

5-10-2002

Ballot Measure Research Study: Oregon State Ballot Measure 13 (School Stability Fund)

City Club of Portland (Portland, Or.)

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Published in the
City Club of Portland *Bulletin*
Vol. 83, No. 50
Friday, May 10, 2002

Ballot Measure Research Study

Oregon State Ballot Measure 13: School Stability Fund

Majority Recommends "YES" on 13

YOUR COMMITTEE FOUND:

Measure 13 proposes to convert Oregon's existing Education Endowment Fund into a new school stability fund. The Education Endowment Fund was created in 1995 and is funded through lottery proceeds. Only interest earned on the principal may be spent. These earnings presently service school bond debt and provide tuition assistance. The new school stability fund would continue to be funded through lottery proceeds and would function as a "rainy day fund." Unlike the Endowment, the principal of the school stability fund could be used to help fund K-12 education in Oregon during times of economic distress.

Your committee found that a school stability fund would yield long term benefits for education without necessarily depriving Oregon of the benefit the current endowment provides by paying bond debt and tuition assistance. Your committee also found reasons to oppose conversion of the Education Endowment Fund to a stabilization fund. Foremost among these reasons is the legislature's absence of resolve over the last decade to establish stable revenue streams for K-12 education. This legislative heedlessness is an important contributing factor to the current biennium's education funding crisis and ensures future crises will occur until the legislature takes concrete steps to provide public education with a more stable revenue stream.

—Executive Summary continued on following page—

The City Club membership will vote on this report on Friday, May 10, 2002. Until the membership vote, the City Club of Portland does not have an official position on this report. The vote outcome will be reported in the *Bulletin* dated May 24, 2002.

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However, on the grounds that creation of a stabilization fund is a solid step in the right direction towards dealing with future budget shortfalls, and one that brings with it a suite of long term benefits, the **Majority of your Committee recommends a "Yes" vote** on Measure 13.

The **Minority recommends a "No" vote** on the grounds that the legislature must have its hand forced to create long needed stable funding for public education and that not taking steps to increase the revenue stream now will lead to larger problems in the next biennium.

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I. INTRODUCTION

Ballot Measure 13 will appear on the ballot as follows:

Caption:	Amends Constitution: Authorizes Using Education Fund Principal in Specified Circumstances; Transfers \$220 Million to School Fund.
Result of "Yes Vote:	"Yes" vote converts education endowment fund to stability fund; authorizes, conditions using funding principal for education; transfers \$220 million from fund to School Fund.
Result of "No" Vote:	"No" vote rejects: converting education endowment fund to stability fund; authorizing, conditioning use of fund principal; transferring \$220 million from fund to School Fund.
Summary:	Amends constitution. Under existing law, the state deposits a portion of state lottery proceeds into the education endowment fund; fund's earnings are used for public education, student assistance; principal is retained in fund. Measure converts education endowment fund to education stability fund. Measure authorizes legislature to use any portion of education stability fund principal for public education if three-fifths of the members of each house of legislature approve, and either (1) legislature makes required finding as to decline in projected state revenue or in seasonally adjusted nonfarm employment, or (2) Governor declares emergency. On May 1, 2003, measure transfers \$220 million from stability fund to State School Fund to be used as provided by law for moneys in State School Fund. Other provisions.

(The language of the caption, question, and summary was prepared by the Oregon Attorney General.)

Measure 13 proposes to meet an immediate need for funding K-12 education in the State of Oregon's 2001-2003 budget by converting an endowment into a stabilization fund and immediately withdrawing 80 percent of the principal to fund education in the final year of the current biennium. The legislature could tap the stabilization fund proposed by Measure 13 only if one or more of the following conditions are met:

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- There is a decline in seasonally adjusted non-farm payroll employment for two consecutive quarters within a 12-month period.
- 1) 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 2) 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.
- The Governor declares an emergency.

If any of these conditions are met, a three-fifths vote majority vote is then required in both houses of the legislature to access the fund. The last time any of these conditions were met was during the 1989-1991 biennium. In the last twenty years, if a stabilization fund with these conditions had been in place, the legislature could have accessed it three times. Governor Kitzhaber called upon the legislature to ensure that the fund could not be used as a resource to establish future spending levels, but this more restrictive condition was not included in Measure 13.

While some fiscally responsible people might balk at withdrawing funds dedicated to earning income, others would certainly value a cash reserve to provide emergency funds when needed. Measure 13 seemingly pits these fiscally responsible values against each other. This committee was created to explain the issues Measure 13 raises and provide a basis for City Club members to take a position.

The committee members were screened for possible conflicts of interest to ensure that no member had any economic stake in the outcome of the study or was publicly identified with a position on education funding. The committee met several times over three weeks, interviewed proponents and opponents of the measure and other interested individuals, and reviewed relevant articles, reports, and other materials.

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II. BACKGROUND

A. Oregon's Revenue Shortfall

Recession in Oregon has depressed projected state income tax revenue resulting in an \$845 million shortfall in the state's 2001-2003 budget. This shortfall takes place in the context of \$253.6 million in foregone state revenue returned to taxpayers through the 2001 "Kicker" refund. It also takes place as the income tax relief contained in Measure 88, passed in November 2000, begins to take effect. (Measure 88 increased the deductibility of federal income taxes on state returns. The measure will reduce state government revenue by an estimated \$133 million in 2001-2003.)

Governor Kitzhaber proposed an increase in taxes on tobacco and alcohol and a delay in the implementation of Measure 88 as a means to meet the current biennium's funding needs and provide a more reliable revenue stream in the future. The legislature rejected the Governor's suggestions and addressed the revenue shortfall with budget cuts and one-time revenue enhancements. Measure 13 was referred to the voters by the legislature at the conclusion of the second Special Session of 2002. It is a key piece of the legislature's effort to balance the state budget and fund K-12 education.

Measure 13 will address the budget shortfall by providing \$220 million in one-time revenue to close a gap in the current biennium's K-12 education funding needs. Measure 13 also creates the state's first stabilization or "rainy day" fund by converting the existing Education Endowment Fund into a school stability fund. The purpose of this newly created fund would be to provide bridge funding for K-12 education in the event of another revenue shortfall.

B. The Education Endowment Fund

The Education Endowment Fund was created through a constitutional amendment referred to voters by the legislature in the May 1995 special election. Ballot Measure 21, as it was known, created the Education Endowment Fund, authorized the deposit of 15 percent of lottery earnings into the Fund and specified that the Fund's earnings would only be used for financing public education. The constitutional amendment itself is silent on the use of the endowment's principal. However, language provided by the legislature for the voter's pamphlet states, "The principal amount of the fund may not be used to directly support public schools, but will be used only as a source of money for investments to benefit public education."

The Education Endowment Fund was envisioned as a way to save

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and invest for the future of public education without raising taxes. Placed in the constitution, the endowment fund would be protected from raids by future legislatures. Ballot Measure 21 enjoyed bipartisan support and no arguments in opposition were printed in the voter's pamphlet. It passed with 87 percent of the voters' support.

Since the passage of Measure 21, monies have flowed into and out of the Education Endowment Fund as shown in Table 1.

**Table 1:
Education Endowment Fund Balance and Interest Earning History**

Biennium	Fund Balance at Beginning of Biennium (\$ million)	Actual Interest Earnings* (\$ million)
1997-1999	\$ 0	\$ 5.0
1999-2001	\$ 91.4	\$15.3
2001-2003	\$171.6	\$12.0 (est.)
2003-2005	\$278.1 (est.)	\$30.0 (est.)
2005-2007	\$375.7 (est.)	\$36.6 (est.)

*Source: Tom Potiowski, Legislative Revenue Office, Office of Economic Analysis

Interest on the fund principal currently amounts to approximately \$12 million per year. Seventy-five percent of the earnings are dedicated to the Oregon Education Fund. This fund is used to pay debt service costs on lottery backed bonds for schools approved by the 1997 and 1999 Oregon Legislatures. These bonds provided a total of \$277 million for schools from 1997 through 2001. The Legislative Revenue Office estimates the debt service costs of these bonds to be approximately \$60 million for both the 2001-2003 and 2003-2005 biennia.

The remaining 25 percent of interest earnings are dedicated to the State Scholarship Commission, which uses the money to fund opportunity grants for Oregon higher education students. These grants are need-based grants provided by the Oregon Student Assistance Commission. In the 2001-2003 biennium, approximately \$44.1 million is allocated for opportunity grants. Funding from the Education Endowment Fund provides roughly 12 percent of the opportunity grant funding.

To put the contributions of the Education Endowment Fund into perspective, state funding for K-12 education—from the General

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Fund, Oregon Lottery, and other funds—was \$4.811 billion in the 1999-2001 biennium. The 1999-2001 Education Endowment Fund earnings of \$15.3 million represented approximately 0.3 percent of total state K-12 education funding for that biennium. Passage of Measure 13 would reduce the interest earnings allocated to debt service and the State Scholarship Commission by an estimated \$10.7 million per biennium.

C. Previous City Club Education Fund Recommendation

In 1987, the City Club approved a long-term report on school finance reform that included a recommendation to create an education fund to achieve stable and equitable school funding for the state. The City Club recommendation proposed that such a fund would:

- Use revenues assessed at a rate or rates that do not distinguish by geographic area;
- Be constitutionally dedicated to funding basic education;
- Incorporate all current miscellaneous local funding sources;
- Incorporate all current state contributions, such as the Common School Fund, and establish an appropriate growth factor for dedicated General Fund appropriations; and
- Offset current local property tax collection to the extent of any new revenue source or sources incorporated in the fund.

The Education Endowment Fund fulfills only the first two of these recommendations.

D. Stabilization or "Rainy Day" Funds

"Budget stabilization funds, or rainy day funds as they often are called, are now common in most states....The original concept of a budget stabilization fund is straightforward: money is saved when state finances are healthy for use when the state's economy takes a downturn." ¹

Oregon is one of five states that do not have a stabilization or "rainy day" fund. The value of a stabilization fund goes beyond the obvious benefit of having a cash reserve to draw upon during stormy economic times. Stabilization funds can enhance or buttress a state's credit rating with the very important consequence of lowering the cost of borrowing money.

¹ Corina Eckl, "States Broaden the Scope of Rainy Day Funds" (originally published in *The Fiscal Letter*, Vol. XVII, No. 2, National Conference of State Legislatures, March/April, 1995).

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Other states have stabilization funds that range in purpose, size and conditions for disbursement. Some states fund their stabilization funds through legislative appropriations while others do not fund them at all and carry a zero or insignificant balance forward from year to year. Sixteen states have stabilization funds with a fund balance of 5 percent or more of their general operating expenditures. Kansas does not have a stabilization fund, but is required by statute to leave a 7.5 percent ending balance in its general fund—a de facto stabilization fund. If Oregon were to abide by this standard, the 2001-2003 budget would have had an ending balance of \$829 million (Oregon's revenue shortfall is currently projected to be \$845 million).

According to the Center on Budget and Policy Priorities (CBPP) "[I]n the 1990s, many states set aside rainy day funds—reserve accounts funded during the recent economic expansion—to be the first line of defense against the pressures that declining revenues and rising need for public services in a recession might place on state budgets. That recession and the resulting fiscal stress have now arrived" The CBPP cautions that "[r]ainy day funds are meant to provide a way for states to maintain programs during a cyclical economic downturn. In some states, the current problems are a combination of cyclical and structural problems. Using rainy day funds to compensate for structural budget deficits—long term imbalances between the growth rate of revenue and the growth in the cost of basic programs—is not good policy because it uses one-time money to fund an ongoing, rather than a cyclical, deficit. Thus states in which structural imbalances exist should take care to use rainy day funds only to offset cyclical deficits and create the climate in which more permanent fiscal problems can be addressed appropriately."²

² "State Rainy Day Funds: What to Do When it Rains?" Center on Budget and Policy Priorities, January 31, 2002 (<http://www.cbpp.org/1-31-02sfp2.pdf>).

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III. ARGUMENTS PRO AND CON

A. Arguments Advanced in Favor of the Measure

Proponents of Measure 13 have advanced the following arguments:

- Measure 13 meets the immediate need for funding K-12 education this biennium. Without the \$220 million provided for in Measure 13, public education in Oregon will suffer the worst budget challenge in living memory. The current Education Endowment Fund contributes very little to the operations of K-12 schools.
- Measure 13 will improve Oregon's standing with credit rating agencies that disdain the state's dependence on volatile personal income tax collections and help preserve the state's good rating. Credit rating agencies place great value on stabilization funds that have a steady income. The stabilization fund proposed would be funded through state lottery income—a relatively stable revenue source even in poor economic times.
- The stabilization fund can be used only for school funding needs. It puts education first while relieving pressure to cut other activities funded through the General Fund during recession.
- There is a good chance the legislature will decide that the interest earned by the Stabilization Fund will continue to be distributed to the Oregon Education Fund (paying bond debt) and the State Scholarship Commission just as the current Education Endowment Fund does.
- The \$220 million to be allocated this biennium will be withdrawn in May of 2003 providing another 11 months for interest earnings to accumulate. The remaining \$58 million left in the fund has the potential to grow to \$600 million in ten years.
- There are strict rules for accessing the stabilization fund. The threshold is set high enough that it can only be used when it is really needed. This measure does not take any pressure off the legislature to find more stable revenue streams for education.
- Measure 13 buys necessary time to build consensus for a more stable educational funding source for the next biennium and thereafter. Creating the stabilization fund does not foreclose on other education funding strategies (i.e., increasing the tobacco tax or raising the school property tax limit from \$5 to \$7 per \$1000 of assessed value).
- Instituting a stabilization fund before settling on other education funding strategies is most likely to deliver both. After the legislature figures out education funding strategies there will be no

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interest in creating a stabilization fund.

- If Measure 13 fails, the stabilization fund concept may not get any further attention from the legislature or make it back onto the ballot for a very long time.

B. Arguments Advanced Against the Measure

Opponents of Measure 13 have advanced the following arguments:

- If Measure 13 is defeated, the legislature will be forced to find a more permanent solution for education funding. A full-blown crisis is required to have any hope of productive action and since the June special session will be after the primary election, the session should be more productive at finding such a solution.
- If the legislature does not act to increase revenue streams in the June special session, it will have a very difficult task funding education in the 2003-2005 biennium.
- The one time payment of \$220 million would create the impression that the education funding issue is solved when it is not. Measure 13 is a shortsighted approach to a problem that has festered for over a decade.
- Passing Measure 13 obscures the fact that education funding in the 2003-2005 biennium will need to be increased by over \$800 million, almost 19 percent, just to keep programs at the revised 2001-2002 level.
- Measure 13 wipes out permanent education financing to meet the need of this biennium only.
- Oregon's economy will not recover quickly enough to prevent another crisis in education funding in the next biennium. Drawing out \$220 million now leaves no cushion for next year.
- It will take many years to build the stability fund back up to a point where it can make a substantial contribution to education funding.
- Taking money from the endowment fund would cut higher education assistance at a time when enrollment in higher education is increasing dramatically-there has been a 7.4 percent increase in enrollment at the state's four-year colleges this year.

IV. DISCUSSION

On its face, Measure 13 might simply appear to be a desperate grab for money by the legislature in order to put off hard decisions regarding school funding. However, the creation of a true stabilization fund has many long-term benefits, which makes the ballot measure attractive despite the risk that it may delay much needed reform to Oregon's school financing structure.

Opponents of Measure 13 frequently mentioned their concern for next year's education funding and cited the fact that creating a stabilization fund would not solve Oregon's school funding crisis. They hold fast to the Governor's conviction that drawing down a stabilization fund not only leaves no cushion for the following year, but also forestalls a permanent solution to a decade-long struggle to adequately fund education. Opponents also argue that the legislature will take the course of least tax resistance at every opportunity, and Measure 13 would continue this trend. They believe that the current revenue shortfall will finally force the legislature to raise taxes—the inevitable outcome, they argue—to properly fund education rather than force an additional \$100 to \$200 million budget cut upon the state's schools. Opponents to the measure believe the difficult decision to raise taxes will be made easier during the next special session because primary elections will be over and legislators will have moved beyond the immediate threat of a challenger from their own party.

Opponents have also characterized Measure 13 as foreclosing on one of Oregon's future revenue streams for education while proponents argue that the Education Endowment Fund does not have a clear purpose and does not make a significant contribution to education funding. The legislature created the Education Endowment Fund with the very broad intent to make investments to benefit education. Both proponents and opponents agree that for the Education Endowment Fund to make any significant contribution to funding education, the principal would have to be vastly increased. Given that the Endowment Fund amounts to such a miniscule portion of state education funding, it appears that the loss of the Endowment Fund interest would not significantly impact education in the state, though other revenue sources for the bond servicing and the State Scholarship Commission would need to be provided.

Witnesses on both sides of Measure 13 agreed that the state's revenue is so severely impacted by the recession that had a stabilization fund been created at any time in the past, this is the year that it would have been tapped. Indeed, Governor Kitzhaber, in an effort to negotiate with the legislature on a funding package prior to the second special session, offered to agree to converting the

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Education Endowment Fund to a stabilization fund if the legislature would, among other things, limit the withdrawal to \$101 million dollars.

Another problem opponents identify is the gamble in spending 80 percent of the principal of a newly created stabilization fund in its first year of existence. It is likened to a family using up their savings to pay rent rather than getting jobs to create income for the long term. When the savings are gone, the situation becomes even more desperate. In the next biennium, the legislature will need to find over \$800 million more in 2002-2003 to return to the same K-12 funding level in 2001-2002. This takes into account inflation, expected increases in enrollment, budget cuts being implemented this year, and the \$220 million from the stabilization fund that will not be available next year.

While Measure 13 does not provide a solution to the very real problem of state education funding, a stabilization fund would represent real progress for the financing of state government. Your committee found compelling the opinion advanced by the State Treasurer's office that the proposed stabilization fund could be a financial benefit to Oregon in terms of supporting or improving the state's credit rating. Credit rating agencies disdain Oregon's dependence on volatile personal income tax collections and the ballot measure system, which can result in drastic tinkering with how the state raises revenue. Credit rating agencies place great value in effective stabilization funds, especially funds with a stable, dedicated funding source. Thus, the stabilization fund proposed by Measure 13 would be distinguished among many state stabilization funds by virtue of its seemingly recession-proof source of funds: lottery revenue. This feature of the proposed school stability fund would ensure the viability of the fund so that money would be available to alleviate future budget shortfalls.

Although the school stability fund would be available only for educational funding, the fund could also provide stability to other state services as well. During dire economic times additional funding for education, which represents 57 percent of the state budget, could serve to reduce the severity of budget cuts to other state service areas. This type of general stabilization affect is only potential, and the legislature could either promote or discourage this development.

If Measure 13 passes, the legislature will decide how the earnings from the fund will be spent. The legislature may direct that the interest earned from the newly created school stability fund be disbursed in the same manner as the current endowment. So far as the recipients of earnings from the endowment are concerned there would be a drop in the funding, but it would return to current levels

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in approximately five years (with no adjustment for inflation). Conversely, the legislature could easily redirect the current interest allocations to purposes other than the Oregon Education Fund and the State Scholarship Commission.

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V. MAJORITY CONCLUSIONS

At best, the Education Endowment Fund makes a nominal contribution to K-12 education. Its purpose was never clearly defined and its principal would have to grow substantially larger before the interest earnings would be a substantial source of stable educational funding.

The legislature has failed to serve Oregon's education system by squandering a decade of good economic times before proposing a stabilization fund. Oregon needs both a school stability fund and more adequate and reliable education funding. These are not mutually exclusive even during a budget crisis. Although Measure 13 does not provide a long-term solution to education funding for Oregon, a school stability fund will provide important benefits beyond the obvious bridge funding during dire economic periods. For these reasons, and with the hope that Oregon's school funding crisis will be addressed in the near future, the Majority of your Committee believes that Ballot Measure 13 deserves support.

VI. MAJORITY RECOMMENDATION

The Majority of your Committee recommends a "Yes" vote on Measure 13.

Respectfully submitted,

Tim Hemstreet
Jay D. Formick, chair

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VII. MINORITY CONCLUSIONS

Measure 13 removes the immediacy and the masks the severity of the education funding crisis. If passed, the pressure will be off the legislature to address the crisis and it is doubtful that the substantial action required will be enacted during the June special session. Indeed, legislators will have an even larger funding problem to face in the 2003-2005 biennium.

The school funding crisis will only worsen while this ballot measure postpones the action necessary to address the situation. By not addressing the situation now by raising additional revenue to provide stable funding for education, Oregon will face an even more difficult situation in the next biennium.

The idea of a stabilization fund is a good one, but the proposed fund will start with little money and take a long time to grow to a point where it can have a significant impact when times get bad.

Additionally, the restrictions on the use of the stabilization fund are too weak. If one of the conditions for economic or budgetary stress is met, the legislature may dip into the fund rather than pursue a more fiscally responsible course of raising revenue to fund education.

VIII. MINORITY RECOMMENDATION

The Minority of your Committee recommends a "No" vote on Measure 13.

Respectfully submitted,

William N. Savage

Gil Johnson, research advisor (for the full committee)
Paul Leistner, research director (for the full committee)

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IX. APPENDICIES

A. Witness List

Chris Dudley, Oregon School Boards Association
Joelle Lester, Oregon Student Association
John Marshall, Oregon School Boards Association
Kate Richardson, Oregon State Treasurer's Office
Ozzie Rose, Confederation of School Administrators
Jim Scherzinger, Portland Public Schools
Lane Shetterly, Oregon State Representative
Jeff Svejcar, Oregon Student Assistance Commission
Jean Thorne, Governor's Office
Joann Waller, Oregon Education Association

B. Resource Materials

Center on Budget and Policy Priorities
Lake Oswego Review
Legislative Fiscal Office
Legislative Revenue Office
National Conference of State Legislatures
The Oregonian
State of Oregon Department of Administrative Services Office of
Economic Analysis
The Statesman-Journal
Oregon Voters Pamphlet
City Club of Portland, 1987 Report on Long-Term School Finance
Reform
City Club of Portland, 1994 Report on Measure 15
City Club of Portland, 2000 Report on Measures 91 and 88