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Appropriations Committee  
February 23, 2015

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[LB32 LB33 LB169 LB656 LB657 LB658 LB659 LB660 LB661 LB662]

The Committee on Appropriations met at 1:30 p.m. on Monday, February 23, 2015, in Room 1524 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a public hearing on LB656, LB657, LB658, LB659, LB660, LB661, LB662, LB169, LB32, and LB33. Senators present: Heath Mello, Chairperson; Robert Hilkemann, Vice Chairperson; Kate Bolz; Ken Haar; Bill Kintner; John Kuehn; Jeremy Nordquist; John Stinner; and Dan Watermeier. Senators absent: None.

SENATOR MELLO: Good afternoon and welcome to the Appropriations Committee. My name is Heath Mello. I'm from south Omaha, representing the 5th Legislative District and serve as Chair of the Appropriations Committee. I'd like to start off today by having members do self-introductions, starting first with Senator Kintner.

SENATOR KINTNER: I'm Bill Kintner from Legislative District 2.

SENATOR NORDQUIST: Senator Jeremy Nordquist, District 7, downtown and south Omaha.

SENATOR KUEHN: Senator John Kuehn, District 38, south-central Nebraska.

SENATOR HILKEMANN: Senator Robert Hilkemann, District 4, west Omaha.

SENATOR STINNER: Senator John Stinner, District 48, Scotts Bluff County.

SENATOR HAAR: Senator Ken Haar, District 21, northwest Lincoln.

SENATOR WATERMEIER: Senator Dan Watermeier from Syracuse.

SENATOR MELLO: Assisting the committee today is Rachel Meier, our committee clerk. Julia will be our page for the day. And our fiscal analyst will be none other than Mike Calvert at the beginning, but we will have other analysts shuffle through. On the tables in the back of the room you'll find some yellow testifier sheets. If you're planning on testifying today, please fill out one of the sheets and hand it to Rachel when you come up. It helps us keep an accurate record of today's public hearing. There are also some white sheets on the back of the cabinet if you do not wish to testify but would like to record your position on a budget item. If you do have any handouts, please bring at least 11 copies of them and please give them to Julia, our page, when you come up. If you do not have enough copies, she can help make more for you. We will begin the bill testimony today with the introducer's opening statements. Following the opening statements, we'll hear from supporters of the bill, then those in opposition, followed by those speaking in the neutral capacity. We'll finish with a closing statement by the introducer, if they wish to give one. We ask that you begin your testimony by giving us

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your first and last name and spelling it for the public record. We will be using a five-minute light system today, so when you begin your testimony, the light on the table in front of you will be green. The yellow light will be your one-minute warning. And when the red light comes on, we please ask that you wrap up with your final thoughts. As a matter of committee policy, I'd like to remind the senators that we...that use of cell phones and other electronic devices is not allowed during public hearings, and at the same time I'd ask all of us in the audience, including senators and others, to please look at our cell phones and make sure that they are on the silent or vibrate mode. With that, at this time we'll begin today's public hearing on LB656, LB657, LB658, LB659, LB660, LB661, and LB662. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: (Exhibits 1 and 2) Good afternoon, Chairman Mello and members of the Appropriations Committee. For the record, my name is Gerry Oligmueller. My name is spelled G-e-r-r-y O-l-i-g-m-u-e-l-l-e-r. I am the State Budget Administrator and administrator of the Department of Administrative Services, Budget Division. I'm appearing here today on behalf of Governor Ricketts in support of LB656 through LB662 which, along with LB663, constitute the Governor's budget recommendations. The funding for the operations of state government, state aid to individuals and other governments, and capital construction are contained in these legislative bills. The contents of this legislation have been summarized and presented to you in a printed publication entitled, "Executive Budget in Brief, 2015-2017 Biennium," and dated January 22, 2015. I've provided a copy of that printed publication along with my prepared remarks to the committee clerk for your record. In addition, we have posted a more comprehensive publication entitled, "Executive Budget, 2015-2017 Biennium," dated January 22, 2015, along with a complete copy of the individual state agency, board, and commissions' biennial budget requests on the State Budget Division Web site at [budget.Nebraska.gov](http://budget.Nebraska.gov). The Governor's recommendations for adjustments to the current fiscal year 2014-15 appropriations contained in LB656 represent a net increase of \$28.3 million in current General Fund appropriations. The Governor's recommendations for 2015-2017 biennial appropriations are contained in LB657 through LB663. LB663, which provides for an increase in the salaries of judges of the various courts, was referred to the Judiciary Committee. The Governor's recommendations for the 2015-17 biennium provide for a two-year average increase in General Fund appropriations of 3.1 percent. LB661 and LB662 contain specific provisions related to various funds and transfers necessary to administer and account for budget recommendations made by the Governor for the upcoming biennium. LB661 includes a transfer of \$198 million, an increase of \$60 million dollars, in each fiscal year of the biennium, from the General Fund to the Property Tax Credit Fund. The Governor's budget recommendations also provided \$32.5 million in FY '16-17 to support additional tax relief measures under consideration by the Revenue Committee for veterans receiving military retirement benefit income and for additional property tax relief. I know that the many state agency budget requests and the provisions of LB656 through LB662 have been the subject of your committee working sessions these past

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five weeks. In addition to this information, your upcoming preliminary recommendations will be the subject of your committee hearings for the next four weeks. Today I will not repeat information already provided to you and will recognize your work in progress by not reviewing in detail the Governor's recommendations. Agency directors will be prepared to discuss specific recommendations related to their agencies during your upcoming budget hearings. In addition, the staff of the State Budget Division and I will be available throughout your committee process to assist as may be necessary in your further work on developing your recommendations for the 2015-17 biennium. On behalf of Governor Ricketts, I do want to share how much we appreciate the hard work of the committee and that we look forward to working with you over the next 40 legislative days as you finalize your recommendations to the Legislature. Thank you. Do you have any questions you'd like to ask today regarding LB656 through LB662? [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: Thank you for your testimony, Director Oligmueller. Are there any questions from the committee? First, I'd like to recognize Senator Bolz from District 29 joining the committee today. Any questions? Senator Nordquist. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR NORDQUIST: Thank you, Mr. Chairman. Mr. Oligmueller, just can you speak generally to the Governor's philosophy on utilization of the Cash Reserve, either for ongoing expenditures or one-time expenditures and kind of at this point not really utilizing those for any additional tax relief or spending measures? [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: The Governor used the Cash Reserve I think only to address a current one-time obligation he confronted as he transitioned to the Office of Governor related to the Title IV-E disallowances at the Department of Health and Human Services. And his view continues to be that a Cash Reserve Fund level of at least \$500 million should be preserved and that we work to construct a budget that restrains spending in a manner, a percent or so, below what we project as ongoing receipts, sort of as a long-term look at the state budget, and preserve the balance of the Cash Reserve for any sort of unforeseen exigencies that develop and/or to leverage future tax relief for the taxpayers of Nebraska. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR NORDQUIST: Thank you. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: Any other questions from the committee? Senator Stinner. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR STINNER: Thank you, Senator Mello. You mentioned a \$500 million reserve. Is there a calculation relative to that or do you have any empirical data that

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would support \$500 million or is it \$450 (million) or is it \$600 (million)? [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: Well, there certainly is no requirement in state law with regards to the balance that's required in the Cash Reserve Fund. There's various studies that have been undertaken in that regard that range as high as, you know, 17 to 18 percent on an annual basis. So that's...\$500 (million) is a number the Governor is comfortable with as he works on the state budget. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: Any other questions from the committee? I've got one, Mr. Oligmueller,... [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: Okay. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: ...and it's maybe just a point of clarification. There was a specific item that was in the capital construction bill that was recommended by the Governor regarding bond payments and there was a lack of a bond payment for the University of Nebraska Vet Diagnostic Lab Center the first year of the biennium, and then it picks up that bond payment the second year and continuing out into the future. Can you provide any feedback or information to the committee in regards to why, why that first year bond payment was left or why that zeroed out that first year's bond payment and then continued on the second year? [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: Well, my understanding is the university hasn't actually entered into the bonds for the Vets Diagnostic Center and it's going to be about a three-year lapse from the original appropriations that would serve to finance those bond payments to the point in time they're actually going to undertake construction. So this represented recognizing that delay. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: Okay. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: Our recommendation reappropriates the two years of appropriations that have not been used,... [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: Okay. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: ...'14 and '15, reappropriates those to the upcoming biennium and preserves the total project cost, so. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: Okay. That helps clarify. Thank you so much. [LB656 LB657 LB658

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LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: Okay. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: Any other questions, committee? Senator Kuehn. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR KUEHN: Thank you, Senator Mello. Mr. Oligmueller, do you have a general idea at this point about, with regard to each of the agencies, their reappropriated balances, what the position is on carrying forward those reappropriations versus lapsing them or the magnitude that may be asked to be reappropriated in the coming biennium? [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: Right. The Governor's recommendations reappropriated General Fund operating balances of the various state agencies, you know, consistent with standing policy, not to promote that those monies necessarily be spent but be saved as the agencies approach the end of the fiscal year. We certainly have information, I don't have it with me, with regards to how much was unexpended of '14 appropriations and carried forward into '15. Knowing exactly what will be available on June 30, 2015, on the other hand, is a estimate or guesstimate, depending upon your choice of terms, regarding how an agency might utilize its existing appropriations. So you know, there's math that can be conducted to make an estimate in that regard, but the Governor's recommendation was to continue those reappropriations. And generally, with regards to aid programs, we do not. We lapse those appropriations. And in a couple instances, if I recall correctly, we did reappropriate the ending balances, Medicaid being one, for example. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR KUEHN: Based on prior years' experience, do you feel the amount to be reappropriated or that the Governor has asked to be reappropriated is equivalent to prior years or greater than prior years? [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: It's probably grown... [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR KUEHN: Okay. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: ...in comparison to prior years. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: Senator Kintner. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

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SENATOR KINTNER: The reason--I'm trying to work through a reasoning why--the reason that we'd rather appropriate it is to reward being frugal and saving versus spend it or lose it type mentality. Is that correct? [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: That is the current policy, yeah. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR KINTNER: All right. I just...I thought that was kind of why we're doing it. Okay. That's all I need to know. Thank you. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: Any other questions from the committee? Seeing none, thank you, Director Oligmueller. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

GERRY OLIGMUELLER: Thank you. Look forward to working with you. [LB656 LB657 LB658 LB659 LB660 LB661 LB662]

SENATOR MELLO: (Exhibits 3, 4, 5, 6, and 7) Are there any proponents for LB656, LB657, LB658, LB659, LB660, LB661, or LB662? Seeing no proponents, we did receive letters of support: one from the Nebraska Historical Society and four letters from the Nebraska Water Resources Association. Are there any opponents to LB656, LB657, LB658, LB659, LB660, LB661, or LB662? Seeing none, is there anyone in the neutral capacity? Seeing none, Director Oligmueller, would you like to close or waive closing? Director Oligmueller waives closing and that will end today's public hearing on LB656, LB657, LB658, LB659, LB660, LB661, and LB662. That will lead us to our next bill, LB169, and I'll turn it over to Senator Hilkemann. Good afternoon, Vice Chairman Hilkemann, members of the Appropriations Committee. My name is Heath Mello, H-e-a-t-h M-e-l-l-o, and I represent the 5th Legislative District in south Omaha. LB169 strikes obsolete language pertaining to completed transfers in Section 84-162 of state statute which concerns the Cash Reserve Fund. In addition of being essentially a cleanup bill, LB169 can potentially play an important role during our budget process. For the new members that may be not away, historically the Appropriations Committee Chair has introduced a similar bill each budget cycle so that if the budget requires a transfer from the Cash Reserve, a vehicle for doing so is available to the committee. This process was used by my predecessor, former Senator Lavon Heidemann, and I introduced a similar bill in 2013. Both bills were ultimately used in the budget process to transfer funds from the Cash Reserve Fund. Thank you for your time and I'd be happy to answer any questions you may have. [LB656 LB657 LB658 LB659 LB660 LB661 LB662 LB169]

SENATOR HILKEMANN: Any questions for Senator Mello? Okay. Are there any additional proponents for LB169? Are there any opponents to LB169? Is there anyone

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who'd like to speak from the neutral side on LB169? Seeing none, Senator Mello waives closing on LB169. Now we will go to LB32 with Senator Mello. [LB169]

SENATOR MELLO: (Exhibit 1) Good afternoon, Vice Chairman Hilkemann, members of the Appropriations Committee. My name is Heath Mello, H-e-a-t-h M-e-l-l-o, and I represent the 5th Legislative District in south Omaha. I'm here today to introduce LB32, a bill that would require the Nebraska Department of Correctional Services to provide performance-based strategic plans along with their biennial budget requests. In the aftermath of the investigations into the Department of Correctional Services that were conducted last year, including the LR424 Special Investigative Committee, the Legislative Ombudsman's reports and related performance audits, it's become clear that adoption of performance-based budgeting requirements would be a critical tool for gauging the success as reforms within the department move forward. Under LB32, the Department of Correctional Services would be required to develop yearly strategic plans as part of the appropriations process during each of the next two budget cycles. In these plans, the department shall identify the main purpose of each budget program, develop key goals for measuring progress in meeting those purposes, and develop benchmarks and time frames for meeting those goals. Each September the department would submit a report to the Appropriations Committee and the Judiciary Committee regarding their progress towards meeting the key goals identified in their strategic plan and would appear at a joint hearing of the committees to present their report. As some members of this committee may recall, in 2012 the Nebraska Legislature passed LB949 which required the Division of Children and Family Services of the Department of Health and Human Services to install these very same performance-based budgeting practices. Additionally, last year I introduced LB974 to this committee which expanded those requirements to more divisions within the Department of Health and Human Services. While LB32 represents just a small expansion of performance-based budgeting in state government, recent investigations and reform proposals have convinced me that the Department of Correctional Services should face a greater level of scrutiny than what our current budget process provides and is the responsible next step to help the Legislature get a better handle on the budget for an agency that is facing a number of comprehensive reforms. It has come to my attention that the fiscal note attached to LB32 states that the Department of Correctional Services believes that they will need to hire an additional staff member to comply with the requirements in the underlying bill. I'd like to remind the committee that when similar legislation was passed for the Department of Health and Human Services, both in 2012 and in 2014, there was no fiscal impact. Additionally, if you look at the excerpt from the agency's own budget request from this year, of which I just had the page provide you a copy of, you will note that all institutions and major programs within the Department of Correctional Services already lay out major goals to strive for. LB32 simply requires the department to quantify and analyze plans that are already in place and measure the effectiveness of their efforts. This analysis and effectiveness review will only be published in five reports, one report per year attached to their budget submission, with the last report due in 2019.

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Furthermore, I've also provided the committee with a copy of the general instructions memo that was sent to every department regarding their budget submission procedures from the Department of Administrative Services, Budget Division. The memo makes clear that essential elements of their budget request include, quote unquote, the development and documentation and performance standards for each program, subprogram, and activity to measure and evaluate present as well as projected levels of expenditures, end quote. Performance-based strategic planning is something that every department in state government is already supposed to be doing based on this general guidance from the Department of Administrative Services. I will be working with the Department of Correctional Services and the Department of Administrative Services, Budget Division to gather as much information as possible to determine the true fiscal impact of LB32 and see if there's a way to mitigate those fiscal costs. Following me in the hearing today will be, in support of LB32, will be the Nebraska ACLU and the OpenSky Policy Institute. Thank you for your time and I'd be happy to answer any questions that you may have. [LB32]

SENATOR KUEHN: Any questions for Senator Mello? [LB32]

SENATOR KINTNER: Yeah, I got one. [LB32]

SENATOR KUEHN: Senator Kintner. [LB32]

SENATOR KINTNER: Mr. Chairman, how many of these reports do we get each year, reports like this? [LB32]

SENATOR MELLO: This report actually, we're requiring this report be part of their budget submission report, so it would be an annual report that they've got to provide the Legislature in September when the budget reports are due each year. Outside of this, the only other divisions we require this kind of report, Senator Kintner, is the major divisions within the Department of Health and Human Services. [LB32]

SENATOR KINTNER: Yeah, I know we'll talk about this when we exec on it, but I get these reports. I look at them. They're about as exciting to read as a Harry Reid speech. And I, you know, I'm sure that they do this planning, but why do they have to give it to us? I mean how is that going to change anyone's life if they give it to us and we have to suffer through it? [LB32]

SENATOR MELLO: (Laugh) Senator Kintner, I'll do my best to provide a perspective that hopefully the committee will consider. The Legislature on any given day passes laws that require state government agencies to perform or implement certain laws or perform certain functions or duties. Something that's unique to this committee, as part of the state budget process, is our unique responsibility to evaluate budget and appropriation requests and then make a determination of whether or not we want to

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fulfill those requests, deny those requests, or meet somewhere in the middle in regards to what was asked for. The unique component behind LB32 is that every state agency, at least based on the guidance I gave you today from the Department of Administrative Services is they run the budget process through state agencies, states that every state agency, when they developing appropriation requests that come to this committee, should already be doing this work; that they should already be developing annually, as well as by program and by subprogram, what their strategic goals are and what their strategic vision of those programs and subprograms should be. Ideally, and obviously if you read through some of that material I gave you, you'll see that their main focus is to ensure that agencies are being effective and being responsible with the appropriations that we as a Legislature are giving them. I think to some extent what we've seen through large state agencies like the Department of Health and Human Services--and the reason that LB32 is targeting the Department of Corrections is it's the second largest state agency behind HHS--where I can tell you in my now seventh year in the Legislature, this Department of Correctional Services has been arguably one of the least transparent agencies in state government, in part because unless there's a problem, normally through the budget process we just don't hear an awful lot from them. It's simply a quick, brief, two- to three-minute prepared remarks, we move forward. And in my time, we've appropriated pretty much every request they've ever asked for. I think the unique component is this agency is going to be starting and going through a number of comprehensive reforms, not just from the executive branch side, which we know they have a new Corrections director, they're hiring new leadership, but obviously a number of legislative proposals that have been brought forward that I have a feeling the Legislature will likely debate and adopt some of those proposals which will also help and ensure the department is moving forward with some comprehensive reforms. I think it's only fitting that the nine members of this committee and the Legislature as a whole get information back from the Department of Corrections in regards to what their intended outcomes were supposed to be with the budget request that we've already given them in a preliminary budget request right now. I think it's only fitting that we ask them for an annual update on that budget request to see if they did, in fact, meet the intended goals with the money that we gave them. I'll only point to two components, Senator Kintner, that really I think raises a real need and desire for us to consider this policy. We heard over the last year, in 2014, during the legislative session and during the interim study hearings, both through the Performance Audit Committee, the Special Investigative Committee, and some work through the Ombudsman's Office, that there's a lack of programming within the Department of Corrections, a variety of programs that are lacking. We as an Appropriations Committee, in a preliminary budget recommendation, had provided an increase in programming funding. I would only expect all nine of us to want to see what the impacts of that programming funding will be a year from now, to see when we appropriated that money, that new funding for new programs or expansion of programs, did the department see the intended outcomes from that appropriation? If they didn't, I sure would like to know, as the Chair of the committee, what did happen with that funding then? Why did they not have the

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outcomes? Was it not enough appropriations? Was the programming a problem on the executive branch side or was it something that we as the legislative side of the house need to work on? I understand I think your general question is we as a legislative branch ask the executive branch to provide a number of reporting requirements and mechanisms back to us when we pass legislation or when we make appropriations. The question I gather from your comments were is this just another added requirement and, really, what are we going to do with this. I think that it is our constitutional responsibility, as a separate, coequal branch of government, to provide legislative oversight over the executive branch in which we appropriate money to. I think LB32 simply provides this committee first, then the Legislature as a whole more reporting information that as a collective we can see in real time almost what are the outcomes from the decisions we made earlier in the fiscal year. Will every member read those reports? I can't tell you that. Will every member feel that these reports will make a...change their mind, so to speak, in regards to whether or not they want to appropriate money in the future? That's left up to individual legislators. But I think providing more data and more analysis to individual legislators and to this committee as a whole can only serve all of us in regards to making a determination if we in fact are getting the best bang for our buck when we appropriate money on behalf of taxpayers. [LB32]

SENATOR KINTNER: Well, gee, Mr. Chairman, you should have just said that in your opening statement. Thank you very much. [LB32]

SENATOR KUEHN: Senator Stinner. [LB32]

SENATOR STINNER: Thank you, Senator Kuehn. I highly endorse this because one of the questions I had of Director Frakes is do you have some way of benchmarking performance. Including in this is very...it's a complete list. The only thing that I would probably add is benchmarks to what. I mean we need to take them to the industry standards. [LB32]

SENATOR MELLO: Uh-huh. [LB32]

SENATOR STINNER: That would be the only thing that I might quarrel with. But you have to have reports. You have to have a strategic plan and the strategic plan starts from a vision and takes you through all the various moving parts. And then you benchmark it to the best in the industry. That's the only way that we can say we're getting our bang for the buck. Our taxpayers expect us to get the bang for the buck as far as efficiencies and doing the right things to protect the safety of the public. So I think this is definitely a step...absolute step in the right direction. So thank you. [LB32]

SENATOR MELLO: Thank you. [LB32]

SENATOR KUEHN: Other questions? Senator Bolz. [LB32]

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SENATOR BOLZ: Very quickly, one of the things that I appreciated about the information that we received from the Department of Health and Human Services was that we also got performance indicators related to operations, so when we gave out aid, for example, to Developmental Disabilities, we could also see how they were going to operationally use that. So perhaps as a point of clarity or maybe just for the record, it is your intention that that same operational performance indicator strategy would be used in this bill. And I think given what we saw previously in the LR424 Committee, that would be exceptionally helpful. [LB32]

SENATOR MELLO: That is correct, Senator Bolz. [LB32]

SENATOR BOLZ: Thank you. [LB32]

SENATOR KUEHN: Other questions for Senator Mello? Seeing none,... [LB32]

SENATOR MELLO: Thank you. [LB32]

SENATOR KUEHN: ...moving on to proponents, those who would like to speak in support of LB32. Thank you and welcome. [LB32]

ALAN PETERSON: Thank you, Mr. Chairman, members of Appropriations Committee. I'm Alan Peterson, A-l-a-n P-e-t-e-r-s-o-n. I am an attorney and the lobbyist or a lobbyist for ACLU of Nebraska, which is the Nebraska affiliate of ACLU but an independent group, very independent sometimes. I'm here in support of LB32. I have spent, as has Senator Mello and members of two pretty good-sized committees, that last most of the year investigating and working on and trying to solve the incredibly large problems at our corrections system, two in particular. Enormous overcrowding: and I know you've seen the stats over and over again that we're somewhere around 160 percent of capacity right now compared to design capacity of our prisons. And some of the institutions or facilities are over 300 percent times capacity. I believe the D&E, Diagnostic and Evaluation Center, in Lincoln fits in that category. And others are 200-and-some percent. The other huge problem is that for some reason, whether by attrition of knowledgeable people or attrition of knowledge, our handling in Nebraska of the segregation or isolation of prisoners, and particularly those who are either vulnerable or mentally ill, has become a catastrophe not waiting to happen but happening right now. There's an incredible urgency to not just working on but solving these two huge problems. I come from ACLU. Our position is based on the fact that the Bill of Rights includes the Eighth Amendment which protects all of us against what's called cruel and unusual punishment. There's lots of laws as to exactly what that means but in this area it basically is tested by whether the authorities in charge of corrections and prison...and our prisons and jails are aware of serious problems causing either serious mental or physical harm to inmates and yet have shown indifference to them.

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The ACLU put out a booklet after a lot of research, oh, six months ago that suggested or came out and said, we're on the brink of the place where we not only are inviting a huge lawsuit, a class action suit, but we're vulnerable to it. Several other states have gone the route of pushing it so far in terms of overcrowding and in terms of maltreatment that they got sued. And I'm not here for ACLU threatening that. That's not the idea. We're not like sidewalk superintendents who stand around a ditch being dug and say, oh, that's not deep enough; dig it deeper, that won't do. The shovel does fit our hands. We want to help. We're glad to jump down in the ditch and throw the dirt out too. But if we don't solve it and if we don't have a strategic plan to get to work on especially these two huge problems, I don't see how it gets solved. I don't see how Nebraska avoids enormous risk of litigation and loss of litigation in the federal court. The state of California tested it. They've been litigating for about the last 12 or 15 years on these specific problems, and California has lost, lost, lost, even in the U.S. Supreme Court. And drastic remedies were applied there, including the court telling California you have to reduce the population by thousands, even if you have to release a bunch of people. And they did and they shipped them to Nevada. They used other jails. They used private companies to help. Arizona, particularly in the area of segregation or isolation of inmates and especially those who are mentally ill already, just settled a huge lawsuit and came to an agreement with the disability rights organization and the ACLU in Arizona just last week. They spent about \$10 million in attorney's fees just to get to the settlement, plus, they'll be paying millions more to fix it. We don't need to go that route, but planning is going to be essential. LB32 requires it and not just the Department of Corrections will have to plan but it will. It needs to not fix these things on a "put that fire out" or "put a finger in the dike here and there." A plan is a great idea, it always is, and then you work the plan. We hope it solves it. If it doesn't, we'll change the plan. This bill is an excellent start and we wholeheartedly support it. Thank you. Be glad to answer any questions. [LB32]

SENATOR KUEHN: Thank you, Mr. Peterson. Any questions of Mr. Peterson? [LB32]

SENATOR KINTNER: I did have one question. [LB32]

SENATOR KUEHN: Senator Kintner. [LB32]

SENATOR KINTNER: Al, thanks for coming. [LB32]

ALAN PETERSON: Sure. [LB32]

SENATOR KINTNER: I've already taken a lot of time. Did I read right in the paper that you guys are assembling a team of bloodsucking attorneys in case there's a possible lawsuit? Okay, I added the "bloodsucking" part, but... [LB32]

ALAN PETERSON: Yeah, leave out the "bloodsucking." (Laugh) [LB32]

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SENATOR KINTNER: Okay, we'll leave that out. Okay. But... [LB32]

ALAN PETERSON: I have been practicing law so long that I know most of the good trial lawyers and asked probably a dozen of the best, who have got experience in prison litigation, if they would advise and help us at the ACLU so we know when to sue and when not to sue. [LB32]

SENATOR KINTNER: Oh, okay, so it's to advise and help. [LB32]

ALAN PETERSON: It's an advisory... [LB32]

SENATOR KINTNER: Okay. All right. That's not what I... [LB32]

ALAN PETERSON: ...but some of them indicated they'd be happy to take the case. [LB32]

SENATOR KINTNER: That's not what it seemed in the paper, but so you're advising, trying to help be part of the solution. [LB32]

ALAN PETERSON: They are to advise the attorneys at ACLU on the legal issues that come up, yes, but they'll also take the case, some of them. [LB32]

SENATOR KINTNER: If it gets to that point. [LB32]

ALAN PETERSON: Yes. We're not quite there yet. We're trying as hard as we can to fix these things with legislation, policy changes, and I think a really good new director that the Governor appointed, Mr. Frakes. He sure looks good on paper. [LB32]

SENATOR KINTNER: Okay. And you obviously see this bill as a step in the right direction, obviously. [LB32]

ALAN PETERSON: To make a plan, always, yes. [LB32]

SENATOR KINTNER: Okay. Hey, thank you for coming out. Appreciate it. [LB32]

ALAN PETERSON: Thank you, Senator Kintner. [LB32]

SENATOR KUEHN: Senator Haar. [LB32]

SENATOR HAAR: Yes, thank you. Mr. Peterson, kind of a broader, higher view question. I mean what you're talking about here are some specifics that we really have to work on. But we have 5 percent of the world's population and 25 percent of the

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world's inmate population. How do you explain that? What do you think...what are some of the really big goals we need to go for? [LB32]

ALAN PETERSON: We need to keep reversing a cultural trend that looked at justice in our country as being the same thing as punishment. Justice, as one of the witnesses said in the Judiciary Committee hearing the other day, is not just punishment. It involves the affects on victims, victims' families, the perpetrator's family, and the whole society. And what we've been doing, you know, 97 percent of the people we throw in prison are going to get out. They're not lifers. And when they get out, they largely go back to their community. Did they learn how to commit crime better while they were in or did they get some training, supervision, education, some vocational help? Right now what they're getting is imprisonment and not much else. It's...the whole country has got this problem but Nebraska is one of the worst right now in terms of overcrowding, just thinking warehouse them, get them in there; when they get out, whatever they do, that's no longer our business. And I don't mean to exaggerate because that's not always the case, but that's the case way too many times and that's how you get this word "recidivism" which was always hard for me to remember if it's the V or the D first--recidivism I think is right--which means repeat offender. That's how you get repeat offenders. If you don't supervise, use probation, parole, transitional services they call them, and maybe mental health services because we think anywhere from 20...I've seen estimates up to 35 percent of our inmates across the state, county jails and prisons, are mentally ill. And since we no longer have the regional facilities, the mental health system that we used to have, that's all been cut back, the jails have become, de facto, our mental hospitals and they don't do a good job. They don't have the people. It's a huge problem. But a number of the bills that have been introduced, including LB592, Senator Bolz's bill, LB598 by Senator Schumacher, are targeting these problems, both for the sake of the inmates and even perhaps at least as important for the sake of the community, so they get supervision, training, and mental health help. And if they need to be committed when they walk out the jail door, that can be done too, particularly under Senator Bolz's bill sets up a provision to possibly require commitment proceedings for some of these people rather than, for example, Nikko Jenkins walking out the door saying he's going to kill people and then going and proving he's an honest man. [LB32]

SENATOR KUEHN: Senator Stinner. [LB32]

SENATOR STINNER: Thank you, Senator Kuehn. Mine is kind of a two-part question. [LB32]

ALAN PETERSON: Yes, Senator Stinner. [LB32]

SENATOR STINNER: In light of the new director, what's your sense of a time line before ACLU starts to act? And what's that bright yellow line that we cross that prompts

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them to act? [LB32]

ALAN PETERSON: Yeah. ACLU of Nebraska, we have a staff of five, six, seven people generally. Three of us are lawyers, but we're not the trial lawyers. We will have to get help to file any major lawsuits, but we do. The time line I just cannot say, but I can say this. The standard for a successful lawsuit in federal court requires essentially that you've tried everything else, including whether it be legislation, persuasion, education on the issues. The effort that the Nebraska Legislature is making right now through the LR424 Committee and the three branch Government Committee and your audit committee, they're all in the right direction. So I guess you're making our case harder, which is great. But our rule, besides the possibility or a credible threat of litigation, and that is what that advisory committee is for, we want to have a credible threat. We want this fixed, number one. We're not looking for lawsuits, but we're there because it's a citizen body and we do, by our credo or our mission, we do have to represent people whose constitutional rights are being violated. That is happening right now. Where is the bright line? We want to see how we do through this spring and summer. And we do, we have been gathering the information and witness reports, particularly on the mental health and segregation issue, and that one is just terrible. That one needs really urgent fixing. Thank you for that question. [LB32]

SENATOR KUEHN: Any other questions for Mr. Peterson? Thank you. [LB32]

ALAN PETERSON: Yes, thank you, Senator. [LB32]

SENATOR KUEHN: Other proponents for LB32. Welcome. [LB32]

RENEE FRY: (Exhibit 2) Thank you. Good afternoon, members of the Appropriations Committee. My name is Renee Fry, R-e-n-e-e F-r-y. I'm the executive director of OpenSky Policy Institute and I'm here today to testify in support of LB32. Performance-based budgeting, as proposed in LB32, is an increasingly popular and effective tool being implemented by state governments to use program effectiveness data to inform budget decisions. Some of the benefits identified in a publication from the Urban Institute include the following: It changes the decision-making culture by introducing strategic and performance-based thinking into policymaking and administration; it introduces performance as one of the elements that influences the budget process; and it includes goal definition and performance targets to achieve the goals as part of the agency administration. However, performance-based budgeting does require a commitment from both legislative and executive branches to be effective. NCSL surveys have found that legislators and staff agree that results-based government requires: permanent institutional commitment from the Governor, Legislature, and agency administrators; a statutory base; adequate staff resources; existence of an oversight agency; investment in data management; and recognition that fundamental change requires time. NCSL explains that it is important for legislators to

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make clear the kinds of measures they care about and how they want results to be presented to them, as agency personnel and legislators may have different ideas about what is important about an agency's work. The Urban Institute notes that state budget offices and the Legislature, especially during the initial years of governing-for-results implementation, often are presented too many indicators, the majority of which are outputs or other management factors such as caseloads, instead of outcomes, such as recidivism rates. While outputs are easier data to interpret, they say little about the outcome of a service. Therefore, the Urban Institute recommends that state legislators provide analytical staff to review the outcome information provided by the executive branch to provide summaries to legislative committees, and find that where legislators have a strong analytical arm that it calls on to review the data, more and better use of the performance information appears to have taken place. They acknowledge such analytical staff can require a significant investment, but they also find that legislators who have...Legislatures who have made this investment believe the money is well spent. I raise these points in comparison to the process that the Legislature has recently been through regarding the state's tax incentive programs. For many years, the Department of Revenue has been issuing legislatively mandated reports with incentive-related data. The data included in the reports has been largely output data--number of eligible businesses, number of qualified employees--rather than outcome data--whether the incentives are creating well-paying jobs and growing our economy. A couple of years ago the Legislature began to require the Department of Revenue to present to the Revenue and Appropriations Committee on the incentive programs. However, the information was limited to output data. The Department of Revenue had not been empowered to analyze outcomes. As a result, the Legislature undertook LR444, the Tax Incentive Review Committee, resulting in LB538 introduced this session. The bill will require the Legislative Performance staff to audit the tax incentive programs based on the outcomes identified in LB538, which will provide much needed information to the Legislature to make policy decisions about the strengths and weaknesses of the state's tax incentive programs. So while we strongly support LB32 as a great first step toward building a responsive budget, we would encourage you to go a few steps further. Take advantage of the new executive branch leadership and work together to identify the state's needs and priorities. Provide funding to collect the data needed to evaluate success of the chosen outcomes and dedicate staff to facilitate the process. Thank you for your time, and I'd be happy to answer any questions. [LB32]

SENATOR KUEHN: Thank you, Ms. Fry. Any questions? I do have one for you. I appreciate that you identified that not all metrics are created equal and that some metrics are simply information and noise, if you will, while others are more outcomes based. How do you recommend or suggest that LB32 meet its mission with identifying the metrics that are of most use, both to members of this committee as well as the body of the whole, when appropriating funds to Department of Corrections? [LB32]

RENEE FRY: So what I've gathered from reading about what other states do, it makes

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the most sense when there is an agreement, there's consensus, much like the LR444 Committee went through quite a process. And you have members on this committee that can speak to that process. But it required a lot of time to make sure that we were focusing on the outcomes that were a priority for the Legislature. And so it's really important to be thinking not just what are the...what are the priority for the administration, which may be different than for the Legislature. So what's important for the Legislature? What are those outcomes that you want to know that are important for policymaking and really critical that those are part of what the department is reporting on. So you want to make sure that either someone is sitting down with them and there's a meeting of the minds in terms of, you know, these are the top five outcomes that we care about and these are the pieces that we want you to report on. We don't want to just know caseloads; we actually want to know, you know...we want to see recidivism rates drop, for example. So you want to make sure that that's something that the department is reporting on and that's part of that strategic plan. So it's really just making sure that the Legislature and the executive branch are aligned in terms of what the priorities are. [LB32]

SENATOR KUEHN: Thank you. Other questions for Ms. Fry? Seeing none, thank you. [LB32]

RENEE FRY: Thank you. [LB32]

SENATOR KUEHN: Other proponents for LB32. Do we have any opponents who would like to speak on LB32? Any individuals in the neutral capacity? With that, Senator Mello waives closing, so that concludes our hearing for LB32. Moving on, we move to LB33, Senator Mello, when you are ready. [LB32]

SENATOR MELLO: (Exhibit 1) Good afternoon, Senator Kuehn, members of the Appropriations Committee. My name is Heath Mello, H-e-a-t-h M-e-l-l-o, and I represent the 5th Legislative District in south Omaha. I'm here this afternoon to introduce LB33, a bill to require the Legislative Fiscal Office to produce an annual report on revenue volatility. States around the country learned a painful lesson when the Great Recession hit us in 2008. As the economy entered its worst downturn since the Great Depression, legislatures across the country scrambled to keep their doors open and their lights on in their respective state. The Great Recession may be an extreme economic downturn of a magnitude that may not happen again in our lifetimes, but we are all aware that the economy moves in cycles and sooner or later there will be another recession. And although the nature of Nebraska's economy and our strong Cash Reserve helped blunt the effects of the Great Recession, revenues fell sharply. Major cuts were made to state programs and an unprecedented federal stimulus program provided our state government with over \$600 million to help balance our state budget. With this in mind, it would be irresponsible fiscal policy to not seek out information that would be useful in mitigating the negative effects of a future economic downturn. It's safe to say that the

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challenges of the next recession will not likely be met with a similar stimulus program that we all saw in 2009. The responsibility will fall to the states to weather the storm on their own. The provisions found in LB33 are a tool that will provide Nebraska's fiscal policymakers with vital information to assist in long-term fiscal planning. Under LB33, the Legislative Fiscal Analyst will prepare a revenue volatility report to be delivered along with the Tax Rate Review Committee's November report in advance of a new biennial budget. The bill contains several requirements of the report, including: an evaluation of the tax base and volatility of revenue streams; identification of projected changes in federal funds coming to the state; identification of projected Cash Reserve balances; an analysis of the Cash Reserve relative to the projected revenue volatility and potential changes in federal funding; a recommendation of the level of Cash Reserve balance necessary in the event of a recession; revenue projections for the ensuing biennium; and any other recommendations that the fiscal analyst determines are necessary to maintain healthy fiscal policy relative to revenue volatility. All of the information accumulated in the revenue volatility report will be used to help guide state fiscal policy in a manner that takes revenue fluctuations into account during the policymaking process. LB33 incorporates best practices in state budgeting, as identified by the Pew Charitable Trusts. You should have all just received a copy of their report from July this past year entitled "Building State Rainy Day Funds." In the report, you will find a detailed analysis of several best practices recommendations, including the use of revenue volatility reports. Following me, you will hear testimony in support of LB33 from the OpenSky Policy Institute, and we're also very fortunate enough to have Robert Zahradnik, the policy director for state policy, state fiscal health, and economic growth from the Pew Charitable Trusts and a contributor to the report, "Building State Rainy Day Funds." He's here with us today to testify in support of LB33 as well. Thank you for your time and I'd be happy to answer any questions you may have. [LB33]

SENATOR KUEHN: Thank you, Senator Mello. Senator Stinner. [LB33]

SENATOR STINNER: Yeah, I think we've had a few conversations on this. This really aligns a lot with the industry that I come from, and that's stress testing--stress testing as it relates to capital, stress testing as it relates to the rainy day fund. The place where I guess our industry starts is from a macro level in taking a look at, you know, the geopolitical risks that are out there, macro events that may impact our economy. Could be a Russian slowdown, Chinese economic slowdown. Those types of things certainly have an impact on our local economy or could have. And then you try to put some kind of probability against that. As you start to work your way down through the stress testing, you go to a micro level, which is...would be our state economy and that's analyzing your revenue streams and concentrations associated with the revenue stream. And I think I can tell you right now that corn isn't working very well on my cash flows in western Nebraska, so we've got to come to grips with that. But the last part of the analysis is really taking a look at history and if you look back at this last recession and what it caused, that could be a worst-case scenario, but that's why I've been so

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interested in seeing do we have a formulation or a formula that computes where this rainy day fund needs to be. And it depends on where you're at in the business cycle. It depends on some of the things that may happen. You know, I think I brought up if SAC Air Force Base closed,... [LB33]

SENATOR MELLO: Uh-huh. Uh-huh. [LB33]

SENATOR STINNER: ...you know, what would be the impact on our state economy, those types of things. And certainly we have industry concentrations that we rely on for our revenue flow. So I really like seeing this. I know we have an econometric model that we're using. I've looked at some of the variations and it's going to be a plus or minus 4 or 5 percent. But this is really good stuff, I think. [LB33]

SENATOR MELLO: Thank you. [LB33]

SENATOR KUEHN: Other questions of Senator... [LB33]

SENATOR KINTNER: I have one little question. [LB33]

SENATOR KUEHN: Senator Kintner. [LB33]

SENATOR KINTNER: In your seven years here, other than an economic downturn, have you ever seen anything freeze or reduce spending in our state overall in our budget? [LB33]

SENATOR MELLO: Well, Senator Kintner, I think that's a...I don't know if it's a philosophical question or is it more a specific... [LB33]

SENATOR KINTNER: Well, actually, have you ever seen us reduce spending or freeze spending if we've ever been under the threat of a gun of an economic downturn? [LB33]

SENATOR MELLO: Well, I can only speak to my...this is my seventh year in the Legislature, Senator Kintner, and I can only speak to my first four years in the Legislature where I was elected in 2008 and started in January 2009, and we had a \$333 million projected budget deficit at the beginning, the first day that myself and Senator Nordquist was in my class and we took office. And so under that four-year period, from 2009 through roughly the beginning part of 2012, the Legislature had a considerable amount of work to do in regards to cutting state spending and balancing our state budget. And as I mentioned in my testimony, I would be remiss not to say in the 2009-2010 biennium, even though we had a special session to reduce spending by close to \$300 million that special session, part of the way...part of the only reason I attribute we were able to balance our budget over that kind of three- or four-year time frame was the assistance from the federal stimulus bill that was passed. It provided over

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\$600 million directly to the state, primarily through education funding, Medicaid, as well as some general stabilization funds that the state used, that was able for us to backfill some lost revenue due to the recession. And I think how that relates back to this bill is that the revenue volatility report, the Fiscal Office, I would be remiss not to discuss this, that I approached this issue with Michael Calvert, the Legislative Fiscal Analyst, to get his feedback on the general concept. And to some extent, the Legislative Fiscal Office is preparing and doing some of this analysis now. Sometimes it's spread out in different reports and I would be remiss not to make sure to give Mike Calvert and the Fiscal Office all due credit in the sense of they're starting to do a lot of this work that I had already discussed in bits and pieces throughout different reports, throughout the biennium. This kind of ties all of that research and all that analysis, as well as a little bit more on federal funds, which as we heard just in the committee a couple...within the last couple weeks of challenges that we have in respects to identifying potential loss of federal funds and how that impacts agency budgets and/or the balanced budget. [LB33]

SENATOR KINTNER: So then what you're saying though is, I think where I'm going was right. The only time we've ever slowed spending down or frozen spending is by a tough economy, right? Other than that in the other two years we just grew it right on up there, right? [LB33]

SENATOR MELLO: Well, I, Senator Kintner, I would be remiss not to say I think your definition of...I'd have to get a better understanding of what your definition is of slowing spending or growing spending is. I've mentioned... [LB33]

SENATOR KINTNER: Well, when you grow it, that means you spend more than the year before. And if you don't, then you've held it even or gone down. [LB33]

SENATOR MELLO: I would actually...I would make a counter argument that, for an example, the last biennium we saw a 6.3 percent average spending growth and that was one of the lowest spending growth bienniums postrecession that we've seen over the last 20 years. So I would argue that postrecessionary budgets, we actually had one of the slowest growing postrecessionary budgets the previous two years because our economic cycle shows that your revenue rebounds significantly after a recession and your state spending, which you reduce during a recession, normally backfills that to make up for your reduction in spending, reduction of revenues in the previous...during the previous recession. That...my perspective view is that's a different way to look at maybe the same economic data in the same time frame that you're referring to. I think what all I can say is what I've seen in my six years in the Legislature and now entering my seventh, the Legislature has tried to be as responsible as possible in regards to meeting its short-term and long-term fiscal priorities and fiscal policy. I think the reality is that we're continuing that process this year with this committee in the budget, and I think LB33 will only help the next Legislature. This won't impact us at all because the first report is not due till November of 2016. So likely, the returning members of the

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committee, this will be a tool that hopefully will help you as you move forward in respects to future changes in revenue, future changes in federal funding, and how that has an impact on the state budget. [LB33]

SENATOR KINTNER: Well, when I asked you for what time it was, you told me how to build a clock. But I appreciate that. Thank you. [LB33]

SENATOR KUEHN: Senator Mello, if I can ask, you can maybe shift gears a little bit. I respect that you pointed out that the Fiscal Office already does a significant amount of forecasting and anticipating and planning. So based on your intention with this particular bill and reporting requirement, let's say in 2008 this reporting requirement was in place. How would you have...how would you predict that the way in which the information available to the Appropriations Committee and the Legislature would have been different and how it might have changed the response starting in 2008 and moving forward? [LB33]

SENATOR MELLO: You know, that's a great question. And while I can't speak on behalf of the Fiscal Office directly in that particular light, or I can't speak on behalf of the senators who were in the Legislature during that 2007-2008 time frame, in the lead up to the Great Recession, I think to some extent my general analysis would be we were fortunate I think as a state to have an Appropriations Committee and a Legislature as a whole that built up our state's Cash Reserve during the economic times of 2006, 2007, and 2008. And prior to us going into the Great Recession, we had a Cash Reserve balance roughly, I want to say, it was roughly...it was more than 16.5 percent of General Fund revenues. It was actually higher than it is right now. That in theory was able to help blunt some of the Great Recession, the fiscal impacts that a lot of other states had to endure. So I think part of what I would say is we got there, to some extent, by a generally more fiscally conservative Appropriations Committee when it came to utilizing the Cash Reserve for any real purpose. That was able to be built up in preparation for the Great Recession. Then we used the Cash Reserve over a course of a four-year period, drew that amount down to help us bridge our revenue volatility. And I think that is kind of the underlying components of what you read in the Pew Report on building up your state rainy day fund and the revenue volatility is. Of late, the Fiscal Office has been able to do kind of, and this started over the last biennium of doing essentially kind of a time frame of revenue volatility of its own of when we saw a significant increase in revenues and when we saw a significant decrease in revenues. If that information was generally, you know, give or take...I can't speak. It's all hypothetical because I wasn't in the Legislature. And I'm looking over at Mike Calvert to make sure I'm not taking anything out of context. That kind of information can only be helpful in regards to your future spending decisions, I have a feeling. When you are able to start seeing a cycle occur, it's best to know that if you look at the Tax Rate Review Committee just from this past November that we as a committee had looked at, the Fiscal Office prepared kind of that time frame a little bit that would be part of this report that shows we normally see a

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revenue volatility of about three or four years. We'll see four or five years positive revenue and then three to four years negative revenue, back to back to back. And you can see those cycles which this information in the report I guess would prepare us to be able to say we know we're not going to see an eight- or nine-year positive cycle of revenue, so we probably should prepare ourselves of being more cautious of utilizing the Cash Reserve because we're going to need to protect ourselves against future revenue volatility. And so we don't want to put the state in a position to have to raise taxes or dramatically cut state spending on public education or on healthcare related programs. That essentially is kind of the gist of what I would say that in 2008, if I was...if this kind of report would have been as drafted in the bill, would only help the Appropriations Committee and the Legislature as a whole. There's an added component, though, of this that I know just from my time on the committee, and we're dealing with it a little bit now in the sense of how federal funding interplays with our state budget in the sense of when we see an increase of federal funds or a decrease in federal funds. And just take, for an example--and this is...I don't want to cause a stir--but the reality is our current state budget, our preliminary budget that we have finished is based, is predicated upon the federal government reauthorizing the Children's Health Insurance Program. And there's a story that's in Governing magazine that was released over the weekend that shows every state in the country right now is basing their state budget on assuming the federal government is going to reauthorize the CHIP Program. And if the federal government, for whatever reason, due to lack of inaction and/or their inability to find compromise, does not reauthorize the CHIP Program, we as a committee and we as a Legislature and the state as a whole may have a very serious challenge in our hands because everyone has just assumed that that's going to happen. And I think being able to have some potential projected changes in federal funds, have that out there early...now, granted, the Fiscal Office can only be able to provide you so far in time a crystal ball that say here are things that you as a Legislature, you as a committee need to consider. I think, though, that's a really great...I think that's good planning on our behalf as a Legislature, as a committee, to have that kind of document every year as we start the process, to know what big changes may be out there, to give everyone kind of a global view of what federal changes may be occurring that could have a pretty big impact to us. I use that Children's Health Insurance Program example as that's something that I was not fully really aware of until I started reading up on it a little bit and realizing that I assumed the feds were going to reauthorize that because I heard about it last spring. But with the change in Congress and to some extent a federal administration right now that is not able to come to a lot of compromise with Congress, that's a legitimate concern that a year ago I would have never thought anything about it. But now it's something that in a report like this, we would know about it, we would talk about it, and we may have to consider or would have had to consider maybe creating some backup plans in case something like that happens. That's just an example, I think, Senator Kuehn, in regards to what a report like this could be moving forward and be helpful as it relates to the Great Recession. I think the bigger issues, as much as anything, is tying in some of the revenue forecasts the Fiscal Office already does, tying

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that in with the Cash Reserve Fund balance, and providing I think a more global perspective of how we are operating both revenue-wise and spending-wise as it relates to those two key areas. [LB33]

SENATOR KUEHN: Senator Stinner. [LB33]

SENATOR STINNER: Thank you, Senator Kuehn. As an add-on to this process and maybe a by-product of this process, once you get into this type of planning, it becomes contingency planning too. And I think on a prospective look, we're using 95 percent of the budget, so that's a little bit of contingency planning. But I think in a situation similar to what we just went through, I think you really sit down and you define what mission critical is all about. And that's an exercise I think we all go through in business: If this happens, this scenario happens, what are we going to look like? What functions do we really have to have? And I think that's going to be a by-product or would definitely be a by-product of what you've started here and what we actually have in place with the 95 percent budgeting. That's kind of first level stuff. [LB33]

SENATOR KUEHN: Senator Haar. [LB33]

SENATOR HAAR: Yes. Thank you. Senator Mello, one of the concerns actually I have is we're talking about collecting more data in a way that we haven't before and maybe analyzing it, because data by itself isn't any good. You have to analyze it. And we're talking about new tools and I was just thinking, I like building. When I go to the hardware store to get a new tool, they don't give it to me free. And I'm just concerned that we don't just expect more of our Fiscal Office without giving them the resources to produce a really useful new tool. [LB33]

SENATOR MELLO: Senator Haar, I would wholeheartedly agree with you. As I obviously shared this draft multiple times with the Fiscal Analyst to get his feedback on the general policy to some extent in which Fiscal Analyst Calvert would probably tell you that they're already collecting most, if not all, of this information. It's available and they've got it. It's more of being able to take their expertise in the Fiscal Office and give them some guidance in policy to give us some analysis on that data that they already have at their fingertips and they've collected, to give us more planning documents in regards to as we move through the budget process. The fiscal note indicates that there's not going to be a fiscal impact to the Fiscal Office. I have to trust, I have to trust Fiscal Analyst Calvert and the deputy director, Tom Bergquist. They are the ones who no doubt are the ones responsible for this bill if we pass this bill into law to be able to create this report. And in that sense, they made it sound to me, both when I talked about the issue as well as in the fiscal note, this would likely be something they could compile with the existing information and data that the Fiscal Office has. It's just a matter of compiling that data in a very usable format in a planning document for legislators to move forward. But believe me when I say I'm always skeptical of wanting

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to...and it was on the same issue to some extent on the last bill. I think there's some deference that's given when you're asking someone to create something new. I should have mentioned on the last bill, the Fiscal Office doesn't have 156 vacant positions in their office, the way the Department of Corrections does, and I think this information though that Fiscal Analyst Calvert could probably talk to you individually if you'd like and walk you through all the data points that they already have available to now. And it's they're doing part of this report already in our Tax Rate Review Committee report. They'll probably provide that similar analysis in the budget document that this committee provides the entire Legislature as we started that process last biennium as well. It's kind of tying some other components of federal funds and some other analysis on specific revenue volatility that mostly the Fiscal Office does some of that through the Forecasting Board, that some of that information doesn't always translate to our budgeting process near as much unless you go watch the Forecasting Board which, by the way, meets this Friday at 1:30. I know we've got a hearing but other people who may be interested can watch that Forecasting Board. [LB33]

SENATOR HAAR: Well, kind of maybe the obvious question, why don't we just ask them for this report? Why do we need...and I'm being serious about that. Why do we need a bill and put more stuff in statute? [LB33]

SENATOR MELLO: You know what, that was a question...that was a question that Mike Calvert and myself discussed before. And I think to some extent, because the Fiscal Office is a division within the Legislature, that it provides I think generally more policy protections for the Legislature to ask them to do this instead of simply one committee chair or nine committee members of the Legislature saying we just want this information. It was something that I think it protects the integrity of what we are asking for in policy of saying these are...we want a report on all of this information for the Legislature to have, giving a very sound direction in policy in state statute of what we want, where it just gives I think the protections of the Fiscal Office in the sense of as they're producing this, they're producing it per state statute, not simply per request from an Appropriations Committee Chair who may, good or bad, I have had some colleagues who have sometimes disagreed with me on points, different data points, different fiscal points, different fiscal information. I don't want to ever put the Fiscal Office in a position of having to come in between a political debate, so to speak, where all we're simply asking for in LB33 is you've got all this data now; compile it in a report for us to be able to utilize it as we're looking at long-term budgeting and short-term developing a biennial budget. [LB33]

SENATOR HAAR: Okay. I'd just like to keep in mind that new tools aren't free. [LB33]

SENATOR MELLO: Sometimes they are not free, but sometimes you can create tools with existing tools. And I think that is what we have in LB33. [LB33]

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SENATOR HAAR: Right, and sometimes it's training the toolmakers,... [LB33]

SENATOR MELLO: Absolutely. [LB33]

SENATOR HAAR: ...but that isn't free either. So I just (laugh)...just a reminder. [LB33]

SENATOR KUEHN: No one expected we were going with a hardware analogy. Other questions for Senator Mello? Thank you. [LB33]

SENATOR MELLO: Thank you. [LB33]

SENATOR KUEHN: Do we have proponents for LB33? [LB33]

ROBERT ZAHRADNIK: (Exhibit 2) Good afternoon, Senator Kuehn. My name is Robert Zahradnik, first name R-o-b-e-r-t, second...last name, Z-a-h-r-a-d-n-i-k. I'm a director of state and local policy with the Pew Charitable Trusts. Pew is a public charity that engages in research and technical assistance at the local, state, and federal levels. Across the country, volatility in state revenue is growing more dramatic. These swings, whether up or down, can confound the best efforts of state officials to forecast revenue and keep budgets in balance. To help states better manage uncertainty, the Pew Charitable Trusts recommends that policymakers periodically study their state's economic and revenue volatility. Such analyses will help you develop policies for rainy day funds that can smooth budgets throughout the business cycle, align states with individual objectives and characteristics. So LB33 calls for the Legislative Fiscal Analyst to produce a revenue volatility study that reflects the best practices identified in Pew's research on state revenue volatility and rainy day fund policy. First, our research has found the characteristics of a state's economy and its tax policies contribute to volatility. The study required by this bill will give policymakers the ability to answer important questions, such as how much revenue volatility is the result of changes in state tax policy, which taxes contribute the most to volatility, how much revenue volatility is caused by fluctuations in federal funds. Our research has found that other states have gained important insights by taking...by asking and answering these questions. For example, a legislative analyst's office study in California concluded that major industries sensitive to the economic cycle, such as technology and housing, are one reason for the state's above average revenue volatility. Second, revenue volatility study provides an opportunity to consider long-term trends. State budgets are often debated in the context of the previous year's collections and spending, but this approach can fail to take into account underlying changes in the economy, particularly in areas that are subject to state taxation. By examining tax collections relative to longer term trends, policymakers can better understand to what degree revenue has become more or less volatile over time, and which individual revenue sources have become more or less volatile. For example, the Minnesota state economist studies volatility in the areas of the economy that are subject to taxation in order to determine how much the state should

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save to weather future downturns. Third, the analysis included in the revenue volatility study can help inform rainy day fund policies. LB33 specifically calls for an analysis of the adequacy of current and projected balances of the cash reserve fund in relation to tax revenue volatility and the risk of the reduction in the amount of federal funds. The volatility study will also include a recommendation on the target size of the Cash Reserve Fund sufficient to sustain essential government operations in the event of a recession, and this is consistent with best practices in other states. For example, policymakers in Utah used their statutorily required revenue volatility study to evaluate the adequacy of their rainy day fund and ultimately adjusted the maximum allowable balances. In addition, the volatility study can also include an analysis of the past performance of the rainy day deposit mechanism compared to alternatives to ensure that the fund is working as intended. In conclusion, this study will provide the data and evidence that you as policymakers need to decide how best to structure Nebraska's savings account--the Cash Reserve Fund. Thank you for the opportunity to speak in support of LB33 and I'm happy to address any questions members of the committee may have. [LB33]

SENATOR KUEHN: Thank you, Mr. Zahradnik. Senator Bolz. [LB33]

SENATOR BOLZ: Thanks for coming this afternoon. I have two questions related to best practices. The first question is as much faith as I have in our Legislative Fiscal Office, this version basically requires one person to put together this report. Is that a best practice? Are there other models out there? What would your advice be? [LB33]

ROBERT ZAHRADNIK: Our experience with other states that have done this, and first of all, I do applaud Nebraska for going down this route. There aren't that many states that are taking this sort of data-driven, evidence-based approach to how to structure their rainy day fund. That's the good news. And also, I think as was discussed earlier, in most cases, oftentimes when it comes to understanding policy, that the most difficult aspect is collecting and reporting on the appropriate data. In this case, the data is available. The real issue is sort of looking at that data in a different way. And I think if you have the right person that has experience understanding trends in Nebraska's economy and revenue structures, the capacity should be sufficient to do the kind of analysis. You're looking at trends over time, some basic statistics. We continue to do work and analysis in this area and we're certainly available as a resource. We'll be putting out a paper later this year looking at sort of the best practices and thinking about optimal size. This goes to the risk analysis that came up earlier. There's been some really interesting work, academic work specifically, looking at how do you gauge the risk of future downturns and how do you then adjust the size of your fund or at least think about how big your fund should be to sort of...to weather future downturns. And then, of course, that has to be calibrated against what is the tolerance among legislators and the Governor for how large of a savings account that you might want. But to get to your question, having a dedicated analyst work on this should certainly be sufficient. [LB33]

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SENATOR BOLZ: Another best practice question I have for you is I think in the context of an economic downturn and in the context of a bad situation where we have to draw down our Cash Reserve Fund, we would ultimately have to have a conversation then about how to build it back up. And my question here is, do you think that a report like this should also include addressing strategies for rebuilding a fund or is that a separate conversation that should be addressed in a different format? [LB33]

ROBERT ZAHRADNIK: No, I certainly think that this, that a report like this, part of the analysis that it can include is looking at what has been the performance of the fund over time, how has the current deposit mechanism functioned. And what we've done, we've worked with some other states to say if you used a different style of deposit mechanism, I know Nebraska basically looks at forecast error. So if revenues come in above the projection, then that money goes into the rainy day fund, and that is...that's a very useful mechanism, particularly from a year-to-year standpoint, because you don't want to end up having a budget problem simply because your estimate was off, because the economy and revenues are becoming more volatile. It's harder and harder to project. But another option is also to structure a deposit mechanism that looks longer term and looks more at what is...what revenues that we're collecting are above sort of our historical kind of baseline and come up with a mechanism, and there are states that have done this, to say, you know, we know that a portion of this revenue we're collecting during this boom time is unsustainable and we're going to take a portion of that, put it in the rainy day fund so that when our revenues decline we'll have it there, available. But back to your question: This is certainly the appropriate type of report to take a look at what is the mechanism that you use to put money in the report...into the fund. It can also take a look at, you know, are you...look at the policies that guide when money goes out of the fund as well. And is there...are there other best practices out there to help guide when this fund should be utilized? Oftentimes, that speaks to what is the purpose of the fund. If the purpose is exclusively to deal with economic and revenue volatility, some states have sort of tightened the rules on when that fund can be accessed to be used for other purposes. [LB33]

SENATOR BOLZ: Very good. Thank you. [LB33]

ROBERT ZAHRADNIK: Uh-huh. [LB33]

SENATOR KUEHN: Senator Stinner. [LB33]

SENATOR STINNER: Thank you. As a little bit tie-in to what we were talking about before with the last big recession, and as I look at the data of the big stockmarket crash in the '20s, the debt crisis, there was always an event that caused that to happen. We can look at all of this data and say, yeah, there's going to be a business downturn or there is a business cycle. The thing that we have to do is convince everybody else that

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we need to defer certain costs. We need to cut this cost so we could add to the reserve. And my question becomes is there a computation that's out there that makes sense that says this is the minimum amount of reserves we're going to keep and then, as the economic data comes in, we do better, we put it away, we business cycle that, we put that away as contingencies? So could you enlighten me on that? [LB33]

ROBERT ZAHRADNIK: Sure, yeah. What we've found is...so in terms of...our work with Pew, we always start with current state practice, you know, what are states across the country doing. Currently, there's really only one state...there's...well, there's two states, Utah and Minnesota, that sort of...that do volatility studies and use it to inform the size of the fund. Minnesota in particular has a very sophisticated methodology for sort of assessing essentially the amount of budget risk the state is going to face, and then they make a recommendation on how big the fund needs to be to sort of manage that amount of risk going forward. So there are methodologies that exist. And I also say there's a spectrum as to how complicated this kind of analysis can be or needs to be. I mean the first are you're starting from a baseline of most states just sort of picked a number out of the air. You know, oftentimes it was 5 percent. There was no real basis for that. So we're trying to raise the bar on, okay, why don't you use a little more evidence. So the first or the next step is, well, let's look at our historical trends. You know, how is our...if we're going to tie this to revenue volatility, how large were our largest drops maybe going back the last two or three recessions. And if everyone is on the same pages, that's a reasonable methodology for saying we want to try to be able to smooth out, you know, the average of the last three recessions and that means we need to save X percent. As long as everyone sort of buys into the underlying assumptions and everyone agrees that's a sound methodology, that's reasonable. There are more sophisticated statistical approaches that can be used and we can certainly talk to the Fiscal Analyst's Office about those and provide them with the documentation on what those look like. [LB33]

SENATOR KUEHN: Senator Haar. [LB33]

SENATOR HAAR: Yes. Thank you. I deal a lot with renewable energy and so I've used Pew's work. So I admire the work you do a lot. But I want to follow up a little bit on Senator Kintner's question. Now I see the really usefulness of a report like this is to protect the cash fund, because it's always easy to go after the cash fund for my pet project sort of thing. Someone has said if you took all the reports the Legislature has done and piled them, it would be taller than The Sower. [LB33]

ROBERT ZAHRADNIK: Uh-huh. [LB33]

SENATOR HAAR: So how is this...how is this report different and what makes it important to do this one? [LB33]

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ROBERT ZAHRADNIK: Yes. And I can say, you know, from a Pew standpoint, Pew, we're very selective about issues that we get involved in working on, and we saw the issue of revenue volatility and, in particular, how that connects to how well states are saving, how they design their savings accounts as one that was worthy of additional research on our part. And as we dug into the issue, we found that very few states were basing the design of their policy on evidence, on data, on trends. So this is a case where there is a clear policy connection to this report. I am certainly on the side of you don't want to produce more reports if they don't lead to policy change or they don't have a connection to policy, and I also, you know, if you're just reporting numbers because someone thought it was a good idea, that's not useful. But one of the key components of this report is that it says, you know, this information is going to inform future decisions about what the rainy day fund policy looks like, how big the fund ought to be, the deposit mechanism. And the reason to do this on a recurring basis, to go back to the question about putting it in statute, is one of the things we certainly found is that volatility has changed over time. It has gotten...revenues are becoming more volatile in a macro sense and each individual state is going to have its own experience. Nebraska's economy is always changing, as is every other state's. So having a look in every couple years to say, okay, you know, what have been the trends in our economy, how is our revenue...is our revenue system becoming further detached from our economy, the point that we're seeing some structural changes? That's important to understand. Because another important point that we stress is it's very difficult to manage volatility through tax changes because the tax code is complicated. You end up with a lot of other...you have a lot of other consequences when you make tax changes other than just potentially stabilizing your revenue stream. It's much cleaner or simpler to use your rainy day fund as your mechanism for stabilizing. You use your...you have tax debates about other issues that are separate from stabilizing your revenues. [LB33]

SENATOR HAAR: Thank you. [LB33]

ROBERT ZAHRADNIK: Uh-huh. [LB33]

SENATOR KUEHN: Other questions? Senator Watermeier? [LB33]

SENATOR WATERMEIER: Thank you, Chairman Kuehn. And thank you, Bob, for coming. Always appreciate your testimony and your insight. Go back to a question that Senator Bolz had asked and I was with you the whole way when you talk about best practices,... [LB33]

ROBERT ZAHRADNIK: Yep. [LB33]

SENATOR WATERMEIER: ...about how to replace the Cash Reserve Fund. Then you went a step further and talked about policy and how to use it. [LB33]

ROBERT ZAHRADNIK: Uh-huh. [LB33]

SENATOR WATERMEIER: I struggle with how you get that out of a report that we're just looking at for volatility. I can appreciate where you might think that, but that would really bring a whole new realm into this, what I had in my mind about strictly ratios, volatility, analysis work. That next step would be a policy stretch for me, I guess. But have you see that done? [LB33]

ROBERT ZAHRADNIK: Yes. So...and when we...sort of the logic of it is when we started looking at...when we started this research, our first report was called "Managing Uncertainty," and that looked at trends in revenue and economic volatility. And we saw every state experiences varying degrees of economic volatility and it's not just the Great Recession. I mean these things happen. You know, it's the business cycle. But it's also we found that revenues are much more volatile than the economy, so even...which is in some ways why a state fiscal crisis lasts longer than the recession. You'll look back and in the early 2000s the recession was nine months, but states were struggling for three years because there was often a lag and also revenues just are not as closely tied to the economy as they used to be for a lot of different reasons. So what we found or, you know, the direction we went is oftentimes when you have a budget stabilization fund, you really want to connect that or you want it to be informed by your own...your state's experience with volatility. So that's the point. Look at your volatility. Depending on how volatile your revenues are and what your experience has been, that can then help you make decisions about how big of a fund do we need. Given our experience with volatility, we now know that, you know, in the first two years of a downturn we experience revenue drops of a X percent, maybe that's what we want to target the size of our fund is so we can weather those first couple years. You know, with our Reserve Fund. The other question, the other issue is how do you put money in the fund? A lot of states just use year-end appropriation, year-end surpluses, which is basically saying if we have money at the end, we're going to put it in our Reserve Fund. Other states that we've looked at, like Virginia, Virginia looks back six years, they take their average revenue growth and then they take the most recent year and they say any revenue that's above our six-year average, we're going to take half of that and put it into our Reserve Fund. What that's saying is we're trying to figure out what is our sustainable revenue growth that we can use to fund programs? Anything above that is really sort of like one-time money and we shouldn't necessarily build it into our base budget. One use of it is the rainy day fund. Other uses could be pay-go capital, paying down debt, dealing with pension liabilities, that sort of thing. So really, conceptually, that's what you're trying to get at: How much of our revenue is sustainable to fund recurring programs? How much of it is sort of more one-time in nature? That's the money you want to put at least some of in the rainy day fund. [LB33]

SENATOR WATERMEIER: Okay. [LB33]

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ROBERT ZAHRADNIK: Does that make sense? [LB33]

SENATOR WATERMEIER: I appreciate that. [LB33]

ROBERT ZAHRADNIK: Uh-huh. [LB33]

SENATOR KUEHN: Senator Stinner. [LB33]

SENATOR STINNER: I do have one more question... [LB33]

ROBERT ZAHRADNIK: Uh-huh. [LB33]

SENATOR STINNER: ...and maybe an observation. I deal with bonds quite a little bit... [LB33]

ROBERT ZAHRADNIK: Uh-huh. [LB33]

SENATOR STINNER: ...in the profession that I'm in. Have you looked at the bond rating agencies and do they have any guidance, like you're supposed to keep X amount in a reserve and that yields a certain bond rating? [LB33]

ROBERT ZAHRADNIK: Yes. [LB33]

SENATOR STINNER: Could we relate our numbers to a bond rating, I guess? [LB33]

ROBERT ZAHRADNIK: Yes. So the rating agencies, they have developed specific guidance on sort of what they consider to be a credit positive when it comes to the size of rainy day funds. And I can follow up with you with some of that data after the hearing. I think it's...there's a range. I think it's 8 to 12 percent of revenue is one, one of the agencies uses as sort of a, you know, a benchmark as credit positive. The Government Finance Officers Association, they've been saying more recently that sort of you should have two months of reserve, which translates into about I think 16 percent. That's sort of on the higher end. But the other interesting point is you know the rating agencies, there's sometimes a misperception that they want you to build up your fund but then they get concerned if you use the fund, and that's actually not the case. They're most interested in do you have a sensible policy for building up the fund and, thereby, if you use it, you know, they feel confident that you'll build it back up. The point is not just to simply hold money for no purpose. They don't necessarily look at using reserve funds as a credit negative as long as you have a very clear policy in place for how that fund will get replenished. [LB33]

SENATOR STINNER: But it also stabilizes that revenue stream during bad times... [LB33]

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ROBERT ZAHRADNIK: Correct. [LB33]

SENATOR STINNER: ...and they're testing...they're stress testing that as well. [LB33]

ROBERT ZAHRADNIK: Yes. Yes, exactly. [LB33]

SENATOR STINNER: I'm just trying to come up with some way of telling my fellow senators, hey, we start here,... [LB33]

ROBERT ZAHRADNIK: Yes. [LB33]

SENATOR STINNER: ...because of... [LB33]

ROBERT ZAHRADNIK: Yes. No, and this... [LB33]

SENATOR STINNER: ...because we got to present the business case for a reserve. [LB33]

ROBERT ZAHRADNIK: Absolutely, yes, and I do think an argument related to the rating agencies is a very productive one. They look at these kind of policies that are informed by experience and data and sort of, you know, this is sort of a business approach to designing a rainy day fund. Let's look at our trends and let's design it based on information as opposed to anecdote. [LB33]

SENATOR KUEHN: Senator Haar. [LB33]

SENATOR HAAR: Yes, thank you. Going door to door campaigning, citizens will often, because the, you know, this cash fund looks like a lot of money just sitting there. What...have you talked about that with various states? What's your response to...because there's a lot of pressure to give that money...all that money sitting there back in tax refunds. [LB33]

ROBERT ZAHRADNIK: Sure. I think it's a couple perspectives. One, it's always better to talk about the number in terms of as a percent of the budget. You know, the total dollar figure is always...always sounds very big but out of context. Most budget numbers are big these days. So I think if you talk about it in terms of this is our, you know, this is our cash cushion, our Reserve Fund, as a percent of our budget. And then also it's all...I mean it's about the hardship that comes, the difficult decisions that have to be made. And those decisions have to be made, whether it's raising taxes or cutting spending, at a time when they have the most negative impact, both on individuals but also on the economy. Because now you have state governments are acting as a drag on the national economy because they're, state governments, are raising taxes and cutting

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spending when the overall economy needs resources in the economy. And the only "countertypical" thing a state government can do is to use reserve funds to maintain spending during a downturn. That's probably not something you're going to say at someone's front door, but it's more about, you know, we need to take the longer view. Remember how bad the Great Recession was? We're just trying to do some planning so it's not as bad the next time. I think that's the... [LB33]

SENATOR HAAR: Good. [LB33]

SENATOR KUEHN: Any other questions? Thank you, Mr. Zahradnik. [LB33]

ROBERT ZAHRADNIK: Thank you. [LB33]

SENATOR KUEHN: Other proponents for LB33. [LB33]

RENEE FRY: (Exhibits 3 and 4) Hello again and good afternoon, members of the Appropriations Committee. My name is Renee Fry, R-e-n-e-e F-r-y. I'm the executive director of the OpenSky Policy Institute and I'm here today to testify in support of LB33. State sources of revenue are volatile and we support efforts to protect our state budget from these ups and downs. I have included with my testimony a chart showing the percent changes in the income tax and sales tax in Nebraska since 1978. The volatility of our revenue can be due to several factors beyond the expansionary and recessionary cycles of the economy. For example, sometimes revenues are affected by shifts in the underlying structure of our economy, such as a shift to largely untaxed service-based economy, that is slowly eroding our sales tax base. At other times they are the result of policy changes passed by the Legislature, such as the indexing of tax brackets passed by the Legislature last year. And at other times these swings are caused by changes in federal policy that ripple down to the states. The best policy response to each of these scenarios may differ, and the careful monitoring called for in LB33 would provide legislators and citizens with a much better sense of how to react to and plan for these changes. Of course, our best tool for responding to revenue volatility is maintaining a strong cash reserve. OpenSky Policy Institute has been a strong advocate for building and protecting our state's Cash Reserve. The Government Finance Officers Association recommends a minimum of two months' worth of cash reserves, which equates to 16.7 percent of the General Fund. Similarly, the Legislative Fiscal Office has recommended a minimum balance of about 16 percent of annual net receipts, based upon the calculation that when revenues fall short of projections, it tends to be by about 4 percent per year for periods of about four years. Nebraska's Cash Reserve is projected to reach \$769 million at the end of fiscal year '17, which is right at the minimum recommended level of 16.7 percent of the General Fund. During the most recent recession, Nebraska was aided greatly by a strong Cash Reserve of \$578 million, or about 17 percent of the General Fund budget at the time. However, according to a Legislative Fiscal Office analysis, without federal stimulus dollars we would have needed a Cash Reserve of

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nearly \$986 million, or 29 percent of the General Fund budget, to get through the recession as we did, which still required spending cuts. This proposal will help our state to determine the appropriate level of Cash Reserves to protect our state budget in the next...in the case of the next inevitable rainy day. Currently we have one of the strongest Cash Reserves in the country, which is something we should strengthen, not weaken. We support LB33 because we believe the tools offered therein will allow for the best state budget decisions now and in the future. I would like to briefly address two issues that were raised. I was not working at the Legislature during the Great Recession but was working at the Legislature in the recession of the early 2000s. At that time, we had a Cash Reserve of 6.9 percent and it was brutal. We slashed...the Legislature slashed spending and increased taxes at that time. It was very difficult to have such a low Cash Reserve. And Senator Kintner had a question about spending. I would tell you that spending as a share of the economy, if we look back starting in about '98, which is where our numbers go back to, spending as a share of the economy, state spending as a share of the economy has decreased pretty significantly. And I'd be happy to share a chart with you that reflects that. So thanks for your time and I'd be happy to answer any questions. [LB33]

SENATOR KUEHN: Thank you. Any questions for Ms. Fry? Senator Kintner. [LB33]

SENATOR KINTNER: I know you knew I was going to ask you one question, right? [LB33]

RENEE FRY: Uh-huh. [LB33]

SENATOR KINTNER: Thank you for coming out. It's always good to have you here. The Governor is comfortable with about \$500 million. He's a guy who's interested in reducing spending, holding the line on spending. People who tend to want to spend a little more money, like to be at that \$700-some million. Why is that? Why do the people want to hold down spending, reduce spending, cut taxes, they want to have that rainy day fund around \$500 million; and the people a little less concerned about tax relief and more concerned with smart spending, let's say, like to have that at about \$700-some million? Why is there a difference? [LB33]

RENEE FRY: I can't say that necessarily there's a difference between, you know, people who want to spend less want to keep the Cash Reserve down. Because from what I've heard from the conversation here today, there are a number of senators on the committee who, my guess is, aren't crazy spenders but see that there's an importance to have a very strong Cash Reserve. And so I don't think this really has anything to do with spending but really has to do with being smart in how we budget and making sure that we have enough reserves so that the next time we do go through a recessionary period, we're in a position where we can maintain a basic level of service and not go through some of the difficulty that many other states went through, through the Great

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Recession. You know, fortunately, we did have a relatively strong Cash Reserve then and we did cut spending, but we were in a better situation than others. So I don't know that it's fair to say that folks who want a low Cash Reserve want low spending and folks that want a high Cash Reserve want high spending. I'm not sure that that's a fair comparison. [LB33]

SENATOR KINTNER: Well, is there a philosophical difference, would you say, between people who want to have a lower Cash Reserve, like the Governor is advocating, and people who want a higher Cash Reserve, like you're advocating? Is there a difference in philosophy? [LB33]

RENEE FRY: You know, I can't answer the question that way. I would say that we've looked to the work of the Pew and the NCSL, who aren't...I don't hear them advocating for increased spending, but we've looked to them, to the Government Finance Officers Association who recommend having adequate cash reserves. And the Government Finance Officers Association, I mean they're about good budgeting and they're recommending a level of 16.7 percent. NCSL and the Pew and Rockefeller have done a lot of work since the recession where states were just not prepared for what came and have been doing a lot of education. I don't...again, I don't really see that as being a philosophy other than good budgeting. [LB33]

SENATOR KINTNER: There's not anyone advocating for not having adequate Cash Reserve. It's just a difference of where they think that is. Isn't that right? [LB33]

RENEE FRY: Yeah, and I think LB33 will help us answer that question. You know, I mean right now we use the tools that we have. We look to the Government Finance Officers Association, what they recommend, what the Legislative Fiscal Office recommends, which is 16 percent. I think LB33 would give us the tools to dig down a little bit further and determine what those...what we do need in reserve. And as you heard from the previous testifier, it may vary year to year, depending on what's happening with our revenues and whether our income tax is strong or sales tax. And so this will...bill will allow us I think to do a better job of really taking a one-size-fits-all approach, which we're relying on now, and really narrow it down to Nebraska. [LB33]

SENATOR KINTNER: Well, you mentioned Legislative Fiscal Office and a few others. You didn't mention the Governor's Budget Office. Is it important what they think? [LB33]

RENEE FRY: I'm just...what I'm saying is that most of the research that we've seen since the Great Recession is looking at states having that two-month recommended level. What I heard earlier when questions were asked about the Governor's recommendation on the Cash Reserve, I heard that there...I didn't hear that there was a specific reason for that number other than he was comfortable with it. So I'm just looking to what national organizations are recommending and what our Legislative Fiscal Office

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recommends. And again, I mean I think having a strong Cash Reserve put us in a lot better shape than other states during the Great Recession, and I can tell you from personal experience when I was here that having a small Cash Reserve in the early 2000s, you know, as I said, we had a Legislature that felt like we had to raise taxes. And I don't think that's a situation that we want to go into again. [LB33]

SENATOR KINTNER: Let me take one more stab at it,... [LB33]

RENEE FRY: Sure. [LB33]

SENATOR KINTNER: ...just one more stab. Could it be, you know, we've got one guy, the Governor, who has run a multibillion-dollar corporation and he's got a free-market capitalist view of the world, and you've got views of other academics that don't have the real-world experience. And there seems to be a difference between someone who's actually done it and someone who advises, looks at it, and studies it. Is there a philosophical difference between those two? [LB33]

RENEE FRY: Again, what I've heard sort of from the questions and comments on this committee is that there are other entities that do this, such as banking, who do this as part of their industry. And it's industry standard to do this sort of stress testing and to make sure that you have those adequate reserves, so. [LB33]

SENATOR KINTNER: Well, I'd love to bring Sid Dinsdale in here and let him sound off on this. I'd love to hear what he has to say. He knows a little bit about money. But I was just wondering. I'm just wondering if you saw a philosophical difference. You're not seeing one, but okay. [LB33]

RENEE FRY: Yeah, I'm not. But I think LB33 would actually maybe give you some piece of mind in that regard that it's really based on what's best for Nebraska based on our ups and downs, our economy's ups and downs, rather than on some particular spending take. [LB33]

SENATOR KINTNER: Well, I appreciate you sharing that with me. I was just wondering if there was anything along those lines. Thank you very much for being honest. [LB33]

RENEE FRY: Thank you. [LB33]

SENATOR KINTNER: Appreciate it. [LB33]

RENEE FRY: Thank you. [LB33]

SENATOR KUEHN: Senator Stinner. [LB33]

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SENATOR STINNER: You recommend 16 percent, 16.7 for a minimum balance. And this question really, since Kate asked it and, of course, Dan talked about policy. Okay, if we put a policy together that says this minimum balance is 16 percent, we go through a recession, we spend it down, how much time do we give ourselves to get it back to 16? [LB33]

RENEE FRY: Yeah, and so... [LB33]

SENATOR STINNER: ...and what methodology do we...I mean by what way do we bring it back? [LB33]

RENEE FRY: Yeah. No, that's a great question. We're recommending, I mean our recommendation is based on what the Legislative Fiscal Office and the Government Finance Officers Association recommend as a minimum level. But obviously, when you draw that down, you know, you're going to draw it down and you're going to use it for that rainy day. [LB33]

SENATOR STINNER: Right. [LB33]

RENEE FRY: Now what I would say is that if...the volatility report I think will help us better understand how long we're going to have to build that rainy day fund back up. And I think it does require, you know, what's happened since the last recession. We've been building it up and we've done a pretty good job. The Legislature has done a pretty good job of using that for one-time, you know, priorities rather using it for ongoing spending or ongoing tax cuts. I don't know. We have not done the analysis in terms of how many years you need to do to bring that back up, but I think that's what LB33 would help with. [LB33]

SENATOR STINNER: Yes, I support LB33 and what we're trying to get done there. What I'm trying to look at is how we take LB33 and build in minimums or... [LB33]

RENEE FRY: Oh, I see. [LB33]

SENATOR STINNER: ...because I'm going to tell you something. When you get all of these projections and economists together, you're going to have opinions that will go across the spectrum. So you don't really have anything that you can set your pole down into and say it needs to be \$800 because. It's a computational basis. I kind of like the set percentage as a minimum and then we use the volatility analysis to maybe build. But I'm going to tell you the last couple ugly recessions we've had have been, you know, the dot-com boom or bust and then the debt crisis. It happens (snaps fingers) many times that fast. And there hasn't been any economist that I know of on the face of the planet that ever predicted that to happen. So I'm just trying to figure out, as we move forward, yeah, I can see this. It's not unlike a bank's minimum. You know, we have a minimum

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amount. One percent is what we keep in a loan loss reserve at all times. That's the same idea as this. We build it up; we have to rationalize how we build it up so we do all kinds of different analysis. We do exposure analysis, those types of things, and it drives into this stress testing that I talked about. But all of that said, there's no connect the dots, because I couldn't convince Bill Kintner that we got to get to \$800 million in the reserve because of this, or even Kate, or anybody else in this room, because everybody is going to have their own opinion. And I guess I'm struggling a little bit with that next step. And are you advocating a policy that says 16 percent minimum and then... [LB33]

RENEE FRY: No, not necessarily. And I think what...I think maybe what you're getting at and I need a little bit of clarification I mean there are some states that actually recommend or require a minimum level. Is that what you're... [LB33]

SENATOR STINNER: Well, I thought that's what you were going to suggest, that we have a minimum of 16 percent of annual receipts. [LB33]

RENEE FRY: Yes. So our position would be that right now we're at minimum recommended levels and so we really need to be cautious about spending that down. But we're not necessarily recommending a policy where you say, and the reason why is because there are things that happen. I mean when you have a policy... [LB33]

SENATOR STINNER: Could you I give you an economic... [LB33]

RENEE FRY: Yeah. [LB33]

SENATOR STINNER: ...analysis. Our economy is going to grow 2 to 3 to 4 percent. We're in fine shape for as far as you can see. So we could draw it down and then build it back and give back the tax money back to the taxpayers. That's one side of the story. The other side is we're in a business cycle that may start to turn down because Federal Reserve is going to start boosting interest rates. What happens then? Then our currency goes up. We can't export as much. Our economy starts to slow down. China has slowed down. Russia has slowed down. So, my God, we ought to have an \$800 million in our reserve. [LB33]

RENEE FRY: So I think what you said... [LB33]

SENATOR STINNER: Which one do you want to pick from? [LB33]

RENEE FRY: Yeah. [LB33]

SENATOR STINNER: I mean that's the type of... [LB33]

RENEE FRY: Right. [LB33]

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SENATOR STINNER: And I can't get to the policy that this has to...because of that, you know? I guess I'm giving you that example. [LB33]

RENEE FRY: So I think you said something that was really important earlier. And you said when we had those recessions... [LB33]

SENATOR STINNER: Right. [LB33]

RENEE FRY: ...previously, it happened like this, right? And so we may anticipate that our economy is going to grow 2 to 3 to 4 percent each year for the next three years, but we don't know when that next recession is coming and it's really important then that we have...that we be mindful of that; that the next one is going to happen and we probably won't be able to anticipate it. LB33 I think will help us get a better idea of what our regular cycle is and maybe, you know, some of those indicators. If you look at...if you look at the chart that I handed out, you can even see here that sometimes we have these sort of spikes right before the recession, which is, you know, a good time then to be saving that rainy day fund rather than spending it and then not having it when we need it. So I think LB33 really helps us sort out these issues that you're really struggling with and our position would be, until we have more information, you know, we should take stock in what experts in this area are recommending and keep that two months of reserve, because we may need it before the study is over. And so really just being mindful that, you know, in the last recession, without that federal stimulus, we would have needed 30 percent, 29 percent. And we still made spending cuts. So I understand, you know, this desire to give the money back or spend the money...you know, give the money back. I would say that if, you know, part of the rainy day fund is for emergencies, right, for one-time expenditures that weren't anticipated, much like a savings account. You know, when you need a new roof, you have the money. [LB33]

SENATOR STINNER: But under your calculation, we wouldn't give anything back to the taxpayer, right,... [LB33]

RENEE FRY: Well, we don't...I mean... [LB33]

SENATOR STINNER: ...or a minimum. [LB33]

RENEE FRY: The minimum recommended level, yeah, we really don't have too much capacity. Now after Friday... [LB33]

SENATOR STINNER: Okay. [LB33]

RENEE FRY: ...that might change, depending on what the Economic Forecasting Board comes back with. And whether they adjust their forecast or not, there could be more

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money in the rainy day fund or less. But I think we just really need to be cautious about dipping below that number, knowing that we don't know when that next recession is going to come and we don't want to be caught flatfooted. But we would say, if there are really critical one-time spending needs that the state has, I mean that is a good use of the Cash Reserve. Where we get really concerned is where it's used for ongoing spending or ongoing tax cuts, because then it's not sustainable. Then we put ourselves in a position where we've drawn down the Cash Reserve and don't have any way to backfill it. So I think that's our larger point. I mean obviously I know that there are some priorities for the Legislature this session and hopefully the Forecasting Board will have good news for us on Friday, but we'll have to wait and see. [LB33]

SENATOR STINNER: Thank you. [LB33]

RENEE FRY: Thanks. [LB33]

SENATOR KUEHN: Other questions? Senator Haar. [LB33]

SENATOR HAAR: Yes, thank you. Well, first of all, I'd like to say that, Senator Stinner, those of us who are really conservative would probably go with your higher number. (Laughter) When I look at your chart, are we really sort of just victims of the economy or does our tax policy have a lot to do with these spikes and ups and downs? [LB33]

RENEE FRY: Our tax policy has a lot to do with the spikes and ups and downs, yes. [LB33]

SENATOR HAAR: So, in your opinion at least, some changes in the way we tax could...not only being aware, of predicting and so on, what's going to happen, but could help smooth this curve. [LB33]

RENEE FRY: Yes. [LB33]

SENATOR HAAR: Okay. Well, we'll discuss those on another time. [LB33]

RENEE FRY: Okay. Thank you. [LB33]

SENATOR KUEHN: Other questions for Ms. Fry? Thank you. [LB33]

RENEE FRY: Thank you. [LB33]

SENATOR KUEHN: Do we have any other proponents for LB33? Would anyone speaking in opposition like to come forward? Anyone testifying in a neutral capacity? All right. [LB33]

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MICHAEL CALVERT: I'm going to make a few comments. Michael Calvert, Legislative Fiscal Analyst, M-i-c-h-a-e-l, last name Calvert, C-a-l-v-e-r-t. I'm going to make a few comments and probably open it up to some of the same questions that you've already posed, but hopefully I can answer some of them. Cost element is negligible and the reason why is the vast majority, if not everything in the bill, those things are elements in just about everything that we do, whether it is for the Tax Rate Review Committee, whether it is for our revenue forecasting involvement, whether it is for our work with the Appropriations Committee, whether it is with the Legislature in general. We do all of the elements that you have talked about to some extent. I think probably, more than anything else, the merit of the bill takes all of those elements and says put them all together in one spot, because you're going to find these pieces in the preliminary report that will probably come out later this week. You'll find some pieces. You'll see some of the pieces in the final report of the budget recommendation that this committee will make. You'll see it in the Tax Rate Review Committee next July; you'll see it in November. You'll see it in the revenue forecasting effort that we will get involved in, in February and April. All of these elements are there. From an economic perspective, there were comments with respect to macro elements. We start with national forecasts that have the highest probability based on the forecasting service. We use two different services because their perspectives are different. So it's a useful perspective to know who's more optimistic view, how it translates into a revenue outcome. We integrate that. We have done alternate forecasts. I think Senator Stinner said something about stress testing. We have done revenue estimates in conjunction with a baseline forecast that was maybe 50 percent and then they had 25 or 35 percent probability of a recession scenario. So we went, we got the economic data for a recession scenario and folded that into a revenue forecast because I wanted to know and I felt that the committee had the opportunity to need to know what the risk was if that happened. So that kind of sensitivity analysis and work is done at a macro level. We bring macro level data down to a state level by relating that to state level measures of personal income, wage salary growth, farm income, nonfarm income, the whole gamut. And there's probably about 24-25 national variables that flow into our economic...our revenue forecast. The single largest risk factor in all of this is economic. The prior revenue forecaster for our office, I asked him before he left, I said, give me an assessment as to what the error factors have been in terms of our prior forecasts. And his conclusion was the economic data that was used from national services was wrong in terms of magnitude and in terms of timing. And when it comes down to state revenues and how they move and how they change over time, it comes down to changes in personal income and it comes down to changes in wages and salaries. And the vast majority, everybody in every single state that has sales and income tax will say that the vast majority of those tax changes, ignoring rate and base changes, the vast majority is driven by those two factors. Okay? So I want to assure you that all of these elements are factors in our thinking, in the work that we try and do with the Appropriations Committee and the Legislature. Our financial status is a five-year financial plan for the General Fund, so all of those factors have to be taken into consideration. One of the elements, we've talked with this committee a

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number of times, addresses the federal funds issue. When it comes to federal funds, in terms of variability, your single greatest risk factor is Medicaid and the variability of Medicaid, because of the FMAP, and that is driven by personal income changes in this state, vis-a-vis, changes in other states on a rolling average. We get ahead of that and have for the last 15 to 20 years in terms of a service that gives us good estimates on federal changes with respect to future funding for Medicaid. Now they don't go off into infinity, but in the next year or two we have a pretty good handle in terms of what that factor is. Because Medicaid is a joint partnership between the state and the federal government, and because we have statutory and legal definitions that tell us what the magnitude of the program is, the question as to whether you're going to substitute state funds or not is pretty much moot. You're going to substitute state funds. And one of the concerns I do have about the bill is it seems to suggest that in the analysis of federal fund losses...now I will say in the last year the federal budget process has been a little bit better. But if you want to look back in the last ten years what the federal budget was going to look like was a real guess coming down to, I mean, the wire literally. So our ability to be able to do that is going to be somewhat problematic. But, by and large, the question that we pose to the Appropriations Committee when confronting losses of federal funds is, is this an area where you're going to pick it up with general or cash funds? A lot of times the answer is, no, it is a discretionary choice. So really, when it comes down the federal fund analysis, it's going to be Medicaid more than anything else. Okay? Now I know there's some talk with respect to highway funding. It does not directly impinge upon the General Fund. This is a General Fund analysis and I'm not suggesting that we should broaden the net here to include highway funding. That's something of a micro situation that we just have to evaluate, and we will evaluate separately. So overall, I think we do quite a few things. A number of issues that were brought up with respect to growth rates, we learned a lot from the last two recessions. In the early 2000s, that recession was not technically really even a recession based on my economics that I learned 40 years ago because you didn't have two or three consecutive quarters a negative GDP. You just didn't. It didn't look like a recession. It happened quickly. We went through the first half of a fiscal year thinking we were in great shape. Then came January, February, and March and the bottom fell out in terms of revenues, and it happened very, very quickly. It happened quickly in a time period when there was absolutely no expectation that there was going to be that kind of a slowdown. So we took a big hit on the revenue side because our revenue estimates were too high. In contrast, '09 and '10, the forecasts saw the recession coming. Our forecasts were moving down. We captured that. We folded that into our financial status. Where we were wrong is nobody knew the magnitude, the depth, and the duration, and the relatively slow or weak recovery that followed. So the hit was very, very harsh. It was a true recession, obviously. So these elements were seen but it took the economic data to be there to help us see it on the forecast side. To me, volatility comes down to a couple of things. It comes down to your forecast errors, and we have cited that as a method of isolating on a 16 percent measure in terms of the adequacy of the Cash Reserve Fund, okay, 16 percent, 4 percent per year. That goes back to about

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2004-2006. It was a memo that I wrote Senator Chris Beutler at the time to answer: Give me a methodology to rationalize a reasonable Cash Reserve Fund. The problem you're going to have is that that will vary over time and judgments will have to be exercised. One of the weakest points I think in the whole process that we have in place right now is that we have a fairly well-defined system of deposits, okay? We don't have a defined system, and I'm not sure you should have a defined system, too tightly defined anyway, of how you take it out. Never underestimate the value of the judgment of the Legislature in terms of those decisions. I mean that's...I mean 25 votes and you can have just about anything you want. That sounds a little scary, but on the other hand, my experience, it's been a pretty good judgment in the last 20 years in terms of using that Cash Reserve Fund. The weak point I also feel is that we have a system of defined deposits but it is based on a potential fallacy. The fallacy is that you are going to depend on revenue errors of 4 percent. You're going to be 2, 2, you're going to collect more than you're actually estimating, in the neighborhood of 4 percent, and that's what you're going to deposit. My biggest worry is what happens if we hit a time period in the middle '90s where our error term on revenue forecasts was probably somewhere around a half a percent to 1 percent per year for about five years? You won't deposit hardly anything. Now past committee has...took proactive action in depositing about \$50 million, I think it was \$50 (million). Was it \$50 (million)? Well, proactively, the committee deposited directly to the Cash Reserve Fund off budget about...some dollar amount. I can't recall the dollar amount. And it was a judgment that just was based on we were at risk potentially as far as the Cash Reserve Fund perhaps not being adequate where we were better off to be in savings mode. So it's predicated on what could be a fallacy, and that's one of the worries that I've had over the last number of years, is what do you...how you instill some kind of mechanism or discipline that substitutes for that error term that has worked, frankly, but there may be a time period where it doesn't? So how do you enforce a discipline of savings in that kind of environment, and I don't have an answer for you on that one. Have any questions? [LB33]

SENATOR KUEHN: Thank you, Mr. Calvert. Any questions? [LB33]

MICHAEL CALVERT: Thank you. [LB33]

SENATOR KUEHN: Thank you. Any other individuals who'd like to speak in a neutral capacity to LB33? Senator Mello, would you like to close on LB33? Waiving closing, all right, thank you. That concludes our public hearing on LB33. [LB33]