Section 3: Defining the Problem

Governor's Task Force on Tax Policy in Nevada

November 15, 2002

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Defining the Problem

Introduction

Assembly Concurrent Resolution 1 ("ACR 1") requires that the Governor's Task Force on Tax Policy (the "Task Force") develop one or more "definitive proposals to carry out the State's need to": 1) provide additional revenue for state programs; 2) stabilize the tax base; and 3) reduce the long-term structural deficit of the State budget.[1] Implicit in such a requirement is the assumption that additional revenue is required to fund state programs, the tax structure is not optimally stable, and a structural deficit exists.

ACR 1 provides no evidence supporting these key suppositions. This section reviews and analyzes the underlying assumptions through the lens of ACR 1. It does not attempt to quantify the magnitude of the State's budgetary condition in terms of dollars and cents, nor does it attempt to fully address all of the issues raised. That effort is undertaken in subsequent sections, including those that deal specifically with revenue and expenditure projections. The objective of this section is to substantiate the fundamental suppositions, which give purpose and direction to the Task Force's efforts.

The Structural Deficit

Defining Structural Deficit

ACR 1 defines a structural deficit as a "[d]isparity between the growth in revenues from *current* revenue sources and the growth in public spending needed to maintain *current* governmental services."[2] (emphasis added). This definition is consistent with the definition of a structural deficit provided by Dr. Hal Hovey in his 1998 report entitled *The Outlook For State and Local Finances*. In that report, Dr. Hovey states, "[structural deficits] reflect a mismatch between growth in spending needed to maintain *current* services and growth in taxes and other revenues"[3] (emphasis added). The definition proffered by ACR 1 is also consistent with the oft-cited Urban Institute/Price Waterhouse *Fiscal Affairs of State and Local Government in Nevada* study. While that report did not

[1] Nevada Assembly Concurrent Resolution 1, Cl. 14. June 2001.

[2] Id. at Cl. 4.

[3] Hovey, H. *The Outlook for State and Local Finances*, 1998. Page ix.

specifically use the term "structural deficit," the authors noted that their primary purpose was to "[a]ssess the adequacy of the *current* general fund revenue structure for funding the *current* level of public services…"[4] (emphasis added). They further noted that a judgment of the adequacy of public expenditures is most appropriately a function of the political process, and thus, beyond the scope of their assessment.[5]

It is noteworthy, however, that the definition cited above is not the only one in common or professional usage. The term structural deficit can also be defined as a budget forecast gap, where projected expenditures consistently outpace revenue projections.[6] It can be defined as the deficit resulting from the economy's less than optimal output.[7] Thus, the difference between the fiscal systems "potential" and what is "actually" generated would result in a "structural deficit."[8] Finally, the term has also been used to describe the discretionary policy actions of an expansionary fiscal stance of the government, measured as a proportion of Gross Domestic Product.[9] These alternative definitions notwithstanding, the analysis herein relies on the plain language provided in ACR 1: *a structural deficit exists where current revenues are insufficient to meet existing service levels*.[10]

Presence of a Structural Deficit

The next question that must be asked is whether or not a structural deficit exists in Nevada. In support of its assertion, ACR 1 posits that Nevada's population, and in particular, its school-aged and senior populations, are growing at a rate faster than public revenue.[11] Some have argued that this assumption lacks foundation;[12] however, such a position is without merit given a complete review of the facts.

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[4] Urban Institute and Price Waterhouse, *Fiscal Affairs of State and Local Governments in Nevada*, Chapter 3: The Outlook (General Fund Projections). 1988.

[5] Id.

[6] *See* Donald Tsang Yam-kuen, Hong Kong's Financial Secretary, as quoted in the South China Morning Post.

[7] *See* Economic Report of the President, 1995. Page 68.

[8] Id.

[9] Jain, LC and Indira, A. in a speech delivered at the International Budget Project Conference. Fiscal Deficit Subsection.

[10] Nevada Assembly Concurrent Resolution 1, Cl. 4. 2001.

[11] Id. at Cl. 1 and 2.

Nevada's population grew from 1.2 million in FY 1989-90 to 2.1 million in FY 2000-01, or by a compound annual growth rate of 5.1 percent.[13] During the same period, the State's school-aged[14] and senior citizen[15] populations grew by rates of 5.5 percent and 5.7 percent, respectively. Please see Exhibit 3-1, on the following page.

Between FY 1989-90 and FY 2000-01, Nevada's general fund revenues grew from $802 million to $1.7 billion, or by 7.3 percent annually, and the State's revenue total grew from $1.8 billion to $4.4 billion, or by 8.5 percent annually.[16] It is certainly true that 5.1 percent is less than 7.3 and 8.5 percent. However, such a comparison assumes that a dollar today has a value equal to a dollar one, two, or twelve years ago. It is well settled that such an assumption is unsound and that a growth comparison must take into account the rate of inflation.[17]

When adjusted for the rate of inflation, the general fund's compound annual rate of growth is 4.2 percent; this is less than the cited rate of population growth, 5.1 percent, and thus, supportive of ACR 1's assumption. At the total State level, inflation adjusted revenues have increased at a compound annual rate of 5.4 percent. This inflation adjusted growth rate is still greater than overall population growth during the period. It is noteworthy, however, that the total State figure includes intergovernmental transfers, which are monies transferred in from other levels of government (i.e., the federal government) and are not reflective of the State's ability to generate revenues through its fiscal system.[18] When these transfers are removed, the revised growth rate is 4.5 percent annually, slightly lower than the cited rate of population growth.

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[12] *See* Nevada Policy Research Institute, *Fiction: Nevada population Growth Necessitates Tax Increases*. www.npri.org/issues/issues02/pop_growth.htm. June 2002.

[13] Nevada State Demographer, Population Projection Summary Worksheet, May 2001.

[14] Generally defined as children between the ages of 5 and 17.

[15] Generally defined as persons at or over the age of 65.

[16] *See* Legislative Counsel Bureau, *Appropriations Report*. Selected issues FY 1989-90 through FY 2000-01; s*ee also*, State of Nevada Controller's Office, *Comprehensive Annual Financial Report*. Selected issues FY 1989-90 through FY 2000-01.

[17] *See* United States Department of Labor, Bureau of Labor Statistics, *Consumer Price Index*. www.bls.gov. (Stating that the consumer price index is widely used as a means of adjusting dollar values).

[18] Burchell, R and Linstokin, D., *The Fiscal Impact Handbook*¸ The Center for Urban Policy Research. 1988.

Exhibit 3-1 Comparison of Demographic and Budget Growth Rates FY 1989-90 through FY 2000-01

				CAGR	
	FY 1989-90	FY 1996-97	FY 2000-01	12-Year	5-Year
State Demographics					
Population	1,233,409	1,785,602	2,127,116	5.1%	4.5%
Senior Population	129,018	194,464	236,504	5.7%	5.0%
School-Aged Population	211,994	328,361	383,530	5.5%	4.0%
Budgets - Nominal					
General Fund Appropriations	$ 802,025,446	$ 1,352,588,553	$ 1,734,105,526	7.3%	6.4%
Per Capita	$ 650	$ 757	$ 815	2.1%	1.9%
Total State Revenues	$ 1,815,101,000	$ 3,740,763,000	$ 4,440,169,000	8.5%	4.4%
Per Capita	$ 1,472	$ 2,095	$ 2,087	3.2%	-0.1%
Budgets - Inflation Adj.					
General Fund Appropriations	$ 1,066,114,433	$ 1,464,885,248	$ 1,672,856,766	4.2%	3.4%
Per Capita	$ 864	$ 820	$ 786	-0.9%	-1.1%
Total State Revenues	$ 2,412,773,040	$ 4,051,334,401	$ 4,283,341,839	5.4%	1.4%
Per Capita	$ 1,956	$ 2,269	$ 2,014	0.3%	-2.9%

A look at the last five fiscal years provides an increasingly concerning picture. Between FY 1996-97 and FY 2000-01, population growth increased by a compound annual rate of 4.5 percent,[23] and inflation adjusted total State revenues increased by only 1.4 percent. During that same five-year period, inflation adjusted general fund revenues increased by approximately 3.4 percent, or 1.1 percentage points less than population growth.

It is clear that a structural deficit exists as defined in ACR 1. Moreover, when the demographic makeup of the State's population growth is taken into consideration, the

[19] Compound Annual Growth Rate.

[20] Nevada State Demographer's Office.

[21] *See* Legislative Counsel Bureau, *Appropriations Report.* Selected issues FY 1989-90 through FY 2000-01; s*ee also,* State of Nevada Controller's Office, *Comprehensive Annual Financial Report.* Selected issues FY 1989-90 through FY 2000-01

[22] *Id. See also,* United State's Department of Labor Statistics, *Consumer Price Index of all Western Urban Consumers.*

[23] Note that during this same period, the school-aged children population increased by a rate of 4.6 percent annually and the senior population increased by 5.0 percent annually.

ability for its system, as currently designed, to fund existing service levels is all the more unlikely.

Factors Contributing to the State's Structural Deficit

There are numerous factors that may contribute to an imbalance between the productivity of current revenue sources and the ability to maintain existing public service levels. Each revenue source may also have a unique set of factors impacting its relative growth or decline in per capita terms. These revenue-specific factors are discussed in greater detail in later sections of this report. Below, some of the most significant contributing factors are briefly reviewed.

Decline in the Number of Visitors Per Capita

On a full-time equivalency basis, visitors to Nevada accounted for approximately 18 percent of the State's population in FY 2000-01.[24] There were 22.8 visitors for each resident of the State, which contributed significantly to the economy and public revenue base (i.e., through gaming taxes and sales and use taxes).[25] Please see Exhibit 3A-1, in the appendix immediately following this summary.

There is evidence that the number of visitors per capita is declining. In FY 1989-90, the ratio of visitors-to-residents was 24.7. While this statistic has varied during the last decade from highs of 25.4 to lows of 22.5, its compound annual growth rate between FY 1989-90 and FY 2000-01 was –0.07 percent. This trend, in combination with changing spending patterns by visitors, appears to be a leading cause of the nearly two percent average annual decline in gaming tax collections per capita.[26]

Fewer hotel-casino projects under construction,[27] changes in consumer attitudes toward travel,[28] and the continued proliferation of gaming and convention facilities worldwide

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[24] *See* Nevada State Demographer's Office, *Population Estimates Worksheet*, May 2002; *see also*, Nevada Commission on Tourism, *Discover the Facts*, Q4 2002; *see also,* Las Vegas Convention and Visitor's Authority, Visitor Volume and Number of Days Stayed in Nevada Estimates. June 2002.

[25] Id.

[26] Id. *see also*, Legislative Counsel Bureau, *Appropriations Report.* Selected issues FY 1989-90 through FY 2000-01; s*ee also,* State of Nevada Controller's Office, *Comprehensive Annual Financial Report.* Selected issues FY 1989-90 through FY 2000-01.

[27] *See* Las Vegas Convention and Visitor's Authority, *Construction Report*, Selected issues 1988 – 2002.

suggests this trend is likely to continue, at least in the short run. This assertion should not be misconstrued to imply that visitor volumes are anticipated to decline; in fact, just the opposite is more likely the case. This analysis merely states that Nevada's rate of population growth is expected to exceed its rate of visitor growth. Thus, to the extent that per visitor spending remains constant, the State's per capita revenue benefit derived from visitor spending is expected to decline.

Decline in Construction Activity

With Nevada's phenomenal rate of population growth comes an equally, if not more, impressive rate of development. Clark County alone has seen residential construction top 20,000 homes per year[29] and has witnessed the erection of multiple mega-resorts with price tags exceeding $1.6 billion.[30]

The impact of this development activity is largely self-evident. The industry employs more than 100,000 Nevadans, it generates billions of dollars in local economic activity, and adds significantly to State revenues, particularly in terms of retail sales and use tax collections. The level of overall construction activity, however, has slowed during the past couple of years, which appears to be putting downward pressure on sales tax revenues.

Between FY 1996-97 and FY 2000-02, construction-related industries accounted for 11 percent of the State's total taxable retail sales.[31] During that same period, inflation adjusted construction-related taxable sales per capita declined by a compound annual rate of 5.9 percent. By comparison, total inflation adjusted taxable sales per capita declined by a compound annual rate of 1.9 percent, or from $14,900 in FY 1996-97 to $13,500 in FY 2000-02. Four of the last five years saw declines in inflation adjusted per capita taxable sales. Please see Exhibit 3A-2 in the appendix following this text summary.

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[28] *See* Consumer Confidence Board estimates of plans to travel during the next six months and plans to travel via airplane during the next six months.

[29] *See* Southern Nevada Home Builders Association, *www.snhba.org/ns/economic_indicators*.html.

[30] *See* Las Vegas Convention and Visitor's Authority, *Construction Report*, Selected issues 1988 – 2002 (citing the Bellagio and Aladdin hotel-casinos as having construction costs in excess of $1.6 billion).

[31] Nevada Department of Taxation, *Retail Sales and Use Tax Collection by Industry*, Selected reports 1997 through 2001.

Low interest rates have bolstered new home sales and new home construction; however, comparatively few large casino-hotel projects are on the drawing board through 2004, commercial real estate markets are showing increasing signs of weakness, and obtaining development financing is becoming progressively more challenging. These are all normal short-run market corrections as the economy simmers somewhat from its feverish pace into a period of more sustainable growth. The impact of this adjustment, however, is fewer tax dollars at the State level.

Revenue Sources Which Do Not Adjust With Inflation

According to the United States Bureau of Labor Statistics, what a family could have purchased for $1.00 in 1990 would cost more than $1.40 today.[32] "Price inflation" has averaged just fewer than three percent per year since FY 1989-90, directly impacting the cost of nearly all consumer goods and services.[33] It is also reflected in the State's cost of administering programs, constructing facilities, and compensating employees.

While the State's cost of providing services increases each year, not all of its revenue sources follow suit. Take, for example, the $0.25 State excise tax levied on cigarettes.[34] Assuming that the price of cigarettes reflects price inflation similar to other goods and services, a $3.00 pack of cigarettes today would have cost approximately $2.20 in 1990. The effective tax rate on these cigarettes would have been approximately 11 percent in 1990, declining each year thereafter to just over 8 percent today. Assuming also that the marginal propensity to smoke remained the same, the State's per capita revenues from cigarette taxes and other similar levies tend to produce less revenue each year in inflation adjusted terms.

It is noteworthy that Nevada's largest revenue sources -- gross gaming fees, sales and use taxes, and property taxes -- all adjust with the rate of inflation. This fact notwithstanding, revenue sources representing hundreds of millions of dollars in revenue are not designed to reflect price inflation; and therefore, erode over time.

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[32] *See* United States Department of Labor, Bureau of Labor Statistics, *Consumer Price Index*. www.bls.gov.

[33] Id. Note that this analysis utilizes the consumer price index for all urban western consumers.

[34] NRS 370.

Changing Demographic Makeup of the State's Population

Certain segments of the State's population require more public services than do others. Common examples include children enrolled in public schools, senior citizens dependent on state funded medical care, and low-income families receiving public assistance. These groups not only require more services, but they also generate fewer tax dollars per capita than the average citizen. The tax system creates a redistribution of wealth, where higher income taxpayers subsidize many public services considered essential.

To the extent a greater share of the State's population becomes "eligible" to participate in these high-cost services, the burden that must be carried by the subsidizing taxpayers becomes larger. Such a condition appears to be conceived by ACR 1 when it states that school-aged children and senior citizens are the fastest growing segments of the State's population[35] and that Nevada is falling behind in the revenue collections needed for funding K-12 education and long-term care.[36]

A review of historical and projected population-by-age demographics provided by the Nevada State Demographer's office is not clearly supportive of this assertion.[37] Please see Exhibits 3A-3 and 3A-4 in the appendix following this summary. Between FY 1989-90 and FY 2000-01, the State's population increased by 72 percent, or roughly 5.1 percent compounded annually. During that period, school-aged children, those aged 5 to 17, grew at a compound annual rate of 5.5 percent. This rate was roughly 0.4 percentage points above the rate of overall population growth. The senior population, those aged 65 and older, grew at a rate of 5.7 percent compounded annually. The fastest growing segment of the population, however, was actually residents between the ages of 45 and 64. This segment of the population, which is among the least likely to be in a high service cost group, grew at a compound annual rate of 6.5 percent, or 1.4 percentage points faster than the population at-large.

Perhaps even more notable is what is projected for the future. According to the Nevada State Demographer, the number of school-aged children per capita is expected to decline slightly from .180 to .176, through FY 2010-11.[38] By contrast, the projected annual rate

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[35] Nev. Assembly Concurrent Resolution 1. Cl. 1. 2001.

[36] Id. at. Cl. 3.

[37] Nevada State Demographer's Office, *Population Projections Worksheet*. May 2002.

[38] Id.

of growth for seniors, 3.6 percent, is forecast to be 0.9 percent higher than the statewide growth average of 2.5 percent. Residents between the ages of 45 and 64 are projected to be the second fastest growing segment of the population, being outpaced by the senior population by a fraction of a percent.

The issue of increasing costs associated with the changing character of the State's population obviously requires a more in-depth treatment than the cursory review provided above. However, the population eligibility factor can impact the State's revenue-expenditure imbalance and has the potential to contribute to the State's structural shortfall.

Increasing Use of the Internet for Retail Purchases

In 1998, Congress passed the Internet Freedom Act,[39] which, among other actions, established the Advisory Commission on Electronic Commerce to study the tax treatment of Internet transactions and temporarily banned the imposition of certain taxes on e-commerce. Not included in the prohibition are the collection of existing taxes, such as sales and use taxes.[40] In November of 2001, the act was "extended to ban new, special, and discriminatory Internet taxes" through November 2003.[41]

The principal problems stemming from the taxation of Internet transactions are those of compliance and nexus. In-state sellers are required to collect sales tax on taxable goods at the time of sale. Out-of-state companies, or remote sellers, with a physical presence (or nexus) within the State are legally required to collect and remit retail sales and use tax -- be those brick and mortar establishments or businesses operating from a virtual storefront on the World Wide Web. Where a remote business is not required to collect the tax, purchasers themselves are obligated to remit the tax for the privilege of use, ownership, or possession of the good. Compliance among this group of transactions is considerably less than the others,[42] and the continued growth of e-commerce is likely to magnify this

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[39] P.L. 105-277, Div. C. Title XI.

[40] United States General Accounting Office, General Government Division, *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses are Uncertain*. June 2000

[41] H.R. 1552

[42] It should be noted that there are multiple subgroups that are required to remit sales and use tax payments. Compliance among individual consumers is almost nonexistent, with business and industry faring slightly better due to reporting and audit requirements.

problem as new types of digital transactions emerge and a highly computer literate generation becomes a formidable consumer group. These challenges have even led some observers to put into question the long-term viability of sales and use taxes.[43]

The United States General Accounting Office estimates that by 2003, Nevada's state and local governments would likely lose between $60 million and $200 million annually in sales tax revenues (including all components of Nevada's sales and use tax) due to problems associated with remote sales.[44] Nevada also has among the highest potentials to be impacted by this phenomenon due to the State's high reliance on retail sales and use taxes at all levels of government.[45]

Tax Base Stability

The second consideration enumerated in the Task Force's mandate is that of stability.[46] The presence of a structural deficit as outlined in the previous section notwithstanding, Nevada's fiscal system has been relatively stable during the past decade. This is evidenced by an inflation-adjusted per capita revenue generation rate, which, on average, has varied by less than three percent per year.[47] The degree of consistency is largely attributable to a healthy gaming industry,[48] a phenomenal rate of population growth,[49] and the longest period of national economic expansion recorded in modern history.[50]

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[43] United States General Accounting Office, General Government Division, *Sales Taxes: Electronic Commerce Growth Presents Challenges; Revenue Losses are Uncertain*. June 2000

[44] Id.

[45] This impact relates to the share of total public revenues generated by retail sales and use tax. It should be noted, however, that Nevada's narrow tax base and numerous exemptions may work as a limiting factor where other jurisdictions have a broader spectrum of goods potentially impacted. Please also see *Section 5: Fiscal Comparison – Nevada and the 50 States*.

[46] Nevada Assembly Concurrent Resolution 1. Cl. 14. June 2001.

[47] *See* Legislative Counsel Bureau, *Appropriations Report.* Selected issues FY 1989-90 through FY 2000-01; s*ee also,* State of Nevada Controller's Office, *Comprehensive Annual Financial Report.* Selected issues FY 1989-90 through FY 2000-01

[48] Nevada Resort Association, www.nevadaresorts.org/taxes.html.

[49] Ameristat, *Growth by State: US Population Winners in the 1990s.* (Citing Nevada, Arizona, and Colorado as those states with the greatest population gains during the 1990s.); *see also*, U.S. Census Bureau, *Population Estimates*.

[50] Wortley, J. *A Record Breaking Economic Expansion.* Senate Notes: Topics of Legislative Interest. Jan/Feb 2000 (citing the economic expansion which persisted through February 2000 as the longest period of expansion since the federal government began monitoring such growth in 1850). *See also* President's Council on Economic Advisors Report on Economic Expansion, 1999.

The stability of the State's fiscal system is generally believed to be the benefactor of good times and good fortune. Nevada's economy and its tax base are unquestionably among the narrowest in the nation. Public revenues are chiefly dependent on the performance of the State's core industry -- gaming and tourism. The dangers inherent in this reliance are magnified by the overall economy's relative dependence on the vitality of the gaming and tourism sector.

At the close of 2001, the hotel, gaming and recreation sector directly employed more than 240,000 Nevadans, representing nearly 25 percent of statewide employment.[51] Inclusion of indirect employment impacts, such as suppliers and supporting industries, could as much as double the number of jobs dependent on the State's core industry.[52] From a fiscal standpoint, the gaming and tourism industry, and its patrons, contribute more than any other single sector to state tax collections.[53] There is evidence that more than 50 percent of the State's general fund revenues are dependent on Nevada's tourist-based economy.[54]

While Nevada's economy has proven itself resourceful and resilient, it has also shown that it is neither impervious nor indestructible. History has taught us well that narrow economies, or those that are highly dependent on a single industry, are more susceptible to economic turmoil.[55] To believe that Nevada's economy and tax base are somehow both narrow and stable is to turn a blind eye to history and economic reality.[56]

The State's issue with stability is further exacerbated by its numerous sales and property tax exemptions and its reliance on construction-related activities. The former only serves

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[51] Nevada Department of Employment Training and Rehabilitation, Nevada *2001 Industrial Employment Summary*. www.detr.state.nv.us.

[52] Bybee, S. *Hospitality Industries Impact on the State of Nevada*, 1998. UNLV International Gaming Institute. 1999.

[53] Id.

[54] Urban Institute and Price Waterhouse, *Fiscal Affairs of State and Local Governments in Nevada*, Chapter 3: The Outlook (General Fund Projections). 1988; *see also* Bybee, S. *Hospitality Industries Impact on the State of Nevada*, 1998. UNLV International Gaming Institute. 1999.

[55] See *Seattle Braces for Boeing Slump*, Chicago Tribune (1993); see also, Ybarra, M.J. *Tourists Find Maui Heavenly, but Locals Tend to Disagree*. Dow-Jones News Service-Edited See also, Blackford, M., *Business, Government, Tourism, and the Environment: Maui in the 1980s and 1990s*. Business & Economic History. (October 1998); see also, *Texas Rises Slowly from Hard Times 'Can-Do' Spirits Battle Adversity With Diversity, The San Diego Tribune*. (May 1988); Wallace, J. *A New Beginning How They Battled Back From the Big Boeing Bust of the '70s*. Seattle Post-Intelligencer (March 1993); *See also Boeing Layoffs Threaten to Cripple Seattle's Economy.* Dow Jones Service-Edited Wall Street Journal Stories (April 1982).

[56] Id.

to further limit an already narrow tax base while the latter relies on sustained economic expansion. There is little doubt the existing tax system has served Nevada well; however, the threat created by its dependence on a relatively narrow base of volatile and cyclical revenue streams is also evident.

Providing Additional Revenue for State Programs

The final element of ACR 1's tripartite mandate, to "provide additional revenue for state programs,"[57] is by far its most daunting. This directive clearly requires the identification of additional or alternative revenue sources aimed at maintaining existing service levels as part of reducing the State's "long-term structural deficit." Less plainly stated, however, is the extent to which the resolution contemplates the Task Force's consideration of programmatic adequacy, or the monies needed to support new or expanded State programs.

ACR 1 expressly presupposes that a long-term structural deficit exists, and empirical analysis of the underlying data is supportive of this contention.[58] The resolution does not, however, include as a fundamental assumption that programmatic funding is less than optimal, beyond the cited inability for State revenues to keep pace with population growth (e.g., the result of a structural deficit).[59] Rather, ACR 1 asks the Task Force to "solicit the executive branch, businesses, labor organizations, and local governments for comments and suggestions for changes to Nevada's tax policy with the *intent being to gather public spending recommendations* for support of K-12 education and long term care needs of the general public…"[60] (emphasis added).

As required by ACR 1, the Task Force has solicited spending recommendations from numerous public and private sector groups. In response, it has have received more than 30 hours of testimony and reviewed dozens of written submissions. This deliberation on "desired" service and spending levels is used to make broad policy recommendations and to establish revenue alternatives for various potential spending thresholds. They are supplemental to the Task Force's proposal to address the State's long-term structural

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[57] Nevada Assembly Concurrent Resolution 1. Cl. 14. June 2001.

[58] Please see the *Presence of a Structural Deficit* subsection.

[59] *See* Nevada Assembly Concurrent Resolution 1. Cl 2, 3, and 4. June 2001.

[60] Nevada Assembly Concurrent Resolution 1. Cl. 12. June 2001.

deficit, understanding that any definitive judgment of service-level adequacy is a fundamental function of the public will and the end product of the full political process. It can be neither substituted nor supplanted by the limited scope of the Task Force's mandate.

A historical Perspective

The Task Force is not the first study commissioned by the Nevada Legislature to review the adequacy and equity of Nevada's fiscal system. In 1959, the Legislative Commission directed the Nevada Tax Study Group to review the fiscal affairs of State and local governments in Nevada. The Nevada Tax Study Group, aided by R.A. Zubrow and others, produced a report entitled *Financing State and Local Government in Nevada*. Mr. Zubrow provided the Legislature with vital information about "[h]ow well the State's fiscal system fit the contours of the economy and the needs of the people"[61] thus enabling the 1960 Legislature to fashion an appropriate tax structure to meet the public's need for services at that time.

In transmitting his report to the Nevada Legislative Commission, Mr. Zubrow cautioned, "As in other states of the West, Nevada's rapid postwar economic development and population growth have intensified the need for public services, with resulting changes in governmental revenue requirements. Under these conditions the maintenance of a tax structure which will be equitable and productive becomes increasingly important."[62] It seems that the questions facing the State in 1959 were not so far removed from those we face today.

Mr. Zubrow advised that Nevada no longer had the luxury to rely on its past experience for guidance about future tax policies. His conclusion was based on 1) the rapid growth in Nevada's economy, 2) the increase in tourism as a dominant factor in Nevada's economy, 3) the increasing urbanization of the State and 4) the growing concentration of economic and social activities in Clark and Washoe counties.[63] Mr. Zubrow also questioned the extent to which tourists, who were not directly part of Nevada's tax base for many

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[61] R. A. Zubrow, R. L. Decker & E. H. Plank, *Financing State and Local Government in Nevada*, (Nevada Leg. Counsel Bur. Rpt. 44 1960).

[62] Id.

[63] Id. at 657.

purposes, could be taxed to support the operation of State and local government.[64] Zubrow concluded, "Wise management of public finance in an expanding economy requires the recognition of the changing needs of the public, the use of efficient means of providing public services, and the development of tax programs which are *consistent with the pattern and capacity of the State's economy*"[65] (emphasis added).

In 1988, the Legislature again authorized a study of Nevada's tax structure, this time under the direction of the Urban Institute and Price Waterhouse[66] ("UI"). A major purpose for this study, as Mr. Zubrow's before it, was to provide "policymakers with an analysis of how well the fiscal system is likely to function in the context of the State's demographic and economic trends."[67]

UI began as Zubrow had, with an analysis of the State's economic and demographic trends to provide an appropriate framework for reference in assessing Nevada's fiscal policies. Next, UI examined Nevada's tax structure to determine the extent to which it was reflective of the State's economic base, affirming Zubrow's contention that "the general level of governmental revenues, and the apportionment of the tax burden must reasonably conform to the community's resource base and pattern of income distribution."[68] In other words, "a tax program, like a suit of clothes, must be tailored to fit the wearer."[69]

UI studied the then-existing State revenue system's ability to meet the State's current services budget needs from FY 1988 through FY 2010. UI's model predicted Nevada would experience a "budget gap" on the order of 5 to 10 percent beginning in the mid-1990's.[70] UI concluded that Nevada's tax structure was faltering in its ability to support the State's current services budget needs.

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[64] Id.

[65] Id.

[66] Urban Institute & Price Waterhouse, *A Study of the Fiscal Affairs of State and Local Governments in Nevada*, Final Report (Nov. 18,1988).

[67] Id. at Exec. Summary 2.

[68] R. A. Zubrow, R. L. Decker & E. H. Plank, *Financing State and Local Government in Nevada*, (Nevada Leg. Counsel Bur. Rpt. 44 1960).

[69] Id.

[70] Urban Institute & Price Waterhouse, *A Study of the Fiscal Affairs of State and Local Governments in Nevada*, Final Report (Nov. 18,1988).

The problems giving rise to ACR 1 are not novel. Nevada once again faces the prospect of revenue shortfalls in the face of the continuing need for public services. And, like those that have studied Nevada's fiscal structure during the past half century, ACR 1 embraces the merits of a fiscal system reflective of the State's diverse economy and befitting its unique character. Having substantiated that a problem exists, the following sections of the Task Force's report focus on estimating the magnitude of the State's budget gap and developing solutions to offset it.

Appendix 3A:
Supporting Exhibits

Governor's Task Force on Tax Policy in Nevada

November 15, 2002

Exhibit 3A-1 Nevada Population and Visitor Volume
FY 1989-90 through FY 2000-01

	FY 1989-90	FY 1990-91	FY 1991-92	FY 1992-93	FY 1993-94	FY 1994-95	FY 1995-96	FY 1996-97	FY 1997-98	FY 1998-99	FY 1999-2000	FY 2000-01
Resident Population (1)	1,233,409	1,315,559	1,368,619	1,428,395	1,522,043	1,607,510	1,692,058	1,785,602	1,871,064	1,946,287	2,017,988	2,127,116
Growth Rate		6.7%	4.0%	4.4%	6.6%	5.6%	5.3%	5.5%	4.8%	4.0%	3.7%	5.4%
Visitor Volume (2)												
Clark County	20,954,420	21,315,116	21,886,865	23,522,593	28,214,362	29,002,122	29,636,361	30,464,635	30,605,128	33,809,134	35,849,691	35,017,317
Washoe County	4,867,083	4,540,099	4,448,144	4,477,731	4,472,506	4,851,269	5,215,010	5,155,649	5,121,993	5,073,641	5,188,325	5,008,504
Balance of the State	4,645,581	5,284,884	5,563,135	6,077,407	6,685,638	6,597,878	6,656,578	6,518,354	6,282,735	8,403,034	8,496,005	8,428,493
Total Visitor Volume	30,467,084	31,140,099	31,898,144	34,077,731	39,372,506	40,451,269	41,507,949	42,138,638	42,009,856	47,285,809	49,534,021	48,454,314
Growth Rate		2.2%	2.4%	6.8%	15.5%	2.7%	2.6%	1.5%	-0.3%	12.6%	4.8%	-2.2%
Visitors Per Capita	24.70	23.67	23.31	23.86	25.87	25.16	24.53	23.60	22.45	24.30	24.55	22.78
Average Stay Per Visitor (2,3)	2.98	3.10	3.25	3.12	3.07	3.41	3.55	3.40	3.23	3.58	3.60	3.50
FTE Population Estimate (4)	1,482,250	1,580,036	1,652,585	1,719,316	1,853,488	1,985,870	2,095,807	2,177,974	2,242,628	2,410,408	2,506,388	2,591,732
Resident Share	83.2%	83.3%	82.8%	83.1%	82.1%	80.9%	80.7%	82.0%	83.4%	80.7%	80.5%	82.1%
Visitor Share	16.8%	16.7%	17.2%	16.9%	17.9%	19.1%	19.3%	18.0%	16.6%	19.3%	19.5%	17.9%

Notes:

(1) Nevada State Demographer's Office, Population Projection Worksheet, June 2002.

(2) Nevada Commission on Tourism; Las Vegas Convention and Visitor's Authority; and Reno-Sparks Convention and Visitor's Authority.

(3) Weighted average based on the stays reported by the local authority and the number of visitors in each area.

(4) Full-time equivalent population estimate. Assumes that Nevada residents reside in the state for 365 days per year.

Exhibit 3A-2: Inflation Adjusted Taxable Retail Sales Per Capita
State Summary by Category
FY 1996-97 through FY 2001-02

Business Code and Type	FY 1996-97	FY 1997-98	FY 1998-99	FY 1999-2000	FY 2000-01	FY 2001-02	CAGR
58 Eating and Drinking Places	$2,422.41	$2,295.80	$2,477.64	$2,708.34	$2,631.18	$2,492.60	0.57%
55 Automotive Dealers & Gasoline	1,897.92	1,846.06	1,965.10	2,012.43	1,960.79	1,999.26	1.05%
59 Miscellaneous Retail	1,557.18	1,513.76	1,589.99	1,620.60	1,549.61	1,408.44	-1.99%
53 General Merchandise Stores	1,069.21	1,173.23	1,251.95	1,297.05	1,284.97	1,258.73	3.32%
52 Building Materials, Hardware,	**1,163.10**	**1,038.61**	**1,023.25**	**978.36**	**927.23**	**877.63**	**-5.48%**
50 Wholesale Trade - Durable Goods	1,105.74	1,028.34	999.80	924.03	833.36	740.85	-7.70%
57 Home Furniture, Furnishings &	726.81	756.00	829.70	825.30	790.32	741.66	0.41%
54 Food Stores	682.76	652.39	645.86	636.89	603.70	578.53	-3.26%
56 Apparel and Accessory Stores	521.36	570.46	588.32	594.08	578.98	531.14	0.37%
73 Business Services	611.71	583.15	565.17	576.70	563.54	517.36	-3.29%
75 Automotive Repair, Services &	412.11	436.34	440.30	440.67	407.65	403.28	-0.43%
17 Construction - Special Trade con	**462.14**	**483.95**	**447.95**	**382.97**	**321.74**	**344.70**	**-5.69%**
79 Amusement and Recreation Services	302.05	285.21	281.78	226.68	246.32	194.99	-8.38%
35 Industrial and Commercial Mach	176.31	229.20	217.92	175.01	199.09	136.95	-4.93%
51 Wholesale Trade - NonDurable Goods	157.67	130.98	133.22	151.73	152.93	160.78	0.39%
61 NonDepository Credit Institutions	140.61	125.39	120.04	109.48	112.55	111.01	-4.62%
48 Communications	112.21	136.19	129.54	119.42	110.91	78.52	-6.89%
49 Electric, Gas & Sanitary Services	119.41	103.55	126.08	88.24	88.87	88.14	-5.89%
15 Building Construction - Gen Cont	**121.74**	**96.86**	**108.65**	**94.83**	**77.07**	**60.03**	**-13.19%**
36 Electronic and Other Electrical	92.09	83.11	81.06	73.80	70.53	59.84	-8.26%
76 Miscellaneous Repair Services	84.36	69.39	68.94	60.65	61.10	51.38	-9.44%
16 Heavy Construction other than	**76.98**	**66.84**	**84.25**	**62.89**	**59.30**	**65.04**	**-3.32%**
39 Misc. Manufacturing Industries	75.36	64.47	64.99	65.30	58.76	50.78	-7.59%
32 Stone, Clay, Glass and Concrt	76.79	73.80	86.09	65.29	56.05	49.72	-8.33%
10 Metal Mining	137.33	94.19	88.79	75.35	56.04	51.20	-17.91%
70 Hotels, Rooming Houses, Camps,	27.61	48.87	47.43	46.36	52.10	38.15	6.68%
72 Personal Services	62.33	57.49	55.46	54.49	46.89	45.52	-6.09%
27 Printing, Publishing, and Alli	25.30	26.03	25.29	25.50	39.24	23.14	-1.77%
28 Chemicals and Allied Products	71.70	55.90	48.95	36.37	37.14	35.34	-13.20%
99 Nonclassifiable Establishments	20.35	18.32	17.62	18.33	31.27	18.27	-2.14%
80 Health Services	34.08	33.29	31.17	31.21	30.40	29.63	-2.76%
78 Motion Pictures	33.07	29.93	29.40	26.77	25.80	22.29	-7.59%
34 Fabricated Metal Products, Ex	36.36	42.17	51.61	36.98	21.89	27.31	-5.56%

Exhibit 3A-2: Inflation Adjusted Taxable Retail Sales Per Capita
State Summary by Category
FY 1996-97 through FY 2001-02

Business Code and Type	FY 1996-97	FY 1997-98	FY 1998-99	FY 1999-2000	FY 2000-01	FY 2001-02	CAGR
65 Real Estate	12.87	15.14	12.11	16.17	19.11	25.51	14.66%
24 Lumber and Wood Products, Exce	22.03	20.54	19.53	19.58	17.86	15.69	-6.56%
29 Petroleum Refining and Related	22.41	18.52	16.79	16.10	15.95	12.67	-10.77%
07 Agricultural Services	18.23	18.31	17.25	16.70	15.31	15.64	-3.02%
87 Engineering, Accounting, Research	10.08	13.50	18.30	11.22	13.93	30.60	24.86%
25 Furniture and Fixtures	18.94	18.67	26.74	15.11	13.42	15.53	-3.89%
38 Meadings, Analyzing, and Contr	14.01	19.72	12.82	13.33	13.01	18.90	6.18%
20 Food and Kindred Products	13.10	12.66	13.03	10.17	11.32	11.96	-1.80%
47 Transportation Services	6.71	7.37	7.12	8.38	8.56	4.82	-6.39%
45 Transportation by Air	15.42	15.00	11.51	8.84	8.56	6.63	-15.55%
60 Depository Institutions	9.73	8.52	16.10	11.45	8.30	7.05	-6.24%
37 Transportation Equipment	12.22	11.47	9.73	8.97	7.50	5.39	-15.10%
42 Motor FreightTransportation and	6.89	7.51	7.21	7.50	7.35	8.46	4.20%
30 Rubber and Misc Plastic Products	4.18	4.64	5.23	4.80	5.68	4.65	2.14%
22 Textile Mill Products	7.11	6.15	10.64	5.96	5.48	5.44	-5.21%
33 Primary Metal Industries	7.47	7.10	4.63	8.53	5.05	7.35	-0.33%
40 Railroad Transportation	1.12	1.97	2.31	2.77	4.44	1.98	12.10%
14 Mining and Quarrying of NonMetal	5.01	4.44	3.61	3.32	3.21	2.88	-10.44%
89 Miscellaneous Services	8.23	4.78	7.01	5.39	2.74	2.17	-23.43%
13 Oil and Gas Extraction	8.56	6.67	2.53	2.03	2.68	2.51	-21.74%
41 Local and Suburban Transit and	3.00	3.68	3.97	2.80	2.51	2.04	-7.43%
86 Membership Organizations	11.31	8.00	6.60	2.12	2.32	2.23	-27.76%
67 Holding & Other Invest Offices	0.26	0.47	1.19	1.62	2.06	2.33	55.29%
26 Paper and Allied Products	3.45	4.27	3.92	3.03	1.89	1.84	-11.81%
01 Agricultural Production-Crops	3.09	2.44	1.75	1.66	1.74	2.17	-6.79%
82 Educational Services	2.42	1.83	1.53	1.44	1.62	1.50	-9.06%
81 Legal Services	1.16	1.68	1.41	1.57	1.49	1.44	4.36%
02 Agricultural Production Livest	1.73	1.41	1.68	1.36	1.34	1.27	-6.02%
44 Water Transportation	1.24	1.14	1.10	1.20	1.15	0.81	-8.20%
23 Apparel and other finished Product	0.84	0.88	0.72	1.20	1.03	0.96	2.74%
62 Security and Commodity Brokers	1.99	5.50	2.87	0.98	0.81	1.42	-6.51%
63 Insurance Carriers	0.53	0.26	0.53	0.54	0.67	0.47	-2.12%
21 Tobacco Products	0.47	0.84	0.74	0.59	0.67	0.55	3.04%

Exhibit 3A-2: Inflation Adjusted Taxable Retail Sales Per Capita
State Summary by Category
FY 1996-97 through FY 2001-02

Business Code and Type	FY 1996-97	FY 1997-98	FY 1998-99	FY 1999-2000	FY 2000-01	FY 2001-02	CAGR
64 Insurance Agents, Brokers	0.55	0.68	0.72	0.50	0.60	0.52	-1.13%
83 Social Services	0.22	0.29	0.34	0.31	0.33	0.36	9.77%
84 Museums, Art Galleries, and B	0.19	0.16	0.23	0.37	0.31	0.30	8.89%
31 Leather and Leather Products	0.71	0.45	0.30	0.19	0.19	0.15	-26.44%
91 Executive, Legislative and General	0.00	0.27	0.20	0.21	0.17	0.06	0.00%
08 Forestry	0.19	0.20	0.24	0.18	0.13	0.11	-10.04%
46 Pipelines, Except Natural Gas	0.62	0.50	0.42	0.17	0.10	0.16	-23.45%
95 Administration of Environmental	0.17	0.07	0.08	0.02	0.06	0.05	-20.35%
94 Administration of Human Resources	0.01	0.02	0.04	0.03	0.04	0.04	24.63%
96 Administration of Economic Productivity	0.00	0.02	0.01	0.02	0.02	0.02	0.00%
88 Private Households	0.00	0.00	0.01	0.00	0.00	0.00	-14.87%
43 United States Postal Services	0.85	0.16	0.31	0.02	0.00	0.27	-20.26%
09 Fishing, Hunting, and Trapping	0.11	0.00	0.01	0.00	0.00	0.00	-67.26%
97 National Security and International	0.01	0.01	0.00	0.00	0.00	0.00	0.00%
12 Coal Mining	0.04	0.00	0.00	0.00	0.00	0.00	0.00%
92 Justice, Public Order & Safety	0.00	0.00	0.00	0.00	0.00	0.00	-15.54%
93 Public Finance, Taxation, and	0.00	0.00	0.00	0.00	0.00	0.00	0.00%
State Total	**$14,876**	**$14,507**	**$14,978**	**$14,861**	**$14,298**	**$13,519**	**-1.89%**

Source: Calculations based on data provided by the Nevada Department of Taxation.

Notes:

(1) Red categories are primary building and construction categories.

(2) Totals may not sum to 100 percent due to rounding.

Exhibit 3A-3: Historical and Projected Nevada Population by Age Group FY 1989-90 through FY 2010-11

Age Group	FY 1989-90	Share of Total	FY 1996-97	Share of Total	FY 2000-01	Share of Total	FY 2010-11 (p)	Share of Total
Under 5	98,059	8.0%	132,509	7.4%	153,041	7.2%	199,065	7.3%
5 to 17	211,994	17.2%	328,361	18.4%	383,530	18.0%	478,389	17.6%
18 to 30	260,800	21.1%	331,985	18.6%	393,754	18.5%	485,673	17.9%
31 to 44	285,949	23.2%	407,807	22.8%	464,158	21.8%	530,560	19.5%
45 to 64	247,589	20.1%	390,476	21.9%	496,129	23.3%	690,913	25.4%
65 and Older	129,018	10.5%	194,464	10.9%	236,504	11.1%	335,951	12.3%
Total	**1,233,409**	**100.0%**	**1,785,602**	**100.0%**	**2,127,116**	**100.0%**	**2,720,550**	**100.0%**

Source: Nevada State Demographer's Office, *Population Projections Worksheet* , May 2002.

Exhibit 3A-4: Historical and Projected Nevada Population by Age Group FY 1989-90 through FY 2010-11

Age Group	FY 1989-90 through FY 2000-01		FY 1996-97 through FY 2000-01		FY 2000-01 through FY 2010-11 (p)	
	Total Growth	CAGR (1)	Total Growth	CAGR (1)	Total Growth	CAGR (1)
Under 5	56.1%	4.1%	15.5%	3.7%	30.1%	2.7%
5 to 17	80.9%	5.5%	16.8%	4.0%	24.7%	2.2%
19 to 30	51.0%	3.8%	18.6%	4.4%	23.3%	2.1%
31 to 45	62.3%	4.5%	13.8%	3.3%	14.3%	1.3%
45 to 64	100.4%	6.5%	27.1%	6.2%	39.3%	3.4%
65 and Older	83.3%	5.7%	21.6%	5.0%	42.0%	3.6%
Total	**72.5%**	**5.1%**	**19.1%**	**4.5%**	**27.9%**	**2.5%**

Source: Nevada State Demographer's Office, *Population Projections Worksheet* , May 2002.

Notes:

(1) Compound annual growth rate.

(2) Totals may not sum to 100 percent due to rounding.