FY2011-13 biennial income tax revenues would be reduced on the order \$756 million. In addition to income taxes, which we can formally model under alternative scenarios, other general fund taxes would also decline, lowering the general fund by an additional \$100 to \$200 million in 2011-13.

Table R.2a**R.2a Alternative Scenarios for Major General Fund Revenues**

		Baseline	Compared to Baseline				Growth Rates		
			Pessimistic	Losses	Optimistic	Gains	Baseline	Pessimistic	Optimistic
Personal Income Taxes									
(\$ thousands)	FY 2011	5,524,015	5,524,015	0	5,524,015	0			
	FY 2012	5,844,957	5,535,001	-309,956	6,258,295	413,337	5.8%	0.2%	13.3%
	FY 2013	6,124,249	5,761,296	-362,953	6,531,865	407,617	4.8%	4.1%	4.4%
	FY 2014	6,565,891	6,176,540	-389,350	7,065,811	499,920	7.2%	7.2%	8.2%
	FY 2015	7,091,840	6,659,464	-432,376	7,622,029	530,189	8.0%	7.8%	7.9%
Corporate Excise Taxes									
(\$ thousands)	FY 2011	468,607	468,607	0	468,607	0			
	FY 2012	412,463	371,616	-40,847	452,647	40,184	-12.0%	-20.7%	-3.4%
	FY 2013	400,178	355,221	-44,956	453,021	52,843	-3.0%	-4.4%	0.1%
	FY 2014	526,266	439,781	-86,485	567,103	40,837	31.5%	23.8%	25.2%
	FY 2015	571,035	473,015	-98,020	601,865	30,830	8.5%	7.6%	6.1%

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

E. Lottery Earnings Forecast

Table R.3 presents a summary of lottery earnings and distribution for the 2011-13 biennium. Projected lottery earnings will total \$1,092.7 million, a decrease of \$6.5 million from the prior forecast. Overall lackluster collections stem from video lottery sales, which dominate overall lottery earnings. Although growth has been relatively slow, lottery revenues have stabilized and returned to continued growth in fiscal year 2011. Revenue fell sharply in the wake of the recession and enactment of the smoking ban. Including the beginning balance and other earnings, total available resources equal \$1,095.4 million. After adjusting for programs that receive a strict percentage of lottery transfers and incorporating changes to distributions made during the 2011 session, the current forecast for the ending balance is \$3.7 million.

Table R.3**2011-13 Lottery Fund Forecast Summary**

	Close of 2011 Session	Sept 2011 Forecast	Dec 2011 Forecast	Changes from:	
				Sept 2011 Forecast	Close of 2011 Session
Transfers of Lottery Earnings					
Traditional Games	\$128.5	\$128.7	\$120.1	-\$8.6	-\$8.4
Video Lottery	\$991.8	\$987.9	\$971.1	-\$16.8	-\$20.7
Administrative Savings	\$8.0	\$8.0	\$8.0	\$0.0	\$0.0
Total Transfers	\$1,128.3	\$1,124.6	\$1,099.2	-\$25.4	-\$29.1
Economic Development Fund					
Beginning Balance	\$0.2	\$0.2	\$0.2	\$0.0	\$0.0
Transfers from Lottery	\$1,128.3	\$1,124.6	\$1,099.2	-\$25.4	-\$29.1
Other earnings ¹	\$2.5	\$2.5	\$2.5	\$0.0	\$0.0
Total Available Resources	\$1,131.0	\$1,127.3	\$1,101.9	-\$25.4	-\$29.1
Dedicated Distributions²					
Dedicated Distributions ²	\$432.9	\$427.8	\$423.3	-\$4.6	-\$9.6
Other Legislatively Adopted Allocations	\$670.6	\$670.6	\$670.6	\$0.0	\$0.0
Total Distributions	\$1,103.5	\$1,098.4	\$1,093.9	-\$4.6	-\$9.6
Ending Balance	\$27.5	\$28.8	\$8.0	-\$20.8	-\$19.5

Footnotes:

1. Includes interest earnings and reversions.

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

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

F. Overview of Budgetary Reserves

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

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

The ESF gained its current reserve structure and mechanics via constitutional amendment in 2002. The ESF receives 18 percent of lottery earnings⁶, deposited on a quarterly basis. The ESF does not retain interest earnings. The ESF has similar triggers as the ORDF (in fact, the ORDF was modeled on the ESF), but does not have the two-thirds cap on withdrawals. The ESF balance is capped at five percent of General Fund revenues collected in the prior biennium.

Budgetary Reserve Outlook

Table R.4 presents projected balances for the ORDF and ESF. In 2009-11, \$115.7 million from the ORDF and \$84.3 million from the ESF were transferred to the State School Fund. The ORDF ended 2009-11 with a balance of \$10.4

million, while the ESF ended the biennium with a balance of \$5.1 million. The General Fund ending balance for 2009-11, \$35.2 million, was deposited into the ORDF at the beginning of the 2011-13 BN.

In 2011-13, the ESF is expected to see deposits of \$187.0 million based on Lottery sales, while scheduled withdrawals this biennium total \$182.2 million. The projected ending balances for both the ORDF and ESF total \$55.9 million this biennium.

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

Table R.4
Oregon's Budgetary Reserves

(Millions)	2009-11 Biennium	2011-13 Biennium	2013-15 Biennium
Rainy Day Fund			
Beginning Balance	\$112.5	\$10.4	\$46.1
Net Deposits ³	-\$103.4	\$35.2	\$197.5
Interest	\$1.3	\$0.4	\$1.9
Ending Balance¹	\$10.4	\$46.1	\$245.5
Education Stability Fund			
Beginning Balance	\$0.0	\$5.1	\$9.8
Net Deposits	\$101.4	\$187.0	\$199.3
Interest ²	\$1.0	\$0.4	\$1.4
Withdrawals	-\$97.4	-\$182.7	-\$1.4
Ending Balance	\$5.1	\$9.8	\$209.1
Total Reserves	\$15.5	\$55.9	\$454.6

Footnotes:

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

⁶ Five percent of these transfers are deposited to the Oregon Growth sub-account. Due to the illiquid nature of this sub-account, only funds in the main account are included in the figures presented here.