

# analysis

January 2003

## *Nevada's Chronic Overspending and How to Deal With It*

by Steven B. Miller

### Executive Summary

In recent decades a 'Who Gets What' theory of government has come to dominate the State of Nevada. As a consequence, state government has more and more degenerated into a tool for transferring some people's money into other people's pockets.

Facilitating this has been the effective neutralization of the Nevada constitution's separations-of-powers clause. This has allowed tax-consuming public employees to increasingly write the laws that tell the rest of us what to do. In the 2001 Assembly, government employees occupied *every position* of major power—a stranglehold on Nevada state government.

Because Nevada state agencies get very little oversight from the governor, the legislature, the news media or the academy, the executive branch is rife with wasteful state practices, lack of financial controls and recurrent episodes of expensive neglect. These go on for decades and never get corrected. NPRI fully documents these charges.

Though heavy new taxes are currently

touted as the solution for Nevada, in fact they would merely avoid the real problem, while rewarding special interests that cannot be satisfied.

Recent American history shows that states that raise taxes to diminish budget shortfalls regularly end up with the worst rates of economic and income growth. For Nevada to impose a bigger tax burden on business would be to throw away the state's bright economic future.

At least four ways of closing budget deficits exist, all of which are superior to raising taxes. The best solution is cutting spending. In addition, just two very modest pro-educational-choice reforms by the Nevada Legislature could save the state hundreds of millions of dollars annually:

- ◆ Deconsolidate the Clark County and Washoe County school districts
- ◆ Allow Nevada parents to choose where their children attend school

Finally, Nevada needs several long-term constitutional reforms to remove the sources of the current problem.

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## PREFACE

**D**ay in and day out, families in the Silver State manage to live within their means. When times are good and the paychecks are strong, families save more and perhaps buy a car, take a vacation or buy a nice piece of furniture. When times are not so good, families tighten their belts and make do with what they have. They know the key to getting through the bad times is to live within their means during the good times.

It's the same with businesses in the Silver State. When revenues are good and the economy is supportive, Nevada business people expand their enterprises, hire more people and innovate. When revenues are not so good, however, or the economy is not that supportive, Nevada businesses pull in their horns and scrutinize their enterprises closely. They ask, "What is our core mission?" and "What is our core business?"

The most successful business people know it's best to do a few things very well, rather than try to do many things in a mediocre fashion. And then, to keep core business functions intact and strong, they'll get rid of the other stuff—even if it means eliminating whole lines of business. In this way, Nevada businesses continually adapt to a changing world.

Because elected representatives of the people preside over Nevada state government, one would expect it to act with the same common sense that guides Nevada

families and business people.

Unfortunately, increasingly over the last two decades state government has become a thing apart, one that refuses to live within its given means. Legislators collectively and governors serially, indulging their political appetites of the moment and disdaining the long term, have in virtually every legislative session increased spending to the limit of existing revenues. Usually paying lip service to Nevada's low-tax traditions, they have nevertheless, in almost every Legislature, increased fees and taxes on their fellow citizens. One result of this pattern over the years is that Nevada, today, is no longer a low-tax state. Another result is the state's current fiscal crisis—a crisis that careless stewards once again seek to meet in the same old way: with ever-higher taxes.

At the Nevada Policy Research Institute, we believe in the Jeffersonian principles of limited government, individual liberty and free markets. We have long advocated tax relief and many reforms as means to those ends. It is now extraordinarily clear, however, that the Silver State has reached a watershed moment. If the forces of ever-greater government cannot be held in check, here in Nevada, if they cannot be compelled to once again live within our given means, something irreplaceably precious is going to be forever lost.

And that is why we have prepared this report.

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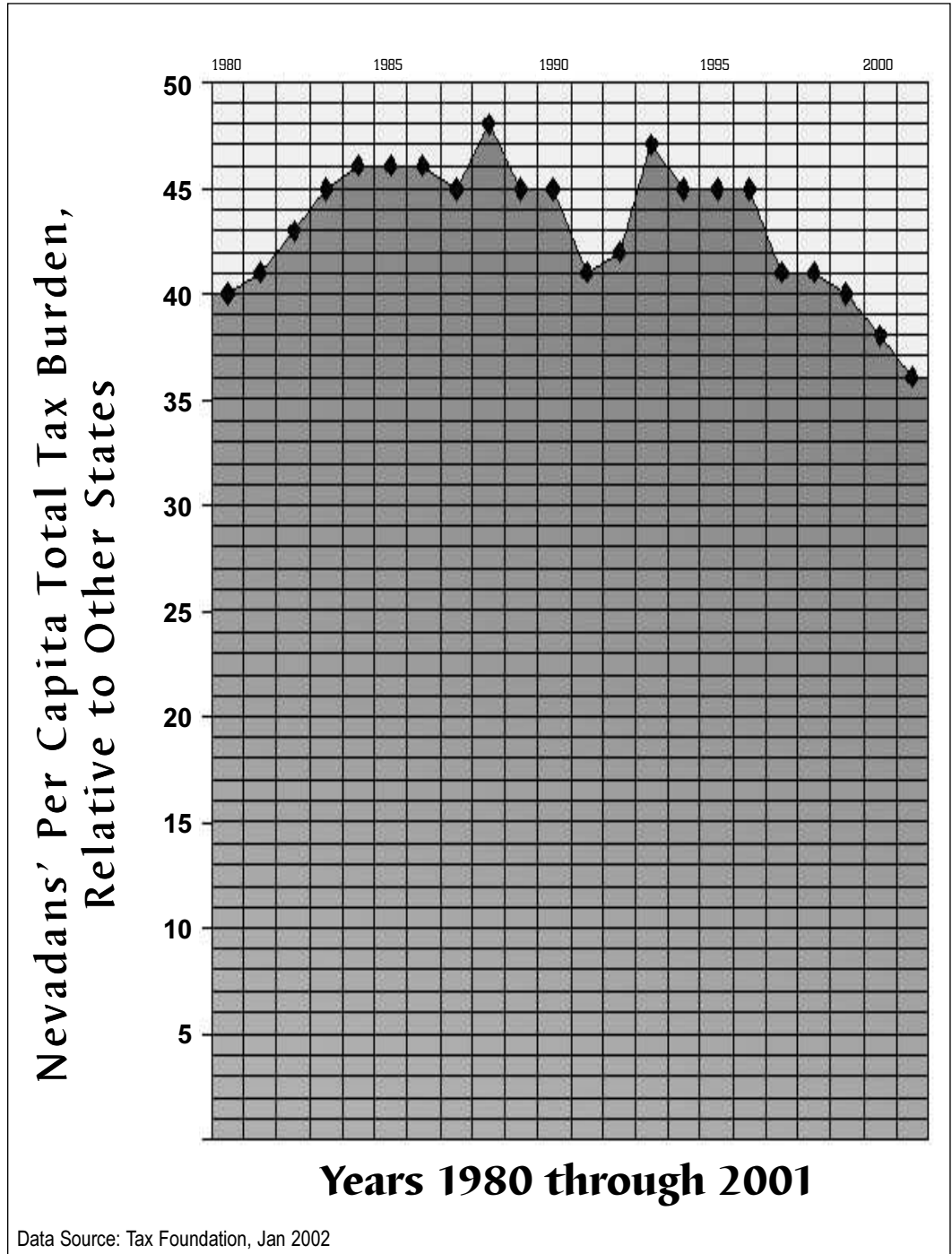
<sup>1</sup>In the decade of the 1990s, Nevada's ranked second in the nation in tax growth, according to the Tax Foundation in Washington, D.C. Average annual growth in Silver State taxes was 6.65 percent, outranking all states but New Hampshire, where taxes grew 8.74. As of 2002, Nevadans' total tax burden had *declined* to 14th highest in the country—the lowest it has been in a decade, according to the Tax Foundation. In 1994 and 1995, the Nevada tax burden was seventh in the nation.

According to the U.S. Census Bureau, between 1980 and 2000, while the state population was increasing by 250 percent, total state government revenues increased by 628 percent.

# Nevadans Pay High Taxes

Because Nevada lacks a personal or corporate income tax, the state has a reputation for low taxes. But Nevadans' total per capita tax burden, including fees, during each of the last 21 years was actually

heavier than that borne by citizens of over two-thirds of the states. And this has been during a period when the average state and federal tax burdens on all Americans have been rising significantly.



## PART I

# HOW STATE GOVERNMENT GOT INTO ITS CURRENT FIX

### A. The ‘Honey Pot’ Theory of Government

*For the last four years, Nevadans have been told by proponents of larger state government that the reason for the state’s growing financial embarrassment is that Nevada citizens and businesses are taxed too little. In actuality, however, the state’s current crisis is only the latest in what is, from all evidence, a permanent campaign of tax-consuming special interests to expand their claims over the earnings of Nevada taxpayers. Herewith a historical survey of the actual, rarely mentioned sources of Nevada’s budget “shortfall.”*

**E**very year, as the state’s Economic Forum assembles, a thrill of anticipation ripples through Nevada’s tax-consuming special interest groups. Like eager youngsters excited over the pending visit of Santa Claus, the interest groups—and the elected lawmakers who regularly serve them—discourse at length to news reporters and to each other about all the goodies that they hope to get while the state Legislature is in session—if, of course, the

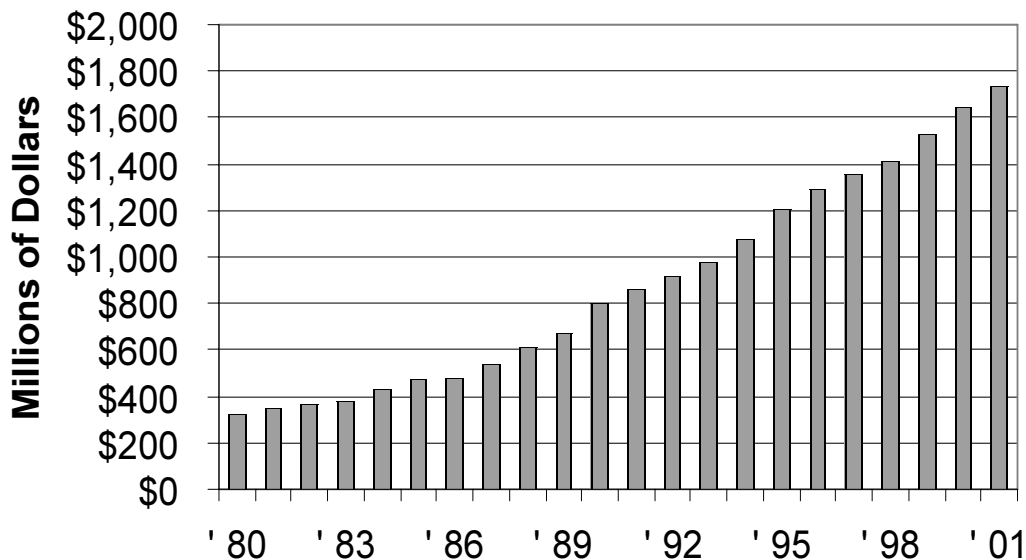
Economic Forum’s revenue forecasts are high enough.

What is the Economic Forum? It is a panel of five business people appointed by the governor and charged by law with the responsibility of adopting the State of Nevada’s official forecasts of future general fund tax revenues. All agencies of the state, including the governor and the legislature, are legally required to use the Forum’s annual tax revenue projections. In even-numbered years the Forum must provide its first forecast no later than December 1, just before the beginning of the coming legislative session. Then during that session, if a revision to the forecast is necessary, the Forum is required to issue the new forecast by May 1.

How did the State of Nevada ever end up with such a unique institution? The precipitating cause was a major embarrassment, early in the 1990s, to the state’s reigning political establishment. Before 1993, the office of the governor held the power to make the state’s official estimates

**Early in the 1990s the state political establishment suffered a major embarrassment.**

## Nevada General Fund Revenues by Fiscal Year



Data Source: Legislative Counsel Bureau

**By 1993, state politicians in Carson City were extremely red-faced.**

of future general fund revenues. As budget proposals were submitted to the Legislature, they would include—along with the governor’s proposed expenditures—forecasts of future revenues. In 1991, however, then-Governor Robert Miller submitted a budget for 1991-1993 that broke ranks significantly with past budgets. Based on aggressively optimistic revenue estimates for the coming two years, the budget increased state spending by 30 percent, and eager state lawmakers passed it into law.

It was a major-league mistake. Almost immediately, the 1991 national recession appeared on Nevada’s doorstep, and state revenue collections plunged. First the governor had to invoke a hiring freeze. Then, over the next 18 months, the executive branch and other state agencies had to struggle through three ever-smaller emergency budget revisions.

By 1993, state politicians in Carson City were extremely red-faced. So, to avoid such fiascos in the future, the Legislature

that year enacted legislation creating the Economic Forum. And though the new legislation effectively reduced the scope of the governor’s formal powers, a chastened governor signed it into law.

The overt rationale for the Economic Forum was to “take economic forecasting out of politics.” What the legislation actually did, however, was provide defense-in-depth for Nevada politicians from the political consequences of the many vagaries (some political, some not) of economic forecasting. The private-sector business people appointed to the Forum were not empowered with funding to develop or purchase significant, independent, forecasting expertise. The understanding, instead, was that the Forum’s members would listen to state government projections—by legislative and executive-branch employees and perhaps some economists from private-industry—and then turn in a “consensus” forecast. Today, practically speaking, this means that—as the National Conference of State Legislatures puts it in its account of

Nevada budgeting practices—the Forum “usually tries to develop a consensus between the executive and legislative forecasts.”

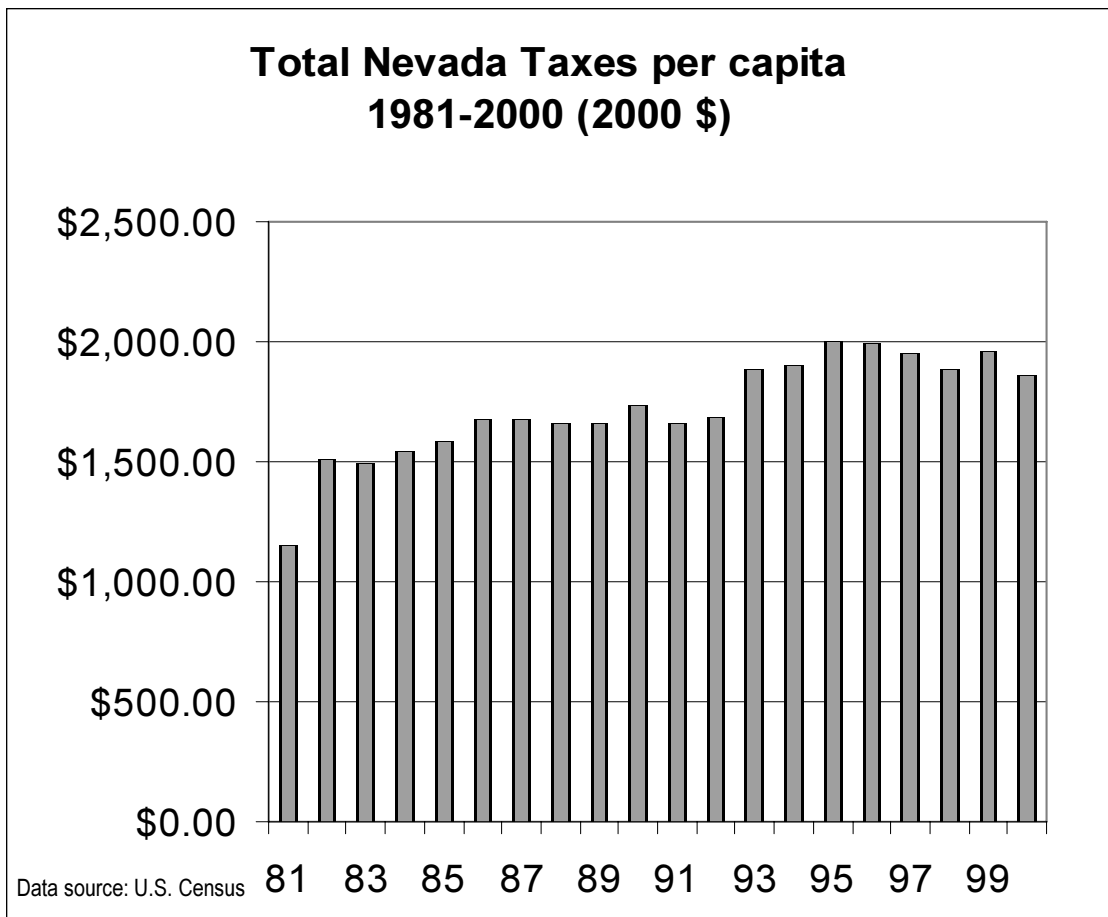
So while the Economic Forum now seems to successfully filter out the worst kind of politically motivated cooking of the (forecasting) books, it cannot remove it entirely. The desires of those who exercise final power in the state’s executive and legislative branches now tend to simply travel less overtly—in the form, for example, of the executive- and legislative-branch forecasts that appear before the Forum, and out of which the Forum is expected to construct its final “consensus” forecast.

While outside observers might tend to think that economic forecasts are merely a matter of economic science, they are necessarily more than mathematical projections. Always, to a significant extent, they are

pictures painted of possible futures—images composed out of countless subjective judgments, nuances and intuitions. So in principle there is always the possibility that a final Forum report can, with effort, be nudged toward a higher revenue forecast—which then increases the chance that one’s pet spending project can be included in the Governor’s Executive Budget and/or the final budget passed by the Legislature. Even if a would-be tax-consumer’s pet project doesn’t immediately make it into law, its chances are immeasurably advanced: It is now on the radar screen of many prospective allies—other interest groups and service-minded lawmakers—and moving on the well-traveled highway to Nevada-taxpayer gold.

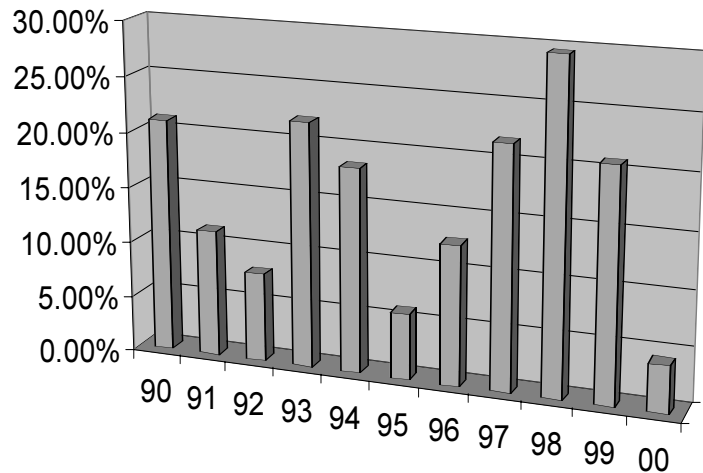
This reality, therefore, puts the Economic Forum right back at the place where it began in 1993—ground zero in the

**The Forum “usually tries to develop a consensus between the executive and legislative forecasts.”**



During the 1990s, Nevada state government received large increases in revenue – jumping on average 16 percent each year over revenues at the same point in the previous decade. The ‘crisis’ appears to be that the trend of per capita increases in revenue may be slowing.

**State of Nevada revenue increases per capita, over the last decade, by year (2000 \$)**



Data source: U.S. Census

**Nevada government has become a mechanism for transferring some people’s money into other people’s pockets**

unremitting campaign of tax consuming groups for ever-greater taxpayer funds. There are, of course, many other paths through which tax-consumers can get their hands on taxpayers’ earnings, but the history of the state Economic Forum remains uniquely illuminating—as is the buzzing that reliably occurs around the Forum every year. Both the history and the buzzing show the extent to which the operative, on-the-ground theory of Nevada government no longer is one of limited powers, exercised in stewardship for a self-reliant people. What clearly reigns today is what might instead be called the “Honey Pot” Theory of Government<sup>2</sup>.

It is illuminating, for example, to search the website of one of the large Las Vegas newspapers, using “Economic

Forum” and “Nevada” as one’s search terms. The result will be pages and pages of news stories over the last five or six years (depending on the paper) documenting the appetites and desires of Nevada’s tax-consuming special interests—and their demands for ever-greater sums of taxpayer-derived funds.

Such an exploratory exercise reveals how much Nevada’s system of government, in recent decades, has degenerated, to an unfortunate degree, into a mechanism for accomplishing the transfer of some people’s money into other people’s pockets. Many of these causes pursued in the Legislature appear at first blush praiseworthy and public-spirited. Virtually all of them, however, turn out to be marked by a revealing peculiarity: The putative do-

<sup>2</sup> Honey-pot, or redistribution politics, went overt and mainstream in America with Franklin Delano Roosevelt. “Politics is the science of how who gets what, when and why,” announced Sidney Hillman, founder and first president of the Amalgamated Clothing Workers of America. Hillman was a self-professed socialist, an admirer of Lenin and longtime ally and adviser to Roosevelt. The same idea had received academic sanction in 1936 when political scientist Harold Lasswell published a book entitled, *Politics: Who Gets What, When, How*.



gooder-sponsors are not willing to seek Nevadans' voluntary support. Rather, they always work to make the support of their fellow Nevadans compulsory—to harness their fellow citizens to their ends through the involuntary, police-enforced mechanisms of the state. This is important evidence that the operative motivations are, in actuality, less than benign. Most often greater personal power or greater personal wealth—or both—appear the real object of pursuit.

The effect on the Silver State of the rise of the Honey Pot Theory of Government has been profound. As the Nevada Taxpayers Association recently pointed out, between 1981 and 2001 Nevada's state and local tax revenues increased 403 percent:

During this time period a new business activity tax and a rental car tax were imposed, sales and gaming taxes, mining taxes, cigarette, liquor, fuel, insurance premium and motor vehicle privilege taxes were all increased. Local permits and fees and property taxes all continue to rise.<sup>3</sup>

Sociologically, Nevada in the last 22 years has seen an accelerating disintegra-

tion of long-established mores—standards and customs upon which the practices of limited constitutional government in the state have historically depended. This has led to, or been reflected in, the gradually accelerating rule of tax-consuming special interests, and—under the constant pressure of their essentially insatiable appetites—the increase of Nevada taxes again and again.

For many years these tax increases were essentially surreptitious—never overtly challenging the desire of most Nevadans to not be subjected to clearly high taxes. Today, however, the state's tax-consuming interests have become too large and powerful to remain content any longer with merely clandestine and incremental tax and fee increases.

Instead they apparently have now concluded that the time is right to overtly impose a new hegemony on all the rest of us. Thus the well-coordinated push for an essentially radical and destructive change in the Nevada tax system.

**Bottom line: The 'Honey Pot' theory of politics that has come to dominate Nevada is a major source of the state's chronic overspending and thus, its current fiscal bind.**

**Tax-consuming interests have become too large and powerful to remain content with merely clandestine and incremental tax and fee increases.**

## B. Government of Taxpayers by Tax Consumers

Language about “the gradually accelerating rule of tax-consuming special interests” may sound a bit strange. But the truth is that over the last 35 years, Nevadans have been quietly deprived of the full protection of one of American constitutional law's most important defenses against oppression<sup>4</sup>.

“It is jealousy and not confidence which prescribes limited constitutions, to bind down those whom we are obliged to trust with power,” wrote Thomas Jefferson in 1798<sup>5</sup>. “Our Constitution has accordingly fixed the limits to which, and no further, our confidence may go.”

Jefferson was speaking of the separa-

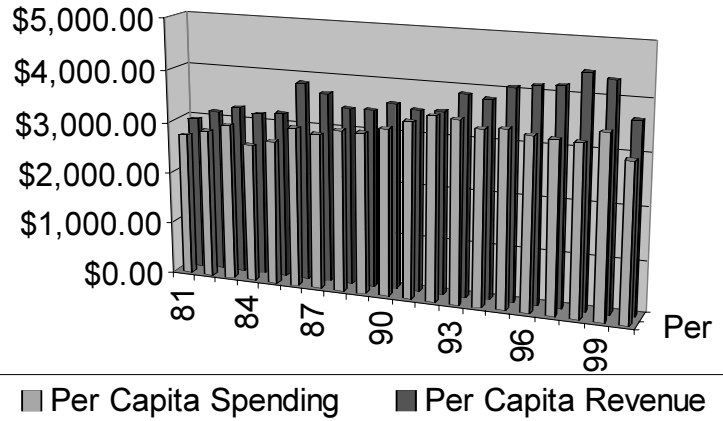
<sup>3</sup> “Back to Basics,” *Tax Topics*, April 2001, Issue No. 1-01, p. 1.

<sup>4</sup> “The concentrating [of the powers of government] in the same hands is precisely the definition of despotic government. It will be no alleviation that these powers will be exercised by a plurality of hands, and not by a single one. One hundred and seventy-three despots would surely be as oppressive as one.” —Thomas Jefferson: *Notes on Virginia* Q.XIII, 1782. ME 2:162

<sup>5</sup> Draft of the Kentucky resolutions, 1798.

The significant gap at right between revenues and expenditures, according to legislative analysts, is primarily insurance trust funds such as the Public Employees Retirement System, the Unemployment Insurance Trust Fund and – before it was privatized – SIIS -- the State Industrial Insurance System.

### Total State of Nevada Spending & Revenues 1981-2000



Data Source: U.S. Census

The basic idea has always been to limit the power of government officials.

tion of powers principle, which allocates the powers of government to three separate branches, each with its own personnel. The basic idea—stemming from hundreds of years of hard-earned English common-law experience<sup>6</sup>—has always been to limit the power of government officials by barring them from occupying positions in different branches of the state. An ancillary concern has been to combat the opportunities for corrupt influence that arise when one branch can remunerate and/or employ an officer of another branch.

But what a Nevada Supreme Court

once called “probably the most important single principle of government declaring and guaranteeing the liberties of the people”<sup>7</sup> has been in essence neutralized in Nevada.

Article III, Section 1, of the Nevada Constitution expressly forbids officers of one branch of government, such as the Legislature, from exercising any function in another, such as the Executive. The exact wording of the section is:

The power of the government of the State of Nevada shall be divided into

<sup>6</sup> “Thus Clement Walker, a member of the Long Parliament in 1648, saw distinctly enough the kind of arbitrary, tyrannical rule against which the governed had to be protected. The remedy, he thought ..., lay in a separation of governmental functions cast in terms of ‘the Governing power,’ ‘the Legislative power,’ and ‘the Judicative power.’

“For Marchamont Nedham, writing under Cromwell’s Protectorate in 1656..., the required separation is that of legislative and executive powers into different ‘hands and persons.’

“John Trenchard’s argument of 1698 carries Nedham’s separation of persons even further.... One might say that *without separation of persons there cannot be a meaningful separation of powers.*” (Emphasis added.) *The Founder’s Constitution*, Philip B. Kurland and Ralph Lerner, editors, University of Chicago Press, 1986.

<sup>7</sup> Galloway v. Truesdell, 83 Nevada (1967).

three separate departments: the legislative, the executive and the judicial; and no persons charged with the exercise of powers properly belonging to one of these departments shall exercise any functions appertaining to either of the others except in cases herein expressly directed or permitted.

Before 1967, the commonly held interpretation in Nevada of this section of the state constitution was that it meant literally what it says: that no individual with power in any one of the three branches could at the same time “exercise any function” in one of the other branches. The only exceptions were those specifically spelled out in the constitution itself<sup>8</sup>.

Thus, in 1952, then-Nevada Attorney General W. T. Mathews, a Democrat, explained to John Murray, an inquiring state senator from Eureka County, that it would violate the state constitution for Murray to continue to be employed in the state department of motor vehicles at the same time he served as an elected lawmaker. “Executive class includes all persons who have functions in the administration of public affairs,” wrote Mathews.

Two years later, Mathews told two other elected lawmakers from Eureka County essentially the same thing. They also held jobs in the Nevada highway department, but the A.G. declared: “We think such practice would ignore if not in fact be violative of the above-quoted constitutional provision [Article III, Section 1],

and certainly against the public policy of this state as so expressed therein.”

Mathews cited an Indiana decision upholding that state’s very similar provision—also placed at Article III, Section 1 of that state’s constitution. The Indiana court had pointed out: “If persons charged with official duties in one department may be employed to perform duties, official or otherwise, in another department, the door is open to influence and control by the employing department.”

Nevada’s next Attorney General, Harvey Dickerson, another Democrat, initially recognized—as had Thomas Jefferson—that the separation of power principle extended vertically in government as well as horizontally<sup>9</sup>. Dickerson<sup>10</sup> ruled that a member of the state Assembly could not at the same time hold a position in local government. Since counties, cities and school districts are creatures of the State, he wrote, citing some of the same precedents as had Mathews, the assemblyman could not also receive remuneration as an employee of the Hawthorne Elementary School District.

“The school districts are political subdivisions of the state government and part of the executive branch,” pointed out the Attorney General. “An employee of the school district is exercising a function appertaining to the executive branch. If that employee is at the same time an Assemblyman, the activity is in conflict with the above quoted constitutional provision.”

**Before 1967, the commonly held interpretation in Nevada of the state constitution was that it meant what it says.**

<sup>8</sup> Such as the governor’s legislative power to veto bills, or the senate’s judicial power to try impeachments.

<sup>9</sup> “The ‘separation of powers’ described by Jefferson has at least three dimensions: First, the allocation of governmental power among separate branches of government (this is ‘separation of powers’ in the strict sense); second, the division of that power in such a way that the authority of one branch in a given matter is limited by the authority of another branch over the same or a related matter. (This is usually called ‘checks and balances.’ It is, in essence, a system of intra-governmental accountability.) *The third aspect of this arrangement is the vertical division of governmental power . . . . This is the principle of subsidiarity, which of course, encompasses federalism.*” (Emphasis added). Robert S. Barker, professor of law, Duquesne University. School of Law, on the U.S. Department of State International Information Programs web site.

<sup>10</sup> The decision was actually written by Deputy Attorney General William N. Duneath.

The Attorney General argued that the separation-of-powers prohibition applies to mere employment in one branch of government if the person exercises power in another.

The A.G. opinion also noted that the duties of Nevada's citizen legislators involved a good deal more than merely showing up, in odd-numbered years, for the legislative sessions. "[D]uring his entire elective term of office," a lawmaker "is charged ... with the exercise of powers properly belonging to the legislative branch of our state government." An assemblyman "is subject to special session duty during his term of office and may and oftentimes does serve on interim committee or commission activity all during his two-year term."

A question was raised whether the assemblyman's school district job—maintenance engineer—constituted a "public office." But the Attorney General argued—correctly, from the standpoint of the strict Jeffersonian interpretation—that the separation-of-powers prohibition applies to mere employment in one branch of government if the person exercises power in another.

### The Summer of Love

By April 1967, however, 13 years later, the times they were a-changin'—and Nevada was not exempt. Hundreds of thou-

sands of young people were preparing to converge on San Francisco's Haight-Ashbury district, shouting "Make Love, Not War" and "U.S. Out of Vietnam!" Bob Dylan's lyric, "The Times They Are A-Changin'"<sup>11</sup> captured well the era's heady atmosphere of cocksure, even intimidating, youthful scorn for existing political norms and players. At the same time, the Warren Court and the Ninth Circuit Court of Federal Appeals had just gutted Nevada's "little federal plan" system of apportionment, which for over 100 years had given Nevada counties seats in the state senate on the basis of their status as counties, rather than their population. The state's major historical bulwark of fiscal conservatism and constitutional humility had been exploded.

In Carson City, Attorney General Dickerson now turned to an already-answered question. Now it was the City of Sparks, asking whether a local government employee—in this case, a fire chief—could also, at the same time, serve as a state legislator. And this time Dickerson turned completely around<sup>12</sup>.

First, Dickerson defined the issue before him as something other than an

<sup>11</sup> For example:

*Come senators, congressmen  
Please heed the call  
Don't stand in the doorway  
Don't block up the hall*

*For he that gets hurt  
Will be he who has stalled  
There's a battle outside  
And it is ragin'.*

*It'll soon shake your windows  
And rattle your walls  
For the times they are a-changin'.*

*Come mothers and fathers  
Throughout the land  
And don't criticize  
What you can't understand  
Your sons and your daughters  
Are beyond your command  
Your old road is  
Rapidly agin'.*

*Please get out of the new one  
If you can't lend your hand  
For the times they are a-changin'.*

Copyright © 1963; renewed 1991 Special Rider Music

<sup>12</sup> There are also many non-substantive, but interesting, differences between this opinion and the earlier one on the same subject. This time only Dickerson himself signed it. The text also is replete with errors in grammar and syntax—unusual considering the usually workmanlike standards of the AGO. Over all, the impression is of a labored and second-rate piece of writing that strains to find rationales for an already-prescribed conclusion. This is likely to have been one reason that the AG's Office returned to the same subject in 1971, under Robert List. That opinion, while reaching the same conclusions, at least offered respectable arguments and superior supporting precedents.

affront to the plain wording of Article III, Section 1:

“The question,” he wrote, “revolves around the determination as to whether the fire chief is charged [sic] the exercise of powers which conflict with his services as a senator, or vice versa.”

In actual fact, of course, this statement was not true: The question did not “revolve” around that, because it was not up to Dickerson to determine if there was a conflict between serving in the legislature and being employed in another branch. That issue had been settled 103 years before, when the wording of the Nevada state constitution, based on an earlier 300 years of common-law precedent, had been adopted.

But Dickerson, of course, was in a bind: Skirting the settled constitutional will of a sovereign people is dicey business; you can’t come right out and say what you’re doing. At any rate, the AG’s office now duly found that it didn’t think letting the fire chief be a state senator while on the payroll of the City of Sparks was going to be a big problem.

In 1971, under newly elected Attorney General Robert F. List, there was another, more polished, effort to square the separation-of-powers circle and roll out the red carpet for the politically powerful and highly active<sup>13</sup> public employees. And in subsequent years many other rationales have been put forward to attempt to make Article III, Section 1 mean something other than what it says on its face.

It has been argued that:

- ♦ Local governments, even though they are legal creatures established to implement the broad outlines of state policy and decisions, are not really part of the implementing or executive branch of state government.

- ♦ The University & Community College System of Nevada, though established to implement the educational function for the state, is also not part of the implementing or executive branch of state government,
- ♦ “Exercising any functions” really means “exercising power” and therefore a legislator does not “exercise any function” in the executive branch if he or she “just works there.”

Clearly the goal in all these instances has been simply to open the door into the state legislature for public employees. Many people just do not understand the problem with this. To not allow local government employees to also hold office in the state legislature alongside private-sector citizens seems “unfair.”

The reality is, however, that America’s historically unique form of government was never instituted for the benefit of all the would-be politicians. It was precisely the opposite: to guard against them. As Jefferson once wrote, “Power is not alluring to pure minds.” Those individuals who have an appetite for political power have to be kept from consolidating it. That would negate the essential point of our federal system, which is to keep power largely divided, both vertically—local, state and national—and horizontally—executive, legislative and judicial.

## **The ratchet wheel**

The successful neutralization of the Nevada constitution’s separations-of-powers clause increasingly gives citizens of the Silver State a skewed and distorted political system. People who are supposed to be our employees now increasingly write the laws and tell the rest of us what to do.

In the 1999 Nevada Legislature, 44 per-

**America’s historically unique form of government was never instituted for the benefit of all the would-be politicians. It was precisely the opposite: to guard against them.**

<sup>13</sup> For years, political scientists have noted the very high voting proportions of public employees at all levels. At the local government level, the turnout is often virtually 100 percent. Members of public sector (i.e., government) unions also vote near 100 percent levels.

**In the 2001  
Assembly,  
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cent of the members of the state Legislature—28 of 63—also held government jobs or were married to government employees. In the 2001 Assembly, a public employee occupied every position of power:

- ◆ Richard Perkins, a deputy police chief in Henderson, held the top job—Speaker of the Assembly.
- ◆ Barbara Buckley, executive director of the Clark County Legal Services Corporation<sup>14</sup>, was Majority Leader.
- ◆ Morse Arberry, a neighborhood services administrator for the City of Las Vegas, chaired the powerful Ways and Means Committee.
- ◆ Wendel Williams, a management analyst for the City of Las Vegas, chaired the Education Committee—long the graveyard of any significant education reforms.
- ◆ Doug Bache, a government-school teacher in the Clark County School District, chaired both the Energy and Government Affairs committees.
- ◆ Bernie Anderson, a government-school teacher in the Washoe County School District, chaired the Judiciary Committee.
- ◆ Ellen Koivisto, a “support employee” for the state university system, chaired the Health & Human Services Committee and also the Health and Legal Issues Committee.

- ◆ Chris Giunchigliani, at the time a government-school teacher in the Clark County School District<sup>15</sup>, chaired the Elections, Procedures & Ethics Committee. She also was the original author of the resolution that eventually set up the so-called Governor’s Task Force on Tax Policy and directed it to find some major new taxes to impose on Nevadans.

Such concentration of state power among public employees is a major reason why Nevada taxes and fees have gone up virtually every biennium over at least the last 22 years. Not only are public employees themselves tax consumers, with a distinct conflict of interest<sup>16</sup>, but the political activists among them tend toward a sectarian ideology that always calls for ever-greater government spending and on many issues often is essentially indistinguishable from socialism.

These are not the “citizen legislators” who were originally intended to occupy the Silver State’s part-time legislature. As libertarian columnist Vin Suprynowicz has pointed out, “Government employees routinely refer to a tax cut not as something that “leaves more money in our pockets,” but rather as something that “costs us money.”

When such a narrow group is allowed to control one house of the Legislature, it means that great public resources—financial and otherwise—become dedicated to an agenda that is permanently hostile to taxpayers. The maneuvering over the years

<sup>14</sup> The CCLSC is a government agency funded by Clark County, the Family Court system and federal grants.

<sup>15</sup> In September 2002 Giunchigliani left her teaching position. She was hired by the Community College of Southern Nevada as director of high school and community relations—a new \$70,000-a-year post.

<sup>16</sup> The liberal organization Common Cause defines *conflict of interest* as:

1. The circumstance of a person who finds that one of his or her activities, interests, or responsibilities can be forwarded only at the expense of another of them.
2. The circumstance of a public official whose private financial interests might benefit from his or her official votes or actions.

of Assemblywoman Giunchigliani—both tactical and strategic—to always increase Nevadans’ taxes is a perfect example<sup>17</sup>.

Further, when such a group controls one house of the Legislature, it also has a stranglehold on the entire Legislature. Nothing can happen without the approval of the caucus—no reforms, no budget cut-backs. The result is what Nevada has seen for the last 20 years: the Nevada Legislature tends to operate like a ratchet wheel, where spending can always increase, but never decrease.

A classic example of the money-wasting ratchet-wheel effect of today’s Nevada Legislature is “class-size reduction”—a very expensive spending program from the viewpoint of taxpayers<sup>18</sup>, but one beloved by the teacher-union bosses who dominate the Clark County and Washoe County school districts. The reason they love it? It assures the union of potentially thousands<sup>19</sup> of new dues-paying members each year.

A quick proof that class size is actually irrelevant to student achievement is apparent in the fact that the United States has far smaller class sizes than Japan and yet far worse test scores. Yet if one probes further, literally over a thousand studies (including

studies done by Nevada’s own state government) have established that class-size reduction, when it even has an impact, is actually one of the least effective ways to attempt to improve public-school student achievement. As a report from the Nevada Legislative Counsel Bureau<sup>20</sup> recently said, “There are several factors overwhelmingly more important in predicating pupil achievement scores—special education status; ESL (English as a second-language) status, ethnicity, free lunch eligibility, and class configuration (in descending order), each accounted for more variance in scores than did class size.”

Nevertheless, Nevada state government has now spent over \$650 million on the program since 1989 when it was first passed into law. And the State of Nevada budget is full of such expensive blunders—there, not because they actually represent good policy, but because they benefit a powerful special interest group.

**Bottom line: The rule over Nevada taxpayers by a coalition of tax consumers is a major source of Nevada’s chronic overspending—and thus the state’s current fiscal mess.**

The state budget is full of expensive blunders – put there because they benefit some powerful special interest group.

<sup>17</sup> Editorially the *Las Vegas Review-Journal* described Giunchigliani’s Assembly Concurrent Resolution—source of the so-called Governor’s Task Force on Tax Policy—as “a pretty good imitation of the piteous sound issuing from a basketful of blind and hungry kittens.” The newspaper also noted that Giunchigliani’s resolution “launch[ed] into blatant falsehood by the time it gets to its 28th word, where this entertaining document asserts, ‘The rate of growth of Nevada’s population is much faster than the rate of growth of its public revenue.’” On the contrary, pointed out the *Review-Journal*, “In fact, in only one year since 1987 has the rate of population growth exceeded the rate of the state’s general fund revenue growth.”

<sup>18</sup> For the next biennium alone, according to the office of the governor, the class-size reduction mandate will have increased to \$225 million. “Guinn wants \$800 million more in taxes,” *Las Vegas Review-Journal*, Dec.3, 2002.

<sup>19</sup> “Assembly Bill 671, of the 2001 Legislative Session, authorizes the expenditure of \$91,822,619 and \$99,730,291 for support of the Class Size Reduction program in FY 2001-02 and FY 2002-03, respectively. This money will pay for the salaries and benefits of at least 1,866 class size reduction teachers hired ... in the first year of the biennium and 1,949 teachers in the second year....” Nevada Legislative Appropriations Report, Seventy-First Legislature, Fiscal Years 2001-02 and 2002-03, Fiscal Analysis Division, Legislative Counsel Bureau, September 2001. See also note 17, above.

<sup>20</sup> Background paper 97-7, “Nevada’s Class-Size Reduction Program, Nevada Revised Statutes 388.700—388.730, “Program To Reduce The Pupil-Teacher Ratio”, Pepper Sturm, policy analyst, Senate Committee on Human Resources.

*The Separation of Powers doctrine is a fundamental principle on which federal, state and local governments are based. The doctrine protects the common interest of the public by requiring that those who make the*

*law be different from those who execute and apply it. To protect against unchecked power, it is necessary not only to have separate branches of power but also to have separate personnel in each branch.*

—*Matter of Walker*  
Arizona Supreme Court, 1987<sup>21</sup>

## C. A ‘Yeah, Yeah – Whatever’ State Bureaucracy

For decades the state has had a severe problem establishing accountability among its own employees.

Given the stranglehold on the Legislature of city, county and school-district public employees, perhaps it’s not surprising that Nevada state government has for decades had a severe problem establishing serious accountability among its own public employees.

To say the same thing differently, state government entities—even after embezzlements<sup>22</sup> and other major indignities—generally get to go their own way, essentially undisturbed. Of course, if a mess-up publicly embarrasses an administration, there usually will be some kind of public beheading. But those cases are the exceptions.

### **The absence of oversight**

You haven’t heard about this state of affairs? Well, that brings us to another level of the problem: Not only are Nevada state agencies often subject to relatively minimal effective oversight from within the apparatus of state government itself<sup>23</sup>, they also don’t get much oversight from outside state government, either.

In many states where private institutions of higher education flourish, political scientists, economists and other academicians commonly do research that looks

closely into various activities of state government and its departments. This provides a level of public oversight, of sunlight, on government that is on the whole of significant public value. Nevada, on the other hand, is a relatively small state with only two major academic institutions—both state-owned and state-run. In addition, these same institutions have always had a historically problematic relationship to the canons of academic freedom. And these problems have not today just disappeared into the mists of the past, either: Many professors and instructors at the University of Nevada at Las Vegas and the University of Nevada at Reno even today have cautionary tales they tell each other, when the lights are low, about what happened to Professor So-And-So when he chanced to do or say something that happened to displease some hypersensitive politician or interest group.

If the academy is unavailable, what about oversight from the news media—from the state’s professional journalists? Unfortunately, the state government has received a similar “pass,” to a significant degree, from them. In this case, however, it is less a matter of fear—though there is some—than of costs: In-depth or investiga-

<sup>21</sup> The exact citation is *Matter of Walker*, 153 Ariz. 307, 310, 736 P.2d 790, 793 (1987).

<sup>22</sup> See Appendix A, page 57, Report LA02-25.

<sup>23</sup> *Ibid.*, especially pages 38-40, 44, 46 and 53.



tive reporting is significantly more expensive on a news organization's balance sheet than is regular beat reporting—which most state papers cannot afford in Carson City anyway.

Face to face with major economic disincentives, newspapers or TV stations do not maintain continuous watch over ever-proliferating government agencies. Thus it is only on special occasions—when the stories to be told are relatively simple and do not require long man-hours of research—that one finds concentrated examination of state programs in the daily news media.

Significant public consequences flow from this absence of effective outside oversight over Nevada state government. Inside the agencies the laxness continues—month after month and year after year. And outside, among the public, a kind of naiveté tends to descend—especially on people who've never been exposed to the actual day-to-day norms that govern inside the warrens of the state bureaucracy.

Realistically, how many of us have heard that Nevada state agencies are paying males for maternity-related medical procedures and females for male-anatomy-related medical services?<sup>24</sup>

Given the lack of public knowledge about the realities of state and local government, it is not surprising that people haven't rebelled during the last 20 years as taxes have risen and risen and risen. We want to believe the best about our public officials. And so when they go on television and say they've "cut out all the fat" and "all that's left is muscle and bone," we, communally, are always inclined to give them some benefit of the doubt. The hard fact is, however, that there will never be satiation for the appetites that have pushed up your taxes to where they are now and that have gotten the state into its current plight. The evidence is thus pronounced

that the state is currently witnessing now only the latest installment of a permanent campaign to lay ever-larger claims on your money.

### **The LCB audits**

Notwithstanding the lack of public understanding of the predatory realities of state and local government, there does remain one potential fly in the ointment for the State of Nevada's more sluggardly departments and agencies—the Legislative Counsel Bureau Audit Division. At the back of this study, in Appendix A, are about 25 pages of excerpts from audits done by the LCB of various state agencies over the last four years.

The LCB usually does good work, and in Appendix A readers will find the specifics on many, many wasteful state practices and recurrent episodes of expensive neglect in the executive branch that LCB auditors have identified—from the Office of the Governor on down.

Unfortunately, however, a long and insistent tradition maintains itself in State of Nevada executive departments. It is to in effect say, upon receipt of an LCB audit, "Yeah, yeah—whatever"—and then proceed blithely down the same old wasteful road in the same old wasteful manner. This means that years later, when LCB auditors come 'round once again, looking into department practices, they again find the same old money-control failings they had identified and reported to department administrators many years before.<sup>25</sup>

In 1987 State Senator Ann O'Connell recognized what was going on and introduced legislation that would have thereafter sent LCB auditors right back to those non-compliant agencies within the next six months. At which point the Miller administration decided to take action. But was it to make agencies finally try to get a handle on

**Year in and year out, LCB auditors again find the same money-control failings they had identified and reported to department administrators years before.**

<sup>24</sup> Ibid., page 50, Report LA00-14.

<sup>25</sup> This is a recurring refrain throughout the audit reports excerpted in Appendix A.

Like caught-up investors, state legislators and executives also began to manifest the “New Era” thinking that characterizes market bubbles.

the waste and abuse they were perpetrating?

No. It was to lobby against O’Connell’s bill and get the administration’s allies in the state Assembly to water it down. So still today, 15 years later, LCB auditors continue to find many of the same financial-control problems in the same state agencies where they’d found those problems years before<sup>25</sup>.

The natural question is: What, really, is going on? And: Why do these state agencies get to go their own way? It’s not currently possible to give thoroughly definitive answers to these questions—this is not a paper on the sociopathology of executive-branch bureaucracies—but some informed guesses can be offered. One thing that’s present seems to be a de facto alliance of tax-consumers: The government employees

running the Assembly are not inclined to force their fellow government employees who run the state agencies to suddenly change their entire lifestyle and embrace Fortune-500 standards of performance. After all, the unionized local government employees who run the state Assembly would have to start acting like “management” over the unionized state government employees who run the state agencies—their fellows in government-union core element of the Democratic Party coalition. The mere idea would probably make shudders run up and down their backs.

**Bottom line: There are easily scores of millions of dollars wasted by Nevada’s state bureaucracy every year—and that’s a major source of Nevada’s current fiscal mess.**

## D. Doubly Incapacitated Economic Forecasting

Nevada’s current fiscal mess also has a fourth source, which remains widely unacknowledged. It might be described as the unfortunate confluence of two different but major streams of economic ignorance.

Consider first that the Silver State is far from alone in currently facing budget problems. During most of 2002, almost every state in the union projected a significant gap between expected revenues and expected spending. Moreover, the national average of state budget gaps did not differ substantially from the one facing Nevada<sup>26</sup>.

What this makes clear is that at least one of the key economic factors behind Nevada’s current financial embarrassment has to have been national, or macroeco-

nom, in its origins<sup>27</sup>.

### The states’ bubble

Now consider the table on the facing page and its very representative headlines. What they chart is the collective, or macroeconomic, experience of the states over the last five years—years, first, of surprisingly fat revenues, followed by years of surprisingly meager revenues.

Every investor who followed the stock market during the 1990s will notice that the revenue experience of the states in general closely resembles the arc of the market indexes. Moreover, state legislators and executives—like caught-up investors—began to manifest the “New Era” thinking that always characterizes market bubbles.

<sup>26</sup> In June, 2002, at the same time that the Governor’s Task Force on Tax Policy was projecting an \$86.4 million deficit on a \$1.8 billion budget—or a gap of 4.7 percent—the national average rate of deficit at the same time was, according to *Barron’s*, projected at around 4 percent. “Raining Red Ink,” Thomas G. Donlan, *Barron’s*, June 10, 2002.

<sup>27</sup> This underscores the lack of credibility of the allegation that Nevada’s tax structure is “structurally” inadequate.

1997

**State Surpluses Rolling In**

9/19/97 - *USA Today*

1998

**State And Local Budget Surpluses Keep Climbing**

5/4/98 - *Business Week*

**State Surpluses Even Higher Than Earlier Predictions**

5/27/98 - *Wall Street Journal*

1999

**States Can't Spend Money Fast Enough**

7/27/99 - *USA Today*

2000

**States Hike Spending, Shrinking Their Surpluses**

1/4/00 - *USA Today*

**States Drawing On Their Reserves**

4/3/00 - *Business Week*

**Are Clouds Gathering Over States' Finances?**

7/10/00 - *USA Today*

2001

**Slowing Economy Forces Governors to Trim Budgets**

2/8/01 - *The Associated Press*

**States Opting For Spending Cuts**

6/13/01 - *Wall Street Journal*

**First Round of Budget Cuts Aren't Enough, States Find**

10/12/01 - *New York Times*

2002

**Tax Collections By States Tumble**

6/4/02 - *Wall Street Journal*

**States' Tax Increases Create Drag on the Overall Economy**

6/3/02 - *Wall Street Journal*

While stock market prognosticators, carried away with the bull market, were arguing that the boom of the '90s had revealed that old paradigms were now obsolete, state elected officials were similarly concluding that the record revenues they were receiving were going to be a more or less permanent feature of state fiscal reality. In each case, as always happens in the blow-off phase of financial manias, the euphoria that accompanies expectations of great wealth essentially swamped prudent standards of fiscal management.

But that was not all. As elements of psychic contagion swept the nation and the states, the economic forecasters—upon which state officials erroneously assumed they could depend—were blind to what was happening. Consequently, as the economic bust arrived, with its accompanying collapse in tax revenues, the states were almost totally unprepared.

Behind the forecasters' inability to give

state leaders adequate impressions of future state revenues are two chronic failings of contemporary mainstream economics. One has to do with an unjustified, even faddish, faith in "econometrics," while the other stems from a failure to grasp the essential nature of the business cycle. Both of these problems, to a large degree, stem from the easy contamination of economics by politics.

### **Econometrics**

Modern mathematics-based economic forecasting, or "econometrics," attempts to produce sound economic predictions by the use of past statistical data and computer modeling. But after almost 70 years as an academic field, it still has never delivered the goods. Indeed, its extremely poor record of success, when attempting any significant long-term macroeconomic prediction, is an increasingly large, but usually unacknowledged, part of the public record.

Behind the forecasters' inability to give state leaders adequate impressions of future state revenues are two chronic failings of contemporary mainstream economics.

If the longest period of accuracy that econometric models can muster is six months, why is the state's political class trying to use a 10-year projection to justify a huge tax increase?

Consider the current recession, for example. In terms of traditional measures, for example, it was evident in an escalating money crunch and an ever-spreading bear market in March 2000—some 20 months before the 9-11 attacks. Both of these conditions, moreover, had followed a classic economic bubble, many of which have dotted the history of the United States ever since the First United States Bank opened its doors in Philadelphia in 1791, leading to many financial crises and even depressions. Nevertheless, economic forecasters employed by government at both state and federal levels utterly failed to spot the oncoming tide.

Let's look at state forecasts first. According to the Nelson A. Rockefeller Institute of Government, in each of the last seven years, state economic forecasts across the country have regularly been seen to be significantly wrong after only two to six months.

Consider these highlights from the covers of the Institute's two most recent Spring-quarter State Fiscal Briefs:

**May 2001 (No. 62):** "Economic forecasts underlying state budgets have become out of date, as the economy has weakened. The median state forecast of 3.2 percent growth in real gross domestic product is well above the current consensus of 1.8 percent."

**June 2002 (No. 65):** "Economic forecasts underlying state budgets have become out of date, as the economy has strengthened. The median state forecast of 0.5 percent growth in real gross domestic product was well below the current consensus of 2.6 percent."

Inside the May 2001 State Fiscal Brief it was further noted that "In each of our

previous five surveys, state governments underestimated economic growth in the nation and in their own states."

Thus, in each of the last seven years, the best the state models could do was simply extrapolate the immediate past into the immediate future. In every case, however, the future, within two to six months, had demonstrated the uselessness of the projections. A natural question is, if the longest period of accuracy that state econometric models can muster is six months, why is the state's political class<sup>28</sup> currently trying to cite a 10-year projection as justification for anything—much less a huge and destructive tax increase?

Well, perhaps mathematical computer-based forecasting works better at the federal level. Let us see.

A major authority on this subject is the Tax Foundation in Washington D.C. For 65 years the foundation has closely monitored federal budgets, including all the obligatory economic projections. Recently, summing up all this experience, the foundation concluded that it is virtually impossible for economists to make accurate long-range forecasts.

The foundation's new report<sup>29</sup> was released in January 2002. It specifically focused on the question of forecasting's reliability. Its conclusion, based on the field's long history of unreliability, was that long-term economic projections should never be the basis for tax legislation.

After scrutinizing the wild swings in forecasts coming out of both the Congressional Budget Office and the federal Office of Management and Budget in recent years, the report concluded that:

While drastic, such swings in fiscal projections are par for the course. Fiscal forecasting is fraught with difficulties not the least of which is predicting the

<sup>28</sup> And its instrument, the Governor's Task Force on Tax Policy.

<sup>29</sup> "Fiscal Forecasting: A Perilous Task," Tax Foundation Special Report #108, <http://taxfoundation.org/forecasting.pdf>.

economic outlook of the country ten years into the future. *Margins of error of 50 percent or greater and swings in deficit / surplus projections of hundreds of billions of dollars are typical.* (Emphasis added.)

This was a point that Marvin Leavitt, Nevada's longtime premier state and local tax expert<sup>30</sup>, sought to make in February when he spoke to the Governor's Task Force on Tax Policy:

I've been around long enough that I've seen these projections, now, several times. And I've had cause to go back and look at them, at the end of the period of time when they were trying to make the projection, 10 years later. And they don't bear any resemblance to reality.

On this basis, Leavitt suggested that Nevada policymakers' wisest course would be to avoid any major tax increases. Lawmakers instead, he said, could simply make minor adjustments to the existing

revenue system. In the highly political context of the Governor's Task Force on Tax Policy, where every member was a political appointee, Leavitt's candor triggered an uproar<sup>31</sup>—one that distracted public attention from his key point about the folly of relying on long-term forecasting models. That distractive uproar may not have been a coincidence: Widespread recognition of the predictive vacuity of such modeling could cripple the entire campaign for higher Nevada taxes<sup>32</sup>.

### **The 'business' cycle**

On Wall Street the cliché is that once a stock market boom has gathered great momentum, it is the job of the Federal Reserve to “come in and take the punch-bowl away.”

Implicit in this metaphor is the well-established idea that it is the role of the “Fed” to decide just when and to what extent “intoxicants” should be injected into the financial markets, and delirium should properly penetrate the economy at large. What corresponds to alcohol in this account, of course, is the money and artifi-

Leavitt's candor triggered an uproar – one that distracted public attention from his key point about the folly of relying on long-term forecasting models.

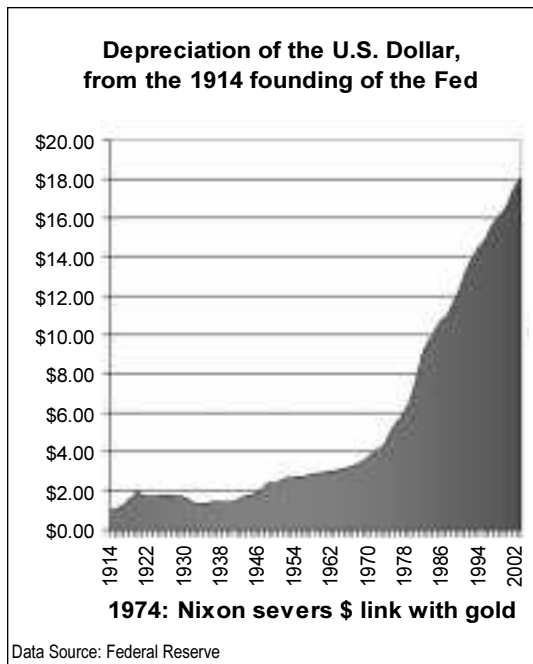
<sup>30</sup> From the minutes of the December 12, 2001 meeting of the Governor's Task Force: “Mr. Leavitt has approximately 30 years experience in working with the City of Las Vegas in various capacities, mostly in the technical and financial aspect. Chairman Hobbs opined that Mr. Leavitt has probably been the single most influential and knowledgeable resource to the State Legislature over the past couple of decades on local government and state tax matters.”

<sup>31</sup> Task force member Brian Greenspun—after recovering from the apparent shock occasioned by Leavitt's remarks—focused on the economist's use of the term “tweaking” to describe adjustments to state budget categories. “I don't think that ‘tweaking’ is going to solve two or three or four billion dollars,” said Greenspun, an eager proponent of a new income tax system. Panel ally Mike Sloan quickly agreed. Later news coverage by both major Las Vegas newspapers also focused upon the *tweaking* word and the reaction to it. All of this, however, ignored Leavitt's main point: that the only support for allegations that Nevada faces cumulative shortfalls over the next 10 years of “two or three or four billion dollars” are the extremely dubious model-based forecasts themselves.

<sup>32</sup> Given the predictive futility of model-based long-term forecasting, a natural question arises: Why does the field retain its powerful constituency among both economists and politicians? There are many reasons, but these are perhaps the following are some of the most prominent.

First, building mathematical and computer-based models is—like any puzzle-solving activity—immensely entertaining. And given the immense magnitude of the goal—successful prediction of the future—the fact that the Holy Grail is somehow never reached tends to always assume merely minor significance. Second, politicians love the idea of modeling, and often assure it of funding for a whole host of reasons. The politician's constant worry is that voters may not approve of the public decisions that he may take. Economic forecasting models, however, can provide effective public relations support for those decisions. Relying on public credulity regarding econometrics, elect-

The common element in these market busts – as it is in the immediately preceding booms – is the activity of the national central bank.



cial credit that the Federal Reserve feeds into the economy through its powerful tools: the discount rate, open-market operations, and changes in reserve requirements.

The price of credit is naturally a key factor in every businessperson’s investment decisions, whether he or she is a small shopkeeper or the CFO of a huge multinational corporation. When there is no intervention by the Fed, interest rates are determined in the marketplace by the supply of credit and the willingness of credit-providers to take risks. When the central bank, however, feeds artificial credit into

the economy by lowering interest rates, it spurs investments in less-competitive projects that would otherwise have been unable to get funding. Projects that otherwise would not have “made the cut” because of any one of a number of reasons—a questionable idea, adverse market conditions, promoters with less-than-sterling credit histories—receive funding when credit is artificially cheap. And while not every one of these projects is guaranteed to fail as soon as the flow of artificial credit into the economy is turned off, most of them, by and large, will.

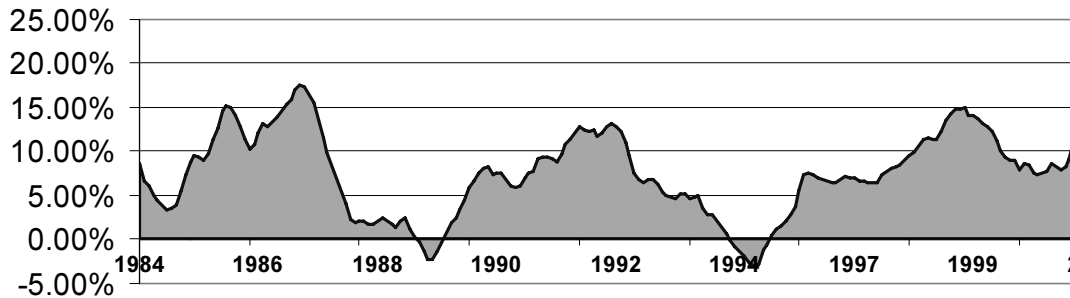
This, in essence, is the source of the so-called “business” cycle. Normally, in a natural economic setting, while some businesses are failing, others are succeeding. Laborers and executives are shifting from one firm and sector to another. In a dynamic market economy, resources—people, money, land—are always finding their way to their most productive uses. What is abnormal is for business failures and layoffs to occur in huge bunches or waves across the economy—as if hundreds of thousands of normally quite astute entrepreneurs had suddenly, all at the same time, just happened to make conspicuously bad investment judgments. The common element in these market busts—as it is in the immediately preceding booms—is the activity of the national central bank. As has been the pattern throughout the world his-

ed officials can point to a favored forecasting model and “explain” how “economic science” allows them to illuminate various possible courses of action. The official then gets the benefit of appearing to be someone who calls on the very latest in “science” to help him do his job for the voters.

Politicians and others with an agenda also like forecasting models because the final output is entirely a function of the information initially entered. Given the right data set and the right formulas, models can be structured by their builders to predict whatever “future” is desired. Efforts to accomplish less-than-popular policy goals can thus be concealed and presented merely as a looming future against which steps must be taken.

For these and other reasons, public officials regularly route taxpayers’ funds to their favorite econometric firms. Indeed, at federal and state levels both, budget rules and lawmaking procedures frequently mandate fiscal forecasts. But the fact remains, there is no magic key to the future. And Nevada’s economic future is not exempt from this rule. What is the best assurance of a better and more prosperous Silver State economy? It remains what it has always been—low taxes and an entrepreneur-friendly regulatory climate.

## MZM Money Supply Rate of Change, Year-over-year, 1984-2002



Data Source: Federal Reserve

tory of financial manias, initially the money-supply spigot is turned on, and then—as it always eventually must be, to prevent runaway inflation—the spigot is turned off. And with the sudden withdrawal of the easy money, exposed companies go belly-up.

### Why Nevada tax revenues fluctuate

This boom-bust cycle is the source of most of the variability that Nevada experiences in year-to-year revenues. The latter, thus, stems primarily from something far beyond the control of anyone in Nevada—or any of the states. Behind the boom in state revenues across the country in the mid-nineties—and also behind the bust in state revenues across the country in the last

three years—have been extreme actions of the Federal Reserve, alternately intensely stimulating, then braking, the national economy with double-digit expansions and contractions of the monetary base<sup>33</sup>.

These actions of America's central bank have been plain for everyone to see—if they knew how and where to look. And though the State of Nevada cannot control the Fed, it can at least pay attention. An appropriate awareness of where the U.S. economy was situated on the Federal Reserve's recurring pendulum swing would have been of immeasurable utility for Nevada during the '90s. It could have assisted lawmakers and the Miller and Guinn administrations to keep their heads during the boom and prepare for the oncoming bust<sup>34</sup>.

**Though the State of Nevada cannot control the Fed, it can at least pay attention.**

<sup>33</sup> Indeed, for those mindful of Twentieth Century economic history, the boom-bust silhouette of the last decade is of great concern. It forces the question: Is America's central bank—beneath its placid exterior—severely out of control? Those who have paid attention to the etiology of the Great Depression (the Federal Reserve's first huge blunder, right out of the starting gate) and the prolonged stagflation carnage of the 1970s, can see similar Fed fingerprints on this current recession. They also note evidence in the credit markets that America may be facing something even worse than a mere cyclical recession—a major, once-in-a-generation Fed-created systemic calamity.

<sup>34</sup> Solving Nevada's revenue forecasting problems will remain highly unlikely so long as the Nevada state government, like most states, relies upon economists whose framework for macroeconomic understanding is the standard labor-based theory of aggregate relationships, whether Keynesian or Neoclassical. The one school that has been able to explain both the stagflation of

Today and in the future, as the American central bank gives every sign of continuing down the same path, informed awareness of the macroeconomic conditions it must generate will remain valuable for every elected official in the state<sup>35</sup>.

**Bottom line: One source of Nevada's current financial embarrassment was the inability of state forecasters to provide state leaders with informed readings of the Silver State's full macroeconomic situation.**

the '70s, plus the boom-bust phenomena of 1991-2002, is capital-based macroeconomics, often called Austrian. This school, in the lineage of Böhm-Bawerk, Mises and Rothbard, focuses on the patterns of demand and relative prices in the structure of production, while standard macroeconomic theory lacks a theory of a capital structure. See especially, *Time and Money: The Macroeconomics of Capital Structure*, by Roger W. Garrison, Routledge, London and New York.

<sup>35</sup> Economists with a background in capital-based macroeconomics spotted the oncoming recession immediately. See, for example, the March 13, 2000 article, "Are We Entering A Recession?" by Dr. Clifford F. Thies, professor of economics and finance at Shenandoah University. See also the April 14, 2000 article by Llewellyn H. Rockwell, Jr., president of the Ludwig von Mises Institute, "Can the Stock Slide Be Stopped?" and the June 6, 2000 article by Dr. Frank Shostak, "Can the Fed Control the Stock Market?" All are accessible on the [www.mises.org](http://www.mises.org) web site.



## PART II

# SOLUTIONS TO NEVADA'S OVERSPENDING PROBLEM

### A. Facing Up to the Facts

**F**or all of its insistence that Nevadans' taxes should be raised, the Guinn administration has had remarkably little to say about steps that would address the actual underlying sources of the state's current financial embarrassment. The presumption seems to be that heavy new taxes, in themselves, are all that the Silver State needs. If Nevadans can be broken to bit and saddle, seems to go the theory, "the

problem<sup>1</sup> will have been "solved." But this is not true.

As Part I of this study described in detail, the real source of Nevada's chronic "budget shortfall" pattern is the control over state government achieved in the last generation by a coalition of tax-consuming special interest groups. Because these groups routinely seek to obtain wealth by getting politicians to give them other peo-

**The presumption seems to be that heavy new taxes, in themselves, are all that the Silver State needs.**

<sup>1</sup> Section 3 of the report of the Governor's Task Force on Tax Policy is explicitly titled, "Defining the Problem," and acknowledges that ACR-1, the Assembly concurrent resolution establishing the task force, "provides no evidence supporting [its] key assumptions" that "additional revenue is required to fund state programs ... and a structural deficit exists." The task force report then says "[t]he objective of this section is to substantiate [those] 'fundamental suppositions....'" But after a short discussion of definitions of the term "structural deficit" that contradict the definition used in ACR-1, the task force report essentially gives up and announces that it will simply rely "on the plain language provided in ACR-1"—despite the lack of "evidence supporting [its] key assumptions." For a more detailed discussion of the "structural deficit" question, see "'Structural Deficit'—The Political Abuse of Language," on NPRI's web site, [www.npri.org](http://www.npri.org).

A huge new tax hike on Nevadans will not satiate the insatiable – let alone even acknowledge the state’s actual structural problem.

ple’s money<sup>2</sup>, a large-scale success of the dimensions being offered them by the current administration is the last thing in the world that would lead them to fold up their tents and steal away.

As economists teach their students, human needs and desires are essentially infinite. Thus as long as the current regimen prevails—as long as there is the prospect of new state spending programs becoming law and dispensing goodies—we will continue to see what we’ve seen over the last 22 years: Ever-larger coalitions of tax-consumers on the Legislature’s doorstep, proclaiming a litany of unmet needs and muscling lawmakers to give them someone else’s earnings.

Given these realities, it is evident that a huge new tax hike on Nevadans will not satiate the insatiable—let alone even acknowledge the state’s *actual* structural problem. Instead, levies of the dimension sought by the administration will only deeply and permanently injure Nevadans in their material circumstances and for generations to come.

### **Smaller is better**

The apostles of ever-expanding government love to pretend that no human needs can ever be met in the state of Nevada except through some government scheme using money confiscated from taxpayers. “If people in Nevada take the view they don’t want more money spent on education, or mental health or basic services, then we don’t have a fiscal crisis<sup>3</sup>,” cries Mike Sloan, the longtime Democratic activist, Nevada Resort Association point

man and political appointee to the Governor’s Task Force on Tax Policy.

The fact is, however, that when it comes to our most important needs, every one of us knows that socialistic state programs are not the way to go. Food, for example, is quite important, even more important than education, and there are some people who can’t get enough of it with their own resources. But does that mean we need government-run farms? Government-run food distribution systems? Government-run grocery stores? Of course not.

What we do instead is simply get out of the way and allow the great power of the entrepreneurial marketplace to maximize everyone’s choices and minimize everyone’s costs. We let the market handle the production, distribution and sale of food. For people who might otherwise starve, we provide vouchers. Not only do the poor not go hungry—nor suffer the indignity of being forced into government food-store ghettos—but the poor, and all the rest of us, get the benefits of ever-increasing quality, variety and economy from the private sector.

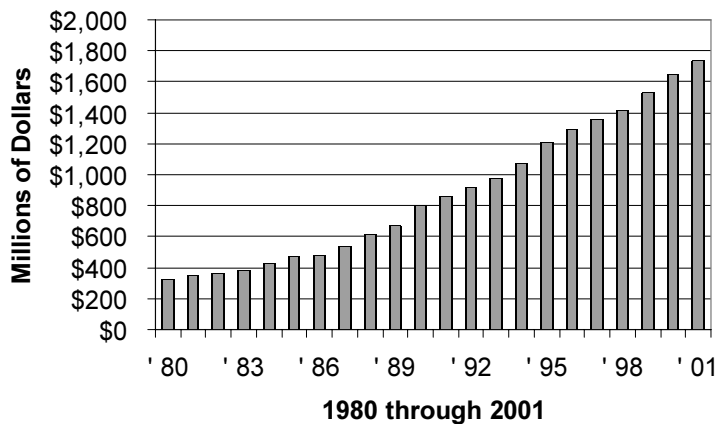
But what if Nevada already had a system of government food stores, run by government-food bureaucrats? Then the idea of allowing a bigger role for the private sector in the distribution and provision of food would, no doubt, seem radical and frightening—especially to the government-food bureaucrats’ union bosses and their political allies.

The point, of course, is that cutting government programs does not mean

<sup>2</sup> The classical liberal German sociologist Franz Oppenheimer postulated in 1908 that “There are two fundamentally opposed means whereby man, requiring sustenance ... obtain[s] the necessary means for satisfying his desires. These are work and robbery, one’s own labor and the forcible appropriation of the labor of others.” Oppenheimer goes on to “call one’s own labor and the equivalent exchange of one’s own labor for the labor of others ‘the economic means’ for the satisfaction of needs, while the unrequited appropriation of the labor of others will be called the ‘political means’ . . . The state is an organization of the political means.” *The State*, first American publication by Vanguard Press, New York, 1914.

<sup>3</sup> *Las Vegas Review-Journal*, November 21, 2002.

## Nevada General Fund Revenues by Fiscal Year



tor of higher spending, some studies have found, is a prior tax increase. That certainly has been Nevada’s experience over the last 22 years.

More importantly, the welfare of every Silver State family requires that we not raise taxes. The combined burden of taxes and fees on Nevadans already requires them to bear one of the nation’s highest tax loads<sup>5</sup>, and adding a heavy new business tax

ignoring human needs. What it means is that in many, many areas our human needs can better be served by the private sector<sup>4</sup>—and consequently should.

This is an important fact for all Nevadans to consider, especially now that uncontrolled appetites in state government have produced yet another state fiscal crisis. But we clearly must deal not only with the immediate fiscal emergency, but also the situation that produced it. And we must deal with both in a manner most likely to serve the best interests of all the citizens of the state.

What the above guidelines at once reveal is that higher taxes are not a genuine solution. As we have seen for years, they merely subsidize and reward ever-higher spending. Indeed, the most reliable predic-

will destroy one of the state’s few remaining real economic assets—its reputation as “business friendly.” Such a tax would be a direct request for the sluggish growth and high unemployment that characterizes high-tax economies. The history of the last decade shows that states that raised their taxes to diminish budget shortfalls have had the worst rates of economic and income growth in the years that followed. On the other hand, states that cut their taxes led the nation in growth and prosperity.

### The Alesina paper

Indeed, a team led by Harvard University’s Alberto Alesina<sup>6</sup> recently produced a major groundbreaking study that is highly relevant to Nevada’s current situation. Entitled “Fiscal Policy, Profits and

**Higher taxes are not a genuine solution, as they merely reward ever-higher spending**

<sup>4</sup> One major reason for this is simply that the private sector is disciplined by market forces while the public sector is subject to no such discipline. Thus, on average, private spending is more productive than public sector spending. It also follows that higher government spending means lower productivity per worker and that an obvious way to more efficiently serve the voters and taxpayers of Nevada is through greater privatization of government functions.

<sup>5</sup> In the last decade—FY 1990-2000—Nevada ranked second in the nation in tax growth, according to the Tax Foundation in Washington, D.C. Average annual growth in Nevada taxes was 6.65 percent, outranking all states but New Hampshire, where taxes grew 8.74 percent. As of 2002, Nevadans’ total tax burden was 14<sup>th</sup> highest in the country—the lowest it has been in a decade, according to the Tax Foundation. In 1994 and 1995, the Nevada tax burden was 7<sup>th</sup> in the nation.

<sup>6</sup> In addition to Harvard’s Alesina, the authors included Columbia University’s Roberto Perotti, and Silvia Ardagna and Fabio Schiantarelli, both of Boston College.

**What the Alesina study finds is that big cuts in government spending are expansionary, making economies boom.**

Investment” and featured in the September 2002 *American Economic Review*, it focused on 18 of the world’s largest economies—those of the United States and 17 other OECD countries<sup>7</sup>.

In earlier decades leading American economists thought that cutting government spending was contractionary, something that would shrink the private economy. What the Alesina study finds, however, is that big cuts in government spending are expansionary, making economies boom.

For example, Ireland slashed government spending by more than 7 percent of GDP in 1986-89, and economic growth from 1989 to 2001 averaged 7.2 percent per year. On the other hand, Japan after 1991 spent hundreds of billions on Keynesian public works schemes, and economic growth averaged only 1.1 percent.

A big part of the explanation is taxes. Ireland now has the lowest taxes on business of any country in the European Union—a mere 15 percent on corporate profits, a 20 percent tax on inflation-indexed capital gains, plus lower tax rates impacting labor. Japan, on the other hand, imposed new taxes on sales, property and capital gains, while maintaining Asia’s most punitive income-tax rates. Clearly, for Nevada to follow the “Japan model”—as recommended by the governor’s task force—would be to sentence Nevada to years of stagnation and economic failure.

Another major finding of the Alesina team is that taxes affecting working people “have the largest negative impact on profits and investment.” A big reason is that private workers “react to tax hikes or more generous transfer payments by decreasing the labor supply or asking for higher pretax real wages.” This, too, is highly relevant to the Guinn administration’s pursuit of hefty new tax burdens on Nevada business. The

reason is this: Even when working people don’t understand why business taxes eventually negatively impact their pay, they will nevertheless experience it. Thus—as the Alesina study has shown happening repeatedly in the world’s top economies—Nevada workers will then leave the state and/or strike for higher real wages, damaging profits and investment.

The third major finding of the Alesina research project is that big government spending is inherently bad for economic growth, even aside from taxes. Government hiring and pay raises lure workers from private businesses, which are forced to raise wages even if that means reduced hiring. This issue is distinctly relevant for Nevada.

In Clark and Washoe counties especially, government employee salaries and benefits far exceed that paid for comparable work in the private sector. And though lesser in degree, the same situation exists in state employment. This overly generous government employee compensation contributes to Nevada’s chronic difficulty in economic diversification, because the high labor cost per qualified employee depresses profits and investment.

Summing up its examination of 18 major world economies, the Alesina study concludes: “[F]iscal stabilizations that have led to an increase in growth consist mainly of spending cuts, particularly in government wages and transfers, while those associated with a downturn in the economy are characterized by tax increases.”

The Alesina paper is only the latest in a long line of empirical studies reaching similar conclusions: Non-tax factors held constant, the higher the level of taxation, the lower the rate of economic growth. An extensive review of the literature—some 40 different studies over the last 25 years—is found in Appendix B of this study.

<sup>7</sup> The Organization for Economic Cooperation and Development has 30 member countries (See [www.oecd.org](http://www.oecd.org) for a full listing). The other 17 national economies studied by Alesina *et al*, were: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, Spain, Sweden and the United Kingdom.

## B. Dealing with the Immediate Fiscal Emergency

If low taxes are critical to the future of Nevada families, what are our alternatives, given the current situation? At least four ways of closing budget deficits exist, all of which are infinitely superior to raising taxes and should be given close scrutiny by the Nevada Legislature.

The first, of course, is cutting spending. Whenever governments spend money, they take command over resources that otherwise would be used by the private sector. And private spending is on average more productive than public sector spending—simply because the private sector is disciplined by market forces while the public sector is not.

The difficulty with spending reduction, of course, is that it tends to be politically difficult because of strong vested tax-consuming coalitions. Yet most Nevada voters—especially if they are aware of the level of state agency performance documented by LCB auditors<sup>8</sup>—would no doubt support the downsizing, in non-critical areas, of state and local governments.

A second way in which government can close budget gaps is through asset sales. Apostles of big government cringe at this idea since it usually entails smaller government down the road. They may also assert that asset sales are irresponsible, being merely a one-time revenue source. But this thinking is fundamentally flawed. Asset sales are desirable not only as a means of avoiding tax increases now but also as a way to achieve long-term efficiencies in government operations. Moreover, the decline in revenue associated with recession is almost surely temporary. Rather than introduce a permanent new tax burden, lawmakers should seek cash infusion from asset sales to provide a respite until revenues start rising again at normal rates. State-owned car fleets, prisons, state

buildings, highway maintenance operations, campus dorms and school buildings—the list is endless. To be sure, care should be taken to not create private monopolies as unwieldy or exploitive as the existing public government monopolies, but this can be done.

There are two other less desirable means of financing, but which are still preferable to tax increases.

The first is borrowing. Nevada first should deplete its rainy day fund, but it may be defensible to borrow against future revenues to a modest extent (say, five percent of one year's general revenue fund receipts). If undertaken, iron-clad agreement will be needed to redeem the bonds in a short period of time from revenues derived after economic expansion resumes.

Finally, as a last resort, higher user charges can be used where the beneficiaries of governmental services can be clearly defined; university tuition fees are a good example. Statistical evidence shows little or no adverse relationship between the use of user charges and the rate of economic growth.

### Where is the money?

Some Nevada state government programs we support with our taxes are clearly beneficial and undoubtedly provide services that only government can provide.

But also in the state budget for years have been some quite large and costly programs providing services that often would be better provided by the private sector. Moreover, these government-provided services are very often not only inferior to those provided by the private sector, but sometimes are even essentially destructive to the basic—and very important—public mission that the programs themselves were intended to serve. Finally, because these

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<sup>8</sup> Again, see Appendix A.

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programs are granted a government-enforced monopoly on the use of tax monies, they usually crowd out the beneficial private sector activity that would otherwise occur.

Given Nevada state government's need for spending reductions in this time of fiscal emergency, you might assume that state legislators would be rushing to put these programs under the knife—or at the very least to introduce into them some new and more taxpayer-friendly reforms.

Not true.

Unfortunately, the programs under discussion are at the core of the problems described at length in Part I of this paper. In other words, this huge area of state spending is Ground Zero in the war by Nevada's tax-consuming special interests to maintain their stranglehold on Nevada taxpayers' funds.

If you haven't guessed yet, the reference here is to the approximately \$800 million<sup>9</sup> that the Nevada Legislature appropriates each year to support the government's K-12 education system in the state.

In this sphere any significant reform has long been rendered impossible by the state's most powerful public employee union, the Nevada State Education Association. Bosses of the NSEA have been adamant for years that Nevada parents are never to be allowed effective choice in the schools their children are to attend. Parents, say the teacher union chiefs, must never be allowed any say in the spending of any part of the per-pupil tax-funds that go to support the education of each child.

The reason the NSEA brass have been so obstinate on this point for so long is quite clear: Let parents choose schools on the basis of what's best for their kids, and they actually may choose private, religious

or charter schools where the union has no contract!

According to research done by Harvard economist Caroline M. Hoxby, the suspicions of the union brass most probably are correct: If parents should choose on the basis of what's best for their kids, they most likely won't choose a contemporary union-dominated school. A highly detailed 1996 study by Hoxby inquired into the effect of teacher unionization on several key education variables, and concluded that:

...teachers' unions are primarily rent seeking [organizations], raising school budgets and school inputs but lowering student achievement by decreasing the productivity of inputs.... [T]eachers' unions may be a primary means whereby a lack of competition among public schools translates into more generous school inputs and worse student performance....<sup>10</sup>

Any such union policy that would willingly consign large numbers of students to inferior educations merely to serve the self-interest of union leaders would imply a significant degree of moral vacuity in the union leadership. But because Nevada schoolteachers themselves, by and large, would never consciously entertain such a scheme, and because the Silver State today does confront a major financial crisis, the environment may at last be right for voters and taxpayers to achieve some key educational reforms.

There is a final reason:

*Just two very modest pro-educational-choice reforms by the Nevada Legislature could save the state hundreds of millions of dollars—while completely obviating any*

<sup>9</sup> Total expenditures to school districts for the 2001-02 fiscal year were budgeted, according to the LCB Fiscal Analysis Division, at \$734.9 million. For the 2002-03 fiscal year, the sum had risen to \$794.1 million.

<sup>10</sup> "How Teachers' Unions Affect Education Production," by Caroline Minter Hoxby, *The Quarterly Journal of Economics*, August 1996.

*genuine need for heavy new tax hikes!*

Yes, it is that simple: With just one stroke Nevada lawmakers could make truly major improvements in Silver State K-12 education and yet at the same time save hundreds of millions of dollars annually.

## **Parental choice saves money**

For years, solid research around America has shown, again and again, that huge bureaucratic school districts like those sprawling across Clark and Washoe counties don't educate as well as small school districts. The main reason? The latter get the benefit of competition.

"[M]etropolitan areas with maximum interdistrict choice elicit consistently higher test scores than do areas with zero interdistrict choice," wrote Harvard researcher Hoxby in another important study. "The 8th grade reading scores of students in highly competitive areas are 3.8 national percentile points higher than those of students in areas with no competition; their 10th grade math scores are 3.1 national percentile points higher; and their 12th grade reading scores are 5.8 national percentile points higher.

"Moreover," noted Hoxby, "highly competitive districts spend 7.6 percent less than do districts with no competition. In other words, interdistrict competition appears to raise performance while lowering costs."

Using Hoxby's proportions as a rule of thumb, we can estimate the average annual savings that would flow from deconsolidating Nevada's two metastasized school districts.

The Clark County School District's

yearly operating budget now runs around \$1.3 billion, so 7.6 percent of that sum would come to around \$87.1 million annually. The Washoe County district reported its budget for the 2001-2002 school year at \$270.2 million, so the same proportion there would be \$20.5 million. Thus, between those two districts alone, savings to Silver State taxpayers would be around \$107.6 million annually.

But deconsolidation of Nevada's too-large school districts is not the only way to save hundreds of millions of dollars<sup>11</sup> and at the same time, greatly improve our state's elementary and secondary education.

Another large fiscal reward would quickly flow from a phased-in program allowing Nevada parents to designate where their children's per-pupil fund allotment is spent. It is, after all, deeply unfair that state and local governments in Nevada take taxes from parents—supposedly for the education of their children—but then deny financial equity to parents who seek better education for their young than that available from unresponsive government schools.

The power behind such a proposal is that thousands of Nevada parents care so much about their children's future that—given just a modest allocation back to them of the taxes they pay—they will scrape up the remainder necessary to allow their offspring to attend superior private, charter or faith-related schools.

It is this reality that offers state lawmakers a way out of their current dilemmas. Not only can they introduce an extremely fruitful reform impulse into Nevada education<sup>12</sup>, but also—at the same time—they can protect their constituents

**Huge bureaucratic school districts like Clark and Washoe don't educate as well as small school districts.**

<sup>11</sup> This paper does not attempt to inventory all money-saving ideas available and appropriate for Nevada. But as Appendix A documents at length, scrutiny of Nevada state government reveals an almost-unending supply of possibilities.

<sup>12</sup> The research literature today is replete with studies documenting the significant improvement in government schools that occurs when they have to compete for the voluntary consent of parents who can realistically now opt to send their children elsewhere.

**A program of designated tax credits is the only way that rampant parental unhappiness with Nevada public schools will ever come to an end.**

from the economic devastation of heavier taxes. A phased-in program in Clark County of these tax-credit scholarships—initially set, say, around \$2,000 and moving up, over a period of years, to around \$5,000—would immediately begin removing hundreds of millions of dollars of costs from school district budgets.

Utilizing exceedingly conservative assumptions—starting from Clark County’s current base of 11,882 non-government school students and per-pupil costs of \$5,576, but figuring in debt service for new construction—the very first year<sup>13</sup> would yield over \$235 million in savings, increasing in 10 years to \$609.4 million annually.

Such a program of designated tax credits—call them supplemental K-12 scholarships—is actually the only way that rampant parental unhappiness with Nevada public schools will *ever* come to an end. This unhappiness is intrinsic to the essential nature of government schools because different parents will always want different things from the schools, while the schools can only deliver, at best, a clumsy compromise that satisfies no one.

David C. Rose, economics professor at the University of Missouri-St. Louis, has written extensively on this issue:

Some [parents] want high-octane academics, some want an emphasis on the arts, some subscribe to educating the “whole child,” some are strong believers in using athletics to develop character, some want religion, some don’t. And so on.... *The fundamental problem with public education is, and has always been, that we all want different things*<sup>14</sup>. (Emphasis added.)

Professor Rose notes that while food, like education, is very important, we don’t

presume that means we should try to impose socialized, centralized government food production, funded by “food-tax” dollars confiscated by the state. Yet in the realm of education, that’s exactly the kind of Soviet-style “solution” Nevada has backed into, like other states all across the country. Rose makes another highly cogent point: that historically the public schools which worked well for kids and families years ago were actually not public schools in the contemporary sense but were essentially private community schools:

The truth is that we never chose public schools; the public school system actually evolved from community schools that were, for all intent and purposes, private....

[Today’s] public school system in general and its teachers in particular never had a fair chance to succeed. When schools were more locally controlled, populations were more segregated and, hence, homogeneous, and traditional pedagogy was the only widely recognized education philosophy; the public school model, though flawed fundamentally, did reasonably well. But in the face of extreme (and growing) heterogeneity of parental preferences regarding education, satisfying everyone is impossible and is becoming more so over time.

This is why it makes so much more sense for Nevada to allow competing schools to arise and allow parents to choose among them. Compelling everyone to attend the same school or kind of school is done really only because government bureaucracies collapse in confusion if required to handle anything more demanding than a single heavily rule-bound pat-

<sup>13</sup> The lag entailed by Nevada’s biennial legislature would most likely postpone the first year of these savings to Fiscal Year 2004 at the earliest.

<sup>14</sup> *The School Choice Advocate*, September 2002, [www.friedmanfoundation.org/resources/publications/advocate/davidrosearticle092002.pdf](http://www.friedmanfoundation.org/resources/publications/advocate/davidrosearticle092002.pdf).



tern. Markets, on the other hand, are wonderful at catering to genuine diversity. The reason? In private markets, many individual firms can experiment with many different dimensions of innovation until they find novel new solutions that attract and please a large and profitable customer base.

Today, Nevada's students are being forced into monolithic, one-size-fits-all school districts, built on the model of Soviet factories. The result of this, naturally enough, is Soviet-style waste—not only of taxpayer funds but, tragically, of young people's lives.

The late Albert Shanker, president of the American Federation of Teachers, made this point some years ago in *The Wall Street Journal*:

It's time to admit that public education operates like a planned economy, a

bureaucratic system in which everybody's role is spelled out in advance and there are very few incentives for innovation and productivity. It's no surprise that our school system doesn't improve: It more resembles the communist economy than our own market economy<sup>15</sup>.

To paraphrase Shanker, for Nevada's school system to improve it needs to stop resembling a communist economy and begin to reflect the genius of American markets.

**Bottom line:** The obvious solution to Nevada's educational and financial problems is *choice*. Private and public schools both must be allowed to specialize. And parents must be allowed to choose among them.

**For Nevada's school system to improve it needs to stop resembling a communist economy and begin to reflect the genius of American markets.**

## C. Longer-Term Fiscal Reforms

### **Separation of powers reform**

Government of the people, here in Nevada, would benefit if the original strict Jeffersonian interpretation of Article III, Section 1 were reestablished in the state constitution through an explicit amendment. That is, the executive branch or department of Nevada state government would be acknowledged to include any implementing function or agency of state or local government. While elected to the Nevada Legislature, members would be cleanly barred from receiving compensation and/or employment in any capacity in state or local government.

### **Expenditure reform**

Nevada's current fiscal crisis could no doubt have been avoided if the state constitution had in place a means of restraining expenditures.

The citizens of Colorado have established, through the initiative process, such a means. Known as TABOR—an acronym for "Taxpayer Bill of Rights"—this constitutional amendment has become a national model for how to limit government growth.

The TABOR amendment clearly illustrates the difference in opinion between lawmakers and citizens over what constitutes a citizen-friendly tax and expenditure environment. Basically the measure—during the years it was sought through the initiative process—stipulated that voter approval would be required for any state or local expenditures of revenue above and beyond inflation and population growth. If higher Nevada taxes had to be approved by voters via ballot measures, the reputation of the Silver State as an entrepreneur-friendly and job-creating business haven would be secure.

Although the initiative's proponents

<sup>15</sup> *The Wall Street Journal*, October 2, 1989.

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and fat.**

failed to win at the polls in 1986, 1988 and 1990, their margin of defeat became smaller each time. When the measure again qualified for the November ballot in 1992, and the likelihood was clear that the measure might pass, public officials from the governor down to county sheriffs wildly predicted that fiscal and economic calamity would descend up the state if the amendment passed. Nevertheless Colorado voters approved it. To date not a single one of the gloom-and-doom scenarios has come true.

### **Higher ed reform**

Nevada's state universities have had huge increases in non-teaching staffs over the last decade, and are ripe for pruning. Rather than efficient and lean, our universities have become wasteful and fat. But there is also a need for academic reform.

Nevada's higher education system has long been an intense fiscal frustration for governors and legislators. At the same time, the fact that the University and Community College System of Nevada is controlled and funded politically, and subject to the vagaries of legislative budget compromises, has long retarded higher education in the state.

These frustrations reflect real shortcomings in the state's method of subsidizing and overseeing these institutions. Such failures cannot be corrected by attempts to further centralize managerial control. Instead, each school needs to operate on a regimen of increasingly greater exposure to the same market disciplines as private institutions.

To accomplish this the current system of operating subsidies and regulatory oversight should be progressively replaced with long-term contractual relationships. Under these contracts, each school would receive from the state a block grant equal to a fixed fee for each resident student it enrolls. That fee would increase each year only to the extent of an inflation index. In exchange, each school would agree to:

- ◆ Enroll a specified number of Nevada resident students,
- ◆ Cap resident student tuition at an amount substantially below market levels, and
- ◆ Admit residents on a need-blind basis, while providing financial aid that varies by need in order to increase overall access to postsecondary education for Nevadans.

Within such constraints, each school would be responsible for managing its own resources over the contractual period.

These reforms would :

- ◆ Impose strict accountability on the management of each school for fulfilling its educational contract within the agreed upon subsidy limits over the contract's term.
- ◆ Limit the state's subsidy obligation over the contract period by allowing the total amount of subsidy for each school to vary only with inflation.
- ◆ Eliminate the considerable costs incurred by the schools, the legislature, and the administration that are associated with the biennial budget process and subsequent regulatory oversight.
- ◆ Encourage long-range strategic planning, including restructuring decisions that permit schools to concentrate resources in their areas of market strength and take advantage of efficiencies that may be available from new technologies.
- ◆ Encourage schools to seek private sources of support and encourage donors by ensuring that their gifts will not simply replace state subsidies.
- ◆ Increase access to higher education by varying the amount of financial aid to academically qualified Nevada residents based upon need.

- ◆ Provide flexibility of implementation, allowing the state's strongest schools to contract first. Additional schools would be included only as they are willing and able to undertake the greater responsibilities imposed.

Such an approach incorporates principles of decentralized, market-oriented decision-making, informed by public choice theory, modern principles of decentralized management, and the deregulation experience in various industries nationwide.

By applying these powerful principles of market choice and accountability to its system of higher education, Nevada can finally open the door to educational excellence, while setting a standard of creative deregulation for the entire nation.

### **Reform Nevada Medicaid**

Medicaid is the state-administered program for medical assistance established in 1965 with passage of Title XIX of the Social Security Act. The Medicaid program purchases or provides medical services for persons who meet certain eligibility criteria. It is the Nevada general fund's biggest expenditure after education.

The 2001 Legislature approved approximately \$513 million in general fund sup-

port for the Medicaid program over the 2001-2003 biennium. That was an increase of approximately \$181.8 million, or 54.9 percent, when compared to the 1999-2001 biennium.

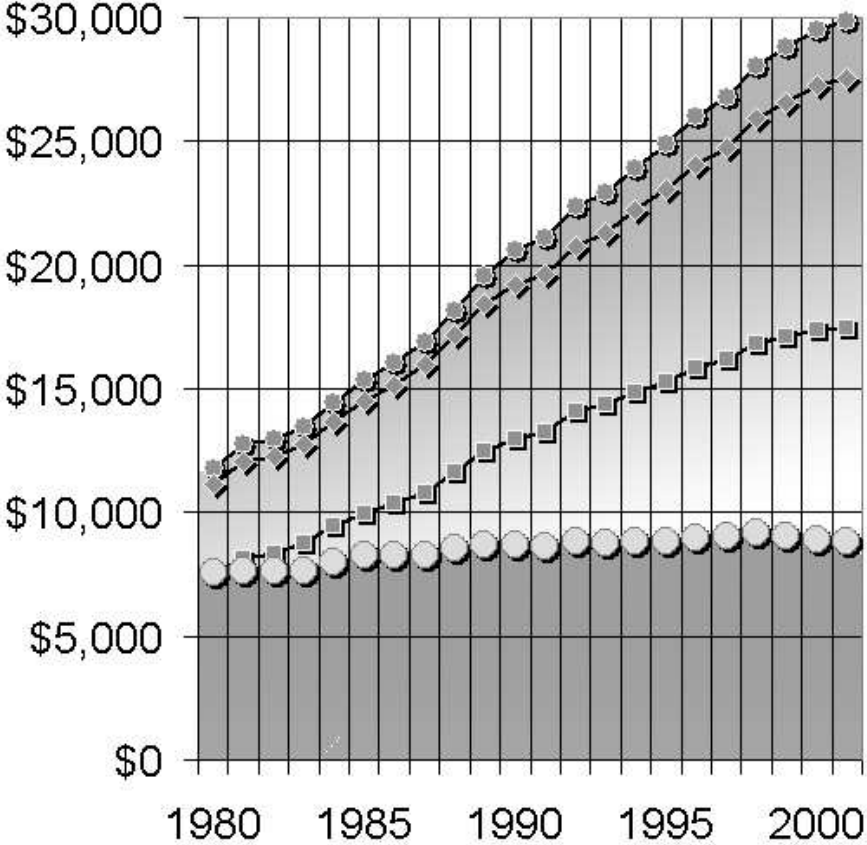
While federal law prescribes minimum eligibility categories and service requirements, states can apply and receive Medicaid waivers to modify existing requirements and to seek innovative solutions. While Nevada has sought and received several waivers that made new groups eligible for coverage, the state has sought no waivers that would allow the state to limit or condition coverage.

Medicaid caseloads are projected to increase by 22.5 percent in FY 2001-02 over the FY 1999-2000 actual and by 6.1 percent in FY 2002-03 over the FY 2001-02 projection. The number of individuals eligible for the Medicaid program is projected to increase to *over 133,000 recipients per month* in FY 2003.

Because Medicaid is notoriously inefficient, Medicaid beneficiaries should face some financial responsibility and / or degree of cost-sharing when they use those services—a small fee, at the minimum. Too many people go to emergency rooms with common colds and other relatively minor non-life-threatening ailments.

**By applying these powerful principles of market choice and accountability to its system of higher education, Nevada can finally open the door to educational excellence.**

### Average Nevadan's *Real* Income, 1980-2001



- Nominal personal income
- ◆ After FICA taken out
- After all taxes
- Real income, in 1980 \$ after adjustment for inflation

# APPENDIX A

## The Actual Level of Performance in Nevada State Government

### LCB Performance Audits of State Agencies

**T**he Legislative Counsel Bureau (LCB) is the Nevada Legislature's research agency. It was created in 1945 to free legislators from dependence on either the executive branch of state government, or lobbyists, for the information and the data needed by lawmakers in their work. Bureau personnel draft bills, do policy research and provide legislators with legal and fiscal expertise. In addition to its research, legal and fiscal divisions, the LCB has an audit division—the source of the audits excerpted below.

#### **Mission of the Legislative Auditor**

The job of the LCB audit division is to provide members of the Legislature with factual information concerning the operations of state agencies, programs, activities, and functions. The division also works with state agencies to identify opportunities to improve accountability, reduce waste, and enhance program effectiveness. Finally, the audit division suggests to the Legislature new legislation or the amendment of existing laws to improve the functioning of state agencies.

Improving any organization requires an objective assessment of that organization's current performance. Therefore the LCB audit division conducts regular assessments of state agencies. Conducted in accordance with rigorous professional standards, these

audits provide an independent and unbiased evaluation of government operations.

Below and on the following pages are highlights from summaries of performance audits conducted of state agencies by the Legislative Council Bureau division of the Nevada Legislature. The full versions of the audit summaries referenced here can be found on the LCB web site<sup>1</sup>.

A note about how the LCB numbers its audit reports: A rough idea of the time span in which the audit was done is provided by the report number. For example, in "Report LA00-17," the first two integers—the "00"—indicate the biennium, while the last two integers—the "17"—indicate the number of the report in that particular biennium's series.

#### **Excerpted Reports**

##### **Office of the Governor Report LA00-17**

**... Since the 1980s, the Office has maintained a bank account for furnishings and improvements to the Mansion. In addition, the Office established an account in 1996 to fund an event for the state's firefighters. However, these accounts were not approved by the State Board of Finance or reported to the Office of State Controller as required by NRS 356.011....**

**Controls have not been established to**

**The job of the LCB audit division is to provide members of the Legislature with factual information concerning the operations of state agencies.**

<sup>1</sup> On the web, see <http://www.leg.state.nv.us/lcb/audit/summaries/execsumlist.htm> .

As shown in recent legislative audits, the failure to establish sound controls has a significant cost to the State.

safeguard the Office's bank accounts. The elements of an effective control system to safeguard assets include procedures for segregating duties, limiting access to assets, and authorizing and recording transactions. The lack of controls increases the risk of theft, loss, or misuse of this money....

### **Internal Controls in State Government** Report LA02-14

The Legislature has demonstrated its commitment to effective internal controls<sup>2</sup> by passing laws to strengthen controls at state agencies. In addition, the Legislature created the Office of Financial Management, Training and Controls (FMTC) to provide training and technical assistance to agencies regarding their systems of internal control. **Despite these efforts, management's commitment to internal controls in state government is lacking. Agency managers have not always established strong internal control systems and have not always implemented recommendations designed to improve controls. As shown in recent legislative audits, the failure to establish sound controls has a significant cost to the State. On the other hand, when weaknesses identified in audits have been addressed, the State has seen significant improvements and millions of dollars in cost savings.**

**... Some agencies have been aware of internal control weaknesses for years but have not taken action to correct the problems. Several recent legislative audit**

**reports included findings and recommendations that had been included in previous audits of the agencies. For example, although a 1993 audit had recommended the Division of Child and Family Services establish a written system of internal control, the recommendation was not implemented at the time a subsequent audit was conducted in 1999. In addition, a 2000 audit found the Real Estate Division had not adequately strengthened internal controls over cash as recommended in a 1994 audit ? despite the identification of an embezzlement in a previous audit.**

Agencies have not always implemented recommendations made by FMTC to strengthen internal controls. FMTC makes recommendations based on training sessions, and reviews and evaluations of agency policies and procedures. However, **FMTC records indicate that as of June 2000, 37% of agencies receiving training and assistance had not adequately implemented recommendations.** (page 12)

Although statutes require agency heads to periodically review their internal controls, the reviews are not always performed. **As of July 1, 2000, only 67% of state agencies reported conducting a review of their control systems. Although this is an improvement over the 54% reported in 1998, it still means that 47 agencies did not comply with the law.**

A reason weaknesses continue to occur is that many agency employees do not have a sufficient level of knowledge to design and implement internal control systems. **In the past, state financial management positions have not always been filled**

<sup>2</sup> "Internal controls" refers to all of the consciously planned and coordinated methods adopted within an agency to safeguard the public's assets—whether those assets are in the form of cash, supplies, or sensitive accounting or other information. Good internal-control systems are required to ensure that assets are appropriately managed. Basic to such systems all over the world are written inventory management policy and procedures, on which staff are trained, and adequate separation of duties between staff responsible for ordering, receiving, using or dispensing assets and staff responsible for the inventory accounting records (approving payments, charging departments, etc.

**with qualified personnel.** A 1996 audit of the Department of Personnel found that in most cases work experience could be substituted for a college degree, and formal examinations were often waived when there were few qualified applicants. **The audit noted that half of the state's accounting personnel who were in positions requiring a college degree or college credits did not meet the current minimum qualifications for their positions.** (page 14)

**Effective internal controls can save the State millions of dollars.** Agencies implementing audit recommendations to strengthen internal controls have achieved significant savings for the State. For example, **by revising its policy for delinquent account collection, we estimate the Division of Parole and Probation increased its collection of offender supervision fees by \$800,000 in fiscal year 2000.** In addition, based on audit recommendations the Department of Prisons strengthened controls over utilization of outside medical care. **We estimate the improved controls saved the State approximately \$3 million during fiscal years 1999 and 2000.** (page 15)

**... some agencies have fallen short in the development of adequate controls in specific areas.** These weaknesses often occur in areas related to unique aspects of an agency's function. For example, the Nevada Equal Rights Commission had not implemented sufficient controls to manage its investigations. **On average, it took 371 days to investigate a discrimination charge for cases closed in fiscal year 2000....**

#### **Auditor's Comments on Department's Response:**

**... The Department rejected our recommendation that it focus more attention on providing assistance to agencies in high-risk areas that significantly impact operations....**

## **State's Contracting Process Report LA02-11**

**... State agencies did a poor job in planning the contracts we reviewed. Agencies incorrectly identified five of seven contractors as sole source providers. In addition, agencies did not typically obtain approval for the use of a sole source provider. Review and approval of the decision not to seek proposals from other providers is important because these contracts bypass full and open competition.** (page 11)

**... Only 1 of 16 contracts we reviewed contained a penalty provision for poor performance.** (page 15)

**Poor planning contributes to frequent contract amendments. The BOE [Board of Examiners, i.e., the governor, attorney general, and secretary of state] approved 27 amendments for the 16 contracts we reviewed. In total, contract amounts increased more than \$5 million from \$2.2 to \$7.4 million.** (page 18)

**The state's contract award process does not ensure vendor proposals are consistently and objectively evaluated, and contracts are awarded fairly. State agencies used a wide variety of methods for evaluating vendor proposals. Only five of nine evaluation methods assigned a score to each proposal as required by state law....**

**State agencies did not follow proper contract monitoring practices.** Contract Compliance Checklists were not prepared for 7 of 16 contracts. In addition, most checklists prepared were incomplete. Furthermore, vendor reporting requirements were not included in 9 of 16 contracts. For the seven contracts with reporting requirements, only two agencies received reports. (page 26)

**The Department of Administration lacks the information it needs to oversee the state's contracting activities.** Information regarding state contracts is not

The state's contract award process does not ensure vendor proposals are consistently and objectively evaluated, and contracts are awarded fairly.

In FY 2000, the Board of Examiners approved contracts costing more than \$500 million without policies and procedures, that would provide assurance the contracts were properly planned, awarded, and monitored.

complete, accurate, or readily available. In addition, Contract Summary forms submitted to the BOE are not always accurate. Furthermore, agencies do not always provide the BOE with adequate justification for their decision to contract. (page 28)

The State does not ensure employees responsible for contracting activities are adequately trained. Although the State offers a contract training course, the training does not provide in-depth coverage on contract planning, awarding, and monitoring. In addition, attendance is not required. Other states have recognized the importance of this training and have developed contract certification programs to ensure employees have adequate contracting skills. (page 31)

The State does not have adequate policies and procedures to ensure contracting activities are properly carried out. In fiscal year 2000, the BOE and its Clerk approved about 1,900 contracts amounting to more than \$500 million. Without adequate policies and procedures, the BOE does not have assurance the contracts it approves are properly planned and awarded, and will be monitored after approval. (page 33)

Accountability for the state's contracting activities is poor. Although the BOE is responsible for approving contracts, it has little involvement in key activities such as planning, awarding, and monitoring. The responsibility for these activities is fragmented throughout state government. Because a framework for accountability has not been established, agencies often delegate contracting functions to employees that may not have adequate skills. In addition, employees may not have proper authority over the function being contracted for, or accept responsibility for ensuring vendor performance. (page 33)

## Dept. of Administration, Purchasing Division Report LA02-10

... Cash discounts offered by vendors for timely payment of goods purchased were not consistently taken. This occurred because payment terms were not included in over 20% of the purchase orders reviewed....

NRS 333.220(4) requires the Division to maintain an inventory of the state's fixed assets. However, current procedures do not ensure all assets will be recorded. We found that fixed asset codes were not entered for the eight asset transactions examined. Although these assets were later identified by property management staff, this occurred after the transaction had been completed. On average, it took almost 2 months after the assets were acquired before they were recorded in the system. In one instance, equipment costing \$118,000 had not been recorded in the state's fixed asset inventory until we brought it to the Division's attention. (page 10)

... In order to process certain transactions, incorrect delivery dates must be used. In 9 of 23 transactions we examined, incorrect delivery dates had been entered in the IFS. Staff indicated they had to enter incorrect dates in order to get the IFS to process "confirming" purchase orders. Date inaccuracies could impact the reliability of reports and other information provided to management, the legislature, and the public. (page 12)

During the period when the State has two fiscal years open, transactions can be completed fully in one fiscal year, but recorded as expenditures in the other fiscal year. We identified three transactions where all the information was entered in July 2000, although these transactions were posted to fiscal year 2000 (the prior



fiscal year).<sup>3</sup> This is possible because there is no system control in place to reject purchasing transactions based on the date of an element of the transaction. (page 13)

## **Dept. of Employment, Training and Rehabilitation, Employment Security Division Report LA02-09**

**The Division's collection procedures are not effective in maximizing the collection<sup>4</sup> of unemployment benefit overpayments.** Several factors hinder the Division's collection process. First, the Division does not use all available collection techniques. Second, statutory restrictions limit the period of time available for collecting overpayments. As a result, **the Division's collection rate is well below regional and national averages. State laws and regulations provide guidance for recovering monies owed the State. Following this guidance and implementing other collection tools could generate thousands of additional dollars for Nevada's Unemployment Insurance (UI) program....**

**... Nevada's collection rate ranked in the bottom quarter when compared to other western states and nationally for the 9 months ended September 30, 2000. Nevada's collection rate was about 45%; however, the regional and national averages exceeded 65%. We estimate the BPC Unit could have recovered an additional \$800,000 for the UI program in 2000 by attaining collection rates similar to the regional and national averages.** (page 7)

**... The [Division's] GUIDE system has the ability to produce a variety of management reports. However, some reports are unreliable. BPC's June 30, 2000, accounts receivable report showed a total overpayment balance of approximately \$6.9**

<sup>3</sup> Maximizing the expenditure of taxpayer monies.

<sup>4</sup> In other words, the reclamation of those funds.

**million while the federal overpayment activity report showed a balance amounting to over \$15 million.** (page 12)

## **Reliability of Performance Measures Used in the State's Budget Process**

Report LA02-19

**Performance measures used in the state's budgetary process were not always reliable. About one-half of the measures we examined lacked sufficient documentation, were based on inappropriate methodologies, or were calculated incorrectly.** In addition, the description of the measure frequently did not reflect what was reported. **As a result, managers and oversight bodies used unreliable information when evaluating programs and making budget decisions.**

**All of the agencies included in our audit lacked sufficient controls to help ensure performance measures were reliable.** Control weaknesses included inadequate written procedures on how to collect and calculate performance measurement data. In addition, we noted insufficient review of the data collection process. **Performance measurement systems should have controls to ensure information is properly collected and reported.**

**... Some agencies could not provide underlying records to support their performance measures reported in the Executive Budget. Of the 35 measures we examined, 15 did not have sufficient documentation.** Although these measures may be accurate, the lack of underlying records prevents the information from being verified. (page 8)

**Thirteen of the measures were based on flawed procedures. For instance, the Northern Nevada Child and Adolescent Services' method for tracking the average number of clients on the Early**

State managers and oversight bodies use unreliable information when evaluating programs and making budget decisions.

Since 1993 state agencies have been required to include performance measures in the Executive Budget. But training still has not addressed procedures to help ensure reliability....

Childhood Services waiting list overstated the measure. The agency included individuals that inquired about services but never followed up for an appointment. These individuals accounted for approximately 40% of the waiting list. (page 9)

Calculation errors resulted in agencies reporting inaccurate data in four of the measures. For example, the Department of Motor Vehicles' measure of the number of transactions processed by employee per month was calculated incorrectly. The reported number was the average for each of the 18 field offices, not the average of all transactions statewide. As a result, the number reported by DMV was overstated by 21%. (page 9)

... Many agencies have not developed written procedures describing how to collect and calculate measures. The effect of not having written procedures was greater because of turnover in positions that collected the data reported in the Executive Budget. This made it especially difficult for some agencies to determine how the performance measures reported in the Executive Budget were derived. (page 11)

At most agencies, one person collected and calculated performance measurement data with little or no review by anyone else. Performance measures are often the result of numerous calculations. As the number and complexity of calculations increases, the risk of errors increases substantially. (page 12)

State agencies have been required to include performance measures in the Executive Budget since the 1993 Legislative Session. Although the Department of Administration has provided training to assist in the development of performance measures, the training has not addressed procedures to help ensure reliability....

## **Integrated Financial System, Payroll Process**

Report LA02-03

Internal controls associated with the state's new payroll system do not always provide reasonable assurance that transactions are input and processed correctly. For example, the time recording process is confusing and cumbersome; agency payroll reconciliation is difficult; payroll errors occur; and the system is vulnerable to unauthorized access.

Contributing to these problems is a lack of documented procedures related to the system's use. As a result, aspects of the state's payroll system are inefficient and the cost and complexity of some processes have increased when compared to the previous system. **Internal controls are intended to promote the achievement of management objectives and the minimization of operational problems. The new payroll/personnel system, which involves an initial public investment of over \$20 million, should properly reflect these control principles....**

## **Office of Attorney General**

Report LA00-24

Our review of the Office of Attorney General (OAG) found some control weaknesses that did not always make it possible for the agency to comply with laws and regulations significant to its financial administration. For example, OAG did not fully comply with laws and regulations governing the handling and deposit of cash receipts, the recording of financial transactions, and the control of telephone cards issued to employees.

In addition, sufficient documentation was not always available to support OAG's financial transactions. Also, policies and procedures did not adequately address OAG's financial and administrative responsibilities.

OAG processed more than \$3 million in cash and checks during fiscal year 1999, logging in \$2.3 million of that amount. We found 43% of the cash receipts logged in during fiscal year 1999 did not meet the timely deposit requirements of NRS 353.250. In addition, we found 13 instances where cash receipts of \$10,000 or more accumulated beyond the one working day allowed before a deposit must be made. (page 7)

... We identified 41 telephone cards listed on the Department of Information Technology's master list as assigned to OAG that could not be traced to specific individuals at OAG. (page 13)

### **State Public Works Board** Report LA00-15

The 1995 and 1997 Capital Improvement Programs represent a \$500 million commitment to the construction and improvement of state facilities. Statutorily, these funds may be spent only on approved projects and must be properly accounted for. ... [W]e noted the following instances of non-compliance.

First, legislative approval was not always obtained for project scope and budget changes.

Second, certain furniture and equipment acquisitions were not consistent with Board policy.

Finally, accounting records for University and Community College System of Nevada (UCCSN) maintenance projects were not sufficient to determine the propriety of expenditures.

As a result, the SPWB does not have reasonable assurance all project expenditures were appropriate. The SPWB needs to implement additional controls to ensure compliance with the financial and administrative requirements established for CIP projects.

... Despite the need for reliable infor-

mation, certain project performance indicators were not accurate or supported by quantifiable data. In addition, construction completion dates were not always documented. Finally, project status reports were not prepared timely. By improving reliability, management information can be more effectively used to direct the resources of the SPWB.

... The SPWB transferred about \$50,000 of expenditures related to a community college renovation project to a statewide roofing project without legislative approval. As a result, renovation expenditures exceeded the authorized amount. (page 10)

NRS 341.090 authorizes the SPWB to expend appropriated funds for the advance planning of a capital improvement project. Advance planning, as defined by this statute, does not include construction costs. Despite this, the SPWB expended \$175,000 of 1995 planning funds for construction costs at a community college. (page 10)

A \$5 million high technology center operated by the UCCSN included a budget of \$220,500 for furniture and equipment purchases. Board policies and procedures require these purchases to be within this authorized funding limit. Despite this requirement, furniture and equipment purchases exceeded \$800,000. In addition, this amount was paid directly to the UCCSN without supporting invoices or other documentation of receipt. (page 11)....

UCCSN maintenance project appropriations in the 1995 and 1997 CIP's, totaled \$25 million. Unlike most CIP projects, the SPWB has delegated accountability for these appropriations to the UCCSN. However, the SPWB has not maintained adequate records to ensure the propriety of the project expenditures. Consequently, we could not determine if expenditures were within the approved scope of the project or if any uncommit-

The Office of the Attorney General did not fully comply with laws and regulations governing the handling and deposit of cash receipts, the recording of financial transactions, and the control of telephone cards....

Report  
LA00-15

...the SPWB does not have reasonable assurance all project expenditures were appropriate.

Report  
LA02-07

Additional costs and delays on the Lied Library project may have been avoided if the SPWB had adhered to appropriate project management standards.

ted funds were available for reversion. (page 12)

The SPWB reported certain CIP performance indicators that were not accurate. For example, project timeliness was reported to be 100%. This statistic was based on the status of three projects, none of which were near completion. Consequently, there was no quantifiable support for the accuracy of this indicator.

The SPWB did not always document a date of substantial completion for construction agreements. This date becomes the basis for measuring project timeliness. Furthermore, without this date the SPWB cannot assess liquidated damages. (page 14)

**State Public Works Board  
Lied Library Project**  
Report LA02-07

The State Public Works Board did not always comply with existing project management standards. Furthermore, additional standards are needed to help ensure projects are completed within budget and on schedule. Additional costs and delays on the Lied Library project may have been avoided if the SPWB had adhered to appropriate project management standards.<sup>5</sup>

The Board lacks formal policies and procedures to ensure open competition and the proper evaluation of contractors' qualifications.... Furthermore, construction monitoring guidelines are not adequate....

The SPWB did not use a competitive evaluation process to select the architect to design the Lied Library. Instead, the SPWB appointed the architect previously selected to conduct a study of the University and Community College System's library needs. A competitive

contracting process provides the framework for selecting an architect on the basis of qualifications and it documents the contract was awarded fairly. (page 8)

Although required by law, the SPWB did not establish a process to evaluate contractors' qualifications.

Consequently, the SPWB did not evaluate the qualifications of the contractors that bid on the Lied Library since criteria and procedures had not been established. (page 12)

... The SPWB issued the contractor four construction change directives to proceed with work related to fire-safety issues. Although these directives stated labor and materials were not to exceed \$115,000, the SPWB authorized change orders totaling about \$690,000 for this work. Despite the impact construction change directives have on a project's cost, the SPWB lacks formal policies and procedures to help ensure they are properly monitored and controlled. (page 15)

The architect did not approve seven progress billings totaling \$4.7 million because of concerns regarding the extent of the project's completion and the sufficiency of money to complete the project. Although Board policy and contract terms require the architect's approval of all billings, the Board paid these billings without documenting the resolution of the architect's concerns. (page 16)...

The date a building is deemed to be substantially complete is a key milestone. For example, the contract provides that liquidated damages cannot be assessed for work completed after this date. However, there is conflicting information regarding the date the Lied Library was substantially complete. This raises doubts about compliance with contract requirements. (page 18)

<sup>5</sup> The Lied Library at the University of Nevada Las Vegas was finished more than six months late and cost some \$22.4 million more than its initial price tag of \$40.4 million. See, for example, <http://www.lasvegassun.com/sunbin/stories/archives/2001/feb/05/511393472.html>.

The SPWB and the State Fire Marshal issued a conditional certificate of occupancy for the Lied Library effective July 6, 2000. This certificate was issued with four outstanding conditions relative to fire-safety. As of February 28, 2001, only one issue had been resolved; therefore, a final certificate had not been issued as of that date. Despite the importance of this certificate, guidelines have not been established to document the conditions that must exist in order to occupy a facility and resolve outstanding conditions. (page 20)

## Strategic Planning Process Report LA00-18

Taxpayers expect more than ever that government will manage and spend tax dollars wisely. To help meet these expectations, many governments have shifted the focus of decision-making from a preoccupation with the activities performed to the results achieved. A key element in results-oriented management is an organization's strategic planning efforts. Because of this emphasis, many governments have increased their strategic planning efforts in recent years.

Although Nevada law requires agencies to develop some elements of strategic planning, there is no requirement to prepare complete strategic plans. Consequently, agencies have conducted strategic planning for a variety of reasons. This has led to a number of different formats being used and a wide variation in the quality of agencies' plans. Recent reports issued by the Legislative Auditor illustrate how inadequate strategic planning has resulted in ineffective management of state programs. Therefore, legislation is needed to provide direction and to help ensure the state's strategic planning efforts are an ongoing priority....

Recent Legislative Auditor reports have cited inadequate strategic planning as a

contributing cause of significant problems. Programs affected include group health insurance for state employees, information systems development by the Department of Information Technology, and inmate medical services. Better strategic planning in these programs may have avoided or lessened the extent of the problems identified. (page 12)

Executive branch agencies have been requested to prepare strategic plans since 1994; however, the Director of the Department of Administration indicated some uncertainty regarding future efforts. Although the administration has discussed the need for long-term planning, a statutory requirement for agencies to prepare complete strategic plans will help ensure strategic planning continues. (page 13)

Agencies' strategic plans often lacked basic elements of a strategic plan. Basic elements include a mission, philosophy, external and internal assessment, goals, objectives, performance measures, and strategies. However, all five of the plans we reviewed lacked at least one of these elements. Since the parts of a strategic plan are linked, the lack of any element can reduce the overall effectiveness of the plan. (page 14)

Even when agencies' plans had some of the basic elements, we noted other weaknesses. For instance, in the three plans that included goals, the goals were not always client-focused or results-oriented. Therefore, the agency may not be directing its efforts in areas of primary importance to its stakeholders. Also, in the four plans that included objectives, many objectives were not time-based or measurable. When objectives are not time-based or measurable, it is difficult to assess the degree to which they have been achieved. (page 15)

Strategic plans are often not communicated to staff. Only one of the five agencies whose plans we evaluated had

Executive branch agencies have been requested to prepare strategic plans since 1994; however ... agencies' strategic plans often lacked *basic elements* of a strategic plan.

The Department of Administration and the Office of the Governor have rejected our recommendation that legislation be requested requiring state agencies to prepare comprehensive strategic plans.

made considerable effort to communicate its strategic plan to staff. Since a strategic plan focuses an agency's efforts towards what agency management and stakeholders value, communicating it to staff helps focus all of an agency's efforts toward the same ends. (page 16)

Since statewide strategic planning was initiated in 1994, the Department of Administration has provided limited guidance and oversight of department-level planning efforts. For instance, the Department provided only one brief training session on preparing strategic plans. Furthermore, the Department did not review the agencies' plans when they were revised in 1996 and 1998. As a result, the Department had limited assurance the strategic plans addressed key planning elements. Officials from other states indicate that training and central oversight are key factors to successful planning. (page 16)....

#### **Auditor's Comments on Agency Response**

The Department of Administration and the Office of the Governor have rejected our recommendation that legislation be requested requiring state agencies to prepare comprehensive strategic plans. Their response states that they do not dispute that strategic planning can be a useful managerial tool. **Done half-heartedly, however, because someone else said it had to be done, then put on a shelf and ignored, strategic planning – or any other management tool – pulls state employees' valuable and limited time away from providing services to Nevada taxpayers. (See page 23)....**

#### **Dept. of Administration Internal Control Reporting Report LA98-31**

Because of long-standing concerns over internal control weaknesses at state agencies, the Legislature passed Senate Bill 460 in 1995 to strengthen these con-

trols. This legislation requires each agency head to periodically review the agency's system of internal control and report the results to the Department of Administration. However, many agencies have not complied with this law. Some agencies did not perform the required review, many did not report timely, and two did not report at all. The lack of compliance is caused, in part, by agencies not assigning a high priority to improving their internal control systems. **In addition, the Department of Administration has not been effective in getting agencies to comply. The result of poor internal controls can be seen in recent audit reports that show how these weaknesses have cost the state millions of dollars. Because of the importance of improving internal control systems through periodic reviews and reporting, legislation is needed to hold agencies accountable for complying with the law....**

Some agencies do not review internal controls as required by law. Of four agencies we examined, one agency had not reviewed its system of internal controls....

Many agencies are not submitting reports timely. In 1996, 55 percent of the agencies did not meet the statutory deadline of July 1. In addition, the Controller's Office ... never submitted a report in 1996. Agencies did show some improvement in 1998; however, 36 percent still did not meet the statutory deadline. (page 15)

#### **Dept. of Motor Vehicles and Public Safety, Administrative Services Div. Report LA02-17**

The Administrative Services Division (ASD) lacks adequate controls to ensure transactions are processed accurately and in accordance with laws and regula-

tions. Because ASD did not periodically review its internal controls, serious deficiencies went undetected resulting in significant errors. These errors included inaccurate calculations affecting the distribution of millions of tax dollars to the state and local governments. Although in some instances ASD became aware of and corrected individual errors, weaknesses in the overall system of controls continue, increasing the risk errors will occur again.

ASD's computer spreadsheet used to distribute sales tax revenue to the state's General Fund contained a formula error. Consequently, from October 1999 through May 2001, approximately \$9.5 million in sales tax revenue was not distributed to the General Fund. (page 8)

During the period of April 2000 to October 2000, over \$3.9 million in governmental services tax collections were not properly distributed to counties. This occurred when the Department added payment options to help improve customer service and reduce wait times. These options included accepting payments at emission control stations, and over the Internet and telephone. However, ASD did not adjust computer spreadsheet formulas to include these additional collection points, and the revenues were not distributed. (page 8)

ASD does not use consistent methods when allocating the governmental services tax to counties and school districts. In some instances, ASD used allocation percentages provided by counties, while other allocations were based on percentages provided by the Department of Taxation. This inconsistency increases the risk of allocations not complying with statutes. (page 9)

**Inadequate controls for processing Motor Carrier Section refunds resulted in undetected errors and incorrect refund checks. Errors occurred in three of the seven special fuel tax refunds we examined that originated from the**

**Motor Carrier Section. One of the miscalculated refunds resulted in an overpayment of approximately \$172,000. The other two refund errors resulted in underpayments totaling approximately \$48,000. Although millions of dollars in refunds were processed, ASD did not review supporting documents to verify the refund amounts. (page 11)**

**ASD does not have an adequate process to verify that deposits from credit card transactions, as recorded on the Department's computer system, agree to the amount deposited with the bank. This reconciliation is important because the Department receives over \$3.6 million in credit card receipts monthly. Any discrepancy between accounting records and the bank deposit should be investigated and resolved timely. (page 13)**

### **Office of the Military** Report LA02-15

**The Office of the Military did not always carry out its financial and administrative activities in accordance with laws, regulations, and policies. Specifically, the Office did not follow rules for controlling expenditures, soliciting and managing contracts, administering personnel and payroll functions, or safeguarding assets. Failure to follow these rules contributed to unauthorized purchases, over expenditure of state funds, questionable contract awards, and improper personnel and payroll administration. These problems occurred because the Office has not established an adequate system of financial and administrative controls as required by state law....**

**The Office did not follow the state's solicitation requirements for 5 of the 10 contracts we tested. For three contracts, the Office did not document it attempted to solicit and review at least three bids from vendors. Two contract solicitations were not advertised in local newspapers as**

The Department of Administration has not been effective in getting agencies to comply.

A person filing a charge of employment discrimination with the Nevada Equal Rights Commission may not know the outcome of the investigation for about 1 year.

required. Because of inadequate solicitation methods, it is questionable whether some contracts were awarded fairly. (page 14)

.... **Of 15 employee personnel files reviewed, 14 did not contain current work performance standards or evidence that a performance evaluation had been completed during calendar year 2000....**

**Department of Employment,  
Training and Rehabilitation  
Nevada Equal Rights  
Commission**  
Report LA02-05

**The Nevada Equal Rights Commission (NERC) has not implemented sufficient controls to manage its investigations of discrimination charges. Current investigative techniques and processes lead to untimely investigations. We found that a person filing a charge of employment discrimination with the Nevada Equal Rights Commission may not know the outcome of the investigation for about 1 year. On average, it took NERC 371 days to investigate a discrimination charge for cases closed in fiscal year 2000. These delays are a direct consequence of the limited control activities the agency currently has in place. For instance, there is little evidence that investigations are supervised and monitored....**

**Many investigations sat for months without evidence of an investigative action. On average, an investigator took one action, such as making a phone call, receiving evidence, witnessing testimony, or requesting evidence, every 4 months. Nineteen of the 48 cases we reviewed had gaps in excess of 6 months where there was no evidence of an investigative action. (page 9) ....**

The agency could do a better job of supervising and monitoring the investiga-

tive process. The limited management oversight gives the opportunity for varied productivity and inconsistent quality.

**Although management stated it periodically reviews investigator reports and case files, meets with investigators, and reviews management reports, we found little evidence of management oversight. (page 12)**

**Department of Business and  
Industry  
Office of Labor Commissioner**  
Report LA02-04

**...In 1994, we reported the Office of Labor Commissioner did not have an adequate management information system. The lack of such a system contributed to the Office reporting inaccurate information to the Legislature during the 1993 session. Instead of establishing a system with minimal resources, the Office chose to have the Department of Information Technology (DoIT) develop a complex and costly system. (page 6)**

None of the system's four components were completed on time. For example, the public works monitoring software was installed more than 2 years after the estimated completion date. As a result, the Office could not provide the 1997 and 1999 Legislatures with system-generated data related to its activities. (page 7)

**Although system expenditures totaled nearly \$300,000 as of June 30, 2000, not all costs have been included. For example, the Office did not pay DoIT for billings totaling more than \$11,000 in fiscal year 1998. In addition, DoIT did not bill the Office for all programming costs since the system was not completed on time. (page 7)**

Because of insufficient testing procedures, **the Office did not detect programming errors in the prevailing wage component of the system. As a result, the hourly wage rate for some work classifi-**



cations was not correct. Incorrect prevailing wage rates affect workers pay and project costs. (page 9)

Although the public works component produces 10 reports, 4 do not contain data and 6 contain inaccurate data. As a result, key performance and project information must be tracked manually. (page 11)....

### **Dept. of Business and Industry Financial Institutions Division** Report LA02-02

The Division's financial management practices need improvement. Revenues and expenditures were not always recorded to the proper account. For example, fines totaling \$180,000 were not deposited to the state General Fund as required by law. Other revenues and expenditures were also incorrectly recorded which caused errors in the amounts assessed against banks and other depository institutions....

The Division incorrectly deposited fines to its investigative account instead of the state General Fund. The Division collected about \$180,000 in fines during fiscal years 1999, 2000, and the first two months of fiscal year 2001. All fines collected during this time were deposited to the wrong account. (page 7)

.... Over half (13 of 22) of the checks greater than \$10,000 received by the Division in fiscal year 2000 were not deposited timely. The longest delay was 8 days and the average delay was 5 days. Audit reports issued in 1982 and 1986 also noted the Division was not depositing money timely. (page 9)

The Division has not adequately separated duties related to revenues and expenditures since one employee performs all of the key duties. In addition, there is minimal review of the work performed by the employee. As a result, billing errors were not detected which

resulted in the Division overcharging depository institutions about \$30,000 in the last 2 fiscal years. (page 10)

### **Dept. of Business and Industry Real Estate Division** Report LA00-28

Although the Real Estate Division has made an effort to improve its financial controls since our last audit, weaknesses persist. For instance, thousands of dollars in fines are assessed against licensees; however, the Division does not have an effective process to account for and collect these fines. As a result, the Division collected about one-third of the amounts due. In addition, deposits are not verified against amounts collected, and money is not always deposited timely. Similar weaknesses in cash management controls contributed to an embezzlement discovered during our prior audit. Therefore, additional controls are needed to improve the Division's financial management practices.

The Division's accounts receivable reports are not complete or accurate. During fiscal year 2000, accounts receivable totaling \$35,000 were not recorded in the Division's reports. In addition, the reports were not mathematically correct and did not always include the balances due. Unreliable accounts receivable information hinders the Division's recovery of moneys owed.

The Division does not have adequate procedures to collect past-due accounts. Collection procedures are limited to a letter requesting payment. No other collection techniques are employed. As a result, the Division collected only \$30,000 out of the \$100,000 due in fiscal year 2000.

The Division's cash handling practices should be strengthened. No one independent of the deposit process verifies the amounts deposited with the

Revenues and expenditures were not always recorded to the proper account. For example, fines totaling \$180,000 were not deposited to the state General Fund as required by law.

amounts collected. This weakness existed when we conducted our prior audit, contributing to the embezzlement of \$21,000 ....

**Dept. of Human Resources -  
Medicaid Division of Health  
Care Financing and Policy**  
Report LA00-14

**Although improvements have been made in the Medicaid system**, some weaknesses still exist that increase the risk claims are not always appropriately paid. We found that program edits designed to help ensure claims are proper did not always work, and overrides were not always approved and documented. **In addition, information in some cases can be input or modified after a claim has been entered without authorization and often bypasses system edits. Finally, payment and rate adjustments occurred without adequate review or oversight.**

Medicaid payments are significant and expanding. They have increased from \$165 million paid to 5,000 medical providers in 1991 to nearly \$450 million paid to 10,000 providers in 1998. In addition, the Division operates in a complex environment resulting from extensive federal and state requirements. **This environment and the dollar magnitude of the program increase the risk for the improper processing and payment of claims. Although the Medicaid system is generally well designed, weaknesses in the system can potentially result in large dollar losses to the program. Therefore, processing and payment controls are essential to reducing the risk of claims being improperly paid**

**The Division's claims processing system ... paid 13 claims totaling over \$6,000 for gender-specific procedures**

performed on the opposite sex. We identified seven recipients listed as male in the system who received maternity-related procedures. We also found six recipients noted as female in the system who received procedures related to male anatomy. (page 13)....

The Division has not reviewed its since 1997. About 60,000 claims totaling \$28 million processed against one of these edits to "pay now and review later" in calendar year 1998. Division personnel indicated that the reviews were time consuming and unproductive (98% error free). However, Department no documentation could be provided supporting this statement. (page 15)....

The override process of Medicaid system edits continues to have problems, as reported in our 1991 audit report. Overrides are occurring without the proper approvals....

**Dept. of Human Resources  
Health Division - Bureau of  
Licensure and Certification**  
Report LA00-09

The Bureau of Licensure and Certification needs to improve its data collection and reporting systems. We found the current management information systems do not produce or provide complete, accurate, or reliable information. Poor quality management information increases the risk that complaint investigations and facility inspections are not always performed timely....

The programs' databases contained duplicate and incomplete information, and did not always track significant events. The Bureau also manually compiled program and performance information resulting in inaccurate information being reported....

The override process of Medicaid system edits continues to have problems, as reported in our 1991 audit report. Overrides are occurring without the proper approvals....

**Dept. of Motor Vehicles and  
Public Safety  
Division of Parole and  
Probation**  
Report LA00-07

Because of significant management control weaknesses, the Division of Parole and Probation is having difficulty meeting its responsibility to protect the public. The Division supervises more than 10,000 criminal offenders in the State. However, offenders have not been supervised according to Division standards. In addition, the Division has many problems in its classification process used to place offenders at the appropriate supervision level. As a result, the Division has little assurance that offenders are supervised according to the risks they pose to the public.

The Division's process to collect monthly supervision fees from offenders needs significant improvement. During fiscal year 1998, about \$900,000 in supervision fees went uncollected because of poor collection practices, inaccurate records, and weak controls over granting fee exemptions. In addition, the Division has not established adequate internal controls to safeguard more than \$2 million in fees paid annually by offenders. While we did not identify instances of fraud, the Division's controls are so weak that fraud and abuse could go undetected. Because the Division's process is both ineffective and inefficient, it can improve collections and internal controls while reducing the amount of resources spent on this function.

Management is ultimately responsible for ensuring the agency achieves its goals and efficiently uses public resources. Although the Division has received sufficient funding to perform supervision activities, it does not have an effective management system to ensure resources are used efficiently. For instance, the

Division needs to improve its performance measurement system, and oversight and monitoring of district operations. Moreover, **we identified numerous inefficiencies throughout the Division's operations. These inefficiencies contribute to Nevada having the highest cost of offender supervision among western states. By eliminating or revising practices that cause unnecessary costs, the Division could make millions of dollars available each year for other priorities.** Although management has made recent efforts to improve the Division's operations, sustained commitment to establishing an effective system of management controls is necessary to correct long-standing weaknesses.

### **Principal Findings**

... For the 62 offender files we reviewed, the Division made only 60% of required contacts. Because many contacts were not made, **the Division rarely met its monthly supervision standards.** Furthermore, some offenders received no supervision. (page 12)

**The Division did not make most required home visits. For the offender files reviewed, the Division made only 36% of required home visits.**

Furthermore, in those cases where home visits were not made, the Division did not attempt a visit 73% of the time. (page 15)

**The Division did not conduct a majority of required supervision level reassessments. For the offender files we reviewed, only 45% of reassessments were done.** Furthermore, some offenders went long periods without a supervision level review. **In 30% of the offender files reviewed, the Division had not reassessed the offender's supervision level in 18 months or more.** Additionally, **in July 1997, the Legislature enacted a law requiring the Division to reassess offender supervision levels at least once every 6 months. Yet, the Division did not conduct 50% of statutorily required**

Because of significant management control weaknesses, the Division of Parole and Probation is having difficulty meeting its responsibility to protect the public.

Inefficient operations contribute to Nevada having the highest cost of offender supervision among western states.

**reassessments between July 1997 and June 1998.** (page 18)

**The Division has a poor process for collecting supervision fees. For fiscal year 1998, the Division collected about 55% of the fees owed.** Several factors contribute to low or inconsistent collection rates among districts. These factors include: (1) inadequate emphasis on collections, (2) inaccurate records for the amounts owed by offenders, (3) an inefficient billing process, (4) a lack of information to monitor collections, (5) inconsistent granting of fee exemptions, and (6) the failure to charge some supervision fees. (page 26)

**The Division has not established an adequate system of internal controls to safeguard more than \$2 million in fees paid annually by offenders.** Internal control weaknesses include: (1) payments not recorded when received, (2) poor controls over cash receipt forms, (3) total payments received not compared to deposits, (4) offenders paying their fees to officers instead of accounting staff, (5) inadequate separation of duties, (6) untimely deposits, and (7) poor controls over payments received by mail. (page 30)...

**The Legislature has provided the Division with sufficient parole and probation officer positions to supervise offender caseloads at formula-funded levels. However, control weaknesses in the hiring process hampered the agency's ability to fill vacancies timely.** The Division lacked policies and procedures, management information on vacancies, and consistent management oversight of hiring. These weaknesses resulted in the Division not testing or recruiting applicants from April 1996 to March 1997. Consequently, by July 1997, the Division had 41 parole and probation officer positions vacant. (page 37)

**The Division lacks management controls to ensure effective performance.** While the Division has a central management office, the office has not provided

strong oversight of district operations. Without controls in place to guide district operations and monitor performance, the Division has no assurance it can meet its mission of public safety. (page 37)

**Inefficient operations contribute to Nevada having the highest cost of offender supervision among western states. Nevada's daily cost per offender of \$5.20 far exceeds other western states and the national average of \$3.13.** Although we did not audit all functions of the Division, we identified numerous inefficiencies in the areas we examined. **If the Division reduced its cost of supervision 10% by eliminating inefficiencies, it could make \$2.7 million available each year for other priorities....**

## **Dept. of Taxation** Report LA00-06

**Weak management controls over the administration of the estate tax have led to poor taxpayer service, delayed collection of taxes, and inadequate methods for processing taxpayer information.** The Department has not developed policies, procedures, or regulations relating to the administration and enforcement of the tax. **Consequently, refunds and billings are often delayed and sometimes contain errors. Some estates have been due refunds for years and have not received payment. Similarly, estates owing thousands of dollars in tax are sometimes never billed or billed only once.** Furthermore, the lack of guidance through policies and procedures has contributed to interest and penalties on delinquent accounts not being assessed uniformly.

**While control weaknesses have had the most significant effect on the estate tax, fuel taxes and short-term auto lease fees would also benefit from strengthened controls. For example, methods for reviewing fuel tax filings do not ensure taxes due are efficiently identified and**

collected. Additional weaknesses affecting all excise taxes exist in the areas of cash receipts and computer security.

## **Dept. of Administration Motor Pool Division**

Report LA00-05

The Motor Pool Division does not have the information it needs to manage its operations. For years it has operated without adequate information on vehicle operating costs. As a consequence, decisions, such as when to replace vehicles or what rental rates to charge, are made without a proper analysis of cost information. Although our 1993 audit contained several recommendations to improve information, these recommendations have not been fully implemented. Furthermore, the Division does not expect to have sufficient information on vehicle operations for several more years. As a result, the Division has little assurance it is meeting its statutory purpose of ensuring economical utilization of state-owned vehicles....

Between fiscal years 1993 and 1999, the Division spent about \$6.5 million on new and replacement vehicles and more than \$4.9 million on vehicle operations without adequate information to ensure sound management decisions are made. Without adequate information, the Division had difficulty responding to questions posed by legislators during the 1997 and 1999 legislative sessions. These questions included concerns about rising vehicle operating costs and replacement of vehicles. (page 7)....

The Motor Pool Division did not fully implement our prior audit recommendations aimed at improving information to ensure the economical utilization of state-owned vehicles. Our 1993 audit estimated the Division could save more than \$600,000 by (1) monitoring vehicle use, (2) revising its rate structure,

and (3) calculating the optimal replacement period for motor pool vehicles. Since that audit, the information generated by the Division has deteriorated, making it difficult to determine if cost savings estimates were realized. Because the number of vehicles operated by the Division increased 34% between fiscal years 1993 and 1999, the potential for savings could be much greater today.

(page 8)

The Motor Pool Division has experienced significant delays in implementing its new fleet management system. While a needs assessment was completed by the Department of Information Technology in August 1994, the new system did not come online until July 1998, a period of almost four years. This includes a 19-month period where no work was done. Although the new system is online, system reporting capabilities are still under development. (page 10)

The performance of certain management functions has been divided between the Department of Administration's Motor Pool Division and the Administrative Services Division without a written agreement outlining specific responsibilities. While the Motor Pool Division pays the Administrative Services Division in excess of \$100,000 each year for professional services, the exact nature and extent of these services is unclear. A written agreement is important because the 1993 reorganization of the executive branch of state government left the Motor Pool Division without the employees necessary to perform financial management functions. (page 11) ....

## **Dept. of Human Resources Division of Child & Family Services**

Report LA00-03

Despite statutory requirements to

The Motor Pool Division does not have the information it needs to manage its operations. For years it has operated without adequate information on vehicle operating costs.

In August 1997 the Division paid all group foster homes – about 600 – the incorrect amount for clothing allowances for children in their care.

establish effective internal controls, the Division of Child and Family Services (DCFS) has not done so. The need for controls has been communicated in prior audits and through training provided by the Department of Administration. However, the Division has not made developing internal controls a priority. Key areas where internal controls need strengthening include supervision and monitoring, computer access, and separation of duties.

Poor supervision and monitoring of the length of time children spend in emergency shelters and transitional care has contributed to delays in placing children in long-term care. Timely placement in long-term care is beneficial because it provides a more stable environment for children and is usually provided at a lower cost. If stronger controls had been in place to shorten the length of stay for children in emergency shelters and transitional care during fiscal year 1998, costs could have been reduced by over \$1 million.

The lack of controls has also resulted in incorrect payments to foster parents. We noted instances where foster parents were underpaid by the Division for more than 2 years before receiving the rate they were entitled. In addition, access to the computer system used to generate checks to foster parents is not limited to authorized personnel acting within the scope of their duties. Consequently, the system is vulnerable to the unauthorized generation of checks and the improper modification of information. Furthermore, although reports currently used by the Division to monitor expenditures are an improvement over the limited information that previously existed, the reports are not always timely or accurate.

The Division has an inadequate internal control system related to foster care payments. The last audit of the Division in 1993 reported the same prob-

lem. However, little progress has been made. Payments related to foster care totaled \$38 million in fiscal year 1998. (page 10)

The Division insufficiently monitored the length of time children spent in emergency shelter care. Children spent an average of 33 days in emergency shelter care before the Division placed them in a foster home. If the average stay in fiscal year 1998 had been 10 days, we estimate the Division could have reduced costs by \$870,000. Moreover, it is better for the children to be placed in a long-term foster home as quickly as possible. (page 11)

The Division had insufficient controls to monitor the time that foster parents were paid transitional care in fiscal year 1998. Transitional care is more expensive than regular foster care. Transitional care rates were paid an average of 344 days, though it was intended to be limited to 30 to 90 days. By reducing the average time to 90 days on cases that are subsequently paid the regular foster care rate, we estimate the Division could reduce costs by about \$300,000 annually. (page 13)

The Division has weak controls over payments to therapeutic foster homes, which receive a much higher rate than regular foster care. The lack of controls increases the risk of inappropriate payments. For example, two foster parents providing therapeutic foster care were underpaid for several years before the errors were corrected. One parent was underpaid \$8,200 and the other \$6,600. (page 18)

In August 1997 the Division paid all group foster homes the incorrect amount for clothing allowances for children in their care. About 600 cases were paid incorrectly. Group foster homes were either underpaid up to \$14 per child or overpaid \$84 per child, depending on the child's age. (page 19)

DCFS has not ensured that access to

**its computer system is limited. Over 50 individuals have input capabilities to the system. As a result, the system is vulnerable to the unauthorized generation of checks. Security controls over the system are critical because it generated over 30,000 checks totaling \$9 million in fiscal year 1998.** In addition, this system generates cards authorizing medical services. The Division paid medical expenses for children totaling \$6 million in fiscal year 1998 through the use of the medical authorization cards. (page 19)....

**Upon gaining access to the Division's computer system, an individual can generate payments to any person or company. The system should limit the issuance of checks to parties that have been approved as legitimate vendors.** Furthermore, the Division has inadequate security over checks generated from its computer system. Division accounting personnel unnecessarily take physical custody of checks after they are printed and signed, increasing the risk checks will be lost or stolen. (page 22)

The Division's reports used to monitor foster care expenditures with budgeted amounts were not always prepared timely. Some reports were not issued for up to 4 months after month-end. In addition, no reports were prepared for two of the months. The less time that is available to take corrective action, when necessary, the more difficult it becomes to comply with the budget. (page 24)

**Reports used to monitor foster care expenditures with budgeted amounts contained errors. For example, actual expenditures for emergency shelter care in the Northern Region were \$519,568 in fiscal year 1998. However, the June 1998 budget report showed \$987,139 – a \$467,571 error.** In addition, forms used to record expenses in the budget reports were not prepared in about 20% of the cases tested. When information used to monitor the budget has errors or is incomplete, there is

an increased risk of improper decisions related to meeting budgeted expenditures. (page 25)

### **Dept. of Administration State Printing Division Report LA02-28**

**By not billing state agencies at rates sufficient to recover costs, the State Printing Division lost approximately \$450,000 from operations during the 18 months ended December 31, 2001.**

**In our prior audit, we recommended the Division develop procedures to establish and monitor billing rates to ensure the rates cover the cost of doing work. Although some procedures were developed, they are incomplete and not always followed.** Furthermore, policies and procedures to control the acquisition and valuation of inventory have not been documented. Therefore, the Division is at risk of purchasing more inventory than necessary and failing to recover all production costs. The lack of inventory controls also resulted in the Division's failure to comply with rules for disposing of property no longer needed and considered excess.

Printing Division hourly billing rates were not sufficient to recover the costs of providing printing services to state agencies. **As a result, the Division was unable to recover approximately \$450,000 in labor, equipment, and other operating costs during the 18 months ended December 31, 2001.** Furthermore, the Division did not retain documentation supporting the development of rates. Therefore, the Division did not have assurance rates were based on reasonable estimates. (page 7)

**The Division did not follow its procedures for monitoring the appropriateness of hourly billing rates.** These procedures require staff to monitor costs and sales monthly using a report produced from the Division's automated cost accounting

Upon gaining access to the Division's computer system, an individual can generate payments to any person or company.

In promotional recruitments with less than five eligible candidates, a college graduate was appointed only 33% of the time....

system. However, this report was not used during the period of our audit. The procedures also instructed staff to adjust the hourly rates quarterly if necessary. **Despite these procedures, rates went unchanged from June 1999 to May 2001**, when they were increased by 5%. This increase was seen as a temporary solution, and was not based on an analysis of costs. **Frequent review of the accounting system's report would have alerted the Division that the hourly rates were not sufficient to recover costs**, and provided an opportunity to adjust rates before suffering continued losses. Subsequent to our discussions with the Division, an increase in rates based on an analysis of costs was made in March 2002. (page 9)....

**The Division sold surplus paper inventory to a commercial vendor in January 2001. However, the Division did not obtain the Purchasing Division's written approval to sell excess inventory as required by state policy. In addition, the Division did not have documentation supporting the solicitation of bids. Finally, the Division did not receive payment until March 2002, when we requested documentation supporting the sale. As a result, we could not determine if the \$4,000 payment received was appropriate since the inventory was purchased for approximately \$30,000.** (page 15)

### **Dept. of Personnel Report LA02-27**

The Department of Personnel has made improvements to the processes used to recruit, hire, and promote financial managers in the State. **Despite these improvements, instances of improper promotional transfers continue to occur, and recruitment practices can limit competition for financial management positions. Therefore, many appointments are made with minimal or no competition.** In addition,

programs established to attract Nevada's university business graduates into state service have not been effective.

**Furthermore, the Department lacks complete documentation for the establishment of qualification requirements for financial managers. As a result, the State may not always hire or promote the most qualified financial managers available for state service....**

**The Department allowed state employees to transfer to higher paying positions without competition.** During the period covered by our audit, 11 of the 230 appointments examined were improper promotional transfers. As a result, these 11 employees were appointed to more responsible financial management positions without a competitive process to determine they were the most qualified candidate available. (page 13)

**Many appointments to financial management positions were made with minimal or no competition. State law requires positions be filled based on open competitive examinations.** However, state law also requires promotion from within an agency or department, when practicable. Promotional recruitments, restricted to state employees, generated only one eligible candidate 41% of the time and five or more candidates 24% of the time. In contrast, 80% of recruitments open to the public generated five or more eligible candidates. (page 14)

Competition promotes the development of a more educated financial management workforce. **In promotional recruitments with less than five eligible candidates, a college graduate was appointed only 33% of the time....**

### **State Emergency Response Commission Report LA02-26**

The State Emergency Response Commission (SERC) needs to improve its



financial and administrative practices. **SERC did not properly monitor state and federal funds granted to local emergency planning committees (LEPC's). As a result, some LEPC's did not comply with grant reporting requirements and SERC has little assurance all grant funds were used as intended.**

Furthermore, SERC did not always comply with laws and procedures for collecting and depositing hazardous materials fees. **Some facilities that store extremely hazardous materials were allowed reporting and payment due dates that did not comply with state and federal laws.** In addition, accounts receivable for hazardous materials storage fees and toxic chemical reporting fees were not adequately monitored.

### **Judicial Branch, Administrative Oversight of the State Court System**

Report LA02-25

**The Administrative Office of the Courts has improved its guidance to the courts on accounting, financial management, and internal controls since our 1995 audit. However, internal control weaknesses persist throughout the court system. Strong internal controls help reduce the risk of embezzlement. Since the release of our 1995 audit, embezzlements have been detected at four courts totaling more than \$90,000....**

... [S]ome courts continue to have difficulty with collections. **As a result, enforcement of penalties is not consistent across the State. In addition, low collection rates result in less revenue flowing into the court system and to state and local governments.**

Although improvements have been made since our 1995 audit, internal control weaknesses persist throughout the court system. **Twenty of 26 district, justice and municipal courts examined lacked an**

**appropriate segregation of duties among staff. In addition, 11 of 24 justice and municipal courts did not have written policies and procedures to guide staff, and 8 of 24 justice and municipal courts did not reconcile deposits made to payments received or had ineffective reconciliation procedures.**

**Since the release of our 1995 audit, embezzlements totaling more than \$90,000 have been found at three justice courts and one district court. Weak internal controls provide opportunities for such crimes to occur. (page 9)**

Basic financial information was not readily available from a number of courts responding to our survey. For example, **80% of the district, justice, and municipal courts responding to our survey reported they do not produce accounts receivable reports. Forty percent of survey respondents either did not report amounts collected, estimated amounts collected, or did not report how fines and administrative assessments were distributed. (page 11)....**

**Collection rates at the court system's two largest district courts improved from our 1995 audit, but they remain poor. The rate of collection of fines and administrative assessments for criminal cases tested at the two courts was about 23%. In 1995, the district courts collected only 13% of the fines and administrative assessments in our sample. Testing found no evidence of collection or enforcement actions taken against those offenders who failed to comply with the terms of their sentences.** Instead, most district courts rely on the Department of Prisons and the Division of Parole and Probation to carry out and monitor an offender's compliance with court orders. (page 16)

Justice and municipal courts remitted more than \$13 million in administrative assessments to the State in fiscal year 2001. However, **the AOC has not established a**

**Strong internal controls help reduce the risk of embezzlement. Since the release of our 1995 audit, embezzlements have been detected at four courts totaling more than \$90,000....**

Poor controls over assets have contributed to thousands of dollars in missing equipment.

process to reconcile the amounts of administrative assessments collected by justice and municipal courts for the State with the amounts subsequently remitted to the State Controller. We found several problems with remittances, including a local treasurer not forwarding \$11,725 of assessments to the State, and three courts that incorrectly calculated the state's share of assessments....

**Dept. of Public Safety  
Division of Emergency  
Management**  
Report LA02-20

The Division needs to improve its financial management practices to ensure proper accountability of state resources. For instance, poor controls over assets have contributed to thou-

sands of dollars in missing equipment. In addition, most overtime worked by Division employees was not properly approved and employee overtime balances were not monitored. These problems occurred because the Division did not follow state laws and regulations and its policies and procedures for controlling these areas.

Poor controls over the Division's assets contributed to lost or misplaced equipment. The Division was not able to locate 5 of 25 assets we selected to review. These missing items cost more than \$7,000. In addition, the Division reported 23 other assets, costing almost \$33,000, have been missing for several years. Inventory problems occurred because the Division did not follow its policies and procedures and state laws for safeguarding assets. (page 6)....

## APPENDIX B

# A Review of the Literature on the Size of Government and Economic Growth

## Do Taxes Matter?

### *Twenty-Five Years of Empirical Studies Show They Do*

**E**conomists increasingly realize that state and local governments provide an excellent laboratory to evaluate tax policy—there are, after all, 50 different states and thus 50 different tax systems.

In what may have been the first empirical analysis, done by economists at the Harris Bank in Chicago, Genetski and Chin (1978) used a simple regression model to show that economic growth was negatively correlated with changing rates of state and local taxation. This finding was replicated and expanded upon by Richard K. Vedder\* in two studies for the Joint Economic Committee of Congress (1981; 1995).

Meanwhile, other economists were showing how high taxation had adverse impact on states or territories such as Illinois (Heins 1976), Puerto Rico (Canto and Laffer 1979) and Massachusetts (Kadlec and Laffer 1981). Articles and books written for broader audiences such as

Gilder (1981), Bartlett (1980), Adams (1984), Wanniski (1978), and Brookes (1982) reinforced the scholarly studies.

This early research became increasingly accepted as new refinements and extensions of the tax-growth literature continued into the middle and late 1980s. Helms (1985), for example, said that the impact of taxes depended on how they were used, with expenditures on welfare, for example, having a negative impact. Mofidi and Stone (1990) reached similar conclusions. Benson and Johnson (1986) showed that taxes had lagged negative effects, with the adverse impact being realized often after about three years. Canto and Webb (1987) concurred, roughly, with the Helms work. Other studies confirmed the tax-growth relationship using other data sets or methodologies, albeit with some variation in conclusions as to the strength of the relationship (e.g., Yu, Wallace and Nardinelli

\* This review of the literature on the negative growth effects of taxation was prepared by Dr. Richard K. Vedder and first appeared in *Grinding to a Halt*, a 2002 study published by the Buckeye Institute for Public Policy Solutions. It is reprinted here through the generous permission of the author, a Distinguished Professor of Economics at Ohio University in Athens, Ohio. Dr. Vedder has written extensively, authoring such books as *The American Economy in Historical Perspective* and, with Lowell Gallaway, *Out of Work: Unemployment and Government in Twentieth-Century America*. Over 100 of his scholarly papers have been published in academic journals and books, and Dr. Vedder's work has also appeared in numerous newspapers and magazines including *The Wall Street Journal*, *Washington Post*, *Investor's Business Daily*, *Christian Science Monitor* and *USA Today*. Dr. Vedder has been an economist with the Joint Economic Committee of Congress, with which he maintains a consulting relationship. He has served as the John M. Olin Visiting Professor of Labor Economics and Public Policy at the Center for the Study of American Business at Washington University in St. Louis and has taught or lectured at many other universities.

Balanced budget reductions in taxes on wages and profits exert favorable effects on employment and growth.

1991). And still other studies showing negative effects of government on growth stressed government spending instead of taxes (Scully 1989; Vedder 1993).

Still more studies showed that a progressive income tax rate structure caused more damaging economic effects than a flatter rate tax schedule (Vedder 1985, 1986; Hunter and Scott 1986). This work extended a pioneering observation of Romans and Subrahmanyam (1979). The early studies using U.S. data were confirmed by numerous international studies (Marsden 1983; Reynolds 1985). Scully (1988) in particular showed that governmental institutional obstacles—e.g., substantial regulation, restrictions on imports—along with taxes, hurt growth. The studies became larger and more sophisticated with time (e.g., Engen and Skinner 1999; Newell and Symons 1993; Barro 1989; Koester and Kormedi 1989; Rebello 1991). Van Sinderen (1993) reached a conclusion somewhat representative of these studies:

Balanced budget reductions in taxes on wages and profits exert favorable effects on employment and growth. The relative impact depends on the specific government outlays and taxes which are cut back. In the long run, tax revenue decreases less than the amount of the initial tax reduction.

Cashin (1995) found that each one percent increase in taxes as a percent of total output lowers output per worker by about two percent. To be sure, he observes positive effects of spending from taxes, but typically the positive spending effects are only about one-half as large as the negative tax effect, which is about the same thing as saying that private sector spending is twice as productive as public sector outlays. A new study by Holcombe and Lacombe (2001) compares counties on both sides of state borders—and observes that high taxes impede growth.

The research has continued up to the present, generally confirming the basic

proposition that taxes have adverse effects on economic growth. Much of it has been done at America's premier economic research center, the National Bureau of Economic Research (NBER). Its president, Martin Feldstein of Harvard (1997) concluded that **“the deadweight burden caused by incremental taxation . . . may exceed one dollar per dollar of revenue raised, making the cost of incremental government spending more than two dollars for each dollar of government spending.”** A recent NBER study (Carroll et al. 2000) concluded, “this finding is consistent with the view that raising income tax rates discourages the growth of small businesses.” James Hines (1996), in a paper originally written for the NBER but published also in the prestigious *American Economic Review*, found that state and local taxes impacted on the location of foreign investment in America.

## Europe

Europeans are similarly observing adverse effects of taxation. A Spanish economist writing for a British research center concluded, speaking of government taxation, that “there is evidence of a sizable negative externality effect on the level of productivity” (de la Fuente 1997). Italian economists Tabellini and Daveri (1997) argued that the increase in European unemployment and the slowdown in economic growth are related because they stem from a common cause: an excessively high cost of labor. In Europe, labor costs have gone up for many reasons, but one is particularly easy to identify: higher taxes on labor.

Using a complex general equilibrium model, German economist Bernhard Heitger (1993) concluded that for the most important OECD countries, taxation turns out to be growth-retarding. Roubini, Milesi and Gian (1998) concluded that, “in general, the taxation of factor incomes...is growth-reducing.” In an interesting recent study (Gittell, Kaufman and Karson 2000),

the authors explore regional and state patterns in American economic change, concluding that the role of geography itself is modest in explaining differentials, but that other factors, including state personal income taxes, play a more important role. Work on Canada similarly shows adverse effects of taxes on growth, both impacting on supply and demand (Fougere 1998). Looking more broadly at OECD nations, Boyle and McCarthy (1996) criticize studies showing a modest role for taxes in explaining inter-country growth rates, showing how labor taxation very strongly negatively impacts on the full utilization of resources.

## **New Zealand**

In a study of New Zealand somewhat similar to studies done by Richard Vedder and Lowell Gallaway (1998) and by James Gwartney, Robert Lawson, and Randall Holcombe (1998), Gerald Scully (1996) concluded that New Zealand would have to cut its taxes roughly in half to maximize the rate of economic growth, and that **“the marginal cost of taxation ... is \$2.64 for each extra dollar of taxes collected”** showing even greater “deadweight losses” and inefficiencies than Feldstein observed for the U.S.

In a study in the highly regarded *Journal of Monetary Economics*, economists from the Federal Reserve and the University of Florida examined changing marginal income tax rates in the U.S. over time, concluding that “lowering taxes significantly raises economic growth and that changing the tax rate schedule also has significant effects on economic growth” (Hakkio, Rush and Schmidt 1996). This last conclusion reflects the view that high taxes not only lower income generation, but that the type of tax can make a difference.

## **Taxes impact business location**

This discussion so far has reported research on the negative impact of taxes on economic growth—about 40 studies. However, another large number of studies look at related issues, such as the impact of taxes on business location. As early as 1977, Grieson, Hamovitch and Morgenstern used econometric techniques to argue that high taxes discouraged business entrepreneurs from locating in a given area. Bernard Weinstein, alone (1977) and with Robert Firestone (1978), noted that high taxes forced up labor costs, as employers had to compensate employees for the burden of high taxes, a conclusion verified empirically in a later NBER study (Gyourko and Tracy 1986). The follow-up studies in the 1980s, using even more sophisticated econometric models, confirmed the earlier conclusion that high taxes deter businesses from investing capital (Carlton 1983; Papke and Papke 1986; Papke 1986; Bartik 1989). Research in the 1990s agreed that taxes matter in business location, albeit with some qualifications, such as Fox and Murray’s (1990) conclusion that the sensitivity to taxes varies considerably with industry and firm size (see also Friedman, Gerlowski and Silberman 1992). The aforementioned Hines study showing foreign investors are deterred by high taxes actually confirmed what an earlier study had shown as well (Couglin, Terza, and Aromdee, 1990). One of the more interesting studies used a distinctly low-tech approach—questionnaires to business leaders—and concluded that high tech firms were swayed considerably by tax considerations in making location decisions (Premus 1983).

Other research has demonstrated that **high taxes reduce in-migration and spawn out-migration**. Early work noting

**High taxes discouraged business entrepreneurs from locating in a given area.**

There is mounting evidence that high taxes reduce job opportunities and sometimes lead to higher unemployment.

the debilitating effects of taxes on local population growth by Cebula (1974), Browne (1979) and Ecker and Syron (1979), have been replicated by others in the past decade or so, including Niskanen (1992), Kotlikoff and Raffelhueschen (1991), and Cadwallader (1991). Research that is more recent reinforces the general conclusion by providing added detail. A recent study in the *National Tax Journal*, for example, suggests that the elderly are influenced by low personal income and death taxes, and prefer states that exempt food from sales taxation (Conway, Smith and Houtenville 2001).

This is consistent with the finding of Assadian (1995) that the elderly in Florida were less likely to migrate into counties with high taxes, even more so than the general population.

### **Higher taxes reduce job opportunities**

Finally, there is mounting evidence that high taxes reduce job opportunities and sometimes lead to higher unemployment.

Wasylenko and McGuire (1985) noted a negative correlation between taxes and metropolitan area employment growth between 1973 and 1980. Plaut and Pluta (1983) observed even stronger findings on this point. Goss, Preston and Phillips

(1994) think previous studies understate the adverse employment effects of taxes by failing to control for other factors fully. Gallaway and Vedder have observed that high taxes are often positively associated with unemployment, both in the U.S. and internationally (Vedder and Gallaway 1996, 1999b). Other research using state and local data reach similar conclusions (Dalenberg and Partridge 1995; Mark, McGuire and Papke, 2000).

This review of the literature, although listing over 65 studies, is not comprehensive. Nor does it discuss every economic dimension of taxation. To cite one excluded example, in a well-regarded study in the *National Tax Journal*, Ladd and Bradbury (1988) observed that high property taxes lower property values, causing significant loss of real wealth. In a work as yet unpublished, Stephen Moore and Richard Vedder have found the same effect for all taxes. To cite another economic impact of state and local taxes, interstate variations in tax rates lead to enormous amount of cross-border activity, and thereby to administrative problems arising from smuggling, etc. Early work suggesting high sensitivity of citizens to tax differentials in border areas (Mikesell 1970, 1971), has been replicated in later work (e.g., Vedder 1993, 1996; Walsh and Jones 1988).

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