REVENUE OUTLOOK

Revenue Summary

In September of odd-numbered years, the revenue forecast closes out the biennium than ended on June 30th. At this time, the Close of Session forecast is calculated by folding any tax law changes made during the legislative session into the May 2021 outlook. This sets the bar for Oregon's balanced budget requirement and its unique kicker law.

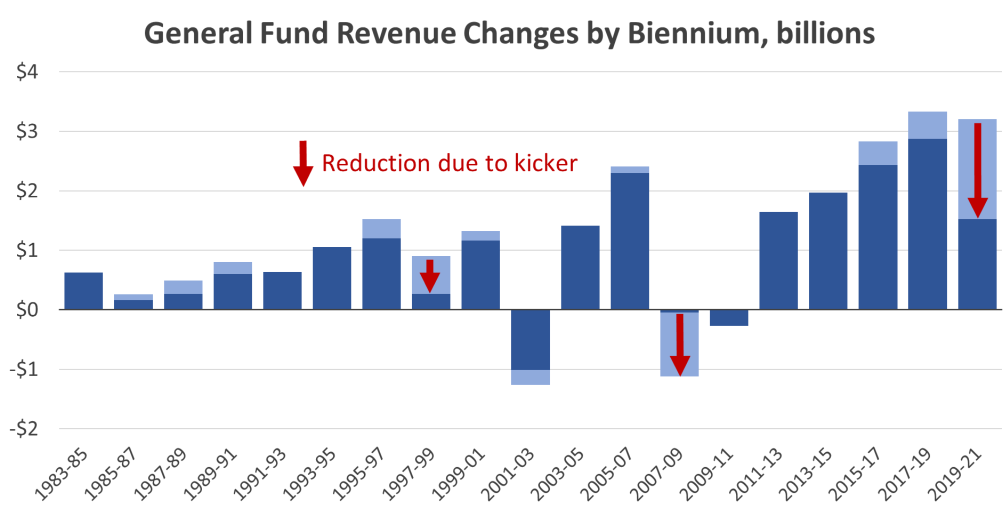
Changes to tax law were relatively small in the 2021 session, with a net revenue impact of -$3.6 million to General Fund resources in the 2021-23 budget period. Personal income tax collections will be reduced by an estimated $38.9 million due to tax law changes. Appendix table B.1b details the Close of Session revenue changes for the current biennium.

The September forecast also reveals where revenues landed in the prior budget period. In a typical year, there are few surprises, since tax collections are relatively small during the early summer. This year was different. Due to a delayed tax filing deadline, much uncertainty remained following the May forecast. When the forecast was developed, the peak tax season had just begun.

By the end of the fiscal year, the 2021 tax season turned out to be a very big one. Collections of personal income taxes, corporate income taxes, lottery sales and the new Corporate Activity Tax all surged at the end of the fiscal year.

As has been discussed earlier, the current business cycle is unique in that household income has risen significantly despite the fact that there are tens of thousands fewer jobs in Oregon than there were before the pandemic began. Given that Oregon is an income tax state, growth in tax collections has been robust. Recent withholdings of personal income taxes are up 17% relative to last year. Payments during the tax season were strong as well, led by collections from high-income taxpayers.

The strong revenue growth seen during the 2019-21 biennium put a cap on a decade of unprecedented expansion in Oregon's General Fund revenues. Over the past decade, General Fund revenues have almost doubled from around $12 billion per year to around $24 billion. Over the decade as a whole, kicker payments amounted to $2.6 billion, reducing cumulative General Fund resources by 2.6%. Last biennium, kicker payments took away half of the General Fund growth. A $1.9 billion kicker credit is slated for the 2021 tax year as well.



2019-21 General Fund Revenues

Gross General Fund revenues for the 2021-23 biennium are expected to reach $23,424 million. This represents an increase of $95 million from the May 2021 forecast, and an increase of $99 million relative to the Close of Session forecast. Most major General Fund revenue sources have outperformed expectations in recent months, but the outlook going forward is stable. Among non-General Fund sources, revenues tied to consumer spending including lottery sales and the new Corporate Activity Tax finished the year stronger than expected.

Table R.1

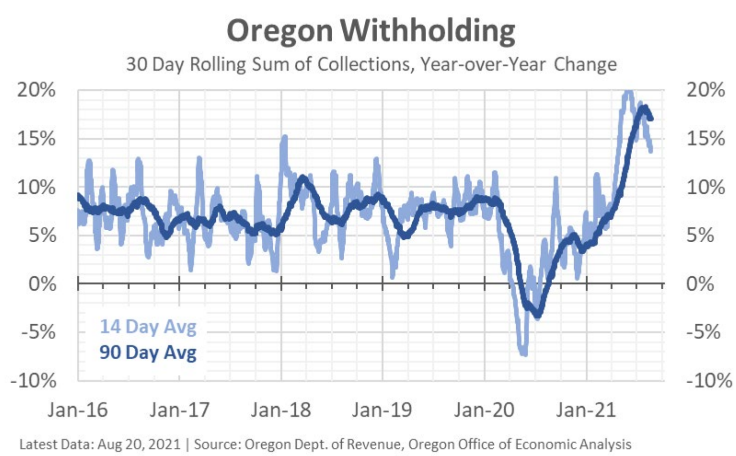
2021-23 General Fund Forecast Summary

(Millions)	2021 COS Forecast	May 2021 Forecast	September 2021 Forecast	Change from Prior Forecast	Change from COS Forecast
Structural Revenues					
Personal Income Tax	$20,628.1	$20,667.9	$20,657.0	-$10.8	$29.0
Corporate Income Tax	$1,344.0	$1,346.2	$1,410.0	$63.8	$66.0
All Other Revenues	$1,353.5	$1,315.0	$1,357.4	$42.3	$3.9
Gross GF Revenues	$23,325.5	$23,329.1	$23,424.4	$95.3	$98.9
Offsets and Transfers	-$171.5	-$171.5	-$174.2	-$2.7	-$2.7
Administrative Actions[1]	-$21.5	$0.0	-$21.5	-$21.5	$0.0
Legislative Actions	-$224.6	-$226.4	-$224.6	$1.8	$0.0
Net Available Resources	**$26,008.4**	**$25,830.6**	**$26,783.3**	**$952.7**	**$774.9**
Confidence Intervals					
67% Confidence	+/- **8.6%**		**$2,014.7**	**$21.41B to $25.44B**	
95% Confidence	+/- **17.2%**		**$4,029.4**	**$19.39B to $27.45B**	

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

Personal Income Tax

Personal income tax collections have far outstripped expectations since the May 2021 forecast. Strong personal income tax collections have come from a range of sources, including a boom in withholdings. Personal income tax withholdings are driven primarily by wages and salaries in the labor market. Along with strong growth in employment and wages, withholdings are expanding at a double-digit rate. In addition to larger paychecks, growth in retirement income and the expanded unemployment insurance benefits have also supported withholdings.

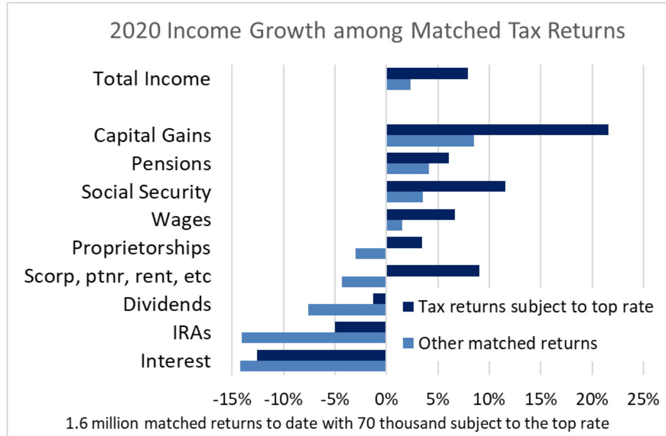


Due to a delayed filing deadline, year-end payments arrived late. Although late, when payments did arrive, they were unexpectedly large. Income from capital gains was a significant factor.

Business income of all types was also surprisingly robust. Given that tax returns reflect the 2020 tax year, large losses of business income were expected. Industries such as leisure/hospitality and education were hit hard by shutdowns and other pandemic-related demand shocks. Also, losses in rental income were expected given eviction moratoriums, and the lack of demand for office space and brick-and-mortar retail. Finally, expenditures made using forgiven PPP loans are considered deductible, reducing business income by as much as $10 billion. Despite all of these negative factors, taxable business income was stable in 2020.

Some of the recent strength of business and investment income can be traced to tax management strategies. In particular, many taxpayers tried to realize additional income in tax year 2020 in anticipation of tax increases at the federal level. Plans have included unwinding some of the corporate and business tax cuts included in the Tax Cuts and Jobs Act, as well as an increase in the tax rate on capital gains.

Looking at tax returns for taxpayers who filed in both tax year 2019 and tax year 2020 helps to highlight recent income gains. However, this represents an incomplete sample since there are still many returns yet to be processed. These outstanding tax returns include many of the highest-income households that file extensions in the fall.



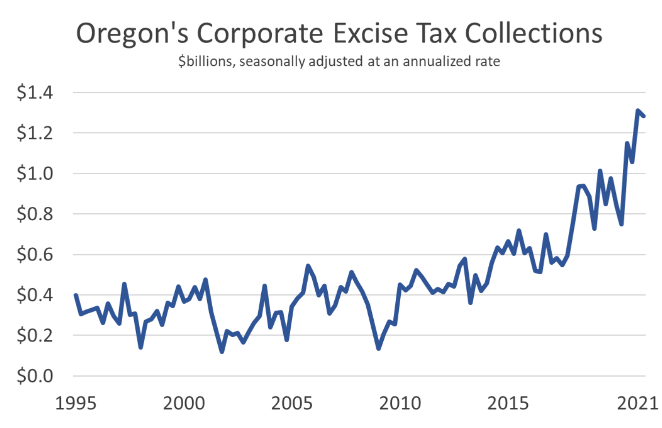
In the available sample, high-income filers have exhibited much stronger income growth than have other taxpayers across every major income stream. Taxpayers subject to Oregon's top tax rate have reported income gains of 8.0% in 2020, while all other taxpayers have reported only 2.4% more income than last year. Although the average tax return has posted some growth, disparities widened further in 2020, with high-income households pulling further away.

Income Group	Adjusted Gross Income*	Rough Estimate of Kicker Size**
Bottom 20%	< $12,100	$30
Second 20%	$12,100 - $29,300	$200
Middle 20%	$29,300 - $52,100	$440
Fourth 20%	$52,100 - $95,000	$790
Next 15%	$95,000 - $195,600	$1,600
Next 4%	$195,600 - $442,700	$3,780
Top 1%	> $442,700	$16,880
Average	**$67,500**	**$850**
Median	**$35,000-$40,000**	**$420**

The robust growth in personal income taxes and other General Fund sources has resulted in an increase in the kicker credit for 2021. The credit now stands at $1.9 billion. The kicker credit is allocated based on 2020 personal tax liability. As such, it is distributed the same as overall tax payments, which are much larger for high-income filers than for other taxpayers. Preliminary estimates suggest that the median 2021 credit will be $420, while the average credit will be $850.

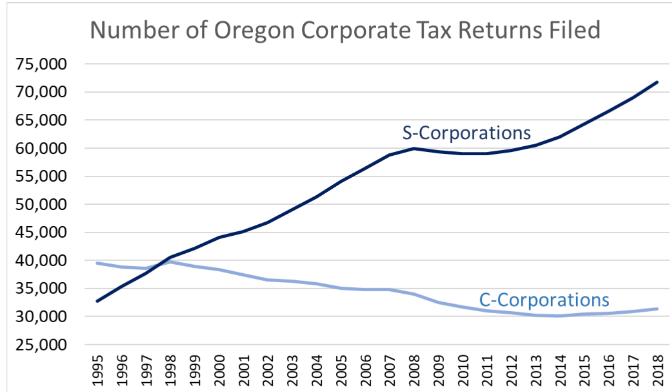
Corporate Excise Tax

Corporate excise tax collections have yet to weaken at all. After a temporary drop at the beginning of the recession, corporate tax collections immediately bounced back and continue to set new records. This stands in stark contrast to the last two recessions when corporate tax collections were cut in half. In fiscal year 2021, corporate collections rose by 44%. When return data becomes available, it will be interesting to see if some of this growth has been fueled by new corporations. The number of C-corporations filing Oregon tax returns has been stuck around 30,000 for several years.



The strong performance of corporate taxes is particularly surprising given that they were expected to come back down to earth even before the recession began. The subtraction for taxes paid under Oregon's new Corporate Activity Tax is also reducing traditional liability. Even so, collections have doubled over the last two budget periods.

While some of this increase likely reflects a permanent increase in the tax base, a significant amount of the growth is expected to be temporary. As with business and investment income on personal tax returns, corporate taxpayers are pulling income forward in advance of possible federal tax legislation.



Record growth in corporate tax collections has led to an $847 million corporate kicker dedicated to K-12 education. Although there is a very long way to go, a $67 million kicker is estimated for the next biennium.

Other Sources of Revenue

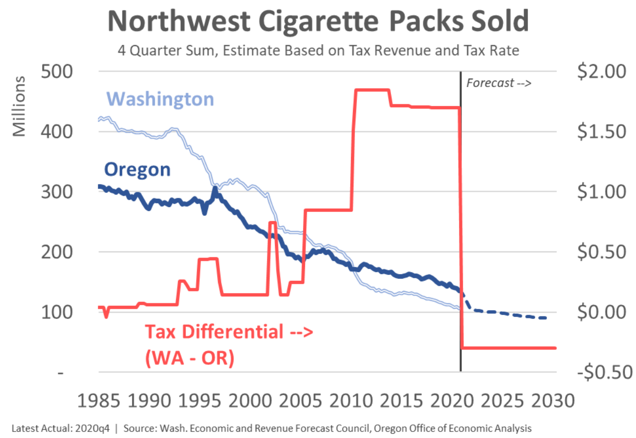
Non-personal and non-corporate revenues in the General Fund usually account for approximately 6 or 7 percent of the total. The largest such source are estate taxes, followed by liquor revenues, and judicial revenues.

Legislation during the 2021 session raised these revenue sources a combined $38.4 million, largely due to budget rebalancing from the 2019-21 biennium and a delay in the implementation of the state's Paid Family and Medical Leave program, which results in a one-time payback of funds to the General Fund. Absent those, legislation reduced the General Fund portion of judicial revenues by $5.9 million, liquor revenues by $15.8 million, and increased Secretary of State fees by $1.5 million.

Relative to the Close of Session forecast, the current outlook for 2021-23 is raised by $3.9 million (+0.3%), driven by an increase in Insurance Taxes (+$4.1 million). The outer biennia are lowered slightly as the reductions in judicial revenues carry forward into the future.

One topic to continue to track are tobacco sales following the passage of Measure 108 at the ballot box last year. To date actual revenues are very close to initial expectations through the first six months under the new taxing regime. Cigarette revenue is coming in approximately $2 million above forecast, while Other Tobacco Products (mostly moist snuff) is approximately $1 million below forecast so far. The largest discrepancy to date is related to Inhalant Delivery Devices which are more than $5 million above expectations. Based on available information, much of this strength was seen in the first quarterly tax return of the year and not the second quarter. As such it is likely that the revenue represents the initial inventory brought into the system and not fundamentally stronger sales than anticipated. However, this will be a revenue stream to closely monitor moving forward. It was not previously taxed, and learning how much of these products Oregonians use will be considerably important in the years ahead as our office forecasts the revenue. See Table B.6 in Appendix B for the full details on tobacco revenues and distributions.

One main reason tobacco sales are important to track is that historically the border tax effect between Oregon and Washington has been very real. Measure 108 raised Oregon's cigarette taxes to $3.33 per pack which are now higher than Washington's at $3.03 per pack, leaving to the side the impact of Washington's retail sales tax. The relative price changes when each state adjusts tax policy have driven short-term tobacco sales trends in each state as well. If historical patterns hold, expectations are that sales in Oregon will drop noticeably this year, while they will likely hold steady, or at least decline more slowly in Washington.



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.

Table R.2

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

Revenue Source	Forecast 2019-21 Biennium	% Chg	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	20,047.0	6.5%	20,657.0	3.0%	24,408.9	18.2%	26,596.6	9.0%	29,610.9	11.3%	33,216.3	12.2%
Corporate Income Taxes	2,041.4	16.5%	1,410.0	-30.9%	1,622.4	15.1%	2,004.4	23.5%	2,228.0	11.2%	2,497.9	12.1%
All Others	1,681.1	25.5%	1,432.3	-14.8%	1,433.8	0.1%	1,505.1	5.0%	1,613.5	7.2%	1,686.8	4.5%
Gross General Fund	23,769.5	8.5%	23,499.3	-1.1%	27,465.1	16.9%	30,106.2	9.6%	33,452.4	11.1%	37,401.1	11.8%
Offsets and Transfers	*(114.8)*		*(174.2)*		*(106.7)*		*(83.4)*		*(92.7)*		*(103.9)*	
Net Revenue	23,654.7	8.6%	23,325.0	-1.4%	27,358.5	17.3%	30,022.8	9.7%	33,359.7	11.1%	37,297.2	11.8%

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.

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]

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 together with more timely updates produced by the Legislative Revenue Office.

Corporate Activity Tax

HB 3427 (2019) created a new state revenue source by implementing a corporate activity tax (CAT) that went into effect January 2020. Collections for 2019-21 totaled $1,374.9 million, which is somewhat higher that the May forecast due to stronger estimated payments in the second quarter. The forecast for the current biennium is $2,376.8 million, only slightly above the prior forecast.

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.

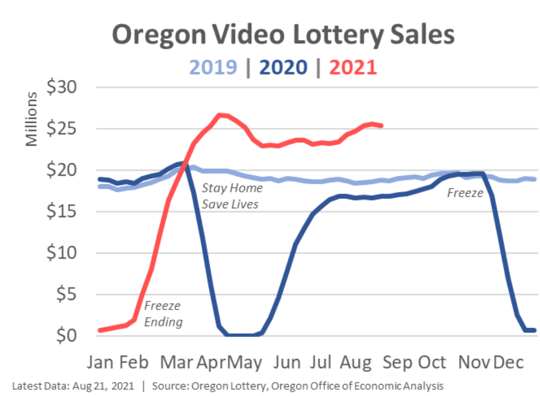
In terms the macroeconomic effects of a major new tax, the Office of Economic Analysis starts with the Legislative Revenue Office's (LRO) impact statement and any Oregon Tax Incidence Model (OTIM) results LRO found. At the top line, OTIM results find minimal macroeconomic impacts across Oregon due to 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.

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 shown in Tables B.1 and B.2.

Lottery Earnings

Our office continues to use video lottery sales to help inform the overall macroeconomic outlook. Video sales are the best real-time consumer spending data we have in Oregon, and the revenue comes from an indoor activity that is among the most impacted by the pandemic and shutdowns in the past 18 months.

To date video lottery sales are holding strong as the delta wave surges. Household income and savings are up, which allows consumers to spend the money if they want to and feel safe enough doing so. While the OpenTable data indicates the number of seated diners going out to eat in Oregon has softened over the past couple of weeks, any slowdown in video lottery sales is much less pronounced.



The current forecast is raised as a result. Not only has video continued to maintain near record-level sales, this strength is now expected to continue into the fall. Households are still flush. Their accumulated savings is expected to boost spending for months, if not years.

The explicit assumption this forecast makes is video lottery sales will slow in November, and revert back to a steady share of current income. This is for at least three reasons.

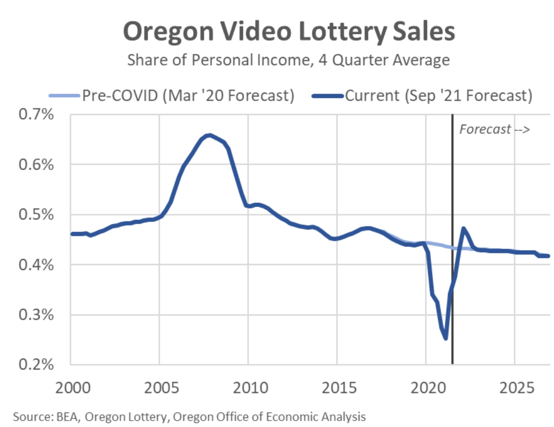
First, the delta wave of the pandemic will wane. Oregonians will continue to move back toward our pre-pandemic lifestyles including going back into the office more frequently and the like. Importantly, other entertainment options like sporting events and concerts will once again compete for households' budgets in greater number. Video lottery faces increased competition as the pandemic wanes.

Second, for most Oregonians their accumulated savings, while impactful, are relatively small. Later this year, many Oregonians' recovery rebates and "excess" unemployment insurance benefits, defined here as greater than 100% wage replacement, will largely be spent down. Rough estimates based on current incomes, the relative size of this savings, and spending patterns suggest this may occur by Thanksgiving. As such our office has video lottery sales slowing in November, even as the exact timing remains an open question and will vary from household to household. After this time, however, consumers will need to rely more on current incomes and less on savings. Video lottery should slow as a result of this process.

Third, sales are also likely to slow from these record levels as pent-up demand is satiated. Total video lottery sales since the start of the pandemic remain about 25 percent below pre-COVID expectations. This has occurred at the same time incomes are 5-10 percent higher than expected. While weekly sales this year are setting records, they have not fully offset the impacts of the two shutdown periods in Oregon when sales were nonexistent. As such, households likely have some continued pent-up demand for gaming, but at some point this should dissipate.

All told the lottery outlook in the current 2021-23 biennium is raised by $48.5 million (+2.9%). Given the biennium just started, this is a substantial increase. The risks are likely to upside as well, depending upon just how long sales stay at their strong levels. To the downside, the risks primarily lie with any potential shutdowns or more stringent health policies. As has been the case twice so far during the pandemic, when bars and restaurants are takeout only, the Oregon Lottery shuts down the video lottery terminals in geographies affected by the shutdowns, and sales go to $0. Should any shutdown be put in place due the pandemic, video lottery sales would decline overnight. Our office's revenue outlook would adjust accordingly.

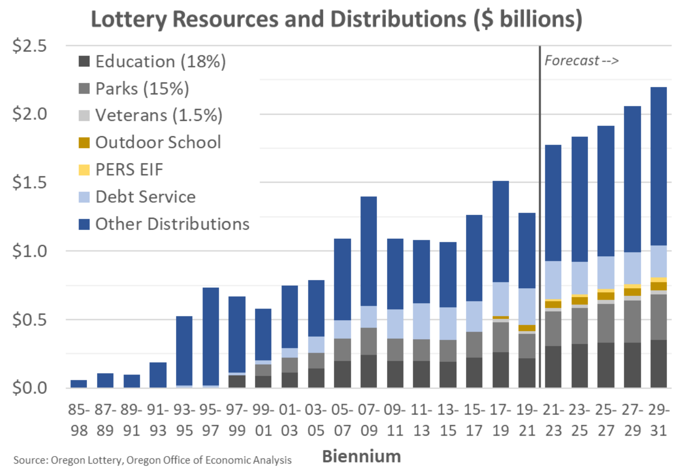
Over the longer-run the video lottery outlook is raised by 0.6 – 0.8 percent, keeping in line with the slightly stronger personal income outlook. Available resources in each biennia, from 2023-25 to 2027-29 are increased by $12-15 million.



That said, there remains upside risks in the years ahead. It is possible that consumers have permanently altered their behaviors and how they spend their household budgets. For now our office is keeping the video lottery sales outlook closely tied to our personal income and consumer spending forecasts. However, if consumers do spend a somewhat larger share of their budget on lottery in the years ahead, it would translate into considerably more state resources. That said, the past 18 months that have upended our lives in many ways are unlikely to be a good barometer of where we end up after the pandemic is managed and brought under control.

Lottery Outlook and Distributions

Big picture issues to watch include broader national trends in gaming markets, demographic preferences for recreational activities, and to what extent consumers decrease the share of their incomes spent on gaming. Up until the past couple of years, consumers had remained cautious with their disposable income. Increases in spending on gaming had largely matched income growth.



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.

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

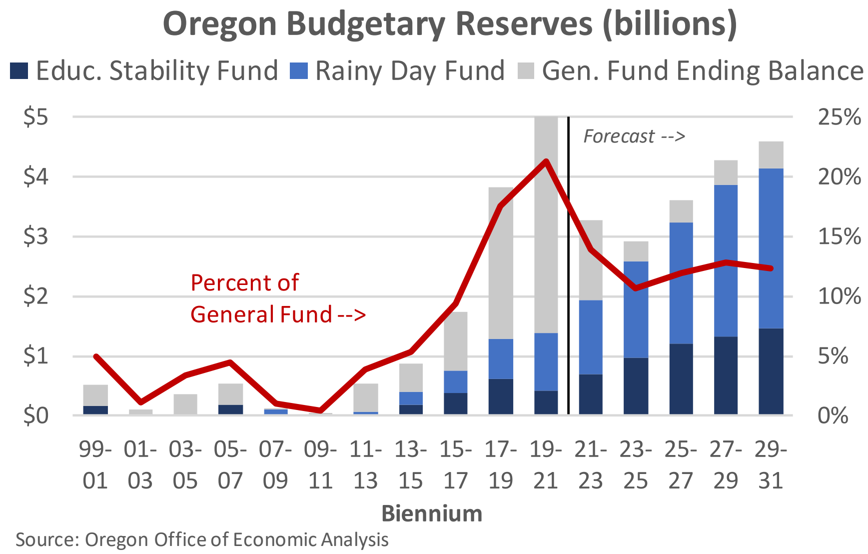
Budgetary Reserves

The state currently administers two general reserve accounts, the Oregon Rainy Day Fund[6] (ORDF) and the Education Stability Fund[7] (ESF). This section updates balances and recalculates the outlook for these funds based on the September revenue forecast.

As of this forecast the two reserve funds currently total a combined $1.41 billion. At the end of the current 2021-23 biennium, they will total $1.95 billion. Including the currently projected $1.33 billion ending balance in the General Fund, the total effective reserves at the end of the current 2021-23 biennium are projected to be $3.28 billion, of nearly 14% of current revenues.

[6] 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.

[7] 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.



Effective Reserves ($ millions

	End 2019-21	*End 2021-23*
ESF	$415	$690
RDF	$962	$1,256
Reserves	$1,377	$1,946
Ending Balance	$3,697	$1,330
Total	**$5,074**	**$3,276**
% of GF	21.3%	13.9%

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 $224.6 million is expected to be made in early 2022 after the accountants closed the books. Additionally a $58.2 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 $1.26 billion.

Looking ahead to the 2023-25 biennium, the ORDF is expected to receive two transfers as well. This includes a projected $254.5 million related to the General Fund ending balance from 2021-23, and $67.5 million related to the increase in corporate taxes. The ORDF is not projected to hit its cap of 7.5% of revenues until FY2029.

The ESF will receive and expected $275.4 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 $689.7 million. The ESF is not projected to hit its cap of 5% of revenues until FY2027, when the deposits will then accrue to the Capital Matching Account.

Together, the ORDF and ESF are projected to have a combined balance of $1.95 billion at the close of the 2021-23 biennium, or 8.3 percent of current revenues. At the close of 2023-25 the combined balance will be $2.58 billion, or 9.4 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.

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

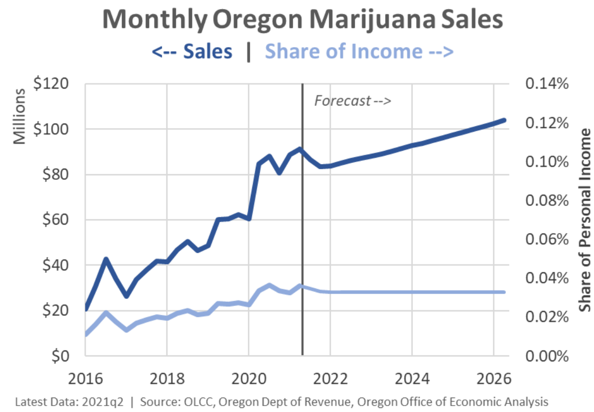
Recreational Marijuana Tax Collections

Marijuana sales continue to track the forecast closely. No fundamental changes are made to the outlook, other than updating for the most recent few months of sales.

Looking forward there are three things of note.

In the near-term, sales are expected to slow as the pandemic improves and Oregonians continue to return to their pre-COVID lives. Some of the pandemic-related increase in sales is likely to come off, even as most sticks.

Over the medium- and long-term, sales are expected to increase as Oregon's population, income, and spending grow. However at this point our office does not have a further increase in marijuana usage rates built into the outlook. As such, the risks lie primarily to the upside should usage and broader social acceptance continue to increase. The next National Survey on Drug Use and Health should be released in early 2022 providing an update on usage trends by age and across states in the past year. In consultation with our advisors, should we expect usage rates to increase further in the years ahead, the longer-run forecast would be adjusted accordingly.



The third forecast item of note is a technical but potentially impactful change to the forecast beginning in 2028. Currently medical marijuana is tax exempt. Previous forecasts treated this exemption has permanent and no revenues from medical marijuana were included. What's changed is that during the recently completed legislative session, HB 2433[8] clarified that medical marijuana's tax exemption meets the definition of a tax expenditure. For more on the topic of tax expenditures see this Legislative Revenue Office's report[9].

In Oregon, tax expenditures automatically sunset after six years. In order for them to be extended in the future, the Legislature must act to do so. Our office does what is considered a current law forecast. Given current law now explicitly states medical marijuana's tax exemption sunsets in 2028, our office has raised the long-term marijuana revenue forecast as a result. Whether or not medical marijuana will continue to be exempt after this date will be determined by Legislative action in the years ahead.

See Table B.11 in Appendix B for a full breakdown of revenues, including the newly added medical marijuana revenue, and associated distributions to recipient programs.

[8] https://olis.oregonlegislature.gov/liz/2021R1/Measures/Overview/HB2433
[9] https://www.oregonlegislature.gov/lro/Documents/HB%202128%20Report%20Final.pdf