CASH RESERVE FUND

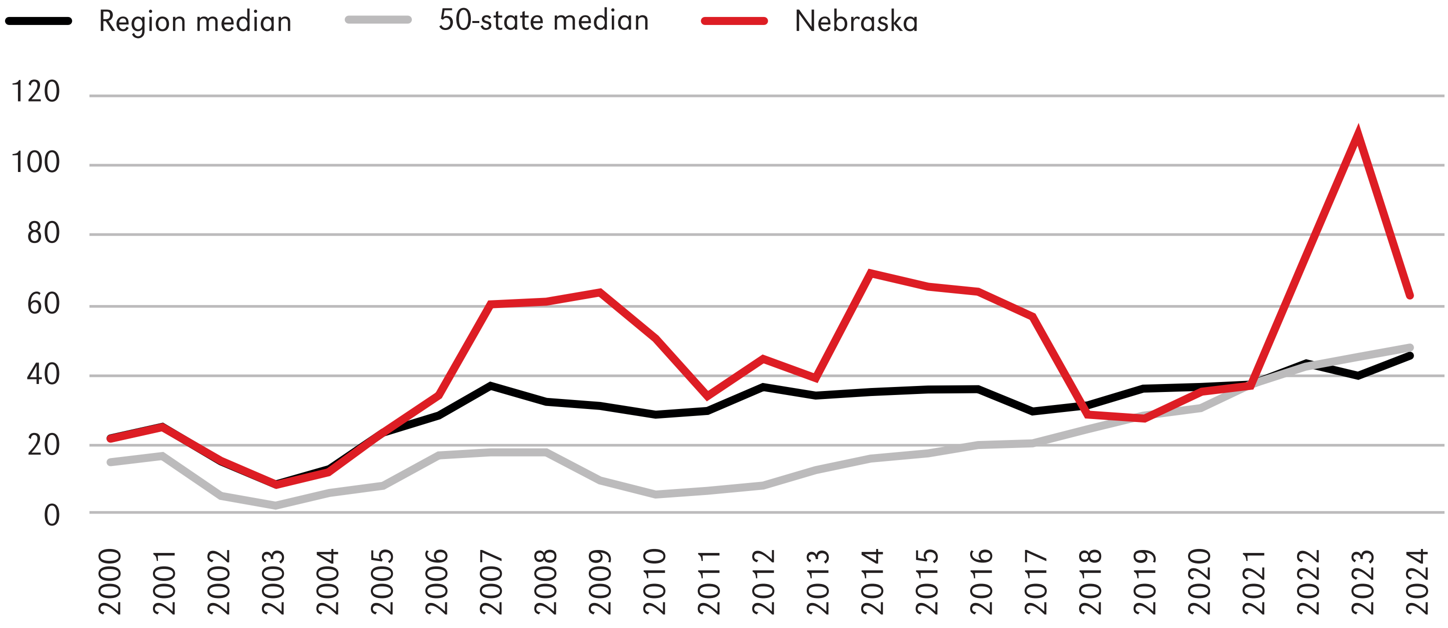
Current Nebraska Policy

Current law (Section 77-4602) requires the state treasurer to make deposits into the Cash Reserve Fund when actual General Fund net receipts are above estimated receipts. If the annual increase for the current fiscal year is greater than 103% of the previous year's increase, the amount transferred to the Cash Reserve Fund is reduced.

The legislative fiscal analyst does a budget stress test report in odd-numbered years. The 2023 Budget Stress Test found that the Cash Reserve Fund and other state cash funds with unobligated balances "exceed the total General Funds at risk under the two economic downturn scenarios evaluated" (p. 1).

The Pew Charitable Trusts recently reported that Nebraska's rainy day fund decreased significantly from FY 2023 to 2024, from 30% of total spending to 17.2%. The 2023 amount would fund 109.6 days of spending, compared to 62.8 days in FY 2024. Despite this increase, the 2024 level is the second highest since 2016. It is also higher than the 50-state median, and the regional median for states bordering Nebraska. (See Figure 1) Taken together, the cash reserves were healthy in 2023 but have been reduced since then.

Figure 1: Days of Cash, Rainy Day Funds, 2000 to 2024



Volatility

One of the issues for the Nebraska rainy day funds is the volatility of revenues. Two national groups have commented on this.

1. The Tax Policy Center recommends that "states consider investing volatile revenue sources, such as capital gains revenues, into budget stabilization funds (BSFs). Policymakers can tie BSF deposit rules to the level of state revenue volatility. BSFs with strict deposit and withdrawal rules mitigate business cycle volatility more effectively than funds with weak rules" (Rueben and Randall, 2017).

2. The Volcker Alliance (Barrett and Greene, 2019) found that in 2019, nine states linked their reserve funds to volatile revenue streams. Seven other states use economic formulas to determine the funding level of reserve funds. For instance, "Indiana contributes to the state fund when personal income grows more than 2% from the previous year (p. 17).

Two studies provide evidence on the volatility of Nebraska state tax sources. The Federal Reserve Bank of Kansas City found that the most volatile tax in Nebraska during the period 1967 to 2007 is the corporate income tax, followed by the personal income tax. The general sales tax was the least volatile (Felix, 2008). The personal income tax is volatile in part because of its progressive tax brackets and the volatility of capital gains income and S Corporations. The Pew Charitable Trusts examined the period 1998 to 2017 and also found the corporate income tax the most volatile, followed by the personal income tax, general sales tax and the motor fuels tax (Murphy, Iyengar and Zhang, 2018).

Current policy makes deposits into the Cash Reserve Fund when revenues are a specified level above the revenue estimate. Three other options are:

1. Dedicate a portion of the unencumbered general fund balance at the end of the fiscal year for the Cash Reserve Fund;
2. Identify a volatile tax (such as the corporate income tax) or a volatile component of a tax (such as capital gains) and dedicate some portion of those revenues to the Cash Reserve Fund; or
3. Use an economic formula to determine the amount of deposits in the Cash Reserve Fund, such as the Indiana policy.

References

Barrett Katherine and Richard Greene, (2019). "Rainy Day Fund Strategies: A Call To Action," Volcker Alliance, New York. https://www.volckeralliance.org/resources/rainy-day-fund-strategies-call-action.

Felix, R. Alison, (2008). "The Growth and Volatility of State Tax Revenue Sources in the Tenth District," *Economic Review* (Third Quarter) Federal Reserve Bank of Kansas City

Murphy Mary, Akshay Iyengar and Alexandria Zhang, (2018). "Tax Revenue Volatility Varies Across States, Revenue Streams," Pew Charitable Trusts, https://www.pewtrusts.org/en/research-and-analysis/articles/2018/08/29/tax-revenue-volatility-varies-across-states-revenue-streams.

Nebraska Legislative Fiscal Office (2023). *2023 Nebraska Budget Stress Test*, https://nebraskalegislature.gov/pdf/reports/fiscal/budget_stress_test_2023.pdf.

Rueben Kim S. and Megan Randall, (2017) *Revenue Volatility: How States Manage Uncertainty*. Tax Policy Center: Urban Institute and Brookings Institution, https://www.taxpolicycenter.org/sites/default/files/publication/149171/revenue-volatility_1.pdf.