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Nebraska's Tax System: At A Crossroads

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Introduction

The old adage (at least the tax part of the phrase) that "nothing is certain except death and taxes" has taken a new twist in Nebraska. There are few other policy issues in Nebraska's political arena today where the level of uncertainty about the outcome is as high.

For a number of reasons, we face a situation today that is approaching political gridlock and institutional meltdown. Citizen concern and discontent regarding state and local taxes and tax policy are running at a feverish pace. Moves and countermoves among the various interest groups and units of government have led to a continued unraveling of our tax system.

Is our tax system in a crisis state? I believe it is in this sense. I see Nebraska at a critical juncture--decisions facing the state in the coming months will bear heavily on the outcome. The outcome of our decisions could be a balanced, fair, and visionary tax system. Alternatively, the outcome could be a hodgepodge of political tax posturing that leaves Nebraska and its citizens limping into the 21st century.

I hope, as I'm sure we all do, that it is the former and not the latter outcome that prevails. But for this to happen, I believe we must approach tax issues and fiscal policy with a new mindset. Rather than reactive or crisis management, we need to assume a proactive style of decision making. Proactive decision making means seeing the longer run, not just the short run; it means understanding the total system, not just a specific component; it means considering broader societal interest, not just individual interest.

It is in this proactive context that I would like to discuss some of the pressing issues of our current tax system. We first will review Nebraska's tax structure and compare it with other states. Second, we will reflect on some fundamentals of sound tax policy. Finally, we will discuss some potential ways in which Nebraska could move toward a visionary tax system.

The Present Tax System

Nebraska's state tax structure comprises three primary broad based taxes: a general sales tax, a personal income tax, and a corporate income tax. The state's general sales tax of 4 percent on most retail items generated about $364 million in 1987. This figure equals about $245 per person, ranking Nebraska 38th of the 45 states that have sales taxes. Nebraska's per capita rate was just 73 percent of the average for the 45 states using the sales tax and lower than all of its neighboring states,

State Economic Scoreboard

Change from same month one year ago.
See Review and Outlook on page 9 for more details.

	State	Metro+	Nonmetro
Motor Vehicle Sales (November) Constant $	↓ -6.0%	↓ -2.6%	↓ -8.6%
Nonmotor Vehicle Sales (November) Constant $	↓ -1.4%	↓ -4.4%	↑ 1.7%
Building Activity (November) Constant $	↑ 19.9%	↑ 15.2%	↑ 26.1%
Employment (January)	↑ 3.1%	↑ 4.2%	↑ 1.9%
Unemployment Rate* (January)	↓ 3.1%	↓ 2.8%	↓ 3.5%

+Omaha and Lincoln. *Unemployment is this month's rate, not a percent change from year ago.

with the exception of Colorado. If this state would have been at the U.S. average ($328 per person), over $140 million in additional sales tax revenues would have been generated by the state sales tax.

The state personal income tax component generates a level of revenue comparable to that of the sales tax. In fiscal 1987 personal income tax revenues were more than $348 million, about $226 per person. Nebraska ranked 32nd on a per capita basis of 44 states that employ the personal income tax, below all of its neighboring states. (Wyoming and South Dakota have no sales tax.) Nebraska's per capita personal income tax rate was 66 percent of the average for the 44 states using the personal income tax in 1987. If Nebraska had been at the U.S. average of $344 per person, state personal income taxes in fiscal 1987 would have totaled $530 million, over $180 million more than was collected.

Another way to assess personal income taxes is to express such taxes as dollars per $1,000 of personal income. In fiscal 1987 Nebraska's rate was $16.39 per $1,000 of personal income, about 70 percent of the overall average and 35th of the 44 states using the personal income tax.

Nebraska's corporate income tax generated about $73 million in revenues in 1986. As a percent of all state tax collections, the corporate tax percentage share ranks Nebraska 33rd among the 46 states that employ the corporate income tax.

The state's low rank is due in part to the fact that its tax rate (or burden) on corporate income is only 50 percent of the national average, ranking Nebraska 43rd of the 46 states. This tax source is staged to fall even more in coming months as the first impacts of LB775 become evident. Department of Revenue researchers now speculate that corporate income tax receipts could fall 5 percent to 10 percent.

There are other tax sources for the state, but these three generate the bulk of revenues. Total state tax revenue on a per capita basis was $755 in 1987. This level was about 75 percent of the 50 state average. Nebraska ranked 44th on an overall basis. Of our neighboring states, only South Dakota was lower. In short, Nebraskans' tax burden at the state level is modest by almost every measure.

Although the state-level tax burden is comparatively light, the local tax burden in the form of property taxes in Nebraska is among the heaviest in the nation. Property tax collections on a per capita basis were $730 in 1988, generating more than $1.1 billion of revenue. The per capita rate of $636 ranked Nebraska 13th among the 50 states in 1987, a rate nearly 28 percent higher than the U.S. average. When calculated on a per $1,000 of personal income basis, property tax collections in 1987 were $46--only seven other states were higher. This rate was nearly 35 percent higher than the U.S. average.

The property tax burden converges on the property owner, regardless of income considerations. The resulting disparities can be even greater. For example, in Nebraska the average effective tax rates (taxes as a percent of $100 of market value) on single family homes with FHA-insured mortgages was 2.29 percent in 1985, compared to the national average of 1.21 percent. A 1988 Syracuse University study of Nebraska's tax system found that only in New York and New Jersey were effective property tax rates higher on single family homes.

Likewise, for holders of Nebraska farm real estate, taxes per $100 of market value in 1987 averaged $2.04, as compared to $.86 nationwide. In 1987, Nebraska claimed one of the highest tax rates on agricultural real estate. These high rates were before the Nebraska Supreme Court mandated a change in farmland assessment that raised tax obligations on this property class even higher.

Combining both state and local tax collections leads to a per capita average of $1,460 for fiscal year 1986, about 88 percent of the national average and 28th among the 50 states. The rate was $106 when expressed as dollars per $1,000 of personal income, placing Nebraska 34th among the states.

It is important to recognize at this juncture that tax structure can not be analyzed independently of the other side of the fiscal coin, i.e., expenditures. The obvious question is, "How does Nebraska compare in terms of state-local expenditures?"

As noted in Table 1, Nebraska's overall expenditure level by state and local units of government is in line with its tax collection performance. In fiscal year 1987, per capita expenditures in Nebraska averaged $2,479, 92 percent of the U.S. average. Expenditures by government placed Nebraska 30th among the states on a per capita basis. We are not big spenders.

One major item, elementary and secondary education, was essentially equal to the U.S. average of $644 per capita, putting Nebraska in 19th place. For some items, Nebraska's per capita expenditures outpaced most states. Direct highway expenditures of $284, for example, were 33 percent higher than the U.S. per capita average, ranking the state 12th overall. High per capita expenditures are expected in a state characterized by relatively large area and low population density.

To some extent, low population density also explains the higher per capita expenditures for health and hospitals and higher education. Institutions have high fixed costs. At the same time, per capita outlays for public welfare, law enforcement, and corrections were considerably below the U.S. average.

The overall expenditure picture does not indicate excessive spending and fiscal irresponsibility by state and local units of government. At issue is how Nebraska allocates the tax burden between different forms of taxation and between different layers of government.

Nebraska's current tax structure is unique. Nebraskans have chosen to follow a path of fiscal decentralization, with continued heavy reliance on local property taxes and relatively modest levels of taxation at the state level. To a considerable extent, the state and local mix reflects the limited role that state-collected tax revenues play in providing local services, principally public education.

According to recent findings of Nebraska's School Finance Review Commission, local sources in Nebraska account for 70 percent of the revenues for public elementary and secondary schools, while the state provides 24 percent and federal sources the remaining 6 percent. In contrast, the U.S. average shows local sources providing 44 percent, the state 50 percent, and the federal government 6 percent of education costs.

Few other states rank below Nebraska in terms of percentage of public school funding provided by state aid. Other states have continued to move toward more state-level support, but Nebraska has done

Table 1
State-Local Expenditure Patterns For Nebraska and The U.S.
Per Capita Levels for Selected Items
Fiscal Year 1987*

	Per Capita Nebraska	Average U.S.	% of U.S. Average	Nebraska Ranking
General Expenditures	$2,479	$2,695	92 %	30th
Elementary & Secondary Education	645	644	100	19th
Higher Education	311	247	126	12th
Direct Public Welfare	260	329	79	25th
Direct Health & Hospitals	265	234	113	12th
Direct Highway	284	214	133	12th
Direct Police	66	101	65	38th
Direct Corrections	38	68	56	40th
Direct Protective Inspection & Regulation	16	18	89	22nd

*Source: Advisory Commission on Intergovernmental Relations, *Significant Features of Fiscal Federalism*, 1989 Edition, Volume II (August 1989)

just the opposite. The state share of school expenses paid using state tax sources in Nebraska has decreased since the early 1980s. School support has become even more dependent on local property taxes.

It is little wonder that many of the major policy issues of our current tax crisis arise from the property tax component. Let me highlight briefly:

1. The status of agricultural land assessment is in flux. In response to Nebraska Supreme Court rulings in 1984 and 1987, the uniformity clause in the Nebraska Constitution still mandates uniform assessment across all classes of property. Actual market value of agricultural land is required. A market value base was enacted under LB361 in 1989. This statute, according to the Nebraska Department of Revenue, resulted in an average increase in valuation of 43 percent for agricultural land in 1989 and could add a 12 percent to 16 percent increase in 1990.

2. A proposed Constitutional amendment scheduled for the ballot in November would allow agricultural and horticultural land to constitute a distinct class of property for purposes of taxation, thereby permitting nonuniformity with other classes of property.

3. Personal property exemptions have been granted in federal district court by railroads and railcar line companies using the equal protection clause of the U.S. Constitution. This ruling resulted in an estimated $12 million loss to local governments in Nebraska.

4. The 1988 Nebraska Supreme Court decision granting pipeline companies exemptions from Nebraska's personal property tax may impact local governments severely. Personal property refunds to these companies from local units of government due to this court decision may exceed $4 million.

5. Subsequent to the Supreme Court's pipeline decision, there has been a proliferation of appeals for personal property exemptions from over 240 companies.

6. Enactment of stopgap measures in the November 1989 special legislative session to limit tax refunds and to redefine certain items as real property in order to isolate taxes from personal property exemptions temporarily has delayed the fiscal loss of some $70 million in personal property tax revenues.

7. A one year property tax relief package was funded through June 1990 from the state general fund surplus.

8. In the present legislative session, a proposed extension of the one year property tax relief bill and a major overhaul of the school finance system would lead to reduced dependency on property taxes.

The above list is incomplete, but I think the point is clear--our tax system is in a state of flux. If we are to proceed in any systematic manner of tax reform, we need to reflect on the basic fundamentals of sound tax policy.

Basic Principles of Sound Taxation

Any tax system evolves in response to a number of influences--economic, social, and political. No tax system has been constructed by a master architect according to optimum requirements for a good tax structure. Yet ideas or principles of sound taxation have had their influence.

Tweeten and Brinkman state that "a good tax system should be easy to administer, generate an adequate amount of revenue, and be fair to the taxpayers." Few would disagree. The trouble lies in implementation. We need more specifics.

In their classic book on public finance, Richard and Peggy Musgrave list several attributes of a good tax system:

1. The distribution of the tax burden should be equitable. Everyone should be made to pay his or her fair share.

2. Taxes should be chosen to minimize interference with economic decisions in otherwise efficient markets. Such interferences impose excess burdens that should be minimized.

3. Where tax policy is used to achieve other objectives, such as to grant investment incentives, changes should be made in a way that minimizes interference with the equity of the system.

4. The tax structure should facilitate the use of fiscal policy for stabilization and growth objectives.

5. The tax system should permit fair and nonarbitrary administration. It should be understandable to the taxpayer.

6. Administration and compliance costs should be as low as is compatible with the other objectives.

Certainly, there are situations where these objectives may conflict. Tradeoffs often are needed. Moreover, we could debate at length the merits of the various elements of a sound tax system without reaching a consensus. Nevertheless, these elements can serve as a useful framework for us to consider. The common ground of agreement may be far greater than we realize. If we were to proceed with these basic principles and our long-run vision for the State of Nebraska, I believe we may find a fertile environment for systematic and innovative tax reform.

Toward a More Visionary Tax System

For discussion purposes, permit me to sketch a few ideas of how we could proceed. I begin with a set of givens:

1. Even though many politicians do not have the fortitude to admit it, increased taxation in some form is inevitable in the years ahead. That is the case in Nebraska for a variety of reasons:
   * Continued maintenance, upgrading, and development of our public infrastructure will be required. At the same time federal funding sources may diminish.
   * Nebraska's natural resources will take public dollars to protect and nurture. Again, the state's role of responsibility and initiative likely will expand relative to that of the federal government.
   * Excellence in public education and development of human capital through lifelong learning is the key to successful living in the 21st century. As a state, we need to invest heavily in this public good. As Justice Oliver Wendell Holmes once stated, "taxes are what we pay for a civilized society."

2. The citizen is not averse to paying taxes as long as he or she shares a common vision of societal objectives and a sense of equity in opportunity and tax fairness. Partiality creates dissension and divisiveness, while fairness creates community. It is my opinion that the voter is not totally preoccupied with tax avoidance.

3. Our present state and local tax structure retains a relatively high degree of localized autonomy and fiscal responsibility, while the expenditure needs and societal objectives increasingly transcend local tax boundaries and become statewide in focus. Omaha, Ord, and Oshkosh are not independent entities. Neither are Lancaster County and Lincoln County. We are increasingly interdependent, and our governmental functions are no exception. Therefore, fiscal responsibility, it seems to me, is evolving toward more statewide emphasis.

Assuming these three givens, one logical first step would be school financing reform. There is currently in legislative debate LB1059, a bill addressing many of the factors previously discussed. The bill was submitted under the signatures of 32 of the state's senators.

LB1059 is first and foremost an educational bill, even though tax implications abound in it. Its primary goal is to provide all Nebraska children a more equitable opportunity for an appropriate education, with consideration given to the vast geographical and financial disparities that exist in Nebraska. It would increase state financial support from the present 24 percent to about 45 percent. That increase would reduce aggregate property taxes an estimated 15 percent. The tax shift would be from local property taxes to some combination of increased state income or sales taxes.

Is such a tax shift reasonable? There are several reasons to suggest that it is. If one considers tax equity on the basis of benefits received, then attributing the lion's share of public education expenses to a tax on property is ill conceived. It reflects a system appropriate for an economy based on a yeoman type of agriculture--something this country has not had for more than a century.

Children of property owners and non-property owners alike are being educated. Unlike expenditures for roads, bridges, and law enforcement that directly benefit property owners, the benefits of public education are indirect at best. The criterion of equity on the basis of ability to pay is distorted by heavy dependence on property taxes for funding education. Large property wealth disparities exist among school districts--there is often no relation to ability to pay. These disparities often lead to distorted educational opportunities as well as tax inequities.

A tax shift from local property taxes to a state-level income or sales tax also implies some geographic shift in tax incidence. Some would argue there will be a shift in the tax burden from rural to urban areas. One can counter that point partially by considering that nonurban school districts across the state have been subsidizing urban areas for decades, as high percentages of nonurban high school graduates have migrated to those urban areas as educated and productive adults.

The school financing reform question ultimately involves an implied tax increase at the state level, something the electorate is never happy to see. Yet I believe that when the public understands the importance of this step to their young persons and the associated enhanced equity of taxation, they will support it.

Let's turn to another component of our tax structure--the corporate income tax. Nebraska currently has one of the lowest corporate income tax rates in the nation. Some would argue that these low rates are part of a sound policy to induce economic development and expansion in the state, but the economic literature does not provide decisive support of this policy.

Although there may be some logic to this argument, I believe we need to consider this dimension in a more holistic context. Corporations operating in Nebraska are also our neighbors, utilizing essentially the same public goods and services as anyone else. The question could be raised, "Why are they not obliged as good neighbors to meet their fair share of state and local tax responsibilities?"

In the special legislative session last fall some senators proposed a corporate tax increase, probably in response to the large number of business firms filing for personal property tax exemptions. The senators' patience with business entities seeking tax avoidance was obviously growing thin. But the general electorate also is concerned about earlier tax concessions associated with LB775 (the Employment and Investment Growth Act) and the perceived disparity of its effects on corporate tax liability when individual taxes were rising concurrently.

We are at a logical point to consider raising corporate income tax rates, at least to levels comparable to national averages, without imposing excessive burdens on corporate interests. Obviously, there would be some negative response to such an increase. In view of the long-run interest of the state, I think the visionary members of the corporate community would understand this step as part of their responsibility to Nebraska's future as well as to their own economic well-being. In turn, the individual tax payer also would perceive a greater sense of equity.

The third issue to consider is the assessment of agricultural land for property tax purposes. Under the uniformity clause in our state constitution, we presently must assess agricultural land on a market value basis. But on the ballot next fall will be a constitutional amendment to allow agricultural and horticultural land to be a distinct class of property for purposes of taxation. This amendment would allow farmland to return to a use-value assessment procedure.

Voters overwhelmingly passed a similar constitutional amendment in 1984, only to have it voided by the Nebraska Supreme Court. The outcome next fall is uncertain. Voter sentiment may be far different than that of 1984, when Nebraska was in the midst of a farm crisis. The vote could be seen as simply a tax shift issue, with farm and nonfarm groups pitted against one another.

In reality the farmland tax issue is a much broader one. Nebraska farmland taxes per $100 of value are some of the highest in the nation. The property tax burden on this state's production agriculture creates an economic disadvantage relative to farm production sectors in other states. Forty-six other states employ a use-value assessment scheme to tax agricultural land, reflecting the notion that earnings in current use are a more reasonable measure of ability to pay. It is ironic that Nebraska, ranking fourth in the nation in terms of cash receipts from farm marketings, now is imposing the higher market value concept instead of an income-derived value on agricultural land for tax purposes.

There are also legitimate questions to be raised about the administration of a market-derived assessment process to agricultural property that is dominated by markets with low rates of turnover and the sale of parcels or add-on units rather than whole farm units. A reliable and equitable procedure would dictate considerable administration costs--a violation of one of the principles of sound taxation. Thus, on the basis of administration as well as on the basis of being a tax burden on a key sector of our state's economy, the farmland assessment issue demands thoughtful deliberation by the electorate.

A fourth dimension of the current tax stew is the proposed one year extension of property tax relief and no less than four bills advocating spending lids for state and local units of governments. The electorate's widespread frustration over tax burdens, particularly property taxes, has forced these reactionary measures. Given the frustration index, a case can be made that these measures are needed. But this is political football.

Shifting some state general fund surpluses into a property tax relief package is a short-run measure. Moreover, when governmental spending lid provisions are attached, it can cripple rational public sector planning for years. I think we must conclude that by all measures this pending legislation is devoid of long-run, visionary policy for the state. We can ill afford many more of these political jump starts when a fundamental overhaul of our fiscal system is long overdue.

These are but a few of the specific tax issues facing Nebraskans in the coming months. Our tax structure is complex. Stress points are proliferating. I think we need to empathize with our administrative and legislative branches who face a monumental task of guiding the state toward rational tax policy while dealing with immediate needs on many fronts.

I conclude by suggesting a modest proposal for the fiscal policy process. Why not establish an ongoing fiscal congress to focus on tax and expenditure issues of state and local governments? The objective of this fiscal congress would be to monitor and assess our system in a comprehensive and systematic manner and to recommend appropriate policy measures and sequences of adjustment. A necessary part of this overall effort would be a vigorous, comprehensive statewide fiscal educational program. Representation would be broad based. It would include members of the executive and legislative branches of state government, officials and employees of various state and local units and agencies of government, representatives of the economic community, and sound representation from the general citizenry. The fiscal congress would need to identify the longer-run direction or vision of the state in terms of fiscal components and then design an appropriate system of revenue generation. Their challenge would be to do what Peter Drucker advocates in his book, *The New Realities*:

> . . . organize around agreement over ends, indeed, to mobilize the consensus on ends--This also may be the only way to undercut the paralyzing power of the small minorities.

From this consensus, based on ideals as well as reality, I believe we could see spirited debate spawning new and effective institutional configurations of fiscal policy.

We are at a tax crossroads. And it is time to seize our opportunities.

Rural Growth Outpaces Urban Growth

The rural growth rate outpaced the urban rate between 1986 and 1988, according to a 1989 U.S. Census Bureau report on rural and rural farm populations.

The U.S. rural population, which includes all nonurban residents, recorded a growth rate of 2.6 percent, exceeding the urban rate of 1.7 percent.

The higher rural growth rate runs counter to the trend for urban population growth rates to exceed rural rates that has existed in almost every decade of U.S. history. One exception to the trend occurred during the 1970s, when urban growth recorded only a 0.1 percent increase. The slight growth that did occur was due to a change in the definition of urban areas by the U.S. Census Bureau. Under the previous definition, urban population figures would have shown a decline of 0.2 percent.

Nationally, one-fourth of the population (about 65 million persons) lived in rural areas in 1988. These areas are defined as open country and areas with less than 2,500 persons. Large cities, their suburbs, and other places with more than 2,500 inhabitants are not included in the Census Bureau's definition of rural areas.

When 1990 census data are collected and analyzed, the 1988 growth may not be reflected, the Census Bureau said. During the 1990 census, urban area boundaries will be redefines, and many of the areas currently defined as rural will be reclassified as urban. Some of the 1988 growth, therefore, will be labelled as urban.

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Nebraska Credit Unions

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Introduction

Credit unions traditionally have been cast as the homely cousin in the banking industry, not possessing the glamour of commercial banks or savings and loan associations (S&Ls). Recent changes in the competitive environment have allowed credit unions to adopt increasingly bank-like services. In order to survive in the big league, however, credit unions must adopt more of the financial management acumen of the banks and S&Ls and even must run the risk of losing some of the special benefits that have allowed credit unions to grow rapidly.

Credit Unions in Nebraska

Credit unions form a relatively minor segment of the credit market, but they have played an important role in the provision of credit. For the year ended December 1988, Nebraska had 118 credit unions. Forty-seven were state chartered, and 71 were federally chartered. Over 18 percent of Nebraska's population belongs to a credit union.

The history of credit unions in Nebraska closely follows that of credit unions in the rest of the country. Although the state's first cooperative credit law was passed in 1919, it was not until a wave of bank failures in 1921 that Nebraskans began to organize cooperative banks.

The credit law, however, precluded these cooperative organizations from replacing commercial banks. An act was passed in 1943 that allowed conversion of cooperative credit associations into credit unions, thereby establishing state-chartered credit unions in Nebraska.

The credit union movement has grown rapidly since that time. Figure 1 shows the growth of credit unions in Nebraska. Although the number of credit unions leveled in the '60s and decreased in the '80s, membership generally has continued to increase. The membership of Nebraska credit unions swelled over 40 percent between 1978 and 1988. The United States credit union membership increased about the same percentage over this ten year time period.

Why are Credit Unions Special?

Credit unions developed as a response to the demand for consumer credit. The consumer credit market traditionally has been undersupplied due to a number of factors. These factors include the relatively high cost of originating and servicing a consumer-oriented loan, high fixed costs, and poor information flows.

Credit unions are member-owned or mutual institutions. The cooperative nature of credit unions is one factor that allows credit unions to strike a competitive advantage in the market for consumer credit. Because credit unions generally do not pay directors and officers, operating expenses are relatively low.

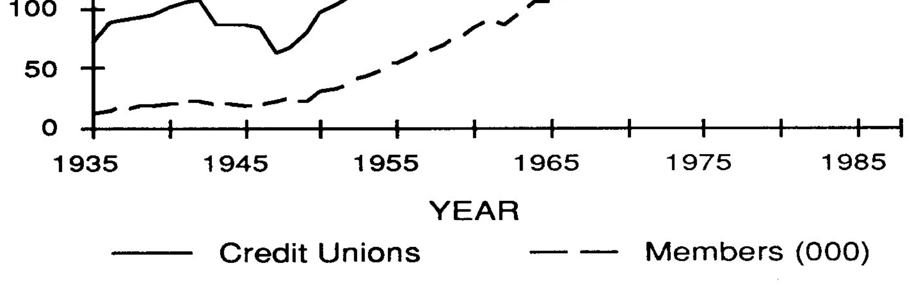
Where there is an occupational common bond, members generally know each other, and the costs of gathering credit information are low. In addition, where there is a sponsor relationship, the sponsor may be able to supply accurate income data for members, reducing the costs of verifying income data. The sponsor also may support the credit union with capital and labor subsidies by providing such benefits as paid time off from regular employment for volunteer officials, office space and furnishings, and payroll deductions. Payroll deductions are particularly important; approximately 90 percent of credit unions with occupational common bonds provide this service. Furthermore, the sponsor relationship provides prompt notice of employee termination to the credit union and may prevent the credit union from making a bad loan to an employee who has just quit his or her job. Occupational and associational organizations together comprise 96 percent of all credit unions.

In addition to employer subsidies, credit unions may receive subsidies from other sources. For example, state credit union leagues and the CUNA Mutual Insurance Society receive government subsidies such as exemptions from federal income taxes. In addition, subsidies furnished by sponsors are deductible business expenses for the sponsor. Credit unions serving government employees, a major part of the industry, sometimes are granted free space and payroll deductions.

Market Share

Nebraska credit unions held over $838 million in savings effective December

Figure 1
Nebraska Credit Unions
(1935-1988)



31,1988. This holding represents a relatively minor share (3.5 percent) of the Nebraska savings market--Nebraska commercial banks had $15.1 billion (63.9 percent) in deposits, while Nebraska savings and loan associations held $7.71 billion (32.6 percent) in deposits at the same time.

At the national level, U.S. credit unions only control 6 percent of consumer savings. Credit union market share is better in certain sectors of the loan market. For example, U.S. credit unions controlled 12.8 percent of the installment credit market and 14.7 percent of the auto loan market in 1988.

Figure 2 shows the percentage of U.S. savings held by various types of savings institutions as of December 31, 1988.

Although credit unions do not enjoy the same market share as commercial banks, they have had comparable growth rates. Figure 3 shows the five year moving average growth rates for U.S. credit unions and the average for all other depository institutions from 1975 to 1988. Credit unions generally have enjoyed a superior growth rate relative to other depository institutions over this period. Credit unions grew 14.5 percent on average over the period. That growth compares favorably to commercial bank rate of 11.7 percent over the same period.

Analysis of the asset size distribution of credit unions suggests credit unions tend to favor a relatively small asset base. As of December 1988, nearly 21 percent of the number of credit unions had assets of less than $500,000. The second largest category is between $2 million and $5 million in assets, with 19.28 percent of the nations credit unions falling into the category. Only 2 percent had assets over $100 million. Loan delinquencies and losses for small credit unions tend to exceed the industry averages, and their loss reserves do not cover delinquencies.

Many of the factors that help to make credit unions competitive also can work against them. The geographical and associational relationships may restrict loan diversification opportunities.

Regulation

Government regulation of credit unions is similar to government regulation of banks, mutual savings banks, and savings and loan associations. In the dual chartering system, state-chartered credit unions are chartered, examined, and supervised by the states. Federally-chartered credit unions are chartered, examined, and supervised by the National Credit Union Administration, a federal government agency.

The Depository Institutions Deregulation and Monetary Control Act of 1980 signalled a shift toward reliance on competitive market forces to stimulate competition among financial institutions. The consequences of these changes are only now beginning to be felt. For some institutions previously protected from the rigors of competition, the change has been difficult. Other institutions have not developed the necessary commercial skills and have moved too quickly into areas where they possess no competitive advantage.

As a result of deregulation, many institutions have had the benefit of insurance, but have been not paying the cost associated with the riskiness of their loan portfolio. Deregulation on credit unions has led to an expansion of credit union activities into areas that traditionally have been the province of other depository institutions.

Share Insurance Funds

Credit unions differ from most other financial institutions--their deposits are classified as shares and are part of the institution's equity, rather than part of its liabilities. The proportion of available cash to members' deposits, like other financial institutions, is necessarily kept low.

To guard against the risk of runs, credit unions, like banks or other financial institutions, participate in share (deposit) insurance funds. The largest insurer of credit union shares is the National Credit Union Share Insurance Fund, insuring 96 percent of all credit union shares. The remaining 4 percent are insured by 11 state credit union funds or guaranty corporations. Only six credit unions operated without some form of share insurance coverage during 1988. Nebraska state law requires participation in the insurance program of the National Credit Unions Administration.

Table 1 shows the ratio of the deposit insurance fund to insured deposits for banks, S&Ls, and credit unions.

In 1985 credit unions recapitalized the National Credit Unions Share Insurance Fund by adding 1 percent of their insured shares to the fund. Since then, the NCUSIF has been the healthiest of the three federal deposit insurance funds.

The Financial Stability of Credit Unions

The nation's Credit Union Share Insurance Fund appears healthy. A study by Veribanc, a credit analysis firm in Woburn, Massachusetts, found the nation's credit unions to be in a safer financial position than the savings and loan institutions.

There are indications, however, that deregulation has forced credit unions to

Figure 2
U.S. Savings Institutions
Over-the-Counter Savings (1988)

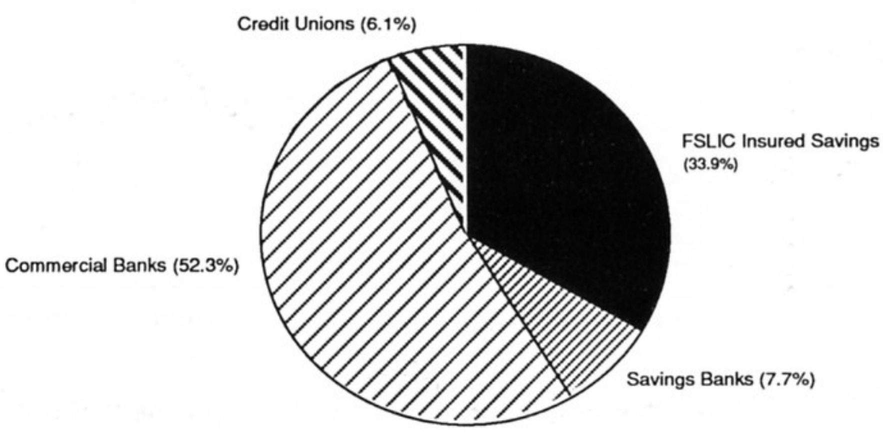


Table 1
Deposit Insurance Fund/Insured Deposits
(percentage)

Date	Banks	S&Ls	Credit Unions
6/89	0.79	(negative)	1.25
12/88	0.80	(negative)	1.24
12/87	1.10	(negative)	1.23
12/86	1.12	(negative)	1.24
12/85	1.19	0.45	1.28
12/84	1.19	0.62	0.31
12/79	1.12	0.29	0.32

expand their mortgage lending activities to compete with S&Ls and banks. As credit unions turn to new lending avenues in an attempt to keep members, they are assuming a greater risk of portfolio losses.

For example, credit unions are holding a greater proportion of 30 year fixed rate mortgages. According to the National Credit Union Administration, the altered loan portfolio of credit unions places these institutions at risk if interest rates rise. If interest rates were to increase, the net interest margin of some credit unions would be squeezed. The institutions would have insufficient reserves to cushion the impact of their losses.

It is estimated that a three percentage point rise in long-term interest rates could cause some of the credit unions' fixed rate investments and loans to lose nearly 25 percent of their value. The losses could drive more than 150 of these institutions into technical insolvency. Although federally insured credit unions have adequate insurance funds, 12 percent of credit unions do not have federal insurance and are insured by state or private cooperative funds with varying degrees of safety.

Although for the most part credit unions generally have a favorable management record, as they engage in increasingly bank-like activities there will be a need for management accountability with control systems to protect the interests of stockholders (depositors) and creditors.

A review by the National Credit Union Administration of 575 of the 1,269 credit unions that failed in the 1981-1985 period finds that the most common cause of credit union failure was mismanagement. The other major cause of failure was weak internal operations, such as sloppy record keeping or failure to control expenses. Poor lending procedures or inadequate lending polices had a major impact in 63 percent of the failures examined.

The remaining failures were attributed to various other factors: apathetic board of directors (56 percent), runaway expenses (46 percent), shabby record keeping (41 percent), weak or nonexistent lending policy (31 percent), employee cuts by sponsoring employers (26 percent), declining membership (21 percent), sponsor failure (19 percent), and negative rate spread (19 percent).

Insufficient liquidity was regarded as critical in only 4 percent of the cases, and as important in 9 percent of the cases. Excess liquidity also may be a concern. Although too much liquidity is better than not enough, excess liquidity may tempt credit unions to put too much money into high yield risky investments.

Future Prospects

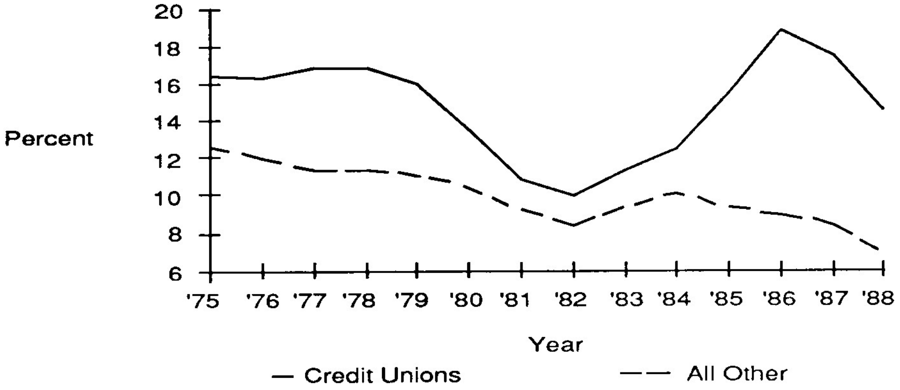
A possible future threat to credit unions is the much discussed taxation of credit union income. Currently, no credit union may be taxed on its income or financial assets by any level of government. Real property, however, is fully taxable. Many of the larger credit unions, however, have come to resemble thrift institutions--they offer services such as first and second mortgages, direct deposit, automatic teller access, preauthorized payments, credit cards, safe deposit boxes, and discount brokerage services. Of the 57.5 million credit union members in the United States, 49 percent now belong to full service credit unions.

As the common bond definition has grown, credit unions have moved into the traditional customer base of savings institutions and commercial banks. For example, the National Credit Union Administration recently granted a federal charter to the American Association of Retired Persons. The AARP has a membership in excess of 28 million persons and is open to anyone age 50 or older willing to pay $5 for annual dues.

Credit unions contend that the original reason for their special tax treatment--that they operate without profit and solely for the benefit of their members--justifies their current status. As their competitive position improves, however, there have been calls from the Congressional Budget Office to tax credit unions like other thrift institutions.

Future prospects for the industry will be determined largely by the response of the industry to competition in the rapidly changing environment of the financial sector. A more competitive environment carries increased risk. Increasing competitive pressure from technological advances in commercial banking may strain credit unions' customer base. The industry will have to move from its Mom and Pop image toward a more professional visage. The challenge for the NCUA will be to motivate member credit unions to adopt adequate control mechanisms to assure prudent financial management.

Figure 3
U.S. Savings Institutions
Five Year Moving Average Growth Rates



Review and Outlook

John S. Austin, Bureau of Business Research, Research Associate

The interdependence of the world economies is demonstrated when the lead story on the *Today* program concerns a major downturn in the Japanese stock market. Fortunately, our own markets have reached a level of international sophistication and did not overreact to what is essentially a domestic Japanese problem. It is refreshing that the American focus is now a broader world view than might have been true only a few years ago.

Some of the most dramatic news was contained in both the Consumer and Producer Price Index (CPI and PPI) reports. The PPI for finished goods in January advanced 1.8 percent. The bulk of this price acceleration was through rapid increases in energy prices due principally to a shortage of fuel oil on the east coast. The PPI for energy advanced 13.6 percent in a single month. Wholesale energy prices already have fallen from their shortage level. The PPI for food increased 2.1 percent in January, led by a whopping 58 percent increase in vegetable prices due to the Florida freeze. Nonfood, nonenergy producer prices advanced 0.1 percent in January, following a December increase of 0.5 percent.

The CPI advanced 1.1 percent in January, the biggest increase in seven years. The major elements affecting that advance were food and energy prices. The nonfood, nonenergy CPI rose 0.6 percent. These major increases in the price indexes should be temporary. There is some speculation that the PPI may decrease in the February report.

As previously indicated, one of the few sources of hope for breaking through the doldrums of 1990 is housing. January housing start numbers showed a dramatic increase, leaping to 1.625 million units at annual rates from a depressed December figure of 1.254 million units. We should not put too much credence into these numbers because the January advance reflected more of a recovery from poor weather conditions in December than any fundamental change in the housing area. January housing start data are always subject to large variation. The seasonal factors for this month are so low that any moderate increase in actual numbers will

Table I
National Indicators

	Annual		Quarterly (SAAR)			
	1988	1989	1989:I	1989:II	1989:III	1989:IV
Real GNP (percent change)	4.4	3.0	3.7	2.5	3.0	0.9
Real Consumption (percent change)	3.4	2.7	2.0	1.9	5.6	0.4
Housing Starts (millions)	1.5	1.4	1.5	1.4	1.3	1.3
Auto Sales (millions)	10.6	9.9	9.8	10.3	10.8	8.7
Interest Rate (90 day T-bill)	6.7	8.1	8.5	8.4	7.8	7.6
Unemployment Rate (percentage)	5.5	5.3	5.2	5.3	5.3	5.3
Industrial Production Index (1977=100)	137.2	141.8	140.7	141.8	142.2	142.3
Money Supply, M2 (percent change)	5.1	3.7	1.9	1.2	7.1	7.6

NOTE: SAAR—Seasonally Adjusted at Annual Rates. Source: Bureau of Economic Analysis

Table II
Employment in Nebraska

	Revised December 1989	Preliminary January 1990	January % Change vs. Year Ago
Place of Work			
Nonfarm	717,016	705,065	2.7
Manufacturing	96,093	95,636	2.0
Durables	46,567	46,603	0.9
Nondurables	49,526	49,033	3.1
Mining	1,313	1,238	-2.1
Construction	22,678	22,481	4.7
TCU*	46,748	46,257	1.8
Trade	188,324	184,460	2.7
Wholesale	54,095	53,695	4.9
Retail	134,229	130,765	1.8
FIRE**	48,628	48,393	2.8
Services	169,032	165,230	2.1
Government	144,200	141,370	3.6
Place of Residence			
Civilian Labor Force	814,338	823,074	2.62
Unemployment Rate	2.6%	3.1%	

*Transportation, Communication, and Utilities
**Finance, Insurance, and Real Estate

Source: Nebraska Department of Labor

Table III
Price Indices

	January 1990	% Change vs. Year Ago	YTD % Change vs. Year Ago
Consumer Price Index - U* (1982-84 = 100)			
All Items	127.4	5.2	5.2
Commodities	119.9	5.3	5.3
Services	135.4	5.0	5.0
Producer Price Index (1982 = 100)			
Finished Goods	117.5	5.9	5.9
Intermediate Materials	113.4	2.6	2.6
Crude Materials	106.7	5.6	5.6
Ag Prices Received (1977 = 100)			
Nebraska	160	-0.6	-0.6
Crops	127	-10.6	-10.6
Livestock	181	4.0	4.0
United States	153	2.7	2.7
Crops	135	-3.6	-3.6
Livestock	170	7.6	7.6

U* = All urban consumers
Source: U.S. Bureau of Labor Statistics

show in dramatic changes in the seasonally adjusted numbers. At the first of the year, three or more months of housing data may be needed to spot a trend.

Further muddying recent economic news is a downturn in industrial production. The Industrial Production Index fell to 140.9 in January, a decrease of 1.2 percent from December. The fall in the index was blamed largely on the cuts in the auto industry. The index now has returned to its own March 1989 levels. I suspect we are in for a prolonged period of relative flatness in industrial production. Such a flatness characterizes the index when the economy has expanded for a long period.

The drop in industrial production has a peculiar benefit to it--the capacity utilization rate is now below 82 percent. That means that inflationary pressures, at least in the industrial goods areas, are reduced.

Nebraska Outlook

The outlook for the Nebraska economy is relatively slow growth in Gross State Product (GSP) of 1.2 percent this year. Nonfarm Nebraska GSP tends to track Gross National Product (GNP). Variations in total Nebraska GSP, however, tend to be due to variations in agricultural income. Agricultural income, as we use the term, is a net concept defined as the difference between gross receipts and gross outlays. Retarding the growth is a mild downturn in the agricultural sector. Nonfarm GSP is expected to grow 1.7 percent, matching our GNP forecast for the year. It is interesting to note that the 1.7 percent growth rate for GNP contrasts with a 1 percent growth rate per year for the nation's population. The population growth rate for Nebraska, however, is virtually stagnant. Thus, a 1.7 percent nonfarm GSP growth rate for Nebraska represents a solid advance in per capita terms compared to the national figures.

With the prospect of a lackluster economic performance for 1990 and with the further prospect of a low rate of economic growth for the remaining years of the 1990 decade, Nebraska's personal income is expected to show only modest increases. Historically, Nebraska's per capita personal income has stood at approximately 92 percent of the U.S. per capita income. Any variation in the ratio of Nebraska's per capita income to the U.S. figure tends to be due to changes in Nebraska's agricul-

Table IV
City Business Indicators
November 1989 Percent Change from Year Ago

The State and Its Trading Centers	Employment (1)	Building Activity (2)
NEBRASKA	0.7	21.4
Alliance	-3.3	-66.6
Beatrice	-1.3	56.2
Bellevue	0.0	49.2
Blair	0.0	-11.6
Broken Bow	-2.4	-94.7
Chadron	-2.7	19.4
Columbus	-0.5	193.8
Fairbury	-1.7	5.3
Falls City	-2.3	41.3
Fremont	-1.3	47.0
Grand Island	-0.5	-24.2
Hastings	-0.9	-10.5
Holdrege	-1.8	627.2
Kearney	-0.3	64.4
Lexington	-1.2	147.3
Lincoln	0.5	31.3
McCook	-0.5	104.5
Nebraska City	-1.5	235.4
Norfolk	-0.8	52.7
North Platte	-1.8	23.6
Ogallala	-1.5	-31.2
Omaha	0.0	4.5
Scottsbluff/Gering	-1.8	-28.8
Seward	-1.4	32.2
Sidney	-1.4	-60.4
South Sioux City	-0.8	-55.6
York	-1.6	1.2

(1)As a proxy for city employment, total employment (labor force basis) for the county in which a city is located is used

(2)Building activity is the value of building permits issued as a spread over an appropriate time period of construction. The U.S. Department of Commerce Composite Cost Index is used to adjust construction activity for price changes

Sources: Nebraska Department of Labor and reports from private and public agencies

Figure I
City Business Index
November 1989 Percent Change from Year Ago

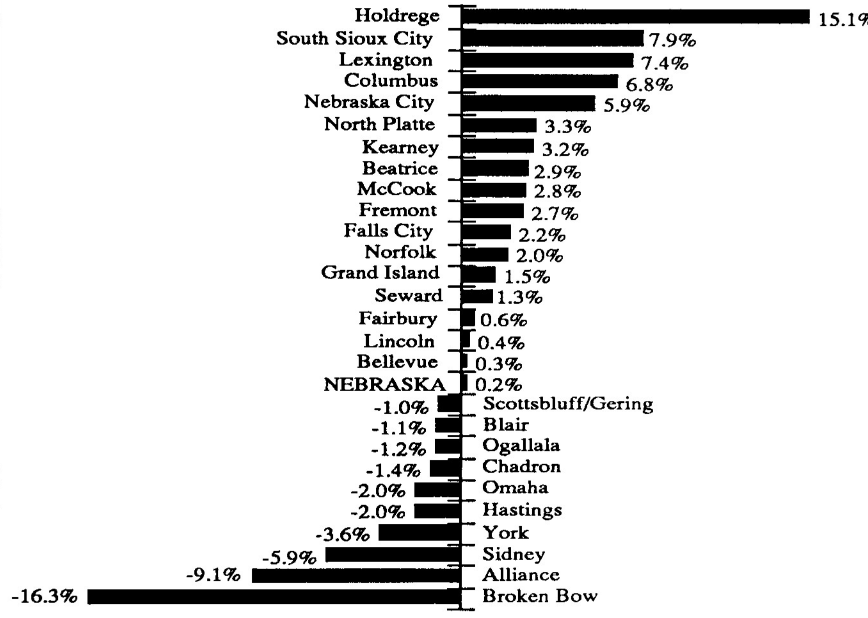
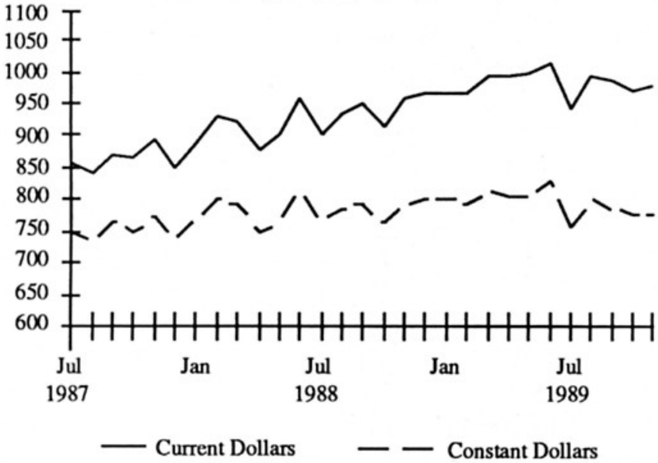


Table V
Net Taxable Retail Sales of Nebraska Regions and Cities

Region Number and City (1)	City Sales (2) November 1989 (000s)	City Sales (2) % Change vs. Year Ago	Region Sales (2) November 1989 (000s)	Region Sales (2) % Change vs. Year Ago	YTD % Change vs. Year Ago
NEBRASKA	$836,833	3.2	$946,830	2.6	6.7
1 Omaha	274,744	-1.0	339,168	-0.4	7.7
Bellevue	12,768	0.3	*	*	*
Blair	4,280	3.1	*	*	*
2 Lincoln	115,874	1.6	131,572	1.8	4.3
3 South Sioux City	5,656	32.8	7,427	27.0	11.4
4 Nebraska City	3,918	5.9	17,158	11.3	2.7
6 Fremont	15,601	7.6	28,203	3.4	5.3
West Point	2,827	14.5	*	*	*
7 Falls City	2,156	7.8	8,499	0.6	-0.6
8 Seward	4,292	5.7	14,624	5.4	2.5
9 York	6,617	-2.6	14,502	-4.3	5.3
10 Columbus	15,130	8.4	26,331	4.7	4.8
11 Norfolk	20,786	4.9	33,887	0.9	5.7
Wayne	2,588	6.5	*	*	*
12 Grand Island	35,684	11.4	48,127	9.4	8.7
13 Hastings	15,006	1.6	23,547	0.5	6.5
14 Beatrice	8,180	7.3	17,061	2.7	1.0
Fairbury	2,800	6.9	*	*	*
15 Kearney	18,974	6.3	25,641	3.4	8.6
16 Lexington	5,804	12.7	14,921	4.2	5.9
17 Holdrege	4,817	19.0	8,115	2.7	6.4
18 North Platte	15,829	11.4	19,746	10.4	6.2
19 Ogallala	5,173	7.1	10,547	3.0	10.5
20 McCook	7,793	3.3	11,079	3.3	3.7
21 Sidney	3,661	2.2	7,372	-1.5	0.0
Kimball	1,579	-1.2	*	*	*
22 Scottsbluff/Gering	18,061	7.6	24,264	3.5	8.4
23 Alliance	4,995	-1.3	13,324	-2.0	1.3
Chadron	2,600	1.8	*	*	*
24 O'Neill	3,955	0.6	13,731	5.2	11.2
Valentine	2,497	2.7	*	*	*
25 Hartington	1,421	12.9	7,716	7.6	2.0
26 Broken Bow	3,410	1.8	11,436	0.5	5.1

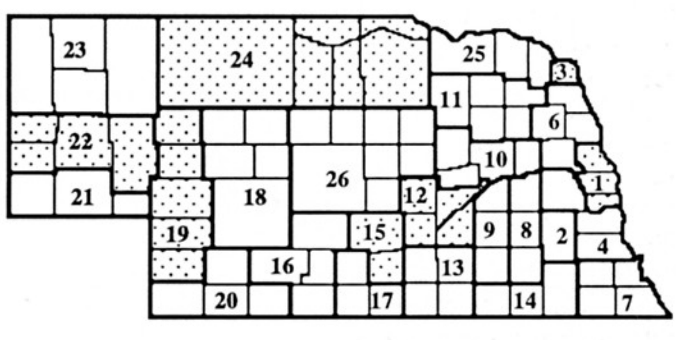
(1) See region map
(2) Sales on which sales taxes are collected by retailers located in the state. Region totals include motor vehicle sales
* Within an already designated region
Compiled from data provided by the Nebraska Department of Revenue

Figure II
Nebraska Net Taxable Retail Sales
(Seasonally Adjusted, $ Millions)



(1) The Consumer Price Index (1982-84 = 100) is used to deflate current dollars into constant dollars

Figure III
Region Sales Pattern
YTD as Percent Change from Year Ago



Shaded areas are those with sales gains above the state average. See Table V for corresponding regions and cities tural income. Thus, in the good farm income years of the early 1970s, Nebraska's per capita personal income momentarily exceeded the U.S. levels.

Offsetting Nebraska's below average per capita personal income is Nebraska's below average cost of living. Based on data from the American Chamber of Commerce Research Association for five Nebraska cities, the state's cost of living appears to hold at about 90 percent of the U.S. level. The data suggest there is parity between Nebraska and U.S. real personal income per capita when purchasing power is considered.

If Nebraska is to match national per capita personal income figures, one logical point of attack is current wage levels. At issue is whether Nebraskans are underpaid for what they do or whether they tend to be employed in low wage jobs. Average hourly earnings in manufacturing in Nebraska are below the comparable U.S. average as well as below the comparable average of several of our neighboring states.

In contrast to the state average, Nebraska's two metropolitan areas have average hourly earnings in manufacturing close to the national average.

Tracking the manufacturing sector, we find that Nebraskans tend to be relatively well paid in the electrical machinery area, meat production area, and grain mill products area. Although these sectors show average hourly earnings slightly ahead of the U.S. averages, they are offset by lower average hourly earnings in many other sectors.

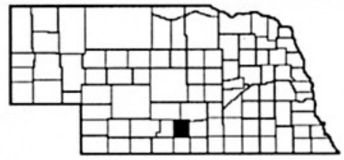
The more dramatic differences in wages appear in the services sector. Here we find Nebraskans are much below U.S. levels. Furthermore, the degree to which we receive low wages tends to hold throughout the entire spectrum of services. Once again, the issue is whether we are overrepresented in low paid service jobs or whether we are paid relatively low wages. In the business service area, Nebraska tends to be somewhat concentrated in low wage business service jobs such as telemarketing. We are underrepresented in other high paying jobs such as legal services, architectural services, and accounting services.

Certainly, more research needs to be done to identify whether Nebraskans are underpaid or whether Nebraskans are being hired in low wage positions.

County of the Month

Phelps

Holdrege--County Seat



License plate prefix number: 37
Size of county: 545 square miles, ranks 72nd in the state
Population: 9,800 (estimated) in 1988, a change of +0.7percent from 1980
Median age: 33.9 years in Phelps County, 29.7 years in Nebraska in 1980
Per capita personal income: \$16,516 in 1987, ranks 11th in the state
Net taxable retail sales (\$000): \$62,811 in 1988, a change of +11.0 percent from 1987; \$61,224 during January-November 1989, a change of +8.3 percent from the same period one year ago
Number of business and service establishments: 317 in 1987; 59.0 percent had less than five employees
Unemployment rate: 2.1 percent in Phelps County, 3.6 percent in Nebraska for 1988
Nonfarm employment (1988):

	State	Phelps County
Wage & salary workers	688,146	3,897
	(percent of total)	
Manufacturing	13.8%	20.6%
Construction and Mining	3.8	3.0
TCU	6.5	8.1
Retail Trade	18.5	18.0
Wholesale Trade	7.3	7.5
FIRE	7.0	4.4
Services	23.0	18.8
Government	20.1	19.6
Total	100.0%	100.0%

Agriculture:

Number of farms: 616 in 1987, 588 in 1982
Average farm size: 603 acres in 1987
Market value of farm products sold: \$191.9 million in 1987 (\$311,507 average per farm)

Sources: U.S. Bureau of the Census, U.S. Bureau of Economic Analysis, Nebraska Department of Labor, Nebraska Department of Revenue

Merlin W. Erickson

Business in Nebraska

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