REVENUE FORECAST

Revenue Forecast Summary

Expectations for General Fund revenue growth have remained largely unchanged since the September 2013 quarterly forecast (aside from changes associated with tax reforms enacted during the October 2013 special legislative session). Along with underlying job growth, growth in personal income taxes withheld out of paychecks has accelerated somewhat during the early months of the 2013-15 biennium. Although growth in tax withholdings remains middling from an historical perspective, growth rates have doubled relative to those seen during fiscal year 2013.

Although labor market conditions have improved, overall revenue growth is expected to remain somewhat modest. Underlying job gains, while accelerating, will not match the pace seen during previous periods of economic expansion. Also, personal income taxes based on investment income will grow slowly in the near term.

Despite rising stock market and housing prices, the outlook for taxable investment income remains subdued in the near term. Many Oregonians cashed out capital gains in 2012 in anticipation of federal tax rate increases, leaving fewer gains to be realized for tax purposes going forward.

Although the revenue outlook remains on track, the 2013-15 biennium is still young, and therefore significant uncertainty remains. With 2012 personal income tax returns from filers who requested extensions (a group that includes many of Oregon’s wealthiest households) having been processed this fall, the first large hurdle for the revenue outlook has been cleared. Nevertheless, two income tax filing seasons remain between now and the end of the biennium. As such, many risks to the outlook remain. On the upside, if asset markets maintain their recent gains or if Oregon’s traditionally strong migration trends and labor force growth reappear, a short-term revenue boom remains possible during the 2013-15 budget period.

The primary downside risk facing the near-term revenue forecast is the uncertain future of the nationwide economic expansion. Should federal policy woes or economic weakness among our trading partners derail the U.S. economy, the expected growth in Oregon’s tax collections will not come to pass. Future asset prices are also at risk as the Federal Reserve unwinds its accommodative monetary policies.

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

2013-15 General Fund Revenues

Thus far in 2013-15, personal and corporate income tax collections have largely matched expectations. Increased income tax revenues in the December quarterly outlook are largely the result of legislative tax changes enacted during the October 2013 special session.

Although underlying economic growth will be stronger in 2013-15, General Fund revenue growth is not expected to match the pace seen during the last biennium. Personal income taxes flowing from labor income have accelerated. However, this improvement is expected to be offset by slower growth in taxable investment income such as capital gains.

Excluding legislative actions taken during the special session, the revenue outlook for the 2013-15 biennium is largely unchanged (-0.1%) relative to the September 2013 forecast. Including legislative changes, the forecast for General Fund revenues for 2013-15 is now $15,763 million. This represents an increase of $115 million (+0.7%) from the September 2013 forecast. Legislative changes have also reduced the required deposit from the corporate minimum tax into the Rainy Day Fund, which increases net revenues by an additional $33 million.

The December forecast for the 2013-15 biennium is $120 million (0.8%) above the Close of Session forecast. In addition to legislative changes, modest improvement in the outlook for personal income taxes was offset by an expected decline in corporate tax collections.

Table R.1

2013-15 General Fund Forecast Summary

(Millions)	2013 COS Forecast	September 2013 Forecast	December 2013 Forecast	Change from Prior Forecast	Change from COS Forecast
Structural Revenues					
Personal Income Tax	$13,558.2	$13,603.5	$13,716.1	$112.6	$157.9
Corporate Income Tax	$1,056.6	$1,012.0	$1,030.5	$18.5	-$26.1
All Other Revenues	$1,027.9	$1,032.7	$1,016.3	-$16.4	-$11.6
Gross GF Revenues	$15,642.6	$15,648.2	$15,762.8	$114.6	$120.2
Offsets and Transfers	-$120.8	-$100.3	-$67.5	$32.7	$53.3
Administrative Actions[1]	-$18.2	-$13.6	-$13.6	$0.0	$4.7
Legislative Actions	-$136.9	-$136.9	-$136.9	$0.0	$0.0
Net Available Resources	$15,910.1	$15,870.4	$16,006.9	$136.4	$96.7
Confidence Intervals					
67% Confidence	+/- 7.5%		$1,182.5	$14.58B to $16.95B	
95% Confidence	+/- 15.0%		$2,365.1	$13.40B to $18.13B	

1 Reflects cost of cashflow management actions, exclusive of internal borrowing.

Personal Income Tax

Personal income tax collections were $1,572 million for the first quarter of fiscal year 2014, $13.5 million (-1.0%) below the latest forecast. Compared to the year-ago level, total personal income tax collections grew by 5.6% relative to a forecast that called for 6.5% growth. Appendix B presents a comparison of actual and projected personal income tax revenues for the July-September quarter.

Personal income tax collections posted healthy gains throughout the fall filing season for extended/amended returns. It appears that the large year-end tax payments that were collected in April did not significantly overstate filers' tax liability.

Going forward into the 2013-15 biennium, personal income tax collections are expected to grow at somewhat below average rates. Although growth in taxable wages is accelerating, growth in overall collections will be held back by slower growth in taxable investment income.

Excluding corporate excise taxes, the General Fund forecast is now $148 million above the Close of Session forecast due to the impact of law changes. As such, we are now about halfway to the personal income tax kicker threshold.

Corporate Excise Tax

Corporate excise tax collections equaled $110 million for the first quarter of fiscal year 2014, $3.2 million below the September forecast. Compared to one year ago, net corporate receipts were down 2.9% with the forecast calling for a 0.1% decline.

Despite being no bigger than two years ago, corporate tax collections remain large from an historical perspective. Near-record corporate profits have yet to go away. Given that corporate tax collections and underlying profits are subject to boom-bust cycles, there is a considerable amount of downside risk to the outlook.

Nevertheless, strong growth is expected during the 2013-15 biennium, due to tax reform and continued economic growth. Oregon's economy is expected to continue to grow, and corporate tax collections are typically very sensitive to the business cycle. However, these growth rates, while large, will remain less than half of what has been seen during recent profit booms.

Corporate income tax collections for 2013-15 are $18.5 million higher than what was called for in the September forecast. Weak preliminary collections data for October and November partially offset the positive impact of tax law changes.

Other Sources of Revenue

All other General Fund revenues are expected to total $1,016 million for the 2013-15 biennium, a decrease of $16 million relative to the September forecast. The decline was driven by two revenue categories: state court fees and inheritance taxes.

Extended General Fund Revenue Outlook

Table R.2 exhibits the long-run forecast for General Fund revenues through the 2021-23 biennium. Users should note that the potential for error in the forecast increases substantially the further ahead we look.

General Fund revenues are expected to total $17,460 million in 2015-17 biennium, an increase of 10.8% percent from the prior period, and $86 million (+0.5%) above the September forecast. In 2017-19 biennium, revenue growth is expected to slow to 9.0%, followed by rates of around 10% in subsequent biennia. The slowdown in long-run revenue growth is largely due to the impact of demographic changes and changes in savings behavior. Table B.2 in Appendix presents a more detailed look at the long-term General Fund revenue forecast.

Table R.2

General Fund Revenue Forecast Summary (Millions of Dollars, Current Law)

Revenue Source	Forecast 2011-13 Biennium	% Chg	Forecast 2013-15 Biennium	% Chg	Forecast 2015-17 Biennium	% Chg	Forecast 2017-19 Biennium	% Chg	Forecast 2019-21 Biennium	% Chg	Forecast 2021-23 Biennium	% Chg
Personal Income Taxes	12,118.2	15.8%	13,716.1	13.2%	15,389.6	12.2%	16,929.0	10.0%	18,666.0	10.3%	20,512.6	9.9%
Corporate Income Taxes	883.9	6.8%	1,030.5	16.6%	1,069.0	3.7%	1,043.3	-2.4%	1,073.1	2.9%	1,167.2	8.8%
All Others	1,164.9	-5.0%	1,016.3	-12.8%	1,001.1	-1.5%	1,063.1	6.2%	1,142.7	7.5%	1,220.5	6.8%
Gross General Fund	14,167.0	13.1%	15,762.8	11.3%	17,459.7	10.8%	19,035.4	9.0%	20,881.9	9.7%	22,900.3	9.7%
Offsets and Transfers	*(12.0)*		*(67.5)*		*(85.6)*		*(94.5)*		*(57.0)*		*(61.0)*	
Net Revenue	14,155.0	13.0%	15,695.3	10.9%	17,374.1	10.7%	18,940.9	9.0%	20,824.9	9.9%	22,839.3	9.7%

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

Tax Law Assumptions

The revenue forecast is based on existing law, including measures and actions signed into law during the 2013 Oregon Legislative Session and October Special Legislative Session. OEA makes routine adjustments to the forecast to account for legislative and other actions not factored into the personal and corporate income tax models. These adjustments can include expected kicker refunds, when applicable, as well as any tax law changes not yet present in the historical data. A summary of actions taken during the 2013 Legislative Session can be found in Appendix B Table B.3. For a detailed treatment of the components of the 2013 Legislatively Enacted Budget, see: LFO 2013-15 Budget Summary. For summary of the revenue impacts for the October 2013 special session see: LRO HB3601 Revenue Impact Statement.

The treatment of the corporate taxes represents an important current area of policy uncertainty. Policymakers and the court system are currently determining if firms can be asked to pay excise taxes based on a single sales apportionment factor. Depending on the future treatment of corporate tax liability, the outlook for collections could be lowered on the order of $100 million per biennium.

Other recent tax law changes involve the treatment of court fees and criminal fines. These changes have significantly increased the amount of judicial related funds flowing into the General Fund, but the exact magnitude of the impact remains unclear.

Although based on current law, many of the tax policies that impact the revenue forecast are not set in stone. In particular, sunset dates for many large tax credits have been scheduled. As credits are allowed to disappear, considerable support is lent to the revenue outlook in the outer years of the forecast. To the extent that tax credits are extended and not allowed to expire when their sunset dates arrive, the outlook for revenue growth will be reduced. The current forecast relies on estimates taken from the Oregon Department of Revenue's 2013-15 Tax Expenditure Report.

Alternative Scenarios

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

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

Two recessionary scenarios are displayed in table R.2b. In a severe recession, biennial revenues could come in as much as $2 billion lower than predicted.[1]

[1] The methodology for computing alternative scenarios has recently been changed to reflect recent work done by the Legislative Revenue Office. Assumptions: Recessions begin in 2015 and return to baseline income by 2022. The moderate recession scenario assumes personal income growth will be reduced by one-half relative to the baseline in 2015 and 2016. The severe recession scenario assumes personal income will decline in 2015 by as much as it did in 2009. The percentage deviation in personal income taxes is 1.4 times the deviation in personal income. The percentage deviation in corporate income taxes is 2.0 times the deviation in personal income.

TABLE R2b December 2013

Alternative Cyclical Revenue Forecast ($ millions)

Baseline Case	2014-15 Fiscal Year	2015-16 Fiscal Year	2016-17 Fiscal Year	2017-18 Fiscal Year	2018-19 Fiscal Year	2019-20 Fiscal Year	2020-21 Fiscal Year	2021-22 Fiscal Year	2022-23 Fiscal Year
Personal Income									
Level	168.53	177.56	187.67	198.14	208.08	218.36	228.57	239.18	250.22
% change	*5.2%*	*5.4%*	*5.7%*	*5.6%*	*5.0%*	*4.9%*	*4.7%*	*4.6%*	*4.6%*
Taxes									
Personal Income	7,103	7,513	7,876	8,272	8,657	9,088	9,578	10,033	10,480
Corporate Excise & Income	549	540	529	523	520	527	546	576	591
Other General Fund	502	496	505	523	540	563	580	604	617
Total General Fund	8,154	8,549	8,910	9,319	9,717	10,178	10,703	11,213	11,687
% change	*7.2%*	*4.8%*	*4.2%*	*4.6%*	*4.3%*	*4.8%*	*5.2%*	*4.8%*	*4.2%*

Moderate Recession	2014-15 Fiscal Year	2015-16 Fiscal Year	2016-17 Fiscal Year	2017-18 Fiscal Year	2018-19 Fiscal Year	2019-20 Fiscal Year	2020-21 Fiscal Year	2021-22 Fiscal Year	2022-23 Fiscal Year
Personal Income									
Level	168.5	173.2	178.7	190.7	202.5	214.3	226.0	237.1	248.4
% change	*5.2%*	*2.8%*	*3.1%*	*6.7%*	*6.2%*	*5.8%*	*5.5%*	*4.9%*	*4.8%*
Taxes									
Personal Income	7,103	7,257	7,346	7,835	8,335	8,852	9,426	9,901	10,358
Deviation from baseline		*-256*	*-530*	*-437*	*-322*	*-237*	*-151*	*-132*	*-122*
Corporate Excise & Income	549	513	479	484	492	507	534	566	582
Deviation from baseline		*-26*	*-51*	*-39*	*-28*	*-20*	*-12*	*-10*	*-9*
Other General Fund	502	496	505	523	540	563	580	604	617
Total General Fund	8,154	8,267	8,330	8,842	9,367	9,922	10,540	11,071	11,557
% change	*7.2%*	*1.4%*	*0.8%*	*6.2%*	*5.9%*	*5.9%*	*6.2%*	*5.0%*	*4.4%*
Deviation from baseline		*-283*	*-580*	*-476*	*-350*	*-256*	*-164*	*-142*	*-130*

Severe Recession	2014-15 Fiscal Year	2015-16 Fiscal Year	2016-17 Fiscal Year	2017-18 Fiscal Year	2018-19 Fiscal Year	2019-20 Fiscal Year	2020-21 Fiscal Year	2021-2022 Fiscal Year	2020-21 Fiscal Year
Personal Income									
Level	168.5	161.8	169.4	183.4	197.2	211.0	224.8	235.8	247.1
% change	*5.1%*	*-4.0%*	*4.7%*	*8.2%*	*7.5%*	*7.0%*	*6.6%*	*4.9%*	*4.8%*
Taxes									
Personal Income	7,103	6,581	6,803	7,408	8,021	8,658	9,356	9,827	10,281
Deviation from baseline		*-933*	*-1,073*	*-864*	*-636*	*-431*	*-221*	*-206*	*-199*
Corporate Excise & Income	549	444	426	445	465	491	528	560	576
Deviation from baseline		*-96*	*-103*	*-78*	*-55*	*-36*	*-18*	*-16*	*-15*
Other General Fund	502	496	505	523	540	563	580	604	617
Total General Fund	8,154	7,521	7,734	8,376	9,026	9,712	10,464	10,991	11,474
% change	*7.2%*	*-7.8%*	*2.8%*	*8.3%*	*7.8%*	*7.6%*	*7.7%*	*5.0%*	*4.4%*
Deviation from baseline		*-1,029*	*-1,176*	*-943*	*-691*	*-467*	*-239*	*-222*	*-213*

Lottery Earnings Forecast

Table R.3 presents a summary of lottery earnings and distribution for the 2013-15 BN. Revenues and available resources from Lottery games and programs are projected to total $1,058.4 million, a decrease of $3.8 million from the September outlook and $1.1 million below the Close of Session forecast. The decrease is primarily the result of slightly lower traditional game sales and a downgraded outlook for unclaimed prizes.

Overall, video lottery dominates total lottery earnings, accounting for approximately 85 percent of all lottery transfers in the past three years. Although growth has generally been slow in recent years, it has stabilized after declining substantially in the wake of the Great Recession and enactment of the smoking ban. In total, declines in video lottery sales approached 23 percent from pre-recession highs to the depths of the recession; the same magnitude of losses seen in slot machine revenues in Clark County, Nevada, home of Las Vegas. So far, Oregon video lottery sales have rebounded at approximately twice the rates seen at Clark County slot machines.

Moving beyond 2013 and into future years as the economic expansion continues and strengthens, so too do video lottery sales. Over the forecast horizon video lottery sales are projected to increase at a rate of growth that is just under the gains seen in overall personal income. Even with the video lottery sales increases in recent years, these gains have not been quite as strong as the underlying economic conditions. Consumers remain cautious with their disposable income and while their overall entertainment spending is increasing, the share of their budgets spent on these activities has not increased. This has not been the case in past years with gains in video lottery having outstripped spending on other items throughout the Lottery's history. Eventually as video games lose some of their novelty, sales growth will slow to more sustainable levels. For a more thorough look at Lottery revenues and consumer spending on gaming over the business cycle, please see [our office's research report available on our website][2].

Table R.3

2013-15 Lottery Fund Forecast Summary

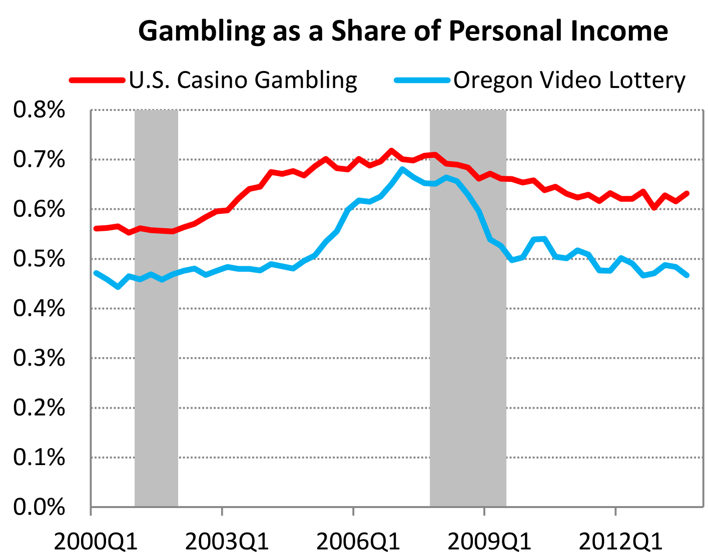
	Close of 2013 Session	Sept 2013 Forecast	Dec 2013 Forecast	Changes from: Sept 2013 Forecast	Changes from: COS 2013
Transfers of Lottery Earnings					
Traditional Games	$122.7	$129.5	$124.5	-$5.0	$1.8
Video Lottery	$1,002.9	$998.9	$1,000.3	$1.4	-$2.6
Administrative Actions	$0.0	$0.0	-$0.1	-$0.1	-$0.1
Video Lottery Terminal Replacement	-$71.0	-$71.0	-$71.2	-$0.2	-$0.2
Total Transfers	$1,054.6	$1,057.3	$1,053.5	-$3.8	-$1.1
Economic Development Fund					
Beginning Balance	$3.5	$3.5	$3.5	$0.0	$0.0
Transfers from Lottery	$1,054.6	$1,057.3	$1,053.5	-$3.8	-$1.1
Other earnings[1]	$1.4	$1.4	$1.4	$0.0	$0.0
Total Available Resources	$1,059.5	$1,062.2	$1,058.4	-$3.8	-$1.1
Dedicated Distributions[2]	$404.1	$405.0	$403.7	-$1.3	-$0.4
Other Legislatively Adopted Allocations	$640.4	$640.4	$640.4	$0.0	$0.0
Total Distributions	$1,044.5	$1,045.4	$1,044.1	-$1.3	-$0.4
Ending Balance	$15.0	$16.8	$14.3	-$2.6	-$0.7

Footnotes:

1. Includes interest earnings and reversions.

2. Includes Education Stability Fund(18%), Parks & Nat. Resources(15%), Sports Lottery (1%), Gambling Addiction(1%), County

Another major item affecting Lottery transfers for state revenue purposes is the capital replacement plan that Lottery will implement over the FY 2014-2017 time frame. During the next two biennia, Lottery will replace the 12,000 existing video lottery terminals throughout the state, some of which will be nine years old when they are replaced. Due to advancements in technology, like a lot of industries, the current machines are becoming obsolete in the marketplace. This replacement plan is expected to cost approximately $215 million over four years, of which Lottery will self-fund $85 million. The remaining $130 million will be deducted from Lottery earnings prior to being transferred for general revenue purposes. The biennial impact of the replacement plan is $71.2 million in 2013-15, or less than 7 percent of available revenue to be transferred, and $59.2 million in 2015-17, or about 5 percent.



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

[2] http://oregoneconomicanalysis.wordpress.com/2013/03/20/gaming-and-the-great-recession/

Overview of Budgetary Reserves

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

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

The ESF gained its current reserve structure and mechanics via constitutional amendment in 2002. The ESF receives 18 percent of lottery earnings[3], deposited on a quarterly basis. The ESF does not retain interest earnings. The ESF has similar triggers as the ORDF (in fact, the ORDF was modeled on the ESF), but does not have the two-thirds cap on withdrawals. The ESF balance is capped at five percent of General Fund revenues collected in the prior biennium.

Budgetary Reserve Outlook

Table R.4 presents projected balances for the ORDF and ESF. The ORDF ended the 2011-13 biennium with a balance of $61.8 million, while the ESF ended the biennium with a balance of $7.6 million. Combined, these reserve funds total approximately one-half of one percent of the 2011-13 General Fund revenues.

As the accounting books for the 2011-13 biennium close out, per statute given the positive ending balance to the General Fund, one percent of appropriation will be deposited into the ORDF in the coming months. This deposit will be $136.9 million. Additionally, at the end of the 2013-15 biennium, the corporate tax revenue due to the increases in the tax rate from Measure 67, however also adjusted during the most recent special session, will be deposited into the ORDF. The current estimate for the biennium is $10 million.

In 2013-15, the ESF is expected to see deposits of $170.5 million based on Lottery sales. There are no scheduled withdrawals out of the ESF and the ending balance is projected to be $177.9 million at the end of the biennium.

B.10 in Appendix B provides more details for Oregon's budgetary reserves.

Table R.4

Oregon's Budgetary Reserves

(Millions)	2011-13 Biennium	2013-15 Biennium	2015-17 Biennium
Rainy Day Fund			
Beginning Balance	$10.4	$61.9	$210.6
Net Deposits[3]	$50.8	$146.9	$167.9
Interest	$0.6	$1.9	$18.7
Ending Balance[1]	$61.8	$210.6	$397.2
Education Stability Fund			
Beginning Balance	$5.1	$7.4	$177.9
Net Deposits	$184.8	$170.5	$185.8
Interest[2]	$0.6	$1.0	$15.1
Withdrawals	-$182.9	-$1.0	-$15.1
Ending Balance	$7.6	$177.9	$363.7
Total Reserves	$69.4	$388.5	$760.9
Percent of General Fund Revenues	0.5%	2.5%	4.4%

Footnotes:

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

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