Spending Trends

Over the past two decades, lawmakers have more than tripled the size of Nevada's general fund, growing state spending from $1.0 billion in FY 1994 to $3.1 billion for FY 2013.

During these years, the Silver State's population has grown significantly, creating additional demand for public services. Lawmakers, however, increased spending at a rate far greater than population growth and inflation combined — meaning that Nevadans face a much higher per-capita cost of government today than they did 20 years ago.

Key Points

General fund spending is only one component of total spending. Public attention often focuses exclusively on the state's general fund, because this spending falls under the direct control of lawmakers every two years. However, general fund spending accounts for only about 40 percent of total state spending.

In addition to the general fund, state spending includes federal dollars that are received to help pay for state-administered entitlement programs like Medicaid. Lawmakers have also established, and bear responsibility for, many secondary accounts like the highway fund and the permanent school fund, through which additional billions are spent annually.

The 2003 tax hikes drove the growth in per-capita spending. Between FY 1994 and FY 2003, inflation-adjusted, per-capita, general fund spending remained relatively constant. However, following the record-breaking tax increases of 2003, lawmakers began spending significantly more on a per-capita basis. Between FY 2003 and FY 2009, inflation-adjusted general fund spending per capita grew 18.4 percent as lawmakers increased employee pay and benefits, expanded the class-size reduction program, instituted limited full-day kindergarten programs in Clark and Washoe counties and began financing the Millennium Scholarship out of the general fund.

Despite recent reductions, current spending still outpaces historical levels. Although lawmakers were compelled to reduce per-capita spending for the 2011-13 biennium due to negative revenue growth during the Great Recession, inflation-adjusted, per-capita spending remains higher than at any point in the decade prior to the 2003 tax hikes.

In fact, since the 2003 tax hikes, lawmakers have spent a cumulative $5.5 billion beyond the inflation-adjusted, per-capita spending levels that existed in the decade beginning in FY 1994 and ending in FY 2003.

Recommendations

Enact meaningful spending controls to protect taxpayers. In successive legislative sessions, lawmakers have debated whether to enact a constitutional limitation on the growth in state spending. The proposed "Tax and Spending Control" (TASC) amendment would ensure that the real, per-capita cost of government does not increase over time by prohibiting lawmakers from increasing spending faster than the rate of population growth combined with inflation.

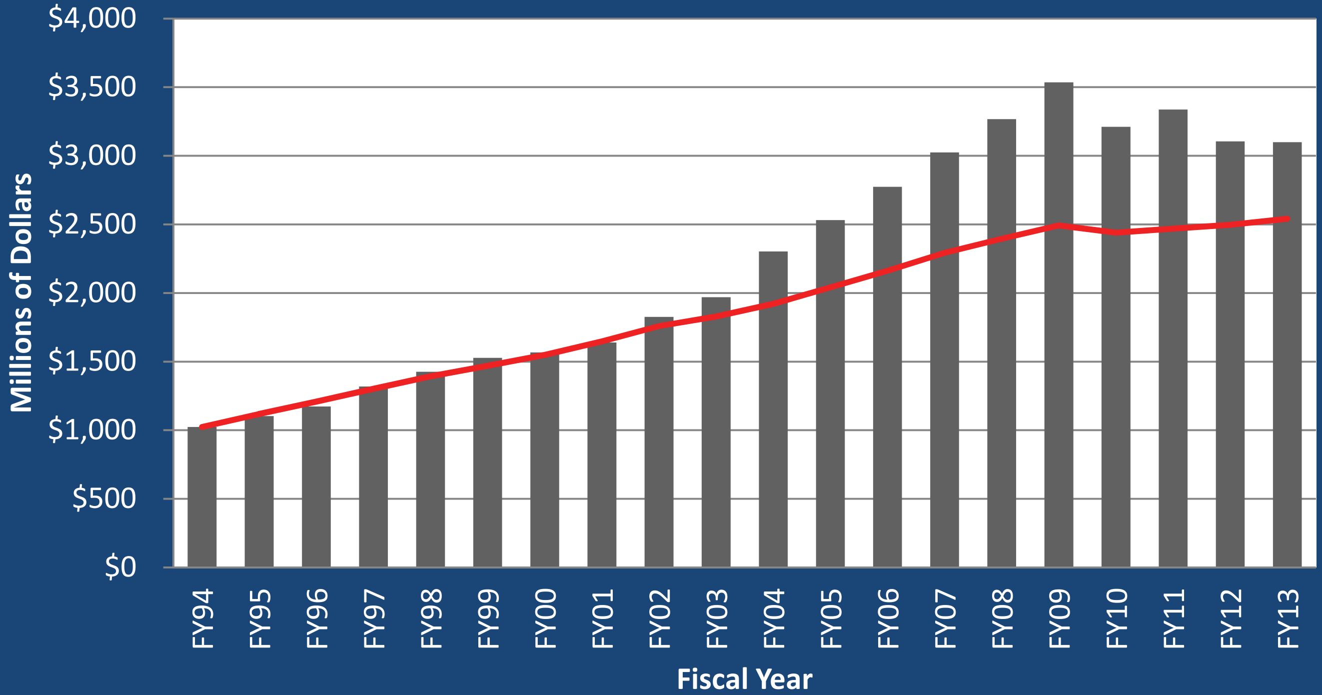
Opponents of TASC have argued that Nevada's spending already has population-growth and inflation controls on it since the governor's Executive Budget proposal is prohibited from exceeding the per-capita spending level that occurred in the 1975-77 biennium, indexed for inflation. However, this limitation is meaningless because lawmakers are free to add as much spending as they like to the governor's proposal with no restraint whatsoever.[1]

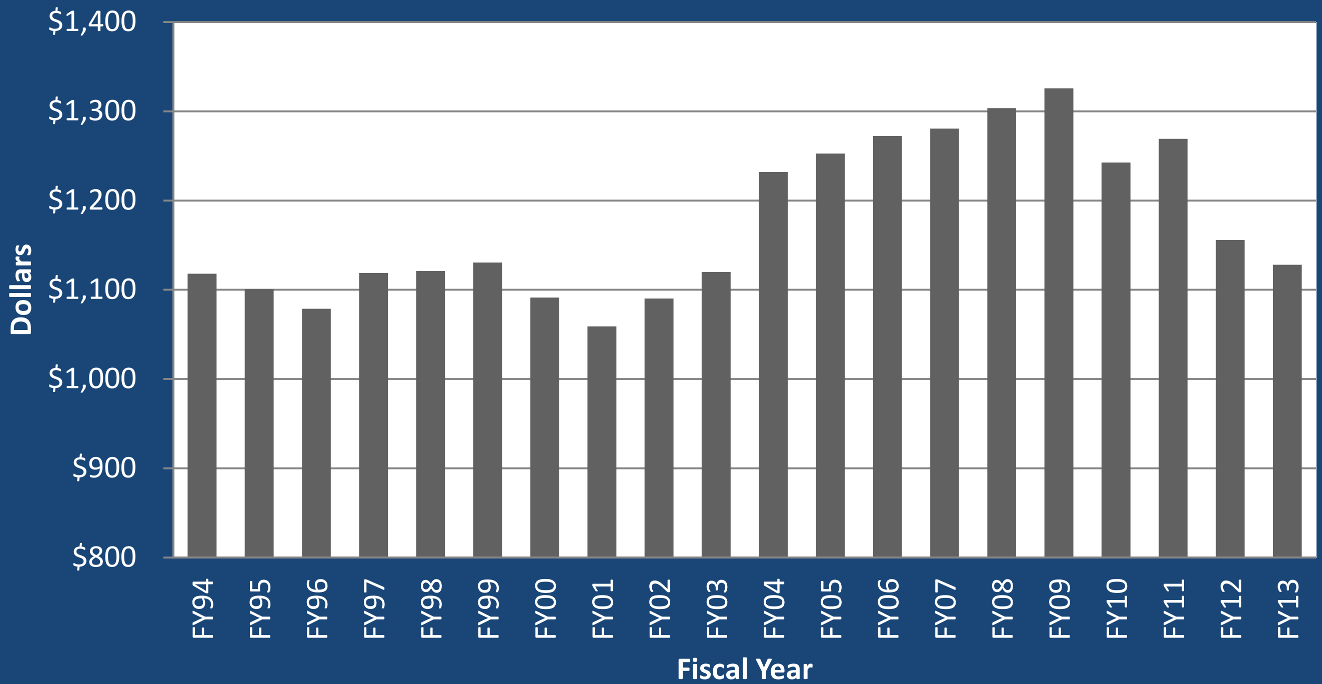
With TASC in place, lawmakers who are convinced of the merits of higher spending on a given program would first need to find savings elsewhere in the budget.

TASC would offer long-term certainty to potential investors and job-creators in Nevada by curtailing the perpetual drive for new taxes.

As such, its enactment should be viewed not only as a centerpiece for fiscal policy, but also as a linchpin for economic development in the Silver State.

[1] Geoffrey Lawrence, "Better Budgeting for Better Results," Nevada Policy Research Institute policy study, 2011.





Source: Nevada Legislature, Legislative Counsel Bureau, Fiscal Division, Appropriations Reports.

Structural Reform: Charter Agencies

Nevada's state government, like those of most other states, has over time turned into a collection of rigid bureaucracies conditioned to emphasize strict adherence to legislatively prescribed processes, rather than achieving quantifiable results.

The new performance-based budgeting process, now required as a result of 2011 legislation, will finally begin to change this culture. This new accountability, however, will be meaningless if agency directors do not gain the flexibility needed to determine the best way to accomplish the Legislature's objectives.

Lawmakers should recognize that those with the greatest knowledge and insight into how public services can most effectively be delivered are often the employees of the state agencies. The top-down approach to governance that lawmakers have historically imposed fails to take advantage of the state's most valuable asset — the specialized knowledge of its employees.

The task of lawmakers should be restricted to setting broad policy goals, while specific decisions over the means for achieving those goals should be left to the agencies themselves.

Key Points

Extend school principals' "empowerment" model to agency directors. In Iowa, lawmakers looking to increase the cost-effectiveness of government experimented by highlighting broad policy objectives and allowing agency directors to determine the best means of achieving those objectives.

To ensure accountability, annual contracts were signed by agency directors, specifying the performance metrics they would be responsible for meeting at the risk of dismissal. They further agreed to reduced general fund allocations.

In exchange, directors gained the freedom to hire and fire employees, upgrade their agencies' technology infrastructure, purchase equipment and outsource certain agency functions as they saw fit — without going through the state's central purchasing or personnel departments.

Further, agencies that met their goals, below budget, retained half the savings with the remainder reverting to the state's general fund. Agency directors could use these savings to reward employees with bonuses or to purchase efficiency-enhancing capital equipment.

The results have been phenomenal. Even as Iowans saved millions of dollars, they saw remarkable improvements in the quality of public services. Iowa's "charter agency" approach has since been recognized with an Innovations in American Government Award from Harvard University's Kennedy School of Government.[1]

Recommendations

Clarify the goals and metrics. Nevada's new performance-based budgeting approach will place agency directors before lawmakers, reporting on the progress made toward specific objectives. It will be up to lawmakers to clearly outline the policy objectives they most highly value and to identify appropriate metrics for evaluating progress toward those goals.

Create a "charter agency" framework and allow agency directors to opt in. The charter agency framework can be modeled after the 2003 enabling legislation from Iowa, SF 453 and HF 837. Agency directors who opt in should be signed to performance contracts that outline their responsibilities for meeting legislatively defined goals. These contracts should reward each increase in agency excellence with more and more agency discretion.

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[1] Harvard University, John F. Kennedy School of Government, "Innovation in State Government: Iowa Charter Agencies," 2005.

Charter agency successes in Iowa

Department of Natural Resources

- Reduced turnaround time for air-quality construction permits from 62 days to six days and eliminated a backlog of 600 applications in six months.
- Reduced turnaround time for wastewater construction permits from 28 months to 4.5 months.
- Reduced turnaround time for landfill permits from 187 days to 30 days.
- Reduced time for processing corrective-action decisions on leaking underground storage tanks from 1,124 days to 90 days.
- Accomplished all reductions without compromising environmental standards or quality.

Department of Corrections

- Reduced the probation failure rate by 17 percent.
- Increased the number of female inmates receiving meaningful work experience by 50 percent while reducing operating costs by $700,000 per year.
- Increased the number of parole recommendations by 5 percent in one year.

Department of Revenue

- Raised the rate of income-tax returns filed electronically from 55 percent to 67 percent.
- Increased the number of personal income-tax filings completed within 45 days from 75 percent to 94 percent.

Department of Human Services

- Reduced the average child-welfare stay in shelter care by 10 days.
- Increased the number of children with health care coverage by 12 percent in FY05 alone.

Iowa Veterans Home

- Reduced the number of residents experiencing moderate to severe pain by 50 percent.
- Reduced admission waiting times by increasing the rate of admissions processed within 30 days from 69 percent in FY04 to 90 percent in FY05.

Alcoholic Beverages Division

- Increased general fund revenue by $9.7 million in FY04 and $11.6 million in FY05.

Source: Jim Chrisinger, Team Leader for Accountability and Results at the Iowa Department of Management, Speech to Manhattan Institute, March 16, 2006.

Structural Reform: Auditing

Entrepreneurs in the private sector often hire consultants to advise them on how best to streamline operations and deliver goods to market as efficiently as possible.

Public-sector entrepreneurs who direct charter agencies[1] could benefit from similar advice. The State of Nevada can ensure such valuable support for its new charter agency directors by establishing a new, independent, state auditor position with the authority and funding to conduct performance audits.

Key Points

Auditors should always remain free of political influence. Currently, the only state auditing offices in Nevada serve at the pleasure of incumbent politicians. The Audit Division of the Legislative Counsel Bureau is directly subordinate to legislative leadership, while the Department of Administration's Division of Internal Audits is ultimately subordinate to the governor.

This subordinance compromises auditors' ability to choose which government agencies or functions should be reviewed as well as the integrity of their findings — which become subject to potential suppression by interested politicians. For this reason, state audit functions should be consolidated into a single, independent state auditor's office.

Performance audits are different from financial audits. Financial audits merely review and reconcile accounting statements and practices without evaluating the relative effectiveness of each spending item. Performance audits go a step further by identifying the organizational structures and spending practices that would achieve optimal results.

Performance audits can identify substantial cost savings while simultaneously improving performance. In 2005, citizens in the State of Washington expanded the powers of that state's independent auditor to conduct performance audits for all state and local governments. To date, the office has conducted 30 performance audits and has conducted reviews of more than 80 state and local governments, programs and services.

[1] See "*Structural Reform: Charter Agencies,*" page 6.

These performance audits and reviews have identified nearly $1 billion in potential five-year savings and increased revenue. What's more, the auditor's advice has been accepted with enthusiasm, as 86 percent of recommendations have been fully or partially implemented.[2]

Performance audits are a natural complement to charter agencies. While a performance audit can be valuable to any organization, the organizational structure of charter agencies especially aligns the incentives facing agency directors with those of lawmakers and taxpayers. When agency directors and their employees see a direct financial benefit — and not a loss — as the result of increased cost-effectiveness, they have every motivation to actively solicit and aggressively implement the recommendations of performance auditors.

Recommendations

Establish an independent state auditor's office. The position of an elected, independent state auditor should be established under Nevada law, free of manipulation by incumbent politicians. The state auditor should be free to select any state or local government or program for review. Existing auditors' offices in the legislative and executive branches should be consolidated with the office of the state auditor.

Endow the state auditor with the funding and authority to conduct performance audits. The 2005 enabling law for performance auditing in the State of Washington, Initiative 900,[3] should serve as a model for instituting performance audits in Nevada.

[2] Washington State Auditor's Office, "About Performance Audit," 2011.
[3] Sam Reed, Secretary of State, State of Washington, Initiative 900, 2005.

Performance Audits in Washington

Name of Audit	Audit's Findings
Department of Transportation — Congestion Management	Provided recommendations for reducing road congestion 20 percent through low-cost measures; **Economic impact: $3 billion**
Collection of State Debt at Six State Agencies	**Uncollected debt: $319.4 million** within four agencies
Port of Seattle Construction Management	**Unnecessary spending: $97.2 million** due to inadequate oversight
King County Solid Waste and Wastewater Treatment Utility Operations	**Potential savings: $78.8 million to $82.4 million; Additional Revenue: $4.8 million to $6.8 million**
Opportunities for the State to Help School Districts Minimize the Costs and Interest Paid on Bond Debt	**Cost Avoidance: $44.6 million to $79.4 million** by following best practices
Administrative and Support Services at the 10 largest K-12 School Districts	**Unnecessary costs: $54 million** within eight school districts
Department of Transportation — Washington State Ferries	**Potential savings: $50.2 million** through better management practices
Department of Transportation — Highway Maintenance and Construction Management	**Cost avoidance: $42 million** by improving inventory and supply management
Educational Service Districts	Provided recommendations for better coordinating services and reducing administrative costs; **Cost avoidance: $25.3 million**
Seattle Public Utility Operations	**Potential savings: $17.6 million to $24.4 million** by restructuring operations
Department of Transportation — Administration & Overhead	**Cost avoidance: $18.1 million** by centralizing functions and avoiding redundancy
Three Public Hospital Districts	**Potential savings: $8.4 million** through organizational efficiencies
Sound Transit's Link Light Rail	**Unnecessary spending: $5.1 million** due to poor construction management
Department of General Administration Motor Pool	**Cost avoidance: $2.3 million** by changing purchasing methods and reassigning underused vehicles
Department of Commerce User Fees	**Could reduce general fund spending: $2.2 million to $2.4 million** if fees were charged for four programs
King County Rural Library District Construction Management Practices	**One-time savings: $715,000 to $1.3 million**; **Potential ongoing savings: $1.1 million** subject to price increases and labor disputes
Use of Impact Fees in Federal Way, Olympia, Maple Valley, Redmond and Vancouver	**One-time savings: $1.18 million to $1.34 million** by more effectively calculating impact fees
Seattle Public Schools Construction Management	**Cost avoidance: $1.2 million** by implementing best practices
Travel Practices at 13 School Districts	**Cost avoidance: $1.1 million** by implementing best practices
Department of Fish and Wildlife Vehicle Use	**Net cost avoidance: $1 million** by improving fleet management practices

Source: Washington State Auditor's Office.

Competition and Performance-based Budgeting

Performance-based budgeting is an approach to budgeting that ranks expenditures in order of their priority — increasing governmental accountability for the efficient use of tax dollars.

Under this approach, policymakers:

1) outline their broad policy goals, in order of priority,
2) define the performance metrics that will be used to measure progress toward those goals, and
3) direct public monies specifically toward the accomplishment of those top goals.

In 2011, Gov. Brian Sandoval submitted the Silver State's first performance-based Executive Budget document.[1] Later that year, Nevada lawmakers passed a bill that institutionalized the performance-based approach into state law.[2]

However, the legislation passed in 2011 fails to envision the performance-based approach in its highest form, which entails a competitive bidding process.

Key Points

Prioritize the results, not the intentions. A performance-based budgeting process cannot succeed unless policymakers first establish their broad policy goals. Policymakers should be discriminating with the use of tax dollars, recognizing that the *results* of state programs — and not just policymaker intentions — are what matter. Not every spending program will produce, or has produced, a result that taxpayers value.

There is no entitlement to public money. Bureaucrats approaching lawmakers with funding requests often do so with the expectation that just because a program has existed in the past, it should continue to receive funding in the future — regardless of its results.

The burden of proof should be on the agency directors to demonstrate that each program operating within an agency reflects lawmakers' broad policy goals and is a worthwhile use of tax dollars. In effect, agency directors should "sell" their product to lawmakers, who, in turn, should act as taxpayers' vigilant stewards.

Government monopoly is not the only way to provide public services. If lawmakers are convinced that a particular result merits the use of tax dollars, they should then "shop" for the most cost-effective supplier of that result. That supplier may not always be an existing state office.

Once lawmakers have decided on a list of worthwhile programs, they should issue a request for proposals to administer those programs. Any state agency or local government should be free to bid to administer a program — as should any potential private-sector or non-profit competitor. Lawmakers can then select from among the most cost-effective bids.

Competition spurs innovation. When the State of Washington pioneered the performance-based budgeting process in 2003, its policymakers realized significant cost savings through submitting the delivery of public services to a competitive process. Facing competition, state agencies reinvented themselves to become more efficient — partnering with other agencies to streamline operations and avoid duplication.

As a result, Washington taxpayers were able to save more than $2 billion over just the 2003-05 budget cycle, while also receiving far greater value from their state government.[3]

Recommendations

Incorporate a competitive bidding process into the performance-based budgeting method. Nevada taxpayers deserve the highest value possible for their tax dollars. Competitive bidding is crucial to that effort.

[1] State of Nevada, Department of Administration, Division of Budget and Planning, "2011-2013 Executive Budget: Priorities and Performance Budget."
[2] Nevada Legislature, 76th Session, Assembly Bill 248.

[3] State of Washington, Office of Financial Management, "Priorities of Government" website, accessed Oct. 2011; see also, David Osborne, "The Next California Budget: Buying Results Citizens Want at a Price They Are Willing to Pay," Reason Foundation, 2010.

Washington lawmakers' statements of prioritized policy objectives

1. Washingtonians value world-class student achievement in early education, elementary, middle and high schools and postsecondary institutions.
2. We must improve the health of Washingtonians and support and keep safe our children and adults who are unable to care for themselves.
3. Washington must promote economic development in a growing competitive environment.
4. Efficient state government services are important to the people of Washington state.
5. It is our responsibility to provide for the public safety of people and property in Washington state.
6. Protect natural resources, cultural and recreational opportunities.

Washington's 2009-2011 Purchase Plan for Student Achievement (Sample Items)

Priority	Rank	Agency Name	Activity	Strategy	Current/ New
High		Supt of Public Instruction	Bilingual Education	Give students individual attention	Current
High		Supt of Public Instruction	General Apportionment	Provide general education support	Current
High		Supt of Public Instruction	Learning Assistance	Give students individual attention	Current
High		Supt of Public Instruction	Special Education	Give students individual attention	Current
Low	18	Supt of Public Instruction	General Apportionment	Provide general education support	K-4 enhancement
Low	19	Supt of Public Instruction	General Apportionment	Provide general education support	All-day K
Low	20	Department of Early Learning	Early Learning Programs	Support early education and learning	Current
Low	21	Supt of Public Instruction	General Apportionment	Provide general education support	Skills centers
Low	22	Supt of Public Instruction	Student Health	Provide general education support	Current
Low	23	Supt of Public Instruction	Professional Development	Strategic and individualized preparation for education staff	Current
Buy Next	54	Supt of Public Instruction	Local Effort Assistance	Provide general education support	Current
Buy Next	55	Supt of Public Instruction	Student Achievement Fund	Provide general education support	Current
Buy Next	56	Supt of Public Instruction	Curriculum and Instruction - Programs	Align curriculum, Instruction and Assessment	Math and Science Standards
Buy Next	57	Supt of Public Instruction	Highly Capable Student Education	Support parent and community connections	Current
Do Not Buy	73	Supt of Public Instruction	Vocational Student Leadership	Support parent and community connections	Current
Do Not Buy	74	Department of Early Learning	Child Care and Early Learning Quality Initiatives		QRIS Pilot Expansion
Do Not Buy	75	State School for the Blind	Off-Campus Services to Students/Districts	Support parent and community connections	Teacher Recruitment

Source: State of Washington, Office of Financial Management.

Total Tax Burden

Much confusion exists concerning the actual tax burden facing Silver State residents. In popular narrative, Nevada is often referred to as a low-tax, business-friendly state. However, the state tax burden, in isolation, is not what taxpayers find most relevant: It is the *total* tax burden — including the taxes assessed at federal, state and local levels.

It is this total tax burden that impacts human behavior — distorting investment and employment patterns and shifting consumer demand toward tax-exempt purchases. Differences in the tax burden across city, county, state and even national boundaries prompt both businesses and individuals to relocate with increasing frequency.

In fact, there has been a sizable population shift within the United States over the past decade as individuals have moved from high-tax states to low-tax states. Over this time, nearly one person per minute has left the 10 highest taxing states for states with lower tax burdens.[1]

While attention in Nevada is often drawn to a relatively low *state*-level tax burden, the uncommonly high *local* tax burden faced by Silver State residents offsets this supposed advantage and undermines state competitiveness.

Key Facts

Nevadans face the ninth highest local-government tax burden in the country. Tax collection data from the U.S. Census Bureau shows that Nevada's relatively low state tax burden is offset by a relatively high local tax burden.[2]

Total per-capita government revenues in Nevada are near the national median. When both state and local government revenues are considered together, Nevada is neither a particularly low-tax state, nor a particularly high-tax state. Silver State governments collected $5,742 for every man, woman and child in the state in 2009 – good for 29th highest in the nation.[3]

[1] Richard Vedder, "High Tax Burdens Lead to Population Losses," *Inside ALEC*, April 2010.
[2] U.S. Department of Commerce, U.S. Census Bureau, State and Local Government Finance.
[3] *Ibid.*

Nevada's tax burden is higher than four of five contiguous states. Among Nevada's neighbors, only California levies a higher tax burden upon its people. Oregon, Utah, Idaho and Arizona governments, respectively, collect $240, $585, $964 and $1,165 less per capita than do Nevada governments.

What's more, each of these states boasts higher student achievement[4] and lower crime rates than Nevada.[5] Nevada's relatively high regional tax burden and subpar results render the state a less attractive destination for investment than most of its neighbors.

A leading reason for high costs at the local-government level is the extravagance of employee pay. Local-government employee wages in Nevada in 2009 were 31 percent higher than the national average.[6] If local-government workers in Nevada earned merely the national median wage for local-government workers, Silver State taxpayers would realize a two-year savings approaching *$2.3 billion*.[7]

Recommendations

Control local-government spending. Through constitutional provision or statute, limit the growth in local-government spending to the rate of population growth plus inflation. Also, reform or repeal NRS 288, Nevada's collective bargaining statute, to eliminate upward pressure on local-government spending from special-interest groups.

[4] U.S. Department of Education, National Center for Education Statistics, Digest of Education Statistics, 2010.
[5] U.S. Department of Commerce, U.S. Census Bureau, The 2012 Statistical Abstract.
[6] Based on data from U.S. Census Bureau: Government Employment and Payroll.
[7] Geoffrey Lawrence, "Better Budgeting for Better Results," Nevada Policy Research Institute policy study, 2011.

State and local government revenue per capita, from own sources, 2009

State	State revenue, per capita	Rank	State	Local revenue, per capita	Rank	State	State + local revenue, per capita	Rank
AK	$13,086	1	DC	$10,477	1	AK	$16,347	1
WY	$6,814	2	NY	$4,890	2	WY	$11,557	2
DE	$5,790	3	WY	$4,743	3	DC	$10,477	3
ND	$5,509	4	NJ	$3,473	4	NY	$9,284	4
VT	$5,475	5	FL	$3,450	5	ND	$7,727	5
HI	$5,357	6	CA	$3,385	6	NJ	$7,693	6
MA	$4,465	7	CO	$3,309	7	CT	$7,357	7
CT	$4,423	8	AK	$3,261	8	DE	$7,296	8
NY	$4,394	9	***NV***	***$3,124***	***9***	HI	$7,118	9
NJ	$4,220	10	IL	$2,996	10	MA	$6,993	10
NM	$4,188	11	NE	$2,943	11	CA	$6,788	11
WV	$4,032	12	CT	$2,934	12	MN	$6,598	12
MN	$3,995	13	WA	$2,856	13	VT	$6,547	13
RI	$3,900	14	KS	$2,783	14	RI	$6,431	14
ME	$3,825	15	TX	$2,748	15	MD	$6,324	15
MT	$3,707	16	IA	$2,724	16	WA	$6,261	16
MD	$3,667	17	MD	$2,657	17	KS	$6,246	17
WI	$3,658	18	LA	$2,655	18	IA	$6,240	18
AR	$3,551	19	OH	$2,620	19	WI	$6,126	19
IA	$3,516	20	NH	$2,608	20	NE	$6,078	20
KS	$3,463	21	MN	$2,603	21	CO	$6,041	21
VA	$3,421	22	VA	$2,583	22	VA	$6,004	22
WA	$3,405	23	GA	$2,574	23	ME	$5,971	23
CA	$3,403	24	RI	$2,531	24	IL	$5,966	24
PA	$3,365	25	MA	$2,528	25	LA	$5,925	25
MI	$3,321	26	PA	$2,500	26	FL	$5,906	26
OK	$3,292	27	IN	$2,468	27	PA	$5,865	27
LA	$3,270	28	WI	$2,468	28	NM	$5,858	28
KT	$3,242	29	SC	$2,409	29	***NV***	***$5,742***	***29***
UT	$3,226	30	OR	$2,395	30	MT	$5,683	30
IN	$3,201	31	MO	$2,341	31	IN	$5,669	31
NE	$3,135	32	AZ	$2,281	32	OH	$5,667	32
OR	$3,107	33	MI	$2,254	33	MI	$5,575	33
OH	$3,047	34	NC	$2,244	34	WV	$5,505	34
IL	$2,970	35	SD	$2,221	35	OR	$5,502	35
SC	$2,946	36	ND	$2,218	36	NH	$5,453	36
MS	$2,917	37	TN	$2,193	37	SC	$5,355	37
NC	$2,914	38	ME	$2,146	38	OK	$5,229	38
NH	$2,845	39	AL	$2,137	39	TX	$5,196	39
AL	$2,841	40	MS	$2,078	40	NC	$5,158	40
ID	$2,754	41	ID	$2,024	41	UT	$5,157	41
CO	$2,732	42	MT	$1,976	42	MS	$4,995	42
SD	$2,712	43	OK	$1,937	43	AL	$4,978	43
NV	***$2,618***	***44***	UT	$1,931	44	SD	$4,933	44
MO	$2,477	45	HI	$1,761	45	KT	$4,909	45
FL	$2,456	46	NM	$1,670	46	MO	$4,818	46
TX	$2,448	47	KT	$1,667	47	ID	$4,778	47
TN	$2,406	48	DE	$1,506	48	GA	$4,765	48
AZ	$2,296	49	WV	$1,473	49	AR	$4,751	49
GA	$2,191	50	AR	$1,200	50	TN	$4,599	50
DC	$0	51	VT	$1,072	51	AZ	$4,577	51

Source: U.S. Census Bureau, State and Local Government Finance.

Tax Reform

For decades, Nevada lawmakers have discussed the possibility of tax "reform." Indeed, they have commissioned a growing library of studies to examine tax-reform possibilities only to later ignore the recommendations of those studies.

It should be noted that Nevada's most prominent fiscal challenges have occurred on the spending side of the ledger — not the revenue side. After all, per-capita state and local government revenues in Nevada outpace those in four of Nevada's five immediate neighbors.[1] Given this reality, there is little reason to believe that Silver State government suffers from insufficient revenue.

Nevertheless, NPRI recognizes that no tax structure is perfect and that Nevada's taxing system could be improved, on a revenue-neutral basis, by designing reform around the considerations outlined here.

Key Points

Tax reform should minimize revenue volatility. Volatility in tax revenues exacerbates the tax-and-spend cycle. During periods of economic growth, upward volatility showers legislatures with unusually high revenues. Lawmakers have historically committed these revenues to expand government programs and liabilities, even though such expansion regularly proves unsustainable when economic recession arrives.

When recessions do occur, downward volatility enlarges the deficit between revenues and the inflated spending levels previously committed to by lawmakers during the period of economic growth. Lawmakers have historically responded to this deficit by calling for new or higher taxes — only to once again over-commit tax dollars as soon as economic growth returns.

The tax structure should be designed to minimize distortions in economic behavior. Taxes that penalize specific behaviors or consumption patterns discourage individuals from engaging in those behaviors. This causes a destruction of jobs and wealth as individuals are pushed away from welfare-maximizing behaviors and toward second-best alternatives. For instance, taxes on savings and investments, such as capital gains taxes, discourage individuals from saving and encourage immediate consumption.

Compliance costs should be kept to a minimum. Complicated taxing mechanisms, such as the federal income tax, carry additional costs as filers must devote thousands of man-hours to understand the tax code and ensure compliance. The Tax Foundation estimates, for example, that compliance costs associated with the federal income tax will amount to $377 billion in 2013 — more than one-fifth of the total revenue collected from the tax![2]

Nevada lawmakers should avoid tax instruments that use complex arrays of deductions and stratified income brackets.

Reform should protect tax equity. Taxpayers in similar circumstances should face similar tax burdens (horizontal equity). Taxpayers at different points along the income scale should also face a proportionally similar tax burden to ensure economic efficiency (vertical equity). Tax structures that are either overly regressive or overly progressive can obstruct economic growth.

Recommendations

If lawmakers are to pursue tax reform, it should be on a revenue-neutral basis. As this publication makes clear, current tax revenues in the Silver State are already more than adequate to provide high-quality government services.

To the extent Silver State governments have failed to deliver high-quality services, the failure has resulted from poor policy design or implementation. The recommendations in this volume will correct for this.

All four major objectives of tax reform can be accomplished through a revenue-neutral expansion of the sales tax base. NPRI has laid out a plan for expanding the sales-tax base with a consequent lowering of the statewide sales tax rate to 3.5 percent and eliminating other taxes, including the Modified Business Tax.[3]

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[1] See "*Total Tax Burden*," page 12.

[2] Tax Foundation, Tax Data, Total Federal Income Tax Compliance Costs 1990-2015.

[3] Geoffrey Lawrence, "One Sound State, Once Again," Nevada Policy Research Institute policy study, 2010.

Volatility levels of major tax instruments in NV, FY99-FY09

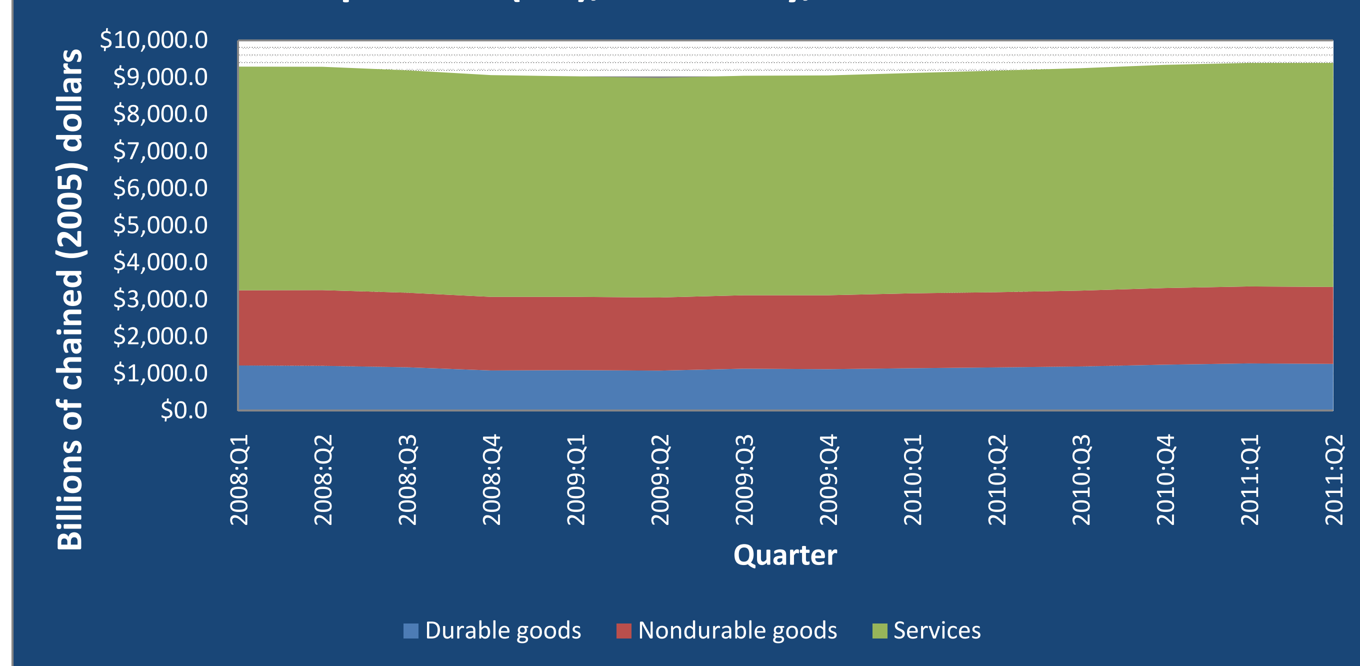
Tax instrument	Short-run elasticity with regard to NV personal income	Short-run elasticity with regard to U.S. personal income
Taxable Gaming Revenues	0.595	1.949
Sales & Use Taxes	1.031	2.211
Modified Business Tax	1.731	2.270
Insurance Premium Tax	1.193*	1.538*
Real Property Transfer Tax	-1.070**	-1.103
Liquor Tax	0.639	1.706
Cigarette Tax	0.305	1.204
Live Entertainment Tax	1.409	1.883
Governmental Services Tax	2.146*	1.297*
*Corporate Income Tax (National Average)****	-	*2.61*

*Less statistical probability; indicating that variability is likely not associated with the business cycle.

**Declining sales in the real estate market preceded the decline in the overall economy, creating the statistical illusion that revenues from this tax instrument are counter-cyclical.

***Volatility values for state corporate income taxes were generated by analysts at the Federal Reserve Bank of Kansas City.

Source: Geoffrey Lawrence, "One Sound State, Once Again," NPRI policy study, 2010.



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Business Margin Tax

In 2011, some lawmakers proposed a new tax instrument to be levied against Nevada businesses. Modeled after a Texas tax instrument of the same name, the proposed business margin tax would be assessed against firms with total taxable year revenue exceeding $1,000,000. For these firms, the proposed tax rate of 0.8 percent would be assessed against the least of:

A) 70 percent of total revenue,
B) Total revenue minus wages, or
C) Total revenue minus the cost of goods sold

Proponents said the margin tax was intended to eventually replace Nevada's tax on private-sector payroll, the Modified Business Tax. However, while repeal of the MBT should be considered, the margin tax proposal is likely an inferior alternative.

Key Points

The business margin tax is a hybrid, combining negative features of both corporate-income and gross-receipts taxes. According to the Tax Foundation, "the Texas 'margin' tax is really a badly designed corporate income tax."[1] However, the margin tax would create a tax liability even for businesses that operate at a financial loss, meaning the tax also possesses the negative attributes of gross receipts taxation.

Corporate income taxes exacerbate revenue volatility. Numerous analyses, including those of the Tax Foundation[2] and NPRI,[3] have shown that state corporate income tax revenues are extremely volatile and would be far more volatile than any tax instrument currently employed in Nevada. This volatility renders financial planning more difficult, particularly in states like Nevada that craft biennial budgets.

Gross-receipts taxes are "distortive and destructive." The Tax Foundation calls gross-receipts taxation "distortive and destructive," because such taxes "pyramid," as they are assessed at every level of production. Thus, highly complex goods that require multiple stages of production are repeatedly subjected to the tax. This results in a higher effective tax rate on more complex goods, which distorts economic behavior and would retard Nevada's economic diversification. As the Tax Foundation says, "Gross receipts taxes do not belong in any program of tax reform."[4]

A margin tax imposes high compliance costs. Margin taxes are extremely complicated — a complication compounded by the vague legal definitions of terms such as "cost of goods sold." Consequently, high compliance costs accompany margin taxes, imposing disproportionate burdens on small businesses, which lack the accounting expertise to navigate the tax.

The Texas margin tax is rife with problems. In 2009, Texas lawmakers heard over 100 bills to modify or repeal that state's margin tax — at the time only three years old.[5] The tax has consistently underperformed revenue projections and is widely perceived as unfair to small or struggling businesses.

Recommendations

Reject any proposal for a Texas-style margin tax. Tax scholar John L. Mikesell has appropriately referred to the margin tax as a "badly designed business profits tax … combin[ing] all the problems of minimum income taxation in general — excess compliance and administrative cost, penalization of the unsuccessful business, undesirable incentive impacts, doubtful equity basis — with those of taxation according to gross receipts."[6]

The Tax Foundation also declares, "there is no sensible case for gross receipts taxation, or modified gross receipts taxes such as a Texas-style margin tax."[7]

Indeed, there is broad consensus among tax economists that gross receipts or margin taxes are more destructive than alternative tax instruments yielding the same amount of revenue. As such, Nevada lawmakers should never consider the imposition of a margin tax in the Silver State.

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[1] Joseph Henchman, "Nevada May Consider New Business Taxes," Tax Foundation Fiscal Fact No. 270, 2011.
[2] *Ibid.*
[3] Geoffrey Lawrence, "One Sound State, Once Again," Nevada Policy Research Institute policy study, 2010.
[4] Henchman, note 1.
[5] *Ibid.*
[6] John L. Mikesell, "Gross Receipts Taxes in State Government Finances," Tax Foundation & Council on State Taxation Background Paper No. 53, 2007.
[7] Henchman, note 1.

Texas margin tax creates inequitable tax liability. The margin tax allows industries that are either heavily labor-intensive or heavily capital-intensive to declare higher exemptions. Industries that employ similar levels of labor as capital are unable to declare higher exemptions and face a larger tax liability. As a result, some industries face a tax liability disproportionate to their share of the state economy. The share of margin tax revenues paid by Texas' agriculture industry, for instance, is 2.6 times greater than its share of economic output

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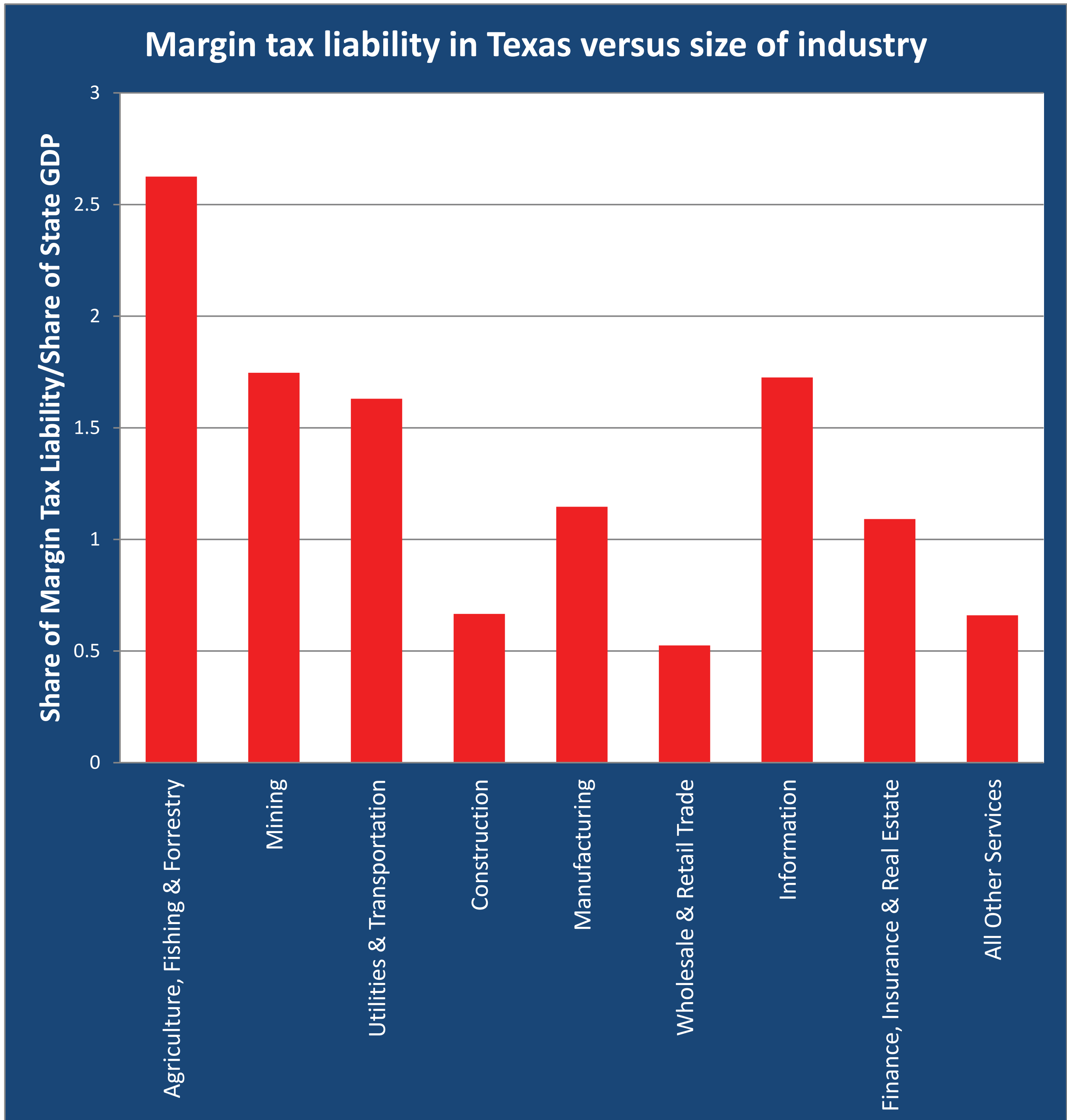


Source: Texas Legislature, 79th Legislature, 3rd Called Session, Legislative Budget Board, House Bill 3, Tax/Fee Equity Note, 2006.

State Lottery

From session to session, Nevada lawmakers have repeatedly considered the creation of a state-run lottery to provide additional state revenue. However, in so doing, lawmakers have deliberately ignored the advice of their own consultants.

In 1988, Nevada lawmakers commissioned a tax study from the Urban Institute and Price Waterhouse.[1] This study is still regarded as the most significant and comprehensive examination of Nevada's fiscal structure.

The study contains an entire chapter that examines whether Nevada should adopt a state-run lottery and concludes that the state should not do so for several reasons.

Key Points

State-run lotteries do not generate significant revenues. Lottery revenues account for less than three percent of total tax revenues, on average, in states that administer these games.[2]

State-run lotteries are not stable revenue sources. Nationwide, state lottery revenues fluctuate dramatically from year to year — for many reasons. Data shows that lottery revenues have increased by as much as 250 percent year-over-year, and have decreased by as much as 50 percent year-over-year. This high degree of volatility renders budgetary planning based on these revenues extremely difficult.[3]

State-run lotteries are a highly regressive form of taxation. Studies indicate that individuals at the bottom of the income scale spend a far higher percentage of their income on state lottery purchases, making state lotteries a highly regressive implicit tax. In fact, as Price Waterhouse says, "The information indicates that as a tax, lotteries are among the most regressive."[4]

In Nevada, a state-run lottery would compete directly with the private sector. Nevada is most unique among the states, because of the extent that private-sector gaming is a legal enterprise. A state-run lottery would compete directly with private forms of lottery such as keno. Moreover, the state already draws revenue from these private-sector games through its array of gaming taxes.

Recommendations

Do not create a state-run lottery. As Price Waterhouse — the Nevada Legislature's own tax consultant — has concluded, "A state-run lottery fails every test of a 'good' tax policy. In Nevada, gaming should be left to the private sector."[5]

[1] Ed. Robert D. Ebel, A Fiscal Agenda for Nevada, The Urban Institute and Price Waterhouse, Prepared for the Nevada Legislature, University of Nevada Press, Reno, 1990.
[2] *Ibid,* p. 418.
[3] *Ibid,* p. 420.
[4] *Ibid,* p. 422.
[5] *Ibid,* p. 17.

State lottery revenues, by state, 2009

State	Income	Prizes	Administration	Net Proceeds
Alabama	---	---	---	---
Alaska	---	---	---	---
Arizona	$452,014,000	$282,483,000	$42,497,000	$127,034,000
Arkansas	---	---	---	---
California	$2,747,141,000	$1,556,121,000	$175,119,000	$1,015,901,000
Colorado	$456,883,000	$301,506,000	$37,863,000	$117,514,000
Connecticut	$935,532,000	$604,712,000	$39,299,000	$291,521,000
Delaware	$429,703,000	$66,797,000	$48,304,000	$314,602,000
Florida	$3,723,641,000	$2,340,372,000	$130,414,000	$1,252,855,000
Georgia	$3,158,198,000	$2,148,681,000	$148,427,000	$861,090,000
Hawaii	---	---	---	---
Idaho	$129,227,000	$84,997,000	$5,288,000	$38,942,000
Illinois	$2,077,166,000	$1,225,864,000	$65,096,000	$786,206,000
Indiana	$682,157,000	$453,225,000	$50,903,000	$178,029,000
Iowa	$228,038,000	$138,425,000	$30,755,000	$58,858,000
Kansas	$211,009,000	$130,911,000	$20,559,000	$59,539,000
Kentucky	$714,786,000	$470,437,000	$38,264,000	$206,085,000
Louisiana	$357,467,000	$193,332,000	$30,836,000	$133,299,000
Maine	$197,147,000	$131,544,000	$14,749,000	$50,854,000
Maryland	$1,576,186,000	$1,025,901,000	$58,717,000	$491,568,000
Massachusetts	$4,162,355,000	$3,217,784,000	$99,599,000	$844,972,000
Michigan	$2,377,437,000	$1,436,372,000	$74,816,000	$866,249,000
Minnesota	$429,025,000	$310,376,000	$23,975,000	$94,674,000
Mississippi	---	---	---	---
Missouri	$908,938,000	$629,277,000	$34,062,000	$245,599,000
Montana	$41,334,000	$23,080,000	$8,038,000	$10,216,000
Nebraska	$115,577,000	$71,861,000	$15,141,000	$28,575,000
Nevada	---	---	---	---
New Hampshire	$226,862,000	$142,050,000	$16,534,000	$68,278,000
New Jersey	$2,363,779,000	$1,421,294,000	$71,864,000	$870,621,000
New Mexico	$134,593,000	$79,896,000	$14,000,000	$40,697,000
New York	$6,820,833,000	$4,003,267,000	$311,195,000	$2,506,371,000
North Carolina	$1,202,654,000	$741,270,000	$54,825,000	$406,559,000
North Dakota	$20,712,000	$11,315,000	$3,705,000	$5,692,000
Ohio	$2,267,618,000	$1,459,048,000	$122,467,000	$686,103,000
Oklahoma	$193,165,000	$95,923,000	$13,532,000	$83,710,000
Oregon	$887,364,000	$211,928,000	$80,106,000	$595,330,000
Pennsylvania	$2,864,359,000	$1,852,499,000	$74,057,000	$937,803,000
Rhode Island	$494,345,000	$144,857,000	$9,118,000	$340,370,000
South Carolina	$933,851,000	$633,196,000	$42,518,000	$258,137,000
South Dakota	$148,753,000	$23,318,000	$7,075,000	$118,360,000
Tennessee	$1,016,357,000	$705,781,000	$50,229,000	$260,347,000
Texas	$3,532,042,000	$2,299,752,000	$192,163,000	$1,040,127,000
Utah	---	---	---	---
Vermont	$90,340,000	$60,737,000	$8,515,000	$21,028,000
Virginia	$1,288,722,000	$781,022,000	$71,836,000	$435,864,000
Washington	$456,968,000	$301,280,000	$42,381,000	$113,307,000
West Virginia	$799,938,000	$119,449,000	$33,227,000	$647,262,000
Wisconsin	$473,414,000	$279,599,000	$32,156,000	$161,659,000
Wyoming	---	---	---	---

Source: U.S. Department of Commerce, U.S. Census Bureau, State Government Finances, Income and Apportionment of State-Administered Lottery Funds.

PERS: Assessing the Liability

Official financial statements from the Nevada Public Employees' Retirement System indicate that, at the close of FY 2010, the system held $24.7 billion in assets versus $35.1 billion in liabilities. This ratio would mean that PERS has a funding ratio of 70.5 percent and an unfunded liability of $10.4 billion.[1]

The actuarial accounting method used by PERS and other public-sector pension programs, however, is at odds with the real-world methods of accounting for risk required for private-sector plans. The PERS method glosses over most of the system's unfunded liability by assuming unreasonable rates of return.

Market-based accounting—which is endorsed by the vast majority of financial economists, is used by financial markets to value liabilities and is required of private-sector pensions — shows that PERS' official liability estimates are dramatically understated. The true value of the system's unfunded liability at the close of FY 2010 was about $41.0 billion.[2]

Key Points

Actuarial accounting conflates assets and liabilities. PERS accounting methods discount the value of expected future liabilities by the system's assumed annual rate of return on investments (8 percent) to calculate the present value of liabilities. Economists, however, agree that liabilities should be calculated independently of assets, which are uncertain over time; liabilities can be calculated with more certainty.

PERS does not account for risk in its investment portfolio. If retirement benefits promised to government workers in the Silver State are regarded as a zero-risk guarantee, then PERS accounting should backstop these benefits with zero-risk investments, or at least investments that are price-adjusted for risk.

The retirement system's current accounting practices treat high-risk investments the same as low-risk investments. This failure to account for the pricing of risk forces a contingent liability onto taxpayers.

[1] Nevada PERS, Comprehensive Annual Financial Report, FY 2010.

[2] Andrew Biggs, "Reforming Nevada's Public Employees Pension Plan," NPRI policy study, 2011.

PERS accounting encourages risky behavior. Because PERS does not price for risk, its administrators can — on paper — strengthen PERS's financial position simply by investing its resources in increasingly risky assets and assuming higher rates of return. PERS accounting practices allow administrators to incorporate these illusory gains into the balance sheet immediately — independently of whether or not those gains will actually be realized in the marketplace. In reality, therefore, this practice just increases the contingent liability faced by taxpayers.

PERS's expected rate of return is unrealistic. PERS assumes that it can receive an 8 percent return on investments every year. However, PERS returns over the past 10 years have averaged only 3.8 percent.

PERS is unlikely to again see the higher return rates earned in decades past. The yield on a 10-year federal Treasury bond—the zero-risk baseline for earnings—has fallen from the 8-plus percentage point range of 20 years ago to around 3 percent today.

Therefore, the PERS-assumed rate of return should be adjusted downward to reflect today's lower yield on zero-risk assets. This will re-incorporate the contingent liability that PERS has pushed off onto taxpayers and reveal the true size of the system's unfunded liability — currently estimated at $41.0 billion.[3]

Recommendations

Require PERS to incorporate a market-based accounting approach. If policymakers and taxpayers want to uphold the promises made to public employees in Nevada, they first need to have a clear understanding of what those promises entail. The current PERS accounting method obscures the magnitude of those commitments.

Federal Reserve Board economists, along with many others, have recently been urging this shift in accounting practices for public pension systems.[4]

[3] *Ibid.*

[4] See, e.g., Donald Kohn, "Statement at the National Conference on Public Employee Retirement Systems Annual Conference," May 20, 2008; David Wilcox, "Testimony before the Public Interest Committee Forum sponsored by the American Academy of Actuaries," September 4, 2008.

Summary data for Nevada PERS financing <u>under current valuation practices</u>, as of June 30, 2010.			
	Regular	**Police/Fire**	**Total**
Employer normal cost	$712,018,796	$271,754,563	$983,773,359
Employee contribution	$90,295,302	$16,741,883	$107,037,185
Total normal cost	$802,314,098	$288,496,446	$1,090,810,544
Unfunded liability	$7,950,505,956	$2,401,769,113	$10,352,275,069
Annual amortization payment	$387,114,092	$116,943,334	$504,057,426
Payroll	$4,943,566,092	$968,353,118	$5,911,919,210
Percent of payroll			
Employer normal cost	14.4%	28.1%	16.6%
Employee contribution	1.8%	1.7%	1.8%
Total normal cost	16.2%	29.8%	18.5%
Unfunded liability	160.8%	248.0%	175.1%
Annual amortization payment	7.8%	12.1%	8.5%
Total employer cost	22.2%	40.1%	25.2%
Source: Nevada PERS CAFR, June 30, 2010.			

Contributions that would be required for Nevada PERS <u>under market valuation</u>, as of June 30, 2010.			
	Regular	**Police/Fire**	**Total**
Employer normal cost	$2,171,657,328	$828,851,417	$3,000,508,745
Employee contribution	$275,400,671	$51,062,743	$326,463,414
Total normal cost	$2,447,057,999	$879,914,160	$3,326,972,159
Market assets (approx)	*$16,628,121,287*	*$4,278,161,818*	*$20,906,283,105*
Market liabilities	*$48,709,012,854*	*$13,160,388,448*	*$61,869,401,302*
Unfunded liability	*$32,080,891,566*	*$8,882,226,630*	*$40,963,118,197*
Annual amortization payment	$2,140,740,929	$646,696,637	$2,787,437,566
Payroll	$4,943,566,092	$968,353,118	$5,911,919,210
Percent of payroll			
Employer normal cost	44%	86%	51%
Employee contribution	6%	5%	6%
Total normal cost	49%	91%	56%
Unfunded liability	649%	917%	693%
Annual amortization payment	43%	67%	47%
Total employer cost	87%	152%	98%
Source: Andrew Biggs, "Reforming Nevada's Public Employees Pension Plan," NPRI Policy Study, 2011.			

PERS: Structure of benefits

When taxpayers' contingent liability for Nevada's Public Employees' Retirement System is accounted for — through a market-based accounting technique — the system's unfunded liability currently approaches $41 billion.[1]

That amount is nearly seven times the annual payroll of all state and local governments that participate in PERS. Put another way, PERS's unfunded liability is slightly larger than all spending from the state general fund between FY 1986 and FY 2010 — a period of 25 years.

Obviously, an unfunded liability of such size means that Silver State taxpayers face a tremendous challenge in meeting obligations promised to Nevada's current and past public-sector workers. Moreover, given such a burden, Silver State taxpayers cannot allow PERS's unfunded liability to continue growing.

Reversing the growth in unfunded pension liabilities will require a significant restructuring of benefits.

Key Points

Defined-benefits (DB) pension plans leave taxpayers vulnerable. The growing unfunded liability to which Nevada taxpayers are exposed stems from the fact that the pension benefits promised to retirees are certain, while PERS's investment returns are not. When a year's investment returns fall short, PERS increases taxpayers' required annual contributions to make up the difference. Thus, taxpayers — in addition to bearing the risk on their own retirement savings — are forced to bear PERS's investment risks as well.

Defined-contribution (DC) retirement plans offer taxpayers greater assurance. DC plans inoculate taxpayers from PERS investment risk. Similar to a private-sector 401(k), in a DC plan taxpayers would contribute a set amount into government workers' personal retirement accounts, and then, government workers would assume their own investment risk — as do most private-sector workers.

DC plans benefit government workers. If Nevada shifted to a DC retirement system, government workers would see many important benefits. First, DC plans are both personal and portable. Under the current, collectivized DB system, workers cannot take their retirement savings with them if they change jobs, resulting in "job lock." Portability of retirement benefits can make public service more attractive to younger workers.

Second, retirement savings in a DC account are a tangible asset that retirees can pass on to their children in case of death. This is not true of a DB plan. In the case of early or untimely death, retirees in a DB program lose their claim to full pension benefits even though they may name a "survivor" to receive partial benefits. In this case, retirees can become net losers, having contributed more money into the collectivized system than they and their survivors will ever receive.

Shifting to a DC plan can be costly in the short term. As PERS administrators have noted, an abrupt, ill-planned shift to a DC plan could accelerate the amortization schedule of the unfunded liabilities that Nevada's DB plan has already incurred. Such a shift would require larger taxpayer contributions until PERS collects enough assets to cover its accrued liabilities. Although already destined to incur these costs, taxpayers would have to do so on a shorter timeline.

A hybrid approach allows such short-term costs to be avoided. Utah created one such hybrid plan in 2010. It allows workers to participate in either a DB or DC retirement plan but it limits taxpayer contributions in either case to 10 percent of the workers' pay. Because Utah will continue its DB plan on an optional basis, its taxpayers will be able to avoid an accelerated amortization schedule for the DB system's accrued unfunded liability.

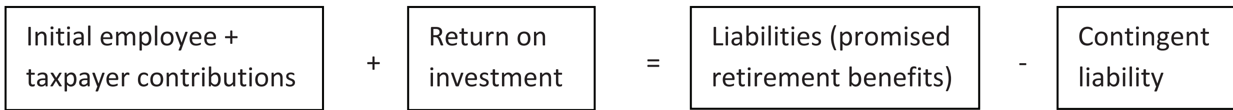
Recommendations

Restructure pension benefits around a Utah-style hybrid system. Nevada lawmakers should protect Silver State taxpayers from the open-ended liabilities associated with DB pension plans by adopting pension reform along the lines of Utah's hybrid system. Utah's system was put in place with the enactment of Senate Bill 63 from Utah's 2010 General Legislative Session, which should serve as a model to guide Nevadans.[2]

[1] See "*PERS: Assessing the Liability*," page 20.

[2] Utah Legislature, 2010 General Session, Senate Bill 63, Third Substitute.

Current structure of NV PERS



1. **Initial contributions.** State employees contribute a percentage of their salary toward retirement and that amount is matched by state taxpayers. These contributions currently total to 23.75 percent of wages for regular employees and 39.75 percent of wages for police and firefighters.

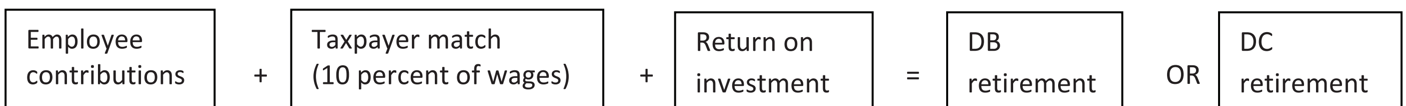
   At the local government level, retirement contribution rates are subject to collective bargaining agreements and, in many cases, retirement benefits are completely funded by taxpayers with public employees making no contribution toward their own retirement.

2. **Return on investment.** PERS administrators invest the retirement fund contributions made by employees and taxpayers in a combination of stocks, bonds and private equities in order to gain capital earnings. Currently, PERS's targeted rate of return is 8 percent per annum, although PERS's average annual yield over the past 10 years has been only 3.8 percent.

3. **Liabilities.** PERS is responsible for paying retirement benefits to participating employees calculated as a percentage of their highest-earning 36 consecutive months of employment. Calculating the total future liability facing PERS can be difficult because so many variables are involved, including: length of career, life expectancy, future pay raises, etc.

4. **Contingent liability.** Any time PERS's investment earnings fall short of its annual 8 percent target, its assets fail to keep up with its accrued liabilities (the retirement promises made to government workers). As a result, a corresponding share of PERS liabilities becomes "unfunded." To account for this unfunded liability, PERS increases the mandatory taxpayer contribution rates in subsequent years. Over time, retirement contributions grow to consume an ever larger proportion of state and local government finances — especially within local governments whose collective bargaining agreements exempt workers from contributing to their own retirement.

Structure of PERS under Utah reform model



Local Government Debt

Cities, counties and school districts in Nevada are legal subdivisions of the state. Unlike many states, Nevada has no municipal bankruptcy statute to allow mismanaged local governments to restructure debt obligations. This means that the liability of poor fiscal management at the local-government level ultimately falls upon state taxpayers.

As such, state lawmakers must remain vigilant over local-government finances and indebtedness. Lawmakers are responsible for developing the finance rules within which local governments must operate and for monitoring local governments to ensure that these statutory parameters are effectively safeguarding taxpayers' interests.

Key Points

Current local-government debt restrictions are tied to property values. Because significant shares of local-government revenues are generated through property taxes, local-government debt limits are expressed as a percentage of the total assessed valuation (AV) within each jurisdiction. The limits are as follows:

Counties:	10% of AV
Cities:	Depends on charter
School Districts:	15% of AV
Towns:	25% of AV
General Improvement Districts:	50% of AV
Library Districts:	10% of AV
Hospital Districts:	10% of AV
Convention Centers:	10% of AV
Fire Protection Districts:	5% of AV

Revenue bonds and other special obligations do not count toward debt limits. Current statutory language exempts revenue bonds and similar special obligations from debt-limit restrictions even though these obligations can encumber local-government finances. For example, revenue bonds issued by redevelopment agencies against future appreciation in property values can encumber, for decades, revenue that would otherwise be available to finance core government services.

To meet debt obligations, Nevada's local governments must pay more than $2 billion annually. The minimum debt payment for all local governments combined will be $2.019 billion for FY12 and $2.168 billion for FY13.[1] These figures amount to 65.0 and 69.9 percent of total state general fund spending projected for those years, respectively.

In total, local-government debt is nearing $23 billion. As of June 30, 2011, the total of outstanding local-government obligations in Nevada was $22.680 billion. That amount is 24.5 percent of the statewide assessed valuation total of $92.694 billion.

Recommendations

Reduce construction costs by repealing prevailing wage requirements. The bulk of local-government bonds are issued to finance the construction of public infrastructure. These costs — and the bond issues required to finance them — can be dramatically reduced by repealing the state's prevailing wage requirements, which artificially inflate labor costs by about 45 percent, on average.[2]

Consider enacting a municipal bankruptcy statute. State taxpayers should not be forced to act as a backstop for poor fiscal management by local politicians. Instead, local politicians who make elaborate and unaffordable promises should openly face the market discipline imposed by investors who must consider default risk.

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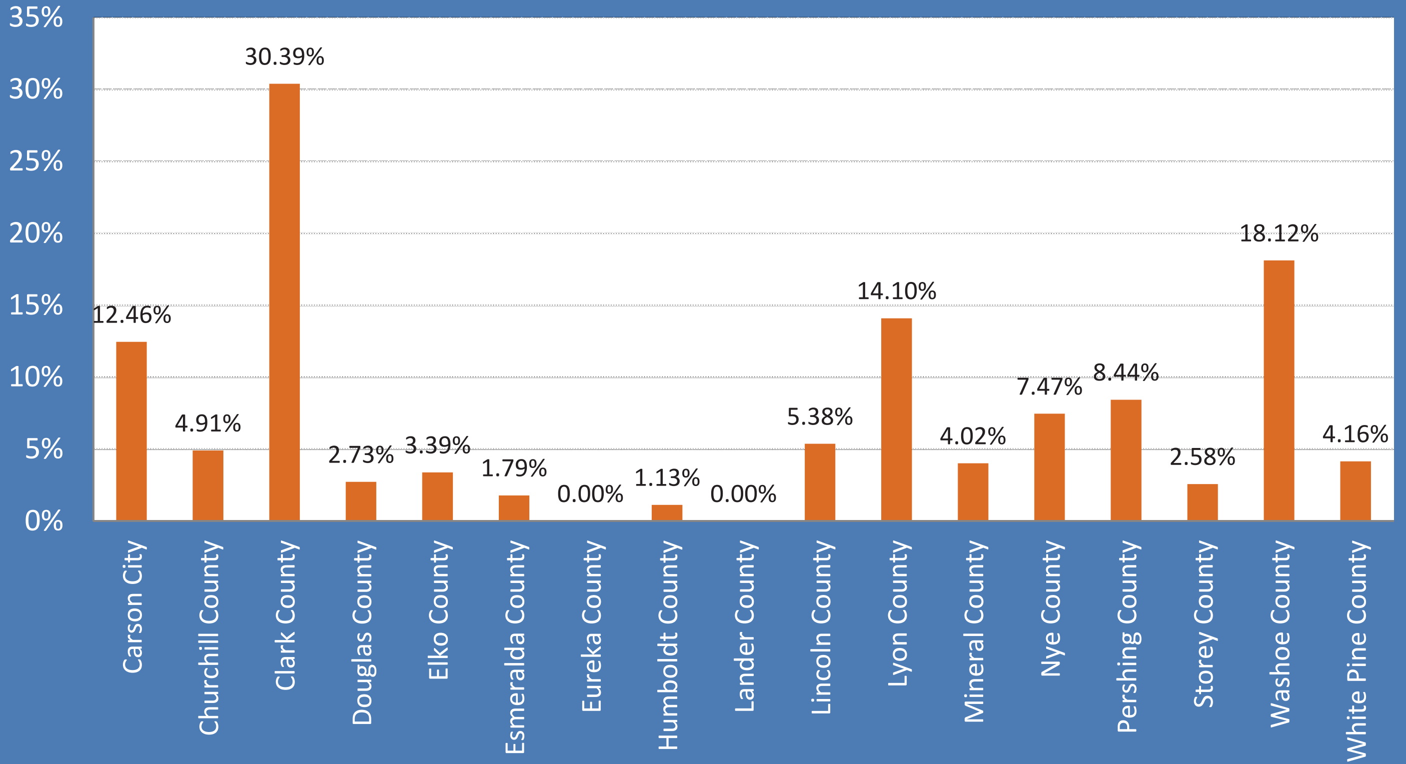
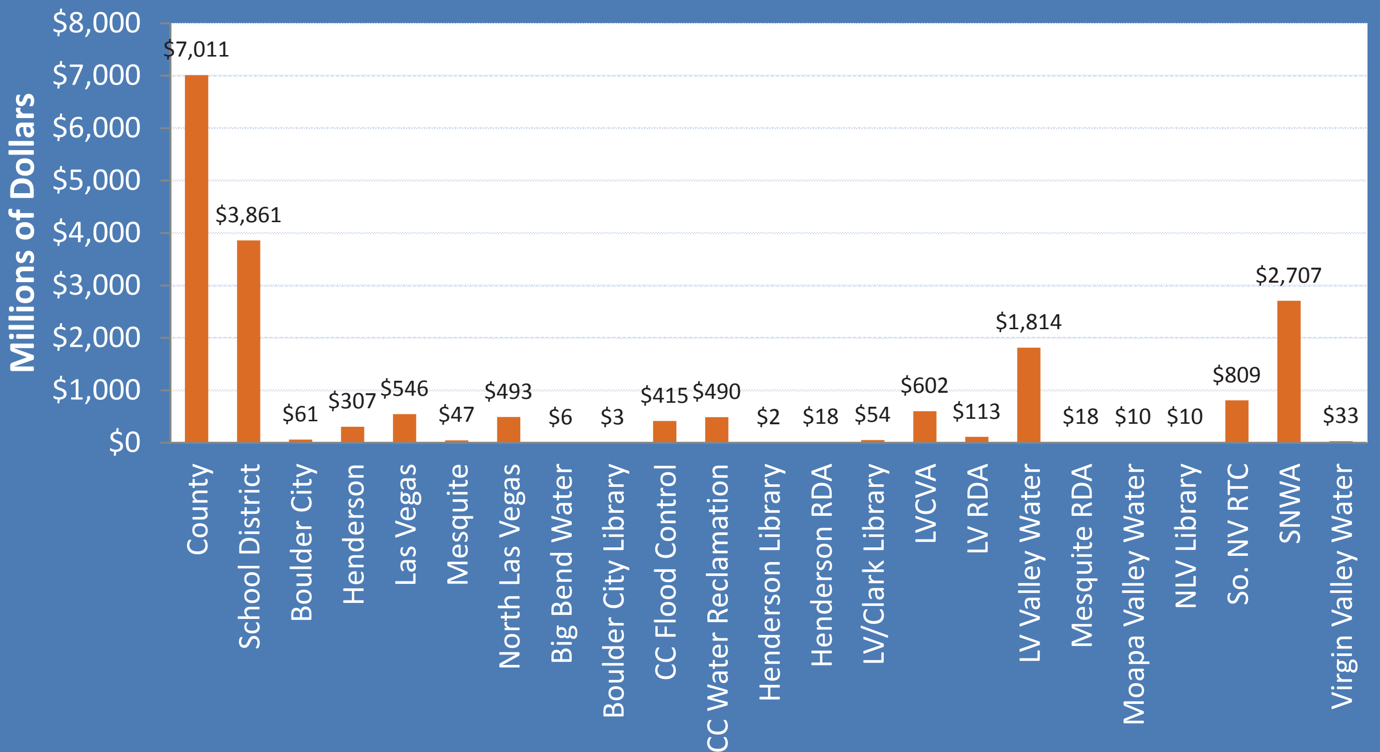
[1] State of Nevada, Department of Taxation, Division of Assessment Standards, "FY 2010-2011 Report of Local Government Indebtedness," 2011.

[2] See "*Prevailing Wage*," page 52.





Source: State of Nevada, Department of Taxation, “FY 2010-2011 Report of Local Government Indebtedness.”