Final Report

Governor's Reset Cabinet

June 2010

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Why Oregon Must Reset State Government

June 2010

To Governor Kulongoski:

We are pleased to present the final report of our Reset Cabinet in response to your Executive Order 09-13.

In this report, we provide the “menu of options” you requested to restructure state government so that it can better fulfill its core functions and preserve and improve critical services for Oregonians in an increasingly challenging fiscal environment.

We analyzed the concerns you raised about the vulnerabilities created by the current economic crisis and the impending loss of one-time federal funds. Our findings not only confirmed your concerns but raised the specter of the “decade of deficits” we highlighted in our interim report. These findings provided stark warning signs for the path we’re on and gave new urgency to our effort to chart paths to a better future.

We frequently discussed the trade-offs between what you have called “budgets of necessity” and “budgets of choice.” We recognized that “necessities” such as the safety of our communities and the protection of vulnerable children cannot be ignored. At the same time, we acknowledged that the ability to make “choices” for greater investments in education is equally compelling.

Also, we called out the stark contrast between the vicious circle of declining personal incomes, diminishing tax revenue and increasing needs for services of necessity and the virtuous circle of a better educated citizenry achieving higher incomes, generating more tax revenue, needing fewer services and creating more opportunities for investments of choice.

In the end, we concluded that creating a stable and sustainable fiscal future will enable the improvements needed to free up resources for better investments and provide our best hope of turning a decade of deficits and further decline into a decade of stability and new opportunity.

Our review of the services that comprise the state’s core responsibilities did not touch on every program in the state’s general fund budget, nor will our recommendations be sufficient to close the deficit in the next biennium, even if adopted in full. But we view these recommendations as a solid foundation for the restructuring and funding of services over the next two biennia. We expect these recommendations will be supplemented by other ideas and by the unavoidable item-by-item budget cutting that will necessarily flow from the budget reductions you implemented this month and the cut lists that state agencies are preparing for 2011.

All of the choices we face will be difficult, and we realize that many of the options we offer are likely to be viewed as provocative and challenging to implement. But it was not our intention to be controversial or theoretical. We were determined to deliver realistic plans to address the real, immediate and continuing problems we face in the wake of the Great Recession.

We hope it is now evident that forced marches through steep budget declines, in which we struggle for a foothold from biennium to biennium, will never lead us to a better future. We need a thoughtful and far-sighted expeditionary approach to see us through the next decade.

We offer this report as a road map of the best next steps that can lead us to a better future.

Members of the Governor’s Reset Cabinet

THE GOVERNOR'S RESET CABINET

Bruce Goldberg	*Director, Oregon Dept. of Human Services*
James Sager	*Assistant Superintendent, NW Regional Education Service District*
Lane Shetterly	*Attorney, Shetterly Irick & Ozias*
Doug Stamm	*CEO, Meyer Memorial Trust*
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INTRODUCTION AND OVERVIEW

The immediate effects of what is now being called the Great Recession have been sudden and severe. More than seven million jobs have been lost in the US, including 143,000 in Oregon. Some 14 million Americans and 203,000 Oregonians are officially unemployed; even more are underemployed and barely scraping by. Record numbers of citizens have turned to their states for health care, food stamps, job training and college educations.

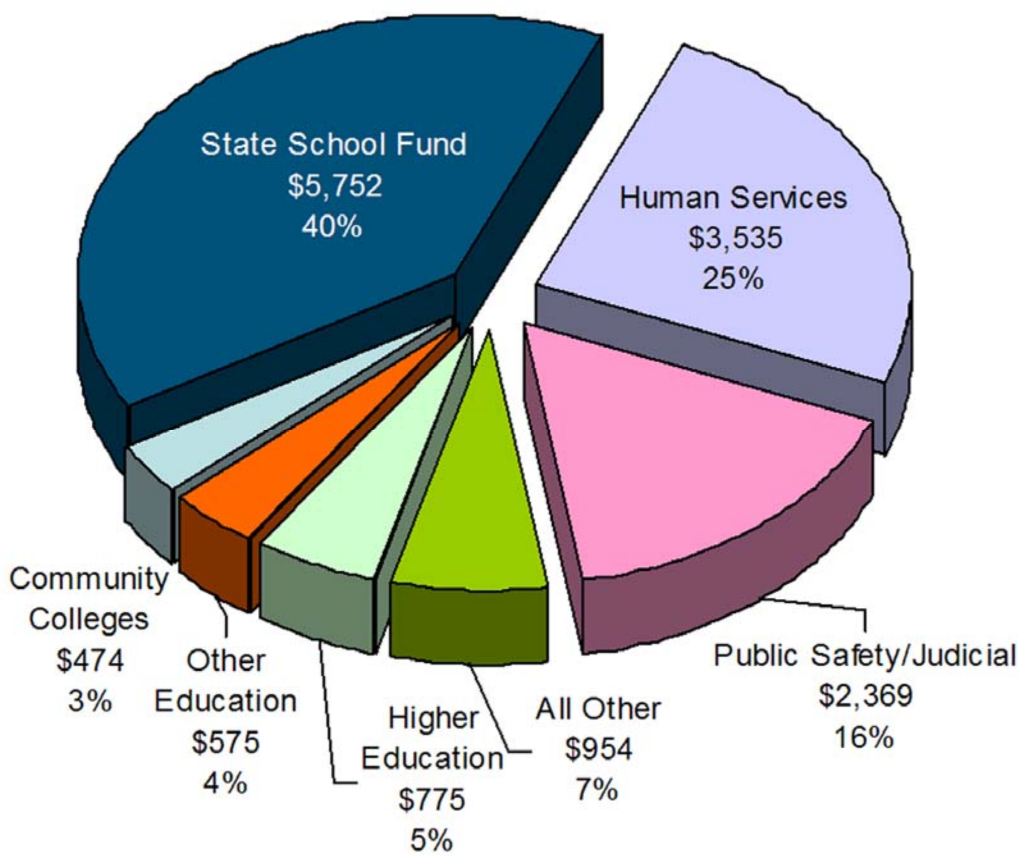
But the longer-term effects of this recession are just now coming into view. Although signs of recovery have appeared, economic activity is not expected to return to pre-recession levels for many years. Unemployment will remain high, prolonging hardships for working families and increasing their needs for state services. In this environment, revenues in many states will fall short of sustaining all programs and services now in place.

As we document in this report, state government in Oregon is emerging from this recession with reduced revenues, higher costs and greater demands for the services it provides. This is the challenge that confronts us now.

This challenge is most compelling for Oregon's general fund budget, in which resources are heavily dependent on household incomes and expenditures are critical to meeting both individual and societal needs.

Legislatively Approved Budget 2009 – 11
General Fund and Lottery Funds Combined

Expenditures Total: $14,434



Introduction and Overview

More than 90 percent of the state's general fund supports three core functions: education; health and human services; and public safety. These are responsibilities that the state cannot abandon. Yet the state's general fund will be hard-pressed to meet these responsibilities in its next budget period beginning July 2011 – and for many years thereafter.

We base this prediction on a thorough reassessment of the state's fiscal future in the aftermath of the recession. Our new look forward reveals a dramatically changed landscape in which the path we're on leads to steep budgetary hills to climb in the years ahead. Just a few years ago, the next decade looked promising. Now it looks daunting.

We conclude that the state will face a decade of deficits if it tries to sustain the type and scope of services it now provides. Business-as-usual budgets will no longer suffice. Current services, as currently structured, will be unsustainable.

We must rethink and refocus our priorities, move from short-term budgeting to long-term planning and develop smarter ways to meet our responsibilities in the challenging years ahead.
In that process, we must reaffirm our common goals and judge what we are doing now and what we propose to change by well defined measures of success. In the end, we must be willing to adopt new ways to organize and deliver services, control costs and get the best value for our tax dollars.

In times like these, we recognize that getting Oregonians back to work is an urgent priority all its own. To this purpose, we offer as an operating principle that meeting the state's core responsibilities to its citizens will stabilize and strengthen the foundations of our economy, just as employing smart policies to create and maintain a favorable business climate will promote job creation and raise family incomes. Further, we note that success in these endeavors will yield dividends for both the state budget and the state's economy, by reducing the need for safety net services, boosting revenues to support our priorities and accelerating economic growth.

States that succeed in such efforts will serve their citizens best in the years ahead. Those that continue on their current paths will struggle and fall behind.

This report makes the case for these findings, shares the thinking that has informed our work to date and presents recommendations to the Governor.

Here is a summary of what you will find in the three sections of this interim report.

Section 1: What's at Stake – The Core Responsibilities of State Government

In this section, we examine the core responsibilities of state government that are supported by broadly shared taxes and reflected in the state's general fund budget.

We begin with purposes, rather than programs. We quantify current budgets in terms of persons served and services delivered, not just dollars spent. We highlight the sometimes hidden shifts in funding and priorities that have occurred over the past two decades. We summarize new developments and attempt to provide a "heads up" for the path we're on.

Finally, we call out the unfinished business of state goals and policy agendas, such as increasing the proportion of Oregonians with college degrees, making health care affordable for Oregonians of all income groups and reducing the incidence of addiction and related criminal activity in our communities. These goals often end up on the cutting room floor when triage is used to rebalance a budget. We are keeping them on the table as we go through the exercise of resetting state government.

Section 2: What We're Facing – A Decade of Deficits and Unsustainable Services

Introduction and Overview

In this section, we provide an overview of the fiscal crisis facing Oregon and states around the country and dig deeper into the causes of that crisis in Oregon.

Revenue growth is expected to resume as the economy recovers and should make up for the loss of one-time funds that sustain the current budget. The most likely scenario is that Oregon will have approximately the same level of general fund resources to work with in the next biennium (2011-13) as it has in the current biennium.

But increasing costs, needs and demands will drive the expenditure side of the budget far beyond its resources. When compared to the cost of maintaining the current level of services, the state faces a shortfall of almost 2.7 billion dollars, or 15 percent of its next budget – a shortfall that persists at that two billion dollar level in budget projections through 2019.

As a result, we find that Oregon faces a decade of deficits, during which we cannot expect to be bailed out by a rebounding economy or a more generous federal government. In fact, trends in both categories could make our fiscal future even more challenging.

It is important to recognize that Oregon is not alone. Most states face similar challenges. Some are beginning to talk about "reset initiatives" of their own.

In one respect, Oregon appears to be in better shape than many of our counterparts. We have a balanced budget in place through June 2011, while some states are still struggling to balance their budgets for the fiscal year that begins this July. But, with cuts made in the current budget, voter-approved tax increases in place and reserves all but exhausted, we will have fewer options for rebalancing our budgets in the future.

These realities create the imperative for resetting state government. To respond to this imperative, we call out the importance of solving the state's deficits in the early years of the next decade, as opposed to "kicking the can down the road" with one-time budget patches or resorting to last-minute cuts that are hoped to be temporary. If we can make the painful but necessary choices up front, the deficits projected for the remainder of the decade will disappear.

Section 3 – What We Can Do – Options for Resetting State Government

This section lists the key areas that the Cabinet and its subcommittees have addressed in order to meet the challenge of the decade of deficits that confronts us. Here, we provide a brief overview of what we're investigating to develop potential reset options in the following categories.

1. Education Through High School
2. Education Beyond High School
3. Health and Health Care
4. Human Services
5. Public Safety
6. Labor Costs
7. Organization and Efficiency
8. Planning and Budgeting
9. Revenue Stability
10. State and Local Partnerships

Conclusion

Oregon faces a crossroads decision in 2011.

If we choose to stay the course and attempt to sustain current services with current practices, we will continue to stumble through the decade of deficits. In that scenario, lawmakers and voters will find themselves again and again between the rock and the hard place of cutting services or raising taxes.

But, if we are able to restructure services and control costs to better meet our responsibilities, we could chart a path to a decade of stability. Achieving this stability will require hard choices, but it need not be all pain and no gain. A more stable fiscal future will create an environment in which we can shift resources to new investments – investments that would not otherwise be feasible during another decade of deficits – to better meet the long-term needs of our citizens and build a more prosperous Oregon.

Section 1:

What’s at Stake – The Core Responsibilities of State Government

WHAT'S AT STAKE – THE CORE RESPONSIBILITIES OF STATE GOVERNMENT

This report begins with the recognition that there is general agreement among Oregonians on the top priorities for government at the state and local level. When asked to confirm these priorities, majorities of Oregonians check off responsibilities that include:

- ❖ Keeping us safe in our homes and communities;
- ❖ Protecting children, the disabled and the frail elderly from abuse and neglect;
- ❖ Helping families in crisis get back on their feet;
- ❖ Preventing the causes and spread of disease in our communities;
- ❖ Ensuring that needy families, children, seniors and the disabled have access to medical care;
- ❖ Educating our children through high school; and,
- ❖ Providing affordable education and training beyond high school.

All of these responsibilities are shared by state government and our cities, counties, special districts and school districts. All of them are financed by taxes and fees. And, although there are differing opinions on how these responsibilities should be met, they all involve the delivery of services – either directly (through public agencies such as police departments and public schools) or indirectly (through providers such as hospitals, community organizations or private contractors).

At the state level, these responsibilities consume 93 percent of the state's general fund budget and additional amounts from fees and federal funds. The state's general fund is supported by broadly shared taxes, primarily income taxes. In turn, the use of these taxes appears to reflect broadly shared priorities – at least in regard to the 93 percent devoted to the responsibilities listed above.

But priorities are not absolutes; they must be weighed against each other and continually rebalanced in the competition for limited resources. This is evident in the major program areas of the state's general fund budget.

Three large program areas encompass the responsibilities that Oregonians regularly cite as priorities for state and local government. These are education, health and human services and public safety. In each, we have seen continual demands to do more and notable shifts in their claims on the state's resources. For each, we see even more challenges ahead.

NOTE: The expenditure data used in this report are based on the state's budget for 2009-11 as amended in the February 2010 legislative session. Following the adoption of this amended budget, the state economist reported an unexpected decline in revenues that created a budget shortfall of $577 million. The Governor responded to this shortfall by using the "allotment authority" to rebalance the budget. The rebalance reduced general fund expenditures by $577 million across-the-board, beginning July 1, 2010. These reductions, which averaged 4.6 percent of all general fund agency budgets for the full biennium, have not yet taken effect and are not reflected in the expenditure data cited in this section.

Public safety

❖ *Keeping us safe in our homes and communities*

The state's responsibilities for public safety extend from the preventing and prosecuting crime to managing prisons and responding to emergencies and threats to our security.

- Law enforcement. The Oregon State Police (OSP) provides a uniform statewide police presence, assisting the public and enforcing state laws on state highways and state lands. In conjunction with other law enforcement agencies, OSP conducts major crime, arson, bomb and terrorism investigations, operates crime labs, participates in drug interdiction, enforces fish and wildlife regulations and enforces gambling regulations.

- The court system. The state provides most of the funding for the administration of justice in civil and criminal matters throughout the state. Total court filings have exceeded 600,000 per year for most of the past decade.

- Corrections. The largest of the state's public safety functions involves the state prison system, which manages 14,000 inmates sentenced to terms of more than one year. The state also provides funding to Oregon's 36 counties to jail and supervise another 30,000 persons on probation, parole or post-prison supervision.

- Emergency response. The Oregon Military Dept. provides combat-ready units, with 8,650 Army and Air Guard members, for deployment in support of national defense and assistance in responding to natural disasters and civil unrest. Also, the Office of Emergency Management provides statewide coordination and assistance in the event of natural disasters and emergencies.

What we spend. The state will spend $2.4 billion in general funds on these services in 2009-11, or 16.4 percent of its general fund budget. This represents $616 per year for each resident of Oregon. It costs the state $84 a day for each prisoner incarcerated in state prisons.

"Other funds," such as traffic fines, court charges and fees, provide $980 million to support services in this program area. Federal funds account for an additional $563 million in expenditures, including $141 million in one-time funds from the 2009 stimulus bill that will expire next year.

Changes over time. After years of little growth in prison capacity, tougher sentencing laws for violent criminals enacted by Measure 11 (1994) required the state to build more facilities and hire more staff in order to send more criminals to prison for longer periods of time. This squeezed funding for other programs, even within the public safety area. The Oregon State Police (OSP) suffered staffing reductions from the 1980s through the middle of this decade. Also, in response to the economic downturn experienced in 2002-03, courts were forced to close one day a week.

Still, shares of the public's tax dollars and the state's general fund expenditures for public safety programs have increased significantly over the past two decades, primarily because of the construction and operation of new prisons. State prisons housed 5,841 prisoners in 1990, compared to 14,000 today.

Recent developments. In 2007, the legislature increased funding for the OSP patrol division with the goal of achieving and maintaining 24/7 coverage on the state's major roads and highways.

In 2008, the voters approved the legislative referral of Measure 57, which increased sentences for persons convicted of repeat property crimes and required drug and alcohol treatment for addicted offenders at high risk of committing new crimes in the future. Portions of this measure were suspended by the legislature in 2009 due to budget constraints, but these provisions are scheduled to come back into effect in 2012.

Trends to watch. Oregon's prison population is expected to increase from 14,000 to 16,000 during the next decade, absent any changes in sentencing laws and practices.

Health and Human Services

These services are best understood as related, but separate, areas of responsibilities – one encompasses public health and health care for individuals, the other involves the protection of vulnerable persons and assistance for families in crisis.

- ***Preventing the causes and spread of disease in our communities***

- ***Ensuring that needy families, children, seniors and the disabled have access to medical care***

These health-related responsibilities involve the following programs.

- Public health is responsible for more than 125 prevention-related programs, including: tracking and responding to more than 200 outbreaks of disease annually, such as the recent H1N1 flu outbreak; enforcing quality standards for 3,617 public water systems in the state; inspecting and enforcing food safety standards at more than 9,000 restaurants and almost 17,000 total food service facilities; screening every baby born in Oregon for 26 metabolic disorders; and, tobacco use reduction programs.

- Medicaid and the Oregon Health Plan. Like most states, Oregon is responsible for meeting the health care needs of poor and disabled persons through federal Medicaid programs and the State Children's Health Insurance Program (SCHIP). Medicaid requires the state to pay approximately one third of the cost of coverage and provides federal funds for the remaining two thirds. In addition, Oregon provides coverage to children and low-income adults whose coverage is not required by federal law. For these persons, Medicaid provides additional federal funds on similar terms – roughly two dollars in federal funds for every dollar in state funds. Oregon's Medicaid coverage is provided by the Oregon Health Plan through contracts with managed care organization, doctors and hospitals. These contracts account for 83 percent of the expenditures of the Oregon Health Plan. Nearly one of every seven Oregonians now has health coverage through the state's Medicaid programs, SCHIP and the Oregon Health Plan, including:

    - 78,415 disabled persons, including more than 10,000 children;
    - 299,243 children;
    - 92,800 adults in and near poverty; and,
    - 39,501 low-income seniors who need medical care (such as acute nursing home care) not financed by Medicare.

- Mental health. The Dept. of Human Services (DHS) and its local government and community partners provide mental health services and supports to 106,000 predominately low-income adults and children. Three state hospital facilities provide in-patient services to all areas of the state. Residential services are provided to individuals with persistent mental health problems at 219 hospitals, residential facilities and group homes.

- Alcohol and drug treatment. Programs supported by state, federal and local government dollars provided 63,000 lower-income Oregonians with addictions services last year. There are 30 residential addictions treatment facilities provided by DHS and its partners.

What we spend. The state will spend $1.8 billion in general funds on these health services in 2009-11, or 12.5 percent of its general fund budget. This represents $231 per year for each resident of Oregon.

These services generate the greatest amount of federal funds in the state budget. Federal funds for health care will amount to $4.9 billion in 2009-11, including $522 million in one-time federal stimulus funds.

Changes over time. The Oregon Health Plan expanded coverage for low-income Oregonians in the 1990s by pioneering a prioritized list of covered services. Savings achieved by focusing coverage on the most critical and cost effective services were applied to bringing more low-income Oregonians into the plan. But the expansion plan came close to extinction in the 2001-03 recession, when needs outstripped the state's ability to meet them.

The Oregon Health Plan is now rebuilding with the help of revenues from a tax paid by hospitals and a large infusion of federal funds. Oregon children now have access to affordable health care, thanks to a new tax paid by health insurers and federal matching funds provided by the State Children's Health Insurance Program (SCHIP).

Over the last two decades, Oregon has moved more mental health care from institutions to community-based residential treatment settings in order to provide care in more humane and more cost effective settings.

Recent developments. Oregon's Health Kids program, launched last year, has expanded affordable coverage options for children. A new Health Authority, overseen by a citizen Health Policy Board, has been organized to focus on controlling the cost of health care and creating affordable coverage options for citizens at all income levels. Federal health care reform is expected to generate an additional $4.9 billion for Oregon during the next decade, over and above existing Medicaid revenue streams.

The new Oregon State Hospital will open its first ward in October 2010. When the facility is complete, it will have 620 patient beds. A smaller Junction City hospital with 360 beds is scheduled to open in 2013. These new facilities were needed to replace and upgrade the aging state hospital in Salem.

Trends to watch. By June 2011, 95 percent of all children in Oregon are expected to have health care coverage, with more than a third enrolled in state sponsored programs. By the same date, close to 600,000 Oregonians are expected to receive health care coverage through Medicaid and the Oregon Health Plan. Federal health care reform will enable the state to expand coverage to more citizens through the Oregon Health Plan, beginning in 2011, and through new health insurance exchanges, beginning in 2014.

Longer term, the aging of the baby boomers and in-migrations of elderly persons will increase demand for state-supported care for low-income seniors in nursing homes and other residential settings.

- ***Protecting children, the disabled and the frail elderly from abuse and neglect***

- ***Helping families in crisis get back on their feet***

These protective functions and "safety net" services involve following programs.

- Seniors and People with Disabilities (SPD) provides, coordinates and regulates services for the state's most vulnerable citizens, helping more than 320,000 individuals access services ranging from in-home care to medical assistance and supplemental nutrition assistance. Also, the agency is responsible for licensing, certifying, regulating and monitoring 6,000 long term care facilities and for processing disability applications for Supplemental Security Income and Social Security Disability Insurance.

- Child protective services focuses on keeping children safe in their homes, in the homes of close family members and, when necessary, in foster care homes, which cared for an average of 8,466 children a day in the past year. Child protective services responded to 67,000 reports of suspected child abuse or neglect.

- Safety net services. The state provides direct assistance to poor Oregonians and families facing severe financial hardships through self sufficiency programs. More than 700,000 individuals are currently receiving food stamps, which are funded by the federal government but administered by state workers. In addition, more than 26,000 families receive cash assistance to help them meet the needs of daily living.

What we spend. The state will spend $1.7 billion in general funds on these services in 2009-11, which represents 12 percent of its general fund expenditures. This represents $224 per year for each resident of Oregon.

Federal funds for these services will amount to $5.2 billion in 2009-11, including $327* million in one-time funds from the 2009 stimulus bill that will expire next year.

Changes over time. In 1996, federal legislation ended Aid to Families with Dependent Children (AFDC) to become the Temporary Assistance for Needy Families (TANF) program. Under current law, states receive fixed, lump sum payments ("block grants") to devise their own welfare programs (with some limitations). Oregon receives $167 million in TANF federal block grant and must spend approximately $98 million in state funds on eligible families for services that meet the goals of TANF.

During the past two decades, Oregon has pioneered a shift to home-based care for seniors and the disabled. Measure 99, approved by the voters in 2000, created a Home Care Commission to oversee these services and care givers.

New developments. The Dept. of Human Services' "transformation initiative" enabled the agency to expand the food stamp program by 44 percent and cut processing time for claimants from an average of nine days to one.

Trends to watch. With the onset of the recession, more families than ever before have turned to the state for assistance in meeting their everyday needs. The need for food stamps is not anticipated to peak before 2011, when more than 750,000 families are expected to need assistance. The number of families who will qualify for temporary cash assistance is expected to rise as well.

The growth in Oregon's senior population, noted in the health care section above, will also increases demand for protective and residential care services over the next several decades.

Education

The range of the state's educational responsibilities begins with early education such as Head Start, continues with what has become a greatly enlarged state role in financing K-12 schools and extends to our community colleges and universities.

❖ ***Educating our children through high school***

There are 197 school districts in Oregon and 20 education service districts (ESDs), which are currently educating 561,698 students from kindergarten through high school. Though governed by local boards, these districts receive two-thirds of their operating funds from the state.

The 20 ESDs are responsible for services to children with special needs and for support services shared by all school districts in a given region.

The state's responsibility for education is enshrined in Article VIII of the state constitution. Article VIII requires that the state provide "a uniform, and general system of Common schools," a requirement that has been expanded with constitutional amendments over the past two decades.

Other programs and expenditures in this program area include: Early childhood programs (Head Start, Early Head Start and Pre-Kindergarten) for children one to four years of age; and, the Department of Education, led by the elected Superintendent of Public Instruction, which provides support for school districts throughout the state.

What we spend. The state will send $6.0 billion to local school districts in 2009-11, including $230 million in one-time stimulus funds, $410 million in lottery funds and $200 million in the state's reserves scheduled for release in June. The state's contribution to schools represents 39 percent of the state's general fund budget and amounts to $731 per year for each resident of Oregon. Funding from state and local taxpayers, including property taxes, amounts to $8,011 per K-12 student in 2010-11.

Changes over time. In 1990, voters approved Measure 5, which reduced local property taxes and required the state to backfill the schools' tax losses for a time. In 1996 and 1997, voters enacted additional measures (Measure 47 and a revision known as Measure 50) to limit the growth of property taxes. Both measures caused a major shift in the state's responsibility for financing local schools. The state's support for the operating budgets of local schools rose from 30 percent in 1989-90 to 70 percent in 2001-02, before declining slightly in recent years to today's 67 percent share.

Oregon's total funding per student in grades K-12 has fallen from 15^{th} to 30^{th} in the nation since 1990.

Recent developments. Senate Bill 100, enacted in 1999, allows school districts to establish charter schools, which operate independently of local school systems. There are now more than 100 such schools in Oregon.

After cuts in state funding that led to canceled school days in nearly 100 districts in 2003, the state's budget for schools reached an all-time high of $6.2 billion in the 2007-09 biennium. But this funding level was reduced after the onset of the recession in early 2009.

Trends to watch. The federal government is encouraging the formation of charter schools and other reforms related to teaching standards and learning outcomes as part of its "Race to the Top" grant process. Although Oregon's application did not make the list of finalists in the first round, its proposed reforms are likely to be taken up at the district and state level.

Changes in the demographics and needs of Oregon's school-aged children, including increasing proportions of students with special needs and English as a second language, are expected to accelerate in the future.

❖ *Providing affordable education and training beyond high school*

Oregon's "post-secondary" education system provides education and training beyond high school through 17 community college districts, the Oregon University System's seven universities and the Oregon Health and Science University's medical education programs. In addition, the state provides need-based financial assistance directly to students who pursue degrees in both public and private institutions in Oregon.

- <u>The state's 17 community colleges</u> are currently educating 198,809 students in programs designed to deliver workforce training certifications, two-year degrees and transfers to four-year degree programs.

  Funding for these programs comes from local property taxes, student tuition and state support. The state's support for operations (excluding capital projects) amounts to $451 million in the current two-year budget period, or three percent of its general fund budget. For the community colleges, the state's funding represents 41 percent of the colleges' operating costs, while 23 percent comes from local property taxes. The remainder comes predominately from student tuition.

- <u>The seven universities of the Oregon University System (OUS)</u> are currently educating 84,237 students in programs leading to baccalaureate and post-graduate degrees.

  Funding for these programs comes from student tuition, state support and donations. Approximately 74 percent of OUS students are Oregon residents, who pay discounted tuition. Tuition from resident and non-resident students amounts to 51 percent of the universities' education budgets (excluding grant-funded research activities). The state's support amounts to $844 million in the current budget period, including $69 million in one-time federal stimulus funds. Excluding stimulus funds, the state's support amounts to five percent of its general fund budget. For the universities, the state's support represents 33 percent of their operating costs.

- <u>The Oregon Health and Science University</u> is a state-chartered public corporation that is largely self-supporting through revenues from its hospital and clinics and from extensive research grants. State support of $79 million in 2009-11 is directed to OHSU's teaching programs for doctors, dentists and nurses.

- <u>Student assistance</u>. In addition to support for its colleges and universities, the state provides financial aid to Oregonians of modest means enrolled in Oregon colleges and universities. The Oregon Opportunity Grant program is designed to supplement students' tuition payments and federal grants to achieve a common level of affordability for all Oregonians.

What we spend. The state will spend $1.4 billion on post-secondary education and financial aid for college students in 2009-11, or ten percent of its general fund budget. This represents $196 per year for each resident of Oregon. Funding from state taxpayers amounts to $2,475 per year for each student enrolled in degree or certificate programs in our public institutions.

Changes over time. State funding for Oregon's community colleges and universities has declined over the past two decades. State funding for university students declined from $4,292 to $3,769 per student over the last two decades before adjusting for inflation. Support for community colleges rose in the early 1990s, as the state helped make up for local property tax losses, but declined since then has declined to $2,159 per student this year.

Oregon now ranks 44th of the 50 states in per-student funding for higher education. As a result of declining state support, tuition has increased dramatically, rising 284 percent in the university system and 210 percent in the community college system since 1990.

Recent developments. In 2007, the Governor and the Legislature adopted a new "shared responsibility model" for the state's financial aid program, known as the Oregon Opportunity Grant. This model established a benchmark for affordability for community college and university students and expanded the program with sliding scale grants to reach more students from families and households of moderate means. The number of students who receive full or partial grants rose from 19,500 in 2003-04 to 43,600 in the current academic year.

Trends to watch. Enrollment in Oregon's community colleges and public universities surged to record levels in the current academic year, as job losses and diminishing employment opportunities motivated more Oregonians to seek education and training beyond high school. This put pressure on capacity, both facilities and staff, and created budget challenges for the Oregon Opportunity Grant program.

Also, some of the universities in the university system have begun to make the case for more autonomy for their campuses to cope with declining state funds and increasing enrollments. Proposals to restructure the Oregon University System are now being considered by the Reset Cabinet and by the State Board of Higher Education.

Other General Fund Services and Functions

Other programs and services are supported by the remaining seven percent of the state's general fund budget.

These include a range of services to promote business development, support key industries, manage state forest lands, protect the environment, expand affordable housing and help veterans. General funds for these services total $954 million, including close to $175 million in lottery funds dedicated to parks and watershed protection.

Also in this category are governance functions including the Legislature, the Governor's Office and the Secretary of State. General funds for these services total $98 million.

Finally, administrative and tax collection services consume $166 million, or just over one percent of the state's general fund budget.

Other State Priorities Outside the General Fund

In the current biennium, the state's general fund budget totals $14.4 billion, with another $1.6 billion in supplemental resources from federal stimulus funds, reserves and one-time revenues. But the state's "total funds" budget is almost four times this amount, with resources and expenditures totaling $59.7 billion.

What distinguishes the general fund budget from the total funds budgets is the source of their revenues. The general fund is supported by broadly-shared taxes, primarily income taxes, and unrestricted lottery funds that can be used for education, job creation and economic development. The total funds budget is supported by federal funds and "other funds."

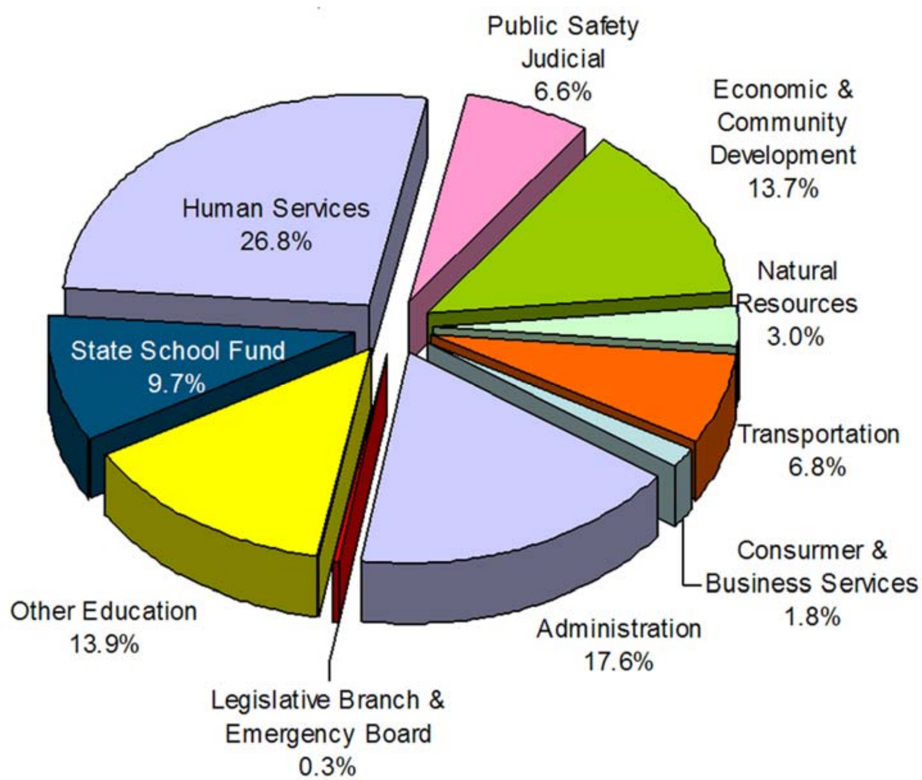
These other funds are comprised of:

- Dedicated taxes, such as gas taxes for highways and payroll taxes for unemployment benefits;
- User fees, such as tuition paid by university students; and,
- License and permit fees that support specified programs and services.

It is important to note that the largest portion of the total funds budget is dedicated to the same top three program areas that dominate the state's general fund. Education, health and human services, and public safety represent 57 percent of the state's total funds budget.

Legislatively Approved Budget 2009 – 11
Total Funds

Expenditures Total: $59,664 million



The remaining 43 percent fund of the federal funds and other funds that comprise the total funds budget supports programs such as:

- Unemployment benefits for jobless workers and job matches for employers and job seekers;
- The construction and maintenance of roads and bridges;
- Medical care and income support for injured workers;
- Home loans and services for veterans;
- The protection of natural resources;
- The investment and payment of retirement funds for public employees; and,
- Consumer protection and workplace safety.

Priorities Supported by Tax Policies

In addition to direct expenditures, the state supports public policies through the use of tax exemptions and credits, known as tax expenditures. These are prevalent in both the state income tax code and in provisions governing local property taxes.

Most of the state's income tax expenditures track federal tax policies, such as the income tax deduction for home mortgage interest and property taxes, which is intended to promote home ownership.

Others are designed to help seniors make ends meet (with a variety of deductions and credits), make health insurance more affordable (by exempting employer and employee payments from treatment as taxable income), encourage saving for college (through a deduction for contributions to college savings accounts) and attract and retain businesses to Oregon (through the accelerated depreciation of newly-purchased equipment).

The state produces a Tax Expenditure Report every two years to keep tabs on these tax expenditures.

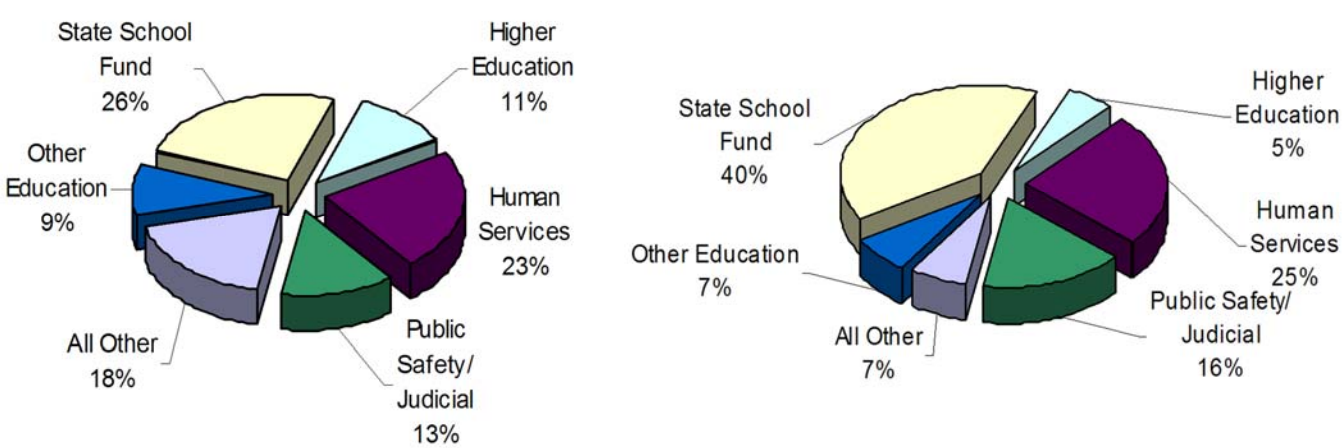
Shifts in Budget Priorities Past and Future

Shares of the state's general fund budget devoted to the responsibilities highlighted above have been far from static. As the following chart shows, the state's commitment of resources to its general fund program areas has shifted dramatically over the past two decades.

General Fund and Lottery Fund Budget Trends
Overall Expenditure

1989-91
Legislatively Approved Expenditures

2009 - 11
Legislatively Approved Expenditures



Most of this shift in state's general fund expenditures has been dictated by ballot initiatives, the consequences of which have not always been foreseen by the voters. For example, 1990's Measure 5 (property taxes) and 1994's Measure 11 (mandatory minimum sentences) forced more state spending for K-12 schools and prisons respectively at the expense of human services and higher education. Other shifts have occurred in response to economic crises, when declining tax revenues forced cutbacks in many areas and job losses increased the need for safety net services.

As a result, demands on the state's general fund resources have grown, even as policy goals have remained beyond our reach. Among the long-term goals established by the Legislature and the Governor which remain more aspirational than feasible, are:

- The commitment to raise funding for K-12 schools to the levels called for in the Quality Education Model;
- The educational attainment goals of 40 percent of our working-age adults with four-year degrees, 40 percent with two-year degrees or workforce certificates and the remaining 20 percent with a high school degree;
- The objective of making college affordable for all students in Oregon through the Oregon Opportunity Grant program;
- The goal of affordable health care for Oregonians in all income groups; and,
- The need to reduce the incidence of addiction and related criminal activity in our communities.

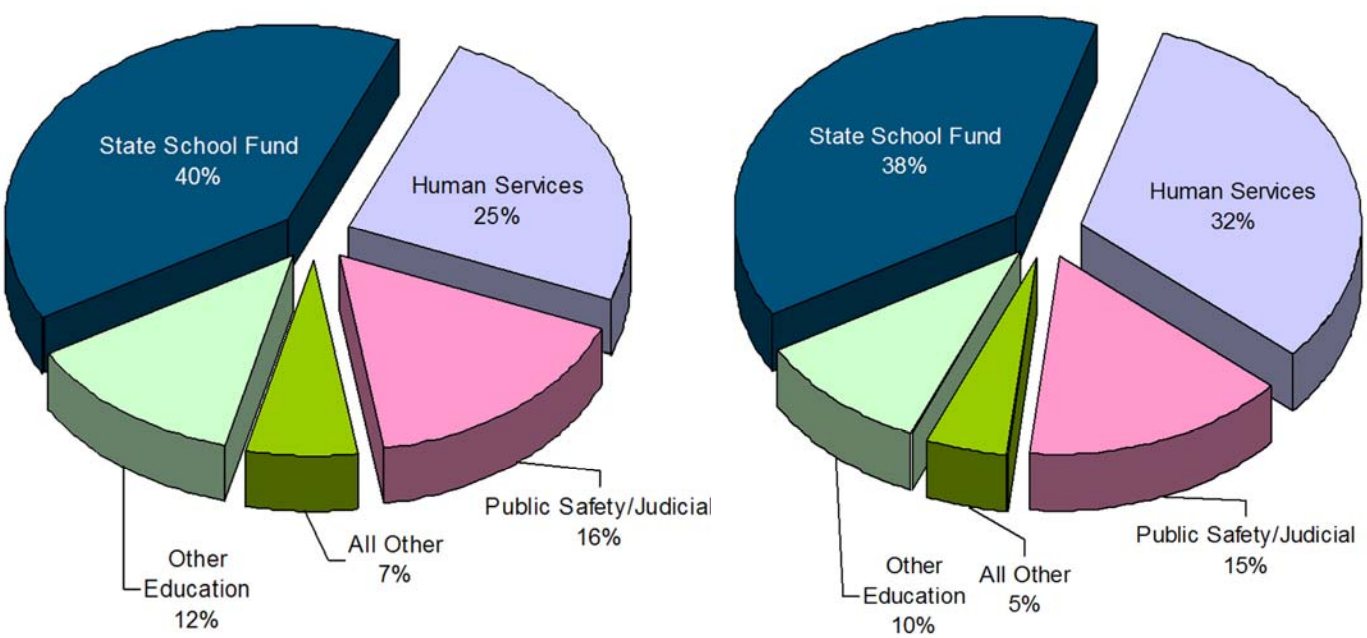
Progress in these areas is now greatly challenged by the prospect of a decade of deficits ahead of us.

If we remain on the path we're on, there will be further shifts in budget priorities toward human services and away from education, particularly higher education (shown in the "Other Education" category in the pie chart below). Looking at the state's projected expenditures for the next decade, we would end up with the following division of the state budget in 2017-19 based on mandates and commitments now in place.

Budget Shares
Overall Expenditure

2009 - 11
Expenditures Total: $14,434

2017 - 19
Expenditures Total: $24,436



However, these projections are not likely to materialize, because our new prognosis for the state's general fund reveals that its resources will be insufficient to support such increases.

Section 2:

What We're Facing – A Decade of Deficits Will Make Current Services Unsustainable

WHAT WE'RE FACING – A DECADE OF DEFICITS WILL MAKE CURRENT SERVICES UNSUSTAINABLE

In 2007, state budget officials prepared a long-term forecast of the state's expected revenues and expenditures through 2020 that painted a relatively optimistic picture of the next decade. At that time, they foresaw balanced budgets in the near term and sizable surpluses by the end of the decade. This was not guess work or wishful thinking. Their forecast was built on detailed projections for revenues and expenditures:

- Revenue estimates were based on economic forecasts provided by private consulting firms and the state's economists; and,
- Expenditure estimates were based on demographic forecasts (e.g. the aging of the baby boomers), policy forecasts (e.g. the number of inmates in the state prison system) and extrapolations of historic budget and economic data (e.g. the cost of medical care).

State budget officials cautioned that their projections did not adequately account for the cost of maintaining that state's buildings and equipment, nor did they assume more support for schools after adjusting for inflation and student population growth. Nonetheless, their bottom line results pointed to a fiscal future bright enough to plan for new investments in targeted priorities.

All that changed with the recession of 2008-09 – both on the revenue side and the expenditure side of the budget.

At our request, state budget officials updated their projections late last year and again after the state's June 2010 revenue forecast in order to get a new fix on the decade ahead. This time, they found the picture had darkened considerably. Their primary finding was that the recessionary decline in economic activity, from corporate profits to family incomes, had carved a deep trough in the state's revenue trajectory from which it will not soon recover.

The state's general fund revenues dropped by $3.1 billion in the current budget period from the level that had been projected in 2007. This represented a 20 percent decline, the steepest since the Great Depression of the 1930s. It is this decline, rather than slower growth going forward, that poses the biggest problem for the coming decade on the revenue side of the budget.

The economy is expected to recover, but it is not expected to come roaring back as it has after past recessions. The state's most recent forecast calls for revenue growth of 7.0 percent per year through 2017 compared to 6.1 percent foreseen in the pre-recession projections. This represents an improvement but not the kind of accelerated growth we saw during the last recovery in 2006 and 2007. As a result, the state's general fund will not regain the revenue heights once predicted for the coming decade. State revenues are expected to trail the previously-estimated trend line by 15 percent or more in each and every budget period through 2019. As can be seen from a side-by-side comparison of estimated revenues for the next decade, comparing pre-recession forecasts in 2007 to post-recession forecasts today, state resources, like the state's economy, have lost the equivalent of two to three years of growth. Revenue levels previously projected for 2011-13 are now not likely to be seen until midway through the 2013-15 biennium.

From a Decade of Surplus to a Decade of Deficits
(Millions of $)

11/2007 Projections	**2009 - 11**	**2011 - 13**	**2013 - 15**	**2015 - 17**	**2017 - 19**
Revenue	17,000.4	19,001.9	21,547.0	24,644.7	28,592.0
Expense	16,989.2	18,822.7	20,925.1	23,037.9	25,352.0
Surplus (Deficit)	11.2	179.2	621.9	1,606.8	3,239.8
06/2010 Projections					
Revenue	13,841.3	15,667.0	18,262.4	20,570.1	23,160.5
Expense	14,433.5	18,337.7	20,680.8	22,967.4	25,461.1
Surplus (Deficit)	(592.3)	(2,670.8)	(2,418.4)	(2,397.3)	(2,300.7)

The recession created new challenges on the expenditure side of the budget as well. State officials now expect the demand for human services to rise, as more unemployed and underemployed Oregonians qualify for assistance. Currently, nearly one of every five Oregonians receives food assistance, and one of every seven is on the Oregon Health Plan. Their numbers are expected to grow in the next budget period. These new demands on the state budget are now expected to increase the previously-estimated costs for health and human services by a cumulative total of two billion dollars from 2011 through 2019.

Also, as the stock market declined, so did the assets of the Public Employees Retirement System (PERS). Thanks to reforms enacted in 2003, PERS was and still is better funded than most public retirement funds in the country. But PERS' losses on investments due to the recession created new liabilities for the state, schools and local governments in Oregon. Under current law, these losses must be offset by higher contributions paid exclusively by public agencies, as employees are not required to share in this effort. The tab for these higher payroll costs is now expected to add $368 million to the state's general fund costs in 2011-13, including the costs of state's own workforce and its share of support for school employees. Longer term, the PERS tab could add more than one billion dollars to the state's biennial general fund costs for state and school employees by 2015-17, if investment returns average eight percent per year.

NOTE: Revenue data cited in this section reflect the downward revisions contained in the June 2010 revenue forecast. However, expenditure data do not reflect the Governor's rebalancing reductions that will take effect July 1, 2010. Thus, the tables on page 25 and page 27 show deficits for 2009-11 that will disappear when the spending reductions take effect.

For an explanation of the methodology used to project ten-year revenue and expenditure trends and a more detailed presentation of findings, see "How We Forecast the Next Decade" on the following page.

How We Forecast the Next Decade

Overall

- General and medical inflation factors developed based on national projections
- Used standard current service level assumptions for program expansions.
- Existing Debt Service schedules built in for agency budgets, and an overall adjustment made that assumes full debt capacity used each biennium.
- One-Time Funds used to balance the budget in 2009-11 are replaced with General Fund in 2011-13

Education

- State School Fund and Community Colleges budgets were projected to grow using a CSL model.
- No enrollment growth included for OUS and Community Colleges
- Opportunity Grants increased only by standard inflation.
- State School Fund and Community College growth was offset by projected growth in local property taxes.

Human Services

- Human Service caseloads were projected to increase based on the demographic growth of the client population.
- Oregon Health Plan cost growth was assumed at about 13% per biennium.
- Assumes that programs funded with Other Funds in 2009-11 will continue to be funded by those revenue sources in 2011-13 and beyond.
- Includes funding changes related to flattened tobacco tax revenue projections and changes in federal match rates.
- Includes construction and operation of new state hospital facilities.

Public Safety

- Caseload growth for public safety programs based on October 2009 prison population forecast, which includes implementation of Ballot Measure 57.
- Includes funding for Junction City prison construction in 2011-13, becoming fully operational in 2013-15.
- Includes debt services for the Oregon Wireless Interoperability Network.

All told, the state must now adjust to a decade in which revenues will average $1.9 billion less per year than previously expected, employee retirement costs will eventually rise climb by more than $500 million per year, and other costs and demands for safety net services will continue to increase. These recession-related shifts on both sides of the ledger have turned a likely decade of solvency into a looming decade of deficits.

The State's Current Budget Rests Heavily on One-Time Solutions

The turnabout in the state's fiscal condition would have been more evident during this recession had it not been for the receipt of federal stimulus funds and the availability of state reserve funds.

The federal government provided a lifeline to state governments in February 2009 with the passage of the American Recovery and Reinvestment Act, also known as the federal stimulus bill. This legislation provided $170 billion in stabilization funds and other targeted funds to state governments to sustain services during the recession. The bulk of these funds were targeted to health care and education, with strings attached. Those strings included a "maintenance of effort" requirement, whereby states were obligated to maintain pre-recession levels of funding or eligibility for services.

In Oregon, these stabilization funds have provided $650 million for health and human services, $392 million for education and $103 million for corrections. These funds served their purpose, in that they sustained services and reduced layoffs. But they also limited the state's ability to reduce or scale back eligibility for services in programs that received these funds.

Also, to its credit, the state had accumulated record levels of reserves prior to the onset of the recession. The Education Stability Fund, approved by the voters in 2002 and funded by a share of lottery revenues, reached $393 million in the 2008-09 fiscal year. A new Rainy Day Fund, created by the Legislature in 2007 and funded by a one-time contribution of excess corporate "kicker" revenues and ongoing ending balances, reached $338 million. Together, these funds provided a partial buffer for state services during a period of rapidly-deteriorating revenues.

One-Time Funds in the State's Current Budget	
Federal Stimulus Funds	941.2
State Reserves (Rainy Day Fund & Education Stability Fund)	435.0
Provider Tax Revenues from 2007-09	116.0
Other Fund Sweeps	144.8
	1,637.0

Even with these one-time funds, however, the state cut just under two billion dollars from the previously-projected current service level for the 2009-11 budget and reduced personnel costs by $72 million through pay freezes and unpaid furloughs for state employees.

Finally, the state raised taxes on businesses and high-income households, which the voters approved as Measures 66 and 67. The higher tax rates are scheduled to be adjusted downward in 2011 and 2013, thus reducing their impact on taxpayers but also lessening their contribution to the state's general fund.

The combination of one-time funds, temporary payroll reductions and new taxes worked to minimize cuts to state services. Without these actions, cuts would have been twice as deep.

This is why the revenue trough caused by the recession did not feel as wrenching on the services side of the state budget. However, most of the budget-balancing mechanisms used in the current period were one-time solutions, which will not be available to the state in the years ahead.

Current Service Levels Are No Longer Sustainable

One-time funds work best when they can provide a level bridge over a one-time deficit. This is not the case in the current budget.

Federal stimulus funds and state reserves amount to $1.6 billion in the current budget. After these funds are depleted in 2011, the state is expected to bank $1.8 billion in new revenues from a recovering economy in the next biennium. On first impression, this may look like a well-constructed alignment: We are losing $1.6 billion in one-time resources and gaining $1.8 billion in ongoing revenues. But these new revenues will fall far short of covering expenditures in the next biennium. Those expenditures are expected to increase 14 percent in 2011-13, while the increase in revenues will amount to only two percent.

Tentative 2011-13 Budget Projections - Including All 2010 Legislative Actions

(June 2010 Forecast)

	Legislatively Approved 2009-11 GF	LF	Total	One-Time $	Adj. Totals	Tentative Budget - Current Service Level 2011-13 GF	LF	Total	Percent Change	Adj % Change
Revenues										
Projected Beginning Balance	-	1.4	1.4			-	4.0	4.0		
Carryforward		52.0	52.0					-		
1% Appropriations to Rainy Day Fund/Beginning Balance			-					-		
Half Lottery 09-11 Ending Balance to K-12 Capital Acct			-				(2.0)	(2.0)		
Projected Revenues	12,733.3	1,078.1	13,811.4			14,750.8	1,161.2	15,912.1		
Less Dedications (ESF, County)		(223.5)	(223.5)				(247.1)	(247.1)		
One-time Resources										
Federal ARRA				1,053.0						
ESF/RDF: K-12	115.7	84.3		200.0						
Other				216.0						
Total Resources	12,849.0	992.3	13,841.3	1,469.0	15,310.3	14,750.8	916.2	15,667.0	13%	2%
Expenditures										
Education - State School Fund	5,258.2	494.1	5,752.3	229.8	5,982.1	6,304.6	409.8	6,714.5	17%	12%
Education - All Other	1,726.9	96.2	1,823.1	80.2	1,903.3	1,994.5	97.4	2,091.9	15%	10%
Human Services	3,523.7	10.9	3,534.6	995.9	4,530.5	5,288.3	11.3	5,299.6	50%	17%
Public Safety	1,855.0	7.2	1,862.2	110.4	1,972.6	2,212.6	7.7	2,220.3	19%	13%
Economic & Community Development	29.2	119.9	149.0	10.0	159.1	27.1	135.4	162.5	9%	2%
Natural Resources	146.9	182.0	328.9	-	328.9	160.0	189.6	349.6	6%	6%
Transportation	23.1	85.4	108.6	-	108.6	81.8	85.2	167.0	54%	54%
Consumer & Business Services	12.9	-	12.9	-	12.9	14.6	-	14.6	13%	13%
Administration	194.4	11.6	206.0	-	206.0	205.3	16.5	221.9	8%	8%
Legislative	75.2	-	75.2	-	75.2	90.5	-	90.5	20%	20%
Judicial	507.2	-	507.2	42.7	549.9	609.9	-	609.9	20%	11%
Program Subtotal	13,352.7	1,007.4	14,360.1	1,469.0	15,829.1	16,989.3	953.0	17,942.3	25%	13%
EFund	20.0	-	20.0	-	20.0	40.0	-	40.0		
Supplemental State Agency Funding	-	-	-	-	-	172.0	4.0	176.0		
Other Special Purpose Appropriations	53.5	-	53.5	-	53.5			-		
Total Expenditures	13,426.1	1,007.4	14,433.5	1,469.0	15,902.5	17,201.3	957.0	18,158.3	26%	14%
Ending Balance	(577.1)	(15.1)	(592.3)	-	(592.3)	169.9	9.5	179.4		
Net Fiscal Position						**(2,620.3)**	**(50.4)**	**(2,670.8)**		

Notes: Both revenues and expenditures include anticipated K-12 trigger of $200 million in 2009-11.
Lottery Funds negative ending balance results from a reduction in dedicated BM 66 revenues.
Supplemental State Agency Funding for costs associated with salaries, benefits, and other unanticipated and unknown expenses.
Millions of Dollars.

The reasons for the expected increase in expenditures, in order of magnitude, are the following:

- Payroll cost increases, as higher PERS rates take effect, salary freezes and furloughs end, and adjustments are anticipated in pay and health benefits;
- Inflationary cost increases for purchased services (such as hospital care for persons enrolled in the Oregon Health Plan), equipment and supplies;
- Funding of positions added and projects initiated midway through the current budget period (e.g. the staffing of the new state mental hospital) that is needed to cover a full two years of operations in the next budget period;
- Higher numbers of Oregonians who will qualify for safety net services, such as food assistance and medical care; and,
- Debt service incurred midway through the current budget period that must be paid for the full 24 months of the next and subsequent budget periods.

Components of 2011-13 Expenditure Increases
Beyond Replacement of One-Time Funds
Millions of Dollars

Payroll Cost Increases	
Restoration of furloughs and 2011-13 Step Increases	156
Maintain current state employee health benefits in 2011-13	104
Potential Cost of Living Adjustment for State Employees in 2011-13	114
PERS (both state and school district costs)	368
Inflationary Cost Increases	533
Funding for projects started midway through 2009-11	247
Higher number of Oregonians qualifying for safety net services	487
Increase in Debt Service	247
Total Increase 2009-11 to 2011-13	**2,256**

These increases in costs and services show up in what is called the budget's "current service level," which represents the cost of continuing current services, covering all expected increases in costs and serving all persons the state is obligated to serve. The current service level sets a target for future budgets and, by extension, signals the likelihood of deficits or surpluses. (See "Looking Inside the Budget Box," below, for a discussion of the current service level and its implications for future budgets.)

Now that we have a better fix on both expenditures and revenues, the prospect of a decade of continuing deficits comes into view. The revenue bridge constructed with $1.6 billion in one-time funds in the current budget period leaves us at the foot of a steep budgetary hill to climb. That hill is represented by the 14 percent increase in expenditures needed to maintain the current service level in the next biennium. Comparing revenues to expenditures yields a likely deficit approaching $2.7 billion in the state's general fund budget for 2011-13.

Long-Term Budget Projections

June 2010 Forecast

	Legislatively Approved 2009-11		Tentative Budget 2011-13			Tentative Budget 2013-15			Tentative Budget 2015-17			Tentative Budget 2017-19		
	GF	LF	GF	LF		GF	LF		GF	LF		GF	LF	
Revenues														
Projected Beginning Balance	-	53.4	-	4.0		-	-		-	-		-	-	
1% Appropriations to Rainy Day Fund				(2.0)										
Projected Revenues	12,849.0	1,162.4	14,750.8	1,161.2	14%	17,266.2	1,261.0	16%	19,478.1	1,382.3	13%	21,930.9	1,556.3	13%
Less Dedications (ESF, County)		(223.5)		(247.1)			(264.8)			(290.3)			(326.8)	
Total Resources	12,849.0	992.3	14,750.8	916.2		17,266.2	996.2		19,478.1	1,092.0		21,930.9	1,229.5	
Expenditures														
Administration	194.4	11.6	205.3	16.5	8%	226.0	17.1	10%	249.2	17.5	10%	275.2	17.2	10%
Consumer & Business Services	12.9	-	14.6	-	13%	16.2	-	11%	18.0	-	11%	20.0	-	11%
Economic Development	29.2	119.9	27.1	135.4	9%	28.5	109.0	-15%	30.1	93.4	-10%	31.8	82.0	-8%
Education - State School Fund	5,258.2	494.1	6,304.6	409.8	17%	7,029.5	456.8	11%	7,835.9	509.3	11%	8,734.8	567.7	11%
Education - All Other	1,726.9	96.2	1,994.5	97.4	15%	2,133.8	108.8	7%	2,292.3	83.0	6%	2,465.9	53.9	6%
Human Services	3,523.7	10.9	5,288.3	11.3	50%	6,185.5	12.0	17%	6,874.7	12.4	11%	7,690.7	12.9	12%
Judicial	507.2	-	609.9	-	20%	673.8	0.0	10%	718.5	0.0	7%	777.1	0.0	8%
Legislative Branch	75.2	-	90.5	-	20%	93.0	-	3%	101.5	-	9%	111.8	-	10%
Natural Resources	146.9	182.0	160.0	189.6	6%	167.6	199.5	5%	182.9	210.2	7%	199.5	221.9	7%
Public Safety	1,855.0	7.2	2,212.6	7.7	19%	2,476.9	8.5	12%	2,741.7	9.4	11%	2,999.3	10.4	9%
Transportation	23.1	85.4	81.8	85.2	54%	81.8	107.4	13%	79.7	111.4	1%	52.5	111.1	-14%
Total Expenditures	13,352.6	1,007.4	16,989.3	953.0	25%	19,112.5	1,019.1	12%	21,124.4	1,046.5	10%	23,358.6	1,077.2	10%
Add'l Debt Service - to Capacity						72.0	37.0		201.0	109.0		346.0	141.0	
EFund	73.5		40.0	-		40.0	-		40.0	-		40.0	-	
Salary Adjustment			172.0	4.0		194.4	4.5		219.6	5.1		248.2	5.8	
Ending Balance	**(577.1)**	**(15.1)**	169.9	9.5		191.1	10.2		211.2	10.5		233.6	10.8	
Net Fiscal Position			**(2,620.3)**	**(50.4)**		**(2,343.8)**	**(74.7)**		**(2,318.2)**	**(79.1)**		**(2,295.4)**	**(5.3)**	
			(2,670.8)			**(2,418.4)**			**(2,397.3)**			**(2,300.7)**		
Total Expenditures	14,434		18,158			20,480			22,746			25,217		
Percent Increase			26%			13%			11%			11%		
Dollar Increase			3,725			2,321			2,266			2,471		

Section 2: **What We're Facing – A Decade of Deficits Will Make Current Services Unsustainable**

Even with state revenues projected to grow at close to 7.0 percent per year from 2011 through 2017, general fund budget shortfalls are expected to exceed two billion dollars in every biennium for the rest of the decade.

Deficits of this size will amount to more than ten per cent of what the state now projects to be its current service level through 2019. In effect, the state faces the challenge of making another round of recession-level reductions in its general fund budget even if no new recession confronts us during the next decade.

Further, with cuts made in the current budget, tax increases in place, federal support on the decline and reserves all but exhausted, there are fewer options for plugging holes and rebalancing budgets in the future.

Other States Face Similar Challenges

Oregon is not alone in facing a decade of deficits. Some states are still struggling to balance their budgets for the fiscal year beginning July 1. And many states will face similar, if not steeper, financial cliffs in the years ahead.

According to a report prepared by the National Governor's Association:

> "The states are facing a protracted budget crisis, like none seen in the last 30 years, and perhaps not since the Great Depression. The long climb toward recovery of state fiscal health has not yet begun, and this has prompted urgent efforts to redesign and downsize government. In some instances, this has given states an opportunity to enact needed changes that have been avoided during prosperous times. But in other cases, it has prompted hard choices on the best way to 'cut to the bone' while doing the least harm to state competitiveness and quality of life."

-- The Big Reset: State Government After the Great Recession
National Governors Association Center for Best Practices
February 23, 2010

When the federal funds bridge ends, states must construct new paths to solvency, at the same time that they will have to deal with the recession-driven demands of their citizens.

Among the states that have produced recent reports on efforts to stabilize or restructure their delivery of core services are:

- Georgia (Final Report, Georgia State Senate Budget Task Force, March 16, 2010);
- Michigan (Charting a Way Forward: A Path Towards Fiscal Stability for the State of Michigan, Legislative Commission on Government Efficiency, November 2009);
- Vermont (Challenges for Change: Progress Report, March 30, 2010).

As the NGA report notes, "Most efforts start by exploring the traditional tools of budget cutting…In today's environment, however, states quickly find that these options do not shift the cost curve sufficiently, and they must look at actions that change the way government does business."

The Next Decade Could Still Be Better – Or Worse

Long-term forecasts tend to hit their mark over long periods of time but can miss the less predictable fluctuations of ups and downs from year to year. Their reliability rests on the law of large numbers and the momentum of trends which are difficult to reverse. With these strengths and fallibilities, forecasts of this kind invariably raise doubts about their accuracy and stir hopes for better scenarios. We respond to those doubts and hopes in the following.

What if the economy does better than expected?

With 12 months and four quarterly revenue forecasts to come before the next budget is finalized, it is possible that the deficit projected for 2011-13 could yet grow or shrink. But given the narrow time frame remaining, we cannot count on further growth offsetting the deficit projected for the next biennium.

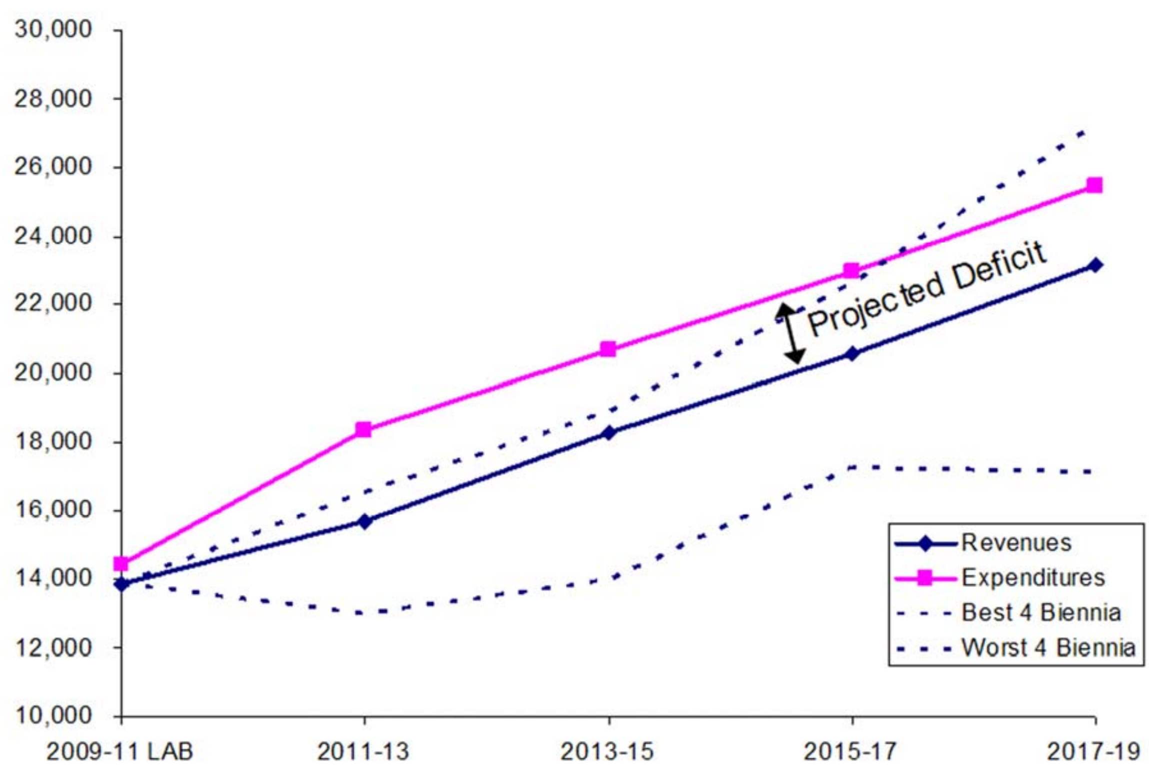
Further, the variations we have seen between forecasts delivered 15 months prior to a budget period (the March forecast in even-numbered years) and those on which the state's final budgets are constructed (the June forecasts in odd-numbered years) have tended to show greater impacts on the downside.

Since 1991, the best variations on the upside amounted to a revenue increase of 3.2 percent (prior to the 2007-09 biennium) and 2.0 percent (prior to the 1997-99 biennium). Thus the best we could reasonably hope for on the upside would amount to $500 million, if we were to replicate the experience prior to 2007.

By contrast, the worst downward adjustments in revenue amounted to 20.4 percent (prior to the current biennium) and 16.8 percent (prior to the 2003-05 biennium).

Looking farther back in time, we can find periods in the late 1980s when forecasts underestimated revenues by four to eight percent. But even the best eight years of revenue experience show greater variations to the downside than the upside, as illustrated in the chart below.

Long Term Budget



> Bottom line: Future revenues could swing up or down from the forecast, but are likely to be close to what we currently expect over the next decade. The greater risk is on the downside, as evident from the high and lows of variations in prior periods.

Why not grow our economy, grow more revenue and grow our way out of these problems?

The state's projections for economic growth in the next decade are not pessimistic by historic standards. Our most recent economic forecast projects growth in personal incomes averaging 5.1 percent per year in Oregon over the next five years. Based on these projections, the state's budget officials foresee revenue growth averaging 7.0 percent through the end of the decade.

The rate of revenue growth will track historic growth rates for states across the nation. According to the National Governors Association, state revenues grew at an average rate of 6.5 percent a year from 1979 through 2007, before the onset of the Great Recession. So we are already assuming a return to growth rates achieved in better times. However, the growth rates we foresee for Oregon in the next decade will lag the unusually high rates experienced by Oregon in the 1990s, when personal income grew 6.6 percent per year and general fund revenue grew 7.7 percent per year.

Still, even the 1990s failed to deliver sustained increases in the personal incomes of Oregonians, and the last decade set us back even further. Oregon's per capita income now lags the national average by 8.9 percent. This is a finding that gives us pause, especially since the state's economic projections for the next decade do not foretell any appreciable improvement in the income of Oregonians relative to the rest of the nation.

We have discussed this finding and have arrived at two conclusions in our deliberations.

First, it is important to recognize that Oregon's income level has been dropping compared to that of the nation. This means that we are trying to deliver services to an increasingly needy population from a steadily shrinking pie. So our costs are increasing, as our incomes decline. This makes the challenge of resetting state government both more challenging and more compelling. We must be cognizant of the need to encourage economic growth as we make difficult budget choices, and just as determined not to shrink from those choices.

Second, while state government doesn't create private sector jobs, which are the key to our future prosperity, it does contribute to the climate in which those jobs are created and sustained. If we allow our schools to stagnate, our social support systems to deteriorate or our communities to decline, we will accelerate a downward spiral that will worsen over time.

We approach our work with the conviction that meeting the state's core responsibilities to its citizens will stabilize and strengthen the foundations of our economy. Similarly, we are mindful that failure to correct the course we're on will leave us stumbling through a decade of deficits, with little chance of making smarter and more far-sighted choices.

> Bottom line: Over the long term, a strong economy should deliver higher incomes for Oregonians and increased revenue for the state. Finding better ways to meet the state's core responsibilities can rebuild the foundations for that growth. But we cannot expect the growth we foresee in the next decade to correct the decade of deficits we face in the state budget.

What are the chances of additional funding from the federal government?

As the federal government grapples with increasing budget deficits, it appears increasingly unlikely that states will receive another round of federal stabilization funds of the magnitude provided in the current budget period. However, even if another round of federal funds were to plug all of the shortfall in 2011-

13, deficits would continue to persist during the rest of the decade. That's because any one-time funds added to sustain programs in one biennium have to be made up in the next biennium – either that, or the services they sustain have to terminate.

More modest federal assistance is possible. The most likely sources of additional federal assistance could come from Congressional actions to extend enhanced Medicaid funding for the states into the next calendar year and continue a modest amount of stabilization funds for schools.

Increased Medicaid payments have provided a big boost to the state's health and human services budget but are scheduled to expire at the end of this year. The Congress is now considering an extension of these higher Medicaid payments through June 30, 2011. If enacted, this could free up more than $100 million for the state to use in 2011-13.

Also, an extension of stabilization funds for schools could yield another $100 million in the latter part of this biennium that could be carried forward to the next budget period.

But these are one-time funds. Once used, there will be no additional state resources available to make up for loss of these or any other one-time funds.

Further, there is substantial risk that local governments could suffer a significant loss of federal funds in the next decade. In 2011-13, counties will lose the benefit of federal forest payments, which now support schools and a variety of public health and safety services. Many of these are services for which funding or operations are shared by counties and the state. In 2011-12, these payments will decline to less than half the amount provided two years ago. In 2012-13, these payments will disappear entirely, creating a revenue loss of $240 million per year. As explained in the January 2009 report of the Governor's Task Force on Federal Forest Payments and County Services, the loss of these payments would have significant impacts on the state's capacity to ensure the health and safety of its citizens and would create additional fiscal pressures on K-12 schools.

Longer term, the new federal health care legislation will be a boon to states seeking to expand coverage, but it is unlikely to add to or offset costs already borne by the states. The legislation is projected to provide a net increase in federal funds of $4.9 billion for Oregon in the next decade, all of which will fund expanded health care coverage, services and cost containment for Oregonians.

> Bottom line: New federal funds for health care will not help the general fund budget; other forms of assistance from the federal government are likely to be modest and transitory. The greatest threats exist on the downside because of the unresolved issue of federal forest payments.

Why not look to other state programs and funds to help solve this problem?

As we noted in Section 1, all of the state's larger total funds budget is already accounted for – either in funds devoted to education, health and human services and public safety or in funds dedicated to specified purposes, such as transportation, jobless benefits and loans for veterans.

However, many of the state's dedicated programs amass fund balances, whose totals can look like ready cash accounts to advocates searching for more money for underfunded programs. Demands for "fund sweeps," or the diversion of dedicated program balances to other purposes, invariably occur during budget crises. But such practices break faith with both the premises and promises that underlie these programs. The most egregious examples have triggered legal actions, which have forced the state to repay the diverted funds with interest.

State programs supported by dedicated funding sources reflect a conscious choice by Oregon policy-makers that those who benefit from particular government programs, or those who cause the need for those programs, should be the ones to pay their costs. This "user fee" connection between funding source and funded program would be lost if dedicated funds were regularly diverted for other governmental priorities. For example, accountants, chiropractors and real estate agents pay fees that support the regulation of their industries. But there would be no justification for such fees if they were pooled with other funds and used for general government purposes. For this reason, such special fees and assessments are statutorily dedicated to the particular purposes for which they are raised.

Similarly, tuition and fees paid by students in the Oregon University System represent payments for educational services. If any of their payments were swept from the fund balances of the universities and used for other state purposes, students could rightly complain of bait-and-switch budgeting.

Finally, programs supported by dedicated revenue sources are themselves subject to marked declines during economic downturns. For example, modest pennies-per-hour fees paid by employers and employees guarantee the payment of wages owed when an employer goes out of business and support workplace safety programs and services for injured workers. But payroll-based revenues decline in recessions, leaving fund balances as the last resort to make good on claims and sustain promised services.

> Bottom line: State programs financed by dedicated funding sources represent promises made to those who pay for them. Where fund balances are needed to keep those promises, they should be off limits to diversions for other purposes.

Why not add borrowing to our list of solutions?

The State Debt Policy Advisory Commission, chaired by the State Treasurer, calculates an upper limit for state borrowing based on standards that earn the highest ratings from the major credit rating agencies. These standards keep the state from taking on too much debt and keep the state's borrowing costs low. The limit established by the commission keeps the state's debt service at or below five percent of general fund revenues.

In its report to the Governor and the Legislature in February of this year, the Commission noted:

> "(T)he State does not have additional General Fund debt capacity remaining this biennium, but may issue a total of $2.7 billion in new General Fund-supported debt from FY 2012 through FY 2015. However, the Commission recommends issuing debt in a phased approach, with no more than $1.3 billion per biennium in 2011-13 and 2013-15."

The Commission also warned against using debt to pay for operational expenses, rather than for capital projects and purposes.

In most cases, issuing debt for operational expenses does not solve a budget problem; it simply defers that problem and compounds it with interest costs, much as a family would do if it used a credit card to pay for groceries. For example, the state is paying $71 million per year to repay $450 million it borrowed and spent to plug a hole in the 2001-03 budget. These payments will continue through 2014, for services provided ten years prior. This is not sound budget policy.

The long-term budget projections we have cited above assume that the state's debt capacity will be used for capital projects up to the five percent limit in each biennium of the coming decade and that bonds which are retired will be replaced in full with new bonds for capital projects within that five percent limit.

> Bottom line: We have already assumed the maximum use of the state's borrowing authority for capital projects, within the limits established by state officials. Borrowing above these limits or for operational purposes would be imprudent.

Why not go after more revenue, if not from new taxes then from better tax collections or cutting back on tax breaks?

With the recent approval by the voters of Measure 66 (personal income taxes) and Measure 67 (business taxes and fees), the state completed a rebalancing of its current budget with $472 million in new revenues from high-income households and another $255 in new revenues from Oregon businesses. The larger portions of these revenue increases are permanent, although both measures provide for a reduction in tax rates over time. We have included these revenues in our projections and have assumed that: (1) no new general fund tax increases are likely in the near future; and, (2) marginal or targeted tax increases are unlikely to secure significant new revenues. We have therefore assumed that general fund revenue as a share of the state's economy will remain roughly constant in the decade ahead.

We recognize that proposals for tax restructuring by means of a sales tax have been and will continue to be discussed by policy makers. But we note that such proposals are most often packaged as revenue-neutral options to stabilize revenues, rather than increase them. This reinforces our opinion about future state revenues remaining roughly constant as a share of the economy.

We also recognize that Oregon remains a low tax state by most measures, and we expect that attention may turn to increased tax collections and reduced tax expenditures as strategies to increase revenues.

In regard to tax collections, the Dept. of Revenue (DOR) successfully completed a tax amnesty program this year that netted $47 million in additional, one-time tax receipts. Also, DOR has continued to pursue increased compliance from taxpayers. With new investments in technology and business systems, DOR estimates that it could produce an additional $30 million to $40 million per biennium in increased revenue receipts by the middle of the coming decade.

In regard to tax expenditures, we note that the 2009 Legislature imposed prospective sunsets, or expiration dates, on many state income and corporate tax credits; if all of these credits are allowed to expire, the state's general fund will recover approximately $165 million per biennium in new revenue by 2013-15. Also, in this year's February session, the Legislature adopted changes to the Business Energy Tax Credit in February that will recover $55 million in revenue for the remainder of this biennium. But, as we described above, the lion's share of tax expenditures support well-entrenched and popular purposes. As a result, we think it is unlikely that significant new revenues will be found in this area. Our ten-year budget projections do not assume any additional revenues from this source.

Still, we expect that there will be interest in increasing revenues in these ways, just as there will be continuing demands for tax reductions. For example, we discern a growing interest in scaling back Measure 66's rates on income from capital gains, as a means to reduce what is perceived to be a deterrent to investment and economic growth.

Finally, we recognize the concern that raising taxes in a fragile economy could slow the pace of recovery in the private sector.

> Bottom line: Increases in Oregon's general fund revenues from increased tax collections or reduced tax expenditures are likely to be offset in part by tax reductions elsewhere. Net tax increases are unlikely to contribute to any material improvement in the state's long-term fiscal condition.

In Section 3, we offer recommendations to address what we believe are the more compelling challenges facing the state on the revenue side of its ledger – namely, how to stabilize and protect the existing revenue streams that provide the working capital for its general fund programs and services.

Looking Inside the Budget Box

Budgets are estimates. Their numbers are never certain, but they do provide the best tools we have for managing resources. In the public sector, budgets are also policy statements, reflecting where a government chooses to spend its money. But even the best budget documents need translation and interpretation in order to tell the story behind their numbers and highlight the policy decisions inherent in their assumptions.

The "current service level," noted above, is a key building block for what is often called the state's budget box.

The current service level is a projection of what the state's current obligations will cost in future budgets. It is built on estimates of both cost and demand. The cost factor includes both unavoidable costs, such as higher charges for electricity, and discretionary costs, such as increases in employee pay and benefits. The demand factor includes services that the state is currently providing and obligations that the state is required to meet because of federal and state mandates or ongoing state commitments. But it excludes other forms of demand not covered by these mandates or commitments, such as enrollment growth in community colleges and universities.

In effect, the current service level provides a "business-as-usual benchmark" for the state's fiscal future. It is this benchmark which we use in this report to calculate expected deficits in the years ahead, based on what the state is obligated to do or has previously chosen to do.

However, it is important to note that what services the state chooses to provide and how it chooses to organize, deliver and control the cost of those services can significantly redefine or "reset" the current service level for future budgets. That is our focus.

As this report was being prepared, state agencies were directed to prepare "cut lists" for 2011-13 amounting to 25 percent of their prospective current service levels for that biennium. This directive was based on projections of current service level increases that ranged from six percent in natural resources to 50 percent in human services, after the loss of one-time funds.

Thinking Outside the Budget Box

The Governor directed us to look beyond the next budget period and learn from the roller-coaster budget experience of the last decade.

In tough times, the short-term approach to plugging deficits dooms us to crisis budgeting and management by triage. In better times, there is a tendency to restore cuts made in prior budgets and attempt to re-establish previous high water marks for favored services.

The impacts and inefficiency of these approaches were demonstrated in the last decade. Coverage for low-income citizens in the Oregon Health Plan came close to extinction and then only partially recovered; funding for schools was put on a roller coaster whose low points forced sudden closures and larger class sizes; and, cuts to our higher education system drove steep increases in tuition. Many of these cuts were restored during the rapid economic recovery that fueled more than 20 percent revenue growth as we entered the 2007-09 biennium. But, when the recession hit in December 2008, those restorations became unsustainable.

Section 2: **What We're Facing – A Decade of Deficits Will Make Current Services Unsustainable**

We need a different approach to managing our resources, one that begins with long-term planning and remains focused on developing and employing smarter ways to meet our responsibilities in challenging times.

Our goal is to identify ways in which the state can eliminate its deficits in the early years of the next decade. If this effort is successful, the deficits projected for the remainder of the decade will disappear. Success will require reductions and changes in spending combined with new efficiencies to achieve an equilibrium of revenues and expenditures. In effect, if a new and lower "current service level" can be established based on 2011-13 revenues, then that level of services should set a sustainable baseline for the remainder of the decade.

Even then, however, the decade of stability we envision is not guaranteed. Continuation of the revenue "kicker," by which higher-than-expected revenues in good times are returned in full to taxpayers, will continue to de-stabilize our revenue future. Similarly, if ballot initiatives continue to create new unfunded mandates, such as those that will require the incarceration of more offenders for longer periods of time, we will continue to throw balanced budgets into deficit.

Fiscal stability will require solving these revenue and spending problems and budgeting to a longer term horizon. But these are decisions which we and our elected representatives control. They are not dependent on external economic forces.

Thus, Oregon faces a critical decision as we approach the 2011-13 biennium. Decisions made for that budget period could keep us on the path to another decade of deficits, if we attempt to sustain current services with current practices. Or, if we restructure our services and control costs to better meet our future responsibilities, we could chart a path to a decade of stability.

The latter approach need not be an exercise in austerity with no rewards. A reorganization of how we finance and deliver services and a reset of our budget in the early years of the next decade could provide a more stable environment in which to shift resources to new investments and better meet the needs of our citizens in the future.

Section 3:

What We Can Do – Options for Resetting State Government

WHAT WE CAN DO – OPTIONS FOR RESETTING STATE GOVERNMNET

The Cabinet focused most of its attention on the 93 percent of the state's general fund budget that is devoted to meeting the core responsibilities of state government. These are the "big three" program areas of education, health and human services and public safety.

We view each of these program areas as top priorities, as each represents responsibilities that cannot can be ignored or abandoned – even in the decade of deficits that now confronts us.

Four subcommittees, led by members of the Cabinet and comprised of additional members from inside and outside of state government, addressed K-12 education, education beyond high school, health and human services and public safety. These subcommittees worked to develop options for restructuring the manner in which the state meets its core responsibilities, reprioritizing obligations where necessary and adopting more cost effective strategies for achieving objectives in their program areas.

Within these program areas, the subcommittees examined the obligations that are reflected in a program's "current service level." Some of these have been mandated by the federal government, but most have been self-imposed. As we outlined in our interim report, these include:

- What we've been told we have to do, as in federal mandates that require states to provide medical care to the poor and disabled as a condition of participating in the Medicaid program;

- What we have told ourselves we have to do, as in the constitutional provisions related to mandatory minimum prison sentences for certain offenders; and,

- What we have decided we want to do and should continue to do, as in establishing and maintaining 24/7 patrol coverage by the State Police and making college affordable for all Oregonians.

To these obligations, we now add a fourth category:

- What we say we want to do and would be smart to do, but can never find the money to get done.

A large number of recommendations emerged from the subcommittees in this last category. These recommendations create a tension between the imperative to live within our resources in the present and the need to produce better outcomes with our resources over time. The latter often requires new money for front-end investments; the former tends to triage scarce dollars into preserving what we are doing now.

Given the reality of immediate budget shortfalls and the prospect of continuing deficits if we fail to put our fiscal house in order, we chose to lead with options for rebalancing the budget as the first step for resetting state government. But we did so with an eye toward the critical second steps that can continue its transformation. This approach recognizes that progress often requires a step back to reassess and find a better path forward.

Our examination of the path we're on and the paths we would prefer to pursue also led to discussions of the trade-off between "budgets of necessity" and "budgets of choice." This raised the issue of shifting resources from one core responsibility to another. We recognize that "necessities" such as the safety of our communities and the protection of vulnerable children cannot be ignored. At the same time, we acknowledge that the ability to make "choices" for greater investments in education is equally compelling. In the end, we did not recommend any shift of resources from one major program area to another, but we hope that our recommendations, taken as a whole, will facilitate such decisions over time.

We reiterate what we hope is now an obvious insight – that creating a stable and sustainable fiscal future will enable the improvements needed to free up resources for better investments.

Also, we recognized a parallel in the discussion of "necessity and choice" with the profoundly unsettling finding described in Section 2 that we appear to be experiencing an accelerating cycle of decline in the well being of our citizens and the fortunes of our state. This finding highlights the stark contrast between the vicious circle of declining personal incomes, diminishing tax revenue and increasing needs for services of necessity and the virtuous circle of a better educated citizenry achieving higher incomes, generating more tax revenue, needing fewer services and creating more opportunities for investments of choice. We view this finding both as a large danger sign for the path we're on and as a reminder of the gains to be achieved from the change of course we must now undertake.

Key Program Areas

The work of our four subcommittees informed the major portions of this report. We reviewed their work at every stage of their deliberations, supported and sharpened their inquiries and, in the end, accepted most of their recommendations.

We present their findings and recommendations in four appendices to this report and summarize what we consider to be their most compelling recommendations in the five subsections that follow.

3.1 Education through high school.

The K-12 subcommittee report dug deeply into savings to be achieved from sharing business functions and consolidating smaller school districts. It recommends moving forward with a shared services model by 2012 and reorganizing Education Service Districts by 2014. Richer course offerings in math and science can be achieved at lower costs and high school students can be offered more opportunities to earn college credits through the use of virtual (online) learning options. In addition, the Cabinet reviewed the state's recent experience with the federal "Race to the Top" competitive grant process and highlighted initiatives now underway as well as new approaches to improve student achievement.

3.2 Education beyond high school.

This subcommittee called out both the challenges and opportunities of a post-secondary education system swamped with record enrollments. By improving retention and graduation rates, Oregon's community colleges and public universities can educate more students with better success at less cost both to state and local taxpayers and to students and their families. The Oregon University System is primed for a reorganization of its relationship to state government that can achieve the state's goals with greater flexibility, new efficiency and lesser costs – beginning with a commitment to manage through a reduction of 15 percent from the state's projected budget levels in 2011-13. Finally, the subcommittee calls for building on the "shared responsibility model" for student financial aid to make college affordable for Oregonians at all income levels.

3.3 Health and health care.

With more than 700,000 Oregonians receiving medical care from the Oregon Health Plan and costs expected to rise by 13 percent in the next budget period, the state's health care cost containment strategies have taken on a new urgency. The subcommittee recommends implementation of strategies to cut the rate of future cost increases to five percent per year, shifting new resources from medical care to prevention and public health, and better controlling the use of hospital-based mental health care for persons convicted of crimes – all of which will reduce costs to the state's general fund over time.

3.4 Human services.

The recession has caused explosive growth in the number of Oregonians seeking safety net services and put more children in need of protective services. Even in better times, the state would struggle to meet its responsibilities for aging seniors. The subcommittee calls out proven strategies for reducing the number of children in foster care and coordinating care for youth with mental health problems. To meet the rising demand for senior services, the subcommittee recommends new initiatives for chronic disease management, expansion of in-home care and the use of a new federal program for long-term care insurance.

3.5 Public safety.

Oregon is a safer place than it was 20 years ago. Our crime rates have declined dramatically and are now at historic lows, representing the largest drops of any state in the country in recent years. However, the state's sentencing policy, not crime rates, determines the number of expensive prison beds. The subcommittee calls for a restructuring of sentencing policy to a modern, uniform sentencing guideline system. It recommends placing the construction and opening of new prison beds on an indefinite hold, adopting the federal earned time system, continuing the suspension of Measure 57 (related to property crimes), adjusting Measure 11 (mandatory minimum sentences) and the use of enhanced home detention and supervision.

Statewide Initiatives

In the remaining five areas of this report, we share the results of our efforts to identify ways in which the state can control costs throughout its workforce, achieve new efficiencies in all program areas, improve its planning and budgeting, stabilize its resources and better coordinate with its partners in local government. Our findings and recommendations are organized as follows.

3.6 Labor costs.

In this subsection, we offer options for controlling costs not only in the state workforce but in the school workforces now supported in large part by the state's general fund. The findings in this subsection should not be viewed as pejorative nor are its options intended to be punitive. Rather, we call out ways in which labor costs can be better managed in fairness to taxpayers and public employees alike. This is the one subsection in this series that generated a longer report from the Cabinet, due to the complexity of the findings and analysis involved. The options in this section offer the largest and most immediate cost savings in the next biennium.

3.7 Organization and efficiency.

The Cabinet describes efforts underway to modernize state government through regulatory streamlining and e-government initiatives and reports on successful transformation efforts in the

Dept. of Human Services and the Dept. of Environmental Quality. Also, we looked at ways to combine diverse regulatory and governing functions in common agencies to reduce administrative costs and duplicative functions and recommended that the Governor be given the authority to appoint and remove executive directors for all regulatory boards and commissions.

3.8 Planning and budgeting.

Options to change the state's planning and budgeting practices sparked an in-depth discussion of the division of powers between the legislative and executive branches of state government. We agreed that the Governor needs more discretion in exercising the "allotment authority" to reduce spending when revenues decline to the point that previously-balanced budgets tip into deficits.

3.9 Revenue stability.

This subsection is singularly-focused on the importance of creating an adequate emergency reserve fund and the need to reform the state's one-of-a-kind revenue kicker. Absent this reform, we could close the budget gap in the next biennium and reset to a path to a better and soon be derailed by another recession and forced into a decade of recurring crises and continued instability. The Cabinet considers this reform to be an urgent priority.

3.10 State and local partnerships.

In this final subsection, we note the shared responsibility of county governments to meet our responsibilities for public health and public safety in partnership with the state. We acknowledge task force efforts underway to find efficiencies in this partnership, and we repeat a recommendation from an earlier task force for the creation of a state-county planning council.

Reprioritization of General Funds and Lottery Funds

As part of our review of the state's general fund priorities, we examined the remaining seven percent of the budget that is now spent on programs other than education, health and human services and pubic safety. These so-called "All Other" expenditures amounted to $954 million before the budget reductions recently implemented by the Governor. We asked whether it would be reasonable to move additional resources from the "All Other" category to the big three program areas.

We found that a major reprioritization of resources from miscellaneous programs to the big three program areas has already occurred during the past two decades. Prior to 1990, 18 percent of the state's budget was devoted to miscellaneous programs in the "All Other" category. Then, as pressures increased for the state to make up for lost property taxes for schools (due to the passage of Measure 5 in 1990) and to finance a major expansion of its prison capacity (due in large part to the passage of Measure 11 in 1994), more and more of these other programs were weaned from the general fund. The reduction from the 18 percent in 1990 to the seven percent that supports miscellaneous programs today amounts to $1.6 billion in the current budget. This represents a significant reprioritization over time in favor of education, health and human services and public safety.

Of the $954 million that supports miscellaneous programs today, just under half is devoted to administration and tax collection (approx. $170 million), parks and habitat restoration (approx. $175 million) and governance, which includes the legislature, the Governor and the Secretary of State (approx. $100 million). With the exception of parks and habitat restoration, these functions consume lesser shares of the state's general fund budget than they did two decades ago.

Spending on parks and habitat restoration is an exceptional case. In 1998, voters enacted Measure 66, which dedicated 15 percent of lottery funds to these purposes for a 15-year period through 2014. These lottery funds were used both to replace general funds previously spent on parks and to expand spending on parks and habitat restoration in the lottery-funded portion of the budget. These programs have grown from about $12 million in the 1989-1991 budget to approximately $175 million today. Oregon voters will weigh in again on the wisdom of this dedication of lottery funds to these purposes, as opposed to other purposes such as education, when a reauthorization of Measure 66 appears on the ballot. This could occur by initiative petition later this year or by a scheduled referral to the voters in 2014.

The other half of the $954 million is devoted to natural resource programs, business development and transportation. These programs, too, now consume a smaller portion of the state's general fund budget than they did two decades ago. Further, many of the natural resource functions that were formerly supported by general funds are now supported by "user" fees paid largely by regulated businesses (e.g., water quality permit and food safety inspection fees) or individuals (e.g., fishing license and state park entrance fees). Further shifts from general funds to fees for these programs are regularly considered and debated in the state's biennial budget processes.

Business development programs represent about the same small portion of the state budget that they did prior to 1990 (roughly one percent). The business development program area has been studied and reprioritized repeatedly over the years, most recently through an in depth legislative restructuring of the Oregon Business Development Department during the 2009 session. As a result, we did not revisit that work.

Transportation consumes an even smaller portion of the current general fund budget (less than one percent), since the bulk of transportation spending comes from constitutionally dedicated revenues from state gasoline and weight-mile taxes and federal grant funds devoted to highway projects.

In summary, we found that the further redirection of general fund resources from miscellaneous programs to education, health and human services or public safety is feasible. But, with the exception of lottery funds, its potential is modest and should be addressed in the state's biennial budget decisions. With regard to the dedication of lottery funds, the potential for repurposing is greater and will be decided by the voters.

Conclusion

Our review of the services that comprise the state's core responsibilities did not touch on every program in the state's general fund budget, nor will our recommendations be sufficient to close the deficit in the next biennium, even if adopted in full. Some of our recommendations will take time to implement and come to fruition. Others, although important, will have only modest impacts on the state's bottom line deficit.

Our tally of the permanent savings to be achieved from the recommendations outlined above exceed $1.5 billion over the next two budget periods (2011-15), with additional savings feasible in later years.

We view these recommendations as a foundation for the restructuring and funding of services over the next two biennia. We expect these recommendations will be supplemented by other ideas they may engender and by the unavoidable item-by-item budget cutting that will necessarily flow from the budget reductions the Governor implemented this month and the cut lists that state agencies are preparing for 2011.

But we hope it is now evident that forced marches through steep budget declines, in which we struggle for a foothold from biennium to biennium, will never lead us to a better future. We need a thoughtful and far-sighted expeditionary approach to see us through the next decade.

With this understanding, we offer this report as a first draft of the road map that we will need to turn the decade of deficits and decline that now confronts us into a decade of stability and opportunity.

NOTE: Savings estimates in the recommendations that follow are derived from agency data or data from outside sources. They should be considered rough estimates that will need more refinement for budgeting purposes. Further, these savings estimates are based on costs projected for 2011-13 and future biennia, as displayed in Section 2, rather than current costs. Thus, they are projected savings that will reduce future deficits.

EDUCATION THROUGH HIGH SCHOOL

Oregon's K-12 education system is on a path to becoming unable to provide a minimal 180-day calendar, a comprehensive program, and the necessary support structures for teachers to teach and students to learn. Oregonians understand we now exist in a knowledge-based economy, where our education and training relates directly to our economic viability and success. This means that if we are to provide our children and grandchildren with the opportunity to prosper, we must provide them with a quality public education system.

The Cabinet reviewed existing research to determine how a quality public education can be delivered in these challenging economic times, with support for maximizing student achievement being the primary desired outcome.

The state's structural deficit has been felt heavily in the K-12 public education arena. Prior to the passage of property tax limits, 70% of the funding for K-12 schools came from local property taxes. Local communities previously were able to impose, on themselves, the tax rate necessary to raise the revenue needed to pay for the education program they desired. However, today, 67% or more of K-12 funding comes from the state general fund.

The current economic recession is compounding the limitations of the K-12 finance structure, and as per-student funding in Oregon has dropped in recent years, local school districts are trying to reduce costs in myriad ways, including cutting the number of school days, delaying new curriculum adoptions, increasing class sizes, and reducing the number of course offerings. Programs like summer school and credit recovery options and opportunities to earn college credit have been reduced or eliminated. Efforts to combat the state's dropout rate and improve student academic achievement have been hampered.

Citizens have been negatively affected by this trend. Students have seen their educational opportunities limited. Veteran educators have been laid off. Newly trained educators have difficulty finding positions. The business community struggles to find qualified workers and many businesses fear they will not be able to expand. People have decided not to immigrate to the state due to this shortage. Parents worry about their children's future and are committed to finding solutions. The future economic viability of the state and the well-being of its citizens are in jeopardy.

Oregon’s K-12 public education system consists of 197 school districts and over 560,000 students. The average number of students educated by most of the state's school districts is less than 1000, with the smallest district educating only four students. This disperse system of school governance and limitations on funding available for education represents an opportunity for significantly increased efficiency in the delivery of education in Oregon, and accordingly freed up, sustainable resources for quality instruction. Simultaneously, Oregon increasingly must focus on those investments that most enhance student achievement.

Shared Services

"Shared Services" is an arrangement by which some traditional school district functions are consolidated in a regional education service district (ESD) or other local government. For example, business services such as payroll or technology support can be shared among multiple school districts, thereby reducing redundancy and administrative costs. While the increased use of shared services may require a major cultural shift in many districts' thinking, it can provide necessary services while costing districts substantially less money to produce the desired educational outcomes.

Oregon has a large geographic area with numerous small districts in remote regions. Budgetary cuts over the years have left the state's Department of Education at a minimal staffing level. The department is not able to provide the assistance to districts that it has in the past. It would be more efficient to have a stronger regional support system so that staff are located close to districts and aligned with local needs.

Interest in shared services has grown across the country over the last several years as many states have faced ever-growing budgetary shortfalls. For example, one recent study by the New York State Commission on Local Government Efficiency and Competitiveness calculated that the use of shared services can save from $300 to $400 per student per year.

Under current Oregon law, however, the functions that school districts are required to "share" by consolidating them with other districts through a Local Service Plan executed by an ESD is open-ended. Consequently, the level to which local districts choose to consolidate business and instructional services across districts varies substantially, and overall is below that which could maximize efficiency.

A recent study conducted for the High Desert ESD and its four component school districts in Central Oregon projected a total potential savings of $2,208,000 per year on staff, fiscal, technology, and instructional functions if all four districts consolidated those services into the ESD and achieved the current average cost for when such functions have been shared by school districts in other parts of the state. The High Desert ESD includes only about 5% of the students in Oregon, so comparable savings statewide could be upwards of $47 million per year through this approach.

The two recommendations that follow can transition the K-12 education delivery system toward greater efficiency through increased use of shared services. The first recommendation is a shorter-term intermediary step, and the second recommendation is the longer-term goal.

> **Recommendation:** Legislatively mandate the development and implementation of a shared services model with all districts participating by July 1, 2012.

Oregon should establish a statutory minimum list of the “shared services” that ESD's must provide to component school districts. ESD's with insufficient resources to provide the minimum level of services under the existing school funding formula should be required to combine programs and resources with other ESD's. The minimum services required to be consolidated in ESD's by school districts should include, but not be limited to: operational functions (business, accounting, information technology, transportation, human services, etc.) as well as special education and other selected instructional programs, so as to reduce overall costs and allow school districts to redirect maximum dollars to the classroom. In addition, at least one ESD service center should be established or maintained in every county in order to ensure a local, physical ESD presence in proximity to every school district. Legislation should be introduced to direct all existing ESD's and component school districts to participate in the shared services program, meeting the minimum requirements beginning no later than July 1, 2012. To the extent that ESD's happen to find themselves with resources under the school funding formula that are in excess of what is needed to provide newly mandated shared services, such ESD's should provide other additional services approved by component districts in their Local Service Plans, such as regional special education, professional development, and school improvement.

In addition to a mandatory list of minimal shared services that must be provided through ESD's in the short-term, the legislature should require the development of an even more consolidated shared services model across the state for the long-term.

> **Recommendation:** Reorganize the current Education Service District system to coordinate shared services as well as provide for specific regional education support services. Transition into Regional Service Providers of a lesser number by July 1, 2014.

Oregon should statutorily dissolve existing ESD's and create a new structure of fewer regional service providers (RSP), beginning in July 1, 2012, with completion by June 30, 2014. Legislation will be required to facilitate the transition of the current taxing structure, funding mechanisms, and governance structures from the existing ESD system to the RSP system. There should be a minimum list of shared services that each RSP would be required to supply to its component school districts, including, but not limited to: business functions, transportation, human resources, information technology, selected special education services, and school improvement support. A streamlined RSP system, with a clear focus on shared services, would provide cost savings for local districts and would allow districts to increase resources spent in classroom and aid their mission of improving student achievement.

For both steps one and two reflected in the above recommendations, a targeted savings amount for school districts should be established by statute at no less than 10%, and annual increased costs should be monitored so as to assure savings from consolidated shared services. To that end, a new single statewide financial and student data reporting system should be established, the cost of which could be funded through state bonding.

A new, more dynamic regional delivery system focused on coordinating shared services, and providing districts with quality staff development and school improvement personnel, can and should be established. Local districts would be freed from many of their business and support roles and could focus on the academic needs of their students more efficiently.

Virtual Education

Oregon should create and fully support a statewide public virtual learning system. The use of online or virtual learning has come of age in recent years. Today's technology makes it possible to provide educational opportunities to remote areas of the country. Florida, for instance, has over ten years of experience with providing a statewide virtual system. In that state's experience, the highest demand areas are in credit recovery and dual credit classes, where students earn both high school graduation and college credit. The average student is not enrolled full-time in a virtual program, but takes one or two online classes per semester.

A 2008 survey by the Association of Educational Service Agencies indicated that the greatest need for access to virtual instruction is in the areas of secondary math and science. Small and rural districts find it especially difficult to hire all of the highly qualified teachers necessary for these academic areas. The survey also showed a strong demand for online courses that provide college credits that are transferable to all state institutions. Oregon could provide more dual credit classes aligned with the Oregon Transfer Module and the Associates of Arts Oregon Transfer, as well as Career Technical Education classes through community colleges.

The Oregon State Board of Education recently received a report indicating that the cost of providing online teaching options is calculated to be 70-80% of the cost of providing the same quality of education in a traditional bricks-and-mortar setting. This indicates real potential to expand educational opportunity for the state's students, while freeing more resources to go back into the classroom.

> **Recommendation:** Create a statewide public virtual education option. Require every district to provide access to this option if the district does not have its own internal program.

A statewide public virtual option should be established to direct that all public dollars going to support students taking online classes go to a public online delivery system. State certified teachers, supervised by school officials, could provide the instruction. School districts may be open to allowing students to participate if each local school district has the authority to determine where the student will attend and full budgetary transparency for the program is assured, as with current school district budgets.

The legislature should continue its support for the Oregon Virtual School District and work with the State Board of Education to establish clear statutes and administrative rules governing virtual education options. Development of a robust public virtual delivery system is critical to both reducing the cost of providing the highest quality education in Oregon, and targeting investments that maximize student achievement.

Dual Credit Options

Building upon the work of the State Board of Education and the State Board of Higher Education, Oregon should help high schools and post-secondary institutions put into practice more dual credit options. Dual credit options allow high school students to complete college level courses, earning credit for both high school graduation and lower division college courses as high school students. While several thousand Oregon high school students take advantage of these programs, much can and should be to be done to expand offerings.

In Oregon's high schools, there are three primary vehicles for high school students to earn college credit at the high school site – the College Board's Advanced Placement Program, the International Baccalaureate Program, and dual credit (or "concurrent enrollment") programs. The name "dual credit" is frequently applied to a range of programs that vary in design, but most commonly involve a course taught in a high school, by a high school teacher, in partnership with a community college or an Oregon University System institution. Successful completion counts as credit for both high school and college/university work. Dual credit courses permit considerable monetary saving for students and parents, since state support typically reduces the cost of the courses to a small fee, well below the actual cost of college tuition.

The effectiveness of dual credit courses was evaluated in a recent Oregon study analyzing students' subsequent academic performance. Specifically, performance in the next related course by students who took a dual credit course in high school was compared with that of students who took the same courses in a community college or university. The aggregate results indicate that dual credit courses are effective, since students taking them performed at least as well as students who took all of their courses at a college or university.

The strengths of a robust dual credit program include, but are not limited to: instructors with depth in their field and credentials that meet college requirements for teaching in the field; multiple and varied assessments to evaluate learning (quizzes, mid-terms, papers, final exam, etc.); rigor and exposure to college-level expectations that smooth the transition to college; joint professional development opportunities for high school instructors and college and university faculty (e.g., workshops and training); close relationships and alignment between high school and post-secondary institutions; tuition savings for families.

> **Recommendation:** Expand, through the public virtual option and in high schools, the dual credit system allowing high school students to earn college credits while also meeting graduation requirements.

Oregon's dual credit programs are good; however, their potential in Oregon has not been fully realized. Since these programs can contribute measurably to meeting the state's student achievement goals, additional steps are critical. Oregon should expand dual credit programs to ensure that all Oregon school districts provide the opportunity for college credit courses to their students. Accordingly, the state should continue to reimburse costs for dual credit courses incurred at both K-12 and post-secondary institutions. Colleges, universities, and high schools should complete work to adopt a common set of standards for all dual credit programs in Oregon—work underway with standards identified and a timeframe for statewide adoption by fall 2013. Oregon should continue the study of subsequent academic performance in order to assure the continued high quality of dual credit programs. In addition, Oregon should expand the pool of qualified high school teachers, by encouraging teachers to pursue the training needed to teach at the post-secondary level (typically a Master's degree in the specific discipline), including establishing a fund to reimburse a portion of teachers' educational expenses.

Additional Student Achievement Improvements

In the process of developing the above recommendations for increasing the efficiency with which the most effective public education programs can be delivered in Oregon, the Cabinet reviewed the extensive research-based efforts of the Race to the Top Application Design Team. Through engagement with an extremely diverse group of education stakeholders, the Design Team's work, while unsuccessful in attaining a competitive federal grant this year, identified a number of priorities for educational reforms that would lead to increased student achievement in Oregon.

National Standards and Assessments: Over the past decade, Oregon has been on the cutting edge among states in developing the student performance data collection systems that will enable more strategic efforts to track students' progress throughout their educational careers and utilize that data to improve instruction and student support programs. The goal is to tailor the highest quality education program possible for every student. The state should continue its work building a statewide, web-based portal that will provide teachers, principals, parents, and policymakers a convenient way to access data to assess and target resources to improving the abilities of our educators and students in the classroom. National evaluations have found that the student examinations currently used in Oregon place the state in the middle of the pack when it comes to learning expectations, but the bar is being raised and Oregon cannot afford to be left behind. A state system that increases access to performance data will enable the public to see where students are making the greatest gains and where the state needs to do more work. Simultaneously, Oregon should be prepared to connect to the benchmarked standards and assessments being developed nationally and internationally in order to prepare students for success.

Teacher and Principal Effectiveness: Oregon should pursue new educator-led reforms of existing professional development programs, including the development of new performance evaluation systems, new career pathways for educators, new salary schedules, and expanded mentoring programs for new teachers and administrators. The substantially increased transparency afforded by improved data tools can and should be used to expand and develop new, rigorous, and fair evaluation processes for local superintendents, principals, and teachers across the state, building on the work that has been started by the Chalkboard CLASS project and others in several districts. These evaluations should help districts effectively target staff development efforts, improve instruction, and where necessary, aid in making staff retention and promotion decisions.

Low-Performing Schools: Oregon's statewide drop-out rate is significant and many individual schools simply are not achieving the robust graduation rates we should expect. Oregon's dispersed system of school governance does not currently enable the state to directly intervene and compel improvements in the state's persistently lowest-performing schools and districts. The state should take action to identify the five percent of lowest-performing schools and then produce and implement intervention plans that increase student learning and subsequent success in work or post-secondary education. Moreover, the state should expand, statewide, the DATA Project (Direct Access to Achievement), which is a significant effort underway in some Oregon districts, training school staff to analyze all available student data when developing individual classroom lessons or creating whole-school and district-wide improvement plans that address the particular needs of current students. DATA Project leaders are also preparing select educators to be "coaches" within their respective schools, helping to make the analysis and use of student performance data a systemic part of everyday practice. With adequate support, proactive training efforts such as the DATA Project, could obviate more onerous interventions in low-performing schools if taken to a statewide level.

As Oregon works to deliver public education as efficiently as possible, so as to maximize the limited resources that can be devoted to quality instruction, these and other steps toward development of a statewide culture that demands educational excellence and equity are critical to the state's future.

Read the Education Through High School Subcommittee Report.

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EDUCATION BEYOND HIGH SCHOOL

Oregonians are attending the state’s 17 community colleges and seven universities in record numbers, many returning to school in response to the downturn in the economy. For the 2008-2009 school year, more than 380,000 students were served.

On one hand this is good news. With more Oregonians pursuing postsecondary education, the state will be building the well-educated workforce it needs to retain existing businesses and attract new businesses that are critical to the state’s economy. It also presents an opportunity to make real progress toward the state’s postsecondary education goals: 40 percent of Oregonians with a baccalaureate or graduate degree, 40 percent with a two-year degree or certificate, and 20 percent at least completing high school by 2025.

However, the demand on the system has exposed, more than ever before, the state’s disinvestment in postsecondary education. Since the passage of Measure 5 in 1990 and more recently, with the challenges of two recessions, tight state budgets have meant that Oregon’s community colleges and universities are struggling to serve more students while also maintaining quality and increasing completion rates. The goal to serve more students – and do it better and faster so that the cost per degree decreases – is strained due to limited resources for Oregon’s post-secondary education system.

Oregon has made significant progress in increasing access to college, but those investments have meant fewer resources for services, such as counseling, that ensure enrolled students stay in school and graduate in a timely fashion. Currently, for every 100 ninth-graders in Oregon high schools, only 16 will go on to complete college by age 25. Many Oregon students drop out or take several more years to obtain a degree because the system is unable to provide the full menu of services students need to be successful.

As the state continues to build upon its successful efforts to increase access and affordability using the ‘shared responsibility model’ under the Oregon Opportunity Grant program, we also need to find ways to fund effective services that increase college graduation rates. Doing both is critical to student success on an individual level and on a collective level that will define the future of the state.

By first focusing on student access and success, the Cabinet does not mean to understate the importance of the ongoing debate about reforming the state’s relationship with its public university system. In fact, the Cabinet agrees that the case is compelling for redefining that relationship– and that it can be done in a way that maintains our efforts to increase access, affordability, student success and accountability.

We can provide the university system with the flexibility needed to better manage revenue and costs, similar to how the state funds community colleges, in exchange for greater accountability. Through the careful design of tailored agreements between each university and system, we can get the most out of the unique capacities and opportunities of each.

Although it must be designed carefully, increasingly we should be paying for educational outcomes such as the time it takes for students to graduate and numbers of degrees awarded, and looking at education budgets in a more comprehensive way.

A system redesign that includes new accountability measures means that state taxpayers can feel confident their tax dollars are supporting a public education system that is centered on student success and producing the well-educated workforce Oregon needs to be competitive in a global economy.

Recommendations

The Cabinet offers the following recommendations:

Recommendation: Implement a student success initiative that integrates set of actions to improve rates of college attendance and completion.

- Develop a unified education budget through the Joint Boards of Education to help allocate money where it will do the most good for student preparation and progress from high school through college degree or certificate. Graduating more students who start college is the most effective next step to achieve 40/40/20 and to bring down the cost-per-degree granted.
- Direct the Joint Boards of Education to follow the recommendations of the Postsecondary Quality Education Commission that improve retention and graduation rates at two-year and four-year colleges, including expansion of dual credit courses for high school students to take college-level coursework. It is more cost-effective to improve rates of retention and graduation among the students who are already in the system than to simply add more students, though the latter is necessary for long-term success.
- In funding formulas, increase the weight given to outcomes (e.g. degrees) not just inputs (enrollment) in funding formulas, taking care not to disadvantage schools that teach the hardest-to-educate or least prepared.

Recommendation: Design new compact between the Oregon University System and the State.

- To help the Oregon University System achieve state goals in an era of tight resources, grant it more flexibility to manage revenue and costs, including converting from line-item to block grant funding from the state.
- Maintain accountability by requiring multi-year plans built around clear performance expectations.
- Maintain a statewide system but allow the State Board of Higher Education to establish operating agreements with each institution tailored to the unique capacities, needs and opportunities of each.

Recommendation: Contribute to overcoming the state's decade of deficits.

- In light of the flexibility granted, fund OUS at a 15-percent cut from expected "current service level" for the upcoming budget.
- Institute multi-year plans and spending programs based on extensive engagement with stakeholders and the broader community. This process would have two main benefits: first a stronger connection of higher education with state interests and needs, and secondly a solid basis for multi-year performance agreements with the legislature.

Recommendation: Build on Oregon's "shared responsibility" model for need-based aid to better manage affordability by connecting all the pieces that affect student cost but are now handled and budgeted separately. (Presently no one looks at all of the pieces at one time through an "affordability" lens.)

- Incorporate institutional need-based aid into the "shared responsibility model."
- Direct the State Board of Higher Education to develop an affordability framework to inform budget decisions.
- Consider structures and incentives to maximize commitments to need-based financial aid at the institution level.
- Reform the Oregon Opportunity Grant program to prevent over-commitments.

Read the Education Beyond High School Subcommittee Report.

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HEALTH AND HEALTH CARE

The state's responsibilities for the health of its citizens encompass both securing health care services for the needy and protecting and promoting health in our communities.

More than 700,000 low-income Oregonians received medical care from the Oregon Health Plan and other state programs last year. Tens of thousands of others received mental health services and treatment for addictions. All Oregonians benefited from public health programs of the kind that were mobilized to stem the spread of the H1N1 virus last year and provide year-round protection from the spread of communicable diseases.

These services have been provided by programs within the state's Department of Human Services (DHS) that are now being reorganized into a new Oregon Health Authority (OHA), overseen by a new Health Policy Board, which will oversee services to close to a quarter of the state's population.

Budget and Background

In recent years, Oregon has seen an exponential rise in the need for health care services from low-income and moderate-income Oregonians.

Increasing needs and rising unit costs for these services are driving a growth in expenditures estimated at 13 percent per biennium for OHA programs, while overall state revenue is projected to grow at seven per cent per year during the next decade.

Funding for the state's health care programs is highly leveraged with Federal funds. Almost half of the $11 billion total OHA budget is comprised of Federal funding, the use of which is federally prescribed. These funds must be used according to federal program requirements, and it is not within the discretion of the state to repurpose or reallocate these dollars.

It is also important to understand that 96.8 percent of the DHS/OHA budgets go directly into local communities. These funds are paid to doctors for Oregon Health Plan clients, counselors for people with mental illness, home health care workers for seniors and people with disabilities, community-based providers such as nursing facilities or foster parents. These are the individuals and small businesses that provide the majority of the health and human service work done in Oregon.

House Bill 2009, enacted last year, laid the cornerstone for health care reform in Oregon with a directive to consolidate most state health care functions into the Oregon Health Authority. This consolidation of state health care functions will give the state greater purchasing power to control costs, improve quality and boost preventive care in the larger health care marketplace.

Passage of the federal health care reform legislation, the Affordable Health Care Act, further accelerated the state's ability to meet these goals. Approximately 95 percent of Oregon's population will have health care coverage when all of the elements of federal reform are in place. The federal health care legislation has created new opportunities to greatly improve the long-term equation for federal matching funds. By initial estimates, the increase in federal support is expected to amount to an additional $4.9 billion over the next decade. The effects on the state are predicted to be close to budget neutral, within a range of plus or minus $50 million over the next ten years for a return of federal dollars close to 100 times that amount.

Recommendations

Controlling Health Care Costs

The Oregon Health Fund Board set as a long-term goal for Oregon to save up to $10 billion in health care costs over 10 years. The Board spelled out seven strategies for achieving this goal, as detailed in the subcommittee's report. The new Health Policy Board is now overseeing this ambitious health care reform agenda, and has begun reprioritizing and resetting the state's health care programs even in advance of the Cabinet's work. The Cabinet endorses the strategies developed by the Oregon Health Fund Board and the current work of the Health Policy Board, and recommends continued implementation through the Oregon Health Authority with the overarching goal of reducing the growth of state health care expenditures to no more than five percent a year.

> **Recommendation**: Implement strategies recommended by the Oregon Health Fund Board to reduce the growth of health care expenditures to no more than five percent a year and improve quality by transforming the health care delivery system throughout the state. Specific strategies include the following:

- Continue to develop and implement evidence-based guidelines and best practice clinical standards;
- Reduce growth in administrative spending by health insurance plans;
- Reduce spending on health care administrative transactions;
- Reallocate spending to primary care, prevention, and chronic disease management;
- Reduce pharmaceutical spending;
- Focus on long-term prevention and population health; and,
- Facilitate statewide use of health information technology.

By reducing the rate of health care spending by one percent a year, Oregon will save approximately $21 billion over the next ten years, including an estimated $330 million from the state's general fund expenditures. Holding the increase in Oregon Health Plan costs to five percent per year will save $24 million in 2011-13.

Improving Public Health and Disease Prevention

In Oregon, less than 10 percent of the state health department's budget comes from the state general fund. Federal funds support most of the OHA's efforts in this area, but the categorical nature of those funds limits its flexibility and ability to address Oregon-specific needs. There are opportunities to rethink how our state general fund dollars can be invested through the OHA to better leverage illness prevention.

> **Recommendation:** Direct the investments of scarce resources to prevention-based services that benefit the entire population. As budget cuts are enacted and as new funds become available, preferentially support prevention and those services that improve the population's overall health.

Among the findings that support a prevention agenda:

- More than 80 percent of preventable deaths are due to behavior and the environment, yet only one percent of our spending to promote health currently supports efforts that address these drivers of poor health.

- Tobacco use, poor nutrition and insufficient physical activity are currently the leading drivers of poor health outcomes. These problems cannot be effectively addressed in a healthcare provider's office. According to the Trust for America's Health, an investment of $10 per person per year in proven community-based programs to increase physical activity, improve nutrition, and prevent smoking and other tobacco use could save the country more than $16 billion annually within five years. This is a return of $5.60 for every dollar invested.

- Oregon supports its Tobacco Prevention and Education Efforts with tobacco tax dollars. Currently only a little over three cents out of Oregon's $1.18 per pack tobacco tax is used to support tobacco prevention; most of the rest of the funds generated by this tax are used to support health care services. Oregon has reduced tobacco use at more than twice the rate of decline seen nationally by investing in tobacco prevention, but we could do even better. Oregon's investment in tobacco prevention is at 14 percent of the level recommended by the Centers for Disease Control and Prevention.

- Investments in prevention will also help contain or lower the costs of health care. In looking at obesity, a study by Dr. Kenneth Thorpe of Emory University, commissioned by the Northwest Health Foundation, showed that the rise in the prevalence of obesity in Oregon between 1998 and 2005 accounted for nearly 34% of the real per capita growth in healthcare spending.

While tobacco use, poor nutrition and insufficient physical activity are currently the leading drivers of poor health in Oregon, substantial improvements in health could also be made by investing in injury and violence prevention focused on the whole community, communicable disease prevention, maternal and child health services, and environmental public health.

Finally, public health methods and tools also have tremendous potential to address addictions and mental health needs. For example, Oregon has been a national leader in suicide prevention efforts and early psychosis intervention programs. Expansion of these efforts would yield enormous benefits and cost-savings.

> **Recommendation**: Undertake a systematic assessment of the state's public health system structure and share services regionally where greater efficiency and effectiveness can be demonstrated.

In Oregon, the public health system includes the population-based components of the Oregon Health Authority and 33 county health departments. The large number of players involved makes governance both resource-intensive and time-consuming. In part as a reflection of these governance difficulties, advocacy for system needs is difficult, and, consequently, funding for this system has stagnated and devolved into a patchwork of federal funds, fees and a small amount of state and county general funds, often with little coherence.

The state-county relationship has its strengths: linkages between the state and county governments, a workforce distributed throughout the state, and a structure that can accommodate a wide range of complementary and interdependent roles. However, the complicated political landscape of such a diverse system, the variation in levels of engagement of county government in public health issues around the state, and the difficulties in aligning such a large group of stakeholders, makes it difficult to synergize efforts and to assure that a core set of public health services are consistently available.

A recent evaluation of county health departments demonstrated that our local health department system currently has the capacity to provide only 57 percent of the ten public health services defined as essential by public health experts in 1994 This 57 percent figure is concerning. But, as a statewide figure, it also the fact that capacity in many geographic areas is even lower. Core challenges include the lack of resources, particularly at the county level, to address several of the leading causes of morbidity and mortality and the needs of a population that is becoming older and more racially and ethnically diverse as well. Workforce development is another opportunity for improvement. Nationally there is a move towards the accreditation of health departments, and if Oregon is going to be competitive for funding in the future, we must be able to meet accreditation standards.

We recognize that county governments are experiencing tremendous financial pressures of their own. While sharing public health services regionally would likely be highly cost-effective for many jurisdictions, we are only beginning to experiment with this structure, and there are many barriers to more widespread adoption. Two notable examples of success in this arena, however, include the creation of the North-Central Public Health District including Wasco, Sherman and Gilliam counties, and shared health officer services among Multnomah, Washington and Clackamas counties.

Mental Health Care and Addictions Treatment

The subcommittee's final recommendations relate to the incarceration and treatment of individuals with mental illness who have been convicted of a crime and the coordination of addictions services.

> **Recommendation:** Reduce the number of individuals in the Oregon State Hospital by improving the initial court process to determine the appropriate placement and treatment for individuals with mental illness who have committed a crime by:

- Developing a certification process for forensic evaluators and standards for the actual evaluation;
- Changing how cases are adjudicated by requiring the courts to allow only forensically trained evaluators to be utilized;
- Creating a standardized assessment process and criteria to be utilized at multiple steps that reviews the individual based on his mental illness and treatment needs;
- Developing a more robust mental health court/jail diversion/ community treatment system that diverts low level defendants from the state hospital to community services;
- Diverting misdemeanants who have received a length of Psychiatric Security Review Board (PSRB) jurisdiction of less than one year to a community setting; and
- Developing a system to educate defense attorneys, district attorneys and judges about the mental health system, Aid and Assist, Guilty Except for Insanity and alternatives to state hospital levels of care.

Improving the process to determine the appropriate placement and treatment for individuals with a mental illness who have committed a crime will assure that: (1) the public continues to be protected, (2) individuals receive the appropriate services in a timely manner (3) individuals who do not meet the statutory definition of Guilty Except for Insanity (GEI) are not committed to the mental health system, thereby saving valuable resources; and (4) the community mental health system is expanded so that more individuals can be served in their communities rather than in extremely expensive care settings.

> **Recommendation:** Improve Oregon's Substance Abuse Prevention and Recovery System by creating a coordinated interagency approach that has a clearly articulated budget and policy priorities, covers as many people as possible, and leverages all available funding sources.

Although over a quarter of a million Oregonians need treatment for alcohol and drug problems, very few of them actually receive services. Investing in prevention and addiction services is critical to Oregon's economic performance. In 2006, substance abuse cost Oregon an estimated $5.4 billion in lost productivity, criminal justice and health care costs. This represents approximately four percent of Oregon's gross state product in 2006 or $1,600 per person. (ECONorthwest, 2008). Every dollar the state invests in prevention and treatment yields a return of between four and seven dollars.

Section 3.3: **Health and Health Care**

In addition to the economic toll, substance abuse takes a huge emotional, physical and financial toll on families, their children and their communities. It contributes to criminal activity, birth defects, children being placed in foster care, domestic violence, unemployment and homelessness.

The Alcohol and Drug Policy Commission was created by the 2009 Legislature and charged with producing a plan for the funding and effective delivery of alcohol and drug treatment and prevention services in Oregon. With the Governor's support and funding that he allocated, the Commission, led by Attorney General John Kroger, spent the past year examining the system. They initially created four committees: (1) Structure; (2) Prevention; (3) Treatment and Recovery and (4) Accountability. A preliminary report to the Governor in May 2010 identified areas of concern and offered initial recommendations. The overarching recommendation listed above, from the Commission's "Goals for Reform," captures both the Commission's and the subcommittee's priorities.

Read the Health and Human Services Subcommittee Report.

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HUMAN SERVICES

The state's responsibilities for protecting the vulnerable and helping families in crisis face ever greater demands from the effects of the Great Recession on working families and from demographic trends driving the growth of our elderly population.

The recession has caused explosive growth in the number of Oregonians requiring assistance and safety net services to make ends meet. Long periods of high unemployment have forced many families to turn to the state for assistance in meeting their basic needs. As of May 2010, 702,000 Oregonians were receiving food stamps. This is 102,000 more individuals than last year and 230,000 more than in July 2008, when unemployment numbers first started to increase.

The same factors force more families into crisis and put more children at risk, increasing demands for the state's protective services.

Even in better times, state government would struggle to meet the ongoing challenge of continuing to take care of aging seniors, whose needs for nursing home care and assisted living are not covered by the federal Medicare program. But many seniors experienced a significant decline in their assets during the recession and will now not have the funds to cover their needs. This places a greater burden on the state to care for those seniors both in and out of institutionalized settings.

The magnitude of this responsibility will increase steadily in the next decade as the baby boom generation enters retirement; but it will explode in the following two decades as these retirees enter their 70s and 80s. This will be even more noticeable in Oregon, where our population of seniors is proportionately greater and growing faster than that of other states.

Recommendations

Children and Families

The Children, Adults and Families Division of the Department of Human Services (CAF) provides benefits and services for youth through a variety of programs. The programs and services tend to reflect funding streams, traditional program cultures and historic core services. Consequently these activities lack inter-operability across programs and a comprehensive approach to meeting the needs of young people in Oregon.

> **Recommendation**: Reduce the number of children entering the foster care system and keep more children safe with their families by better utilization of community based care systems and by assuring that all parents with substance abuse problems can get needed treatment. Obtain federal waiver to allow re-direction of federal funds for these purposes.

Foster care is intended to be a temporary service for families unable to maintain safety for their children at home. It is the most intrusive plan for protection and should be used only when lower level, less intrusive protective actions are not viable.

Other states have had success at reducing the number of children entering the foster care system by using assessments based on a continuum of risk that families experience. Children at lower levels of risk are better served through community based, in home services. These services can be provided in the absence of, or in partnership with, child welfare program, depending on the level of risk involved.

Community and system "navigators" assist families to understand the resources available to them and then navigate the process with them to help maximize the resources needed to safely keep their children at home.

Finally, the use of family meetings has been demonstrated to have a positive effect on reducing the disproportionate representation of children of color in foster case.

Everyone that comes into contact with the Child Welfare program should be served in this manner. This system shift could be paid for by flexible use of a variety of funding sources, including federal funding streams. However, this recommendation may require a federal waiver to allow for the commingling of the federal funds.

Each five percent reduction in the number of children in foster care produces $10 million of total savings annually, including $4 million of federal fund savings, which could be used to fund the continuation of the program going forward.

Further, data confirm that investments in prevention and early intervention can cost less and have better outcomes for those being served. One example of this work is the collaborative Intensive Treatment and Recovery Services (ITRS) program, which provides:

- Residential treatment for parents and dependent children who go to treatment with an addicted parent;
- Intensive outpatient treatment;
- Regular outpatient treatment;
- Case management; and
- Clean and sober housing options for addicted families.

The ITRS program has had a significant impact. Over 868 children have been reunited with their parents and are no longer in family foster care. Their parents have accessed addiction treatment and recovery services with ITRS providers. A majority of these parents remain in treatment and recovery services.

The average cost per month of caring for a child in family foster care in Oregon is $1,974, including food, clothing, shelter and caseworker time involved in the case management. This means $1,713,718 per month was saved by keeping these 868 children from placement with foster families.

> **Recommendation**: Target high-need youth 15 to 25 years of age currently served by the Child Welfare, Self Sufficiency and Vocational Rehabilitation Programs of the Children, Adults and Families Division (CAF) to provide services for these youth in making the transition from high school to post secondary education and/or employment.

A critical element in providing youth services is meeting the transitional needs of young people as they move from high school into young adulthood. This issue has been recently identified as a significant unmet need for youth aging out of the foster care system.

Eligibility for these services is often age driven and doesn't reflect the developmental needs of a particular young person. Further, the age-driven eligibility criteria vary across the array of programs a young person might access, as transition programs typically are tied to the last year of eligibility in a particular program.

Poverty is a strong factor influencing youth well being, putting youth and young adults at a higher risk for a wide range of problems. Young adults who transition from public systems such as foster care and TANF have increased risk of poverty, unemployment, homelessness, health related issues and have limited access to supportive adults to assist in the transition.

Oregon should develop a comprehensive and culturally appropriate transitional plan for youth being served in a variety of programs to ensure that these youth complete high school and successfully make the transition from school to post secondary education and/or employment at a level that allows them to be self sufficient. Moving from dependence on public systems to living independently with natural community supports and systems can best be achieved through a comprehensive transitioning strategy.

The full subcommittee report provides a detailed description of the most successful transition programs and outlines the components of a more comprehensive model for these services.

> **Recommendation:** Ensure the statewide implementation of the Wraparound Initiative, organizing a system of care for children with complex emotional and behavioral health needs using evidence based practices.

Children in the custody of DHS have a prevalence of mental health disorders nearly four times that of the general population. They relocate more frequently, have more frequent and longer episodes of facility-based care, remain in foster longer than necessary, have poor education outcomes, experience the juvenile justice system more frequently, and have fewer family and social supports.

The Statewide Children's Wraparound Initiative, enacted by HB 2144 (2009), uses national and local research models for organizing a system of care for children with complex emotional and behavioral health needs using the evidence based practice of the "wraparound" approach to coordinating services. Three project sites are implementing the first phase of the initiative that will inform statewide implementation across a broader population of children by 2015. The initiative is expected to produce positive outcomes for children and their family and offset future costs across the spectrum of public services. The underlying goal for outcomes is summarized by the phrase: "Children are at home, in school, with friends, and are out of trouble."

While the Wraparound project will initially focus on high needs children, HB 2144 requires that all children, age 0 to 18, benefit from a "system-of-care approach" to services. The resulting cost savings achieved by the initial focus on high-need children will be the foundation for investment in the expansion of universal system of care services for all children with behavioral health challenges.

Reducing by five percent the cost of serving 340 of the highest need children through wraparound has a projected savings of $500,000 compared to serving them in the traditional way.

Services for Seniors and People with Disabilities

Some 13 percent of our state's population is age 65 and over. By 2030, 20 percent of our population will be in this age range. And, there are 76,000 Oregonians over the age of 85 today, a number projected to grow to 120,000 by 2030.

This change in demographics will result in the doubling of the demand for long-term care, greatly increase demands on Medicaid and Medicare, severely test the capacity of our medical care systems and exceed Oregon's financial capacity to pay for the care it currently purchases.

Oregon has been a national leader in providing community-based care and services for seniors. We have reduced the percentage of seniors who require long-term care in an institutional setting over the last 20 years. Unfortunately, this also presents an even greater challenge for improvements to the system. There are no easy answers, no low hanging fruit. Oregon needs to address the growing numbers of seniors who require state assistance through innovative changes at both the state and federal levels.

We must develop strategies for redesigned services that deliver quality supports to seniors, but at lower costs.

Recommendation: Decrease the percentage of Oregon's long-term care budget spent on nursing home care by better coordinating and managing health care and long term care resources:

- Expand pilots to monitor and follow up with seniors discharged from hospitals;
- Develop umbrella management organizations that will purchase community based care in multiple settings for persons with high acuity needs;
- Enter into voluntary agreements between Seniors and People with Disabilities (SPD) and health plans in each area of the state to develop joint care plans with shared case management and integrated care coordination for individuals identified at high risk for both expensive long term and acute care needs; and,
- Explore bundled and capitated acute and long term care combinations.

Despite serving about 17 percent of seniors and people with disabilities in nursing homes, Oregon still spends 35 percent of its long term care budget on the institutional side. Additionally, the growth in the over-65 population will result in escalating acute physical health costs. Linking acute and long-term care is a compelling option to achieve both quality client and cost containment outcomes simultaneously.

According to the Spring 2010 SPD caseload forecast, Oregon serves almost 4,800 individuals in nursing homes. For every 100 individuals who could be served in community settings rather than nursing homes, the state could save $3 million or more in a biennium.

Recommendation: Develop low cost and high impact services that will keep seniors safe, healthy and independent at home, as well as mitigate an early or premature spend down of personal resources and the need for publicly paid long-term care assistance:

- Fund and empower Aging and Disability Resource Centers; and
- Increase training in evidence-based chronic disease management programs.

Aging and Disability Resource Centers (ADRCs) are currently being piloted in Oregon. They offer an opportunity to streamline low cost, high impact services along with educational assistance for both the client and the care giver. Specifically ADRCs should be funded and empowered to: (a) provide community level, healthy aging programs including chronic disease management, fall prevention, etc.; (b) provide training, peer support and respite care for family caregivers; and, (c) provide intensive options counseling for individuals at the initial point of potentially needing long term care (often hospital discharge) to assure the person can stay at home with family support or low-cost in-home services.

In another strategy related to chronic disease management, it was estimated an outlay of $3.2 million would be offset by savings of $4.8 million by 2014 if 3,800 participants completed training under an evidence-based program called the Stanford Chronic Disease Management Program. Almost 65 percent of persons over 65 have two or more chronic diseases. At the point when Oregon implements integrated acute and long-term care models, the savings would be substantial.

Other strategies relate to seniors over the age of 65 who have or develop severe functional impairments and can only access coverage for the services critical to their independence (such as housing modifications, assistive technologies, transportation, and personal assistance services) through Medicaid. Their reliance on Medicaid for critical support services creates a strong incentive for them to "spend down" assets and remain poor and unemployed.

The Lewin Group estimated that, if Oregon implemented a single entry point for all Oregon seniors requesting information on long-term care options and reached about 159,000 contacts by 2014, expenditures of $4.2 million would be offset by long-term care savings of $11.4 million.

A very high percent of care is currently provided by family members. Training, peer support and respite care supports will extend the ability of these family care givers to continue in that capacity, thereby avoiding the need for state paid services. ADRCs can provide these services, which are very difficult to find today, and offer a point of connection with employers whose employees struggles with the care-giving obligations for elderly parents. Appropriate respite care will minimize lost employee productivity, job loss and the burden on employers helping employees who are also care givers.

> **Recommendation:** Reduce the need for publicly paid long term care by implementation and enrollment in the CLASS (Community Living Assistance Services and Supports) Act insurance program; explore options for expanding the purchase of long-term care insurance.

The Community Living Assistance Services and Supports Act (CLASS Act) offers another solution to the "spend down" problem. This federal legislation creates a national, voluntary disability insurance program under which: (a) all employees are automatically enrolled, but are allowed to waive enrollment; (b) payroll deductions pay monthly premiums; and (c) two-tiered benefits are provided, based on the level of disability, to purchase non-medical services and supports that the beneficiary needs to maintain independence.

Financed through voluntary payroll deductions (with opt-out enrollment like Medicare Part B), this legislation will help remove barriers to independence and choice (e.g., housing modification, assistive technologies, personal assistance services, transportation) that can be overwhelmingly costly, by providing a cash benefit to those individuals who are unable to perform two or more functional activities of daily living.

The state should carefully monitor the specifics of the CLASS Act as they are developed at the federal level. Consideration should be given to how the state can minimize employee opt-out through both incentives and penalties.

The state should also consider the benefits of requiring the purchase of long-term care insurance in much the same way the newly enacted federal health care legislation requires the purchase of health insurance. Application of the same policy choices we have made in the health care arena to long-term care could reduce the need for state assistance in this arena as well.

Technology and Systems Improvements

Information technology (IT) offers unfolding opportunities for improved efficiencies and effectiveness. But, with agencies operating in silos, and funding streams limited to specific programs and agencies, we face great challenges to implementing interoperable IT systems.

> **Recommendation:** Reduce business costs and improve efficiency by adopting a statewide Strategy to Apply Reusable Technology (START).

IT systems for human services have mimicked the silos of funding streams and eligibility systems. As a result, many health and human services programs have their own program-specific, stand-alone computer systems that cannot effectively share data and are costly to staff and maintain. Oregon has joined with the states of Illinois, Minnesota and Utah to build information technology systems that can maintain a master provider list, track services provided, record quality measures, manage contracting, ensure credentialing and better detect fraud and abuse. This four-state partnership is uniquely positioned to prove and realize shared services and "cloud computing." If successful, states will no longer have to develop their own systems in isolation, with the corresponding duplicative costs.

Read the Health and Human Services Subcommittee Report.

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PUBLIC SAFETY

Oregon is a safer place than it was 20 years ago. Our crime rates have declined dramatically and are now at historic lows. We are now 40th for violent crime and 23rd for property crimes among the 50 states. Property crimes in Oregon have fallen by more than a third since 2004; violent crime rates have fallen by a quarter in the same time period. These were the largest drops of any state in the country.

As Oregon's person and property crimes reached historic lows, prison capacity grew to its highest level, and the cost of operating the prison system has increased dramatically over the last fifteen years.

During the next decade, when the state faces continuing budget deficits in excess of two billion dollars if nothing is done, 2,000 additional prison beds will be necessary to carry out our current sentencing policies – pushing the prison population to 16,000 by 2020.

There are three main cost drivers in building and operating prisons. The Public Safety Subcommittee focused on the first two: who is entering the prison system and how long they stay. (The third cost driver – the pay and benefits of public safety workers – was addressed by the Cabinet. Its conclusions and recommendations are presented in subsection 3.6 and a separate report from the Cabinet on labor costs.)

The subcommittee addressed the first two cost drivers by looking at what gives taxpayers the greatest return on their public safety investment and continues to protect communities and reduce future crime victimization. It concludes that none of these options will be easily achieved, but that they represent a viable opportunity for the state to emerge from its financial crisis with a well balanced and efficient system that prioritizes the public's safety.

Because sentencing policy, not crime rates, drives the use of expensive prison beds, the subcommittee believes a restructuring of sentencing policy to a modern, uniform sentencing guideline system based upon truth in sentencing will provide fair, transparent allocation of prison time to those offenders posing the greatest long term threat to our communities. These guidelines must:

- Take advantage of the more than 9,000 prison beds that have been added to system since the old guideline system was created in 1989;
- Keep faith with the spirit of the statutory sentencing changes that have been implemented by the Legislature and citizens since those guidelines were created;
- Acknowledge the scarcity of resources in this environment, an issue that is too often ignored when sentencing policies are established.

Finally, at the recommendation of many in the public safety community, the subcommittee proposes that the state adopt federal earned-time guidelines including 15 percent earned time for all offenders who are not incarcerated for life, and greater use of transitional resources such as halfway houses and electronic monitoring at the end of their sentences.

Many of the options presented in the subcommittee report, if implemented, would take more than a single biennium to achieve their desired result. Yet, if enacted and adhered to over time, its options can result in potentially hundreds of millions of dollars in avoided costs and system savings.

The short-term budget challenge is, however, more daunting. While politically difficult to address, the subcommittee believes the biggest short-term savings would come from a further legislative delay in the implementation of sentence enhancements contained in Ballot Measure 57, dealing with repeat property offenders. A decision to delay the measure's implementation would result in estimated savings of almost $40 million in the 2011-2013 biennium alone.

Virtually all of these options would require legislative action. The key sentencing guidelines measure, however, will require a bi-partisan legislative effort with a two-thirds approval or a referral to the ballot in May 2011. The incoming Governor and Legislature must understand the gravity of the state's financial situation and seriously consider their role in crafting a long term stable public safety system against the backdrop of our current and projected financial picture.

If Oregonians fail to plan for our public safety system's future with an honest assessment of the financial situation, the state will be forced to consider the early release of offenders who have already been sentenced and will risk the same overcrowding of inmates that brought federal litigation in Oregon in the 1980's. In addition, the state risks disproportionate reductions in certain segments of the public safety system that will create dangerous imbalances in the system as a whole. Cuts to courts and indigent defense, for example, have the effect of shutting down the criminal justice system. These actions erode the principle of "swift and certain" sanctions and destroy accountability as certain crimes are essentially ignored. Likewise, limiting resources for law enforcement, prosecutors, and community corrections can create an unbalanced system.

Findings

The Public Safety Subcommittee identified the following current circumstances relevant to its assigned task.

- By objective measures, crime has declined in the state. Citizens and their property are safer than they have been in decades.

- Public safety professionals are rightly proud of their work, but feel increasingly burdened by shrinking budgets and fewer resources and a perceived decline in public respect for the important work they do.

- Oregon invested hundreds of millions of dollars in increased incarceration in the last twenty years. That investment improved public safety, but is susceptible to the economic law of diminishing marginal returns. The new beds had their greatest impact when filled by the most violent offenders, when crime rates were over 40 percent higher than they are today.

- Based on a research model developed by Dr. William Spellman, a 10 percent increase in the incarceration rate should lead to a two percent to four percent decrease in the crime rate. Based on that ratio, in theory, increased incarceration would have accounted for about a 15 percent reduction in the crime rate from 1995 to 2008. The total crime rate decrease was 46 percent, so roughly one-third of the decrease in crime would be explained by incarceration according to Spellman's theory. However, from 2004 to the present, Oregon's crime rates have dropped substantially with only marginal increases in the incarceration rate.

- Spending in Oregon has focused on the severity of punishment as measured by the length of the prison sentence, at the expense of swiftness and certainty in our response to crime. While the state spent millions of dollars over the last two decades lengthening state prison sentences, cities' and counties' local response to crime has been hampered by a lack of funding. The state invested heavily in longer sentences, without assuring swiftness and sureness of sanctions in the local community. This trend tends to create a snowball effect of increased reliance on state prisons: the less investment in local public safety, the more officials rely on state prison.

- Ten Oregon counties will be facing at least 20 percent reductions in their discretionary general fund revenues as the federal timber safety net ends in 2012-13. This will create a disproportionate burden on those counties and will require new models and structures of service delivery to meet the needs of citizens in those counties.

- Investing in incarceration feels like a sure bet. While the offender is locked up he or she cannot commit new crimes. However, this approach ignores the reality that 93 percent of all offenders return to the community. The jails, police, treatment, and supervision systems that exist when offenders transition back to our counties and cities are critical to future safety.

- Oregon has reduced crime while increasing incarceration; other states have experienced similar reductions in crime, while reducing incarceration rates.

- Oregon is a leader in the adoption and implementation of evidence-based policies and practices in public safety. In 2003, the Oregon Legislature passed Senate Bill 267 that required State agencies to use "evidence-based programs" for drug and alcohol treatment, some mental health treatment, adult recidivism prevention and juvenile crime prevention.

Oregon is also a leader in using data to inform decisions at the policy and practice level. Oregon is one of the few states with an information system capable of tracking felony offenders throughout their custody and supervision, from probation, to prison, to post-prison supervision. The data are used routinely to monitor system outcomes and adjust performance at the officer level, the program level, the agency level and the state level.

- Over 70 percent of the offenders in Oregon's prisons need some level of A & D treatment.

- Some, if not much, of the recent decline in property crimes is attributable to tough new controls on the pharmaceutical products that can be used to manufacture methamphetamine. These actions were largely regulatory, accomplished at minimal cost to the state. Beginning in 2003, Governor Kulongoski pushed his Meth Task Force to "lead an effort to crush methamphetamine production, distribution, and use in Oregon". The results have been dramatic. In 2005, the Oregon legislature made Oregon the only state that restricted access to pseudoephedrine, so that a person must have a prescription to purchase cold or sinus remedies with this active ingredient. Meth lab seizures fell from 472 in 2004 to 10 in 2009. More than 40 states have taken steps to address domestic methamphetamine production, but none as aggressive as Oregon.

- Opinion polls indicate that the public believes crime is on the increase, although it is not one of the major issues in the public's mind. This suggests a disconnect between Oregonians' perceptions of crime and the reality that they are safer today than they have been in decades.

- There are examples from numerous states of how bi-partisan efforts can reduce deficits by redirecting resources from building and operating new prisons to community based treatment and punishment.

Conclusions

The subcommittee reached the following conclusions in fashioning its recommendations.

- The major priority of the system must be to protect the public from truly dangerous offenders through the use of effective risk assessments, sentencing and incapacitation in prison.

There is no state-wide policy in place to guide the prioritization or use of the prison bed resource. This key disposition phase of negotiating the sentence is not guided by any written policy and is not informed by feedback about the different practices in each county and how they affect the state's public safety spending.

- Investments solely in traditional criminal justice resources (police, jails, prosecution, courts, and prisons) may not be the best long term way to reduce the number of new crimes committed by offenders leaving jail and prison. Those investments should be accompanied by long term prevention strategies using treatment and health and human services that address some of the root causes of criminality. Finally, greater resources should be tied to the reentry and reintegration of offenders into society.

- The number of Oregonians victimized by crime can be reduced and many offenders in the system, having served their sentence and been held accountable, can become productive citizens in our society. Our challenge is to structure a system that balances accountability, reformation and the public's safety.

- Because many of the public safety functions complement each other, the major priority is for rational balance among all of the functions. However, the functions must be geared towards a more effective overall system. It is not realistic to assume the state will simply stop doing certain public safety functions.

- Though often not included when public safety is discussed, reinvestments in juvenile, alcohol and drug, and mental health systems are likely to have a greater long term impact on improving public safety in the State than direct investments in the system itself.

- While much remains to be done in improving outcomes on treatment tied to reducing recidivism, Oregon has accomplished much and is positioned to do more. The Governor's Alcohol and Drug Policy Commission, chaired by the Attorney General, is tasked with improving outcomes and accountability in Oregon's alcohol and drug (A & D) treatment system.

Many of the subcommittee's specific options address the best practice policy steps that must be taken to achieve a more balanced and more rational public safety system. (Its full report includes an extensive survey of best practices in other states.)

Recommendations

The Cabinet offers the following recommendations:

> **Recommendation:** Modern Sentencing Guidelines Model - Create a modern system of uniform, transparent, and proportional sentencing guideline practices that optimizes use of the most expensive resource – prison. Incorporate the intent of the mandatory minimum initiatives into a comprehensive guidelines structure. Increase sentences where appropriate for violent offenders posing ongoing risks to the general population. Place construction and opening of new prison beds on indefinite hold. Stabilize and potentially reduce use of prison beds as modern guidelines take effect.

> **Recommendation:** Federal Earned Time System - Adopt the federal system of 15 percent earned credits for offenders including consideration of federal policies on the use of halfway house and electronic monitoring during the final year of sentencing on appropriately screened offenders**.**

> **Recommendation:** Selectively Adjust Specific Measure 11 Sentences **-** Instead of completely moving away from all mandatory minimum sentences, selectively adjust Ballot Measure 11 sentences to provide sufficient protection for the public, but lower the overall impact on prison beds.

Recommendation: Continue Ballot Measure 57 Suspension - As a temporary measure, continue to suspend the implementation of Ballot Measure 57.

Recommendation: Enhanced Home Detention and Supervision - As a temporary measure only, provide the DOC with the ability to allow some offenders to serve the final year of their sentence under DOC custody and county supervision**.**

Recommendation: Incentives and Performance Goals for Counties **-** Increase system efficiency and reinforce use of evidence based practices.

- Continue to enhance the effectiveness of local accountability measures implemented by community corrections agencies by providing financial incentives for counties that reduce recidivism of offenders under their supervision.
- Consider expansion of the impact of local control funding by allowing counties the option of keeping offenders sentenced to up to 24 months in the local system of sanctions and supervision. Violators would be returned to DOC, if local sanctions including jail proved ineffective.
- Provide greater uniformity to charging and sentencing through the district attorney offices by providing financial incentives for counties to offices that adopt effective charging guidelines and appropriately charge, convict and manage offenders within their community.

Read the Public Safety Subcommittee Report.

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LABOR COSTS

Approximately three of every four dollars that the state spends from its general fund ends up in a paycheck and in payments for benefits that accompany a paycheck. These are the "people costs" of delivering services to Oregonians. They extend far beyond the state's own workforce to teachers and support staff in local schools and community colleges, employees of cities and counties and the health care and construction workers employed by state-funded contractors.

As these people costs rise, the cost of maintaining the state's current service level rises as well. The largest category of such costs in the state's general fund budget includes the payrolls of state agencies, including the university system, and the state's share of payments for teachers, support staff and administrators in 197 school districts and 17 community college districts. When projecting these costs, the state calculates required or expected increases in pay, retirement and health care benefits and builds those increases into its budget.

The state's share of these labor costs align as follows when viewed as a percentage of each sector's payroll costs.

State's General Fund (GF) Share of Payrolls
(Budgeted as Direct Labor Costs)

Sector	% of Payroll Funded by State GF	Total GF $ in 2009-11
State agencies	35%	$1.8 billion
Oregon University System	26%	$0.5 billion
K-12 Schools	57%	$4.6 billion
Community Colleges	34%	$0.4 billion

Note: Excludes positions supported by federal grants and private donations.

We concluded that the labor costs of school employees should be of equal concern to state policy makers as the costs of its own workforce. Where data are available and where state general fund costs are involved, we address both groups in our analysis.

We found that compensation for state employees is now in alignment with that of comparable jobs in the larger labor market, but future increases in compensation are expected to exceed increases in the private sector. The state's direct labor costs are projected to increase 13 percent on average in the next biennium for its own workforce and at close to double digit rates for at least several biennia thereafter. More than half of this increase will be due to higher benefit costs.

The state and other public jurisdictions that participate in the Public Employees Retirement System (PERS) will be required to make up for losses on investments that finance the pensions of active and retired employees beginning July 1, 2011. These retirement cost increases, combined with rising health benefit costs and projected pay increases, have emerged as a large contributor to the decade of deficits forecast in this report. If these cost increases are absorbed in full in the state's budget and in education budgets, they will force greater reductions in service and trigger more employee layoffs. In the end, cost increases of this magnitude will be unaffordable and unsustainable.

The good news is that these cost increases have not yet materialized. Retirement cost increases will be unavoidable, but payments to PERS can be restructured to create new cash-or-savings options for employees and offset future costs for employers. In the case of pay increases and health benefits, these costs can be better managed and moderated. Negotiations with labor organizations will play a large role in this. So will legislative enactments and the actions of local governing boards in the education sector.

We will need to build consensus among all interests that tracking, not exceeding, the pace of compensation increases in the larger labor market is an appropriate goal for public employees' compensation in the years ahead. The 13 percent increase now budgeted for state employees over the two years of the next biennium is likely to exceed the pace of labor cost increases in the private sector in that period by a wide margin. This is why we have searched for strategies that can control costs in ways that are fair to public employees and taxpayers alike.

Summary of Findings

- State employees on average are not over-compensated compared to their counterparts in the larger labor market. The most recent surveys of pay and benefits showed that the compensation of all state employees averaged 96 percent of the compensation for their counterparts in the private sector and 103 percent of the compensation for their counterparts in the larger public/private labor market. These findings are based on job-to-job comparisons of the cost of pay and benefits combined. Pay rates in many state occupations are low compared to the larger labor market, while benefits are uniformly higher. The same pattern holds for faculty in the Oregon University System, whose total compensation averaged 90 to 98 percent of the total compensation received by their counterparts in peer institutions.

Pay Increases During the Current Budget Period

- Pay systems based on graduated salary steps that reward years of service are a common aspect of the compensation system for state employees and school employees, although few faculty members in the university system are paid in this fashion. These step increases average 4.75 percent per year in state employment. Step increases have been suspended for state employees, but approximately two-thirds of the state's workforce will be eligible for such increases when the suspension ends.

- All state employees and most university employees waived seniority-based "step" increases for 12 months and longer, went without cost-of-living adjustments and took 10-14 unpaid furlough days in the current biennium. Some school districts cut school days in the final month of this school year, thereby reducing paid days for teachers and support staff. More districts are expected to cut school days in the next school year, as they adjust to another round of state revenue declines.

- Pay rates for union-represented state employees will increase an average of 4.75 percent over the two years of the current biennium, while pay rates for managers and unrepresented workers will remain frozen. Paychecks for both groups will be reduced by approximately 2.5 percent through the use of unpaid furloughs during the biennium. After accounting for the effects of furloughs, the average union-represented employee will see a gain in pay of two percent during this two-year budget period; the average manager will experience a reduction of 2.7 percent.

- Average pay rates in the statewide (public and private) labor market increased 1.1 percent last year and are expected to increase 4.2 percent this year, according to the state economist.

Retirement Costs

- PERS retirement costs are expected to increase by 6.5 percent of payroll for state employees on July 1, 2011, by another five percent of payroll on July 1, 2013 and by another three percent of payroll on July 1, 2015. Approximately three-fifths of these cost increases are related to the cost of financing retirement benefits for current employees. The other two-fifths are “legacy costs” for retired employees (described below). Similar retirement cost increases will take effect for school employees.

- In addition to its defined benefit retirement program, PERS provides a separate 401k-style retirement savings plan, called the Individual Account Program (IAP). Payments to this plan are set by law at six percent of salary. Most public employers, including the state, agreed to pay this six percent for their employees in lieu of past salary increases. This “six percent pickup” is part of the compensation of all state and OUS employees, 80 percent of community college employees and 55 percent of K-12 school employees. Most school employees who now pay their own six percent contributions to the IAP received offsetting salary increases when they shifted to this self-pay approach.

Health Benefit Costs

- The costs of health benefits provided by the state’s Public Employees Benefit Board (PEBB) are expected to increase nine percent per year for the next two to three years. These include medical, dental and vision benefits. A nine percent increase in PEBB’s costs represents 2.8 percent of the median salary for state employee. Similar increases in health benefit costs are projected for school employees.

- State employees do not share in the cost of their health care benefits, nor do their plans require deductibles. Most school employees pay a portion of their health care premiums and have benefit plans which include deductibles.

Compensation Increases Projected in Future Budgets

- State budget projections for the next biennium anticipate general salary increases, in addition to step increases, of 2.5 percent on July 1, 2011 and another two percent on July 1, 2012, in order to keep pace with inflation in the statewide labor market.

- The combined effect of retirement cost increases, health benefit cost increases, step increases and general wage increases would raise the state’s personnel costs by an average of 13 percent during the course of the next biennium. However, the increases for individual employees from the beginning to the end of the biennium would be greater. The total compensation of a typical state employee who receives one salary step would increase by 15 percent from July 1, 2011 through June 30, 2013.

- State and school employees have not made demands for the large increases in benefit costs that are projected in the next budget period. Rather these projections are based on legally-required payments to make up for losses on retirement fund investments incurred during the recession and from the trend of health benefit cost increases that is expected to persist absent changes in benefits or other cost controls.

- According to the state economist, average pay rates in the statewide labor market are expected to increase 2.6 percent next year and 2.3 percent in 2012 and to remain below three percent per year until 2015. Benefit cost increases combined with these pay increases are expected to produce an average increase in total compensation of 2.7 percent to 3.5 percent per year in the statewide labor market over the next several years.

Retiree "Legacy Costs"

- Among the state's personnel costs are retiree "legacy costs" – costs the state incurs for the pension and health benefits of retired employees. Although legacy costs embedded in PERS' basic contribution rates had declined to close to zero in the current biennium, they will spike in 2011-13 and subsequent biennia due to the need to replenish PERS assets that support retiree pensions. Some 40 percent of the state's PERS cost increases will stem from these legacy costs. These increases will cost the state general fund an additional $147 million in the next biennium for retiree pensions whose costs will be borne by state and school payrolls.

- The state and many school districts incur additional costs for the health benefits of under-65 (non-Medicare) retirees who participate in the state's active employee health plans and pay active employee rates for their coverage. This practice will cost the state approximately $4.5 million dollars in its current general fund budget for retired state employees who participate in PEBB in 2011 and a total of $10 million in the next budget period.

Summary of Conclusions

- "Salary step" systems are perceived differently by public employees, employers and the public. Employees view these increases as promised increments on an advertised salary scale. Public employers have used salary steps to phase in equity and market-based pay adjustments but have come to see them as an added labor cost that is difficult to reconcile with demands for general salary increases. Critics call them a form of double-dip pay increases which are not honestly acknowledged as such. All of these various perceptions reinforce the view that salary steps are pay raises and should be viewed as such.

- The cost of maintaining existing benefits will far exceed the ability of the state to pay for them and maintain competitive pay rates at the same time.

- This is a problem for state and school employees as well as their employers. Benefit cost increases will squeeze take-home pay and reduce or postpone pay increases unless a new way is found to rebalance the costs of benefits and pay.

- Total compensation should be used as the measure for comparability of pay and benefits between the public sector and the larger (public and private) labor market. But pay rates by themselves, exclusive of benefits, are a critical element in recruiting qualified employees for public employment and should not be ignored. Pay rates must remain competitive.

- Future increases in the costs of pay and benefits for state and school employees should be aligned with the rate of increase in the total compensation of employees in the statewide (public and private) labor market. This alignment will reduce the cost increases that are now expected to be a major contributor to the decade of deficits ahead of us.

- Efforts should be made to curtail the costs of benefits and to shift compensation increases more toward pay increases when needed to better align employees' pay and benefits with those of their counterparts in the larger labor market. Doing so should make it possible for employees to secure reasonable pay increases that track those of private sector employees. Otherwise, the decade of deficits could easily turn into a decade of pay freezes, if benefit costs lay first claim to the scarce resources of state government and school districts.

- The state should apply these principles both to its own workforce and to the payments it makes to support the employees of K-12 schools and community colleges. The payroll costs of school employees account for more than twice the payroll costs of the state's own workforce in the state's general fund budget. Controlling the labor costs of the state workforce while ignoring the labor costs of the schools' workforce will not achieve the savings needed to overcome future deficits nor will it meet any reasonable test of fairness for balancing resources between the two groups.

Summary of Recommendations

Given the large increase in unexpected retiree pension costs that will fall on state and school district budgets in the next biennium, the state should seek reasonable cost reductions in the benefits provided to retired state and school employees.

Recommendation: To better manage escalating employee benefit cost, align state and school employees' compensation increases with changes in the costs of pay and benefits projected for comparable jobs in the private and public sector. Establish budgetary mechanisms to reflect this standard going forward. Use this standard as the basis for bargaining and decisions regarding pay and benefits for state and school employees, recognizing that exceptions may be warranted to address recruitment, retention and equity issues for specific job categories. Update this standard based on relevant data every two years.

- The state would save more than $400 million in general fund payroll costs budgeted for the next biennium by achieving this goal. This estimate is derived from the effect of limiting total compensation increases for state and school employees to the 6.5 percent increase that is likely to be experienced in the statewide labor market over the next two years.

Recommendation: Modify PERS to reduce the six percent payments to the Individual Account Program to three percent or lesser amounts over time; consider moving these amounts to salary as part of the total compensation standard. Employees who prefer the existing arrangement could choose to redirect additional salary amounts to deferred compensation plans, giving them more flexibility to tailor their compensation packages to better meet their needs over time. Use this as a mechanism to offset the compounding of pay increases and retirement cost increases for state and school employees.

- A reduction of the IAP contribution to three percent from six percent could save $132 million in the state's general fund budget in the next biennium for state and school employees combined. This savings could be applied to the overall goal above.

Recommendation: Control health benefit costs by establishing upper limits and managing to those limits from year to year. These increases should include upper limits for increases in employer costs, consistent with the standard for compensation increases above, and upper limits for overall benefit costs, consistent with state and federal cost containment goals. The latter should reflect the state's cost containment goals for the Oregon Health Plan and the objective of keeping future costs below the level that would be subject to the federal tax on high-cost health plans in 2018. These targets could be achieved in one or more the following ways for PEBB's health, dental and vision benefits.

a) Establish premium cost-sharing in PEBB in a way that requires greater employee contributions at higher salary levels and offsets such premium costs for employees with rewards for healthy behaviors.

b) Limit the state's contribution to PEBB medical and dental plans to the lowest cost plan available in a given geographic area.

c) Continue to pursue evidence-based benefit design changes in both PEBB and OEBB to keep the cost of these programs below the threshold for so-called Cadillac health plans in the federal health care reform legislation.

d) Establish deductibles and co-payments in line with industry standards.

e) Consider converting the state's health, dental and vision benefits and, potentially, other benefits such as deferred compensation and paid time off, to a cafeteria plan model.

- The savings from (a) alone would likely amount to $8 million for PEBB-covered employees in the next biennium.

Recommendation: Ensure that the state's limits on employee compensation increases are extended to school budgets and that state funds for employee compensation increases are applied consistently to state and school employees. Possible ways to do so include conditions established by the state for use of its payments to schools or through statewide or regional collective bargaining for school employees.

Recommendation: Consider offsetting the state's increased costs for retiree pension and health benefits with changes in benefits for retirees. Explore the feasibility of such changes to post-retirement benefits. Consider separately rating and pricing the health benefits for pre-65 retirees who choose to participate in their former employer health plans.

Read the Cabinet's full report on Labor Costs.

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ORGANIZATION AND EFFICIENCY SAVINGS

State governments around the nation, including Oregon, are adopting various methods of continuous improvement techniques to better utilize the resources they receive and to attempt to overcome the public perception public that state government is inefficient.

At the national level, people believe their state government wastes 42 cents out of every dollar it spends (Gallop Poll, 2009). Oregonians feel their state government wastes 31 cents of every dollar, better than the national average, but far from a desired perception (Davis Hibbitts, Midghall, 2010). And this perception of waste and inefficiency remains relatively constant over time, notwithstanding significant improvements.

Many of the techniques used are attempting to move government from the traditional bureaucracy of the mid-20th century to the transformational government of the 21st century.

From: Mid-20th Century Bureaucracy	To: 21st Century Government
Statute & rule directed	Mission & results driven
Hierarchically driven	Team & network driven
Control centralized	Decentralization
Primarily accountable for conformance to rules	Primarily accountable for results for people
Manage costs	Manage value
Quality defined as adherence to standards	Quality defined as meeting or exceeding customer expectations
Exclusive service mandate	Choice and competition
Focus on what's best for government	Focus on what's best for customers, citizens, and taxpayers

Continuous Improvement

In Oregon, much has been accomplished but much remains to be done. State agency **regulatory streamlining** initiatives over the past eight years have resulted in hundreds of state agency projects that reduce paperwork, eliminate regulatory burdens, make better use of technology, and create efficiencies. Agencies have developed and are using key performance measures, with regular legislative review of performance toward goals. Customer satisfaction surveys are in common use. And statewide pricing agreements have allowed the state to leverage its purchasing power.

State government has also moved aggressively toward offering services to citizens on-line. Through **e-government** initiatives, Oregonians can now use their computers (and in some cases their smart phones) to register a business, obtain or renew a wide variety of licenses, check road conditions, search for licensed contractors or other service providers and review their complaint records, stay updated on government activities, find out how government funds are spent, get a building permit, take required training, pay university tuition, search for jobs, enroll in state benefit programs, reserve a campsite, renew a vehicle registration, and much more. New services are being added on an ongoing basis.

More recently, led by the Department of Human Services, many agencies are adopting the disciplines commonly found in the private sector for continuous improvement (e.g., Lean Kaizen). These techniques are built around several key principles providing a roadmap to a more effective delivery system. These key principles include:

- Voice of the Customer – looking at outcomes and processes from the customer's vantage point. The customer measures quality by comparing delivered outputs against their requirements.
- Respect for the employee – engaging all employees to improve the work they perform every day. In a transformational organization it is the employees who drive change and improve the ability of the organization to satisfy customers. A direct consequence of these initiatives is almost invariably improved employee morale and satisfaction.
- Eliminating waste – while the term waste can be a loaded political term, it is part of the standard vocabulary of continuous improvement disciplines referring to the tendency of processes to become bloated over time. This is true regardless of the sector and not unique to the public sector. These techniques focus attention on processes and eliminating waste by reducing steps, eliminating inventory, cutting out wait times, reducing hand-offs and other similar efforts.
- Continuous pursuit of perfection – organizations never achieve perfection; it is the relentless pursuit of improvements that yields the greatest value of these transformational efforts. Processes never stop falling under scrutiny and can always be improved so organizations need to value constant review of their processes. Small, incremental changes result in significant improvements over several months and years.

The **Department of Human Services (DHS)** seeks to transform over a 3- to 4-year period to become a world-class health and human services organization with improved service delivery, increased efficiency, and enhanced effectiveness in meeting the agency's mission. DHS results achieved to date include:

- Reducing the waiting time for adoptions from between 200 - 400 days to no more than 45 days
- Reducing the time required to recruit a qualified nurse from 80 to 20 days, adding 1,124 days of RN capacity
- Reducing time for nutritional consults at OSH from 150 days to seven days
- Reducing the time it takes to amend county contracts from 84 to 30 days
- Improving service on food stamp applications to same day rather than two weeks
- Eliminating red tape and redundancies in practices ranging from purchasing and travel authorizations to freeing up discretionary dollars used for foster children and to keep children from needing foster care

The **Department of Environmental Quality (DEQ)** is using Office Kaizen, a rapid process improvement technique, to transform the organization to become a leader in environmental stewardship and an employer of choice. DEQ successes achieved to date include:

- Enforcement processing time reduced by eliminating 50% of the process steps, and reduction of a 12 month case backlog to no backlog
- Laboratory analysis turnaround time decreased by 50% through adding an efficient barcode system which improved quality and freed up time to focus on improved customer service
- Business System Development significantly reduced program process steps which increased user efficiency and provided easier access to business systems and staff

A similar effort is under way at the **Oregon Judicial Department.** In early 2010, OJD launched a system-wide effort to re-engineer the way the judiciary does business, with the joint goals of reducing the cost of operations and improving service to citizens, lawyers, and other stakeholders. That work has three major components: First, the Chief Justice established the Court Re-engineering and Efficiencies Workgroup (CREW) to identify efficiencies and best practices from courts around the state and implement them across OJD. Close to 300 OJD employees responded to a CREW survey with over 1400 specific suggestions, and CREW is in the process of prioritizing the most promising suggestions – even as some changes are being implemented or tested immediately. Second, OJD is consulting with the National Center for State Courts (NCSC) to obtain their expertise in examining and making recommendations about potential restructuring of our court functions. Third, OJD continues with its critical implementation of eCourt and related technology innovations that will improve our service to Oregonians while increasing efficiency.

OJD may propose legislative changes in 2011 that would allow the Chief Justice and the State Court Administrator to more effectively allocate judicial work across the state to existing judge and staff resources. This might include changes to venue statutes, existing judicial districts, and the prevalence of in-person court appearances in order to effectively use technology and existing resources to serve the increasing judicial needs of the state.

> **Recommendation:** Build on continuous improvement, streamlining, and e-government efforts throughout state government, and require all agencies to report on progress regularly to the Governor, the legislature, and the public.

Entrepreneurial Management

The state's **Department of Administrative Services**, which provides a variety of internal services to state agencies and some local governments, has also been exploring different service delivery models. One option is an Entrepreneurial Management model similar to the one employed in the state of Iowa. Entrepreneurial Management groups internal services into one of three business models:

- Leadership – typically policy and regulatory activities.
- Utility – customers must purchase from a single provider. Customers negotiate the level of service, quality and rates, through a Customer Board.
- Marketplace – customer agencies are free to determine how much service they want and can purchase from any provider. The state competes with other providers in the marketplace for business.

For the marketplace and utility models, the service delivery mechanisms can include in-house, contracting out, and shared services. If there is a business case for continuing a marketplace service, the staff that currently provides the service will be equipped to compete in the marketplace. Entrepreneurial Management is aimed at providing results that best meet the needs of customer agencies, incorporating competition where appropriate to provide the greatest value.

In order for Entrepreneurial Management to be successful, the budgetary barriers in the state budget system (such as expenditure limitation and position authority) that do not allow an agency to respond to changes in demand for services would need to be removed.

> **Recommendation:** Move toward the concept of Entrepreneurial Management for internal services, separating policy and regulatory services from utility services (with customer agencies negotiating the level of service, quality, and rates) and marketplace services (with customer agencies free to purchase from any provider). Next steps include:
> - Determine which business model is the best approach for each internal service provided by the Department of Administrative Services;
> - Develop a business case for transitioning each service placed into the utility and marketplace categories; and
> - Identify statutory and budgetary barriers that need to be removed for the transition to Entrepreneurial Management.

Boards and Commissions

Since the 1950's the number of state agencies has roughly doubled. A large proportion of those new agencies are small boards and commissions, created to deal with niche regulatory issues. Often funded through fees and assessments on the industries they regulate, and with boards and commissions comprised largely of members of the regulated industries, these agencies have a minimal direct impact on the General Fund.

These agencies do, however, have an impact on the efficiency of state government in other ways. Each agency's small size creates management challenges, as a small number of generalist staff are expected to take on a wide variety of specialized duties, from regulation and enforcement to fiscal and personnel management. Due to the issues that inevitably arise, these agencies receive an amount of attention from executive and legislative leadership that is significantly disproportionate to their size and scope, often distracting from higher impact General Fund-related issues.

In addition, these small agencies create risk exposure to the state. While formed in more simple times, the legal complexities of the modern era make it difficult for the small staffs of these agencies to be knowledgeable in all areas of employment, procurement, and contracting law, thereby exposing the state to legal challenges. And inefficiencies result from the need to duplicate systems and processes in each individual agency.

The presence of these small agencies also often confuses the public, not understanding the funding structure of state government, as to why cuts are being made to K-12 education when lower-priority single-industry boards still exist.

The regulatory programs administered by these small boards and commissions are generally desired by the industries they regulate, who also pay the fees to support the programs. For this reason, the Cabinet does not recommend eliminating these programs. However, the Cabinet recommends serious consideration of consolidation of the majority of small boards and commissions into one or two new stand-alone agencies that can provide the appropriate level of administrative support for the functions they perform. One agency should focus on health care professions with a second focused on other professions. Where it makes sense, board and commissions could merge into existing agencies where there is a nexus of interest.

To improve accountability and responsibility, the Cabinet also recommends that the Governor be given the authority to appoint and remove the executive directors and agency heads for all of these small regulatory programs, whether or not they are consolidated into larger agencies. Many of these directors and agency heads are currently appointed by the industry boards they administer, who may not be in the best position to evaluate and oversee the skills needed for effective program management.

> **Recommendation:** Consider the consolidation of the majority of small boards and commissions into one or two new stand-alone agencies. Grant the Governor the authority to appoint and remove the executive directors and agency heads for all of these programs, whether or not they are consolidated.

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PLANNING AND BUDGETING

During the 1990's Oregon's economic gains were strong, and that strong economic activity translated into predictable revenue growth for the state budget. That predictability changed with Oregon's recession in 2001. State revenues declined steeply, and there were limited reserves in place to soften the budgetary impact. Programs were reduced and ultimately the state borrowed resources to maintain critical programs.

Out of that crisis, Oregon's policy makers created formal reserve funds for the state by creating both the Education Stability Fund (approved by the voters in 2003) and the Rainy Day Fund (enacted by legislation in 2007). These reserve funds proved to be increasingly important in a decade marked by tremendous economic and revenue volatility. In fact, without the reserves, Oregon would have needed to eliminate another $800 million of programs during the current recession.

In normal economic cycles, one-time reserves are most effectively used to bridge economic dips when there is a robust economic recovery on the back end. With the current economic downturn, however, economists believe our nation will experience a more subdued and protracted recovery.

Long Term Budget Projections

One of the tools that has been useful to the Cabinet has been the use of long term budget projections. For its conversations, the Cabinet used budget projections spanning the next four biennia. By their nature, long term projections are unreliable because they are constantly subject to changing economic conditions and decisions at the national, state, local and individual level. It is also true that the further the projections go out, the more unreliable they become.

In spite of those risks, the Cabinet has found the long term projections to be a useful tool to provide context on how today's decisions will impact our future. As state government makes program reductions, or adds new programs, it will have an impact on whether the future budget is balanced or not.

As can be seen throughout this report, the long term budget outlook highlights the need for very tough decisions in the next several biennia. Even as Oregon emerges from the current recession, the Cabinet believes the use of long term budget projections should be used to continue informing our decisions.

Long term budget projections are helpful for decision-makers in looking beyond the pressures of a two-year biennial budget and keeping an eye on the normal business cycle of revenue expansions and contractions. When state revenues are growing strong, many advocacy groups exert pressure on elected officials to add programs. If elected officials do not have a long term budget projection in mind, they won't know if they can afford that program expansion in the future.

Likewise, long term projections are helpful for decision-makers in deciding how to address deficits. If a deficit is truly short-term in nature, then one-time fixes are an appropriate solution. If, however, policy makers are facing a long-term deficit, short-term fixes will only prolong the difficult budget decisions.

> **Recommendation:** Use long-term, multi-biennia budget projections to inform decisions for both the Governor's Recommended and Legislatively Adopted Budgets.

At the federal level, Congress takes the long term budgeting process a step further as a means of containing expenditure growth. Certain federal appropriations are subject to a long term "scoring" requirement. Under this requirement a new federal expenditure can not be added unless a similarly sized program is also cut. In theory, this would maintain a balanced budget into the future. In practice, however, large parts of the federal budget are exempt from the scoring requirements, such as the ongoing growth of health care spending for the elderly and the poor, as well as Social Security.

One significant difference between Oregon and the federal government is that Oregon operates under a constitutional balanced budget requirement. Long term scoring requirements are important at the federal level because no such balanced budget requirement exists. Oregon has borrowed to cover operations only once in the past 30 years, during the 2001-03 biennium, and the debt incurred at that time will be paid off in 2014. The federal government, by contrast, is projecting to continue deficit spending each year for the next decade and has a total debt load that counts in the trillions.

The Cabinet is not recommending that Oregon adopt a formal long term budget scoring requirement for two reasons. First, Oregon's balanced budget requirement has the same effect of limiting expenditure growth, and, when compared to the experience at the federal level, has proven to be more effective at avoiding long term deficits. Second, as mentioned above, long term projections become increasingly unreliable in the out years. This inherent unreliability potentially exposes them to manipulation if they become a formal requirement.

Allotment Authority

Under current law, the Legislature is required to pass a balanced budget for the state every two years. This budget is based on revenue and expenditure projections and the best information available to the Legislature at the time. As our current experience shows, however, sometimes those revenue and expenditure projections fall far short of our actual experience.

Under Oregon law, when the revenue projections fall short of expectations and the state is facing a deficit, the Governor has the authority to reduce executive agency general fund expenditures to bring the budget back into balance. In essence, the Governor reduces each agency's allotment of available general fund resources. Stated a different way, Oregon's default answer to a budget crisis is to cut programs back instead of raising taxes.

This authority is very important because it means there is always a solution to avoid a budget problem, even if it the solution means very difficult budget cuts. One of the issues facing the state of California relates to the fact that their Legislature needs a super-majority vote to both raise taxes and to cut programs. This super-majority requirement makes it very difficult to reach any solution, and therefore the chances of gridlock rapidly increase. In Oregon, however, the Governor retains the ability to bring the state budget back into balance through budget cuts.

As currently constructed, however, there are three issues that routinely face the Governor when attempting to use this authority. First, the Governor can only make across-the-board reductions to agency spending. The language in ORS 291.261 specifically directs:

> Unless statutes or the legislatively adopted or approved budget indicate otherwise, the department and the Governor shall assume that all General Fund appropriations have the same priority and shall reduce allotments of General Fund moneys for each state agency receiving General Fund moneys by the same percentage.

Despite this statutory language, members of the Legislature and public opinion generally appear to reject the proposition that all state programs should be treated equally, instead favoring prioritization among program when making reductions.

Across-the-board spending reductions also routinely run into conflict with other statutes that mandate agency program levels, making the reductions impossible to implement. As an example, to meet the current across-the-board reduction targets, the Department of Corrections plan includes closing three minimum security prisons, releasing over 750 inmates back into the community. While the merits of this reduction can be debated, the Department of Corrections currently lacks the authority to release these prisoners.

Recommendation: Modify the Governor's reduction authority to allow targeted reductions.

Priority-Based Budgeting

The Cabinet discussed the use of "priority-based budgeting" as a method to make better decisions during an economic downturn. Each biennium, state agencies prepare a priority ordering of their major services for review by the Governor and the legislature. This program priority list is used by the executive and legislative branches to focus on which state services are most important, and which services are on the "bubble" and could be facing elimination during a downturn in the economy.

In its purest form, this approach to budgeting does not look at what was funded in the prior two years, but instead starts with how much money does the state have to spend. Once the available revenues are determined, it starts "buying" the highest priority services that will be funded in the next two years. Once the money runs out, the remaining programs are eliminated, or not purchased for the next two year period.

This approach to budgeting is very important during economic downturns because it helps prioritize highly valued services and eliminate services that provide a more limited return on investment. The downside to this approach is that it can be extremely labor intensive to examine all individual state agency services every two years if it is done at a very low level of detail. As an example, it is highly unlikely that the state will choose to not purchase the education of elementary age school children each year.

The Cabinet recommends that state agencies continue to integrate priorities into the budget decision process and the Governor and legislature eliminate programs that have limited effectiveness or a low return on investment.

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REVENUE STABILITY

Several studies of Oregon's revenue system have identified Oregon's over-reliance on the personal and corporate income tax as a key feature of Oregon's General Fund revenue system.[1] In 1999, Governor John Kitzhaber's "Review of Oregon's Tax System: Policy Recommendations" stated:

> "Oregon is more reliant on the personal income tax for its tax revenue than any other state in the country. This tax is very sensitive to changes in economic conditions. Public finance experts consider it the most volatile of the major state-local revenue sources." (1999 Report, p. 3.)

This finding, and the risk it represents to critical state programs and services, was more recently confirmed and amplified by the 2007 Task Force on Comprehensive Revenue Restructuring:

> "The state revenue system, dominated by the personal income tax, remains highly volatile over the short-term. This makes it difficult for the state to maintain an adequate level of public services during economic downturns. State policy-makers have taken major strides to offset revenue instability by the creation of the Education Stability Fund (2002) and the Rainy Day Fund (2007) *but risks to major programs remain substantial in the event of future recessions*. With the state economy now in recession, the adequacy of the state's reserve funds takes on added relevance and urgency." (Task Force Report, p.9.)

These observations were confirmed yet again in the June 2010 revenue forecast, which identified an unexpected budget shortfall of $577 for the current biennium. As was the case in the spring of 2002, capital gains income was a major factor causing a sharp drop in the General Fund revenue forecast. The estimate for capital gains income in the 2009 tax year was reduced by 46 percent between the February and June 2010 forecasts, leading to a $200 million reduction in estimated income tax revenue from this one income source.

During the 2001 recession, state revenue declined 7.5 percent (it would have declined by 12 percent had the legislature not borrowed $450 million by issuing appropriation credit bonds to balance the 2001-03 budget). A look at recent fiscal year revenue shows the devastating impact of the recession on Oregon's General Fund. The current estimate for the nearly completed 2009-10 fiscal year shows General Fund revenue of $5,981 million. Prior to the recession, general fund revenue totaled $6,311.8 million in the 2005-06 fiscal year and $6,430 million in the 2006-07 fiscal year. It would have totaled $6,961 million in the 2007-08 fiscal year, if kicker refunds had been included. This means that Oregon's General Fund tax base declined by roughly 14 percent over a 2-year period and is now below the level of four years ago.

With 93 percent of the General Fund budget devoted to education, public safety and services to seniors, the poor and medically needy, this instability puts at risk the state's ability to maintain consistent and adequate funding for these critical services. This has led to a recurring pattern of "boom and bust" budgeting, where budgets are increased during good economic times with strong tax collections, and cut during periods of economic decline.

The impact of this revenue volatility on state budgets has been aggravated by Oregon's unique "kicker" law. Created in 1979 as part of a larger package of fiscal reforms, and placed in the Constitution by a vote of the people on referral from the legislature in 2000, the kicker requires the Governor to estimate

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[1] [1] See reports and record of Governor John Kitzhaber's Review of Oregon Tax System (1998); Legislative Revenue Options, School Funding and Accountability Task Force (2002); Joint Interim Committee on Tax Reform (2004); Task Force on Comprehensive Revenue Restructuring (2007-09). The 2007-09 Task Force was created by HB 2530 (2007) and included 30 members, both public and private, representing business and labor, and education, health care and tax policy and advocacy groups. It was supported by an advisory committee of tax accountants, tax attorneys and economists and staffed by the Legislative Revenue Office.

state revenue for the coming biennium in May of each odd-numbered year. If revenue for the biennium exceeds the forecast by more than two percent, all of the excess revenue is refunded to taxpayers. (Personal and corporate revenues are forecast separately; based on these forecasts, the personal and corporate kickers are calculated separately. The personal kicker is refunded by checks mailed to taxpayers; the corporate kicker is returned to corporate taxpayers by way of a tax credit.)

Experience demonstrates, as common sense suggests, that Oregon's volatile taxes are hard to predict. Either the personal or the corporate kicker has been triggered 11 times during the 15 biennia since the kicker was created. In four instances, the kicker has been suspended or modified – the personal kicker in 1991, and the corporate kicker in 1993, 1997 and 2007. In 2007 the corporate kicker was diverted to the statutory Rainy Day Fund created in that session by the legislature. On average, kicker refunds have amounted to about three percent of biennial revenues. More significantly, the timing of recent kicker refunds has tended to come just before economic downturns, making the loss of tax revenue even more keenly felt. Just prior to the 2001 recession, the kicker returned $253.6 million. Again, in 2007, just before the most recent economic and budget downturn, over one billion dollars was returned in the way of kicker refunds.

Paradoxically, even though the June 2010 forecast predicts a budget shortfall of $577 million for the current biennium, the state economist says it appears likely the corporate kicker will "kick," returning several million dollars at the end of the biennium, even while the state is in the depths of the most serious economic downturn since the Great Depression. Barring suspension of the corporate kicker, Oregonians will face unprecedented cuts in programs and services in the coming biennium, while millions of dollars in collected taxes will be transferred out of the general fund and made unavailable to offset those cuts.

When the state experiences a budget shortfall, the only options to address the shortfall are to (1) raise taxes, (2) cut programs and services or (3) borrow. In the two most recent recessions, the state has done all of the above. The legislature increased personal and business taxes by $727 million in the 2009 legislative session. (These tax increases were referred to the voters by popular referendum and passed in January, 2010.) In both the 2001 and current recessions, the legislature made significant budget cuts. Reduction in school funding in 2001-03 forced schools statewide to cut days off their school year; courts were forced to close on Fridays and stopped hearing small claims and many misdemeanor criminal cases. Once again, following the June, 2010 forecast, the state faces serious and immediate budget reductions; schools are again being forced to close early during the current school year, with more reductions planned for the 2010-11 school year. In 2003, as noted above, the legislature also issued $450 million in appropriation credit bonds to fund current services; those bonds will not be paid off until 2014.

All three of these options for dealing with a budget shortfall have negative economic consequences. Raising taxes and cutting services can even extend the period of recovery from recession. And borrowing creates a claim on future revenue for debt service that makes it unavailable to fund programs and services.

The Task Force on Comprehensive Revenue Restructuring concluded that the state should avoid the disruptive program cuts caused by dramatic changes in tax revenue from biennium to biennium, and recognized the need limit the resort to tax increases and debt during downturns. The Task Force concluded that the best way to stabilize state budgets and services would be to increase Oregon's budget reserves.

The Task Force recommended that state reserve funds should be between 12 and 15 percent of the biennial general fund budget, an amount it determined would be sufficient to substantially maintain spending through 90 percent of all recessions. To achieve this target would require a savings rate between three and four percent of general fund revenue during expansions, or about $569 million, based on the legislatively adopted budget for 2009-11.

To increase state reserves, the Task Force recommended changing the revenue forecast methodology for the kicker, to allow for excess revenue, up to one standard deviation above the current forecast (six percent for the personal income tax forecast, as of the 2007-09 biennium) to be allocated to a constitutionally-established emergency budget reserve. The emergency budget reserve would be capped at ten percent of the general fund budget (which, with the five percent cap of the Education Stability Fund, would accomplish the 15 percent cap recommended by the Task Force). Any revenue received in a biennium over the standard deviation would be returned to taxpayers; once the emergency reserve cap has been reached, the Task Force recommended reverting to current kicker law, including the two percent threshold.

The Task Force recommended that the emergency budget reserve be accessible only with a three-fifths vote of the legislature and only when one of the following clear and objective economic triggers has been met:

- A two consecutive quarter decline in seasonally adjusted non-farm payroll employment within the last 12 months;
- The final forecast of the biennium indicates that general fund revenue will be at least three percent less than general fund appropriations in the current budget; or
- The quarterly General Fund revenue forecast for the current biennium projects that revenue will be at least two percent below the forecast used for the legislatively adopted budget.

If this method of funding had been in place since 1981, the triggers would have been met six times. Historic modeling by the Task Force showed that it would never have taken more than two biennia for the emergency reserve to reach its cap after being drawn on.

During the 2010 special session of the legislature, and in his 2010 State of the State speech, Governor Kulongoski strongly endorsed stabilizing Oregon's budget by creation of a constitutional emergency budget reserve to be funded by kicker reform, but proposed a funding methodology different from that of the Task Force. The Governor proposed that half of the revenues over the corporate and personal revenue forecast be deposited to the emergency budget reserve (up to the cap on the reserve), with limits on withdrawal so the reserve could not be depleted in any single budget period, and that the rest be refunded to taxpayers. The Governor also recommended that the emergency reserve be an interest bearing fund, to add value from earnings to the reserve and maximize its potential.

This Cabinet agrees that budget stability is critical for Oregon's economic well-being. Stable funding for education, public safety, our seniors, the poor and the medically needy is essential for a healthy and growing private sector economy. Amending the kicker and placing an emergency budget reserve in the constitution, funded by surplus revenue during strong economic times, would end the cycle of boom and bust budgeting, reduce the need to raise taxes or borrow during recessions[2], and protect critical state services at times when Oregonians need them the most. This Cabinet believes that the funding of an emergency reserve is the most appropriate use of unanticipated, occasional revenue, which occurs when the forecast underestimates biennial revenue.

The Cabinet recognizes that supporters of a statewide sales tax promote the sales tax as another way to stabilize state revenue. History teaches the sales tax is not a viable option in Oregon. Voters have soundly rejected one form or another of the sales tax nine times. Recent polling does not demonstrate any more support for it today. The Task Force on Comprehensive Revenue Restructuring studied the

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[2] *This concept of saving excess resources during times of abundance, to be available during times of want, is not new; the first recorded application of the concept occurred in ancient Egypt. See Genesis 41: 17-49.*

sales tax option and conducted a statewide poll as part of its work that included several different sales tax proposals, including proposals to eliminate or substantially reduce income and property taxes. None of them drew even close to majority support. Second, while states with sales taxes have generally seen greater revenue stability than the income tax, even sales taxes showed declines in the most recent recession. Sales taxes are predicted to be a declining source of revenue in the long term as well, due to the growth in non-taxed internet commerce. For these reasons, the Cabinet does not recommend consideration of a sales tax at this time.

> **Recommendation:** Place a constitutional amendment before Oregon voters to establish an emergency budget reserve and amend the kicker to transfer some portion or all of excess biennial revenue (up to the reserve cap) to the budget reserve.

The recent passage of the personal and corporate income tax increases embodied Measures 66 and 67 has made Oregon's revenue system more dependent on the income tax and increased volatility, meaning we face bigger booms and deeper downturns (and more and larger kickers) in the future. Now is the time to act.

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STATE AND LOCAL PARTNERSHIPS

Oregonians routinely express a decided preference for programs and services controlled closer to home. However, this commitment to local control can come at a price when issues of scale and capacity create greater costs or hamper efficiency. The question posed to the Cabinet by one observer of voter attitudes is, "How much do you want to pay for local control?"

Another question posed by the Cabinet is, "What can we do to make the delivery of services by the state and its local government partners more efficient and cost effective?"

The high-priority services addressed throughout this report – from education to health and human services and public safety – depend in large part on shared financing and delivery systems at the local level.

We have highlighted the role of local taxpayers and local governing boards in the education sector and have advanced proposals for consolidating services and administration across existing district lines.

In the areas of public safety and health and human services, this report has called attention to the important role of county governments in financing and delivering services in partnership with the state.

The final report of the Task Force on Comprehensive Revenue Restructuring, delivered in January 2009, noted that "many government services are jointly provided by state and county governments. This means that fiscal stress at one level of government affects the other." The Task Force summarized the following array of jointly-financed services in the public safety and health care, based on data collected for 2003-05.

State-County Services

State-County Services	County	State	Other revenue
Public safety	55%	34%	11%
Community corrections	20%	60%	20%
District attorney	70%	7%	23%
Juvenile services	68%	17%	15%
Health			
Mental health	11%	29%	60%
Public health	27%	11%	62%

Other jointly-financed services include assessment and taxation, economic development and veterans' services.

The state's general fund payments to counties for these services now approach $800 million per biennium.

The Governor's Task Force on Federal Forest Payments and County Services, which delivered its report to Governor Kulongoski in January 2009, noted this inter-dependence and warned that:

- The loss of federal forest payments in the 2011-13 biennium will have a large impact on the funding of shared services; and,
- Many of the shared services affected by the reduction of state support or declines in county support can be turned back to the state.

The state bears ultimate responsibility for an array of critical services now financed or delivered in whole or in part by county governments or multi-county regional governments. In many cases, counties and regional governments can decide to turn over responsibility for these services to the state. These services include: child support enforcement; services to seniors and the developmentally disabled; alcohols and drug services; public health; and, community corrections, where county participation is based on state funding levels specified in state law. In some cases, as in community corrections, the affected programs would be taken over by state government. In other cases, such as alcohol and drug services, state would assume the responsibility to take over the delivery of services or find and contract with alternative providers.

The Forest Payments Task Force also noted wide variations in the levels of county support for programs that require minimum levels of service to meet public needs. In public health, for example, the Task Force found that, "counties general fund support for their local public health authorities ranged from zero (in six counties) to a high of $73.50 per capita in Multnomah County" in 2007-08.

Less extreme but notable variations were found in other program areas, such as assessment and taxation. For these reasons, this task force recommended that counties should be freed from state restrictions on transient lodging taxes and real estate transfer taxes to facilitate local revenue-raising and should take advantage of their ability to enact local option property taxes and establish new county service districts with the approval of their voters.

The Forest Payments Task Force concluded with the recommendation to create a joint state-county County Services Planning Council to coordinate fiscal planning for counties facing the loss of federal forest payments. Based in part on this recommendation, the 2009 Legislature created a 21-member Task Force on Effective and Cost-Efficient Service Provision, chaired by Rep. Nancy Nathanson. This task force is now examining service delivery improvements in the areas of assessment and taxation, elections, human services and criminal justice.

Other efforts underway to achieve efficiencies and improve services that involve the state-county relationship include the Chief Justice's Court Re-engineering and Efficiencies Workgroup (CREW) and the Alcohol and Drug Policy Commission, chaired by Attorney General John Kroger.

In this report, the Cabinet's subcommittees have noted and recommended:

- School districts can achieve significant savings from sharing business functions, regionalizing the delivery of specialized services such as special education and consolidating special districts;
- Public health services could benefit from regional, multi-county arrangements such as the North-Central Public Health District of Wasco, Sherman and Gilliam counties and from shared health officer services of the kind now in place for Multnomah, Washington and Clackamas counties;
- Public safety services could be made more cost effective with the use of incentives for counties to reduce recidivism, make greater use of county jail beds for offenders now housed in state prisons and achieve greater uniformity of charging and sentencing practices; and,
- A task force should be created to consolidate public safety functions now isolated within county boundaries.

> **Recommendation:** Create a state-county planning council to engage county leaders in creating and expanding regional service delivery structures services jointly financed or delivered by county governments and the state.

Service delivery systems that appear to be most in need of re-examination include health and human services, public safety and assessment and taxation. Where relevant, the recommendations of the Task Force on Effective and Cost-Efficient Service Provision should be addressed in this effort.

Counties and regions most in need of immediate attention are those identified by the Forest Payments Task Force as most affected by the loss of federal forest payments.

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