**Scandal, Marijuana and Budgeting in the Land of Portlandia: Oregon 2015**

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Oregon tends to get more attention for Portland’s stereotype as “weird” and its distant environmental legacy than for any contemporary political or budget news. At the end of 2014 and the beginning of 2015, Oregon climbed into the national news a bit more than usual, propelled by the success of the Democrats, fall of its seemingly permanent governor and by joining the legalized recreational marijuana club. But as with all things concerning the budget, it is the shape of the economy, pre-existing commitments (possibly including the impact of its unique “kicker law” being activated), and core group politics that will determine the budget that emerges in June or July 2015. In short, the state faces a re-hash of old issues with the remote possibility that the powerful Democratic majority may actually break some long-established patterns.

This paper examines four aspects of Oregon’s budget context in 2015: 1) the political context created by the 2014 election and the resignation of a long-standing governor, 2) the state of the Oregon economy and its effects on the state budget; 3) the 2015 legislative budget process and legislative approaches to the key issues of K-12 school funding and the Affordable Care Act; and 4) a concluding consideration of the tendency towards incrementalism and consideration of whether marijuana is a gimmick or significant budget tool.

**The Political Scenario: The Nature and Consequences of the 2014 Election**

The most obvious message of the 2014 election in Oregon is the rejection of the rightward drift of the rest of the country. While nationally Republicans gained eleven state chambers and three governorships, Democrats in Oregon advanced their control of the state House to 35-25 and the state Senate to 18-12.[[1]](#footnote-1) Oregon also re-elected Democratic Governor John Kitzhaber despite campaign revelations that his first lady, Cylvia Hayes, had once had a sham marriage (of which he was unaware) and was connected to a misfired marijuana growing scheme, and came under scrutiny for whether her consulting business improperly benefitted from insider state contracting and questionable access to government officials.

Kitzhaber’s victory was not the coronation expected earlier, however. Winning with 49.98% of the votes gave the governor a 5% margin over his conservative Republican opponent, a safe but unimpressive win for a person seeking a record-breaking fourth term in office. After the revelation of Hayes’s other activities that more directly involved the governor’s integrity in early 2015, Kitzhaber found himself abandoned by the Democratic establishment. Faced with a ceaseless run of media accusations and significant circumstantial evidence regarding conflicts of interest and impropriety, the governor chose to leave office after the Democratic Speaker of the Oregon House and the Democratic Senate President joined in the calls for his resignation. It was a very sudden thing, and Kitzhaber commented on the sadness he felt when "so many of my former allies in common cause have been willing to simply accept this judgment at face value."[[2]](#footnote-2)

Following the state constitutional guidelines on succession, John Kitzhaber’s resignation on February 13, 2015 elevated the Secretary of State, Democrat Kate Brown, to the governorship. The political and policy impacts of this change remain unclear at this time. Brown was originally elected to the state legislature from one of the most liberal districts in the liberal city of Portland (often referred to as “The Kremlin” by political insiders) and enjoyed very strong support from labor and other progressive social groups. In contrast, Kitzhaber had positioned himself as more of a non-partisan problem-solver and accordingly enjoyed more campaign financial support from business groups and wealthy individuals in Oregon and beyond. But comparing political contributions between a governor and a secretary of state is problematical. Brown’s different policy orientation is probably better shown by how her legislative record and general political positions more consistently match the core Democratic Party compared to Kitzhaber’s frequent pattern of working across the aisle while keeping a distance from public unions.[[3]](#footnote-3) In her first month in office, Governor Brown seems to have staked out a leftward and partisan tilt by an explicit endorsement of Kitzhaber’s commitment to early education spending and by signing both a fairly controversial environmentalist bill regulating gas formulation and a measure to automatically register people to vote when they receive or change their driver’s license registration.[[4]](#footnote-4)

Oregon changes the lead with California regarding the number and importance of ballot measures voters decide, but the 2014 ballot measures brought very little significant political change. Of the seven measures, only three passed. Voters amended Oregon’s constitution to incorporate an equal rights amendment that forbids gender discrimination (Measure 89) and to allow public workers to take on other positions in government in certain circumstances (Measure 87). Voter approval of the legalization of recreational marijuana will have the most immediate consequences, however. It is also notable that Oregonians rejected the idea of allowing illegal aliens to obtain driver’s licenses, a rebuke to the legislature which passed this law only to see it petitioned onto the November 2014 ballot.

One notable highly-publicized issue that will demonstrate whether the united Democratic front in Salem will foster anything more than incremental change in state and local finances is school funding. Before the legislators heard a single bill, this issue was made unavoidable. A study by the Education Week Research Center released in early January 2015 graded Oregon with an unsatisfactory “C-“ grade. The details of the study were even more powerful than Oregon’s summary score of 69.5, well below the national average of 74.3.[[5]](#footnote-5) Among the glaring facts from this study presented in the *The Oregonian*, the state’s leading newspaper, was that Oregon was the worst-in-nation rating for its growing gap between poor and non-poor students’ reading and math skills, 46th in early education, and 46th in state spending on K-12 education considering its economic status.[[6]](#footnote-6)

Besides a clarion call for improving education, the 2015 legislature faces great uncertainty on the finances of the state and local government pension system (the Public Employees Retirement System, “PERS”). Ironically, the uncertainty arises from efforts to reduce liability risks. Although far better than the situation in some states, in 2013 the assets of the PERS system remained 13% below pre-recession 2007 levels.[[7]](#footnote-7) The need to correct the unfunded liability impacted state and local school budgets powerfully. A 2013 article by Ted Sickinger of *The Oregonian* highlighted how the need to cover future obligations was costing the average Oregon household $700 per year.[[8]](#footnote-8) Such information led Governor Kitzhaber and state legislators to make two significant changes to the PERS system in 2013: 1) limit the Cost of Living Adjustment(COLA) of PERS benefits to 1.5% on first $60,0000 and 1.25% of any higher income, and 2) end adjustments to PERS made to out-of-state retirees to compensate for tax liabilities. The 2013 reforms and the recovery of the stock market and other investments slowed the increase in state and local PERS obligations from a 30% rate of increase in 2013 to only 1% in 2015, as overall unfunded liability for the PERS system declined from about $16 billion to $8.5 billion.[[9]](#footnote-9)

The reform is not a settled issue, though. Public employees quickly challenged these reforms in a case that was ultimately heard by the Oregon Supreme Court on October 14, 2014. If the Court should rule that the reforms violate the state’s contractual obligations towards public employees (and therefore violating the constitution) and that the public benefit does not outweigh the violation, then the state and local governments’ PERS liabilities will instantly rise by $5.3 billion, which translates into about an $800 million obligation in the 2013-2015 budget and about $1 billion in the next biennium. Oregon governments will not have to pay this increased liability immediately, but they will have to make up for those extra obligations and reduced payments after 2017.[[10]](#footnote-10) Regardless of their concerns for public employees, it is hard to imagine many state legislators or the governor would like to see the 2013 law reversed judicially.

**The Oregon Economy, the “Kicker” and Projected Revenues in March 2015**

In general, the Oregon economy seems to be having a sustained recovery. The March 2014 Economic and Revenue Forecast by the Oregon Office of Economic Analysis provides a decidedly upbeat tone about things:

Oregon has regained its traditional growth advantage in expansion and is making up lost ground. More importantly, signs of a deeper labor market recovery are evident in the state. Unlike in the nation as a whole, strong job growth is bringing real wage gains to Oregon. Not only is the labor force growing with more Oregonians looking for work, but the labor force participation rate itself increased throughout 2014. The key question is whether or not Oregon can take another step up in growth, to rates seen during the typical Oregon expansion. All told, Oregon is approximately halfway back to full employment with the current pace of improvement considerably faster than the nation as a whole.[[11]](#footnote-11)

In the second year of Oregon’s two-year budget cycle, economic good news means a mixed revenue situation, however. On one hand, faster than predicted growth is good in that it means a larger base for the upcoming budget cycle. One the other, due to the unique “two-percent kicker” law, if personal income tax revenues exceed projections by more that 2%, then all revenues above the projections are returned to individual taxpayers. Thus for optimal immediate revenues, it is best for income tax revenues to exceed projections by just less than 2%. For a state that depends on personal income tax for 86% of its general revenue in 2011-2013, this extra revenue matters.

The state economist determines the revenue figures used for the state budget, including the official projections used for determining the Kicker. Although the final report used for this determination is not due until May, the 2015 legislative session is operating according to the number provided in the state economist’s March 2015 report. The two-sides of revenue growth are reflected in the following passage from the March 2015 report:

The March 2015 outlook assumes that revenues included in the personal income tax kicker base will exceed the kicker threshold by $59 million at the end of the biennium. Should this outlook hold true, a personal income tax kicker of $349 million will be issued. …. If the March 2015 outlook comes to pass, and a kicker is triggered, it will not fundamentally change the task faced by legislative budget writers during the current session. Most of the reduction in 2015-17 income tax collections due to the kicker will be offset by larger balances heading into the biennium together with improved prospects for the regional economy over the next two years.[[12]](#footnote-12)

In past decades a similar “kicker” law applied to corporate income taxes. Corporate income taxes in Oregon are much less important in total amounts, being about 6.2% of the state’s 2011-2013 general fund budget, but they have high volatility and therefore have in the past often exceeded budget projections by much more than 2%. But in 2012, Oregon voters approved Measure 85 directing that Corporate Income taxes would “kick” automatically to the General Funds budget to be used for K-12 Education spending.[[13]](#footnote-13) As of March 2015, it appears that the 2013-2015 budget may be the first to receive these extra monies.

In planning for the 2015-2017 budget, Oregon legislators have the happy prospect of a projected 9.8% increase in general fund revenues at this time, to a projected total of $17,491 million. The state economist is bullish for the long-term as well, predicting 10% or better revenue growth for both the 2017-2019 and 2019-2021 biennial budgets. Of course such predictions are always premised by disclaimers and much more negative projections based on possible “Recession” and “Severe Recession” scenarios.[[14]](#footnote-14)

**The 2015 Legislative “Budget Framework”**

Normally the governor’s proposed budget serves as the starting point of the biennial budget formulation process. Although Kitzhaber released his proposed 2015-2017 budget in December 2014 and his successor Kate Brown has not disowned it, the legislature’s control over the process was inevitably enhanced by Kitzhaber’s distraction and ultimate departure. The leading document for budget action in Salem in early 2015 is the “Co-Chairs’ Budget Framework 2015-17” developed by the co-chairs of the Joint Ways and Means Committee (Oregon’s “budget” committee), Senator Richard Devlin (D-Tualatin) and Representative Peter Buckley (D-Ashland) and released on January 14, 2015. The significance of this document is further enhanced by the fact that Devlin and Buckley are leading this process for their third consecutive budget cycle.

The “framework” shows that the co-chairs initially (at least) plan to take an incremental approach to the state budget and the effort to restore the state’s education funding. While the revenue increases allow significant increases in education spending, going from $6.6 to $7.2 billion, proportionally that is actually a cut of .6% of the general funds.[[15]](#footnote-15)

It is interesting to consider whether things would have been different had Kitzhaber remained in office. In his 2015-2017 proposed budget, Kitzhaber endorsed almost the same amount of General Funds going to education, about 51% compared to the co-chairs rounded off 52%. There is currently no indication that any major re-allocations will occur in the budget, although the projected larger General Funds pie (growing from 17,596.3 in 203-2015 to 19,441 million in 2015-2017) makes many positive adjustments possible.[[16]](#footnote-16)

The seeming clarity and absoluteness of the Co-Chair incremental proposal was reinforced by the speed in completing the K-12 appropriations bill in the joint committee, with a recommendation sent to the floor to approve $7.225 Billion sent on March 26, 2015.[[17]](#footnote-17) But the ability of the committee to move ahead with its plans could hit a roadblock. As has happened in the past, the passage of the Ways and Means Committee’s Education Funding bill was on straight partisan lines, and education groups are making common cause with Republicans to challenge the spending numbers. As Betsy Hammond notes in *The Oregonian*, it’s an odd case to declare poverty when you are receiving a 9% increase, but the argument hinges on two points: 1) schools get more money but must also provide full-day kindergarten, about a 3% budget hit; and 2) the increase is based on the annual

**Chart 1:** OREGON CO-CHAIR PROPOSED BUDGET FRAMEWORK



Co-Chairs budget Framework, Oregon State Legislature, January 14, 2015

< https://www.oregonlegislature.gov/lfo/Documents/2015-17%20Co-Chair%20Budget%20Framework.pdf>

distribution from 2013-2014, not the actual budget levels of 2014-2015. The 2013 legislature voted to make a 5% increase in 2014-2015 allocation to schools to push the base upward. This action created this year’s “no cut” budget enabled schools throughout the state to actually expand their programs. The good news is the bad news also, as these higher bases demand to be fed more, and the 9% increase essentially disappears into existing commitments and general wage increases. School official want another $265 million for K-12, but Democratic leadership argues that Higher Education and other demands deserve a chance to increase as K-12 did in the 2013-2015 budget.[[18]](#footnote-18)

 As the education budget grinds on through Spring 2015, one issue that haunts (or inspires) politicians in various state capitals across the country is whether the United States Supreme Court will administer another blow to the Obamacare system by ruling that the federal health care exchanges do not qualify for the federal subsidies they have received since they are not “state-based” as one passage of the law requires. The case hinges on whether the court will reject that current implementation process due to a literal interpretation of a line in the ACA or take a broader view of the intention of Congress in passing the law. As things stand, citizens in thirty-four states have federally established exchanges whose subsidies for seven and one-half million people would become illegal. Oregon, Nevada, and New Mexico created state-based exchanges but moved to a federal exchange system and have a unique status since they lack a clearly state-based system but had created one in the past and operate their exchanges through a state agency.[[19]](#footnote-19)

The fact there is any uncertainty here for Oregon constitutes a further insult to the Kitzhaber legacy. When the ACA passed, Kitzhaber’s “Cover Oregon” program was widely praised as creatively leading the implementation of Obamacare. As late as March 2012, an Urban Institute study team concluded, “Oregon is well on its way to fully implementing the ACA as well its own health reforms by January 1, 2014.” [[20]](#footnote-20) All praise came to a complete halt when the program’s launch almost totally imploded and the misunderstandings, expectations, and technological complications confronting the state and the primary contractor Oracle were bared. It was something of a miracle that over 200,000 people were singed up, mostly by paper into the Cover Oregon Exchange in 2014. Kitzhaber and others recognized the wreckage was complete and identified the federal exchange system as the quickest more cost-effective alternative, a process completed on March 6, 2015, when Governor Brown signed a bill ending “Cover Oregon”.

Various experts generally agree that Oregon and Oregonians are not in danger of losing the ACA exchange subsidies immediately since the three “Federally-supported State-based Marketplace” appear to be excluded from the states losing subsidies should the Supreme Court rule against the Obama administration. Evidence of this different status is clear, and petitions in the *King v. Burwell* case itself include only the 34 states with clear federal exchanges in their arguments.[[21]](#footnote-21) It appears that, for now, Oregonians dodged a bullet in this area, although the Court could get expansive and should ACA opponents win, they can re-file targeting Oregon and the other outliers.

Concluding Issues to Consider: Pushing Boundaries of Revenue Generation without Breaking Fences

Oregon’s state revenues took a beating in the recent recession. While clearly the problems far exceeded any state’s control, this recession, as in previous ones, generated much attention to the insufficiency and “imbalance” of Oregon’s state and local revenue system. Those who favor enhanced and/or more stable funding for public services often attribute much of Oregon’s revenue problems to three factors: impractical property tax limits adopted in the 1990s, the lack of a general sales tax, and the insufficiency of Oregon’s “rainy day funds”.

Progressives often trace Oregon’s “decline” to Measure 5 (1990) and Measure 50 (1996) by which voters imposed strict limits on property tax increases. While the inequities caused by how the limits have differential effects on different properties have recently become a hot topic, the more long-term criticism is simply that these cuts have permanently lowered K-12 funding and increased dependence on the presumably less stable state budget. A typical example of this sentiment was demonstrated when in 2013 “(s)everal mayors and school-board members made their case to state lawmakers … complaining that property-tax limits from two 1990s ballot measures are severely hampering their ability to pay for police and fire services, libraries, parks, road maintenance and teachers.”[[22]](#footnote-22)

The second common criticism of the state revenue systems centers on the “imbalance” that arises from Oregon’s lack of a sales tax. In the 1980s budget experts commonly argued that a good state and local revenue system would have the “three-legged stool” of general sales, property, and income taxes. This form would balance the each revenue source’s specific strengths and weaknesses. The stability of property taxes would counteract the volatility of the theoretically more progressive income taxes, and sales tax would provide a moderately stable revenues that enable states to extract revenue from consumption and visitors. In 2015 state and local governments depend much more on gambling revenues, excise taxes and charges and user fees (especially when this is read broadly to include items such as college tuition). Still recessions hit Oregon public revenues especially hard due to the state’s extraordinary dependence on income taxes, which is further accentuated by the dependence of K-12 education on state revenues due to property tax limits. One result of this situation is that every time the economy (and state revenues) decline, there are wide calls for reforming the state and local revenue systems to be more balanced.

 For example, in 2013 *The Oregonian* editorial board recommended that Oregon consider the sales tax.[[23]](#footnote-23) Early in his 2014 campaign, Governor Kitzhaber seemed to be willing to spend some political capital on the idea of pursuing the sales tax. By the evening of his election victory, Kitzhaber made the more complex observations that:

 “26 million tourists stayed three or more nights in Oregon over the prior year. Without a sales tax, he said, "we're leaving money on the table. But … it's abundantly clear we can't go there," Kitzhaber told the board. "Two things are clear: People are not upset about the tax system, and they don't believe it's being spent well.”[[24]](#footnote-24)

With the strong Democratic dominance in Salem, 2015 seems like a good time to advance revenue reform. As of March, major changes appear unlikely, although Senator Mark Hass (D-Beaverton), Democratic chair of Senate Committee on Finance and Revenue, has sought to “at least start the conversation”. [[25]](#footnote-25) Hass’s initial goals would center on reforming the property tax system to improve equity, but he also has an important insight on how things could progress when he notes that property tax reform should probably be accomplished with a public vote on a legislative referral. Although Oregon voters have not welcomed sales tax reforms, in 2010 they voted in support of legislative referrals raising both the top rates for private income earners (Measure 66) and to establish higher minimums for businesses. Furthermore, in 2012, voters passed an initiative directing the corporate income tax kicker money to the state school fund.

Perhaps the voters are showing their endorsement of this incrementalist approach more clearly that we want to admit. The boundaries of reform have seemed clear since at least 1990: no major increases in property taxes and no sales taxes, but some support for “taxing the rich”. Within these boundaries, other things are possible. Certainly the rise of gaming revenues to about 7% of the amount raised in General Fund/Lottery Funds area represents a somewhat creative adaptation within these boundaries. There is also a relatively strong tolerance for increases in user fees and other charges. Tuition and fees at the University of Oregon have risen from $4071 in 2001-2002 to $9918 in 2014-2015, a rise of 143% in 13 years.[[26]](#footnote-26) Overall Oregon has moved into the top ten of states in its reliance on charges to pay for public services.[[27]](#footnote-27)

Could the latest new area of incremental evolution be marijuana? Projections of the proceeds of marijuana revenue in Oregon are not as impressive as those for Colorado or Washington. Colorado’s well-established medical marijuana market probably fostered a better understanding and acceptance of harvesting this as a revenue stream. Data from the February Report of the Colorado Department of Revenue show that for the month of January 2015 to be $7,705,502, which was 163% more than the total for January 2014 of $2,927,095.[[28]](#footnote-28) This slow start but continual acceleration implies there will be minimal annual revenues of over $100 millions in the near future. Washington’s estimates for cannabis-related revenues are projected to be $221.6 millions in 2015-2017 and $362.8 millions for 2017-2019.[[29]](#footnote-29) Placed in the larger scale of state budgets, even the general funds portions, these amounts are notable but not transformative unless specifically directed.

As in other states, Oregon’s cannabis advocates claimed the passage of Measure 91 would open new horizons of public revenue and great savings in public justice expenditures. After its passage, one liberal website declared Oregon the new leader for marijuana policy because: “First, and maybe foremost, is the revenue stream; both in tax revenue and an immediate $71 million savings (annually) in law enforcement savings typically spent on cannabis enforcement. According to a 2012 study by a Harvard economist and Cato Institute fellow, Jeffrey Miron, Oregon will bring in at least $100 million annually in tax revenue.”[[30]](#footnote-30)

The state of Oregon has much more conservative estimated revenues, with a range of $13,1 to $19.4 million in revenue estimated for the half year of legality in 2015 and then accelerating net revenues so that in the 2017-2019 biennium there will be a public gain of about $40.1 million.[[31]](#footnote-31) A private research group, Eco-Northwest, has a more generous estimate that in its first full year of operation (July 2016-July 2017) there will be $38 million in revenues.[[32]](#footnote-32) These estimates are based on very elaborate assumptions and calculations, but have tremendous uncertainty. The one certainty here is that marijuana will not generate any truly game-changing funding flow, although some cities may find significant revenue in local marijuana taxes.

 If there is one continuous thread through Oregon budget politics of the past twenty year, it seems to be the search for easy answers interrupted by the occasional realization, usually deep in a recession, that the small steps are not adding up to be effective permanent solutions for revenue and public service stability. Now that income revenues are up, the need for deep reform seems less pressing. But perhaps this pattern of small changes will soon bear better fruit. In the past decade, Oregon has created two stabilization funds, made the personal income tax slightly more progressive, absorbed the core of the business tax kicker system, increased reliance of user fees and charges, and basically maxed out the gambling revenue stream. Maybe marijuana revenues are the last incremental piece needed to free Oregon of the old “three-legged stool” criticism. It is hard to not put another innuendo referring to marijuana here.

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