CONTROLLER'S MONTHLY REPORT

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Nevada's Budget Challenges: A Public-interest Perspective

As one of two Nevada elected Constitutional officers with financial and fiscal responsibility, I offer here some long-term, public-interest perspectives and information on our state's budget challenges. The State Treasurer is also presenting related spending and revenue proposals. Our goal is to address the issues in ways that best serve the public interest and provide for Nevada's children in the long term. We hope to engage the People, Legislature and Administration of Nevada in a process and discussion to achieve that goal. In sum, the issues addressed here are:

1) **It is erroneous to say Nevada's fiscal system yields insufficient revenues; instead, it fails to control costs.** Instead of fostering effective cost management and reasonable improvements in government, we now make the People serve government by continually increasing the fraction of their lives, outputs and incomes that it consumes. Government should serve the People, not vice-versa. We must reform state fiscal processes to make government serve families, businesses and our economy -- that is, the public interest -- by living within reasonable budget constraints. We must adopt performance- and priority-based budgeting to give state managers the charge, authority and flexibility to efficiently and effectively run their operations for real cost management and improved service.

2) **The fiscal processes we must reform have damaged the public interest by raising steadily over six decades government's burden on families, businesses and the economy; so, we must restrain state spending to growth rates less than Nevada's economy.** In the last ten years alone, state spending has grown 10% more than Nevadans' incomes, proving that the problem is spending, not revenues. By slowing economic growth, excess spending has reduced incomes from what they would have been with better public policy, and it will continue to do so until we rein it in. If new spending is needed, it should be financed by cutting less meritorious spending, not by tax increases.

3) **Budget-cut claims are irrelevant, and we should instead focus on changes in actual spending year by year.** State Health and Human Services and K-12 Education spending have actually increased faster than all other areas of the budget and Nevada's economy. Relative to the incomes of Nevada families and businesses, HHS spending has risen 37% and K-12 spending has increased 23% in the last decade; other major categories have trailed the growth of incomes or even fallen. Thus, Administration K-12 proposals are a repeat of failed practices of the past, and no new money should be spent on K-12 without a compelling showing that new programs are certain to yield better results. Education is too important to continue such failed approaches. Instead, we should pursue promising low- and no-cost policy and practice reforms such as more parental school choice, teacher merit pay and tenure reform. We must focus on student achievement, and cease to throw ever more money at a failed system while allowing it to successfully resist reform.

It is important to note that the change in taxpayer burden figures used above and throughout this report are not due to inflation, population growth or headcount changes in students or human service clienteles. Instead, figures such as the 10% (state), 37% (HHS) and 23% (K-12) are increases in taxpayer burden in addition to the increases in state spending caused by inflation and population and head-count growth.

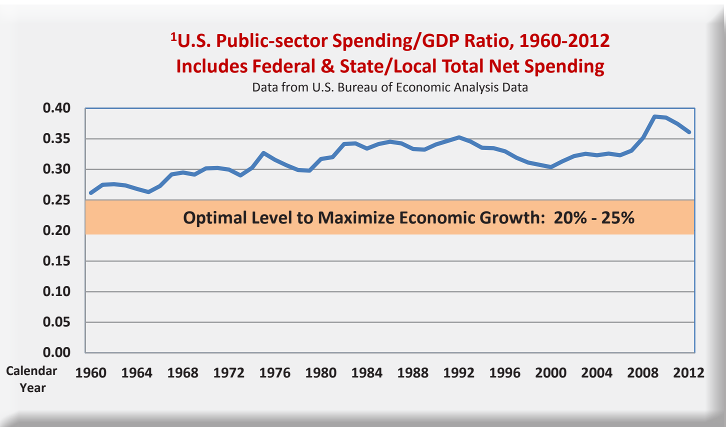
To leave our children a better future, we must stop the growth relative to the economy and to Nevadans' incomes of taxes and of the public spending and regulation that drive taxes. And we must avoid serious mistakes such as the latest version of the business margins tax that has been proposed right after Nevadans voted that basic idea down 4-1 in November. Reining in growth of spending is urgent because expenditures for health care will escalate due to Nevada's participation in the so-called Affordable Care Act. When federal government subsidies for the population newly eligible for second-rate health coverage through Medicaid begin to disappear in two years, Nevadans will carry an ever much larger burden. We have raised ample revenue in the past but funneled almost all gains to HHS and K-12, while beggaring other categories. Besides reining in the growth of spending, regulation and taxes, we need to sensibly re-prioritize our spending. Finally, elimination of collective bargaining by local governments and of project labor agreements and prevailing wage rules would be other useful steps forward.

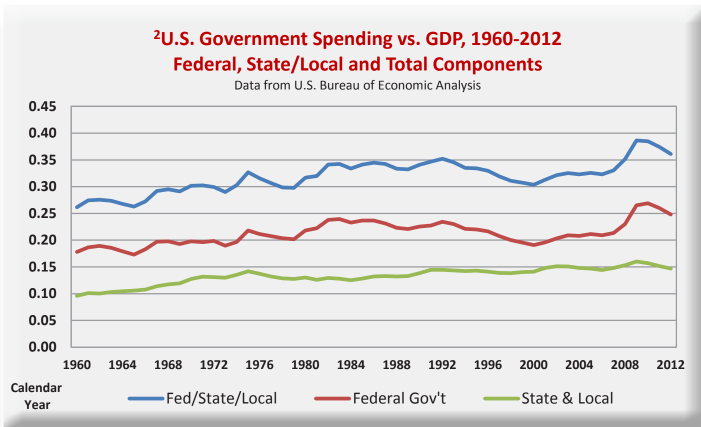
Further Detail on the Key Issues Summarized on the First Page

1) ***Cost Management, Not Higher Taxes:*** The idea that Nevada lacks a fiscal system to produce appropriate revenues is completely backwards. It assumes that Nevada families and businesses exist to satisfy the aspirations of government bureaucracies, instead of those agencies existing to serve the People and the public interest. Present fiscal practices fail to make those agencies do what families and businesses do: live within reasonable means. In the current system, public agencies compile their wish lists, modest amounts are shaved off the top to make the process appear reasonable -- and then total requested spending is compared to expected revenues, with the difference being designated as the amount of tax increase needed. The real world does not and cannot work that way, and neither can government continue to do so.

   Families and businesses necessarily start not from their spending aspirations but from their budget constraints: the income and other resources they reasonably anticipate. Then, they make their spending plans within those constraints to get maximum value from their available resources. Instead of requiring effective cost management and reasonable improvements in government, we now make the People serve it by continually increasing the portion of their lives, outputs and incomes that it consumes. We must reform state fiscal processes to make government serve Nevada's families, businesses and economy - that is, the public interest - by living within reasonable budget constraints. Performance- and priority-based budgeting approaches that give state managers the charge, authority and flexibility to efficiently and effectively run their operations for real cost management and improved service are a major part of the solution. Extensively re-engineering business processes as part of replacing the state's information technology systems in the next few years will be a major start toward better efficiency, effectiveness and service.

2) ***The Public Interest in Growing Government Slower Than Nevada's Economy:*** Over the last 60 years, the government fiscal processes we seek to reform have damaged the public interest by increasing steadily over time government's burden on families and businesses, not just in dollar terms, but relative to the incomes of the American People -- the important measure. See Graph 1. Over half a century ago, the government burden passed the levels that maximize human wellbeing, and in recent decades it has risen to 50% higher than those public-interest levels as America has chased Old Europe in this race to the bottom.[1] State and local government has been as much a part of the problem as has the federal government, as shown in Graph 2. Nevada is as much a part of this problem as any state, as shown by the fact that its total tax burden has risen to the middle among states (25th or 26th, depending on how measured), refuting partisans' "low-tax" claims. Contrary to misleading "budget-cut" narratives of the tax-and-spend advocates, even in the economic turmoil of the last ten years, state spending has increased 10% more than the incomes of Nevadans – proving that the problem is spending, not revenues.





[1] *See*, for example, "What Is the Optimal Size of Government in the United States?" by Gerald W. Scully, November 1994, which concludes that optimal combined federal, state and local taxation to maximize economic growth is 21.5% to 22.9% of gross domestic product. "Government Size and Economic Growth" by Richard K. Vedder and Lowell Galloway, December 1998, finds federal spending should be 13.42% and state and local spending 11.42% to maximize economic growth. "The Size and Functions of Government and Economic Growth" by James Gwartney, Robert Lawson and Randall Holcombe for the Joint Economic Committee of the U.S. Congress, April 1998, embraces 20%. There is a large econometric literature on this subject, beginning in the 1980s, and while some studies support levels lower and higher than the 20% - 25% range used here, that range is reasonably representative.

If public-sector over-reach had been restrained, we wouldn't have endured as much slowing of economic growth in recent decades as we have, nor the poorest recovery since the Great Depression during this last six years. So, aggregate incomes and human well-being would be significantly higher than they are today. As long as government excess continues, we will fall further and further behind where we should be, regardless of what feel-good public programs we add and expand. The damage to economic growth caused by the continuing and growing excesses of government taxing, spending and regulation overwhelms any good that such new spending and programs can do. Hence, people who understand how the world works and care about our children's futures want to restrain the growth of government.

The erroneous notion that more public-sector activity and spending serves the public interest is the problem: When government is already too big – as it is – the public interest is served by paring it back, not by doubling down on the failed practices of the past. If meritorious new spending is proposed, it should now be financed by cutting less meritorious spending, not by tax increases. So, also, claims that people oppose increased taxes only for selfish reasons are false, because lower tax burdens serve the public interest when those burdens are, as now, unduly high. Finally, claims that public-sector activity should not contract or slow with the economy are also false, because the private sector is just as important to providing human well-being as is the public sector. In fact, when the public sector is unduly large, as it now is, at the margins the private sector contributes even more to the public interest than the public sector.

3) ***Focusing on Actual Spending, Not Misleading Budget-cut Claims:*** Budget-cut claims are misleading by nature, because current budgeting systematically inflates spending beyond reasonable levels and fails to require reasonable efficiency gains. So, budget-cut claims are irrelevant, and we should instead focus on changes in actual spending year by year. Doing so reveals that, contrary to the most widely and loudly trumpeted narratives, state HHS and K-12 spending have actually increased faster than all other areas of the budget and much faster than the incomes of Nevada families and businesses. Relative to the incomes of Nevadans, HHS spending has risen 37% and K-12 spending has increased 23% in the last decade, while other major categories (including general government; law, justice and public safety; etc.) have actually fallen or trailed the growth of incomes. See the table nearby. ***[Note again that these percent figures are increases in taxpayer burdens in addition to the increases in state spending caused by inflation and population growth.]***

In the last decade, total higher education spending has risen quite modestly, but state tax support for it has fallen precipitously and the burden has been shifted greatly to students and their families via higher tuition, fees and other charges. Transportation spending has varied, as is appropriate for spending that can be deferred in hard times, but its current levels are much lower than all but one of the last 20 years. Unemployment compensation increased hugely due especially to federal policy in the Great Recession and ensuing slow recovery, but has now returned to more normal levels.

Nevada State Spending Category

	FY2014 $Millions	Growth in Burden vs. Taxpayer Incomes 2004 - 2014 (%)*
Health and Social Services	$ 3,784	37
K-12 Education	1,953	23
State Total Spending	9,745	10
Higher Education -- All Sources	1,621	4
Gen.Gov., Law & PS, Reg., Rec., Etc.	1,503	-18
Higher Education State Gen. Fund	486	-31
Transportation	328	-51
Unemployment Insurance**	552	17

* These changes are not due to inflation, population growth, change in student or human services headcounts, etc. Instead, they are changes to Nevada taxpayer burdens in additions to increases in spending due to inflation, population, etc.

** Changes mainly driven by federal mandates; increased greatly, then decreased greatly.

These facts totally invalidate claims that Nevada has "systematically dismantled" K-12 schools or failed to invest in them in recent years. Moreover, they undermine claims that new initiatives involving significant new spending will improve the dismal student achievement results our K-12 schools have shown. Not only is there significant research showing little if any correlation of student achievement with K-12 spending, but Nevada's experience of throwing hundreds of millions of dollars more at it in various budgets (especially fiscal years 2007, 2008 and 2009) and getting the same results as before shows that the real purpose in increased K-12 spending (including more pre-kindergarten, all-day-kindergarten and class-size reduction) is to politically pacify teacher unions. Thus, some Administration proposals are a repeat of failed practices of the past, and no new money should be allocated to K-12 without a compelling showing that the programs so funded are certain to yield much better results. These points are not refuted by endless

"underfunding" claims. In fact, many other nations that show better student achievement results than our schools spend much less than we do. What we need is to pursue more promising low- and no-cost policy and practice reforms such as more parental school choice (vouchers), merit pay and tenure reform for teachers.

Final Observations: Some people have suggested that if other parties cannot produce complete detailed spending cuts and revenue enhancements for an alternative budget, then the Administration's proposed budget must be adopted. That's an attempt to hide the unreasonableness of the proposed budget, despite the Administration's command of the full resources of the bureaucracy, and to inappropriately shift the main burden to those who do not have such resources and responsibility. It is akin to a customer who orders a cheeseburger at McDonald's being told that, despite the fact that the Burger King a block away sells that product for $3, the customer will have to pay $4 for it unless the customer can detail changes in McDonald's operations that will cut its cheeseburger costs to $3. If McDonald's tried that, it would deservedly go out of business promptly. In the real world, market competition forces firms to operate efficiently.

Even without competition, Nevada must require efficient cost management and continuing productivity gains in government by imposing budget constraints instead of having taxpayers write blank checks to cover whatever spending advocates propose. It's not the duty of legislators, citizens or anyone else to do the job of the Administration that commands the full resources to do it. Nonetheless, to be as constructive and helpful as possible in starting this discussion, the Treasurer offers specific proposals for both the spending and revenue sides.

The Administration has also proposed real collective bargaining reform. The public interest would be best served by eliminating collective bargaining by Nevada local governments and by also eliminating prevailing-wage and project-labor-agreement rules that increase the costs of public projects as much as 20%.

As for new taxes, margins-type business taxes such as those overwhelmingly rejected recently by Nevada voters and now proposed again, are among the most destructive to economic growth and to attracting the new businesses and industries Nevada needs. If new tax revenues are needed, perhaps Nevada's gambling "drop" tax, the lowest among major gaming venues, should be increased. This is a tax paid not by gaming investors, but by casino patrons.

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http://www.controller.nv.gov/