

Rethinking Nevada's Fiscal Structure

While Nevada continues to face one of the most difficult fiscal situations of any state in the country, we are not alone. According the Center on Budget and Policy Priorities, the recession created budget gaps in most states. In addressing these gaps, 42 states cut spending while 33 increased tax and other revenues. The American Recovery and Reinvestment Act (ARRA) also provided important funds that assisted states in closing about 33 percent of their gaps.

Nevada, however, fell into the deepest hole. From the end of 2007 through the middle of 2009, Nevada's personal income declined by 6 percent, twice as much as in any other state in the country. Over the same period, Nevada's state revenues declined by more than 12 percent, twice the national average decline for state and local government tax collections.

Our last legislative session balanced the budget with cuts in program spending, salary saving through furloughs, and temporary increases in taxes. The recent special session cut programs even more. While the ARRA prevented even more drastic expenditure cuts or tax increases, we will not likely see additional relief from the federal government going forward. Unless the Nevada economy recovers more quickly than most analysts anticipate, the Legislature will face an even more difficult task in balancing the next biennium's budget than they faced during the last session.

Nevada's biennial general fund budget is roughly \$7 billion, which works out to about 2.5 percent of total state output, or a little more than \$100 per person per month. Current estimates report a \$3 billion hole, all things included, a huge portion of the total budget but a small portion of our overall economy.

Why are tax revenues declining so much more in Nevada than elsewhere, and can we expect them to ever recover? Our state heavily depends on gaming taxes, and related taxes on hotels and restaurants, because visitors from out-of-state pay a large share. Gaming in Nevada was once a profitable monopoly, but that monopoly is gone and these revenues have declined as a share of our economy for decades.

We also heavily depend on the sales tax. The boom in housing construction, and the added money spent on furnishings for new houses covered the relative decline in gaming receipts. The Great Recession hurt these revenues disproportionately, but few

people expect that they will bounce back to former levels, once it is over. Tax revenue lagged behind economic activity, because activity shifted from taxed to non-taxed areas.

We no longer can continue to plug budget holes with quick fixes that do not address our longer-term problems. Instead, we need long-needed modifications in the existing tax structure that will provide a better revenue stream going forward. We could accomplish this with new taxes, such as personal or corporate income taxes, but a less dramatic approach would instead broaden the bases for existing taxes.

With its propensity to tax narrow parts of the economy, recent structural changes in Nevada's economy means that we no longer collect the revenues necessary to maintain necessary state services. This unstable structure demands immediate attention.

This inherent problem means that the Legislature revisits the revenue issue on a regular basis, tinkers with existing taxes, and adds new wrinkles. Nevertheless, several prior tax-funded studies commissioned by the Legislature yielded the same forgettable result. We know we need to change it, but legislators fear the political consequences of favoring "big government," even though Nevada runs the smallest state general fund in the country, as a share of our economy, and even though Nevada successfully constrained the growth of the total general fund expenditure for decades to no more than population growth plus inflation.

We need serious consideration of several changes in tax structure and offer several examples. First, the explosion of internet purchases has shifted transactions from those that yield sales tax revenue to those that do not, and has created a big hole in this revenue source. We need to continue Nevada's movement toward collection of sales tax revenue on internet transactions (i.e., continue implementation of the Streamlined Sales Tax).

Second, consumption spending nationwide has shifted from goods to services over recent years, but the latter is largely exempt from the sales tax. The sales tax levy should fall equally on goods and services, and our tax structure should reflect the overall economy. Extending the sales tax to services, however, requires careful consideration of what constitutes final, rather than intermediate, transactions. Moreover, when considering this, we should also reconsider the existing exemptions to the sales tax to make sure that they still make sense.

Third, the modified business tax (MBT) collects revenue from wages and salaries. More broadly, taxing wages and salaries comprises a part of the value added by firms. Replacing this with a value-added tax on firms would expand the base to include non-wage and salary income, such as rent, interest, and profit.

The economy changes as production and consumption patterns adjust to changes in technology, competition, consumer preferences, and demographics. A well-designed tax system needs to adjust in concert with the changing economy.

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