

Nevada's Fiscal Woes

The Governor's Task Force on Tax Policy in Nevada recently filed their report, generating a gush of news stories and commentary. The charge to the Task Force limited their scope to consider broadening the tax base to reflect the diversity of the state's economy, reducing the long-term structural deficit, generating new tax revenue, and stabilizing the tax base. Fundamental to the charge were the assumptions that (i) the existing tax base is too narrowly bounded, (ii) the necessary government spending exceeded revenues in the long run, (iii) revenues will not fund the necessary government spending even in the near term, and (iv) the narrow tax base contributes to too much cyclicity in government revenue.

Taxes afford only a means to an end, government services (e.g., police, fire, roads, bridges, education, and social services). The political debate determines what goods and services the government should and should not supply.

One position proposes cutting government spending rather than raising taxes, a la Arizona. Most discussion, however, spotlights what taxes Nevada should raise or enact to finance its deficit. This essay examines two related issues. How do Nevada's government spending and tax revenue compare to other states?

To begin, consider how Nevada's government spending on various programs compares with the US 51 (50 states and the District of Columbia), with the Mountain 8 (Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, and Wyoming), and with the West-Southwest 3 (Arizona, Nevada, and Utah). All comparisons reflect spending per capita in each state.

Using the most recent data available posted by the US Census Bureau on state and local government spending, educational spending ranks Nevada 46th in the US, 8th in the Mountain-8, and 3rd in the West-Southwest-3, where a higher rank means higher spending per capita. Spending on social services and income maintenance positions Nevada as 50th, 8th, and 3rd. Nevada places much higher in other spending categories. Transportation spending puts Nevada at 7th, 2nd, and 1st. Public safety spending spots Nevada at 4th, 1st, and 1st. Nevada places 15th, 2nd, and 1st in environment and housing spending. Finally, Nevada scores 9th, 2nd, and 1st in spending on government administration.

Where Nevada spends less per capita than the average state provide the two largest pots of spending and the likely targets for cuts. Education spending captures 27.3% of the total spending in Nevada, 3% lower than the average across all states; social services and income maintenance, 14.8%, 6.1% lower than all states. Higher than average state spending occurs in the other categories. Transportation spending equals 11.5% of total spending, 4.7% higher than other states; public safety, 12.0%, 4.1% higher; environment and housing, 7.8%, 1.1% higher; and government administration, 6.6%, 1.9% higher. In sum, Nevada spends 9.1% less per capita than the average of all states in education, and social services and income maintenance and 11.8% more than the average in transportation, public safety, environment and housing, and administration.

Nevada also exports some of its tax base through the gaming, sales, tobacco, alcohol, and gasoline taxes. It's estimated that on any given day around 20% of Nevada's population are tourists. While tourists do pay taxes, they also use services – transportation, police, parks, and so on. Some analysts question whether the current tax system can support continued growth in the permanent population. If tourism grows along with the permanent population, then the tax system can keep pace with spending needs. Yet September 11th highlighted the problem that Nevada faces, since visitor volume flattened and the permanent population continued to grow.

Most states rely on a three-legged tax stool – sales, property, and income taxes. Moreover, the income tax leg usually possesses two feet – individual and corporate income taxes. Nevada's stool only includes two of those legs, since income taxes are constitutionally prohibited. Households and businesses do pay taxes – e.g., property, sales, and use taxes. Moreover, two business sectors – gaming and insurance -- contribute healthy sums to state coffers. And most businesses pay the business license tax, the fixed tax per full-time employee. The gaming tax generates revenue comparable to the sales tax, and together the two taxes total more than 70% of state tax revenue, not including local tax revenue. The insurance premium tax garners somewhat less than 10% of state tax revenue while the business license tax generates around 5%. Finally, since the sales tax hits low and middle-income households harder on a percentage basis than more-affluent households, Nevada currently exempts food, clothing, and so on. Those exemptions narrow the tax base, reducing the revenue productivity of the sales tax.

How does Nevada compare to the other states in tax revenue per capita? Nevada ranks dead last, 51st, 8th, and 3rd in the US-51, the Mountain-West-8, and the West Southwest-3, in federal revenue sharing per capita. For total taxes, Nevada appears at 24th, 3rd, and 1st, where a high rank means high revenue per capita. Dividing taxes into its components, Nevada once again falls dead last in individual and corporate income tax revenue per capita, tying with the 7 and 4 states without individual or corporate income taxes. For the property tax, Nevada scores 35th, 5th, and 2nd. The sales and gross receipts taxes put Nevada at 2nd, 1st, and 1st. Motor vehicle taxes place Nevada at 25th, 5th, and 1st. Finally, the other tax category comes in at 4th, 2nd, and 1st.

Now, consider how Nevada's taxes as a percent of total revenue compare with the average of all states. Nevada's federal revenue sharing per capita equals 10% of total government revenue, 5% lower than the average across all states. Total tax revenue equals 49% of total government revenue, 4.1% higher than other states. General revenue exceeds tax revenue because of various fees charged for government services (e.g., tuition, park entrance fees, employee contribution to state retirement systems, and so on). Looking now only at total tax revenue, the property tax generates 24.7% of tax revenue, 3.9% lower than all states. The sales and gross receipts tax produces 61.6% (35.4% from general sales and 26.2% from selective sales) of total tax revenue, 26.1% higher (10.7% higher from general sales and 15.4% higher from selective sales). The motor vehicle tax raises 2.0%, 0.5% higher. Other taxes produce 11.8%, 7.2% higher. Finally, the other states receive 10.8% from individual income taxes and 3.3% from corporate income taxes, sources not available in Nevada.

The Task Force recommended a series of tweaks and adjustments to existing taxes. Their most controversial recommendation is the new gross receipts tax. Moreover, the Task Force also recommended temporarily increasing the business license tax until the gross receipts tax becomes operational. Since Nevada prohibits a corporate income tax, that limits the types of business taxes that the Task Force could consider. The gross receipts tax does, however, require that the state expend tax money on administering the tax, no small amount. In addition, some analysts note that since few other states have a gross receipts tax, this argues against its adoption. But, most states impose a corporate income tax. Thus, what is the broad-based alternative?

Critics of the gross receipts tax also note that it is a tax on a tax. But, let's take a closer look at the issue. Three related broad-based business taxes exist – gross receipts tax, value added tax, and sales tax. The following discussion applies those taxes to all goods and services produced, not narrowing the tax base with exemptions and making comparisons easier to follow. The Task Force wanted to raise a certain amount of new revenue and to broaden the tax base. A gross receipts tax applies to all business revenue with no exclusions. A value added tax is a gross receipts tax where each business excludes the purchase of goods and services from other businesses. That exclusion eliminates the cascading of taxes (i.e., tax on a tax). A sales tax levied on final goods and services does not directly impose a tax liability on intermediate goods and service providers. To raise the same revenue from a sales tax on final goods and services and a value added tax requires identical tax rates, because the sum of values added equals the sales price of the final good or service. A gross receipts tax that generates the same revenue requires a lower tax rate, since it applies to all business revenue with no exclusions. For example, if the values-added of all business equal one-half of their sales prices, then the gross receipts tax rate equals exactly one-half the value-added (sales) tax rate. Finally, a sales tax levied on all goods and services – final and intermediate – requires a tax rate equal to the gross receipts tax rate.

In sum, areas where spending cuts can generate the most bucks fall in areas where Nevada ranks nearly dead last in spending per capita. The constitutional provision against a corporate income tax constrains the options for a broad-based business tax. Nevada faces tough issues and tough decisions.

Stephen M. Miller is Professor and Chair of the Department of Economics, College of Business at the University of Nevada, Las Vegas.
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