Revenue Summary

During odd-numbered years, Oregon’s September revenue forecast provides a look back at the biennium that just came to a close. Unlike the nationwide economic expansion, Oregon’s revenue picture has yet to show any cracks. Through the end of the 2017-19 biennium, all major types of Oregon’s General Fund tax collections continued to outstrip gains in the underlying economy.

The largest part of Oregon’s General Fund, personal income tax collections, surged during the peak tax season with collections coming in one-third larger than what was seen in 2018. Both year-end income tax payments net of refunds, as well as withholdings out of paychecks, have been posting growth rates above what economic gains would call for. Corporate tax collections have slowed a bit in recent months, but remain elevated above their typical size as well.

The strong growth at the end of the biennium has resulted in an increased estimate of the kicker refund. The personal income tax kicker is now expected to be $1.57 billion, making it the third largest as a share of liability on record. Kickers of this size occur about once every decade, typically around the peak of the business cycle. As was the case with the large kicker generated during the mid-1980’s, changes in federal tax policy played a large role in generating above-trend state collections last biennium. Taxpayers are very sensitive to federal rules, and often shift the timing of their payments in order to minimize their federal liability over time. The federal Tax Cut and Jobs Act has greatly altered taxpayer behavior, suggesting that some of the recent growth in state tax collections may not be sustainable going forward.

Over the next month, the Office of Economic Analysis will double check the accounting records before certifying the size of the kicker by October 1st. As it now stands, when taxpayers file at the beginning of next year, they will receive around a 15% refundable credit off of their bill. For the median filer, this amounts to a credit of $346, while the average filer will receive $739.

Although the corporate kicker refund is no longer returned as a credit to taxpayers, corporate collections have come in above expectations as well. Similar to personal income taxes, federal tax reforms have clearly played a large role in the surge in collections. As a result of the unexpected corporate collections, an estimated $676 million will be dedicated to K-12 programs during the 2019-21 biennium. This is $60 million more than was expected during the May forecast.

While kicker payments have grown as a result of the unexpected revenue gains, so too have Oregon’s cash balances. The General Fund beginning balance is now more than $200 million larger than what was expected at the close of the session. With the near-term outlook for corporate collections being revised upward as well,
policymakers will have around $300 million in additional resources to potentially add to the recently-enacted 2019-21 budget.

All told, the September forecast reflects a stable economic outlook, with the expected size of General Fund collections increasing slightly over what was expected at the Close of Session. However, when tax policy changes from the 2019 legislative session are factored in, the General Fund is expected to be significantly smaller than what was expected in May. Most notably, the enactment of a Corporate Activity Tax (HB3427) brought with it personal tax rate cuts, and is expected to reduce business tax liability. While the Corporate Activity Tax will clearly be a net positive for the state budget as a whole, it will reduce General Fund resources since the new collections will not be deposited there. Instead, Corporate Activity Tax collections will be directed to a Fund for Student Success, thus keeping them out of the kicker calculation10.

These General Fund cuts, together with a big kicker payment, a slowing economy and the federal tax policy hangover do not bode well for tax collections in 2019-21. Even if we are able to avoid a recession (as is expected in the baseline case), General Fund resources are expected to be smaller than they were last biennium.

Heading into the new biennium, uncertainty about the performance of the nationwide economy has become paramount. Growth will certainly slow to a sustainable rate in the coming years, but the path taken to get there is unknown. Fortunately, Oregon is better positioned than ever before to weather a revenue downturn. Automatic deposits into the Rainy Day Fund and Education Stability Fund have added up over the decade-long economic expansion. When the expected ending balance for the current biennium is included, Oregon has more than $2.5 billion in reserves set aside, amounting to more than 12% of the two-year budget.

Longer term, 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.

2019-21 General Fund Revenues

Gross General Fund revenues for the 2019-21 biennium are expected to reach $21,112 million. This represents a decrease of $211 million from the May 2019 forecast, and an increase of $92 million relative to the Close of Session forecast. Although the economic outlook is stable, policymakers enacted tax laws during the 2019 legislative session that are expected to reduce General Fund resources.

<table>
<thead>
<tr>
<th>2019-21 General Fund Forecast Summary</th>
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<tr>
<td>(Millions)</td>
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<tr>
<td>Structural Revenues</td>
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<td>Personal Income Tax</td>
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<td>Corporate Income Tax</td>
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<td>All Other Revenues</td>
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<td>Gross GF Revenues</td>
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<td>Offsets and Transfers</td>
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<tr>
<td>Administrative Actions1</td>
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<tr>
<td>Legislative Actions</td>
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<tr>
<td>Net Available Resources</td>
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</table>

Confidence Intervals

| Confidences | | | | |
|----------------------|----------------------|----------------------|----------------------|
| 67% Confidence | +/- 8.6% | $1,823.9 | $19.29B to $22.94B |
| 95% Confidence | +/- 17.3% | $3,647.8 | $17.46B to $24.76B |

1 Reflects cost of cashflow management actions, exclusive of internal borrowing.
**Personal Income Tax**

Personal income tax collections were $3,471 million during the fourth quarter of fiscal year 2019, $260 million (8.1%) above the latest forecast. Compared to the year-ago level, total personal income tax collections rose by 32% relative to a forecast that called for a 22% increase. Table B.8 in Appendix B presents a comparison of actual and projected personal income tax revenues for the April-June quarter. Strong growth in collections has continued into fiscal year 2020.

**Corporate Excise Tax**

Corporate excise tax collections equaled $389 million for the fourth quarter of fiscal year 2019, $26 million below the May forecast. Compared to the year-ago level, net corporate excise tax collections rose by 8.5%.

Federal Tax Law Changes have injected a good deal of uncertainty into the outlook for corporate tax payments. It is likely that the corporate tax base has become larger in Oregon. In part, firms are now recognizing more of their global income streams. Also, some employees, investors, partnerships, S-corps and sole proprietorships face a larger tax incentive to incorporate. Conversely, some C-corporations and employees will benefit from becoming pass-through entities. Accelerated depreciation provisions are also impacting the revenue stream, as is the repatriation of deferred income from multinational corporations. While large, the amount of taxes on repatriated earnings appears to be falling short of expectations, and has been revised downward.

**Other Sources of Revenue**

Non-personal and non-corporate revenues in the General Fund account for approximately 7 percent of the total. One-fifth of this amount comes from Oregon Liquor Control Commission revenues, while estate taxes account for another fifth. In terms of forecast changes in recent biennia, estate taxes stand out as they have come in considerably above expectations.

Overall the number of estates impacted by the tax is relatively steady over the past decade, both in absolute numbers and as a share of all Oregon deaths. The growth in tax collections largely reflects the increasing size of a few very large estates. Looking forward, the outlook for collections remains strong, however not quite as strong as demographics and asset markets alone suggest due to household’s tax planning capabilities.

All told, General Fund revenues excluding personal and corporate taxes are expected to total $1.55 billion in 2019-21, an upward revision of $3.7 million relative to the Close of Session forecast. In the out biennia, these revenues are unchanged as Legislation this past session offsets by raising judicial and liquor revenues but decreasing retaliatory taxes (insurance taxes) as part of HB 3427.

**Extended General Fund Outlook**

Table R.2 exhibits the long-run forecast for General Fund revenues through the 2027-29 biennium. Users should note that the potential for error in the forecast increases substantially the further ahead we look.
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.

**Table R.2**

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<td>(117.4)</td>
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<td><strong>Net Revenue</strong></td>
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<td>31,465.3</td>
<td>10.0%</td>
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**Tax Law Assumptions**

The revenue forecast is based on existing law, including measures and actions signed into law during the 2019 Oregon Legislative Session. OEA makes routine adjustments to the forecast to account for legislative and other actions not factored into the personal and corporate income tax models. These adjustments can include expected kicker refunds, when applicable, as well as any tax law changes not yet present in the historical data. A summary of actions taken during the 2019 Legislative Session can be found in Appendix B Table B.3. For a detailed treatment of the components of the 2019 Legislatively Enacted Budget, see: LFO 2019-21 Budget Summary.

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 2019-21 Tax Expenditure Report together with more timely updates produced by the Legislative Revenue Office.

**General Fund 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. economic recovery will lose steam 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 $4.7 billion lower than predicted over the next two biennia.11

**Corporate Activity Tax**

HB 3427 (2019) creates a new state revenue source by implementing a corporate activity tax (CAT). The tax is expected to generate $1.6 billion in revenue in 2019-21 and $2.8 billion in 2021-23. These revenues are dedicated to spending on education. The legislation also included personal income tax rate reductions, reducing General Fund revenues. The net impact of HB 3427 was designed to generate approximately $1 billion per year in new state resources.

This forecast represents the first time the new CAT has been included. Table B.12 in Appendix B has details on 10 year forecast and the allocation of resources, while the personal income tax reductions are built into the General Fund forecasts as shown in Tables B.1 and B.2.

In terms of the big picture economic impacts, as always, our office starts with the Legislative Revenue Office’s impact statement and any Oregon Tax Incidence Model (OTIM) results LRO found. At the top line, OTIM results find minimal macroeconomic impacts across Oregon due to the new tax. Personal income, employment, population, investment and the like are less than one-tenth of a percent different under the new tax relative to the baseline. The model results also show that price levels (inflation) will increase above the baseline as some of the CAT is pushed forward onto consumers. Of course these top line, statewide numbers mask the varying experiences that individual firms and different industries will experience. There are likely to be some businesses or sectors that experience large impacts from the CAT, or where pyramiding increases prices to a larger degree, while other businesses or sectors see relatively few impacts.

Today we have no real economic or revenue data to evaluate the impact of the corporate activity tax as it begins in 2020. While businesses will make quarterly payments throughout 2020, it really will not be until April 2021

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11 The methodology for computing alternative scenarios has been changed to reflect recent work done by the Legislative Revenue Office. Assumptions: Recessions begin in 2019 and return to baseline income by 2026. The moderate recession scenario assumes personal income growth will be reduced by one-half relative to the baseline in 2019 and 2020. The severe recession scenario assumes personal income will decline in 2019 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.
when their annual tax return is due that we will have a complete look at the revenue, taxpayer behavior and the
like. As data does become available, our office, in conjunction with our advisors and the Legislative Revenue
Office will work together to better understand the revenue and its impact. Our office will update the outlook
accordingly at that time.

**Lottery Earnings**

While the underlying sales outlook for Lottery is largely unchanged relative to last forecast, available resources are
raised due to the incorporation of Scoreboard, or Lottery’s forthcoming sports betting game for the first time in our
office’s forecast. The game is set to launch in the coming months and is projected to generate $8.3 million in available
resources in 2019-21. These revenues are dedicated to the PERS Employer Incentive Fund per SB 1049 (2019). Total
available resources in 2019-21 are revised higher by $11.7 million when compared to the May forecast as video lottery
sales have come in above expectations in recent weeks as well.

Longer term, sports betting is forecasted to generate $29.4 million in 2021-23 and $42.2 million 2023-25 for the
Employer Incentive Fund. These estimates are highly uncertain and come from myriad assumptions about the
size of the sports betting market overall, industry competition, player adoption rates, administrative costs and
the like. The research team at Lottery provided the underlying estimates of the handle, gross gaming revenue
and expenses. Our office worked to extend the analysis over the full forecast horizon and to translate the
gaming revenue estimates into available resources.

We also know that additional uncertainty arises from the volatility of revenues as wagers come in heavy on one
team or another. For this reason, the forecast also assumes that Lottery will build reserves out of the sports
betting revenue to help account for the expected volatility.

These figures have been discussed among the Lottery forecast advisory group and represent just a first step in
incorporating sports betting revenue into the outlook. As actual sales data comes in, our office, along with the
Oregon Lottery, Oregon Legislative Fiscal and Revenue Offices, and the state CFO’s office will discuss trends,
issues and risks. We will update the outlook accordingly.

**Lottery Outlook and Distributions**

One ongoing issue to monitor is the ilani Casino Resort in southwest Washington. In analyzing casino trends
elsewhere in the country, sales increase for a year or two after a new casino opens. Obviously ilani has been
open longer than this today so the initial ramp-up period is likely over. There will be ongoing impacts at retailers
along the Oregon-Washington border, however the biggest impact on statewide sales is likely in the rearview
mirror. That said, the opening of the gaming floor is just phase one for ilani. Future expansions may include a
buffet, and a hotel to attract overnight guests and make it more of a destination and not a day trip activity. In
the event any of these options materialized, our office would reassess the impact on video lottery sales. Our
office will continue to work the Lottery advisory group to monitor sales and discuss the outlook.
Given the uncertain economic outlook and discussions with the advisory group, our office went ahead and modeled the impacts a recession would have on video lottery spending in Oregon. Of course one can model myriad alternative scenarios, however this one starts with IHS Markit’s pessimistic scenario of a mild to moderate recession. Our office then ran this through our economic and lottery models and compared the outcomes relative to the baseline.

All told, there is a clear impact and a permanent reduction in sales over the forecast horizon amounting to around $45 million per year ($29 million in transfers). Consumer spending on recreational services in this scenario is not expected to return to the baseline. However, given that the baseline has ongoing growth built into it, the mild to moderate recession scenario really results in a couple of flat years for video lottery sales. At this point, they also just happen to split into 2019-21 and 2021-23. If this scenario comes to pass, overall lottery resources for both biennia will show growth, albeit slower growth than the baseline. And the more severe a recession is, the larger the impact on consumer spending.

Other big picture issues to watch include broader national trends in gaming markets, demographic preferences for recreational activities, and to what extent consumers increase the share of their incomes spent on gaming. In much of the past 10 years, consumers have remained cautious with their disposable income. Increases in spending on gaming have largely matched income growth at best.

Over the long-run our office expects increased competition for household entertainment dollars, increased competition within the gaming industry, and potentially shifts in generational preferences and tastes when it comes to gaming. As such, our outlook for video lottery sales is continued growth, however at a rate that is slightly slower than overall personal income growth. Lottery sales will continue to increase as Oregon’s population and economy grows, however video lottery sales will likely be a slightly smaller slice of the overall pie.

Finally, in recent years Oregon voters approved two new amendments for where lottery resources are to be spent. The Outdoor School Education Fund is set to receive the lesser of 4 percent of net proceeds or $5.5 million per quarter ($44 million per biennium), adjusted for inflation. The Veterans’ Services Fund is set to receive 1.5 percent of net proceeds.
For more on the Lottery and overall gaming outlook, see our office’s recent report\(^{12}\).  

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

**Budgetary Reserves**

The state currently administers two general reserve accounts, the Oregon Rainy Day Fund\(^{13}\) (ORDF) and the Education Stability Fund\(^{14}\) (ESF). This section updates balances and recalculates the outlook for these funds based on the May revenue forecast.

As of this forecast the two reserve funds currently total a combined $1.29 billion. At the end of the upcoming 2019-21 biennium, they will total $1.76 billion. Due to lower interest rates, the reserve funds’ interest earnings outlook have been lowered over the forecast horizon.

The forecast for the ORDF includes one deposit for this biennium relating to the General Fund ending balance from the previous biennium (2017-19). A deposit of $199.5 million is expected in early 2020 after the accountants close the books. The ORDF deposit relating to the increased corporate taxes from Measure 67 was made in June 2019. We had previously assumed it would occur during the 2019-21 biennium, however statute requires it to occur by the end of the biennium in which the revenues were received. All told, at the end of 2019-21 the ORDF will total $902.4 million.

The forecast for the ESF calls for $238.4 million in deposits during the 2019-21 biennium based on the current Lottery forecast. This would bring the ESF balance to $858.1 million at the end of the current biennium.

Together, the ORDF and ESF are projected to have a combined balance of $1.76 billion at the close of the 2019-21 biennium. Provided the General Fund ending balance remains unallocated, total effective reserves at the end of 2019-21 would total more than $2.5 billion, or 12.2 percent of current revenues.

Such levels of reserve balances are bigger than Oregon has ever been able to accumulate, at least in the state’s recent history. However, such reserves would likely be just sufficient enough to withstand a typical recession’s impact on state revenues, but not likely enough to account for the increase in public services and programs during downturns. That said, reserves of approximately 7 percent are generally accepted to withstand a medium sized recession. Oregon now has reached that threshold.

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\(^{13}\) 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.

\(^{14}\) The ESF gained its current reserve structure and mechanics via constitutional amendment in 2002. The ESF receives 18 percent of lottery earnings, deposited on a quarterly basis – 5% of which are deposited in the Oregon Growth sub-account. The ESF does not retain interest earnings. The ESF has similar triggers as the ORDF, 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.
Recreational Marijuana Tax Collections

The baseline outlook for recreational marijuana remains largely unchanged relative to last quarter. Two minor adjustments to the outlook raise available resources by less than $4 million in the 2019-21 biennium. The larger impact comes from stronger-than-expected sales in May and in July. The smaller impact comes from HB 5033 (2019) which increases the Department of Revenue’s audit abilities and is expected to raise a modest amount of revenue via better tax compliance. This results in around $0.2 million in additional marijuana revenue per year over the forecast horizon.

Recent Market Trends and State Comparisons

Underlying sales and tax collections in recent quarters are matching forecast overall. That said, after strong growth in recent years, retail sales have slowed or even leveled off since late 2018 in many recreational states. That said, growth is ongoing on a year-over-year basis and more timely sales data indicates further gains, at least in Oregon and Colorado.

However, these relatively flat trends in total dollars spent masks important shifts taking place within the market. Shifts that have big implications for Oregon tax collections.

As discussed every quarter since our office began developing the recreational marijuana forecast, prices are a big risk to the outlook. Oregon levies its recreational marijuana tax based on the price of the product. As such if prices fall, then the state receives less tax revenue for every ounce sold, or every edible purchased. This is exactly what has happened. Over the past two years, recreational marijuana prices in Oregon have declined by at least 50 percent across various product types.
Actual tax collections have increased because the total quantity sold has more than tripled over the same time period. This increase in quantity sold is coming from multiple sources.

First, for normal products, as the price declines, consumers buy more as their dollar stretches further. A customer can now buy two ounces of usable marijuana for the same price as they bought one ounce previously.

Second, black and medical market conversions result in larger recreational sales. As a recent research report from OLCC\(^{15}\) shows, recreational sales have increased from zero percent of Oregon’s total marijuana market a couple years ago to more than half today. Even if the total marijuana market is stagnant, consumers converting to legal, recreational sales would drive the quantity sold at OLCC-licensed retailers higher.

Third, an overall increase in consumption drives the quantity sold higher. This increase can come from existing users buying more and/or new customers entering into the market.

Based on the latest usage data, Oregon now leads the nation in the share of the adult population admitting to federal survey takers that they use marijuana on a regular basis. At 20%, marijuana usage now outstrips cigarette smoking (16%) in Oregon, but trails alcohol usage (60%). It is somewhat of an open question how much this surveyed increase in marijuana usage is truly an increase and how much is due to people being more willing to admit to usage now that it is legal at the state level. Over the long-run, just how high usage goes will determine the ultimate size of the marijuana industry in the state.

All told, lower prices should lead to higher volumes of sales, it is just indeterminate to know in advance whether the income or substitution effect will be larger. So far, it seems to be both are driving Oregon tax collections higher, even if in recent months they are closer to offsetting one another.

Recreational Marijuana Outlook

In terms of the outlook, Oregon is poised for strong growth in the coming years. However, it remains highly uncertain with substantial upside and downside risks. These risks include not only usage rates and prices, as discussed above, but supply constraints and regulatory changes that impact the ability for product to reach consumers, in addition to potential actions by the federal government where marijuana remains a controlled substance and leakage into other states is a big concern.

Long-term the real economic impact from recreational marijuana will come not from the growing and retailing, which are low-wage and low value-added market segments. It will come from higher value-added products like oils, creams, and edibles, in addition to niche, specialty strains. These developments, as economist Beau Whitney points out, would be somewhat similar to the emergence and growth of craft beer in recent decades. It is here, among the value-added manufacturing processes in addition to the building up of a broader cluster of suppliers and ancillary industries that Oregon will see the real economic impacts. Furthermore, the long-term potential of exporting Oregon products and business know-how to the rest of the country remains large, at least once marijuana is legalized nationwide. Such a scenario is still years away at least, but remains a big upside risk to the long-term outlook.

See Table B.11 in Appendix B for a full breakdown of distributions for recreational marijuana tax collections. Note that these distributions are based on current law.