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# A Plan to Rebuild and Reinvest in Oregon

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for Governor 2010

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## Introduction

Like all states Oregon is facing a serious fiscal crisis driven by some very disturbing trends. Today the percentage of Oregon tax dollars spent on prisons and the human cost of things like addiction, neglect and abuse is increasing. But the percentage we spend on educating our children and building a better economy is decreasing. And this trend is accelerating.

To understand the problem this creates we need to understand the two ways in which Oregon spends money. The first way we spend money is by investing in people – in children and families, in education and in workforce development – investments which make people’s lives better; which give them a pathway to a family wage job; which give them a secure future; and which lift up our whole state. Educated citizens are more likely to succeed in the workplace and less likely to need social support services or to become involved in the criminal justice system.

The other way we spend money is by taking care of problems after they have developed – in foster care, in public assistance, in the criminal justice system. Locking people up in our jail and prisons; and much of what we spend in our health care system and social support systems are expenditures – important in the sense that they deal with immediate problems -- but problems that could be prevented if we increased the size and effectiveness of our investment in people.

Today we are spending more on problems than we are investing in people and it is taking us in the wrong direction. We have our priorities backwards and the central challenge facing Oregon today is to reverse this trend. To do so requires three steps. First we must set clear priorities; a clear vision of where we want our state to be in the future. Second, we must overhaul state government to deliver on those priorities. That starts with balancing the next budget by focusing the resources we have on the goals we need to achieve. Third, we must stay the course by developing a reinvestment plan – a clear strategy to guide how we will invest new revenues that become available in the future in a way that will continue to move us toward our goal.

## Step One: Set Clear Priorities

By 2020, the end of this decade – by the time the children entering kindergarten this year graduate from high school -- we should live in a state where all of our children are ready to learn before they get to school; where we have eliminated the achievement gap on the front end; where drop out rates are steadily falling and graduation rates are steadily rising; where all Oregon high school graduates are prepared to pursue a post-secondary education without remediation; and where 80 percent of them achieve at least two years of post-secondary education or training. We should live in a state that creates family wage jobs and career pathways that lead to those jobs; and where the average per capita income exceeds the national average in every region.

If we commit ourselves to building that future; we can, over time, reverse our current trend of disinvestment in education; we can increase the per capita income of Oregonians; we can reduce incarceration rates and the cost of corrections; and we can reduce the cost of human service programs.

We must recognize, however, that we cannot achieve this vision over night -- it will take eight to ten years. But if we commit ourselves to achieving it; if we agree that this is the kind of future we want to build for our state; it can provide a context and a road map for the individual decisions we will have to make along the way. It will inform us as to whether individual choices move us toward – or steer us away from -- our goal. This will be particularly important in managing through our looming budget crisis.

## Step Two: Overhaul State Government to Deliver Priorities

Oregon faces a projected revenue shortfall for the 2011-2013 biennium of over \$3 billion.<sup>1</sup> This poses a significant challenge in terms of maintaining important public services over the short term; and setting our state on a new course over the long term. The key to managing this fiscal crisis lies in viewing it through the lens of a ten year budget strategy; not just a two year strategy. In other words, we can no longer try to manage Oregon around a two year budget. We need a ten year budget framework – with projections of both revenues and expenditures – which can give us a framework for balancing the 2011-2013 budget in a way that meets our current responsibilities; while laying the foundation for reaching our destination – our vision for 2020.

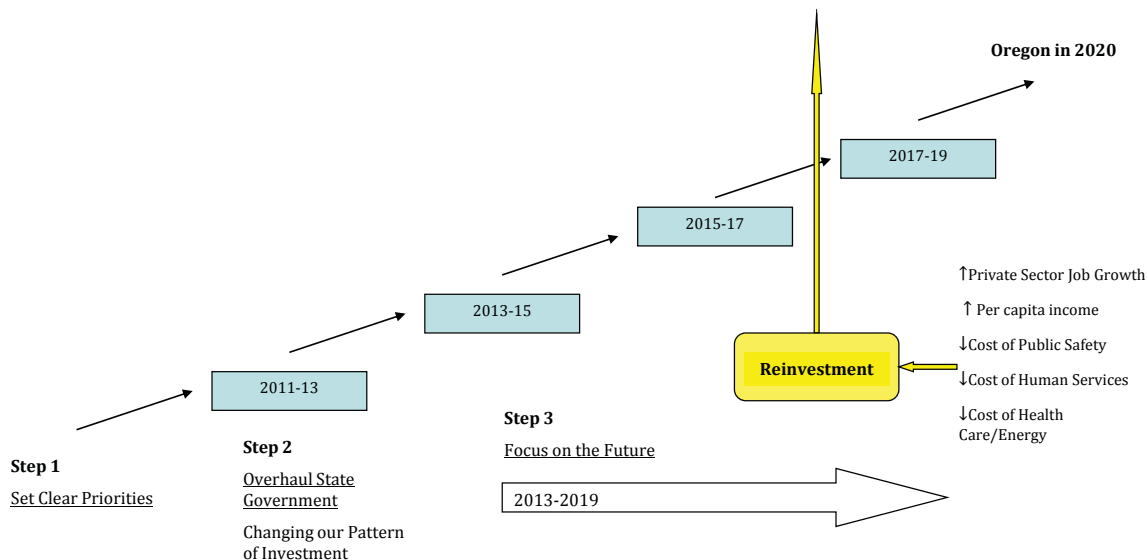
I believe that next year will be our most difficult -- which is why we have to approach it together and approach it correctly. We are at or near the low point in state revenues; and at or near the highpoint in terms of human need (more people on food stamps, the Oregon Health Plan, unemployment insurance, etc.). Therefore we should not delude ourselves into believing that balancing the next budget is going to be simple or easy. It isn't. It will require some very difficult choices; it will require managing to a clear set of priorities – within the revenue we have – and in a way that reflects our long term vision. It will require triage; and it will require leadership with the courage and discipline to look beyond the next two years to where we want Oregon to be in 2020.

But if we do this right – and if we do it together – the 2011-2013 beinnium can become the “floor” – the foundation on which we will rebuild our Oregon: rebuild our economy; rebuild our system of public education; rebuild our system of support for the vulnerable among us; and rebuild the sense of community which has always been a hallmark of Oregon and Oregonians.

In short we must view the upcoming biennium as the first and foundational step of four linked steps to achieve our vision by 2020. Toward that end, I will present to the 2011 Legislative Assembly with two documents. First, I will present a budget using the revenue we do have to begin to change our pattern of investments going forward and to lay the foundation for Oregon’s future – and a down payment on that future.

Second, I will present a prioritized “reinvestment budget” which will show how I propose to invest new revenues that become available in the future. In other words, I will lay out a plan that details the steps and investments we must make in 2011-2013; in 2013-2015; in 2015-2017; and in 2017-2019 in order to create a different future for our state.

### A Plan to Rebuild and Reinvest in Oregon

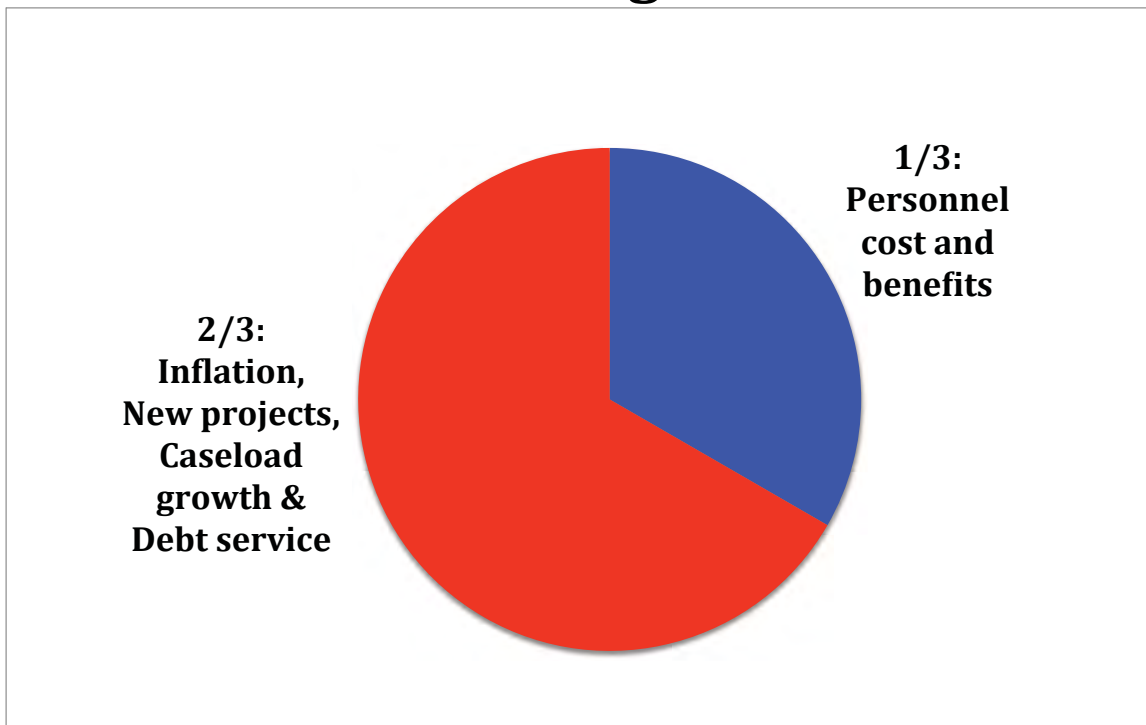


## Understanding the Budget Deficit

In the current biennium (2009-2011) the state general fund with lottery and one time money is just under \$15 billion (June forecast). The projected general fund budget for next biennium (2011-2013) is about \$18 billion. The difference -- \$3 billion -- is our projected revenue shortfall and reflects the projected roll-up costs in current programs and services and assuming no change in the way we do business. This future cost estimate -- known as Current Service Level (CSL) -- includes enrollment and caseload growth; general inflation; personnel costs; new programs, and other factors.

The CSL approach forces us to frame this challenge as a “budget cutting” strategy. We need to change the frame to an “investment” strategy –an opportunity to take the revenue we know we have and invest it differently going forward to create a solid foundation on which to build our future. And that means we need to understand and manage the major growth components of the projected shortfall.

## 2011-2013 Budget Shortfall

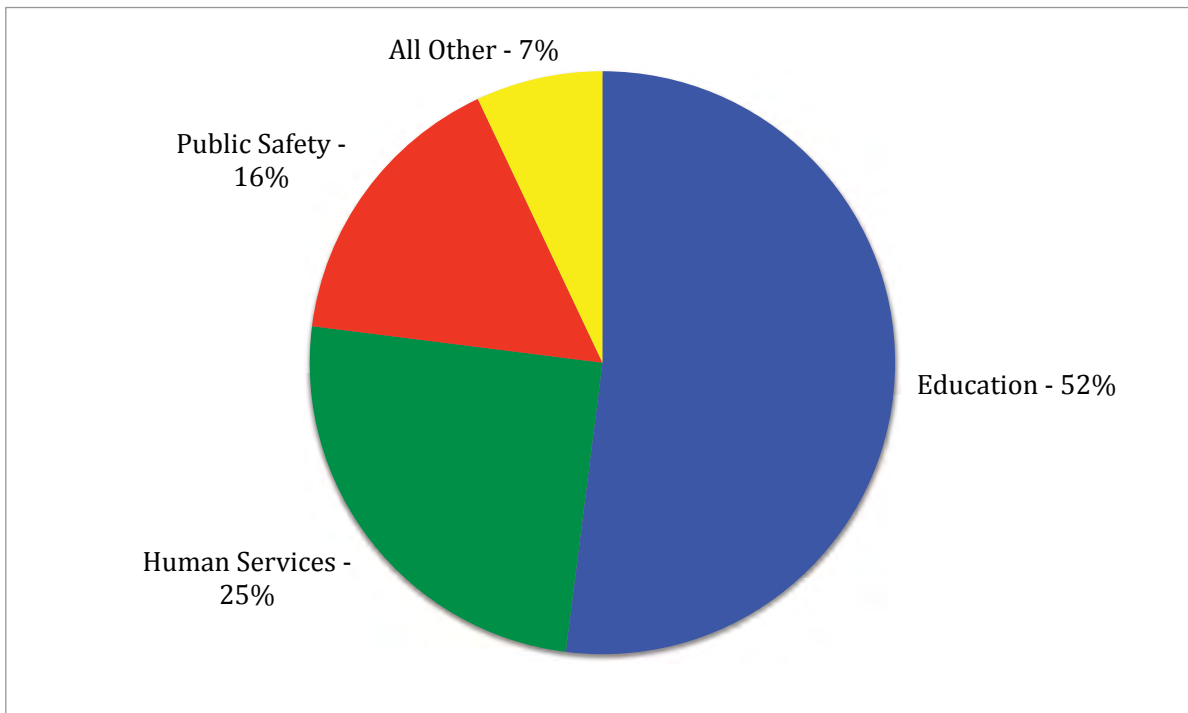


*Oregon Department of Administrative Services, June 2010*

One third of the shortfall is due to the growth of personnel costs; and two thirds is due to other factors: the loss of the stimulus money; general inflation in the cost of goods and services; increased caseloads; etc. The point here is that we cannot solve the budget crisis simply by addressing personnel costs: they are an important cost driver and must be addressed, but two thirds of the problem is due to other factors. In other words, the political narrative that wages and benefits for public employees are the chief cause of our budget shortfall is simply not true.

We also need to recognize that 93 percent of the dollars in the general fund budget are spent in three areas: education (52%); human services (25%); and public safety (16%). So the biggest management challenge lies in these three areas.

# 2009-2011 Investments & Expenditures



*Oregon Department of Administrative Services, June 2010*

Therefore, to balance the 2011-2013 budget we must:

1. Address the growth in personnel costs
2. Manage within available resources
3. Start to shift funding from managing preventable problems to investing in people by setting priorities within each budget area
4. Increase productivity, transparency and accountability

## Addressing the Growth in Personnel Costs

My overall policy in regard to public employee compensation is to eventually erase the artificial distinction between public employees and private employees – as well as the divisive politics which have grown up around this issue. To do that requires the objective that total compensation for public employees and private employees doing similar work in large labor markets be comparable. Furthermore, this objective must include a commitment to moving total compensation for all Oregonians upward until it exceeds the national average in every part of our state.

There are two components to addressing the increase in personnel costs. The first component will involve tough collective bargaining negotiations with the state employees represented by SEIU, AFSCME and other public employee unions. The issues which must be on the bargaining table include:

- PERS system reductions from changes to the 6% pick-up;
- Step increases and cost of living adjustments for existing workers;
- Value-based cost sharing for employee health care benefits

I will seek to reduce the projected increase in total compensation for public employees for the 2011-2013 biennium. I will seek additional savings by ensuring that total compensation reductions for state management employees – including the Governor – are comparable to or exceed those of represented

employees. I will also seek to reduce the ratio of management to front lines workers and minimize the impact on our lowest paid workers.

The second component of managing the increase in personnel costs involves the State School Fund which pays for primary and secondary education. Although the state provides most of the revenue for our K-12 system, teacher contracts are negotiated by individual bargaining units in 197 local school districts. My policy objective for the 2011-2013 biennium will be to place some conditions on how state resources will be spent at the district level. In other words, while agreements will continue to be negotiated at the local level, the state will predicate its funding for K-12 on the compensation and benefit agreements with state workers.

This will require that the results of local school district contract negotiations be reported to the state in a timely manner. The combination of these actions will not replace the local negotiation process but will set reasonable parameters since the state is ultimately responsible for funding over 70 percent of the agreements reached. This will restore an important degree of local fiscal accountability which was lost under Ballot Measure 5.

### Managing within Available Resources

We know that Oregon faces a revenue shortfall of over \$3 billion which reflects the projected roll-up costs in current programs and services, assuming no change in the way we do business. Because of the way the CSL budget is framed, one of the most frequent questions raised in this campaign is: “what are we going to cut?” The superficial answer is: “we are going to cut education, human services and public safety because that is where 93 percent of our money is spent.”

We **cannot** successfully approach the upcoming budget – or our future – in that way. The far more important question is this: “how do we take the revenue we do have and invest it going forward in a way that moves us toward what we want Oregon to look like in 2020. Our challenge is to view the next budget not simply as a two year balancing exercise but rather as the opportunity to lay the foundation for that future.

To do so we must manage each budget area within the resources we have available by spending those resources differently. The focus of how we invest our limited resources in the next two years must be on building a better future rather than simply perpetuating the past.

Let me offer a few examples of this management strategy in each of the major budget areas: education (e.g. K-12); human services (e.g. programs that deal with health, mental health and additions; services to seniors and those with disabilities; services to children and families); and public safety (e.g. corrections).

### EDUCATION [52% General Fund]<sup>2</sup>

Funding 2009 -11	Funding 2011-13	Projected CSL Increase	Difference = Deficit
\$7.575 B	\$7.575 B	\$8.806 B	\$1.231 B

### State School Fund (K-12)

Funding 2009 -11	Funding 2011-13	Projected CSL Increase	Difference = Deficit
\$5.752 B	\$5.752B	\$6.715 B	\$963 M

### Major Cost Drivers in State School Fund

- Enrollment Growth 6%
- Inflation (services/supplies) 6%
- Personnel Cost 88%

Education will have about \$7.575 billion in 2011-2013 which is almost exactly the same it is receiving in the current biennium. The projected roll up cost under the CSL is projected to be \$8.8 billion. The difference -- \$1.23 billion -- is the projected revenue shortfall.

Of the money allocated to Education, 78% -- or \$5.7 billion -- goes to the State School Fund for K-12. Again, this is approximately the same as it is receiving in the current biennium. The projected roll-up cost for K-12 is projected to be \$6.715 billion for a deficit of \$963 million. Furthermore, 88%<sup>3</sup> of the roll up cost in K-12 is in personnel.

## Management Actions:

- Establish a single unified education budget – the Oregon Education Investment Fund (OEIF) -- by combining the pre-K dollars in the Oregon Department of Education; with the State School Fund; and the budgets for community colleges and the Oregon University System. This fund will be managed by a newly created State Education Investment Board which will be responsible for investing these resources across the continuum of our 0 – 20 system of public education.
- Manage the increase in personnel cost (see section above).
- \$20 million from the OEIF will be combined with certain early childhood resources in the Department of Human Services to begin a sustained targeted investment in at risk children and families to reduce the achievement gap before these children reach school.
- Reduce duplication in education service districts (ESDs) by directing the 4.5 percent of the State School Fund currently allocated to ESDs directly to the districts which, in turn can purchase the services they value from ESD's or provide the services themselves.
- Develop a strategy for School District consolidation and the regionalization of services by 2012.
- \$20 million from the OEIF will be combined with \$40 million from the 4.5 percent of the State School Fund currently allocated to Education Service Districts to create an Education Outcome and Assistance Fund which will:
  - Target assistance to schools facing financial challenges
  - Promote development and dissemination of best practices targeted at student success
  - Smooth the change in ESD service delivery
- From the Oregon Education Investment Fund we will allocate the same percentage for K-12 as we do for the current biennium to create a "funding floor" --the level of state funding which our school districts will be able to count on every year from now to 2020. This is the floor from which we will rebuild as revenue becomes available from a recovering economy; and from other cost savings and efficiencies within the state budget.
- This level of funding will not be "adequate" by the current definition but it will be stable – which is a very important point. While the lack of adequate resources is the larger problem, the inability to know from month to month and year to year how much money is available makes management almost impossible.
- Establishing a stable funding floor will allow each district to see how much of the Quality Education Model (QEM) can be funded within that floor and what gap remains. This will allow us to mobilize the private sector, not-for-profit organizations and other community resources to help support our schools over the next two years.
- Establish Education Assistance Teams (modeled after the successful Community Solutions Teams of my previous administration) which will help galvanize and mobilize other community resources to help the school districts.
- Identify child support services within the Department of Human Services which might be more effectively and efficiently allocated at the school district level.

- Discourage the practice of simply cutting days from the end of the school year in order to preserve a functional school year that allows children to remain academically engaged and connected with their schools.

#### HUMAN RESOURCES [25% General Fund]<sup>4</sup>

Funding 2009 -11	Funding 2011-13	Projected CSL Increase	Difference = Deficit
\$3.535 B	\$3.535 B	\$5.300	\$1.77 B

#### Medical Assistance/Mental Health/Addictions [K-12]

Funding 2009 -11	Funding 2011-13	Projected CSL Increase	Difference = Deficit
\$1.473 B	\$1.473B	\$2.506 B	\$1.033 B

#### Seniors/Disabilities/Children/ Adults/Families

Funding 2009 -11	Funding 2011-13	Projected CSL Increase	Difference = Deficit
1.671 B	\$1.671B	\$2.215 B	\$644 M

#### Major Cost Drivers in...

##### Medical Assistance

- Caseload Growth 23%
- Inflation (services/supplies) 22%
- Personnel Cost 0.05%
- Loss AARA/One time \$ 46%

##### Mental Health Additions

- Enrollment Growth 24%
- Inflation (services/supplies) 9%
- Personnel Cost 54%
- Loss AARA/One time \$ 16%

##### Seniors/Disabilities

- Enrollment Growth 42%
- Inflation (services/supplies) 4%
- Personnel Cost 5%
- Loss AARA/One time \$ 49%

##### Children/Adults/Families

- Enrollment Growth 26%
- Inflation (services/supplies) 5%
- Personnel Cost 19%
- Loss AARA/One time \$ 45%

Human Resources will have about \$3.535 billion in 2011-2013 which is almost exactly the same it is receiving in the current biennium. The projected roll up cost under the CSL is projected to be \$5.300 billion. The difference -- \$1.77 billion -- is the projected revenue shortfall.

Of the money allocated to Human Services 89% -- or \$3.14 billion -- goes to two broad program areas: medical assistance, mental health and treatment of addictions (42%); and services for seniors, those with disabilities, children, adults and families (47%)

Unlike the State School Fund, the major cost drivers in these program areas are caseload growth, inflation and the loss of one-time revenue (especially the loss of federal stimulus dollars). For example, in the area of Medical Assistance, Mental Health/Addictions, inflation and caseload growth account for 45% of the projected deficit, loss of one time revenue accounts for 46% and the growth of personnel cost accounts for less than one percent.

Furthermore, many of the state general fund dollars in these programs receive federal matching dollars. For example, the state dollars in Medical Assistance, Mental Health/Addictions bring in nearly \$5 billion in additional federal dollars. State dollars spent on seniors, those with disabilities; children, adults and families leverage about \$3.3 billion in federal dollars.

To manage the human services budget we must set clear priorities and seek flexibility in how we use federal dollars, just as we did with the Oregon Health Plan.

## Management Actions

- Recognize that there are four primary ways in which costs can be managed in this area:
  1. Reducing the number of people who receive services;
  2. Reducing the number of services provided;
  3. Reducing what we pay those who provide the services (e.g. doctors, hospitals); and
  4. Changing the way services are delivered.
- Deploy all four strategies across our human resource programs recognizing that they must be deployed differently in different parts of the budget because the cost drivers are different.
- Guide all actions by a clear set of priorities including (but not limited to):
  1. Maintaining support/services for the most vulnerable;
  2. Considering cost-benefit/effectiveness of the services;
  3. Considering whether a reduction in services will result in the need for care in a more expensive setting; and
  4. Considering how much federal matching money is generated from each dollar of General Fund.
- Seek federal flexibility (waivers) to allow Oregon to begin to invest federal matching dollars in a way that moves us toward the future we want to build. Consider, for example, the important areas of protective services for children; and health care.

### *Foster Care*

One of the biggest cost drivers in child protective services is foster care. Over 50 percent of the kids who are in a foster home in Oregon have at least one parent with an untreated substance-abuse problem. It costs \$16,000 a year to keep a child in foster care. It costs between \$3,000 and \$4,000 a year to treat the parent. So our objective over ten years should not be to locate more foster homes, but rather to reduce the number of kids who need foster care in the first place. And to do that we need to treat the cause rather than the symptom.

The problem is that much of the federal revenue provided for child protective services must be spent on foster care and cannot be used for treating the parent with the substance abuse problem. This makes little sense and Oregon must seek waivers from the federal government to begin to shift those resources to front end prevention.

### *Health Care*

Throughout the area of human services – and indeed throughout the entire state budget, rampant medical inflation is a huge and growing cost driver. This problem will not be

solved with more money because this inflation is embedded in the way health care is organized and delivered. And double-digit medical inflation affects not only the state but private employers, families and individuals as well.

The State of Oregon is affected in two ways: first, in terms of the state’s responsibility to pay for health care for low income Oregonians; and, second as a large employer financing health care for public employees. This challenge cannot be resolved by changes within the budget of the Department of Human Services. It will require a separate comprehensive strategy that seeks to shift the focus of our delivery system from treating the acute complications of chronic conditions like diabetes, cardiovascular disease and asthma to prevention, wellness and the appropriate home and community based management of chronic disease.

We will be releasing our proposals to address this problem in October.

**PUBLIC SAFETY [16% General Fund]<sup>5</sup>**

Funding 2009 -11	Funding 2011-13	Projected CSL Increase	Difference = Deficit
\$1.862 B	\$1.862 B	\$2.221 B	\$359 M

**Corrections**

Funding 2009 -11	Funding 2011-13	Projected CSL Increase	Difference = Deficit
\$1.252 B	\$1.252 B	\$1.526 B	\$274 M

**Major Cost Drivers in Corrections**

- Prisoner/offenders caseload 7%
- Inflation (services/supplies) 10%
- Personnel Cost 38%
- Loss AARA/One time \$ 41%
- Debt Service 12%

Public safety will have approximately \$1.862 billion for the upcoming biennium. Like education and human services this is approximately the same amount we are spending on public safety in the current biennium. The roll-up cost for public safety is projected to be \$2.221 million for a deficit of \$359 million.

Of the money allocated to public safety 67% -- or \$1.252 billion -- goes to Corrections. Again, this is approximately the same as we are spending on corrections in the current biennium. The projected roll-up cost for corrections is \$1.526 billion for a deficit of \$274 million.

Let me be clear about one thing: we will spend these resources in a way that keeps dangerous people in prison and out of our communities. That is the primary responsibility of our system of public safety and we intend to fulfill it.

At the same time, we need to recognize that our long term goal is to invest in people not prisons -- to keeps kids in school and the workforce and out of the criminal justice system in the first place.

That means we must manage our current prison capacity in a way that avoids the necessity to open and operate another prison by seeking ways to shift investments from corrections to prevention – from incarceration to investing in people.

## Management Actions:

- Manage the increase in personnel cost (see section above).
- Reduce management and the non-security workforce
- Review overall sentencing policies for non-violent offenders; and a second look for juvenile offender under Ballot Measure 11
- Consider adopting portions of the federal system of earned time and prerelease custody

Oregon may not adopt all of these provisions, but our public safety policy will be guided by the objective of reducing the money we spend on corrections and increasing the money we spend to prevent people from getting involve with the criminal justice system in the first place.

## Transparent, measurable and accountable management

In addition to changing the way we invest our resources, we must also increase the efficiency of how they are managed. This will require Oregon state government to change – and change very quickly. It is the kind of change that only an experienced manager can deliver. Transformation will not be easy, but it can be achieved by following a clear path forward:

- *Accountable Management*

I will ask all state government managers to submit their resignations and will appoint or reappoint officials who demonstrate a clear commitment to lead a transformation in state government by focusing on increasing performance and reducing costs.

Managers will need to focus on cutting administrative overhead and transaction costs, not direct program services. Managers will be required to get written approval from my Chief Operating Officer (the Director of the Department of Administrative Services) before they propose cuts to the direct services delivered to Oregonians.

- *Require Public Cost-Benefit Reports Every Program/Every Year*

I will require each state agency and program manager to produce, within 45 days of the election (and within 90 days after each subsequent fiscal year), a concise analysis of the actual costs and benefits achieved by every program during fiscal year 2009-10 (or the previous fiscal year). These reports will measure the end results each program actually delivered to Oregonians, and will be posted online for public review. Annual public reports will help improve program performance and allow Oregonians to see what they get for the tax dollars they send to Salem.

- *Use these Cost-Benefit Reports to prioritize state budget*

I will use these Cost-Benefit Reports to prioritize programs in state government. The Governor's Recommended Budget will fund the highest-priority programs that can be accomplished given the limited resources available. If legislators believe some other program is a higher priority, they will need to specify which other program they will cut to provide necessary funds. The difficult choices and tradeoffs needed to balance the budget will be fully transparent to citizens.

- *Final 2011-13 Budget incorporates projected savings*

Working with the Legislature we will take reasonably projected savings from reorganization, consolidation and elimination of programs and improvements in the effectiveness and efficiency of programs into account in preparing the final 2011-13 budget.

- *Investing in the Future*

The 2011-13 budget will be part of a 10-year budget projection that shows expected

future costs and investments. As the country emerges from the Great Recession, the 2011-13 biennium will be the trough in state revenues and peak in need for services. I plan to invest additional revenues and savings into education, early childhood measures and other “preventative” programs that over the long-term reduce the need for high-cost corrections and human service programs.

## Step Three: Focus on the Future

The third step is to make sure we stay the course; that we stay on the compass heading to our destination; and that we never go back. This is a ten year journey, not a two year journey; so we must view it through the lens of a ten year budget strategy; not just a two year strategy.

Step three involves developing a “reinvestment budget” to ensure that the way we invest the new revenues that become available in the future builds on the priorities we establish in the next budget; keeps us on course; and keeps us headed toward our destination. And there will be new revenue -- from growth in the private sector economy; from the savings we will realize in public safety and social services by investing in people; and from lowering the cost of energy and health care.

As we take these three steps – and particularly the most difficult second step which we now face – we must remind ourselves that it is not always going to be like this. It is going to be better. We are at the low point in state revenues; and the highpoint of human need. So if we do this right – and if we do it together – the next biennium can be the foundation on which we will rebuild our Oregon: rebuild our economy; rebuild our system of public education; rebuild our system of support for the vulnerable among us; and rebuild the sense of community which has always been a hallmark of Oregon and Oregonians.

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1. State of Oregon, Office of Economic Analysis, September 2010 Revenue Forecast
  2. State of Oregon, Department of Administrative Services, Budget and Management Division, June 2010
  3. State of Oregon, School Local Revenue Forecast, Legislative Revenue Office, May 2010
  4. State of Oregon, Department of Administrative Services, Budget and Management Division, June 2010
  5. State of Oregon, Department of Administrative Services, Budget and Management Division, June 2010