Feeling the Squeeze: Counties Likely to Boost Property Taxes, Cut Services if Inheritance Tax Ends
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Our mission is to improve opportunities for every Nebraskan by providing impartial and precise research, analysis, education and leadership.
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If Nebraska follows through on a proposal to eliminate the state’s inheritance tax, the ability of many counties to deliver essential services will be threatened, and property tax increases will be highly likely in many counties.

Under Nebraska’s system of government, the role of counties is closely tied to state government. Most services that counties provide have been delegated to them by state government. And the state tells counties what options they have for raising the money to pay for those services. That’s why the inheritance tax is so important to counties’ ability to provide important services. The counties are charged with collecting the inheritance tax for their use. The money – averaging about $43 million per year over the past three years – contributes to keeping roads safe, administering elections, and supporting business through zoning and licensing, among many other functions.

Besides providing day-in, day-out services, counties also play critical roles in times of emergencies like drought, floods, fires, and other natural disasters. They can’t plan for these emergencies other than to maintain sufficient reserves, but even with such reserves unforeseen events can place great burdens on counties.

Nebraska’s 93 counties use their inheritance tax revenues in multiple ways. Some attempt to set the money aside for rainy days or major infrastructure projects. Some put the money directly toward general operating expenses to help fund essential services and keep property taxes down. In practice, most do some combination of the two.

Losing the inheritance tax would come on top of counties seeing declines in various forms of state and federal financial support, such as elimination of the State Aid to Counties Program and reimbursements for housing state prisoners, further hampering their ability to deliver services that are crucial to the quality of life Nebraskans have come to expect. Many counties are already taking extreme measures to meet their state-imposed obligations. Hall County, for example, is saving money by turning paved roads into gravel, which are cheaper to maintain. In addition to the problems that such drastic measures can cause for the quality of life and ability to do business in these communities, a further concern is that counties
could reach a point at which they can’t sustain further service cuts or increase property tax levies without violating the Nebraska Constitution or state law.

For most counties, alternatives to the inheritance tax would be few and painful. Several counties containing Nebraska’s mid-sized cities would suffer most, including Adams, Buffalo, Dodge, Gage, Hall, and Platte counties. This high level of fiscal stress would extend to rural areas throughout the state as well, from Keya Paha to Red Willow to Richardson.

The Inheritance Tax in Nebraska
Since 1901, real and personal property owned by Nebraska residents or located in Nebraska has been subject to an inheritance tax. The rate of the tax and the amount of an inheritance subject to that tax depend on the relationship of the recipient to the person who owned the property. For example, surviving spouses pay no tax. Close relatives and siblings pay one percent on the part of inheritance that exceeds $40,000, remote relatives pay 13 percent on the amount over $15,000, and non-relatives pay 18 percent on the amount over $10,000.

The amount collected varies greatly by county, from Grant County receiving $8,524 per year on average over the past three years to Douglas County receiving an average of $8.5 million. Inheritance tax revenue ranges from .88 percent of the General Fund budget in Keith County to 22.33 percent in Blaine County.

Alternatives to the Inheritance Tax
Counties vary widely in the amount of financial reserves they have been able to accumulate, their property tax rates, and their flexibility to use those reserves or change those rates. Consequently, the ability to adapt to a loss in the inheritance tax also varies greatly by county. Most counties would have to choose some combination of reducing services, drawing down their reserves, and raising property taxes.

Reduced Services: It is unlikely that very many counties could reduce spending to compensate for the loss of their inheritance tax revenue without serious declines in services like public safety and road maintenance. Nebraska counties have a history of controlling their spending (see Figure 1 on page 3). In inflation-adjusted dollars, county spending per person remains lower today than it was in fiscal year 2004.

In some counties these cuts have been significant even without accounting for rising costs due to inflation and population pressures. Twenty-three counties reduced their budgets from fiscal year 2011 to fiscal year 2012, and nine counties have a smaller fiscal year 2012 budget than in fiscal year 2010. Lancaster County, for example, has
reduced spending about 15 percent over the past two years, and Banner County by 13 percent. Already dealing with the effects of the recent recession and cuts in state aid, further reductions would likely cut deeply into those vital services.

**Drawing Down Reserves:** In addition to paying for essential day-to-day services, many counties use their Inheritance Tax Funds as savings accounts. These reserves are used to save for large one-time expenses that are planned, such as an important infrastructure project, and as “rainy day” funds to help counties weather unexpected events. York County, for example, recently had to dip into its Inheritance Tax Fund to purchase snow removal equipment during a winter emergency.

Counties are advised to maintain “rainy day” reserves equal to at least two months of General Fund expenditures at all times. Failing to do so can not only interfere with their ability to provide services but also their ability to repay their debts. For this reason, credit rating agencies like Fitch, Moody’s, and Standard & Poor’s look closely at these reserves when evaluating county creditworthiness. Insufficient reserves may cause credit downgrades, leading to higher interest rates on borrowing, bringing even more trouble for county budgets.
**Property Tax Hikes:** Raising taxes on Nebraska property owners may be unavoidable for many counties. However, there are two state-imposed limitations that will make it difficult for some counties to replace the loss of the inheritance tax with a property tax increase.

The first state-imposed limit on property taxes is the “levy limit,” which constitutionally limits the total property tax rate that counties can charge to 50 cents per $100 of property value. At least 19 Nebraska counties were already at their limit in fiscal year 2011, and at least 39 were within 90 percent of that limit. This leaves little flexibility to increase property taxes to absorb the loss of a revenue source like the inheritance tax or deal with unexpected expenses.

The second limit on property taxes is called the “spending lid,” and functions as a limit to how much certain revenues can grow from year to year. The standard limit on revenue growth is 2.5 percent, and county boards can increase it to 3.5 percent if three-fourths of board members approve. Ninety percent of county boards did so in fiscal year 2012, suggesting that the 2.5 percent target is very difficult to meet. In fact, nearly half of all counties (46 of 93) would be unable to replace inheritance tax revenues with property taxes without a public vote to exceed 3.5 percent.

These two state-imposed limitations can only be exceeded through countywide public override votes. Such elections can be costly for the counties to administer, and levy limit overrides only last a maximum of five years before another public vote is required to renew them.

**Other Revenue Options:** Counties in Nebraska have few other revenue sources outside of state-set fees, property taxes, the inheritance tax, state aid, and federal aid. Unlike its municipalities, Nebraska’s counties do not have broad authority to impose occupation taxes on activity at businesses such as hotels, restaurants, bars, and telecommunications companies. Counties’ use of occupation taxes is limited to businesses outside city limits that charge admissions for certain types of events. Due to these limitations only 10 counties have occupation taxes. Collectively, they brought in less than $30,000 in fiscal year 2012.

Counties can also enact sales taxes, but there are significant limitations with this option as well. Local option sales taxes apply an additional rate of 0.5 to two percent on top of the state sales tax rate of 5.5 percent. Many Nebraska municipalities levy such a tax, but under state law, the county sales tax can only be applied to transactions that take place outside any municipalities that have their own sales taxes.
Consequently, the potential revenue from county sales taxes is minimal. Only one county, Dakota, charges sales tax. The 0.5 percent tax cannot apply within Jackson or South Sioux City, which have their own sales taxes.

Counties can also impose a lodging tax on the total gross receipts charged for sleeping accommodations furnished by hotels in the county; however, those proceeds may only be used for local visitor promotion and improvement activities.

For these reasons, and because the fees that counties can charge for such things as licenses and court fees are set by the state legislature, it would be a mistake to expect that counties could rely on these revenue sources to any significant degree as a way to make up for revenue lost by eliminating the inheritance tax.

**Likely Effects of Inheritance Tax Elimination for Nebraska Counties**

If counties replaced all of the lost inheritance tax revenue with an increase in property taxes, the average overall county tax rate would have to increase by 7 percent. For the average Nebraska farm, this would mean a property tax increase of $476 per year. More likely, counties would consider other options, such as cutting services or tapping reserves to make up some of this revenue loss. A useful way to explore the variance between counties and their ability to

**Figure 2: How Ending Inheritance Tax Harms Counties**

- Counties that will suffer the most hardship because they have low reserves and cannot raise property taxes to replace the revenue without exceeding property tax limitations
- Counties that can temporarily manage the loss of revenue by drawing down their reserves but lack flexibility to raise property taxes when those reserves run out
- Counties with low reserves and room under state property tax limitations to replace the revenue through increased property taxes
- Counties with the most flexibility to manage the loss of revenue
manages the loss of inheritance tax revenues is to divide counties into the four
categories analyzed below. Please see Figure 2 on page 5 for a color-coded map
of Nebraska’s counties by category.

**Counties that will suffer the most hardship because they have low
reserves and cannot raise property taxes to replace the revenue without
exceeding property tax limitations**

Approximately 26 counties are in this most dangerous category. If these counties first
turn to replacing the inheritance tax with reserves, they would have on average less
than two years – in many cases much less – before their reserves are reduced below
recommended levels, risking service lapses and credit downgrades. Garfield and
Hamilton Counties, for example, already have reserves below recommended levels.
These 26 counties are the most likely to slash services, or if a reduction in services
isn’t feasible, ask local taxpayers through a county-wide vote to raise property taxes
beyond existing property tax limitations.

For 10 of these counties, inheritance tax revenues contribute more than 10 percent
of the general fund budget.

These counties are *Adams, Buffalo, Dakota, Dodge, Fillmore, Furnas, Gage,
Garfield, Greeley, Hall, Hamilton, Hayes, Hitchcock, Holt, Jefferson, Johnson,
Keya Paha, Merrick, Platte, Polk, Red Willow, Richardson, Saline, Thurston,
Valley, and Webster.*

**Counties that can temporarily manage the loss of revenue by drawing
down their reserves, but lack flexibility to raise property taxes when
those reserves run out**

There are 36 counties in this category. Each could potentially replace inheritance tax
revenues by tapping their reserves for at least three years, but once those reserves
have been exhausted, these counties will find themselves in the same pinch as the 26
counties in the previous category.

If sufficient service reductions cannot be achieved while these counties draw down
their reserves, raising property taxes will be the only remaining option, but a public
vote to exceed the property tax limitations would be required to do so. And one-
third of these counties are already at the maximum 50-cent property tax levy.
Moreover, the apparently large reserves in many of these counties may be an illusion,
for example if the money is being saved for a badly needed infrastructure project
that cannot be ignored.
The counties in this category are Antelope, Banner, Boone, Brown, Butler, Burt, Cass, Cherry, Cheyenne, Clay, Colfax, Custer, Deuel, Dixon, Franklin, Garden, Howard, Kimball, Lincoln, Madison, McPherson, Nance, Nemaha, Nuckolls, Pawnee, Perkins, Rock, Scotts Bluff, Sheridan, Sherman, Thayer, Washington, Wayne, Wheeler, and York. Four of them – Blaine, Nuckolls, Sherman, and Thayer – have large enough reserves that they may be able to avoid a public vote on the matter by phasing in property tax increases over time, but this would mean several consecutive years of property tax increases in these counties.

**Counties with low reserves and room under state property tax limitations to replace the revenue through increased property taxes**

This category comprises eight counties that would have to cut services or raise property taxes, as they do not have sufficient reserves to cover the loss of the inheritance tax revenue. However, they would not be constrained by state limitations if they have to make up the lost revenue by raising property taxes.

Half of these counties have already made recent budget cuts. Lancaster, as mentioned earlier, has cut its budget 15 percent over the last two years. Five counties in this category – Douglas, Lancaster, Loup, Morrill, and Saunders – are either already dangerously low on reserves or would be in less than one year, and the remaining three – Dawson, Harlan, and Otoe – have one to three years of draining their reserves before they would drop below recommended levels. Whether increasing property taxes is politically feasible is a separate question, but these counties do have capacity to do so under the state-imposed limits.

**Counties with the Most Flexibility to Manage the Loss of Revenue**

Approximately 23 counties have larger reserves and would not be constrained by state limitations if they have to make up the lost revenue by raising property taxes. With at least four years before they would reduce their reserves below minimum recommended levels, these counties have a bit more flexibility to manage the loss of inheritance tax revenue than other counties. That is not to minimize the importance of the inheritance tax revenue to these counties, who use it to bolster their reserves and keep property taxes down. In Cuming, for example, inheritance taxes equal over 20 percent of the general fund budget. However, relative to the other 70 counties, these counties are in an enviable position.

The counties in this category may have large reserves because they are saving for important projects. Cedar County, for example, recently used its Inheritance Tax Fund to set aside money to expand the county courthouse and bring the building
into compliance with federal Americans with Disabilities Act regulations. Also, unexpected expenses could arise at any time, putting these counties on less solid ground. Finally, while adjusting to elimination of the inheritance tax may be less painful in these counties than in others, gradual property tax increases and service reductions will be inevitable in these counties as well.

These 23 counties are *Arthur, Box Butte, Boyd, Cedar, Chase, Cuming, Dawes, Dundy, Frontier, Gosper, Grant, Hooker, Kearney, Keith, Knox, Logan, Phelps, Pierce, Sarpy, Seward, Sioux, Stanton*, and *Thomas*.

Endnotes

1 Subject to certain exemptions, Neb. Rev. Stat. §77-2001 to §77-2040.
2 These include aunts, uncles, nieces, nephews and their lineal descendents, Neb. Rev. Stat. §77-2005.
3 Inheritance tax revenue data retrieved from county budget documents submitted to the State Auditor of Public Accounts.
4 See Appendix for a description of the methodology used in this report.
6 Adjusting for inflation, these numbers would increase to 39 counties with smaller budgets in fiscal year 2012 than in fiscal year 2011, and 34 with smaller budgets in fiscal year 2012 than in fiscal year 2010. Sufficiently detailed data are not available to also account for population changes in each county.
7 See Appendix for a description of the methodology used in this report.
9 See Appendix for a description of the methodology used in this report.
12 Specifically, “recreational, cultural, entertainment, or concert events” (Neb. Rev. Stat. §77-27,223). Another state statute (Neb. Rev. Stat. §23-386) allows county “occupation” taxes on “community antenna television service,” but we are only aware of one county with such a tax (Lancaster), and there it is considered a franchise fee; it raises approximately $100,000 annually.
13 As of 2006, 93 percent of total sales in Nebraska were already subject to a municipal sales tax and would thus be off limits to a potential county sales tax. Since then, 52 more municipalities have implemented the local option sales tax, bringing the total number of Nebraska cities and villages with a local option sales tax to over 200.
14 See Appendix for a description of the methodology used in this report.
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Nebraskans depend on counties to help keep their communities safe and healthy. The past few years have been hard on counties. State aid has been cut and federal aid has shrunk and is expected to further shrink. Losing any revenue source would only make things worse.

The loss of inheritance tax revenue would leave most counties with an impossible choice: slash services, deplete reserves, or raise property taxes. Many counties have already had to deeply cut services. The Nebraska wildfires and drought of 2012 serve as a painful reminder that emergencies happen, but many counties may feel that with the loss of inheritance tax revenue their only option is to tap into these reserves and cross their fingers. For many counties raising property taxes will be a last resort, but it may be an unavoidable option.

This debate over the inheritance tax, coupled with the dire consequences that would come from its repeal, reinforce the need to explore comprehensive state and local tax reform. In the meantime, the state would be well-served if the counties began collecting and reporting inheritance tax statistics, such as who pays the tax, how much beneficiaries pay, etc., so that these data can help inform the debate. Until the implications of eliminating the inheritance tax are studied in the larger context of tax reform, the better choice for preserving Nebraska’s future is to keep the inheritance tax, a proven source of funds to meet important needs.

Conclusion

Nebraskans depend on counties to help keep their communities safe and healthy. The past few years have been hard on counties. State aid has been cut and federal aid has shrunk and is expected to further shrink. Losing any revenue source would only make things worse.

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Appendix: Research Methodology

Property Tax Levies and Limits:
The property tax levy limit for counties is 50 cents per $100 of property value. Counties can allocate a portion (up to 15 cents) of their 50 cent maximum levy to sub-districts within their borders, for example rural fire districts. These allocations are considered part of the county’s levy and included in the 50 cent limit. The sub-districts may choose not to use the full allocation, or alternatively they may vote in a town hall meeting to approve a levy greater than their allocation from the county. Data on which sub-districts approved such overrides are not available. To estimate the portion allocated to sub-districts in each county, we used the maximum rate actually charged in each type of sub-district, added them together, and capped the total at 15 cents. Using the maximum rate accounts for the fact that some sub-districts may use less than their allocated amount, and capping the sub-district total at 15 cents helps account for the fact that some of the sub-districts may have overridden their allocated amounts via a town hall vote. We also capped the total in each county at 50 cents as another way to limit the possibility of overestimating due to overrides at the sub-district level. This methodology and our results have also been confirmed anecdotally in conversations with county budget officials.

To estimate the average property tax increase across all counties (see text accompanying footnote 14), we use a somewhat different measure that includes taxes paid for bonds and overrides but is weighted for the amount of property value that is subject to each rate. This is a better estimate of the average property tax rates paid to the counties by all property owners, which can differ from the calculation used by the counties to determine how close they are to their levy limits.

Data on property tax levies in the counties and sub-districts such as townships, rural fire districts, and other miscellaneous districts was obtained from the Department of Revenue Property Assessment Division, primarily from their Certificate of Taxes Levied reports. Levies approved to pay off bonded indebtedness are exempted from the levy limit and were excluded from this analysis.

Reserves: The Government Finance Officers Association (GFOA) recommends that all general-purpose governments keep a reserve balance equal to at least two months (16.7 percent) of their General Fund budgets. Credit rating agencies
such as Moody’s and Standard & Poor’s look at a variety of factors to determine their ratings (which in turn determine interest rates on government bonds) and do not publish a specific recommendation for the level of reserves, but it is generally considered a “red flag” to have reserves below 15 percent of the budget. In this paper we use GFOA’s 2-month recommendation as the line that counties should generally avoid falling below.

Although not all counties in Nebraska use their Inheritance Tax Funds as reserves for the General Fund (many use it to save for major capital projects), for purposes of this paper we combine all Inheritance Tax Fund balances and General Fund balances and treat them as reserves available to the General Fund. This was necessary in order to apply the same standard to all counties, but will overstate the true availability of reserves in many counties.

General Fund expenditures are used for this purpose because that is the measure that the ratings agencies tend to examine. We also use General Fund expenditures when examining inheritance tax revenues as a share of the total budget (for example, see text accompanying footnote 4). For purposes of looking at changes in the budget over time (i.e. in Figure 1 and the text accompanying footnotes 5 and 6), the measure of spending is total Operating Expenses from all funds, which is a more comprehensive measure than General Fund expenditures.

**Spending Lids:** The state-imposed “spending lid” is a cap on how much local budgets can grow from one year to the next. After allowing exceptions for certain types of spending growth and rapid construction of new taxable property, the standard lid is 2.5 percent. As discussed in the text above, county boards have the ability to approve an additional 1.0 percent on top of this, and nearly always do.

When determining the amount their budgets can grow, counties perform a calculation that includes most major county revenue sources, such as the property tax and state aid, but does not include inheritance tax revenues. This is because inheritance tax revenues can vary greatly from year to year. However, because inheritance taxes are not included in this calculation but property taxes are included, raising property taxes to replace lost inheritance tax revenues would register as “growth” in the budget, causing problems for many counties even if they were only seeking to maintain the previous year’s level of revenue.

Because the 2.5 percent lid is nearly always overridden by county boards, and the question does not have to go to a public vote unless the county wishes to exceed 3.5 percent growth, we use the 3.5 percent lid in this paper. We calculated how much room each county had beneath that 3.5 percent maximum in the most recent budget...
year and compared that amount to their average annual inheritance tax revenues to
determine whether they could replace the lost inheritance tax revenue with property
taxes. We also adjusted these figures to account for the possibility that a county may
increase property taxes in smaller amounts over a number of years while drawing
down its reserves.

**Estimate of Property Tax Increase for Average Nebraska Farm:**

According to the Institute of Agriculture and Natural Resources at the University of
Nebraska- Lincoln, the average farm size in Nebraska in 2012 was 972 acres at an
average value of $2425 per acre. According to our calculations, the average property
tax levy is 38 cents per $100 of property valued. Since agricultural land is taxed at 75
percent of value\(^\text{20}\), this average farm, valued at $2.357 million, would see a property
tax increase of $476 if the county levy was increased seven percent.

Endnotes


17 Neb. Rev. Stat. §77-3443. The full list of miscellaneous districts that share in the counties’ 50 cent levy limit is: Rural
and Suburban Fire Districts, Airport Authorities (County, City & Joint), Libraries and Bookmobiles, Townships,
Road Improvement Districts, Railroad Transportation Safety Districts, Cemetery Districts, Drainage Districts,
Community Buildings Districts, Agricultural Societies, Hospital Districts, Public Building Commissions, Historical
Societies, Reclamation Districts, Ambulance Districts, Metropolitan Transit Authorities, Downtown Improvement
Districts, Metropolitan Utilities Districts, Parking Districts, and Community Redevelopment Authorities. Nebraska
trendsshift.htm on November 12, 2012.

BestPractice.pdf on November 8, 2012.

19 Lid exceptions include allowable capital improvements, bonded indebtedness, public facilities construction
projects (Neb. Rev. Stat. §72-2301 to 72-2308), interlocal agreements, joint public agency agreements, public
safety communication projects (Neb. Rev. Stat. §86-416), judgments, refunds of property taxes to taxpayers,
repairs to infrastructure damaged by a natural disaster, and reassumption of the property assessor function.

OpenSky Policy Institute: Clear Thinking for a Stronger Nebraska

OpenSky’s mission is to improve opportunities for every Nebraskan by providing impartial and precise research, analysis, education and leadership.

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