REVENUE OUTLOOK

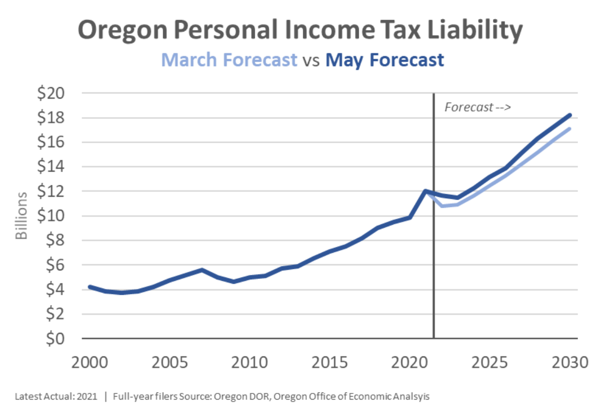
Revenue Summary

Available resources are expected to be up sharply relative to what was assumed in the March 2023 forecast, both in the near term and over the extended horizon. The upward revision in the outlook is based both on a stronger than expected tax filing season, as well as methodological changes made in light of fundamental shifts seen in recent years.

The tax filing season once again outstripped expectations, albeit modest ones. Revenue gains have cooled some, but it is clear that Oregon's tax sources have become more effective than they were pre-pandemic.

Before the filing season, it was expected that most of Oregon's primary sources of revenue would quickly revert back to pre-pandemic trends. This has not occurred, as Oregon's major taxes have grown in relation to the amount of underlying economic activity.

One major factor has been the current inflationary environment and related wage pressures. The vast majority of Oregon's taxes are not adjusted to inflation and rise along with prices. With demand outstripping supply, businesses and consumers are paying premiums for their needs. This has translated into a wide range of taxable business and labor income, which has moved many filers into higher tax brackets. The new Corporate Activity Tax, Vehicle Privilege Tax, alcohol, and tobacco taxes have risen with inflation as well.



Inflationary dynamics have not been captured well by Oregon's revenue models, given that this sort of environment has not existed since years before computerized models have. In addition to accounting for inflation, Oregon's revenue models have been refined to better account for fixed tax brackets and federal tax reform.

Qualitatively, there is not much difference between the updated revenue outlook, and what was predicted in March. After unsustainably high revenue collections over the past two years, tax revenues are expected to come back to earth over the next biennium, before returning to healthy growth thereafter if the economic expansion persists.

Quantitatively, small differences in trajectory matter a lot, and compound over time. Taken together, the outlook for

personal and corporate income taxes has risen by $1.5 to $2 billion over the forecast horizon due to the updated model methodology.

2021-23 General Fund Revenues

Gross General Fund revenues for the 2021-23 biennium are expected to reach $30,666 million. This represents an increase of $1,871 million from the December 2022 forecast, and an increase of $7,341 million relative to the Close of Session forecast. Although personal income tax collections over the filing season came in smaller than last year, they did not return to earth as expected. Corporate taxes have yet to decline meaningfully as well.

Table R.1

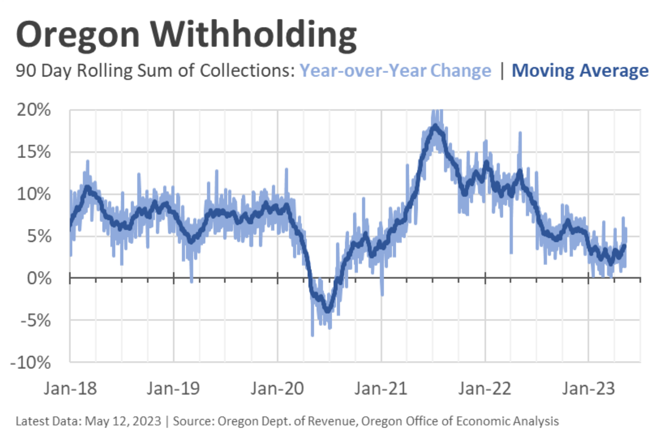
2021-23 General Fund Forecast Summary

(Millions)	2021 COS Forecast	March 2023 Forecast	May 2023 Forecast	Change from Prior Forecast	Change from COS Forecast
Structural Revenues					
Personal Income Tax	$20,628.1	$24,185.4	$25,659.5	$1,474.1	$5,031.4
Corporate Income Tax	$1,344.0	$2,889.4	$3,161.2	$271.7	$1,817.2
All Other Revenues	$1,353.5	$1,720.2	$1,845.5	$125.3	$492.0
Gross GF Revenues	$23,325.5	$28,795.0	$30,666.1	$1,871.1	$7,340.6
Offsets, Transfers, and Actions[1]	-$417.6	-$477.8	-$468.1	$9.8	-$50.5
Beginning Balance	$3,025.6	$4,082.5	$4,082.5	$0.0	$1,056.9
Net Available Resources	**$26,008.4**	**$32,488.7**	**$34,369.5**	**$1,880.8**	**$8,361.1**
Appropriations	$25,446.0	$27,861.0	$27,367.4	-$493.6	$1,921.4
Ending Balance	**$562.4**	**$4,627.6**	**$7,002.1**	**$2,374.5**	**$6,439.7**
Confidence Intervals					
67% Confidence	+/- **1.0%**		**$320.5**	**$30.35B to $30.99B**	
95% Confidence	+/- **2.1%**		**$641.0**	**$30.03B to $31.31B**	

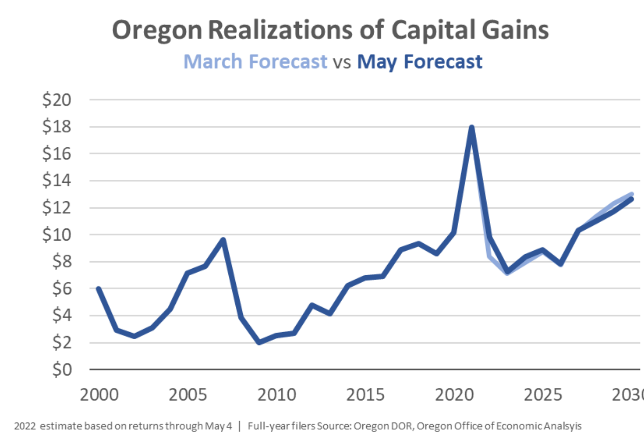
1 Reflects personal and corporate tax transfers, cost of cashflow management actions (TANS), and Rainy Day Fund tranfer

Personal Income Tax

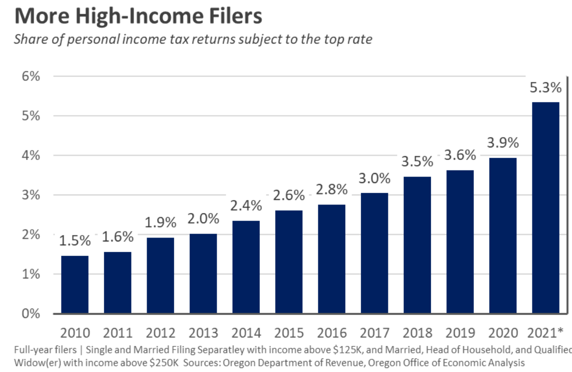
Growth in withholdings has remained slow in recent weeks, growing at an annual rate of around 4%, far slower than what is typically seen when Oregon's economy is expanding. Although there are other factors involved (e.g. retirement income, bonuses, and stock options), withholdings are mostly driven by wages and salaries. As such, slower growth could be welcome news, given that the labor market needs to cool down. However, other broad measures of wage growth have yet to show this degree of weakness to date.



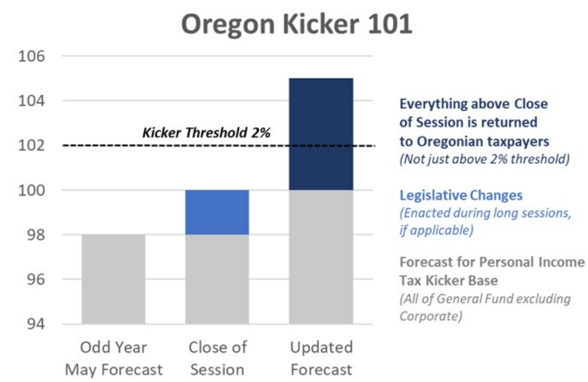
Although overall income tax collections were not as weak as expected during the filing season, assumptions about underlying income streams closely matched the March forecast. Unexpected revenues were largely the result of an upward shift in average tax rates. In particular, reported income from capital gains fell back to a more sustainable level. Capital gains realizations were roughly cut in half relative to last year, right in line with the March outlook. When this sort of correction has happened historically, average tax rates have fallen sharply as well. This was not the case this year, in part due to continued growth in labor income that kept many filers subject to the top rate.



In the past, the mix between income sources has done a good job of explaining the average personal income tax rate. The share of income sources that are typically realized by high-income filers (e.g. capital gains, business income) relative to the share of income from other sources (e.g. wages, retirement) has proven to be an accurate predictor of average tax rates. Now, in light of rapid wage growth and gains in business income, many fewer filers are falling below the top-rate threshold despite large losses in investment income. The fixed rate threshold has now been explicitly modeled, contributing to a stronger long-run outlook for tax collections.



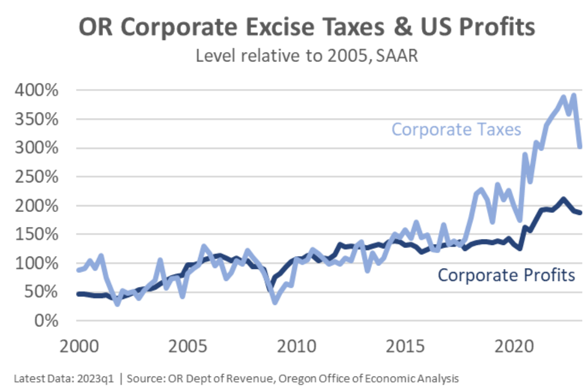
According to the September forecast, the outlook for the personal income tax kicker base is now significantly (25.1%) higher than the Close of Session forecast. If the current outlook holds, a kicker of $5.5 billion would be paid out when taxes are filed in 2024.



As a reminder, the threshold for the kicker calculation is if revenues over the entire biennium are more than 2 percent above the Close of Session forecast made prior to the start of the biennium. If they are, the entire amount of revenues above the Close of Session – including the first 2 percent – are returned to taxpayers the following year.

Corporate Excise Tax

Oregon's traditional corporate income and excise tax collections have continued to outstrip expectations, as well as underlying corporate profits. The current inflationary environment is one factor supporting recent corporate tax collections. With underlying demand so strong, businesses have largely been able to pass cost increases along to their customers. Profits and earnings have skyrocketed. Even so, growth in corporate tax payments has been far faster than has growth in underlying business income.



The surge in tax collections relative to underlying profits began around the same time as the federal tax reforms included in the Tax Cuts and Jobs Act. Among many other things, the reforms encouraged corporations to realize more of their income domestically, potentially increasing the tax base for states. With more than four years of post-reform data now available, the federal reforms are now incorporated in the corporate tax model. This has led to a stronger outlook for collections throughout the forecast horizon.

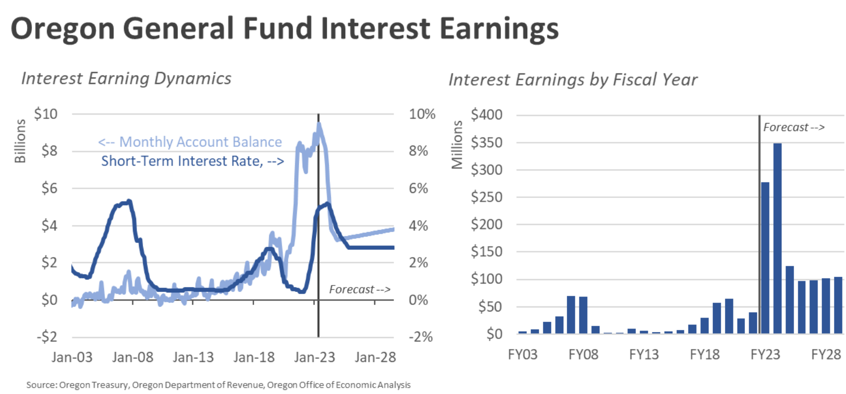
A $1.8 billion corporate kicker is currently estimated for the next biennium. According to statute, this would be retained in the General Fund for additional funding for K-12 education during the 2023-25 budget period.

Other Sources of Revenue

Non-personal and non-corporate revenues in the General Fund usually account for approximately 6 or 7 percent of the total. The largest such source are estate taxes, followed by liquor revenues, and judicial revenues.

However interest earnings are now of substantial size given high fund balances (revenues exceeding expectations and spending) and rising interest rates. Interest earning this fiscal year are expected to total $277.7 million, which is more than the previous 13 years combined of interest earnings. Looking forward, the outlook is uncertain. Today, fund balances are $6.5 billion higher than back in 2019, and the interest rate on short-term U.S. treasuries is around 5 percent. Even as the big increase in fund balance is expected to fade as the record kicker is returned to taxpayers during the next tax filing season, total interest earnings in FY 2024 will be $348.9 million. After that time, interest earnings will be larger than last decade given both higher fund balances, and higher interest rates. One risk here, given the now substantial size of interest earnings in the General Fund, is any timing related to when fund balances are spent down, and any changes to monetary policy or financial markets.

Relative to the previous forecast, the current outlook for these non-Corporate and non-Personal Income tax revenues in 2021-23 is raised by $125.3 million (6.9%). This net figure masks many changes under the surface for different sources of revenue. On the positive side, there are sizable upward revisions Interest Earnings (+$117.7 million), and Estate Taxes (+8.9 million). These gains are partially offset by small declines to judicial revenues (-$2.4 million), and tobacco (-$0.9 million).



Looking forward, these other sources of revenue in the General Fund are raised considerably in the 2023-25 biennium. The combined change is an increase of $273.1 million (16.0%) relative to the previous forecast. The primary reason for the change in the outlook for Interest Earnings (+254.3 million) that fully incorporates the high fund balances and interest rates. Other notable changes in 2023-25 include Secretary of State Fees (+$13.7 million), Estate (+$11.7 million), judicial revenues (-$6.5 million), liquor earnings (-$4.1 million), and tobacco revenues (-$2.5 million).

Extended General Fund Outlook

Table R.2 exhibits the long-run forecast for General Fund revenues through the 2029-31 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

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

Revenue Source	Forecast 2021-23 Biennium	% Chg	Forecast 2023-25 Biennium	% Chg	Forecast 2025-27 Biennium	% Chg	Forecast 2027-29 Biennium	% Chg	Forecast 2029-31 Biennium	% Chg
Personal Income Taxes	25,659.5	28.4%	21,088.3	-17.8%	29,911.4	41.8%	34,601.6	15.7%	39,217.9	13.3%
Corporate Income Taxes	3,161.2	60.7%	2,245.0	-29.0%	2,380.3	6.0%	2,673.2	12.3%	2,960.9	10.8%
All Others	1,934.5	15.1%	1,975.3	2.1%	1,724.4	-12.7%	1,828.3	6.0%	1,950.8	6.7%
Gross General Fund	30,755.1	30.1%	25,308.6	-17.7%	34,016.2	34.4%	39,103.1	15.0%	44,129.6	12.9%
Offsets and Transfers	*(245.2)*		*(128.6)*		*(116.5)*		*(113.8)*		*(140.8)*	
Net Revenue	30,509.9	29.6%	25,180.0	-17.5%	33,899.7	34.6%	38,989.3	15.0%	43,988.8	12.8%

Tax Law Assumptions

The revenue forecast is based on existing law, including measures and actions signed into law during the 2021 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 2021 Legislative Session can be found in Appendix B Table B.3. For a detailed treatment of the components of the 2021 Legislatively Enacted Budget, see:

Legislative Fiscal Office's 2021-23 Budget Summary[6]

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 2021-23 Tax Expenditure Report[7] 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. Our office 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.

The near-term outlook is particularly uncertain right now. The probability of the soft landing, no recession is rising but the odds of a recession in the upcoming 2023-25 biennium remain uncomfortably high. See page 17 for more on the economic alternative boom/bust recession scenario.

[6] https://www.oregonlegislature.gov/lfo/Documents/2021-1 LAB Summary 2021-23.pdf
[7] https://www.oregon.gov/DOR/programs/gov-research/Pages/research-tax-expenditure.aspx

Looking at the upcoming 2023-25 biennium, in the pessimistic scenario, General Fund revenues in Oregon would be $2.4 billion lower than in the baseline. Revenues in 2025-27 would be recovery but still $1.2 billion below the current baseline outlook.

Recession Forecast Changes

	$ Millions from Baseline				
	21-23	**23-25**	**25-27**	**27-29**	**27-29**
General Fund Total	**0**	**-2,387**	**-1,195**	**-733**	**-291**

Other Revenues	$ Millions from Baseline				
	21-23	**23-25**	**25-27**	**27-29**	**27-29**
Lottery	0	-42	-44	-33	-21
Corporate Activity Tax	0	-372	-171	-123	-93
Marijuana Tax	0	-6	-7	-9	-9
Total	**0**	**-420**	**-222**	**-165**	**-123**

	$ Millions from Baseline				
	21-23	**23-25**	**25-27**	**27-29**	**27-29**
Total Sum	**0**	**-2,807**	**-1,417**	**-898**	**-414**

Changes would also be seen outside of the General Fund among Oregon's consumption-based revenues as well. Such taxes are generally less volatile than income taxes and help to stabilize Oregon's overall revenue base. Specifically, the state's Corporate Activity Tax next biennium would be $372 million lower in the boom/bust scenario. Lottery resources would be $42 million lower, and marijuana revenues would be $6 million lower in the pessimistic scenario.

Corporate Activity Tax

The 2019 Legislature enacted the corporate activity tax (CAT)[8], a new tax on gross receipts that went into effect January 2020. While taxpayers were required to file on a calendar year basis for tax year 2020, a law change allowed taxpayers to switch to a fiscal year basis beginning with tax year 2021. Thus a complete picture of the 2021 tax year will not be available until near the end of the 2023 calendar year. The current estimate for 2021 tax liability has been revised upward significantly due to an absence of refunds as the tail end of the return season transpires. The same is even more true for tax year 2022, for which the tax filing season is just getting underway. The net result is an increase in revenues for the current biennium of $90.3 million and a jump of $175.7 million for the 2023-25 biennium. In addition, Senate Bill 5545 passed early on in the 2023 legislative session reduced 2021-23 allocations to the three subaccounts of the Fund for Student Success by $55 million. Combined with the current revenue increase and a modest increase to the State School Fund distribution, the 2023-25 beginning balance in the FSS is increased $128.6 million, thus contributing to a change in available resources for next biennium of $304.3 million.

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, or $2 billion per biennium.

In terms the macroeconomic effects of a major new tax, the Office of Economic Analysis starts with the Legislative Revenue Office's (LRO) 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.

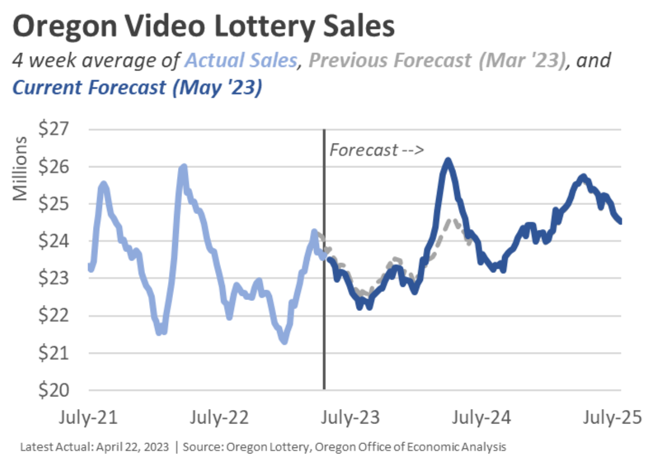
[8] https://www.oregonlegislature.gov/bills_laws/lawsstatutes/2019orlaw0122.pdf

Table B.12 in Appendix B summarizes the 10-year forecast and the allocation of resources, while Table B.13 presents a more detailed quarterly breakdown of the forecast. The personal income tax reductions are built into the General Fund forecasts shown in Tables B.1 and B.2.

Lottery Earnings

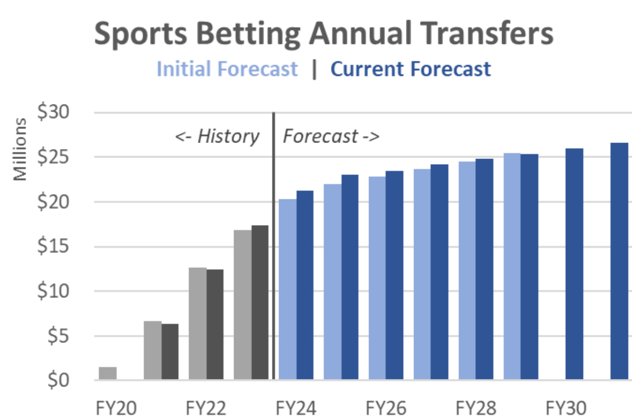
Overall lottery sales have tracked the previous forecast well. When combined with a modest upward revision to the economic outlook, the lottery forecast is raised slightly. The upcoming 2023-25 biennium outlook is increased $17.8 million (1.0%) while the outer biennia are increased about $12 million (0.6%) each.

The current 2021-23 biennium is now in the books as sales in one quarter are transferred for revenue purposes the following quarter. 2021-23 finishes as a record-setting biennium for lottery sales and earnings, far outpacing anything seen in history and 9.9 percent higher than our office's forecast made before the budget period began. The fundamental reason why is due to strong household finances and consumer spending, especially when factoring in pent-up demand following the public health restrictions and shutdowns early in the pandemic.



Overall, this strength is expected to hold in the years ahead. Sales did slow following the pandemic reopening high, but remain well above pre-pandemic levels, and are rising again more recently. One additional factor impacting sales next year is the record $5.5 billion personal income tax kicker that will be return to taxpayers. While video lottery sales are only approximately 0.45 percent of Oregon personal income, such a large increase in disposable income is likely to result in higher consumer spending statewide, including on discretionary items like video lottery. The result is expectations are sales next spring to regain the pandemic reopening highs, followed by slightly lower sales the following year when there will be no kicker paid out.

The modest increase in the Lottery forecast is not due to video sales alone, but also due to upward revisions to both Sports Betting and Traditional Lottery products as well.



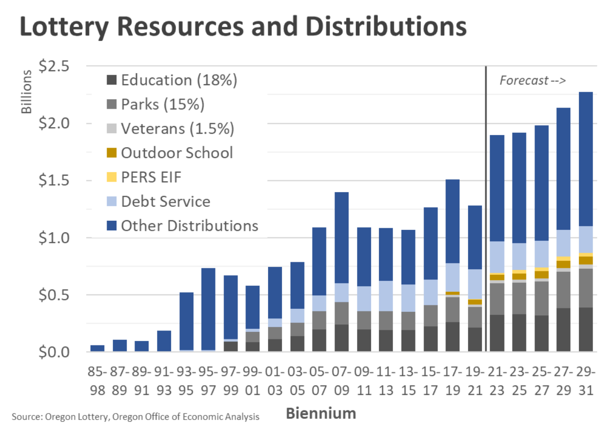
Sports Betting is raised $11.1 million in the upcoming 2023-25 biennium and $5 or $6 million in the out biennium. This brings the current outlook to a level just a bit higher than the original estimates made when sports betting was first authorized. The path from then until now has been anything but smooth given the pandemic, and sports either canceling or moving their games and the like.

However the increase in underlying sales, plus a hold, or win percentage a bit higher than expected means actual sports betting transfers are matching and exceeding those expectations. Overall there is 5 year ramp-up period assumed for fundamental growth in the player base. The start of the NFL season in the fall typically coincides with a big increase in players. As the next football season approaches in the fall, our office will be looking to see the growth in registered user that is expected.

Risks to the Outlook

Risks to the outlook abound and vary depending upon the timeframe. In the very near-term, risks lie primarily to the upside. Consumer spending remains robust and sales may continue to outstrip expectations. Conversely, should inflation begin to take a toll on households, discretionary purchases may be cut back, similar to what appears to have happened during the recent holiday season.

Over the medium term, in particular the upcoming 2023-25 biennium, risks are balanced. Sales may outpace expectations, or the economy may fall into a recession. Looking back historically, Lottery held up well in both the 1990 and 2001 recessions. However Oregon also did not have line games back then, which makes comparing historical periods more challenging to today. To the extent that player behavior for line games differs than overall consumer spending, discretionary spending, or even gaming in a broad sense, sales could under- or overperform as a result.



Over the long term a few sets of risks stand out. 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 discussed in depth in the March 2023 forecast, the structural impact of aging has been fully absorbed and has minimal impact moving forward as the Millennials are now entering their peak lottery years. 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. This outlook has been revised up some, so the relative decline is smaller than in previous forecasts due to the updated player demographic work.

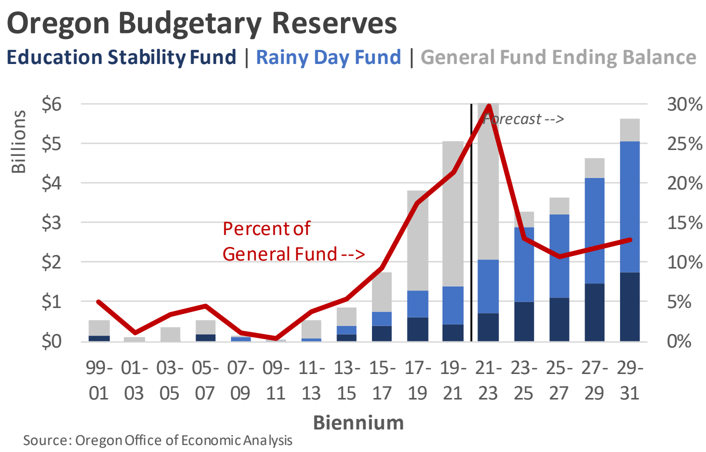
However, longer run upside risks remain as well. While it is true that spending on video lottery grew slightly slower than income and spending last decade, that has reversed in the past couple of years. Some of the strong sales since reopening are due to pent-up demand, strong household finances, and the fact that other entertainment options were either not available initially (concerts, spectator sports) or possibly less desirable due to the virus (long distance travel, movie theaters). Even so, the ongoing strength in video sales likely points toward some more permanent and not just pandemic or temporary changes in player behavior.

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[9] (ORDF) and the Education Stability Fund[10] (ESF). This section updates balances and recalculates the outlook for these funds based on the December revenue forecast.

As of this forecast the two reserve funds currently total a combined $1.9 billion. At the end of the current 2021-23 biennium, they will total $2.1 billion, which is equal to 6.8% of current revenues. Including the currently projected $7.0 billion ending balance in the General Fund, the total effective reserves at the end of the current 2021-23 biennium are projected to be $9.1 billion, or 29.7% of current revenues.



Effective Reserves ($ millions)

	Current Apr-23	*End of 2021-23*
ESF	$675	$708
RDF	$1,213	$1,352
Reserves	$1,887	$2,060
Ending Balance	$7,002	$7,002
Total	**$8,889**	**$9,062**
% of GF	29.1%	29.7%

The forecast for the ORDF includes two deposits for this biennium relating to the General Fund ending balance from the previous biennium (2019-21). A deposit of $220.7 million was made in early 2022 after the accountants closed the books on last biennium. Additionally a $129.0 million deposit relating to the increased corporate taxes from Measure 67 is expected at the end of the biennium in June 2023. This exact transfer amount is subject to some revision as corporate filings are processed, however the transfer itself will occur. At the end of 2021-23 the ORDF will total $1.4 billion.

Looking ahead to the 2023-25 biennium, the ORDF is expected to receive two transfers as well. This includes a projected $279.7 million related to the General Fund ending balance from 2021-23, and $91.6 million related to the increase in corporate taxes. The ORDF is projected to hit its cap of 7.5% of revenues in the middle of FY2026. At that time, should the forecast prove accurate, the ending balance transfer related to 2023-25 would not be

[9] 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.

[10] 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 – 10% 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.

made, and those revenues would be retained in the General Fund. The ORDF would once again hit its cap in FY2032 based on the current outlook.

The ESF will receive an expected $294.0 million in deposits in the current 2021-23 biennium based on the current lottery forecast. At the end of current 2021-23 biennium the ESF will stand at $708.4 million. The ESF is not projected to hit its cap of 5% of revenues until the end of FY2026, when the deposits will then accrue to the Capital Matching Account.

Together, the ORDF and ESF are projected to have a combined balance of $2.1 billion at the close of the 2021-23 biennium, or 6.8 percent of current revenues. At the close of 2023-25 the combined balance will be $2.9 billion, or 11.4 percent of revenues. Such levels of reserve balances are larger than Oregon has been able to accumulate in past cycles, and should help stabilize the budget when the next recession hits.

With a potential recession in the upcoming 2023-25 biennium, the state is expected to meet the trigger for withdrawals should the recession come and should policymakers choose to. In particular the reserve fund trigger of two consecutive quarters of employment declines would be expected to be met based on our office's alternative scenario of a moderate recession. The other triggers may or may not be met. If revenues come in below forecast next biennium, that could trigger a potential withdrawal. And for the ESF only, not the ORDF, a Governor's declaration of emergency could also trigger a potential withdrawal.

Additionally, in the Governor's Recommended Budget for 2023-25, the proposal was to suspend or divert the upcoming distributions to both the ORDF and ESF. Should the Legislature choose to follow this proposal, the impact on the reserve funds would be the following. The diversion of the transfers into the ORDF next biennium, along with the interest earnings would total $479 million. This would mean the ORDF does not hit its cap until FY2031. The practical difference for the ORDF would be diverting the transfer in 2023-25 as in the Governor's Recommended Budget, or diverting the transfer in 2025-27 as the fund will reach its statutory cap.

For the ESF, diverting the transfers would amount to $294 million not going into the fund. The end result is $773 million would be suspended or diverted based on the current forecast and the expected combined reserve fund balances at the end of 2023-25 would be $2.1 billion instead of $2.9 billion, or 8.2 percent of revenues instead of the 11.4 percent currently expected.

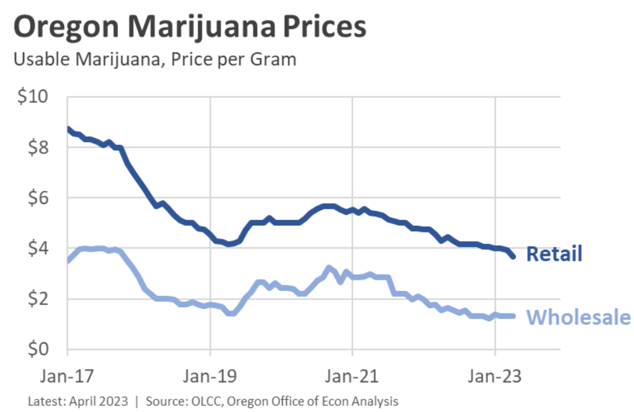
Finally, these are the technical considerations for using the reserve funds in the upcoming 2023-25 biennium. Ultimately policymakers will decide whether to use the funds or not. Regardless of the trigger(s) met, the Legislature would need a three-fifths vote in each chamber to approve an ESF reserve fund withdrawal and a simple majority vote in each chamber to approve an ORDF withdrawal.

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

Recreational Marijuana Tax Collections

The underlying recreational marijuana forecast remains unchanged. Revenues in the current 2021-23 biennium are raised $1.7 million and raised by $1.1 million in the upcoming 2023-25 biennium. The outer biennia are unchanged compared to the previous forecast. The primary reason is sales are coming in as expected, and the previous outlook made substantial changes given market dynamics. What follows is largely the summary provided last quarter and updated where appropriate.

The combination of an oversupply of production and saturated retailer market continues to drive prices lower. Given Oregon taxes marijuana based on the price, the trend is for lower tax collections even as the underlying volume of sales remains steadier. None of this is new.



However, these ongoing issues have really come to a head in recent quarters where actual tax collections are considerably below expectations based on actual sales as firms struggle with profitability in the market, leading to rising tax delinquencies. It's a complicated picture of businesses struggling with market conditions, and being unable to pay all their bills. The cascading impact is for those lower on the priority list, be they growers on consignment or the taxing authority to see the biggest impacts. Oregon's Department of Revenue is working with firms who are behind on their taxes, and through increased enforcement activity expect some revenues to be regained. However, given the tough current market conditions, our office's forecast is taking more of a wait and see approach. Declines in delinquencies represent an upside risk to the forecast in the quarters ahead.

Market Conditions

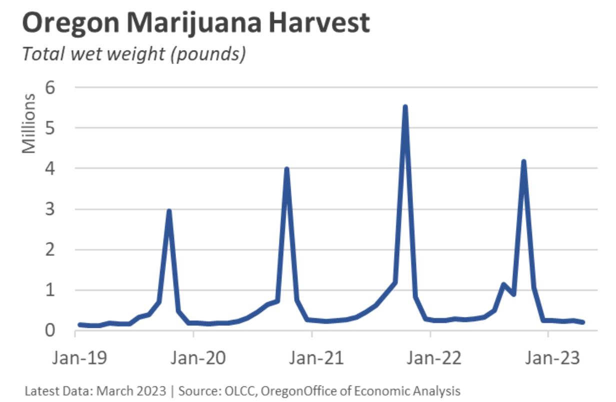
As former Oregon state economist Tom Potiowsky said during the dark days of the Great Recession, the good news is when you're flat on your back, everywhere you look is up. For recreational marijuana, even though it feels that way, it's hard to know if the industry is truly flat on its back yet, or if more weakness is to come first. But eventually a bottom will be reached as demand strengthens with a growing population and economy, and supply stabilizes.

The crux of the issue today are the record low prices. The underlying reason for the low prices is an oversaturated market where production (harvest and inventory) outpaces consumer demand, and there are more retailers per capita than in most other states, leading to increased competition.

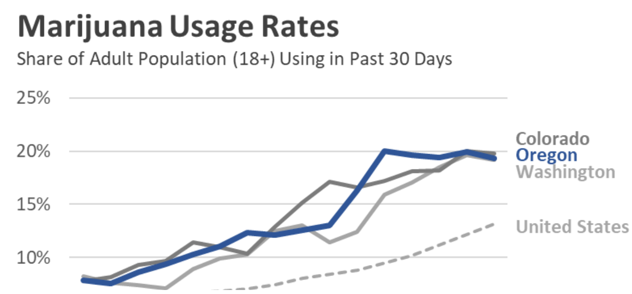
These dynamics are great news for consumers who can enjoy widely available products at low prices. However, one key item to note is that today's lower prices do not appear to have resulted in an increase in quantities sold. Now, OLCC estimates that the total amount of THC sold increased in 2022 compared to 2021 but at the product level the number of pounds of usable marijuana, or number of edibles and the like is more steady. Consumers appear to have stable consumption patterns and have pocketed the savings or had to spend it on other items in their budget due to high inflation.

Typically in a mature market, sales would more closely track incomes and inflation or the cost of production. However in the current marijuana market this is not happening due to the ongoing price declines, a result of increased competition. These dynamics are bad news for firms trying to operate a profitable business.

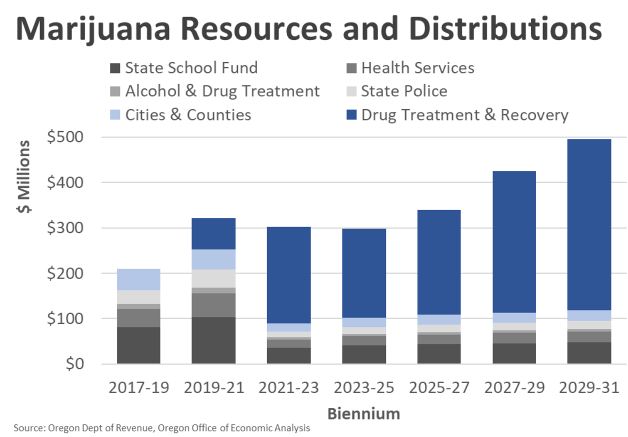
Now, an initial supply response occurred last year. Total harvest in 2022 declined 13 percent compared to 2021, with an even larger 19 percent decline during peak harvest season. That said, the market still is not in balance. Some of our advisors indicated another similar decline this year, bringing harvest closer to 2019 or 2020 amounts would likely bring the market into better balance.



The other source of balance could come from increased consumer demand. That said the low-hanging fruit for demand growth is behind us. Marijuana usage rates are steady in recent years, after increase considerably in the past decade. Many former black market consumers have converted to the legal market, and those that remain may be harder to switch. And underlying population growth has slowed during the pandemic, with only a modest rebound expected in the outlook.



Overall, expectations are the market will stabilize in the not too distant future. Sales and tax collections will remain relatively steady this year and next. Overall revenue and resources will be unchanged from the current 2021-23 to 2023-25 biennium. As supply and demand are expected to get into better balance, some pricing power and profitability will return to the market. Overall sales and taxes will increase with a growing population and economy in the decade ahead. Usage rates and consumption as share of income are expected to hold steady in the longer-run. Both upside and downside risks abound to this outlook.



See Table B.11 in Appendix B for a full breakdown of revenues and associated distributions to recipient programs.

Psilocybin Tax Collections

Ballot Measure 109 which voters passed in 2020 and legalized psilocybin, tasked our office with the revenue forecasting responsibilities. After speaking with other state agencies and private businesses entering the psilocybin industry there are a few important items to note up front.

First, the overall cost of a session to a customer is expected to be in the hundreds, and even thousands of dollar range. Second, the state's 15 percent retail sales tax which was part of BM109 only applies to the product itself and not the overall cost of the session. Third, by all accounts the cost of the product is relatively small compared to the overall cost of a session, where the vast majority of the revenue will go to cover the operational costs of the service center and facilitator.

This newly legal industry is just getting started. The Oregon Health Authority has recently issued some of the first licenses in the state. Once the industry is up and running, OHA will gather data, including the number of sessions, product prices and the like. Unfortunately for now there is no data and our office's initial forecasts are based entirely on assumptions. Those assumptions are as follows.

OHA estimates they will license 28 service centers in the first year. Assuming 20 customers per day, the equivalent of one large class, all year long results in 204,000 individual customers or session over the course of the first year. Some service center centers will accommodate many more customers while others may focus on smaller, more in-depth sessions.

As uncertain as those projections are, the average product price assumption is even more so. Service centers may charge customers whatever price they want to for the actual product. There are two main ways to think through these possibilities, and for now our office is taking a middle ground approach.

On one hand, service centers may charge customers the traditional retail price that includes a markup over wholesale cost which largely relates to production, testing, and distribution costs. Whether the sales tax piece would be an additional charge on top of the session costs overall, or already factored that price is unknown. Tax revenues are estimated to be $1-2 million per year under these scenarios.

On the other hand, service center may charge customers a minimal product cost of $1 or $10, even if that is below their wholesale or acquisition costs. The benefit to doing so would be to increase revenues and profits for service centers and facilitators as less of the overall session price would be sent to pay taxes. This is more likely to be the case if the sales tax is folded into the total session price initially and not an add-on fee when the customer pays. Tax revenues are estimated to be tens of thousands or hundreds of thousands of dollars a year under these scenarios.

For now, given the uncertainty of a newly legal industry our office is taking a middle ground approach and assuming a $10 average product price per session. The state is likely to receive a bit more than $600,000 in the upcoming 2023-25 biennium based on the assumptions discussed above. We know that business practices will vary and time will tell what ultimately becomes the industry standard. Our office will continue to update these estimates as we learn more. Expectations are by this fall there will be useful data to help guide these estimates and they will not be made entirely upon assumptions.

Oregon Psilocybin Retail Sales Tax Revenue (millions)

Average	Biennial Revenue			
Product Price	2023-25	2025-27	2027-29	2029-31
$1	$0.062	$0.064	$0.067	$0.068
$10	$0.618	$0.643	$0.666	$0.679
$25	$1.545	$1.608	$1.664	$1.698
$50	$3.091	$3.215	$3.329	$3.396