State of Nevada

Popular Annual Financial Report

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For Fiscal Year Ended June 30, 2015

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NEVADA
A WORLD WITHIN.
A STATE APART.

Spending and Revenue Summary

Spending:

1. Health and Social Services (HSS) and education accounted for 80% of State Total Spending of $10.9 billion in fiscal year (FY) 2015. Their growth also exceeds growth in State Total Spending from 2005 to 2015.
2. HSS and K-12 spending grew rapidly while All Other State Spending and the Nevada economy and the wellbeing of Nevadans declined significantly.
3. Most importantly, the burden of state spending on Nevada families and businesses, driven by HSS and education, was 19% higher relative to their incomes in 2015 than in 2005.

Revenues:

1. Government Grants and Contributions account for 38% of total state revenues of $11.6 billion in 2015, and they grew much faster than other revenues in 2005-2015.
2. Charges for services and grants and contracts for higher education comprise 10% of total state revenues, and they also grew rapidly.
3. Other program revenues amount to 9% of total state revenues, and they grew very slowly.
4. In sum, increases in program revenues, driven mainly by HSS and higher education receipts, grew rapidly while tax revenues grew only moderately.

Demographic Information

	FY 2015	FY 2005	% Change
Population	2,864,563	2,389,183	20%
Per Capita Income	$41,457	$37,465	11%
Debt per Capita	$1,237	$1,595	-22%
Personal Income *	$118,758	$89,510	33%
Gross State Product *	$138,200	$114,973	20%
Inflation Index	241.42	195.55	23%
K-12 Public School Enrollment	459,152	401,218	14%
Higher Education Enrollment (FTE)**	68,861	60,657	14%

*Figures in Millions

**FTE stands for full-time equivalent

For additional information, visit: controller.nv.gov

State Spending

Introduction

This Popular Annual Financial Report (PAFR) is designed to provide Nevada citizens, officials and others a short summary of key facts, data, analysis and issues on the state's fiscal condition and challenges. The State Controller has a statutory charge to recommend plans for support of public credit, promoting frugality and economy, and better management and understanding of the fiscal affairs of the State. This PAFR first summarizes and analyzes state spending and revenue sources over the last decade. Then it presents the economic outlook for Nevada, focusing especially on the long term, which for reasons explained below, is necessarily based mainly on the national outlook.

How and on What Does Nevada Spend Your Tax and Fee Dollars?

Table 1 below analyzes Nevada state spending by category. Key conclusions follow.

Table 1: Nevada State Spending Analysis

State Spending by Category	FY2015 $ Figures in Millions (1)	FY2005 $ Figures in Millions (1)	Percent of FY2015 Spending	Growth Rate % 2005-15	2005-15 Real Per-Person % Growth	% Growth in Tax- & Fee-Payers' Real Burdens (2)
Health and Social Services	$ 4,887	$ 2,083	45	135	59	77
Primary and Secondary (K-12) Education (3)	2,022	1,246	19	62	15	22
Higher Education (All Spending) (3)						
Primary Government Spending	491	471	NA	NA	NA	NA
Discrete Unit Spending	1,202	833	NA	NA	NA	NA
Subtotal	1,693	1,304	16	30	-7	-2
Law, Justice and Public Safety	695	535	6	30	-7	-2
Transportation	462	665	4	-31	-53	-48
Unemployment Insurance	380	238	3	59	8	20
General Government	280	305	3	-8	-34	-31
Regulation of Business	130	92	1	41	0	6
Recreation, Interest & Miscellaneous	356	410	3	-13	-38	-35
State Total Spending	**$ 10,905**	**$ 6,878**	**100**	**59**	**7**	**19**
Subcomponents and Statistics of Interest						
All Other State (Except HSS, K12 & NSHE)	2,339	2,343	21	0	-33	-25
Higher Education (State GF-Based Spending)	516	560	5	-8	-38	-31
Nevada Economy: Personal Income (FY)	118,758	89,510	NA	33	-10	NA
Nevada Economy: Gross State Prod. (FY)	$ 138,200	$ 114,973	NA	20	-19	NA

(1) Data are taken from CAFR and CAFR workpapers. For consistency, Cultural Affairs spending is reported both years under General Government, where it is now classified; before 2014, the CAFR included it under Education. Also, for consistency, Nutritional Education Programs are classified both years under K-12, as they were before 2014, although they are now classified as Regulation of Business for CAFR reporting.

(2) These percentage changes are not due to inflation, population growth, increase in student or HSS client head counts, etc. They are the changes in the Nevada tax- and fee-payers' burdens in addition to increases in those burdens to cover inflation, population, etc. These percentages are computed based on personal income; if they were computed based on GDP, the increase in burden would be greater because GDP grew slower over the 2005-15 decade than personal income (20% versus 33%).

(3) Real Per-person Growth Rates computed based on state population figures for all categories except K-12 and Higher Education, which are based on student head-counts.

State Spending

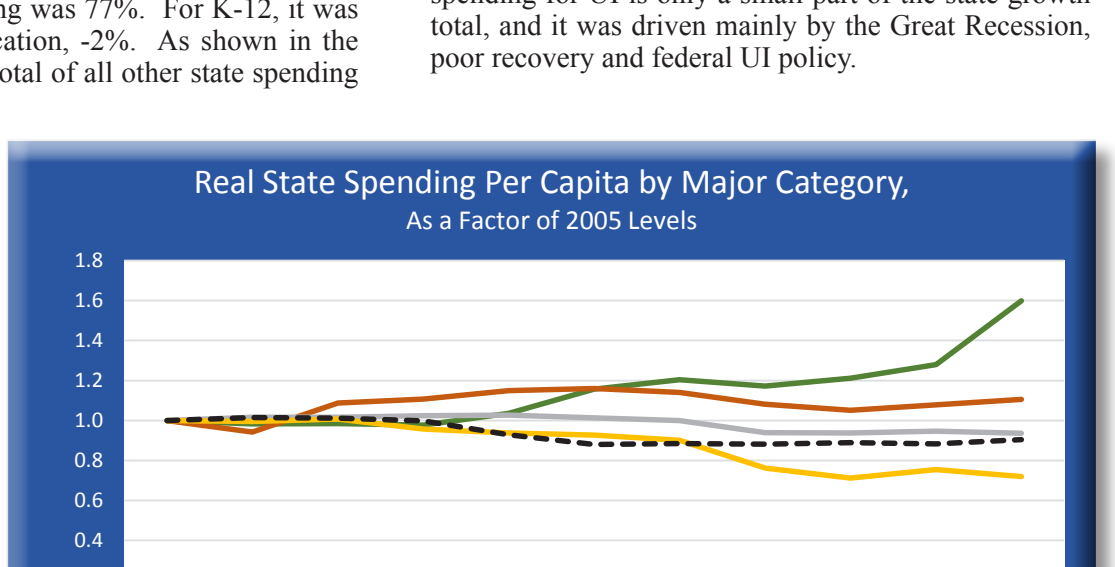
1. **Health and Social Services (HSS) and education accounted for 80% of State Total Spending of $10.9 billion in fiscal year (FY) 2015. Their growth also exceeds growth in State Total Spending from 2005 to 2015.** In 2015, HSS consumed 45% ($4.9 billion), with Primary and Secondary (K-12) Education taking 19% ($2.0 billion) and Higher Education another 16% ($1.7 billion). All other activities – Law, Justice and Public Safety, Transportation, Unemployment Insurance, General Government, Regulation, etc. – total merely 21% ($2.3 billion), as shown in the All Other State line.

2. **HSS and K-12 spending grew rapidly while All Other State spending and the Nevada economy and the wellbeing of Nevadans declined significantly.** Chart 1 below displays the annual state spending growth by major category in real per-capita terms over the last decade. Table 1 shows the ten-year totals: increases in HSS (59%) and K-12 (15%) drove up State Total Spending (7%), despite a small decrease in Higher Education (-2%) and a large decrease in All Other State spending (-33%). Meanwhile, Personal Income of Nevadans (-10%) and Gross State Product (-19%) also contracted substantially.

3. **Most importantly, the burden of state spending on Nevada families and businesses, driven by HSS and education, was 19% higher relative to their incomes in 2015 than in 2005.** The right-hand column of Table 1 shows the growth in spending on each category as compared to incomes of Nevadans. The growth in burden from HSS spending was 77%. For K-12, it was 22% and for higher education, -2%. As shown in the All Other State line, the total of all other state spending grew 25% slower than incomes. These burden figures mean that, besides covering spending increases due to inflation and growth in HSS client and student headcounts, rising HSS and K-12 spending required families and businesses to pay taxes and fees 19% higher in 2015 than in 2005.

The following points also are noteworthy:

- Nearly $3.0 billion (61%) of HSS monies was spent on Nevada Medicaid. This spending will likely continue to rise in coming years due to the state's decision to expand eligibility pursuant to the federal Affordable Care Act (Obamacare). However, federal contributions toward this spending will decrease beginning in 2017, requiring additional state dollars.
- Nearly $1.5 billion (73%) of K-12 monies was paid from the Distributive School Account to local school districts to supplement their local revenues. By various measures, Nevada K-12 education continues to deliver poor results, despite rapid increases over the last decade in state K-12 spending. Despite the well-known lack of statistically significant correlation between spending and student achievement, in 2015 the Legislature and Governor increased K-12 budgets by hundreds of millions of dollars for the current biennium.
- Total Higher Education Spending rose 30% over the decade, as shown in Table 1, but the state-funded portion fell 8%, as shown in a line near the bottom of the table. Large increases in tuition and fees, grants and contracts, and self-supporting operations (meal plans, housing, ticket sales, etc.) shifted significant portions of the cost burden from taxpayers to students and their families, who get most of the benefit of the services.
- Transportation spending rose from $665 million in 2005 to $802 million in 2012 before falling a net 31% to $462 million in 2015.
- Unemployment Insurance costs rose nearly ten-fold from $238 million in 2005 to $2.233 billion in 2012, before falling to $380 million in 2015. The 59% growth rate in spending for UI is only a small part of the state growth total, and it was driven mainly by the Great Recession, poor recovery and federal UI policy.



State Revenues

Where and How Does Nevada Get Its Tax, Fee and Other Dollars?

Table 2 below presents the state's comprehensive revenue analysis.

- Revenues are classified either as Program Revenues, which include charges for services and grants and contributions received by the state, or as General Revenues, which include mainly taxes and also smaller miscellaneous items.
- Both Program and General Revenues come from governmental activities, business-type activities of the state, and three entities that file separate accounting reports in addition to the state reports covering primary governmental spending. These entities are called Discretely Presented Component Units, and the Nevada System of Higher Education (NSHE) accounts for over 96% of their total.

The following points emerge from Table 2.

1. **Government Grants and Contributions account for 38% of total state revenues of $11.6 billion in 2015, and they grew much faster than other revenues in 2005-2015.** Program revenues from government grants and contributions (operating and capital) totaled $4.3 billion in 2015. This revenue increased more than $2.5 billion from 2005, and it accounted for 62% of the growth in total state revenues. These revenues are mainly comprised of federal government funding for Medicaid, Supplemental Nutritional Assistance (food stamps) and Temporary Assistance for Needy Families (TANF), and they are the revenue side of much of the increase in state HSS spending discussed above. That is, much of this spending is driven by federal mandate and also funded by the federal government and its taxpayers. A notable risk is that federal funding is sometimes diminished, but federal mandates rarely are. In coming years, Nevada faces just such a problem with Medicaid revenues and spending.

2. **Charges for services and grants and contracts for higher education comprise 10% of total state revenues, and they also grew rapidly.** Program revenues totaled $1.2 billion for NSHE in 2015, an increase of 48% ($0.4 billion) over the last decade.

3. **Other program revenues amount to 9% of total state revenues, and they grew very slowly.** Other program revenues of $1.0 billion grew only 11% ($0.1 billion) since 2005, much less than the 33% nominal growth in incomes.

4. **In sum, increases in program revenues, driven mainly by HSS and higher education receipts, grew rapidly while tax revenues grew only moderately.** In 2005, most state revenues came from taxes. But over the last decade, program revenues grew 84%, becoming 57% ($6.6 billion) of total state revenues. General revenues, which include all taxes and small accounting adjustments, grew only 27% ($1.1 billion) and now account for only 43% ($5.0 billion) of the state total ($11.6 billion). Although past spending growth was supported mainly by increasing grants and contributions, the 2015 tax increases will place much of the burden of future spending growth on taxpaying families and businesses.

Table 2: Nevada State Revenue Analysis

State Revenues by Category	FY2015 $ Figures in Millions (1)	FY2005 $ Figures in Millions (1)	Percent of FY2015 Revenues	Growth Rate % 2005-15	2005-15 Real Per-Person % Growth	% Growth in Tax- & Fee-Payers' Real Burdens (2)
Program Revenues						
Governmental Charges for Services	$ 829	$ 738	7	12	-24	-15
Governmental Grants & Contributions (Op'g & Cap.)	4,348	1,837	38	137	60	78
Business-Type Charges for Services	112	106	1	6	-28	-20
Business-Type Grants & Contributions (Op'g only)	76	74	1	2	-31	-23
Discretely-Presented Units Charges for Services	691	474	6	46	-2	10
Discrete-Unit Grants & Contributions (Op'g & Cap.)	546	359	5	52	3	15
Total Program Revenues (Gov, Bus., Disc.)	6,602	3,588	57	84	24	39

Table 2 Continued

State Revenues by Category	FY2015 $ Figures in Millions (1)	FY2005 $ Figures in Millions (1)	Percent of FY2015 Revenues	Growth Rate % 2005-15	2005-15 Real Per-Person % Growth	% Growth in Tax- & Fee-Payers' Real Burdens (2)
General Revenues & Other Net Position Changes						
Governmental Activities	4,221	3,524	36	20	-19	-10
Business-Type activities	707	303	6	133	58	76
Discretely Presented Units (NSHE, CRC, NCIC)	533	547	-	-	-	-
Less: Payments from State of Nevada (Primary Gov)	(487)	(471)	-	-	-	-
Net, Discretely Presented Units	46	76	0	-39	-59	-54
Total General Revenues (Gov., Bus., Disc.)	4,974	3,917	43	27	-14	-4
Total Program & General Revenues	11,576	7,505	100	54	4	16

(1) Data are taken from CAFR and CAFR workpapers. Data for Discretely Presented Units covers NSHE (by far the largest component), CRC and NCIC.

(2) These percentage changes are not due to inflation, population growth, increase in student or HSS client head counts, etc. They are the changes in the Nevada tax- and fee-payers' burdens in addition to increases in those burdens to cover inflation, population, etc. These percentages are computed based on personal income; if they were computed based on GDP, the increase in burden would be greater because GDP grew slower over the 2005-15 decade than personal income (20% versus 33%).

Table 3 on the next page presents analysis of state taxes by source. The big-picture tax issues center on:

- their overall level compared to incomes and the economy;
- growth trends;
- breadth of base and level of rates;
- incidence upon consumption, savings and investment, employment, and property;
- burden upon persons versus business; and
- diversification.

All but the first of these can be addressed to some extent with the data in Table 3. There is no definitive source for the right level of taxes relative to incomes and the economy. However, as discussed in the section below on the economic outlook, the overall level of state and local taxes in the U.S. is already well above public-interest levels, yet still rising. In Nevada, local-government taxes are the really big problem (due to high spending and pay), and state taxes have been a lesser problem. Turning to trends, Table 3 shows the following:

1. **The burdens on consumption and on persons of state taxes fell 2% in the last decade.** Revenues from the following key taxes fell significantly relative to the growth in incomes: sales and use, gaming, property, motor and special fuels, liquor and tobacco, and other minor items. The incidence of these declining tax revenues lies greatly with consumption, not with savings, investment and employment; and on persons, not businesses.

2. **To compensate for this decline, the state added new levies and increased taxes mainly on savings, investment and employment and on business.** It did so via the modified business tax (that mainly taxes employment) and unemployment assessments; levies on auto leasing, lodging and motor vehicles partially countered this overall trend. The largest rise, which was for unemployment assessments, was driven mostly by federal mandate. The upshot is that the growth of total tax burden is trending down, but that trend masks a shift of burden from consumption to savings, investment and employment; and from persons to business.

3. **The shift in tax burden from consumption to investment and employment and from persons to business diminishes tax neutrality.** Neutrality is important because maximizing economic growth and fairness requires that taxes influence as little as possible the spending-versus-savings, investment and employment choices people and firms would make without them. The choices they would make in markets without taxes would maximize economic growth and also maximize aggregate human wellbeing and fairness, the fundamental public policy goals. Since individuals overwhelmingly use their dollars for consumption versus savings and investment, and businesses also spend much of their revenue on goods and services, taxes should fall mainly on consumption of goods and services, and less on savings, investment and employment.

4. **The shift in tax burden from consumption to investment and employment and from persons to business also diminishes transparency.** Transparency is

fostered by taxing people, not business; as economists note, businesses don't so much pay taxes in the sense of actually absorbing their economic burden as they collect them for the government from consumers. Hence, taxing people directly increases transparency, accountability and economic growth by reducing distortions, economic inefficiency and reductions in investment and employment caused by using businesses as the tax middlemen.

5. **With various taxes accounting for 1% to 23% of general revenues in Table 3 and considering their incidence mainly on persons and consumption, Nevada's tax base can be called reasonably well diversified.** Such diversity is important for the optimal balance between stability of public revenues and the revenue constraints that government needs to make it operate efficiently and not grow unduly large. Diversity also keeps rates generally low and the base broad, but in Nevada that benefit is offset by limiting the range of goods and services to which the largest tax revenue source, sales and use taxes, applies. So, no strong conclusion can be pronounced on this criterion.

Tax Issue Highlights

1. The burdens on consumption and on persons of state taxes fell 2% in the last decade.
2. To compensate for this decline, the state added new levies and increased taxes mainly on savings, investment and employment and on business.
3. The shift in tax burden from consumption to investment and employment and from persons to business diminishes tax neutrality.
4. The shift in tax burden from consumption to investment and employment and from persons to business also diminishes transparency.
5. With fractions from 1% to 23% in Table 3 for the various categories and considering their incidence mainly on persons and consumption, Nevada's tax base can be called reasonably well diversified.

TABLE 3: NEVADA STATE TAX ANALYSIS

Taxes Analysis	FY2015 $ Figures in Millions (1)	FY2005 $ Figures in Millions (1)	Percent of FY2015 Gen. Revenues	Growth Rate % 2005-15	2005-15 Real Per-Person % Growth	% Growth in Tax- & Fee-Payers' Real Burdens (2)
Sales and use taxes	$ 1,161	1,000	23	16	-22	-12
Gaming taxes	906	900	18	1	-32	-24
Modified business taxes (3)	414	227	8	82	23	37
Insurance premium taxes	301	215	6	40	-6	5
Property and transfer taxes	219	287	4	-24	-48	-43
Motor and special fuel taxes (3)	340	282	7	21	-18	-9
Liquor and tobacco taxes	148	157	3	-6	-36	-29
Net proceeds of minerals tax	39	16	1	137	60	78
Auto lease and lodging taxes (3)	199	27	4	644	402	460
Unemployment assessments	746	321	15	133	57	75
Other taxes	195	163	4	19	-19	-10
Total Taxes	4,668	3,595	94	30	-12	-2
Other Changes in Net Position	306	322	6	-5	-36	-28
Total General Revenues	4,974	3,917	100	27	-14	-4

(1) Data are taken from CAFR and CAFR workpapers.

(2) These percentage changes are not due to inflation, population growth, increase in student or HS&S client head counts, etc. They are the changes in the Nevada tax- and fee-payers' burdens in addition to increases in those burdens to cover inflation, population, etc. These percentages are computed based on personal income; if they were computed based on GDP, the increase in burden would be greater because GDP grew slower over the 2005-15 decade than personal income (20% versus 33%).

(3) Modified business taxes were increased significantly in 2010 and new motor vehicle and short-term-vehicle rental and transient-lodging taxes were also added in that year. These changes affect growth and burden rates.

Economic Outlook

Lower Growth, Increased Uncertainty Due to Long-term Secular Changes

Economic outlook discussions in reports like this one are typically based on business-cycle analyses and address the short term (i.e., less than a year). That approach is based on assuming there are no salient long-term developments, or "secular trends," to alter the cyclical outlook. As we show below, important secular trends have been developing over decades and have already wrought profound changes in the U.S. and Nevada economies and substantially changed the outlook for future growth. We discuss trends in four areas, followed by a synthesis of these trends for the long-term U.S. economic outlook, and concluding with Nevada-specific considerations. More discussion of the outlook is posted on the web site, controller.nv.gov.

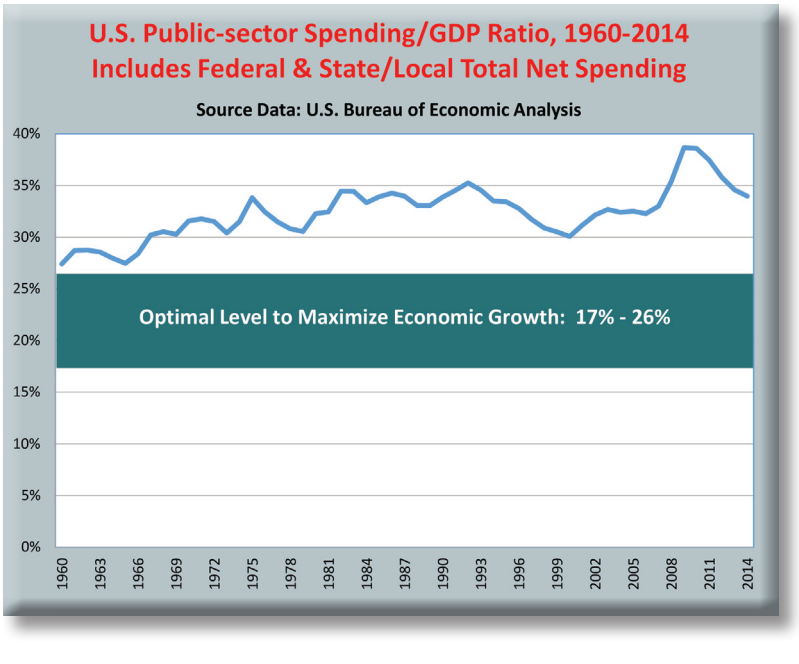
We show first that the size, scope and reach of government have long been excessive relative to our economy, yet still growing; that overreach has produced an increasingly substantial drag on economic growth. For decades this burden was offset by three growth-inducing factors: 1) demographic and labor-force participation trends; 2) increasing debt levels; and 3) rapid growth in emerging economies, plus globalization and increasing trade and foreign domestic investment. Unfortunately, trends in all three areas have reversed. So, for the foreseeable future, economic growth will be suppressed perhaps even from current 2% real annual rates (or 1% per person per year).

People looking here for a Nevada-specific economic growth rate for coming quarters, forecasts of housing starts in an urban area, prognostications on particular kinds of interest rates, state taxable revenues for the next fiscal year, etc. won't find them for good reason. Such short-term and particular forecasts have not been very reliable for a decade and they are much less so now. The new normal secular changes are disruptive of the whole economy and trends, and they operate nationally with uncertainty levels that swamp out state and sectoral variations. Our basic message for policy, planning and budgeting is that: 1) growth will be much lower going forward than it has in the past; and 2) uncertainty has increased greatly. National long-term trends today may yield useful insight and guidance. Sectoral, state, etc. trends more than ever involve spurious precision and particularity.

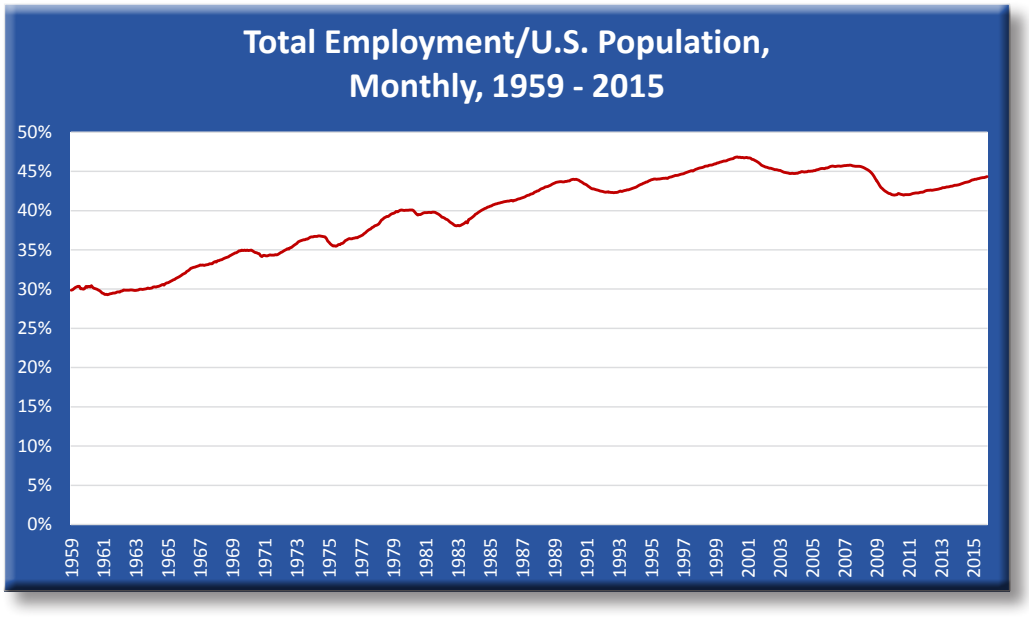
Government Overreach: The size, scope and reach of American government – including spending, taxing, borrowing, regulation, monetary and credit-allocation policy, and other intervention – long ago exceeded levels that promote the public interest in maximum economic growth and fairness. These excesses at federal, state and local levels have increasingly slowed growth and will continue to do so unless they are reined in. Economists now understand that economic growth and thus aggregate human wellbeing levels are determined more by the economic, political and social institutions, practices and policies of a society than by geographic, infrastructure, resources and other earlier development-theory factors. The rule of law, limited government with separation of powers, personal liberty and individual rights, strong property rights and high levels of economic freedom are essential for growth.

As detailed on the Controller's web site, empirical literature – research based on real economic data – supports and quantifies theory suggesting that there's an optimal range of government spending that maximizes economic growth. There are classically defined public goods that are most efficiently provided by government and there are market failures that justify regulation and other intervention. However, excess spending, scope and reach of the public sector diverts efficient private investment and consumption, and it slows growth. While there are uncertainties and debate about the levels of public spending relative to the economy that maximize growth, the best evidence shows that the U.S. passed those levels by the 1960s and has increased government excess to the present time.

The chart below of public spending over time as a percentage of the U.S. economy vividly illustrates this point. The excess growth has not been limited to the federal government; state and local spending have grown even faster in relative terms. Nevada's local-government and total public-sector spending have grown particularly fast. Nationally, increasing government intervention in health care has long and greatly driven up its cost and its share of the economy relative to optimal levels and has thereby contributed to slowing of economic growth.



Economic Outlook



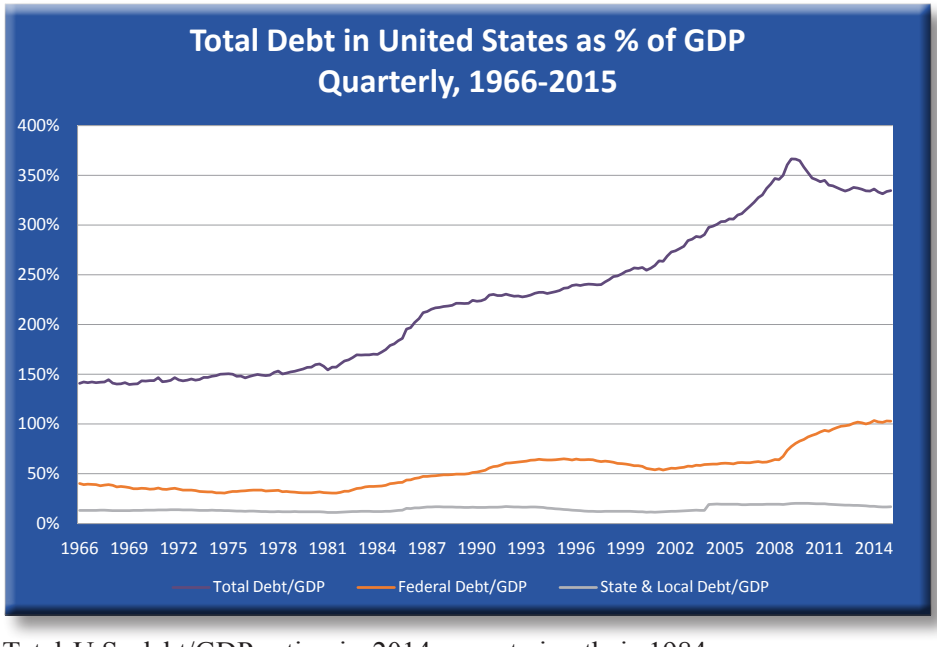
While public spending is the measure of government overreach easiest to quantify, analyze and understand as a growth determinant, other measures also drive and reflect the excess. Taxes and public debt are directly driven by public spending, and public debt has now reached its highest level relative to the gross domestic product (GDP) since the early 1950s, when the debt from World War II was being worked off. Government regulation in a wide range of economic, environmental, public health and safety areas, plus intervention including monetary stimulus and credit allocation and federalization of health insurance and education have all increased to unprecedented levels and metastasized in the last decade. The net effect has been an increasing drag on economic growth; with the overreach at record levels and still increasing, the drag may even get worse.

Demographics and Work-force Participation: Demographic changes driven by public policy and non-policy factors are reducing the fraction of the population doing productive work, while increasing numbers consuming but not producing. These changes include falling birth rates, increasing longevity, more public subsidy for retirement and of persons not working, and changing social and economic roles of men and women. These changes are slowing growth and may even bring social upheaval.

The 1970s movement of Baby Boomers into working age, plus the movement then and later of women into paid work drove labor-force participation to a record level of 67.1% in 2001. The aging of Boomers into retirement years, plus declining birth rates in younger cohorts, the slippage of female workforce participation and the non-recovery from the Great Recession have all dropped participation to 62.4%, the lowest level since 1977. Falling labor-force participation in the 16-54 age range more than offsets recent increases for the 55+ group, netting a continued decline in total employment ratios. Low unemployment rates are due to counting "discouraged workers" out of the labor force and to increases in "under-employed" part-timers – both driven by the non-recovery and palliative effects of increases in benefits to people not working. As shown in the graph nearby comparing population and employment, through 2002, demographic and workforce participation factors gave a huge boost to economic growth countering public-sector overreach, and the employment/population ratio rose more than 56% in 42 years (from 0.30 to 0.47).

However, since 2002, these factors have reinforced the increasing drag from government excess that depresses growth. The movement of the large Boomer cohort into retirement began in 2011 and will accelerate and then continue for 20 more years. Because retirement age and support policies were set when longevity was lower and health of people over 60 was less robust, U.S. dependent/producer ratios will continue to rise relative to what they would be under market incentives. So, total-factor productivity and thus the economy will continue to grow slowly. The burden on productive cohorts will increase, especially with slow income growth, leading perhaps to social upheaval in the absence of significantly increased legal immigration. Slow economic growth and low interest rates and other rates of return on investment will challenge retirement funding and exacerbate all these problems.

Debt in All Sectors and Net Saving and Investment: Total debt levels relative to the U.S. economy increased hugely until the financial crash and Great Recession of 2007-09. As shown in the graph below of total American debt as a percentage of the economy, they have retrenched only mildly since then, leaving an excess-leverage overhang that may not be receding. All debt sectors are involved: government at all levels; business; and households (mortgage, auto, student and consumer loans, etc.). Monetary and credit-allocation policy drove much of the excess, especially in the decade ending 2008, providing artificial and unsustainable temporary stimulus to growth. It also produced mal-investment, and that problem plus deleveraging have already contributed to weak business earnings and anemic economic growth; they will continue to do so for the foreseeable future. The resulting sustained low interest rates have destroyed much economic wealth and damaged institutional retirement and endowments investors and savers.

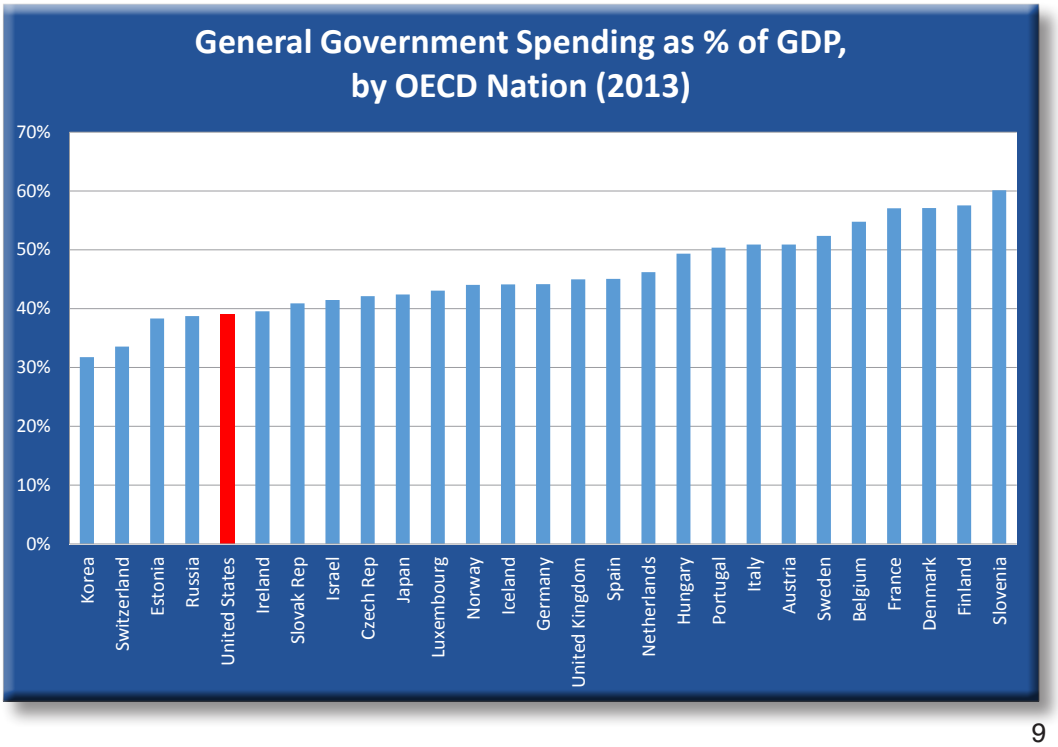


Total U.S. debt/GDP ratios in 2014 were twice their 1984 levels, despite retrenchment following the financial crash and Great Recession. Consumer debt growth was driven mainly by federal mortgage lending policies, causing the housing bubble and subsequent collapse. Business debt grew in finance and large corporate stock buybacks, mergers and acquisitions, meaning there is now perhaps an equity bubble. Federal government total debt/GDP ratios have more than doubled as fiscal and monetary policy have been used to try to ameliorate the negative growth effects of a wide range of public policies. Further retrenchment from current debt levels is needed to restore the economy, so demand for capital and interest rates and investment returns will all remain low, as will economic growth.

International Economic Growth, Trade and Investment: Until the Great Recession, long-term growth of the world and developing economies, especially China, was more rapid than in the U.S. and other advanced nations. Driven by and contributing to increasing 1) globalization, 2) trade and 3) foreign direct investment in the U.S., this growth increased U.S. economic growth by lowering costs to American consumers and businesses and spurring more efficient investment and production by domestic and foreign businesses.

Since 2007, trade increases have lagged world economic growth. Growth in China and other developing nations has slowed, further depressing American growth. The three factors above that previously helped U.S. economic growth but now retard it are even worse in other major economies, advanced and developing. While this makes our economy the "cleanest dirty shirt in the laundry pile" for investors, it also means the global trade and investment cavalry will not be riding to our rescue. The world economy will no longer spur U.S. economic growth to the degree it did before the Great Recession.

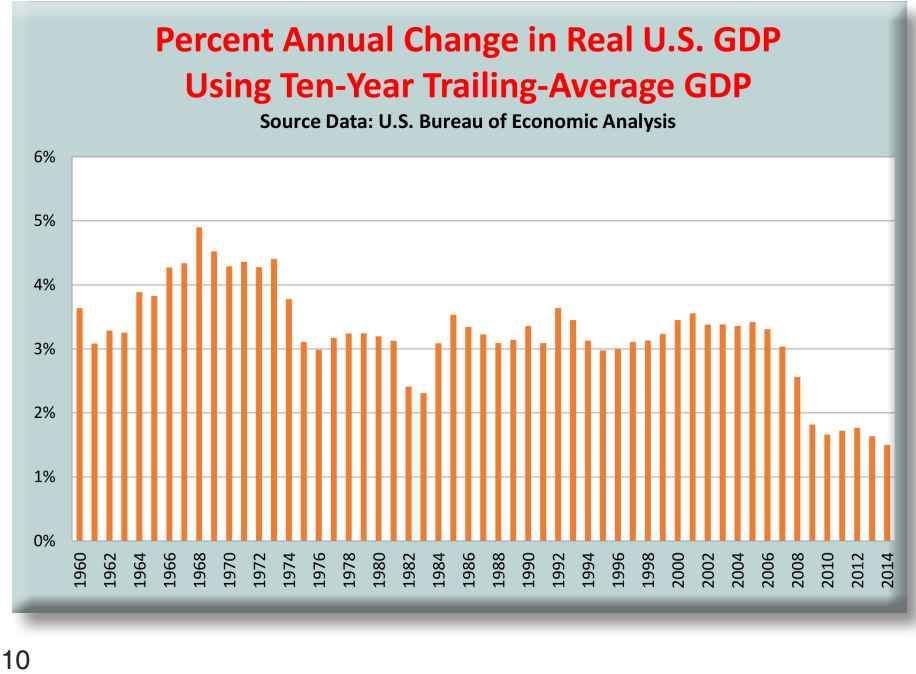
The problems of excess and still growing size, reach and scope of government are worse in every other major economy than in the U.S., as shown in the chart below. So are demographic problems of low birth rates and labor force participation plus increased aging. Europe (the only other comparably-sized economy) and Japan continue to struggle as they long have done with very low growth. China has grown hugely into the second-largest national economy, but the command-and-control methods that remain even after its liberalization have yielded massive mal-investment and debt growth. Due to mal-investment, persistent low consumer demand and the recently eased one-child policy, a policy mistake and human tragedy, China is headed for ever lower and possibly negative growth. All other economies are too small to make a significant difference to U.S. growth.



Economic Outlook

Total debt worldwide is now about 5.6 times what it was 20 years ago, while the world economy is only 2.8 times its prior size, meaning debt/GDP ratios have doubled in only two decades. That increase is likely unsustainable even with increasing development and globalization, leading to future retrenchment. Europe is now following Japan and the U.S. into monetary and credit-allocation overreach, and Italy and others (possibly including Japan and China) soon may face Reinhart/Rogoff excess debt levels (debt above 90% of GDP leading to financial collapse). Birth rates being an inverse function of women's education and wealth levels explains much of the world demographic problem, but in India and Africa they are dropping even faster than education and income indicate. Slow population growth will slow their growth.

Upshot: Continued Slow Economic Growth: All four mutually reinforcing problems discussed above have already produced the poorest recession recovery on record, with real growth of about 2% annually – or, adjusting for population increase, real per-person growth of about 1%. With none of these problems abating (and some perhaps increasing), the most reasonable outlook is economic and productivity growth at recent anemic rates or even lower. The chart below of rolling ten-year growth rates shows that U.S. economic growth has long been declining due to these factors and has collapsed to record sustained low levels since 2008. Growth at 1% per person per year sounds only slightly lower than historic 2.5% levels, but the compounding impact is huge: Namely, average human wellbeing growing only 32% each generation instead of doubling, the social norm for 300 years. So, instead of average family incomes doubling from $50,000 yearly to $100,000, they will grow only to $66,000. Restoring the economic growth legacy left by previous generations, an essential public policy need, requires government to grow slower than the economy for decades.



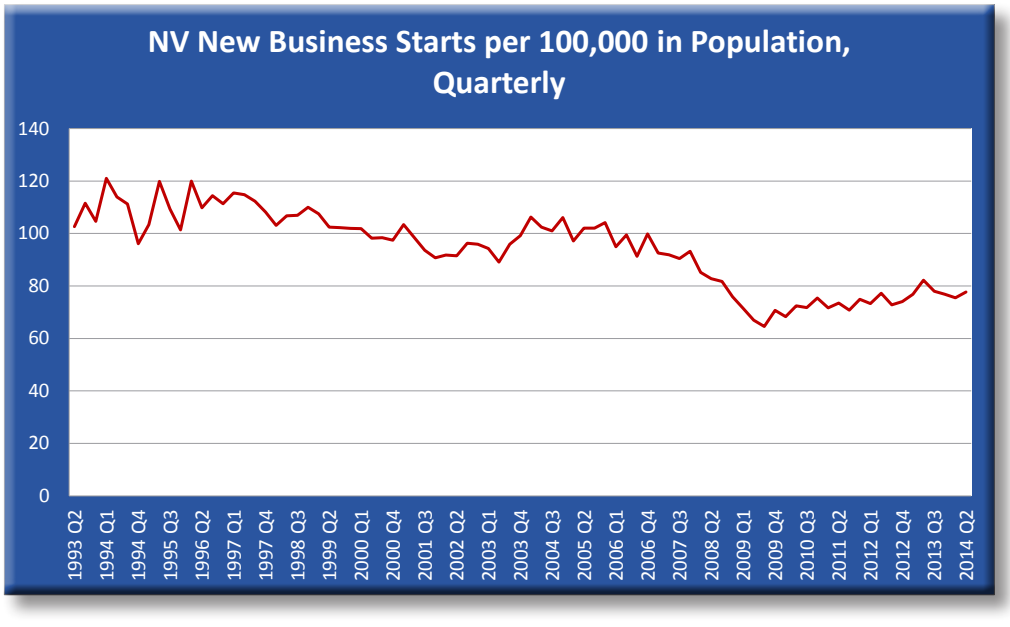
Down-side risks may even make things worse. Some economists claim that invention, innovation and technological progress have slowed from levels of recent decades, meaning that this key driver of growth will have a diminished effect and economic growth will fall toward zero. A related issue is that the recent slow growth has occurred despite falling energy and other commodity prices that, all other things remaining equal, would have increased it; possible returns of these prices to historical levels could dampen growth even further. Two other factors are likely to further burden economic growth: 1) slow economic growth produces low investment returns, which in turn tend to keep growth lower in a negative feedback loop; and 2) our current recovery, anemic as it has been, is now longer than the average cyclical upturn and we may be due for a contraction. We see no salient upside factors in the U.S. outlook.

Nevada's Prospects Are Similar to U.S. Prospects: Nevada's overall tax levels lie in the middle among the states, and they may rise significantly due to the new spending and taxes promulgated in 2015 by the Legislature and Governor. The state has long practiced onerous regulation of professions and occupations and it recently intervened in housing finance in ways adverse to growth. In assisting destructive federal policies in health care, education and energy, state policy further retards growth. Nevada's demographic and workforce outlook is no better than the national picture, especially due to modest workforce education levels. Further, there is no reason to believe Nevada will do better on non-state debt levels, or on trade and foreign direct investment. Historically, Nevada and the Southwest have grown much faster than the U.S., but their net in-migration has slowed greatly. So, despite faster growth currently than most states, the most prudent forecast for Nevada is growth at the anemic national rates. Moreover, the dominance of the outlook by long-term secular trends obviates fine-tuned state cyclical growth estimates. A notable bright spot is that Nevada has managed conservatively its debt load; so, maintaining its creditworthiness will be assured by continued prudence.

Between 2011 and 2014, Nevada's state gross domestic product grew meagerly from $118.9 billion to $120.8 billion (in constant 2009 dollars). Per capita, that's a growth rate of 0.53%, ranking 43rd among the states in that period. This poor recovery comes on the heels of an economic recession in which Nevada saw the largest per-capita decline in GSP of any state. Between 2007 and 2010, per-capita GSP shrank by an average of 5.87% annually versus a national shrinkage of 1.23%. Even more concerning are some deteriorating fundamentals. Since 2007, Nevada's median household income has fallen from $61,700 to $49,900 and the poverty rate increased from 9.7% to 17.0%.

Economic Outlook

Further, entrepreneurial activity in Nevada remains near historically low levels. As shown in the graph below, start-up density, measured by the number of business starts per 100,000 persons, fell roughly 30% between the mid-1990s and recent years, according to Bureau of Labor Statistics data. Non-governmental data sources, providing a longer time series, indicate that startup density has fallen 61% since 1977. This long-run decline in entrepreneurial activity portends a less dynamic state economy. Studies indicate that nearly all net new U.S. job growth is attributable to start-ups, so future Nevada economic growth prospects may be significantly diminished if entrepreneurial activity does not rebound to historic levels.



In sum: Government at all levels has long been so big, yet still growing relative to our economy, that it increasingly consumes our time, energy and productivity; crowds out private entrepreneurship and business spending and investment; and thereby stifles economic growth. Until 2002, falling birth rates plus Baby Boomers and women entering the workforce greatly mitigated this problem. Sustained low birth rates leading to small working-age population cohorts, plus somewhat falling rates of workforce participation by women and by men ages 16-54, have lately decreased the fraction of the population working and the producer/dependent ratios that fed earlier growth.

Increasing debt levels relative to the economy, which were mainly driven by policy far into unsustainable territory, promoted growth until the financial crash. Mild retrenchment during the non-recovery has not worked off the overhang; so, slow growth of non-government debt demand will add to the drag on economic growth. Rapid growth of developing economies, plus faster growth of trade and foreign domestic investment also helped greatly until 2009. Growth in most countries has slowed since then because the government overreach, demographic and workforce participation and debt problems are worse in other major economies. And trade is now growing slower than the world economy. The most reasonable expectation is that these world trends will continue, not improve, despite (or even due to) low commodity and energy prices.

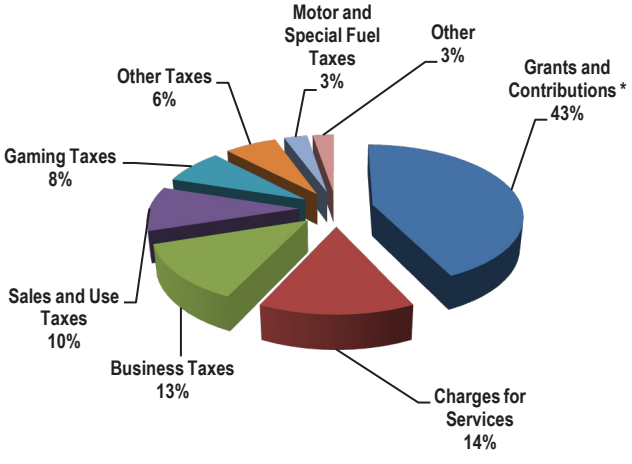
Hence, all four fundamental factors are now driving U.S. economic growth down from the current 2% annual real levels (1% per person), and human wellbeing will grow much slower in the future than in the last 300 years. The increasing time since the Great Recession also suggests cyclical factors may stunt growth in coming years. Nevada is not exempt from this unfortunate outlook: As detailed above in the section on spending, its public-sector metastasis has been greater and it continues. Other demographic, debt and international trade and investment factors do not portend improvement from the national economic outlook. Nevada's creditworthiness is a single bright spot. However, low economic growth will yield low expected investment returns, greatly challenging management of state retirement and endowment funds.

Economic Outlook Summary

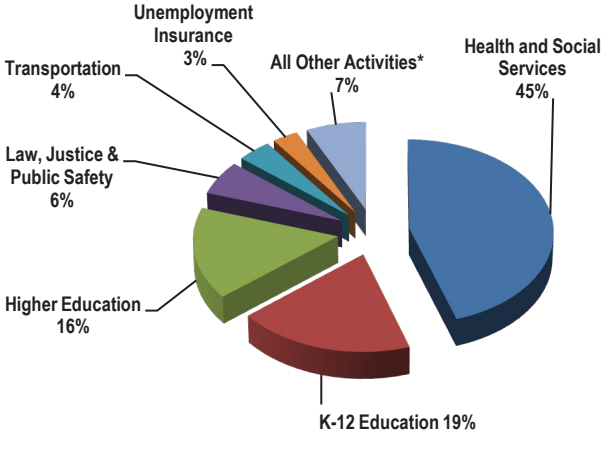
Government at all levels has long been so big, yet still growing relative to our economy, that it increasingly consumes our time, energy and productivity; crowds out private entrepreneurship and business spending and investment; and thereby stifles economic growth. For decades this burden was offset by three growth-inducing factors: 1) demographic and labor-force participation trends; 2) increasing debt levels; and 3) rapid growth in emerging economies, plus globalization and increasing trade and foreign domestic investment. Unfortunately, trends in all three areas have reversed. So, for the foreseeable future, economic growth will be suppressed perhaps even from current 2% real annual rates (or 1% per person per year) and uncertainty has increased greatly. Nevada's public-sector metastasis has been greater and it continues. Nevada's creditworthiness is a single bright spot. However, low economic growth will yield low expected investment returns, greatly challenging management of state retirement and endowment funds.

Nevada State Government Financial Summary

Sources of Revenue



Functional Expenses



Conclusion: Some people have claimed that Nevada has a revenue problem. Some argue that Nevada spends insufficiently on K-12 education, although they have not said how much would be "enough." The analyses herein show that total state spending has increased much faster than the incomes of Nevada families and businesses and that state revenues increased even faster than spending. Hence, Nevada has a spending problem, not a revenue problem. Also, K-12 spending has increased much faster than incomes and all other state spending except that for HSS. As discussed in the economic outlook section, growth in public spending is a prime reason economic growth in our nation and state has slowed and will continue to be anemic. Instead of new revenue sources, Nevada needs effective cost control in HSS and K-12 spending. Further, claims that budgets have been cut are misleading when actual spending and tax/feepayer burden have increased as they have. Public-sector excess is a drag on the economy and it diminishes human wellbeing and fairness in our society. It, not some alleged failure to adequately fund HSS and K-12, is the principal threat to our prosperity and children's welfare. For a long time to come, government in Nevada needs to grow slower than our economy.

FY 2015 Revenues by Source

Revenues by Source Expressed in Millions	2015 Revenue	2005 Revenue	% Change
Grants and Contributions *	$ 4,970	$ 2,270	119%
Charges for Services	1,632	1,318	24%
Business Taxes	1,500	779	93%
Sales and Use Taxes	1,161	1,000	16%
Gaming Taxes	906	900	1%
Other Taxes	761	634	20%
Motor and Special Fuel Taxes	340	282	21%
Other	306	322	-5%
Total Revenues**	**$ 11,576**	**$ 7,505**	**54%**

*Grants and Contributions include Operating and Capital Grants
**Total Revenues includes revenues from Primary Government Activities and Discretely Presented Component Units. Payments from the State of Nevada to Discretely Presented Component Units are eliminated.

FY 2015 Expenses by Function

Expenses by Function Expressed in Millions	2015 Expenses	2005 Expenses	% Change
Health and Social Services	$ 4,887	$ 2,083	135%
K-12 Education	2,022	1,246	62%
Higher Education	1,693	1,304	30%
Law, Justice and Public Safety	695	535	30%
Transportation	462	665	-31%
Unemployment Insurance	380	238	60%
All Other Activities*	766	807	-5%
Total Expenses**	**$ 10,905**	**$ 6,878**	**59%**

* All Other Activities include Governmental and Business-Type Activities
**Total Expenses includes expenses from Primary Government Activities and Discretely Presented Component Units. Payments from the State of Nevada to Discretely Presented Component Units are eliminated.

An independent audit of the State's financial statements resulted in an unmodified audit opinion. Financial information in this report is derived from Generally Accepted Accounting Principles (GAAP) data in the State's Comprehensive Annual Financial Report (CAFR).

To see the Comprehensive Annual Financial Report, visit: controller.nv.gov