The typical responses to fiscal stress—creative accounting, borrowing against future revenue to pay current costs, short-sighted use of tobacco settlement revenue, across-the-board cuts, and reductions in services to those with the least political clout have only served to weaken the entire enterprise…it is time for a more common sense solution to the fiscal crisis by addressing the issue of how citizens can get the most value for the taxes they pay.

From the introduction to *The Price of Government: Getting the Results We Need in an Age of Permanent Fiscal Crisis*

By David Osborne and Peter Hutchinson

Education Funding In Oregon:

HOW WE GOT INTO THIS MESS, AND HOW TO GET OUT

by Scott Bailey

For as long as I can remember, Oregonians have been locked in a fierce debate on public finance in general, and school (K-12) finance in particular. The days of my youth include memories of fundraising to save high school athletics in Portland (in the late 1960s) and the failed sales tax proposal sponsored by Tom McCall, perhaps the most popular governor in Oregon's history. Beginning in the late 1970s, almost every general election featured a ballot measure intended to change the state tax structure. Oregonians finally passed Measure 5 (limiting property taxes) in 1990, and followed up with Measures 47 and 50 in 1996-97, but dissatisfaction with taxes and financing continued. Today, most Oregonians would agree that we need tax reform, but few are able to articulate why or to what end.

The debate about taxes and schools is as American as apple pie, and cuts to the core of what our country is all about—the intertwining of economics and politics. The debate also involves some interesting issues about economics and taxation. In this article I discuss how by the early 90s a major shift in the base for property taxes from businesses to homeowners had misled people into believing that government spending was spiraling out of control. I also explain the backlash—how this shift in the property tax base inspired Measure 50 and combined with equalization in school funding to create our current fiscal crises in education. My conclusion explores ideas for changing the piecemeal and emotional way we currently think about the budgeting process for education.

A Brief History of the Property Tax

Oregon's recent tax history can be divided into two eras—before Measure 5 and after Measure 5. Before 1990, local property taxes paid for about 60 percent of the K-12 budget. Voters in local districts could establish a permanent tax base, which specified a total dollar amount that could be raised by property taxes. Through simple division (total property value divided by total tax base) a tax rate was applied to property throughout a local tax district. There was a strict limit on the tax base: it could only rise by 6 percent per year, unless a special vote was taken. Since population growth averaged 2 percent a year, and inflation around 4 percent, this tax limit kept spending in check.

The chief problem with the funding system for K-12 before 1990 was equity. School districts that had lots of high-value industrial and commercial property within their tax base could have relatively low tax rates and still provide plenty of support for education. An outstanding example is Millersburg, outside of Albany, a small city that includes several large industrial properties, but in general the larger urban areas did well while small towns and rural areas did not. Some school districts, like Estacada, could never get their voters to approve a permanent tax base, and had to put their budget up for a vote every year; when the measure failed, as it did from time to time, schools would close down in the middle of the year.

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While such inequities caused much hand-wringing, they didn't lead to decisive action. A different, much less visible development inspired widespread voter dissatisfaction instead—and led to the eventual passage of Measure 5.

In the late 1960s, homeowners paid about 28 percent of the total property tax bill in Oregon while business including land-

Shifts in the base for property taxes misled people into believing that government spending was spiraling out of control.

lords paid 72 percent. By the late 1980s homeowners were paying 42 percent of the total. During this period, property taxes per capita increased by an average of 20 percent. The property taxes paid by homeowners, however, jumped by about 80 percent (both figures adjusted for inflation). Put differently: if this shift hadn't occurred, homeowners in 1990 would have enjoyed the same level of government services while paying a third less in property taxes, and would have been much less susceptible to the arguments of the anti-tax advocates who initiated Measure 5. How did the shift of property taxes from business to homeowners take place? While no definitive study has ever been done, there are three likely culprits: tax breaks for big business, bigger homes, and growth of the service economy.

- During the 1970s, the State Legislature approved several reductions in the way business property was taxed, thus reducing the tax income from business. This resulted in homeowners paying a higher percentage of their property value in taxes each year to pay for government services, which stayed constant relative to the population.
- The trend toward bigger homes in the last 3 decades also increased the percentage of overall property taxes paid by homeowners. As incomes rose, the average square footage of new homes rose as well, this meant that homes took up a bigger percentage of total property value.
- In 1960, 28 percent of Oregon's jobs were in manufacturing. A small manufacturing firm with fifty workers would typically require five acres of valuable land, buildings that housed expensive machinery, and company-owned trucks for transporting goods. By 1980, factory jobs were only 21 percent of the economy, and today are only 13 percent; most new jobs have been in service industries. To better understand how this might change the tax base; contrast the small manufacturer with a fifty-worker fast-food outlet located on a relatively small lot with one deep-fat fryer and a refrigerator.

The lower capital requirements of the service economy are the reason the value of taxable property per worker decreased over the past few decades. As Oregon's population has grown, the total value of its homes grew faster than the total value of its business property.

All three of these forces are still at work. Rising home property values due to higher incomes and an influx of cash-rich Californians in the early 1990s only exacerbated the problem. Measure 5 was supposed to provide tax relief for Oregon homeowners. However, the biggest beneficiaries of the new law turned out to be large businesses and, in particular, out-of-state landowners—a Portland State University study showed that half of downtown Portland, with some of the most valuable property in the state, had out-of-state ownership. The current share of property taxes paid by homeowners has been estimated at over 60 percent.

Aroused Homeowners

Again, no one has identified a specific cause for the shift, or defined the relative contributions of a number of likely factors, but we do know the shift was significant. More importantly, the shift led the average Oregonian homeowner to make a logical but incorrect deduction: that government spending was spiraling upward at the same rate as their tax bill.

How did a quiet shift of property taxes from business to homeowners take place? ...There are three likely culprits: tax breaks for big business, bigger homes, and growth of the service economy.

This misunderstanding proceeded in tandem with what is known by tax economists as the great disconnect. Just about every public survey has shown that most Oregonians want more public services—or at least they don't want them reduced. The same surveys also indicate people want to pay less in taxes. However, even with higher property taxes, "Government Spending Out of Control," historically voters were hesitant to approve tax cuts. This changed with Measure 5, which ingeniously avoided the traditional reaction, "Don't Hurt Our Schools!," by phasing in property tax cuts over five years, and mandating that the state would cover the difference in school budgets during the phase-in period.

The disconnect in people's desire for more government services as well as lower taxes cuts to a core problem of our modern republic. Public opinion polls conducted by Robert Sahr and Brent Steel and sponsored by Oregon State University have consistently shown that a majority of Oregonians lack even the most rudimentary knowledge of our tax structure. Nor do they have a good idea about how local and state governments spend their money. The latest poll also shows that the less knowledge of public finance respondents have, the bigger their estimate of government waste. Sahr in his article *The Tax Tug of War* in this issue of *Oregon's Future* discusses perceptions of waste in government and how such perceptions affect voter's choices in general. He speculates that this belief in large government waste may explain people's idea that we can reduce taxes without affecting services.

Measure 5, Equalization and State Funding For Education

Over a five-year period in the early 1990s, funding for education in Oregon shifted dramatically. As Measure 5 was phased in, receipts from property taxes fell by an inflation-adjusted $700 million (23 percent). During this period, the state was required to backfill school budgets with money from the general fund. Sources of education funds shifted from roughly 60 percent local, 30 percent state, and 10 percent federal, to 30/60/10.

At the same time, another simmering issue came to a boil. The state, which had been under legal pressure on the issue of inequitable school funding, implemented an equalization formula to redistribute funds from rich school districts to poor ones. Local education property tax dollars and state education funds were put into one pot, and distributed to school districts on a per-student basis. The formula was weighted to account for students with special needs, along with factors such as poverty, teacher experience, and small rural school districts. Some districts that had been perennially pinched found themselves flush with funding, while others that had been relatively well-funded were forced to lay off staff. The result was more equity in funding, with urban areas subsidizing rural ones.

Many observers (including the author) expected the state budget to be squeezed for funds in the aftermath of Measure 5, with an ensuing public outcry.

This didn't happen for three reasons. First, during 1990s, an influx of Californians, cash rich from selling their homes, made their way to Oregon to escape from their state's recession. They helped bid up property values and increased revenues as they built new houses, so the decline in total property tax receipts was not as large as expected. Second, Oregon's economy shifted into high gear early in the decade, with new high-wage, high-tech jobs boosting incomes and income tax revenues. Third, the stock market bubble led to huge increases in capital gains, also taxed as part of income. Capital gains are also impossible to predict with any accuracy and the revenue forecasts were consistently low during the 1990s, resulting in a string of big "kicker" refunds. Only the onset of the 2001 recession brought Oregon's fiscal balloon back down to earth.

Meanwhile, the shift from local to state funding had led to a more equitable education system, but also a switch in roles between winners and losers in the funding game. It also shifted power from local school boards to the state legislature. By the mid-1990s, parents from the losing side were biennial regulars in Salem, lobbying for more school funds, sometimes at odds with advocates for human services and corrections.

The Hard Landing

Education funding on a per student basis, adjusted for the general rate of inflation, remained flat during the high tech boom from 1990 through 1997. But comparing the cost of providing education with the price of consumer goods and services is misleading. The major cost of education—compensating teachers —rose faster than the general rate of inflation in the 90s. Wages, especially those for occupations requiring a college degree, increased faster than inflation throughout the economy due to tightening labor markets. The cost of health insurance jumped at double-digit annual rates, and pension costs ate up a bigger piece of state budgets because PERS was structured to match returns on high risk investments chosen by employees—investments that were paying off. Furthermore, the number of special needs students (students with disabilities, or new immigrants who didn't speak English) rose as a percentage of the total student body. As a result, in spite of the economic boom, many districts cut back education services during this period.

Districts that had lost funding in the equalization process had a particular axe to grind. They took a hit with equalization, and then another hit with the rising costs of providing services. When they took their argument to the Legislature, they succeeded in winning a small breach in equity: legislation was passed allowing voters to approve a small increase in their property taxes devoted to education.

The funding squeeze that didn't develop in the 1990s finally showed up with the decline of stock prices and the onset of the 2001 recession. Oregon's per student education funding had remained above the national average until the 2001-02 school year when it dropped from 102 percent to 99 percent. The next year it plummeted to 91 percent, before recovering slightly to 92 percent in 2003-04 (without the Multnomah County Income Tax, it would have been 91 percent). Support for human services such as healthcare for low-income families and services for the disabled and the elderly were also cut back.

Citizens should be suspicious of their governments, but for our republic to succeed, we need an informed suspicion.

According to the Tax Foundation, Oregonians now pay less state and local taxes as a percent of personal income than 33 other states. Since 1990, our ranking in this category has fallen from tenth highest to thirty-fourth.

Now What?

Much of the discussion on tax reform and school funding in Oregon focuses on technical fixes; tweak this, substitute this tax for that, etc. None of the alternative plans being proposed stands a chance of adoption until a clear majority of voters agrees on some basic premises. The fundamental questions have to do with the amount of money that needs to be raised, and who will pay it.

What level of public services do we want, and how much money is adequate to maintain services at that level? Because a majority of voters lack basic knowledge of taxes and expenditures, they have no clear way of answering that question. Not incidentally, very few people guess correctly when asked Oregon's national ranking based on total state and local taxes. With voters wanting both high levels of service and low taxes, the majority believe that cutting government waste would solve the services problem. So corollary questions are: how much does the government waste, and how much waste is tolerable?

The second basic question is: Who pays? We can tax wealth, income, and consumption, broadly or narrowly. The type and scope of taxation determines both the stability of revenues and the burden of payments. As with tax adequacy, there is widespread lack of knowledge about the basics of the forms of taxes and who pays them. There is consensus that we need to stabilize revenues. While there are relatively easy technical fixes for stability, the issue has been caught up in the larger debate around adequacy.

What we need are organic ways for a threshold of citizens to get a basic understanding of taxes, the budget, and realistic views of waste. Citizens should be suspicious of their governments, but for our republic to succeed, we need an informed suspicion. The question is, how do we get there?

Any solution(s) would have to address three dimensions. First, we need to change the way governments talk about their budgets—the language of budgets. Second, we need to widen the frameworks in which we as citizens view taxes and expenditures. We need a bigger picture of the whole process. Third, we need structural changes in the relationship between citizens and their governments.

Currently, the language of budgets is too often the language of accountants. Even when government budgets are readily available to the public, too often they are simply a table of line items that make little connection between dollars and programs, and fail to address issues of efficiency or effectiveness, or even which year expenses or revenues are really created.

The Chalkboard Project makes a very important point about school budgets in its Feedback Guide. In their material, they ask the right question: "How can we use the budget process to display an accurate cost picture, demonstrate accountability, and earn public confidence?" They continue by presenting education costs in a number of ways (per pupil for different types of students, etc.), and include some comparisons between state and national spending. While their efforts fall short of the mark, they still deserve credit for trying. *(Please see Scott's comment on the Chalkboard data at the end of this article —Ed)*

A different approach might use much of the factual material that the Chalkboard Project presents, but in a different format. It could start with the basic questions a citizen might pose: How do I know the money is being spent on the things that will make the most difference in our schools? How do I know it is being spent efficiently? What should I look for when comparing Oregon with the national averages on taxes and education costs? What does it mean if we are spending more or less money in a spending category?

These questions flow into the second point. We need different frameworks in which we as citizens view budgets and taxes. Currently, there are two popular perspectives: naive cynicism and helpless optimism. The former has its roots in Jeffersonian "keep government small," but has become ossified in its knee-jerk reaction to bureaucracy. It expresses well the gap between government and the citizenry. Why give more money to government if theyare just going to waste it? The optimistic perspective gives more weight to the important services government provides, but doesn't adequately acknowledge the lack of accountability of most government agencies.

How do I know the money is being spent on the things that will make the most difference in our schools?

Some frameworks that could be cultivated:

- The healthy skeptic. Government is not evil, but that does not mean we should never view its actions with suspicion.
- The informed consumer. We need to constantly ask: What are we buying here? Are we getting a good value?
- The savvy investor. Can we save money in the long run by investing now? Which investments have the best payouts? When is it time to cut one's losses and move on?

Healthier frameworks would require a substantial shift in relationships between government and citizens—easier said than done when we're too busy watching American Idol to pay attention to the gory details of running a state agency. But it's all about relationships:

- Public outreach on an ongoing basis—e.g. speaking to service groups, scheduling informal focus groups, internet surveys.
- Clear explanations of mission and programs, the budget and how it connects with results, program effectiveness, and plans for improvement.
- Cost-benefit analysis—what more money would mean for the agency, what less money would mean in terms of consequences.

What is missing is a nonpartisan intermediary—a good government group, for lack of a better term—that would, on the one hand, frame the questions that an informed consumer and savvy investor would ask, and on the other hand, link government accountability efforts to a broad group of stakeholders throughout the state. Such an organization could:

- Prod government agencies to translate their budgets and programs into accountable language.
- Work with the secretary of state's office on follow-up of agency audits to pressure agencies to become more effective.
- Broadcast findings—good and bad—to citizens and media all around the state.
- Involve its members in a communication network that raises the level of understanding of public finance in the state.

Closure

My thesis is that economic changes and tax breaks changed the nature of the property tax in Oregon during the 1970s and 1980s, and helped to decrease the trust Oregonians had in their government. The conditions of mistrust—the growing gap between government and citizens—were already there. The result is that substantial numbers of voters shifted into a naïvely cynical view of government that will make tax reform difficult if not impossible, and will arguably leave the state unable to meet the growing challenges of a global economy.

To repair the breach between citizens and bureaucracies, we need better communication on the part of government agencies, more sophisticated questioning from citizens, and structures—including independent, non-partisan organizations—that bridge the gap between Oregonians and their governments.

Scott Bailey has been the Regional Economist for Southwest Washington with the Washington Employment Security Department since 1989. He is the author of the Washington Wage Report, and has published research on the business growth and decline in both Washington and Oregon. A native of Portland, he is president of Community & Parents for Public Schools, a grassroots organization working to improve the quality of education in Portland Public Schools, where his two children attend school. He holds an M.S. in economics from Portland State, and a B.A. in Liberal Studies from Oregon State University.

A Comment on the Chalkboard Project Data

by Scott Bailey

The Chalkboard Project attempts to shed light on education spending data—a daunting task. Unfortunately, they fall short of success. For example, their guide uses one type of per-pupil spending in one section, and another type in the following section. Which is the citizen to believe? The data is two or three years old, and so does not reflect large cuts that came in subsequent years. Snapshot data is used, without a discussion of trends. No connection is made between spending and what the money is buying. What consumer would make this kind of purchase? They use the term “accountability” without ever defining it (which does keep them in good company in the education world). Their data provides no comparison with private schools. See their guide at http://www.chalkboardproject.org/citizen_feedback.php.

The Chalkboard Project: What Do You Think, Oregon?

by Sue Hildick, President

When the five Oregon foundations sat down in 2003 to create what now is The Chalkboard Project their chief goal was, and still is, to raise the level of public debate on K-12 quality, accountability, and finance. As a long-time Oregonian with a rich perspective on taxation, Mr. Bailey’s commentary makes a valuable contribution to that debate. If every Oregonian thought as long and hard about K-12 finance as he, we would have solved the problem long ago or collapsed trying.

Among his key recommendations is a call for transparent education budgets. On this point, we couldn’t be in more agreement. Before meaningful education reform can advance, Oregonians need clear, concise, and accurate information on the services they receive for their education tax dollar. The Chalkboard Project is committed to fostering clearer budget presentations through our own analyses, as well as proposed tracking systems that chart spending per student across grades, schools, and programs.

Our first attempt at shedding light on K-12 spending appears in our Citizen Discussion Guide (http://www.chalkboardproject.org/citizen_feedback.php) and reports—for the first time ever in Oregon—how spending per student differs across key programs (e.g., regular education, special education, English as a Second Language, Talented and Gifted, and the like). Mr. Bailey believes we have fallen short here, but I suggest he and other interested Oregonians read on.

In addition to the materials in our Citizen Discussion Guide, Oregonians can learn more about K-12 finance in two recently released reports: *The Condition of K-12 Education in Oregon* and *Oregon School Finance: A Review of System Stability, Adequacy, Equity, and Transparency* (http://www.chalkboardproject.org/learn_more.php). Taken together, the reports provide a wealth of information on K-12 spending over time, the evolution of Oregon’s local option process, how equalized spending affects districts in different areas in the state, and how Oregon’s K-12 staff salaries and benefits compare to those across the nation.

That’s not to say we have all the answers. Far from it. Conveying budgets to a busy public is challenging work. Presentations that work well with one audience flop with another. As part of our statewide civic engagement process, we are formally testing alternative budget presentations and beginning to understand which add value and which simply add to the confusion.

We’re learning more with every meeting and have a ways to go, but we’re here for the long haul.