

With Nebraska facing a \$1.2 billion shortfall through FY21¹, figuring out how to close it will be one of biggest challenges for the 2017 legislature. In order to prepare for the budget debate ahead, OpenSky has prepared three policy briefs to help inform the discussion. The first policy brief examined how previous large shortfalls were addressed. The second brief explored the contribution of past revenue measures to the current shortfall. This third and final brief discusses recent reports that highlight future budget uncertainty as additional factors to be taken into consideration as the legislature begins its work.

Current shortfall could be rooted in structural issues

Recent reports on national fiscal trends show that Nebraska's current budget shortfall might be part of a larger structural trend that could be further exacerbated by potential changes at the federal level. The reports help highlight the need for Nebraska's lawmakers to exercise caution this legislative session in order to keep the state on steady fiscal footing.

State and local revenues slowing nationally

The Rockefeller Institute² and the National Association of State Budget Officers (NASBO)³ recently released reports that found state and local revenue growth was lower in FY16 than in FY15 in most states. This is certainly true in Nebraska where lagging revenue growth has contributed to our growing budget shortfall. Causes for the declines in revenue cited by NASBO and Rockefeller include a slowdown in the post-recession recovery as well as regional economic changes, growth in untaxed internet sales and long-term demographic changes, among other factors.

Rockefeller reports that the future revenue picture for states "remains gloomy" and that "state tax revenue growth is likely to remain slow and highly uncertain throughout the remainder of FY17." NASBO notes that even the most optimistic projections of future revenues lag behind the projections for future budget growth. Recent data⁴ shows this

¹ Nebraska Legislature, "General Fund Financial Status," downloaded from <http://www.nebraskalegislature.gov/FloorDocs/Current/PDF/Budget/status.pdf> on Dec. 28, 2016.

² Rockefeller Institute, "Widespread Declines in State Tax Revenue in 2016," downloaded from http://www.rockinst.org/pdf/government_finance/state_revenue_report/2016-11-30-srr_105.pdf on Dec. 21, 2016

³ National Association of State Budget Officers, "The Fiscal Survey of the States, Fall 2016," downloaded from <https://higherlogicdownload.s3.amazonaws.com/NASBO/9d2d2db1-c943-4f1b-b750-0fca152d64c2/UploadedImages/Fiscal%20Survey/Fall%202016%20Fiscal%20Survey%20of%20States%20-%20S.pdf> on Dec. 21, 2016.

⁴ Nebraska Department of Revenue, "General Fund Receipts – November 2016," downloaded from http://www.revenue.nebraska.gov/news_rel/dec_16/November_General_Fund_Receipts_12-15-2016.pdf on Dec. 21, 2016.

may indeed be the case in Nebraska, as our budget shortfall is projected to grow to \$1.2 billion in the FY20-21 biennium.⁵

GAO: Shortfalls could persist for 40 years

Budget shortfalls experienced by states in 2016 are likely to persist for upwards of 40 years, a recent report by the U.S. Government Accountability Office⁶ finds. The persistent shortfalls are likely to occur because of the increasing costs of health expenses and pensions that will mount as our population continues to age. GAO writes that in order to close the fiscal gap, state and local governments will need to either reduce spending or raise taxes by 3.3 percent annually.

Potential federal tax changes present new uncertainty for states

Talk of major tax cuts at the federal level has created a major new source of uncertainty at the state level, the Rockefeller report noted. The report's authors write, "States will need to worry about at least three kinds of effects, all of which are highly uncertain: (1) the impact of tax reform on the economy; (2) the direct impact of tax reform on state government tax bases in cases where states conform to federal tax law; and (3) indirect impacts on state tax revenue as taxpayers change their behavior in anticipation of, and in response to, federal tax reform." They go on to say that "states will need to do their best to understand and estimate these potential impacts, and then buckle up for the ride."

Federal tax actions often have consequences at the state level. In response to federal tax changes made in 2003, which reduced the calculation of federal adjusted gross income, Nebraska lawmakers passed legislation to offset most of these changes and reduce the fiscal impact to the state.⁷ Had the state not enacted these measures, the federal changes would have resulted in Nebraska losing about \$303.4 million in revenue in the FY04/05 and FY06/07 biennia.⁸ But even with these adjustments, the federal tax changes still resulted in a \$53.3 million loss of state revenue over that same period.

Summary

As the Legislature takes on the budget challenge ahead, we hope this brief series has raised up important issues for consideration. First, that the current \$1.2 billion shortfall

⁵ Nebraska Legislature, "General Fund Financial Status," downloaded from <http://www.nebraskalegislature.gov/FloorDocs/Current/PDF/Budget/status.pdf> on Dec. 22, 2016.

⁶ U.S. Government Accountability Office, "State and Local Governments Fiscal Outlook, 2016 Update," downloaded from <http://www.gao.gov/assets/690/681506.pdf> on Dec. 21, 2016.

⁷ LB 596 (2003)

⁸ Nebraska Legislature, "State of Nebraska, FY04/05 Biennial Budget," downloaded from http://www.legislature.ne.gov/pdf/reports/fiscal/2003budget_0910.pdf on Jan. 23, 2017. See pages 30-32, for details on federal tax changes.

could grow in size due to a variety of structural issues, including a growing fiscal gap between revenue and spending that will increase as our population ages, and past tax changes that can act as unnoticed drains on revenue. Second, that past budget shortfalls of this magnitude haven't been closed through budget cuts alone. And third, that there is uncertainty about changes at the federal level that could increase the size of Nebraska's budget shortfall. All of these points will be important for our lawmakers to keep in mind as they look to address Nebraska's budget shortfall.