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The 2 Percent Lid: Part II

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This is the second part of a series on Ed Jaksha's petition-initiated amendment to the state constitution that would place a 2 percent lid on government spending in Nebraska. The first part, in the September issue of *Business in Nebraska*, examined what other states have done to limit taxes and expenditures.

The first article pointed out that there are two basic types of restrictions: the variable formula method and the fixed number method. The variable formula method permits state and local governments to meet the increased demand for public services that generally accompanies growth in economic activity and/or population.

In contrast, the fixed number method imposes an inflexible lid on government expenditures. The lid is independent of changes in demand for government services. The 2 percent lid proposed for Nebraska is a fixed number lid.

If the 2 percent referendum is passed by voters in November, Nebraska's state and local governments will be required to function under an extremely restrictive budget and expenditure limitation formula. The economic implications of the proposed 2 percent limitation formula are summarized at the end of this article.

This article applies the 2 percent lid to budgets representative of Nebraska's municipalities and school districts. The purpose of this mathematical exercise is to provide Nebraska voters with sufficient information to gauge the wisdom of the 2 percent formula as a constitutional law to restrict government budgets.

To review, the proposed constitutional amendment, Measure 405, would limit government spending to a 2 percent annual increase unless special approval is granted. The proposed 2 percent lid has a provision to increase expenditures at the state level if four-fifths of the members of the legislature (or 40 senators) approve or, at the local level, if a special election is held.

If a local governmental unit asks voters for a budget increase that exceeds the 2 percent formula and a simple majority of the voters vote no (actually, the referendum's language would require a "yes" vote), the government's budget would be frozen at the current year's level of total expenditures. Current year expenditures can be even less than the current year budget.

The 2 percent lid proposal makes no allowances or adjustments for inflation, emergencies, or economic growth.

Local Government: Municipalities

The hypothetical municipal budget in Table 1 typifies municipal governments in Nebraska. Budget categories and budget proportions by category used in Table 1 are representative of municipal

State Economic Scoreboard

Change from same month one year ago

See Review and Outlook on page 7 for more details

	State	Metro+	Nonmetro
Motor Vehicle Sales (June) Constant $	-5.3%	-6.1%	-4.5%
Nonmotor Vehicle Sales (June) Constant $	2.3%	-1.4%	6.1%
Building Activity (June) Constant $	7.6%	2.7%	14.3%
Employment (August)	3.0%	1.9%	4.1%
Unemployment Rate* (August)	2.3%	2.4%	2.3%

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

Table 1
City of Goodville 1991-92 Budget

Category	Actual Budget 1990-91 (1)	Preliminary Budget 1991-92 (2)	2% Threshold Limit (3)	Final (+) or (-) Over or Under (4)	Budget 1991-92 (5)
General Government	$217,458	$231,923	$221,807	$10,116 (+)	$214,786
Building & Insurance	835,892	837,700	852,610	14,910 (-)	837,700
Public Works	168,081	179,096	171,443	7,653 (+)	179,096
Public Safety	1,248,740	1,325,857	1,273,715	52,142 (+)	1,250,269
Street Maintenance	425,854	454,539	434,371	20,168 (+)	440,139
Parks & Recreation	564,566	607,453	575,857	31,596 (+)	534,428
Library	199,995	213,955	203,995	9,960 (+)	203,995
Capital Improvements	969,600	1,141,350	988,992	152,358 (+)	1,066,052
Contingency & Other	45,838	43,080	46,755	3,675 (-)	43,080
Total Expenditures	$4,676,024	$5,034,953	$4,769,545	$265,408 (+)	$4,769,545

government budgets. Additional municipal government budgets could be exhibited, but basically the only difference would be scale, where scale or size of budget varies directly with the size of the community.

The actions of municipal government officials used in this article are pure conjecture. We believe, however, that these conjectures represent probable decisions that a municipal government would make if the 2 percent lid amendment passes.

Our representative city will be called Goodville. Goodville's population is 14,386, and the city employs 171 workers. The city has an assessed valuation of $267,306,600 and a tax rate of 78 cents per $100 valuation. Finally, Goodville is managed by a mayor-council government.

Column (1) of Table 1 shows Goodville's current, base year (1990-91 fiscal year) budget. Column (2) shows the city officials' recommended budget for fiscal year 1991-92. The 2 percent lid budget for Goodville is given in column (3). (Each category in column (1) was increased 2 percent.) Column (4) shows the over/under budget amounts produced by the 2 percent lid. Column (5) shows the city officials' final 1991-92 budget for Goodville that conforms to the 2 percent lid law. (Definitions of the various budget categories are presented on page 3.)

Approximately 64 percent of Goodville's base year (1990-91) budget represents personnel services, which includes wages, salaries, and fringe benefits. Personnel services presently average slightly over $17,000 per employee. Nebraska's Commission of Industrial Relations has ordered Goodville's city officials to increase its employee's salaries 5 percent to meet comparability requirements of Section 48-818 RRS of Nebraska.

This mandate alone requires Goodville to increase its 1991-92 budget $149,743. This mandate requirement is reflected in the recommended budget shown in column (2) of Table 1. Other factors reflected in this column include adjustments for anticipated increases in the cost of materials and supplies (which are expected to increase 8 percent to 12 percent because of anticipated price run-ups, especially for energy-related items) plus carryover capital construction projects that the city is obligated by contract to pay.

By contract, two construction projects are being carried to the 1991-92 fiscal year. These projects involve final work and payment on a new senior citizen center ($240,000) and final work and payment on a major street widening project to accommodate recent city growth ($288,000). The total construction cost carryover is $528,000. This amount is included in the capital improvements figure of $969,600 in column (1) of Table 1.

The carryover in construction projects of $528,000 plus the salary adjustment of $149,743 required by Nebraska's Commission of Industrial Relations means that Goodville is obligated to increase its 1991-92 budget at least $677,743. To mitigate part of the increase, $348,814 is cut mainly from the capital improvement segment in the preliminary budget and other segments of the budget.

Accounting for carryover obligations and for expected increases in cost of materials and supplies, Goodville has a preliminary budget of $5,034,953 for fiscal year 1991-92. No new programs or expansions of existing programs are included in the preliminary budget. Goodville's preliminary budget exceeds the 2 percent lid amount by $265,408 (sum of column (2) - sum of column (3)).

Goodville city officials either must reduce their preliminary 1991-92 budget $265,408 to comply with the two percent lid law or place the appropriation issue on the ballot at a special election. The cost of a special election is approximately $4,000.

Some city council members believe that the city should hold a special election because the preliminary budget for 1991-92 is realistic. The city attorney cautions the council members that if the voters reject their proposed budget of $5,034,953 for 1991-92, Goodville could face a $886,929 budget problem (the difference between the preliminary 1991-92 budget and actual 1990-91 expenditures of $4,148,024) instead of a $265,408 problem.

The attorney's interpretation is that in the event of a voter rejection, next year's budget will be limited to this year's expenditure level. The current year budget for Goodville is $4,676,024, but the current expenditure level is $4,148,024. $528,000 of this year's budget represents carryover construction projects.

With the prospect of a voter rejection plus the $4,000 cost of a special election, Goodville's city officials decide to trim their preliminary budget to comply with the 2 percent lid law.

The following is a record of various actions Goodville's city officials may take to meet the budget limit of $4,769,545 ($4,676,024 x 1.02 = $4,769,545).

General Government

Eliminating one full-time auditing position and reducing the hours of a part-time clerk cuts $17,137 from the general government category. The auditing position is eliminated because the primary responsibilities of the job are for federal grants—because of the 2 percent lid, the city will be getting out of the grant business. Hours for the part-time clerk are cut because part of the clerical duties for ambulance billing will be eliminated when the city ambulance service is privatized.

Building & Insurance

The budget for building and insurance is kept at the preliminary budget level because most of this category's appropriation is for insurance. The only savings that could be anticipated would require larger deductibles for losses. With only $43,080 allocated for contingencies, the council believes it would be too risky to cut insurance or increase deductibles.

Public Works

No cuts are made in this category. Public works had experienced severe cuts in recent years when several building inspectors and a part-time clerk were eliminated.

Public Safety

Eliminating the city's fire squad and ambulance service cuts $75,588 from the ambulance and fire department. The council decides that a private company can provide this service.

Discontinuing this service, which presently is staffed with on- and off-duty fire personnel, means that three fire fighter billets can be eliminated. (Goodville will ask that the private company make an effort to hire the fire fighters who would be dismissed. This will be an issue in the ambulance company's contract with the city.) The council's decision could affect Goodville's ISO fire insurance rating, as manpower on the department will be reduced by three.

An adverse rating will increase fire insurance premiums on all insured buildings and structures. Also, Goodville residents will have to pay a private company $118 per emergency call instead of the $65 rate they now pay the city.

Street Maintenance

Severing contracts for snow removal with local heavy equipment contractors prunes $14,400 from the street maintenance budget. The city's current policy calls for Goodville city crews to remove snow only on major city streets and the downtown area following a snowstorm. Under current policy, residential areas are cleared by four local contractors. Usually the entire snow removal process takes approximately ten hours for completion.

With the cancellation of private contractors for the residential areas, the city's public works director estimates that it will take about 32 hours for city crews to remove snow from all areas of the city.

Parks and Recreation

The parks and recreation portion of the budget is trimmed $73,025. The council will work with YMCA officials to see if eliminated programs can be shifted to the YMCA. Council members will help the YMCA raise funds from businesses and individuals to support these programs.

Library

The acquisition budget at the library is reduced $5,000. Part-time student help is cut to save $4,960. Library hours will not be reduced, at least for 1991-92.

Capital Improvement

Resurfacing and pavement replacement are sliced by $75,298 to meet the requirements of the 2 percent lid. Several council members voice concerns that delaying work on streets may send a signal to the city's residents that the town is starting to deteriorate economically.

Contingency & Other

The council elects not to reduce this portion of the budget because most members feel that the $43,080 budget figure is already inadequate. If Goodville experiences a flood, for example, the current $43,080 appropriation most likely would not cover all costs of the disaster.

The city's independent auditors consistently have recommended a

Budget Categories Defined

General Government	Administration, accounting, and legal
Building & Insurance	Building maintenance, health-life-property-liability insurance, workers and unemployment compensation insurance, and employer's share of Social Security
Public Works	Engineering, building inspection, planning & zoning, board of adjustment, and airport
Public Safety	Police, fire, animal control, civil service, civil defense, and ambulance service
Street Maintenance	Street repair, street cleaning, parking lot maintenance, snow removal, airport runway maintenance, and storm sewer repair, maintenance, and cleaning
Parks & Recreation	Parks and cemetery maintenance, recreation programs, swimming pools, parks and street right-of-way tree maintenance, and senior citizen center operations
Library	Local and regional library activities
Capital Improvements	Street and storm sewer construction and reconstruction, sidewalks, street resurfacing, parking lot acquisition and construction, building construction, park acquisition and improvements, and other capital improvements
Contingency	Emergencies and unforeseen expenses

contingency fund of approximately $150,000 or at least 3 percent of the city's total budget. Their recommendation has never been implemented because it would have required an increase in property taxes.

The council's position was to pass a supplemental appropriation ordinance in the event of an emergency situation. Under the 2 percent lid law, emergency appropriations would not be permitted.

The foregoing adjustments bring Goodville's budget for fiscal year 1991-92 into compliance with the 2 percent lid law. Many council members wonder what the city will do next year. This first round of budget cuts only can be made once. Additional cuts must be made in the future. To prepare for next year, Goodville's city council votes to investigate the following areas for possible future budgets cuts.

- Reduce the hours and staff for some services such as the library, swimming pool, athletic events, etc.;
- Transfer all recreation activities to the YMCA for private support;
- Sell several city parks for development to eliminate maintenance expenses;
- Establish a police reserve program and volunteer fire program to mitigate the public service impact when manpower is cut from these departments;
- Eliminate most, if not all, temporary and part-time positions used in the summer months on ditch cleaning, park mowing, and street work;
- Develop a program for neighborhoods to adopt a park or ditch or street for volunteer maintenance. Goodville's council members recognize that this action could reduce the attractiveness of the city. Whether Goodville's residents share the council's concern will not be known until the service is eliminated;
- Privatize as many city services as practical. The city council recognizes that in many cases all they are doing is transferring expenses from the city to private individuals. Although all transfers would be readily identifiable, the impact of these transfers may not be immediately apparent. For example, reducing the number of fire personnel would decrease the size of the municipal budget, but this action also could raise insurance rates for private individuals and businesses.

As the council ends its emergency session, several members express disappointment and concern. It seems to the council members that Goodville and the city council are being penalized for practicing efficient government.

If the council had practiced excessive or even liberal spending practices in past years, they now would be working with a higher budget base to which to apply the 2 percent lid law. The higher budget base would provide the city with a cushion to minimize the economic impact of the 2 percent lid, at least for the first few years.

Local Government: School Districts

Table 2 represents a typical school district budget in Nebraska. Because there are substantial differences in size, number and condition of facilities on each school's campus, transportation needs, and number of special education students of grade schools and high schools across Nebraska, it is more meaningful to discuss school budgets in terms of the percentages of the total allotted for various expenditure categories. The budget appropriations shown in Table 2 are in percentage terms.

Our representative school district will be called Prairie View.

Table 2
Current Prairie View Budget
(in percentage terms)

Category	Percent
Instructional Services	69.59
Central Administration	3.61
Building Administration	5.54
Business Services	2.24
Operation of Plant	7.82
Maintenance of Plant	3.54
Transportation	3.55
Other Expenses	4.11
TOTAL	100.00

Approximately 80 percent of Prairie View's budget involves salaries and salary-related expenditures. A substantial part of salaries is established through the public employees bargaining law and is subject to final adjudication on a comparable pay standard by the Nebraska Commission of Industrial Relations.

Special education, a mandated program, accounts for approximately 9 percent of the school's budget. The 9 percent figure is typical of most schools' appropriations to special education programs in Nebraska.

Prairie View's mandated programs can be grouped into five basic categories.

Special Education Services

Special education services are mandated by both federal and state law. These special education programs must be provided regardless of the school's budget situation. For the last several years, the average expenditure for special education services has increased approximately 9 percent per year.

Schools likely will see the 9 percent rate continue for some time because of recent and expected future inflation and the growing need for special services. With total special education costs representing 9 percent of total expenditures and costs increasing 9 percent per year, special education mandates would require approximately 40 percent of the allowance under the 2 percent lid law.

A simple example explains the mathematics for the 40 percent figure. Suppose that Prairie View's total budget is $100. Of this budget, $9 will go to special education mandates ($100 x 0.09 = $9.00). If special education expenses increase 9 percent per year, the district will need to increase its special education budget for the next fiscal year 81 cents, for a total special education budget of $9.81.

The 2 percent lid law would limit the Prairie View's budget to $102.00 for next year ($100 x 1.02 = $102.00), for a total increase of $2.00. Of the $2.00 increase, 81 cents (or 40.5 percent) would have to be allocated to special education mandates.

The 2 percent lid law combined with special education mandates could produce severe budgetary impacts on some school districts in Nebraska. The added enrollment of one severely handicapped child, for example, could surpass by far a district's 2 percent allowance.

Accreditation Standards

Minimum education program requirements are rules and regulations prescribed by law to meet accreditation standards. These standards require 400 credit hours of course offerings in the core curriculum of a high school.

Failure to meet the minimum standards for accreditation removes a school from the legal operations list. Removal from the legal operations list exposes the school to possible closure, because student attendance likely will decline as students transfer to accredited schools. The school also is at risk of losing state funding.

The accreditation issue is a major concern to a majority of Nebraska's high school districts. Of the 275 high schools in 1988-89, 13 offered less than 400 hours; 29 offered between 400 and 425 hours; 66 offered from 426 to 450 hours; and another 99 offered between 451 and 500 credit hours.

Seventy-three percent (201) of Nebraska's 275 high schools offer less than 20 percent more than the minimum accreditation requirements—a factor that would be crucial under long-term application of the 2 percent lid. Most likely, the impact would be more severe for many of Nebraska's rural high school districts.

Safety Standards

Mandates in safety standards, hazardous product management (asbestos, radon, lead, etc.), and accessibility to the handicapped require building and facility modifications and maintenance.

Transportation

School districts are required to provide transportation or 60 cents per mile one way in lieu of transportation per family in excess of four miles from the attendance center. Transportation services are especially important to the rural high school districts of Nebraska.

Nebraska Industrial Commission

The Nebraska Industrial Commission sets final wage orders for school employees in cases of disputes in order to maintain comparable pay standards. These wage orders must be implemented by school districts.

The implementation of wage orders can increase the salary portion of a school's total budget considerably more than 2 percent. A wage order in excess of the 2 percent limit would require a reduction in personnel or other budget cuts.

Figures and calculations given in the following table provide a simple way to understand the budgetary implications of the 2 percent lid formula. The calculations are made for five years.

Assume that our hypothetical Prairie View's current base year budget is $100. Also assume that expenditures will continue to increase at the current rate of 6.1 percent per year. A 6.1 percent increase is a reasonable assumption in light of current and expected inflation rates and in light of the impact of mandated programs and services on school district budgets.

Column (1) in Table 3 shows the annual budget levels for years one through five based on an average annual 6.1 percent increase in school expenditures. Column (2) of Table 3 shows annual budget limits under the 2 percent lid law. Column (3) shows the difference between projected budgets without the 2 percent lid law and budgets under the 2 percent lid.

The task that Nebraska school districts would face under the 2 percent lid law would be to eliminate the differences shown in column (3).

Table 3 shows that the budget shortfall on a hypothetical base year budget of $100 by the fifth year would be $24.05. If the expected increase in cost of education did not exceed 2 percent per year, there would be no budget shortfall at the end of the five year period.

It is highly unlikely, especially in light of inflation, however, that the increase in educational costs will not exceed 2 percent per year. This means that under the 2 percent lid law, Nebraska's school districts will have to make hard choices about what programs to reduce or eliminate.

If the 2 percent lid amendment is passed, Nebraska's school districts probably will be forced to identify three levels of impacts related to possible program and service reductions or eliminations. For this discussion, these levels will be referred to as *minimal impact, moderate impact*, and *severe impact*.

Minimal Impact

Areas that should have minimal impact on school performance and the quality of programs involve the reduction or elimination of noneducational services.

- Defer maintenance and repair;
- Cease transportation and pay parents for transporting over four miles;
- Eliminate hot lunch programs;
- Reduce or eliminate facility use beyond school day to curtail operations expenses.

Moderate Impact

The moderate impact level would consist of reductions or eliminations of indirect educational services.

- Curtail purchases of new textbooks;
- Curtail purchases of new equipment and supplies;
- Eliminate teacher aides;
- Reduce or curtail extracurricular activities;
- Reduce library services to minimum requirements;
- Reduce counseling services to minimum requirements;
- Reduce administrative services to minimum requirements;
- Eliminate staff development.

Severe Impact

The severe impact level would consist of reductions in direct educational program offerings.

- Reduce or eliminate gifted programs;
- Reduce or eliminate advanced placement offerings;
- Reduce or eliminate electives in all core curriculum areas that exceed the minimum offering requirement;
- Reduce the number of teachers by increasing pupil enrollments per classroom;
- Reduce the number of teachers by combining grade levels (e.g., 1st and 2nd, 3rd and 4th, etc.);
- Reduce or eliminate minimum offerings required for accreditation.

In view of mandated programs that school districts are required to offer, the rising cost of materials and supplies, and the fact that some of these reductions are only deferrals and not real cuts, it is

Table 3
Projected School Budgets With and Without the 2 Percent Lid Law
(Based on a $100 Base Year Budget)

Budget Period	Budget Without Lid (1)	Budget With Lid (2)	Difference (3)
Year 1	$106.10	$102.00	-$4.10
Year 2	112.57	104.04	- 8.53
Year 3	119.44	106.12	-13.32
Year 4	126.72	108.24	-18.48
Year 5	134.45	110.40	-24.05

conceivable that many of Nebraska's school districts will have to consider areas listed under the severe impact category within a year or two of enactment of the 2 percent lid law. A considerable number of schools probably would lose their accreditation, and undoubtedly many school districts would be forced to close schools.

The impact likely would be more severe in the rural areas of Nebraska. On the quality side of education, optimal education levels likely would be reduced to minimum levels, which would be a move counter to President Bush's national goal of substantially enhancing the quality of education by the year 2000.

Summary

The mathematics of the 2 percent lid law clearly indicate that such a law would place severe restrictions on governmental units of the state. Several summary observations can be made about the impact of the 2 percent lid law.

1. Growing communities would be hit harder by the 2 percent lid, especially small growing communities. This point is based on the fact that economic growth requires growth in public services.

Economic growth for growing communities can exceed 2 percent. Growth rates in excess of 2 percent are likely for smaller communities because the base is smaller.

For example, a business expansion of 50 employees in a community of 3,000 mathematically is a larger percentage increase when compared to the percent increase of 50 employees in a community of 100,000.

2. Even in Nebraska's declining communities, the 2 percent lid could contribute to the closing of community-owned hospitals and nursing care facilities.

About half of Nebraska's hospitals, including the University of Nebraska Medical Center, are owned by cities, counties, hospital districts, or the state. A fifth of the state's nursing homes are owned by cities, counties, or the state.

3. Under the 2 percent lid law, governments would be penalized for past practices of government efficiency. This was the situation in the hypothetical Goodville case.

4. The 2 percent lid law could increase local property taxes to offset reductions in state aid to local governments. Because the state legislature also would be required to operate under the 2 percent lid law, it is conceivable that the legislature might cut state aid to local governments. That could force local governments to increase property taxes to finance even a 2 percent budget increase.

All in all, the 2 percent lid law likely would impact economic growth severely for the thriving communities of Nebraska. That, in turn, could jeopardize Nebraska's ability to compete with other states for industrial growth and development.

Moreover, the 2 percent lid law would run counter to the state's efforts to promote economic development, because the 2 percent lid law most likely would eliminate Nebraska's prospects for future economic development. In short, Nebraska's potential for economic growth and development likely would be transferred to our neighboring states if Nebraskans enact the 2 percent lid law.

Two individuals were invaluable in obtaining background information for this article. Mr. Dale Siefkes, executive director of the Nebraska Association of School Boards, and Mr. Jack Sutton, city administrator and acting finance director of the City of Fremont, provided data, analysis, and several different perspectives on the possible effects of the 2 percent spending lid amendment.

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Review and Outlook

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

National Outlook

The Budget Compromise

The budget compromise and its possible economic impacts currently are primary concerns. At the time this is written in early October, we are in the midst of debate. The House failed to pass the original compromise, but legislation currently has been approved that allows broad outlines of a budget compromise.

A budget compromise is necessary because the deficit has gotten out of hand. Although in past years we struggled to meet Gramm-Rudman targets, meeting the targets was usually a matter of artful manipulation. This year, the deficit is almost $0.25 trillion. The savings and loan reorganization and the Middle East crisis make matters worse. Although these two items may be kept off-budget, no one is fooled. Government spending is still government spending, no matter what label is applied.

The compromise of September 30 was more than the Band-Aid that I originally had expected, but far from a complete cure for the deficit problem. The compromise had the potential to anger everyone. It focused on sin taxes—the tobacco, alcohol, and gasoline taxes.

Furthermore, there were cuts in Medicare spending and payments to farmers. There were also luxury taxes on expensive cars and fur coats. It was difficult to find any group that would have emerged unscathed from the compromise. The package hit the poor the hardest. Most taxes raised were regressive taxes. The impact on the rich would have been minor.

The original compromise died in the House of Representatives. A new compromise was reached the ensuing weekend. The second compromise eased the original Medicare provisions and made adjustments to the original tax proposals. Details of the new proposal are to be resolved by various congressional committees. The proposal ultimately will be brought before Congress.

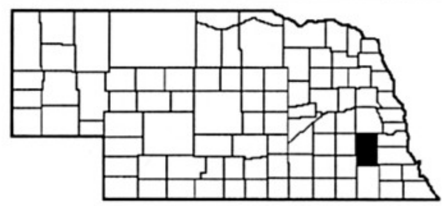
No one is completely happy with the new compromise, but it is essential that a compromise be passed in order to avoid implementation of the Gramm-Rudman ceilings. Under current circumstances, the ceilings would impair the functioning of the federal government severely.

The major issue is whether a budget compromise will restore confidence in the economy. There are two key places where this confidence can be reflected: the financial community and the household. The stock market immediately responded positively on the Monday following the announcement of the original last minute compromise. The next few weeks will show whether the confidence of the stock market will continue.

Whether consumer confidence will be impacted by the budget compromise will take time to determine. Consumer confidence surveys are conducted monthly. There is a publication lag between the time of the survey and when it is released. In August, following the start of the Iraqi invasion, both the University of Michigan and the Conference Board surveys showed that consumer confidence had plummeted from already weakened levels.

County of the Month

Lancaster



Lincoln--County Seat

License plate prefix number: 2
Size of county: 846 square miles, ranks 26th in the state
Population: 211,600 (estimated) in 1988, a change of +9.7 percent from 1980
Median age: 27.5 years in Lancaster County, 29.7 years in Nebraska in 1980
Per capita personal income: $15,078 in 1988, ranks 26th in the state
Net taxable retail sales ($000): $1,600,398 in 1989, a change of +4.1 percent from 1988; $810,989 during January-June 1990, a change of +6.0 percent from the same period one year ago
Number of business and service establishments: 5,466 in 1988; 50.6 percent had less than five employees
Unemployment rate: 2.5 percent in Lancaster County, 3.1 percent in state for 1989
Nonfarm employment (1989):

	State	**Lancaster County**
Wage & salary workers	705,672	118,834
	(percent of total)	
Manufacturing	13.4%	12.1%
Construction and Mining	3.6	3.3
TCU	6.5	5.5
Retail Trade	18.5	18.2
Wholesale Trade	7.6	4.5
FIRE	6.8	7.2
Services	23.7	22.9
Government	19.9	26.3
Total	100.0%	100.0%

Agriculture:

Number of farms: 1,508 in 1987, 1,547 in 1982
Average farm size: 297 acres in 1987
Market value of farm products sold: $55.7 million in 1987 ($36,900 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

Restoring consumer confidence is important, as consumer spending accounts for two-thirds of Gross National Product (GNP). With low consumer confidence, it will be hard to avoid a recession.

With a recession at our front door, some observers have asked why we are concerned about the federal deficit. Shouldn't government spending be encouraged to stimulate the economy and possibly prevent a recession?

There are two responses to this question. First, a $0.25 trillion deficit is a stimulant. The size of the compromise cut won't make that much difference.

Second, the issue of confidence in our government is paramount. If consumers and the domestic and international financial communities loose faith in our government, the result could be a collapse in consumer spending, a downturn in the U.S. stock market with a perceived loss of wealth, and a flight from the U.S. dollar with an attendant outflow of foreign capital.

The Weak Economy

News of a weak economy continues. The final GNP figures show real second quarter growth of only 0.4 percent. This is a substantial downward revision from previous reports of a 1.2 percent increase. The economy may be even weaker than the 0.4 percent figure suggests.

Details are buried in some of the more obscure GNP accounts. Final sales (GNP less the adjustment for changes in business inventory) were down 0.7 percent. The same figure less Commodity Credit Corporation (CCC) inventory change decreased 1.5 percent.

Only three components of GNP increased. Consumption of services offset decreases in goods consumption. Personal consumption expenditures showed a small increase (0.2 percent).

Second, changes in nonfarm business inventory were strong. The change in inventory was more a matter of goods that did not sell than an intentional building of inventories. In the long run, increased nonfarm business inventory may hurt the economy. If businesses fear a recession, they may cut inventories to keep them in line with expected drops in sales volume.

Last, federal government spending—mostly nondefense—was a strong positive. The biggest change was a reversal of a decumulation of CCC inventories. CCC inventories decreased $7.0 billion in the first quarter and increased $1.1 billion in the second. These changes led to a total change in CCC inventory alone of $8.1 billion for the second quarter. If any of these three changes had been negative, GNP would have decreased. Thus, the economy was weak in the second quarter.

Things did not improve in August. Housing starts fell for the seventh consecutive month. They were down 1.7 percent from July. The unemployment rate crept from 5.5 percent in July to 5.6 percent.

Capital spending plans were cut again in August. Industrial production fell 0.2 percent. Personal income rose marginally (0.3 percent) in nominal terms in August.

Once inflation and taxes were removed from the figures, real disposable personal income decreased 0.3 percent. Real spending fell 0.1 percent. A major concern is that inflation spawned by the Middle East crisis has just begun. As inflation works its way through the economy, it will become increasingly difficult for incomes to keep pace with inflation.

Prices and Interest Rates

Oil prices have been on a roller coaster ride since the Iraqi invasion began. Before the invasion, west Texas crude intermediate, a U.S. benchmark crude oil, was selling in the area of $18 per barrel. Following the invasion of Kuwait and the loss of 4 million barrels per day from world production of crude, oil prices shot up–west Texas crude touched $40 per barrel. Crude prices are hovering in the mid-$30 area.

Price movements have been speculative. In September OPEC, principally Saudi Arabia, the United Arab Emirates, and Venezuela, covered over half of the loss in world production. World stocks are high. They were reported as 2.93 billion barrels in commercial on-shore inventories at the end of August. That was an increase of 87 million barrels from the previous year. U.S. stocks are up. Pending winter demands for fuel oil are causing speculative price changes.

It is not just the price of oil that should concern us. Oil is part of many products; its effects are felt throughout the price system. USDA estimates that food prices will rise 1 percent to 2 percent based on oil price rises alone. The August price index reflected first round price rises. The Consumer Price Index (CPI) and the Producer Price Index (PPI) showed the immediate direct effects of increases in energy prices on final consumers.

The CPI rose 0.8 percent in August, 9.6 percent at an annual rate. The increase without energy prices was half the reported gain. The gasoline prices used in that calculation showed an increase of 7.6 percent. We all know better. Pump prices have risen over 30 percent from late July.

The next report on the CPI should show still another large increase in gasoline prices. As an interesting sidelight, August retail sales dropped 0.6 percent, but gasoline station sales jumped 6.4 percent.

The PPI increase was larger than that of the CPI. The PPI for finished goods

Table 1
National Indicators

	Annual		Quarterly (SAAR)			
	1988	1989	1989:III	1989:IV	1990:I	1990:II
Real GNP (% change)	4.5	2.5	1.7	0.3	1.7	0.4
Real Consumption (% change)	3.6	1.9	4.6	-0.8	1.1	0.2
Housing Starts (millions)	1.5	1.3	1.3	1.3	1.4	1.2
Auto Sales (millions)	10.6	9.9	10.8	8.7	9.7	9.5
Interest Rate (90 day T-bill)	6.7	8.1	7.8	7.6	7.8	7.8
Unemployment Rate (%)	5.5	5.3	5.3	5.3	5.3	5.3
Money Supply, M2 (% change)	5.1	4.0	6.9	7.0	6.2	2.9
Industrial Production Index (1987=100)	105.4	108.1	108.1	108.1	108.3	109.4

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

increased 1.3 percent or over 15 percent at an annual rate. The PPI without energy rose 0.5 percent. Finished energy prices alone grew 9.6 percent. Crude petroleum prices jumped 62.5 percent, the largest monthly increase ever. Total unfinished goods increased 9.3 percent.

We will continue to see inflation increases. I would expect the general level of inflation to settle in the 8 percent to 10 percent range. Increases beyond that are possible as long as the Iraq/Kuwait situation remains unresolved. Because inflation expectations help determine long-term interest rates, high inflation will bring higher long-term interest rates. Although the expectation of increased long-term rates seems plausible, it is difficult to speculate about the direction of short-term rates.

The Federal Reserve controls short-term rates closely. Now the Fed faces a dilemma–should it lower short-term rates to stimulate the economy (with the possibility of bringing even greater inflation) or raise short-term rates now in an effort to control inflation (only to see the economy enter a recession that much quicker)?

If the Fed chooses to fight the near-term recession by lowering interest rates, we could see a broadening spread between short-term and long-term interest rates.

Nebraska Outlook

Once again Nebraska reported the lowest unemployment rate in the country for July. In July, Nebraska's unemployment stood at 2.2 percent. The next lowest state was Hawaii at 2.8 percent. The lowest city unemployment rate in the country was Iowa City at 1.9 percent, followed closely by both Lincoln, Nebraska and Madison, Wisconsin at 2.0 percent. In fourth position was Charlottesville, Virginia.

All four cities are major university towns. Students are not in the labor force unless they work: An unemployed student is not in the labor force, but an employed student is counted in the labor force. This counting phenomenon helps account for extremely low levels of unemployment.

Also, these rates are estimates. Estimates are subject to error. In more recent data, the state's unemployment rate is now 2.3 percent for August. It will be difficult to maintain such a low unemployment rate if a recession begins in the near future.

Job formation is helping to keep our unemployment rate low. In August, the number of jobs increased 2.5 percent versus a year ago. That figure is in line with increases that we have reported for several months.

According to the Federal Reserve Bank of Kansas City, Nebraska's job growth in the first half of this year was 2.6 percent at a seasonally adjusted annual rate. That figure was only 0.1 percent ahead of the U.S. average. In comparison to other Tenth Federal Reserve District states, Nebraska was only 0.1 percent behind Oklahoma and 0.4 percent behind Colorado. Nebraska led all other Tenth District states in job growth (Kansas, New Mexico, Missouri and Wyoming) and led the Tenth District average by 0.9 percentage points.

Retail sales in Nebraska continue to do well. In June statewide retail sales increased 6.0 percent. On a year-to-date basis through the first half of the year, retail sales have grown 6.2 percent. By comparison, the year-to-date CPI increased 4.9 percent. Thus, real retail sales were up approximately 1.3 percent.

Despite that good news, retail sales in either current dollars or constant dollars have not met their January peaks. One should not make too much of high seasonally adjusted figures on months that have low seasonal factors. That's the case for the month of January. Nevertheless, the constant dollar sales increases are reassuring, given the weakened state of the economy. Maintaining that level of retail sales advance will be difficult when the economy turns down.

Nebraska harvest is underway. Most major grain crops are in good or fair condition. There are areas of the state where there have been some difficulties, but for the state as a whole grain production appears to be strong this year.

There are still some long-run concerns over moisture conditions in the state.

Table II
Employment in Nebraska

	Revised July 1990	Preliminary August 1990	August % Change vs. Year Ago
Place of Work			
Nonfarm	719,829	721,555	2.5
Manufacturing	95,762	97,285	1.9
Durables	45,227	47,118	0.2
Nondurables	49,555	50,167	3.3
Mining	1,729	1,724	0.5
Construction	26,910	26,939	4.8
TCU*	46,591	46,577	1.2
Trade	186,415	186,766	1.4
Wholesale	55,749	55,287	2.9
Retail	130,556	131,479	0.8
FIRE**	48,552	48,361	-0.7
Services	173,026	173,603	3.7
Government	140,826	140,296	4.3
Place of Residence			
Civilian Labor Force	863,424	838,884	2.3
Unemployment Rate	2.0%	2.3%	

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

Source: Nebraska Department of Labor

Table III
Price Indices

	August 1990	% Change vs. Year Ago	YTD % Change vs. Year Ago
Consumer Price Index - U* (1982-84 = 100)			
All Items	131.6	5.6	5.0
Commodities	122.8	5.2	4.5
Services	140.9	5.9	5.4
Producer Price Index (1982 = 100)			
Finished Goods	119.2	5.2	4.3
Intermediate Materials	114.4	2.1	1.0
Crude Materials	110.2	9.1	1.7
Ag Index of Prices Received (1977 = 100)			
Nebraska	161	3.9	3.5
Crops	121	-4.7	-7.0
Livestock	186	8.1	8.6
United States	150	4.2	3.0
Crops	127	0.8	-4.0
Livestock	174	8.1	8.9

U* = All urban consumers

Source: U.S. Bureau of Labor Statistics, Nebraska Department of Agriculture

Subsoil conditions in recent reports are showing a return of dryness. Once crops are harvested, some good heavy winter rains and snow would help our soils.

USDA recently released figures estimating the cost penalties to farmers of increases in oil prices. In short, the jump in oil prices will decrease 1991 net farm income. The USDA estimates that a $30 per barrel price of crude will raise U.S. farm cost $1.7 billion. A $40 per barrel price will raise farm costs $2.6 billion. Nebraska farmers will not be exempt from these increases.

At the same time that Nebraska farmers face an increase in their costs, they may face a reduction in farm payments. The original compromise budget bill would have cut another $13 billion from commodity subsidies over the next five years. That overall goal is still intact in Congress. The first year cut has been reduced to $1 billion in this fiscal year starting October 1, 1990. Details of the cut will be determined by the Senate and House Agriculture Committees.

Nebraska construction continues to do well according to F.W. Dodge. In August gains in residential and nonbuilding construction did not fully offset drops in nonresidential construction. For the month as a whole, total construction values were down 4.7 percent from year ago levels. The year-to-date averages are still showing solid advances in Nebraska.

On a year-to-date basis through August, building square footage is up 15.8 percent. Total value is up 21.0 percent. In contrast with national activity, Nebraska housing starts on a year-to-date basis have increased 21.3 percent. Most of the strength lies in the apartment building sector.

Correction

In the August issue of *Business in Nebraska*, total personal income for Lancaster County was shown as $2,509.2 million. This number should have been $3,190.3 million.

Table IV
City Business Indicators
June 1990 Percent Change from Year Ago

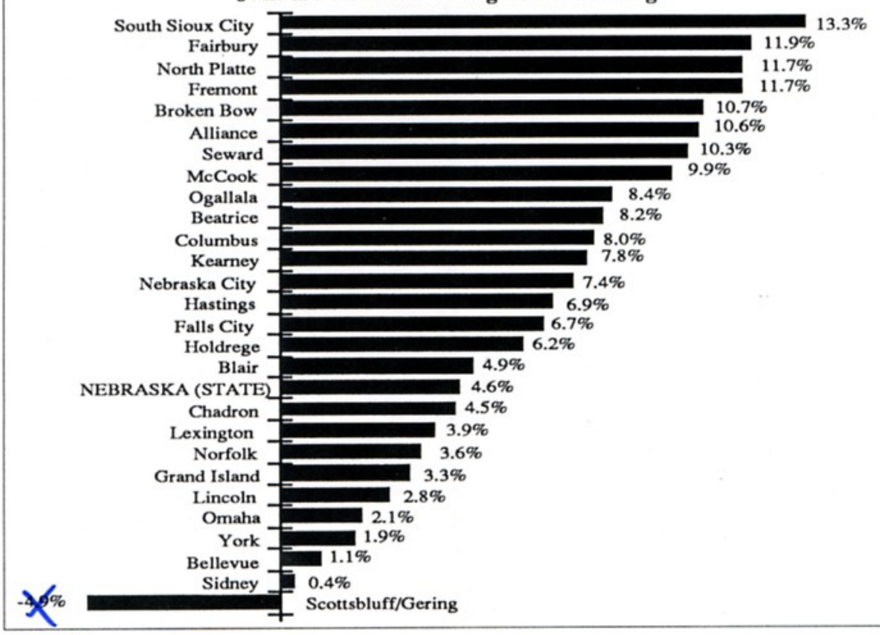
The State and Its Trading Centers	Employment (1)	Building Activity (2)
NEBRASKA (STATE)	6.0	10.4
Alliance	5.4	100.0
Beatrice	6.0	103.7
Bellevue	4.7	-42.2
Blair	4.7	-30.0
Broken Bow	5.7	378.1
Chadron	21.0	-60.7
Columbus	8.6	11.0
Fairbury	4.2	511.1
Falls City	10.8	-15.9
Fremont	9.3	120.4
Grand Island	7.9	22.3
Hastings	8.2	-13.6
Holdrege	5.4	18.3
Kearney	7.8	119.5
Lexington	10.9	-55.4
Lincoln	5.4	6.1
McCook	4.7	26.9
Nebraska City	1.6	69.0
Norfolk	11.6	-33.7
North Platte	12.2	124.0
Ogallala	11.4	50.9
Omaha	4.7	9.6
Scottsbluff/Gering	6.1	0.0
Seward	8.3	118.2
Sidney	7.7	-60.1
South Sioux City	3.1	-40.7
York	12.3	17.7

(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
June 1990 Percent Change from Year Ago



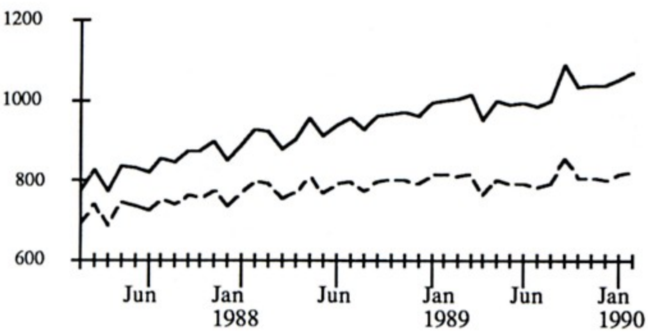
+2.8

Table V
Net Taxable Retail Sales of Nebraska Regions and Cities

Region Number and City (1)	City Sales (2) June 1990 (000s)	City Sales (2) % Change vs. Year Ago	Region Sales (2) June 1990 (000s)	Region Sales (2) % Change vs. Year Ago	YTD % Change vs. Year Ago
NEBRASKA	$962,737	7.1	$1,107,597	6.0	6.2
1 Omaha	317,774	2.7	400,698	2.4	4.4
Bellevue	13,408	7.7	*	*	*
Blair	4,918	14.3	*	*	*
2 Lincoln	121,393	3.9	144,515	3.9	6.0
3 South Sioux City	5,702	37.6	8,903	23.0	29.3
4 Nebraska City	3,782	13.5	19,959	10.0	8.6
6 Fremont	17,943	12.4	33,137	10.5	8.1
West Point	2,917	18.1	*	*	*
7 Falls City	2,127	10.2	9,573	10.4	6.3
8 Seward	4,285	10.5	15,480	4.8	7.6
9 York	6,386	-6.3	16,191	-1.7	2.0
10 Columbus	16,319	12.3	30,548	9.6	7.1
11 Norfolk	19,904	4.7	36,981	6.0	6.1
Wayne	2,967	23.2	*	*	*
12 Grand Island	34,749	1.0	51,173	1.9	3.4
13 Hastings	17,680	13.0	38,447	4.4	2.4
14 Beatrice	7,789	8.8	19,363	12.1	11.4
Fairbury	2,953	5.8	*	*	*
15 Kearney	20,215	5.1	30,268	3.9	4.5
16 Lexington	6,297	10.7	18,074	11.0	4.2
17 Holdrege	4,894	10.7	9,009	2.2	5.5
18 North Platte	18,192	9.3	23,072	7.7	7.6
19 Ogallala	6,845	7.0	14,556	8.5	4.8
20 McCook	8,957	19.4	12,811	14.7	6.5
21 Sidney	3,910	7.1	8,520	10.8	3.7
Kimball	1,941	23.2	*	*	*
22 Scottsbluff/Gering	~~15,530~~ 18,788	~~-14.0~~ +4.0	26,805	2.3	5.0
23 Alliance	5,657	15.2	15,108	5.3	2.8
Chadron	2,751	2.9	*	*	*
24 O'Neill	4,328	-6.4	16,637	4.1	7.9
Valentine	3,440	30.3	*	*	*
25 Hartington	1,835	27.9	9,474	13.1	5.4
26 Broken Bow	3,657	5.1	13,325	4.7	3.0

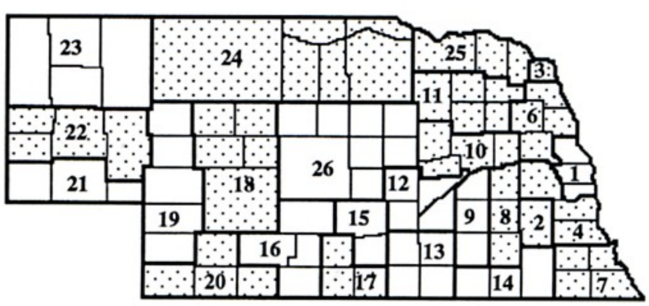
(1) See region map
(2) Sales on which sales taxes are collected by retailers located in the state. Region totals include motor vehicle sales
* Within an already designated region
Compiled from data provided by the Nebraska Department of Revenue

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. Solid line indicates current dollars; broken line indicates 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

Speakers Include:

Gary Parker
Lindsay Manufacturing

Tom Olson
Lisco State Bank

Mogens Bay
Valmont International

Arnold Bateman
University of Nebraska Panhandle Research and Extension Center

Dick Good
Grand Island Industrial Foundation

Tony Raimondo
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Nebraska Department of Agriculture

Bob Duckworth
Twin Cities Development

Stephen Frayser
Department of Economic Development

Roy Frederick
UNL Department of Ag Economics

Joyce Hillman
Scottsbluff Chamber of Commerce

Hod Kosman
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