Nevada Budget Outlook and State Spending Facts

By Ron Knecht and Lynn Hettrick – 15 February 2011

This article uses actual Nevada state spending data to demonstrate two points central to our state's budget challenges this year. First, the gap between expected revenues under current state law and the spending that would be needed to maintain current state service levels is $2.4-billion.

Second, while more than half of the gap results from state revenues declining due to the Nevada Depression, over $1-billion has been caused by state spending growing since 2000 completely out of proportion to the growth of Nevada's economy and Nevadans' incomes. Contrary to claims of specific beneficiaries of state spending (public employees, vendors and subsidy recipients), there have been only minor recent reductions in some state spending and not a long series of draconian cuts, with K-12 education and human services actually getting major increases. Because Nevada had its largest two tax increases in the last eight years – totaling just under $2-billion – the inescapable conclusion is that Nevada has a spending problem and not a problem of unduly low tax rates.

Table 1 summarizes the basic facts of state general-fund revenues and spending, using the two-year executive/legislative budget framework (which excludes significant state spending such as pass-throughs of federal funds) that all parties reference in budget debates.

$Billions	**Item (State General Fund + ARRA Budget) – Table 1**
$6.4-B	Current (2009-11) general fund spending
+0.6	Current federal ARRA ("bailout") spending
7.0	Current general fund + ARRA spending
+0.5	Shortfall in local school support and property taxes, etc.
+0.5	End of state furloughs, merit-pay freezes, etc.
+0.2	Medicaid caseload cost increases, per current law
+0.2	Miscellaneous statutorily required spending increases
+0.1	Interest on federal unemployment tax loan
-0.2	Elimination of one-time miscellaneous expenditures
8.3	2011-13 spending under current law and service levels
-5.3	2011-13 expected revenues under current law
3.0	Gap between current-law revenues and costs
-0.6	Replacement of furloughs, etc. with 5% pay cuts
$2.4-B	**Shortfall, current-law revenues vs. current services**

The first three lines show current (2009-11) state general-fund spending levels, totaling $7.0-billion. (Other revenues and expenses related to general fund accounts – such as pass-throughs of certain federal funds – would drive the total above $16-billion, but those other areas are not part of the primary budget debate.) Some folks discount the federal ARRA-based spending for Medicaid, education and corrections, but those funds were intended and used to cover state revenue shortfalls during the current biennium. So, they are properly considered as present general-fund revenue sources, and the spending supported by them is part of the current state services level.

The next seven lines show the effects of five new costs that Nevada's general fund will have to cover in the 2011-13 biennium, less the elimination of some non-recurring miscellaneous expenditures. Under state law, the shortfall of about $0.5-billion in the local school support and property taxes the last two years must be paid by the state to the local governments. (By listing this or any other item, we do not endorse the underlying policy, practice or law, but instead merely set forth the facts.)

The furloughs and suspension of step, merit and longevity pay required of state employees during the current biennium expire under state law in mid-2011; so, if they are not renewed, state costs will increase $0.5-billion. Similarly, by law, the $0.2-billion in Medicaid, another $0.2-billion in miscellaneous items (such as $78-million for a 12% increases in health benefits for local schools) and $0.1-billion in unemployment-insurance interest costs must be covered by state general funds beginning with the next biennium. A slight offset of $0.2-billion comes from elimination of one-time miscellaneous expenditures. Adding $1.3-billion for these six items to the $7.0-billion of current spending gives $8.3-billion of current-law spending for current service levels.

Our $8.3-billion figure – which is the same amount as recent state departmental requests – does not result from baseline budgeting practices noted by some critics as faults in normal state budget process. We recognize the flaws in baseline budgeting practices, but our estimate is based solely on current spending and service levels and state and federal statutory requirements, and is not the product of "roll-ups", cost-of-living adjustments (COLAs), etc.

The next two lines show that under current tax laws, the expected general-fund revenues estimated by the Economic Forum are $5.3-billion, leaving a $3-billion gap between spending and revenues under current law. Gov. Brian Sandoval has proposed replacing the furloughs, etc. that are involved in producing current state service levels with 5% pay cuts for state employees, for a savings of $0.6-billion. So, the remaining shortfall would be $2.4-billion.

Current state law also ends collection in mid-2011 of $1-billion in tax increases passed by the 2009 Legislature, and that amount is therefore not reflected in the $5.3-billion revenues estimate. Extending the sun-setting taxes would be controversial because people will argue whether doing so is a tax increase or not; it is an increase versus current law, but not as compared to current tax levels. More important than the semantics is that the Legislative Counsel Bureau has decreed that such extension will require a two-thirds vote of each house of the Legislature, not merely simple majorities. Also, Gov. Sandoval has said he opposes extending these taxes.

The $2.4-billion gap between current service levels and expected revenues means that there would have to be tax increases of as much as 45% (versus $5.3-billion current revenues), spending cuts of 31% (versus $7.7-billion of current-service spending), or some of each.

In sum from a short-term accounting perspective from Fiscal Year 2011 (FY11) to FY12, the $2.4-billion gap is the product, first, of the expiration by law at the turn of the fiscal year of $1-billion of sun-setting two-year taxes. Another $0.7-billion is due to cost increases in the next biennium mandated by state and federal law (assuming pay cuts replace furloughs, etc.). And $0.6-billion more accrues from the expiration of federal ARRA or "bailout" funds given to Nevada. The last $0.1-billion is attributable to additional declines in tax revenues expected from the current biennium to the next one. As we noted, that this analysis assumes no COLAs or other increases in pay for state employees.

While state employees' pay has been frozen and they have been required to forego longevity, step and merit pay increases and take furloughs that reduce their pay, people in the private sector who pay the taxes that support them have experienced much greater cuts in their employment and total pay levels. As one indicator of how much worse the burden has already been outside the public sector, over the last three years, 16.6% or one of every six private-sector jobs in Nevada has disappeared – more than 190,000 jobs. By contrast, the number of state employees (not "positions") has declined from its high-water mark by only 2.5%.

Another problem lurking in the shadows is that the state's charges to all employers for unemployment insurance will have to rise dramatically next year and probably more after that. The increased charges will be most extreme for businesses that have laid off people, which will greatly discourage them from trying to rehire or fill new positions as they seek to grow again when a recovery finally does begin. The combination of these greatly increased fees and any other taxes to close the general-fund gap will be suffocating to business and delay Nevada's return to prosperity – which is unlikely for years.

When such figures and issues were discussed at a forum in Carson City last year, a strident objection was raised by one observer that the state can't continue cutting education, and the speaker emphasized K-12 education as what is needed to pull us out of our state's current depression. Has state spending been cut significantly and has education been the sacrificial lamb its employees and their political supporters regularly claim?

As shown Table 2, using data from the state's Comprehensive Annual Financial Reports (CAFRs) and other state sources: 1) state K-12 spending has risen faster in the last 16 years than all other categories of state spending; and 2) all major state spending categories have increased much faster than the growth of our economy, personal incomes and inflation. Predictably, human services spending rises fastest during economic downturns, but over 16 years and even more so in the last decade, K-12 spending has grown faster than human services and much faster than everything else. Over the last ten years, state spending has grown cumulatively 31% faster than the state economy and the incomes of Nevadans, and K-12 spending grew 38% faster.

Total state spending rose every year through FY09 and was essentially constant from FY09 to FY10. State spending for higher education and public safety fell by an average of less than 1%/year over the two-year Nevada Depression period (FY08-FY10). However, driven by large increases in human services (5.86%/year) and K-12 (3.98%/year, total state spending rose 4.66%/year during that time, while Nevada personal incomes plummeted by 3.11%/year. In sum, over the last two years, while the public sector **grew** by 9.5%, Nevadans' incomes **dropped** by 6.1% -- a combined difference of 15.6% in favor of the public sector!

Table 2: Annual Percentage Growth Rates for State Spending and Nevada Personal Income

Sector/Period	FY94-FY10	FY00-FY02	FY02-FY08	FY08-FY10	FY00-FY10
K-12 Schools	**8.63**	**9.98**	**9.69**	**3.98**	**8.58**
Higher Education	7.44	7.81	8.30	-0.69	6.34
Human Services	8.21	11.59	7.74	5.86	8.12
Public Safety	7.00	6.61	8.28	-0.51	6.02
All General Fund	**8.28**	**9.53**	**8.65**	**4.66**	**8.01**
Personal Income	**6.94**	**5.11**	**8.04**	**-3.11**	**5.13**
Inflation	2.53	3.30	2.82	0.93	2.53

The basic conclusions above hold no matter how the figures are manipulated -- even if educational spending is expressed on a per-student basis and other state spending and personal income are expressed on a per-resident basis, all figures are adjusted for inflation, etc.

In short, the actual state spending figures show that Nevada's public sector has continued to grow rapidly relative to our economy and relative to the well-being of average Nevadans. So, private-sector taxpayers – families and businesses – have been devastated by a depression that is greatly the product of excessive public-sector taxing, spending and regulation. Yet, they have been required, via tax increases, to keep Nevada public employees and the recipients of state subsidies insulated from the great majority of the effects of that depression.

How do the facts about continuing increased public spending square with the continual whine about "budget cuts" that public employees, vendors and subsidy recipients may face? An analogy may help. If your child, who is getting an allowance of $10/month, suddenly decides he needs some toy that costs $15, he may ask you to increase his allowance to $15 so he can buy it this month. When you say that's more than you can afford but that you'll up his take to $12, you may think you've increased his budget by 20% (because your spending has increased by 20% from $10 to $12). But if he is like the tax-eaters, his version of the story will be that you cut his budget by 20% (from $15 to $12) because he needed the larger amount to buy what he wanted.

Tax-eaters' claims (i.e., claims made by public employees, vendors to public agencies and public subsidy recipients) about public budget cuts never reference actual amounts that spending changed from one year to the next. Instead, they reference amounts that some bureaucratic or political entity (maybe the Legislature, but perhaps even just the requesting agency) approved in the budget process that they think thereby becomes their entitlement or due. Hence, even when their actual funding and spending goes up from one year to another, they can claim that their "budget" was cut, because they reference a plan they had to spend even more. (The dictionary definition of a budget is "a plan to spend money.")

Further, tax-eaters and their political allies studiously overlook the actual damage already suffered by private-sector families and businesses – such as the disappearance of one out of six jobs – while they complain about their own take growing slower than they think is their right and propose to raise taxes on the private sector.

Returning to Nevada K-12, any decline in educational quality has occurred in the context of rapidly increasing education spending, while structural reform has been essentially completely absent. Hence, throwing money at the provider special interests (teacher and administrator unions) while not making any meaningful effort at reform is the failed policy that has caused Nevada's education problems. (There are low-cost reforms that could improve educational results, but that the education bureaucracy successfully opposes – a subject for another day.)

Further, increased spending or any policy to improve education quality – improvement we absolutely need – cannot have an effect on the quality of our workforce in time to reverse any cyclical downturn. So, any claim that education or research spending will pull us out of the current depression is false, even though such spending promotes economic diversification and growth in the long run. Low tax rates do have timely counter-cyclical effects, and they promote long-term economic growth. The public policy challenge is to combine optimal tax rates and education reform. By over-promising, education advocates are not doing the causes of education and the public interest any favors.

Bottom line: The false claims that any part of state spending has been cut significantly and that more state spending would cure our current economic troubles are a smoke screen to cover up the fact that our state budget problem is a spending problem, not a problem of unduly low tax rates. Beyond the fact that in the last eight years the state had its two largest tax increases ever, more than $1-billion of the current budget gap is due to the growth rate of the state sector vastly exceeding that of Nevadans' incomes and our state economy in this decade – with a slightly larger amount being due to the Nevada Depression. Considering the whole picture, clearly our problems are spending and a state economic depression, not low tax rates.

All agree that Nevada's budget outlook is grim. So grim that we cannot afford shrill rhetoric, hyperbole and self-serving claims. We need a sober, adult focus on the facts, the real numbers such as the 15.6% difference between state spending and personal incomes during the current depression and the 31% margin the last decade, and the making of tough choices.

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