

BUDGET ENVIRONMENT

Budget Environment

Expenditure Drivers

Inflation

The rate of inflation is expected to remain moderate through the 2009-11 biennium.

- As measured by the U.S. Consumer Price Index (CPI), inflation is projected to decline from current levels. FY 2011 will see a 1.9 percent increase.
- The GDP implicit price deflator is forecast to hover around the 2 percent range through FY 2011.
- Medical service inflation is projected to be higher than other inflation factors. Medical CPI will stay around 3 percent in both FY 2010 and FY 2011.

| Forecasted Inflation FY 2008-2011 | | | |
|--------------------------------------|------|---------------------|-----------------|
| FY | CPI | Medical Deflator | GDP Deflator |
| 2008 | 3.0% | 3.1% | 2.1% |
| 2009 | 1.5% | 3.2% | 1.7% |
| 2010 | 1.9% | 3.0% | 1.8% |
| 2011 | 1.9% | 2.9% | 2.0% |

Demographics

- Population growth is the major state government budget driver. Policies and alternative opportunities, however, often modify the direct impact of the population change on the state budget allocations. Demands for public resources as well as a state's revenue and economic health depend upon the size, composition, structure, and characteristics of its population.
- Oregon has been a favorite destination for people seeking jobs, quality of life, and retirement. Census 2000 enumerated 3,421,399 persons in Oregon on April 1, 2000. This is an increase of 579,078, or 20.4 percent since the 1990 Census count. Although growth slowed down during the first half of this decade, it has picked up the pace in recent years. Oregon's population is expected to grow at moderate rate and reach 3.957 million by the year 2011, adding an average of 52,400 persons annually between 2009 and 2011.
- Oregon's population growth rate for the period of 1990 to 2000 was eleventh fastest in the nation. The slowdown in Oregon's economy after 2000 resulted in slower population growth as well. Between 2000 and 2007, Oregon's population growth was thirteenth highest in the nation. However, population growth rates in all of our neighboring states (except California) exceeded that of Oregon during this period. Therefore, high rates of population growth have been a regional characteristic and Oregon is lagging behind most of its neighbors.
- Nearly 73 percent of the 1990-2000 population growth was due to net migration, where the number of in-migrants exceeded the out-migrants. The net migration component in population change declined to 65 percent during 2000-07. Oregon's growing economy during the 90's coupled with the shortage of workers, especially in the hi-tech sector, attracted job seekers from other states and around the world. Net migration averaged 42,000 annually during the 90's and declined to 29,000 annually during 2000-07. In the 2009-11 biennium net migration is expected to average 35,000 annually, showing continued economic recovery. Net migration will account for 68 percent of population growth. The size and composition of Oregon's future population depends upon the nature of our economy as Oregon's economic growth has relied on its ability to attract highly skilled workers from elsewhere.
- With the high volume of in-migration, the racial and ethnic composition of Oregon's population is becoming increasingly diverse. Asian and Black racial groups and the Hispanic ethnic group have grown very rapidly in recent years. Between 2000 and 2007, Black or African American, Asian and Pacific Islanders and the multi-racial group exceeded 17% growth. During the same period, Hispanic

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population growth approached 38%. Consequently, the racial/ethnic composition in adjoining table is changing dramatically, especially by ethnicity.

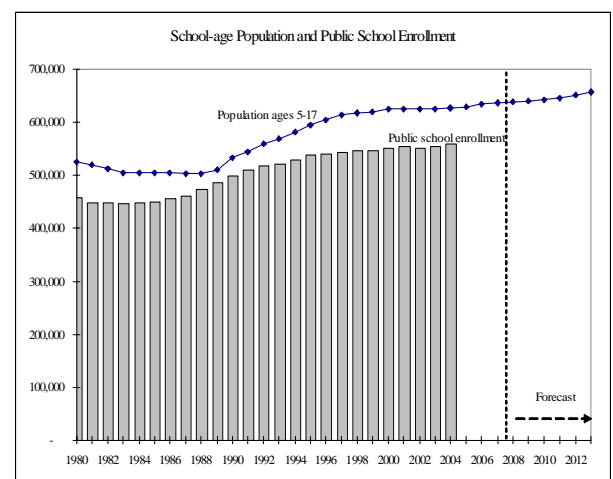
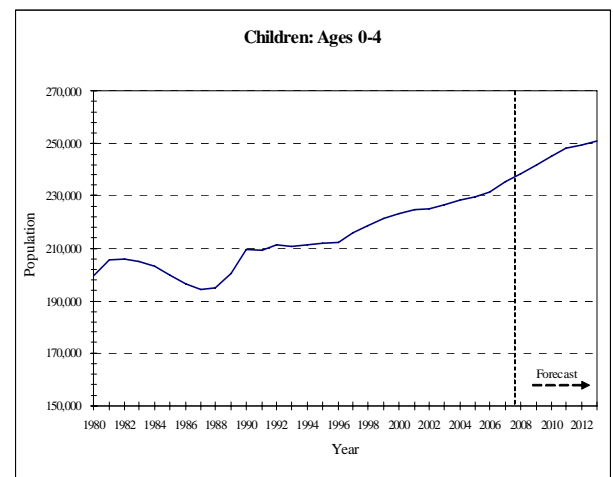
- The age structure of the population has significant budgetary implications. For example, the numbers and shares of pre-school and school-age children, college-age adults, criminally “at-risk” adults, those applying for welfare, and the senior population needing public assistance pose critical budgetary choices for policy makers.
- Oregon had 223,000 children aged 0-4 in the year 2000, which is estimated to have grown to 235,300 by 2007. After several years of slow growth, this group will resume an increasingly higher rate of growth for the next few years. This group is expected to increase by 6,000 between the years 2009 and 2011, an annual rate of 1.3 percent. The size and growth of this population will have an impact on the demands for childcare, Head Start, and other children’s services.
- The number of persons aged 5-17 determines, to a large extent, the K-12 enrollment. The population aged 5-17 constitutes 17 percent of Oregon’s total population and use up a large share of State’s budget in public education. Total K-12 enrollments account for 89 percent of this school-age population. In 2003, nearly 91 percent of all K-12 students were enrolled in Oregon’s public schools. The remainders were enrolled in private schools (5.7 percent), and 3.4 percent were in home schooling. In times of economic downturn, publicly funded schools seem to bear a greater burden as the students move from fee-paying private schools to the public schools. In times of negative perception of public schools in terms of quality and services, the enrollments shift to private and home schooling.

The school-age population has grown from 533,000 in 1990 to 624,000 in 2000. This amounts to an average increase of over 9,200 persons per year. Oregon's school system faced enormous pressure as a result of this rapid growth in the school-age population. The rate of increase has slowed down considerably since then and is expected to remain well below the overall population growth rate in the near future. Between 2009 and 2011, this population group is expected to increase on average by 2800 persons per year. As an effect of high migration from other countries, nearly 2.3 percent of school-age children do not speak English well or do not speak English at all. As the overall population has become more racially and culturally diverse, so has the student population. The proportion of minority students has increased from 11.2 percent in 1990 to 29 percent in 2007.

Oregon's population by race and Hispanic ethnicity, 2007

| <u>Race/ethnicity</u> | <u>Number</u> | <u>Percent</u> |
|--|------------------|----------------|
| Total population | 3,700,758 | 100.0% |
| One race | | |
| White | 3,348,473 | 90.5% |
| Black or African American | 68,610 | 1.9% |
| American Indian and Alaska Native | 51,209 | 1.4% |
| Asian | 133,740 | 3.6% |
| Native Hawaiian and Other Pacific Islander | 10,277 | 0.3% |
| Two or more races | 88,449 | 2.4% |
| Hispanic or Latino (any race) | 379,038 | 10.2% |

Source: U.S. Bureau of Census



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- Young adults aged 18-24 are generally referred to as college-age population. Reversing a long, declining trend of the 1980's, the young adult population has grown to 330,000 in 2000. The growth rate accelerated in the recent years and peaked in 1998. It is tapering off since then. The rate is expected to remain low and lag well behind the state's overall growth as children of baby-boom age out of this cohort.

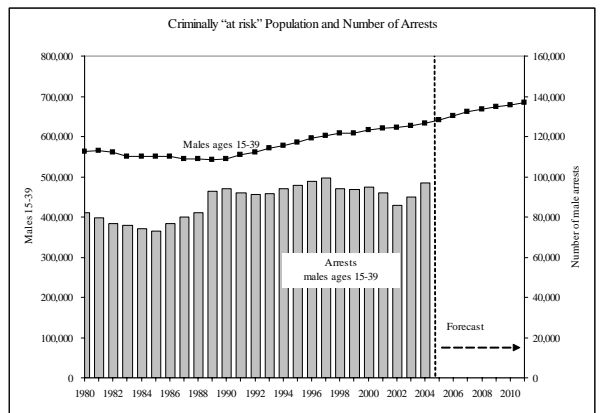
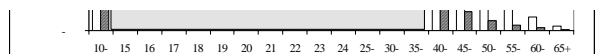
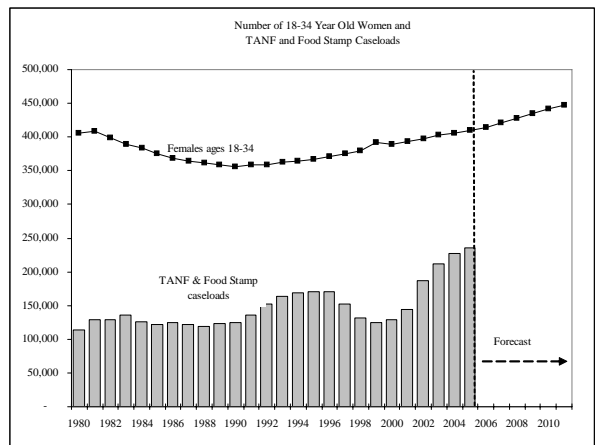
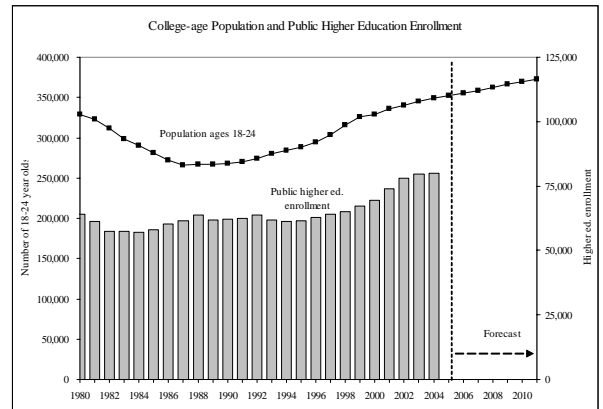
Nearly 76 percent of all undergraduate students in Oregon's public four-year colleges and universities are 18-24 years old. Growth in the young adult population is likely to increase demand for higher education and community colleges, work training programs, and entry-level jobs. Actual enrollment in public higher education also depends upon competing employment and educational opportunities. Consequently, despite a long period of rapid growth in the young adult population during the 1990's, only recently has the higher education enrollment growth rate outpaced the young adult population growth rate. The growth in the college-age adults is expected to remain slow in the future. This may have direct impact on college enrollment.

- Males aged 15-39 are considered criminally at-risk because the majority of arrests and convictions have historically been associated with this age-sex group. For example, nearly three-fourths of all arrests are of ages 15-39 and three-fourths of them are males. Increasingly, however, crimes committed by young females have been on the rise.

After a net decline during the early 1980's, this population has grown steadily since 1990, but at a much slower pace than overall population growth rate. This population is expected to grow by an average of 4,600 persons each year between 2009 and 2011. Growth in this at-risk population, along with sentencing policies, will determine the pressure on law enforcement and the corrections population.

- Welfare caseloads in the Oregon Department of Human Services are affected by demographics, family economic situations, available public resources, and outreach programs. However, demographics only help identify and provide general trends of the population groups to be served. Actual numbers of caseloads are greatly determined by welfare-related policies.

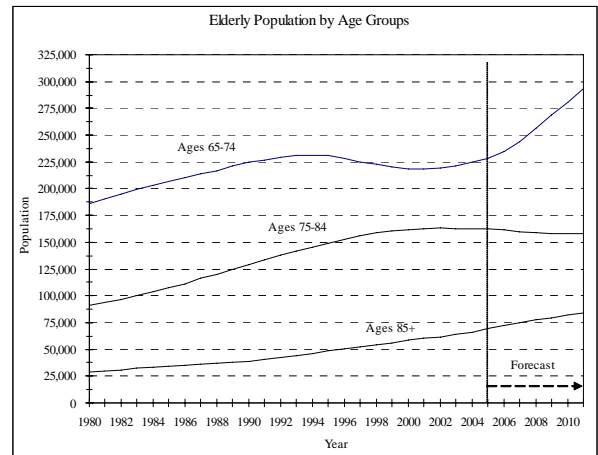
The majority of welfare recipient households are headed by women ages 18-34. Female headed households with children tend to have one of the highest poverty rates in the state. Two major welfare programs are Temporary Assistance for Needy Families (TANF, previously AFDC) and Food Stamps.



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The accompanying chart shows the number of caseloads compared with the corresponding population. The first half of the 1990s was a period of rapid growth in these caseloads, far exceeding population growth. This period of rapid growth was followed by a rapid decline in the caseloads largely due to policy change. Caseloads have increased since 2000, possibly due to the economic recession in association with decline in income. In the coming years, the growth in 18-34 year old women will slow down considerably after 2009.

- The senior population age 65 and older accounts for nearly 13 percent of the total population. Between 1990 and 2000, the senior population grew from 392,000 to 439,000. For over a decade this population was growing at a slower pace than the overall population until 2005. However, during the coming 2009-11 biennium, the elderly group is expected to outpace the overall population and increase at an annual rate of 2.9 percent, more than twice the rate of overall population growth.
- The number of youngest seniors (aged 65-74) declined in the 1990's. Growth has been positive since the year 2001 and will accelerate in the future as the baby-boom generation enters retirement age. The number of youngest seniors will increase by nearly 25,200, or 9.3 percent, between the years 2009 and 2011.



- The senior population aged 75-84 was growing at a much faster rate during the 1980's and 1990's. The number of 75-84 year olds grew from 128,800 to 162,100 between 1990 and 2000 – an increase of 25.8 percent. However, despite the continued net in-migration of senior population, the number of seniors in this age group has been declining as a result of higher death rate and entry of the Depression Era generation into this age group. Between 2009 and 2011, this group of seniors will barely change, although the growth will turn positive.
- The oldest senior population group, aged 85 and over, is small but growing very rapidly. The number of oldest senior grew from 38,800 to 58,100 between 1990 and 2000 - an increase of 50 percent. The fast paced growth, at times exceeding 3 percent per year, will continue in the future. Between 2009 and 2011, this group of seniors will increase by 5.3 percent. Differential birth cohorts, increasing life expectancy, and continued net in-migration of seniors are responsible for the accelerated growth in the oldest senior population. Many members of the senior population require health care, pension support, and special housing. They are highly dependent on state long-term care services.

Inmate Population

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- Oregon's prison population is forecast to grow by 19.3 percent in the next decade. The table below shows the forecast population over the next decade with the percent change from the July 1, 2007 population.
- The prison population forecast is based on current law and interpretation of current policy. Statutory, constitutional, and criminal justice policy changes pose the most important risks to the forecast. These include changes in the law brought about by the initiative or legislative processes or cuts in criminal justice services due to budget reductions.
- In the absence of major legal or policy changes, prison intakes depend in part upon the number of arrests for serious offenses. Arrests for violent, property, drugs, and weapons crimes have been increasing since 2002. These increases can put more pressure on the courts, prison, and community justice systems.

Inmate Population Forecast

| Year | July 1 Population | Cumulative Pct Change from 2007 |
|------|-------------------|---------------------------------|
| 2007 | 13,508 | |
| 2008 | 13,769 | 1.9% |
| 2009 | 13,864 | 2.6% |
| 2010 | 14,131 | 4.6% |
| 2011 | 14,454 | 7.0% |
| 2012 | 14,714 | 8.9% |
| 2013 | 15,003 | 11.1% |
| 2014 | 15,283 | 13.1% |
| 2015 | 15,608 | 15.5% |
| 2016 | 15,860 | 17.4% |
| 2017 | 16,118 | 19.3% |

The Economy

National

- The national forecast used by OEA now includes a recession in the baseline forecast. The recession is expected in the first half of 2008. Mild growth returns through 2010. Inflation is expected to remain relatively low through 2011 though risks due to energy are present. Interest rates will be lower in 2008 and 2009, rising by the second half of 2009 and into 2010. Global markets should weather the U.S. national slowdown and stay relatively healthy.
- Unemployment will rise through 2010.
- Business investment in equipment and software will soften during the economic downturn. The housing market will continue to weaken in 2008 with improving conditions in 2009. Exports continue to be helped by a low dollar value and the economic growth of trading partners.

Oregon

- The 2001 recession hit Oregon's economy hardest compared to any other state. The currently forecasted national recession is expected to be mild, and the impact on Oregon should likewise be mild.
- Oregon appears to be less impacted by the housing market collapse. Although slower consumer spending will slow all economic sectors, lower interest rates and the federal stimulus package will lessen the strain on the economy. Oregon should see better growth in 2009 through 2011. Export growth should continue to assist businesses.
- Personal income is forecast to grow 5.8 percent in FY 2010 and 5.7 percent in FY 2011. This is slightly faster than the projected growth of 5.4 percent in FY 2009, which follows the second half of FY 2008 and the forecasted recession period for the U.S. economy. Employment growth is projected at 1.8 percent

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growth in FY 2010 and 1.7 percent growth in FY 2011. This is a slight increase from the 1.3 percent growth projected in FY 2009.

- In the near future, several forces will be at work to affect the Oregon economy. The Oregon economy will follow the national trend, and the growth rate will not be as high as in 2005 and 2006. Manufacturing will not be the engine of growth, but a robust global economy will continue to assist Oregon's modest expansion. Job and income gains will most likely come from private non-manufacturing sectors.

Revenue

General Fund/Lottery

- Based on the March 2008 forecast, General Fund revenues are projected to grow 21.4 percent to \$15,697.7 million. A personal kicker distribution during the prior biennium accounts for the large change. Personal income tax constitutes 88.6 percent of the total, with corporate income tax contributing an additional 5.8 percent. The projected beginning balance as of the March 2008 forecast is \$28.8 million.
- Lottery resources are expected to be \$1,381.2 million for the 2009-11 biennium. Video lottery will account for slightly more than 90 percent of lottery resources.
- Risks to the overall revenue forecast are similar to those for the economy in general. For lottery revenue specifically, risks also include a greater-than-expected impact from the ban on smoking in bars and restaurants.

Tobacco/Health Plan

- Cigarette and Other Tobacco taxes dedicated to the General Fund are forecast to total \$112.5 million in the 2009-2011 biennium.
- Cigarette and Other Tobacco taxes dedicated to the Oregon Health Plan are forecast to total \$336.2 million for the 2009-2011 biennium. An additional \$15.2 million in tobacco taxes will be available to fund the Tobacco Use Reduction Account.
- The greatest risk to tobacco taxes is a large increase in the wholesale price or the federal excise tax, which would decrease consumption and in turn could decrease cigarette tax revenues to the state.

Risks

National/International

The forecast is dependent on the conditions in world markets, mainly Asian, and the strength of domestic demand. The Oregon economy faces some of the same risks as does the U.S. economy. The projected recession in FY2008 could last longer and spill over into the 2009-2011 biennium. A "typical" recession could reduce General Fund revenues by about 7.1 percent, or \$1,150 million, from the current forecast for the 2009-2011 biennium.

- Asia, China in particular, is projected to continue experiencing strong growth. The continued decline in the U.S. dollar will assist exports. Global market growth is key to the health of high technology, lumber and wood products, and agriculture.

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- Energy prices and inflation can put a substantial dent in the economy. While the economy was resilient in spite of high energy prices and hurricanes, prolonged elevation of energy prices could eventually have a negative impact on the economy.
- Consumer spending is a driving force of economic growth. Throughout the expansion, consumers continued to spend due to tax cuts and low interest rates. Economic growth could be stalled if consumers pull back too much on spending and financial investment in businesses. Geopolitical risks have the potential to weigh on the confidence of consumers and thus lower their spending. The housing market collapse could further lessen the use of home equity to boost consumption.
- Changes in federal budget policy, either through federal programs or changes in the federal income tax base, could potentially cause significant changes in Oregon's fiscal environment.

State Specific

Oregon faces some additional state-specific risks over the next biennium.

- Rising regional energy prices. Regionally, electricity generation may move towards natural gas powered turbine engines as the expanding economy demands more electricity relative to the supply of hydro generation. Wind generation and other alternative energy sources will not be enough in the short term to fulfill increasing electric load demands. Drought conditions could occur during the 2009-2011 biennium, placing additional need for electricity generation other than hydro. Higher electricity prices could result from being pegged to natural gas prices.
- Initiatives, referendums, and referrals. The ballot box brings a number of unknowns that could have wide-sweeping impacts on the Oregon economy.
- Continued outsourcing of manufacturing could slow growth in the state. Recent commitments to move research out of the country would be very harmful to Oregon's high technology sector.