

# Recovering from the Great Recession in the U.S. and Nevada

Elliott Parker, Ph.D.  
Professor of Economics  
University of Nevada, Reno

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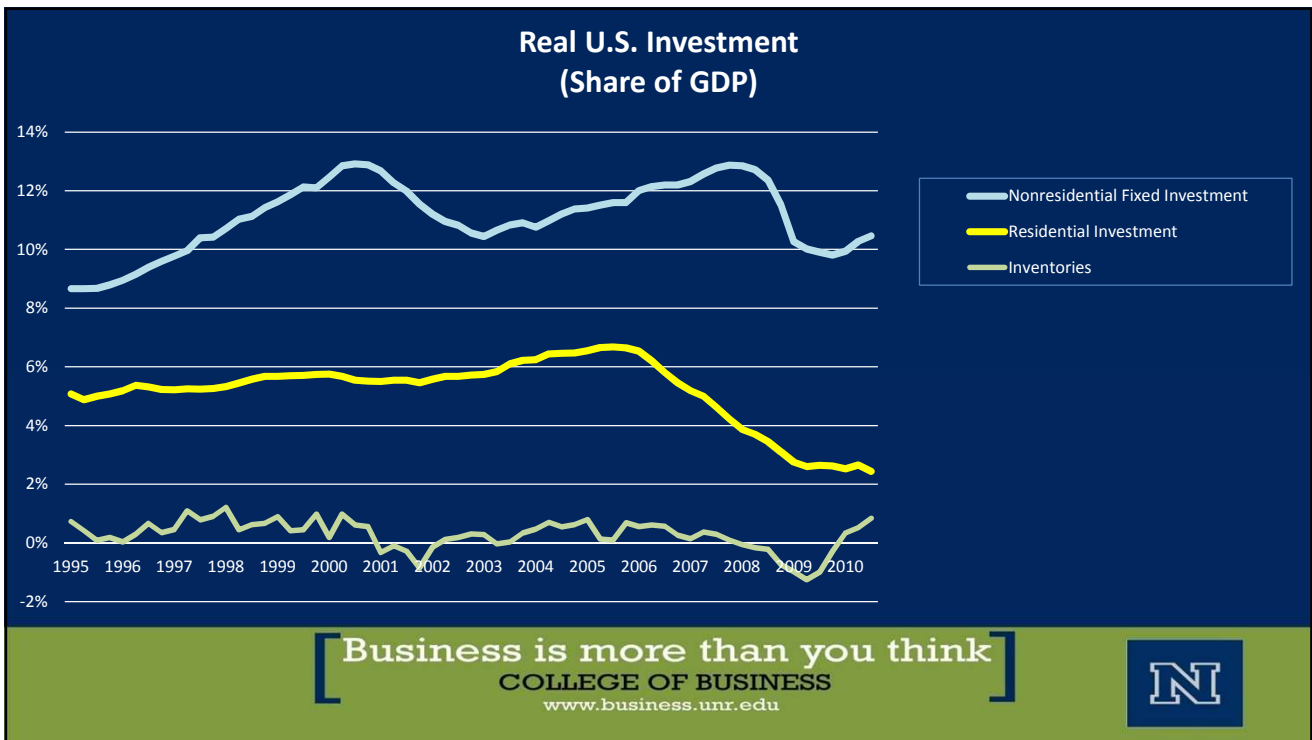
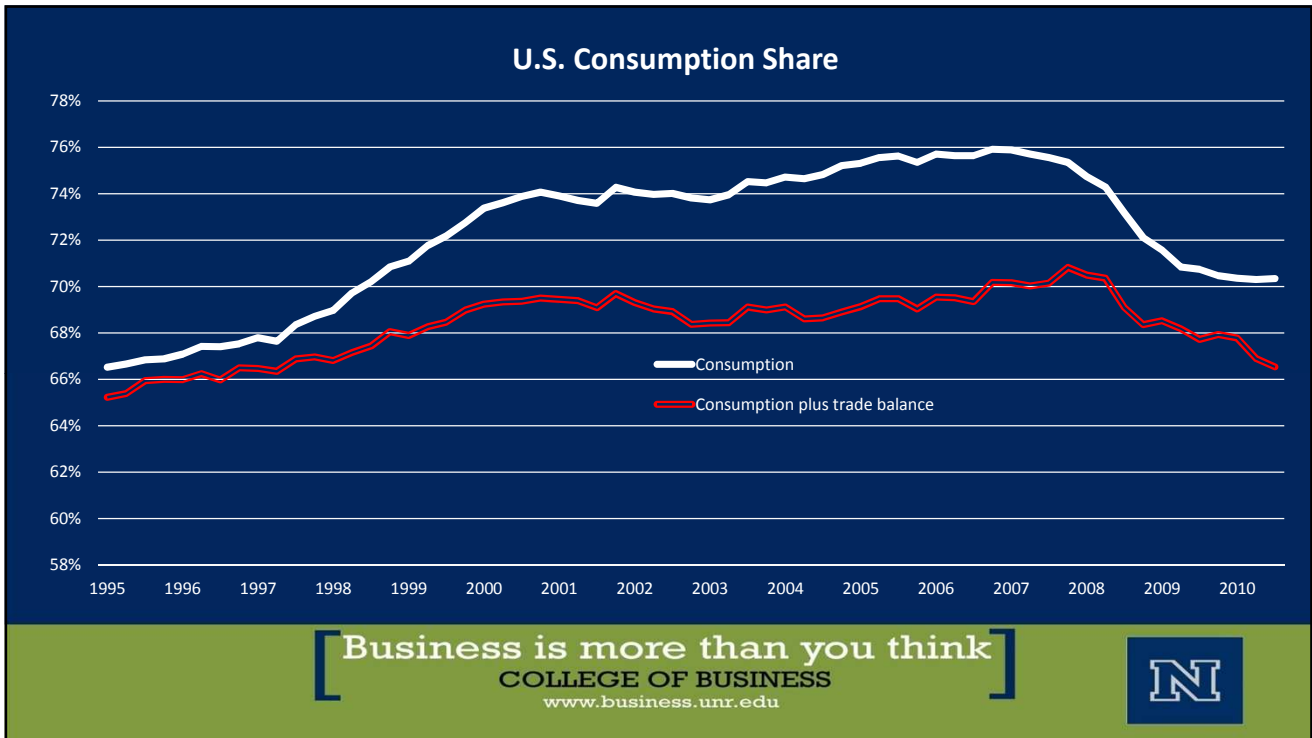


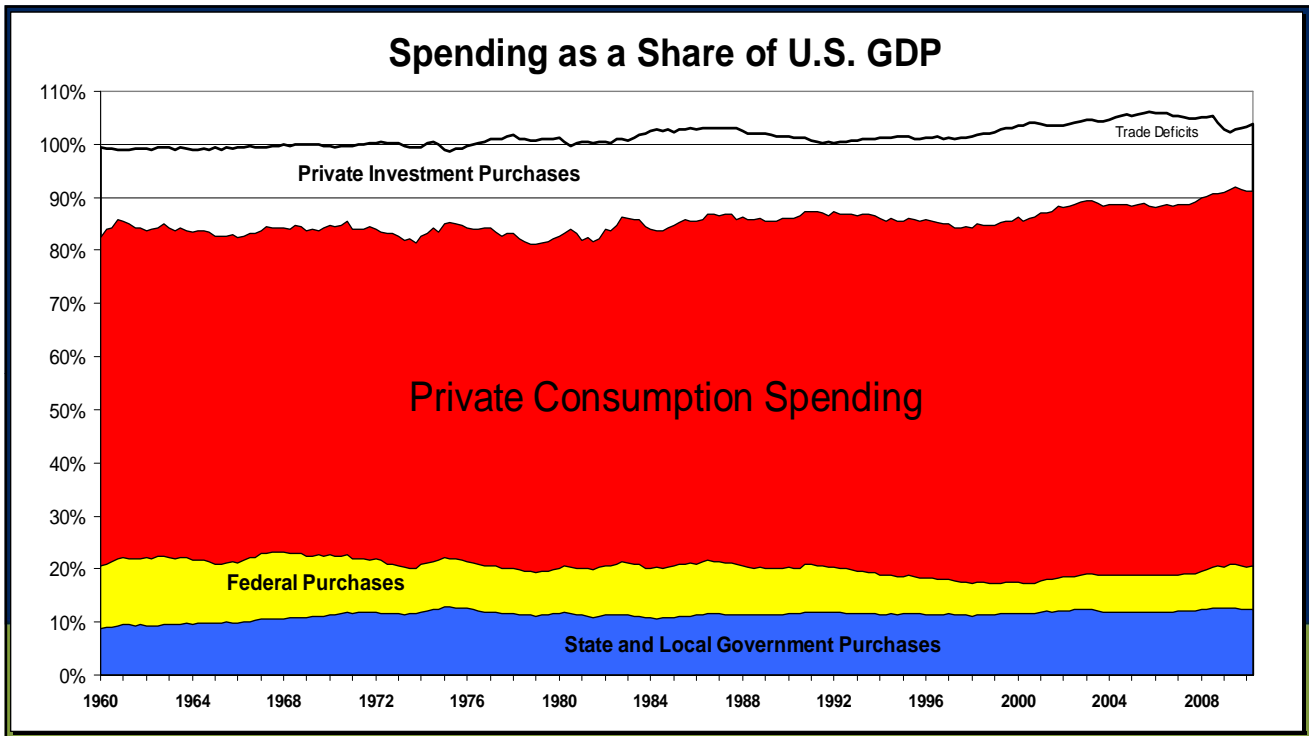
## The Great “Balance-Sheet” Recession

- Recessions - less common than they used to be.
- Depressions – much less common, much longer and deeper than normal recessions.
  - A recession caused by a financial crisis
  - A “balance sheet” recession: financial wealth collapses, banks collect reserves to offset bad debt, government becomes borrower of last resort, deflation and ZIR.

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## Response #1: Monetary Intervention

Federal Reserve authorized:

- Quantitative easing: purchase of government bonds, helped drive yield to zero.
- Purchase of private mortgage-backed securities, central bank currency swaps, target federal funds rate near zero.
- *Pushing vs. pulling on a rope.* Effectiveness varies.

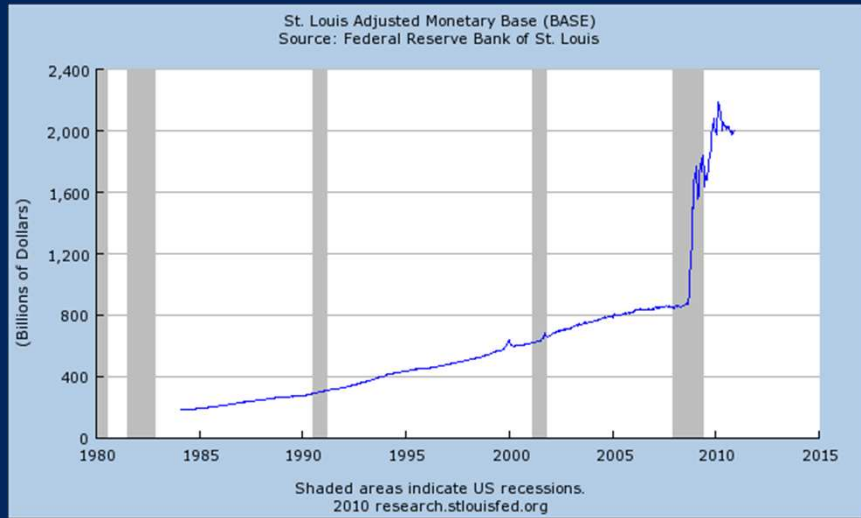
QE II is currently planned:

- – “Hail Mary pass” – to prevent deflationary expectations.

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# Monetary Base (Currency plus Bank Reserves)



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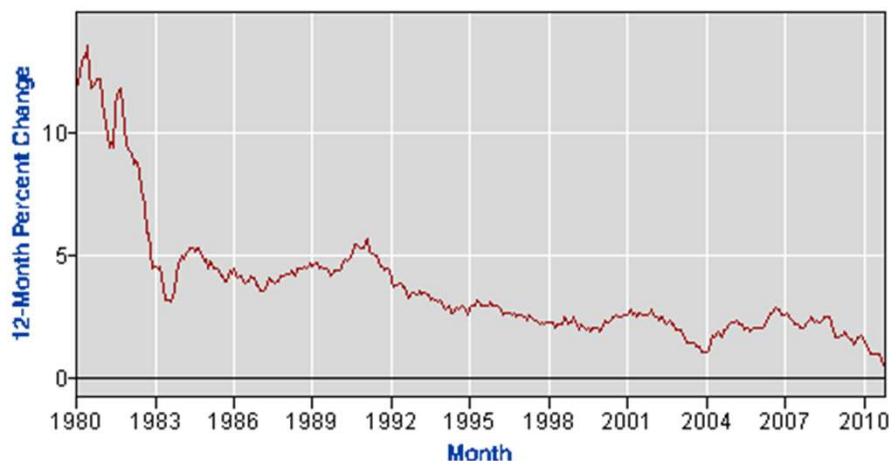


# Money Stock (M2)



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But inflation hasn't been a problem yet!

Low interest rates and inflation have increased money demand.

## Response #2: Bank Bailouts

### Emergency Economic Stabilization Act:

- \$700 billion authorized in October 2008. Only \$550B used.
- TARP funds first for purchase of troubled MBS, but changed to an equity purchases approach with executive pay restrictions.
- \$270B went to AIG, GM, Wells Fargo, Citigroup, BoA, JPMorgan Chase, Morgan Stanley, and Goldman Sachs.
- \$27B went to over 600 banks (\$300K-\$968M)
- Majority has already been paid back, with interest.

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## Response #3: Fiscal Intervention

- Economic Stimulus Act of Feb. 2008:
  - Tax rebates for 2008, estimated \$150B cost (about 1% of GDP) in 2008.
- American Recovery and Reinvestment Act of 2009:
  - Estimated \$800B cost over several years, with less than \$200B spent in FY 2009, and \$400B in FY 2010 (about 3% of GDP).
  - About 40% in tax credits, 30% in state fiscal support, and 30% in infrastructure investment (education, energy, health care), and some extended benefit support.
  - How effective was this stimulus?


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## Three Questions Answered...

- Why isn't the economic recovery more robust?
  - It's a depression, dummy. They last a while. Banks stopped lending, and people stopped building houses. But the economy did not collapse.
- Is inflation a threat?
  - No, the bigger concern has been deflation. However, the Fed must be willing to unwind the monetary base, once banks start lending again.
- Has the overconsumption problem eased?
  - Yes, consumption spending plus residential investment has fallen – though as a nation we are still spending more than we make.


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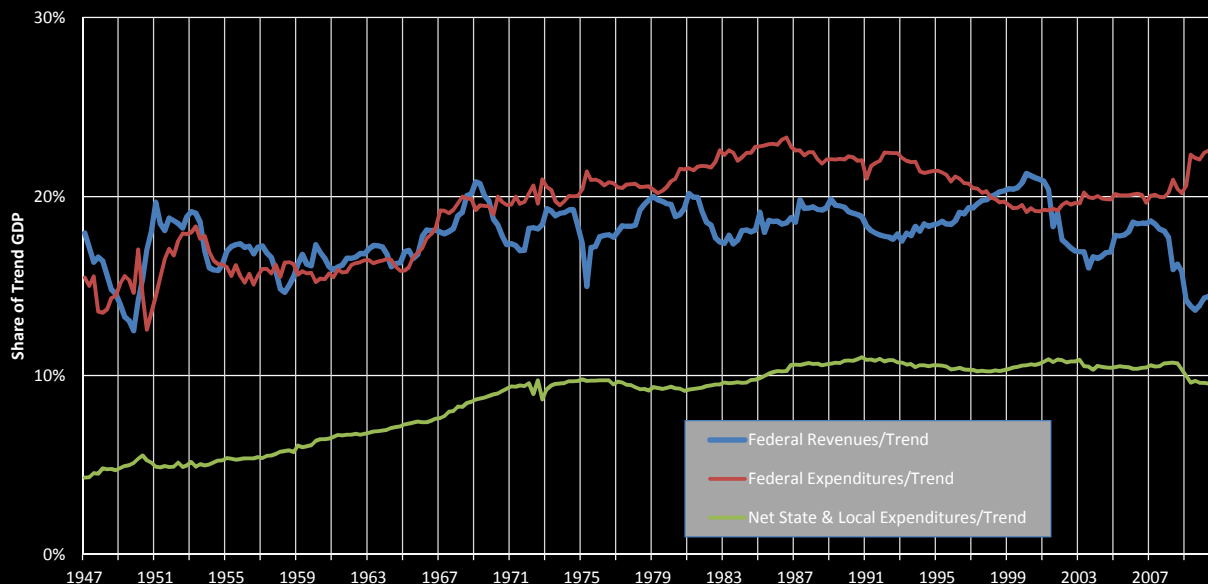
# The Federal Deficit and the Debt

- The Federal Debt is almost \$14T, about our annual GDP (\$10T in 2008, compared to less than \$6T in 2000).
- About \$8T is held by private, half of that by foreigners.
- The current deficit is temporary due to the recession, but there are serious structural problems: tax cuts, the growth of health care costs (i.e., Medicare).
- Borrowing for investment, or in bad times, makes sense. Borrowing in good times for consumption does not – IBGYBG.

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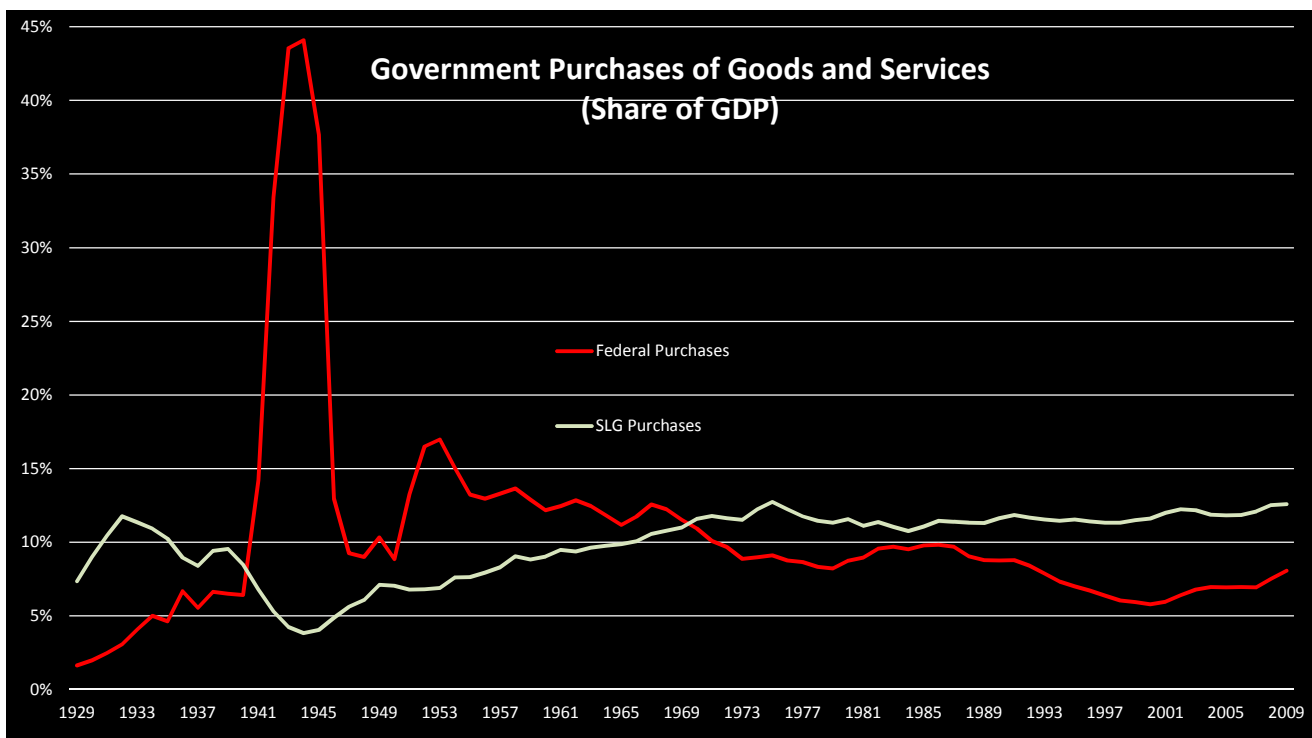
Government Spending and Revenues  
(Share of 1950-1990 Trend Quarterly GDP)

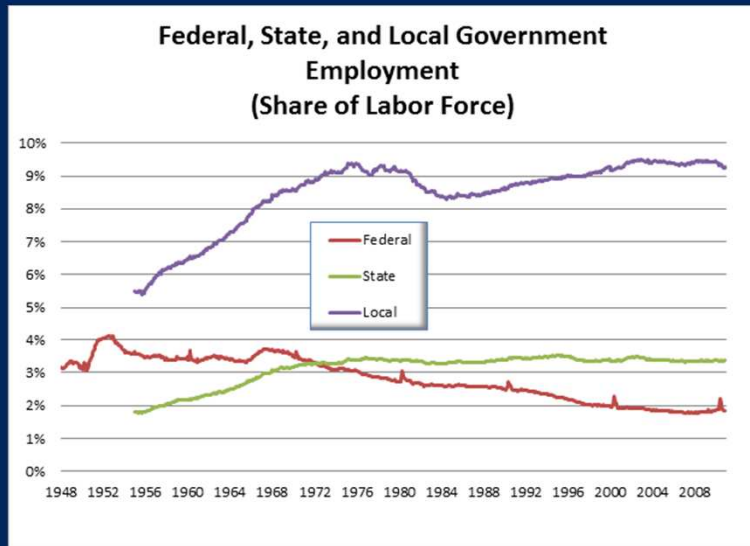


# Fifty Herbert Hoovers

- State and local governments are often ignored.
- SLGs purchase more goods and services, and employ more people, than the federal government.
- Most SLGs have balanced budget requirements, which means they must either cut spending or raise taxes during recessions.
- SLG financial crises lag the rest of the economy.
- Estimates: cuts to SLG lead to twice the fall in GSP the next year.

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Spending cuts have more effect than tax increases.

It should therefore be no surprise that when SLGs are cutting as the Feds are spending, the economy does not recover very fast.

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## What happened to Nevada?

- Gaming was a sustainable model, until monopoly ended.
- Las Vegas maintained growth by building new properties, but gaming/hotels/tourism still a falling share of state economy.
- Rapid construction was not sustainable: building homes for other construction workers, dependent on California bubble.
- Low educational attainment: supply and demand.
- Relatively undiversified economy: little public investment.
- State and local government revenues reliant on gaming tax, narrow-based sales tax.

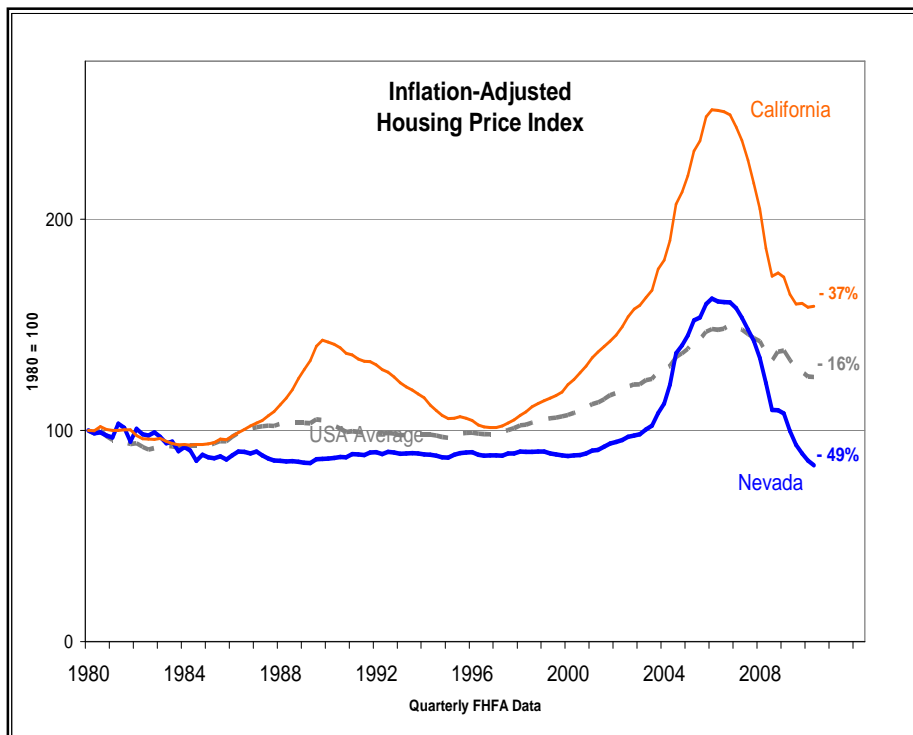
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# Nevada's Economy

- Housing prices fell more than elsewhere, most mortgages underwater.
- Personal income had been growing by 8% per year for previous decade. It declined by 6% from 2008:1-2009:1, and has been flat since.
- Gaming in long-run decline – 17% of GSP in 1980s, 10% in 2007, 8% in 2009.
- Construction boomed from 1997-2006, became largest share of any state.
- Unemployment highest in country.

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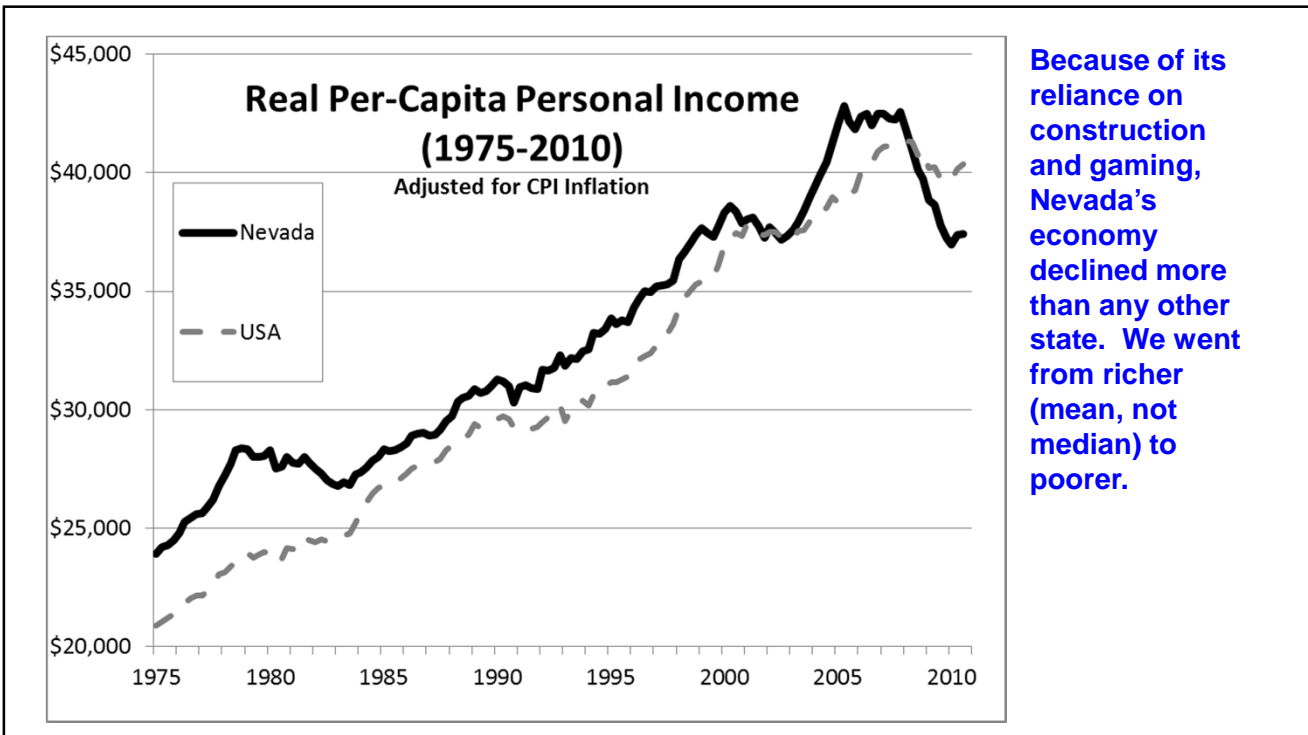
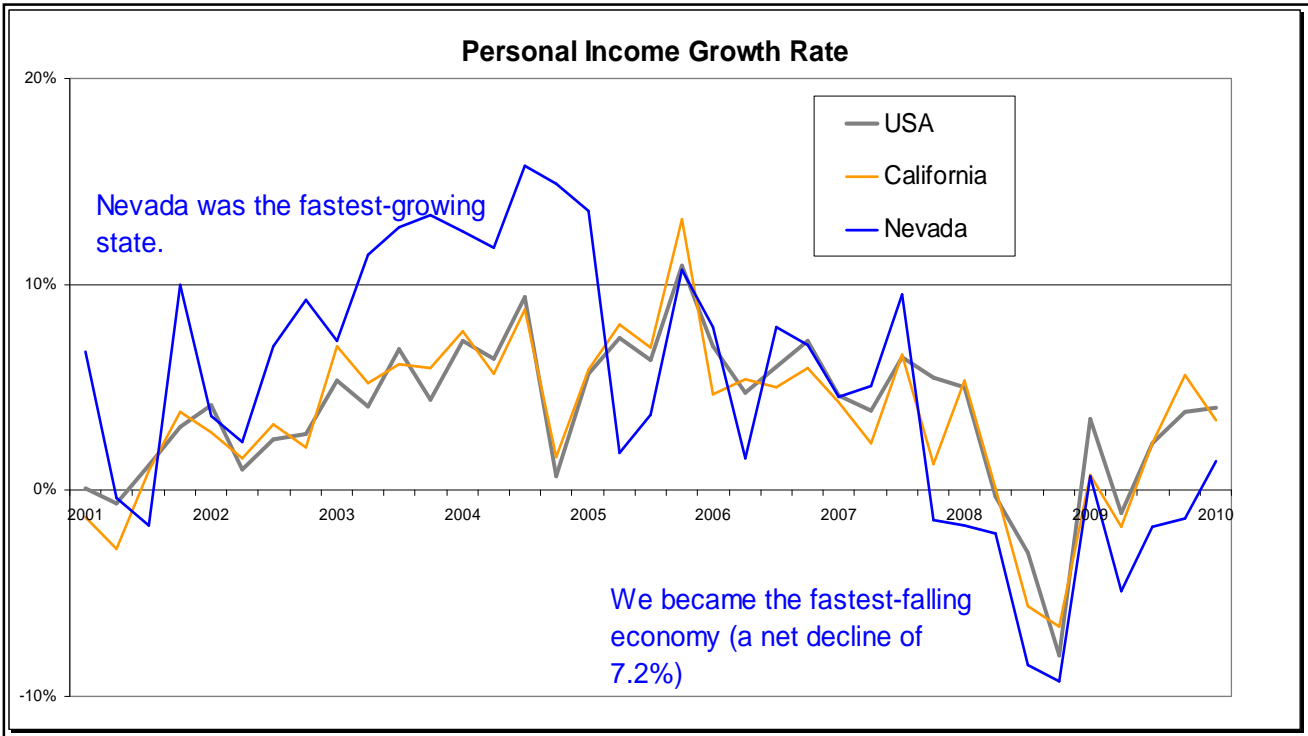
**Nevada lagged California, and our initial housing stock was smaller.**

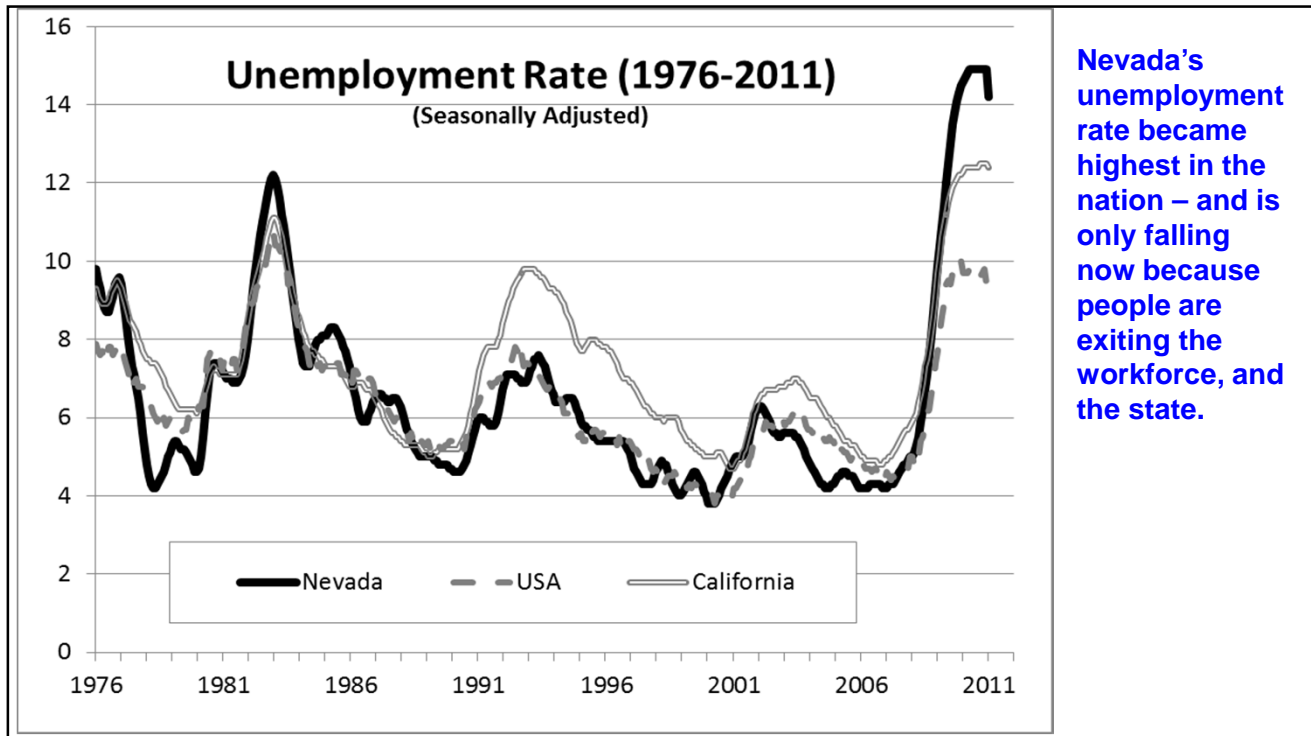
**They came here looking for deals.**

**Our construction sector was the country's largest.**

**Underwater mortgages:**

- USA 23%
- CAL 33%
- NEV 66%



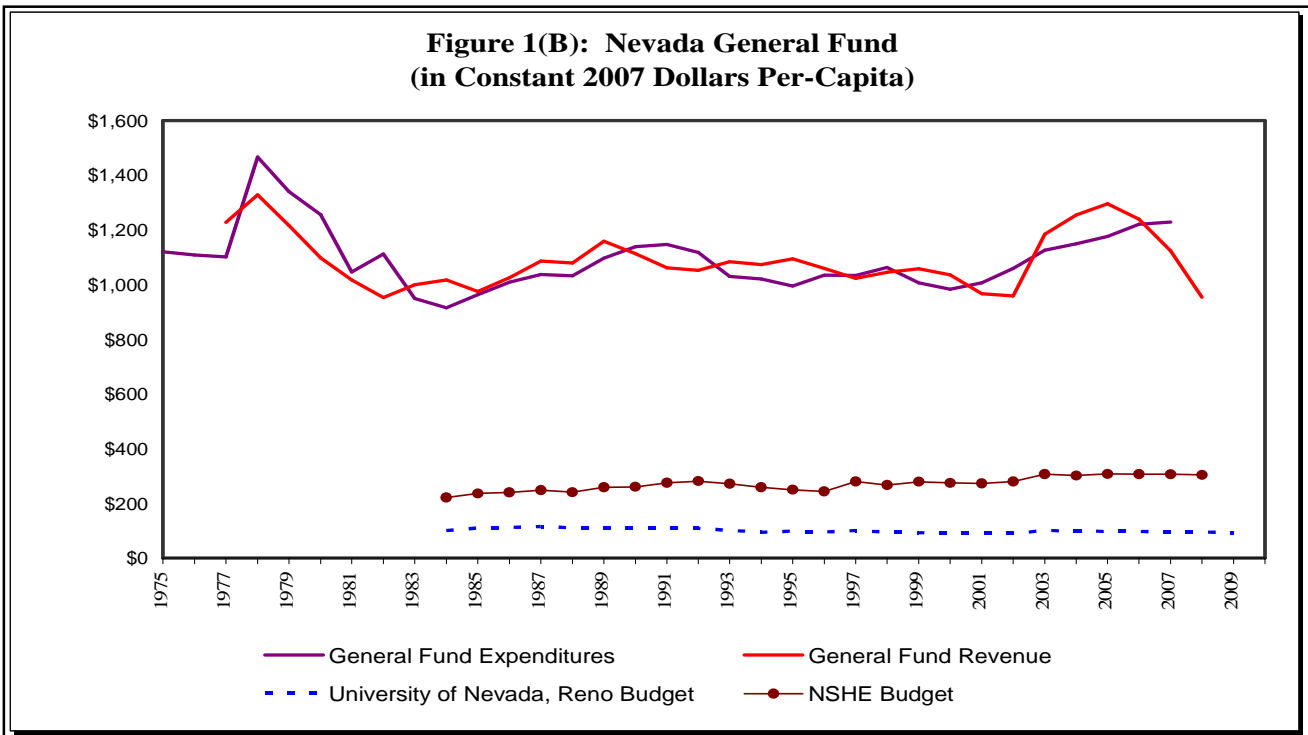
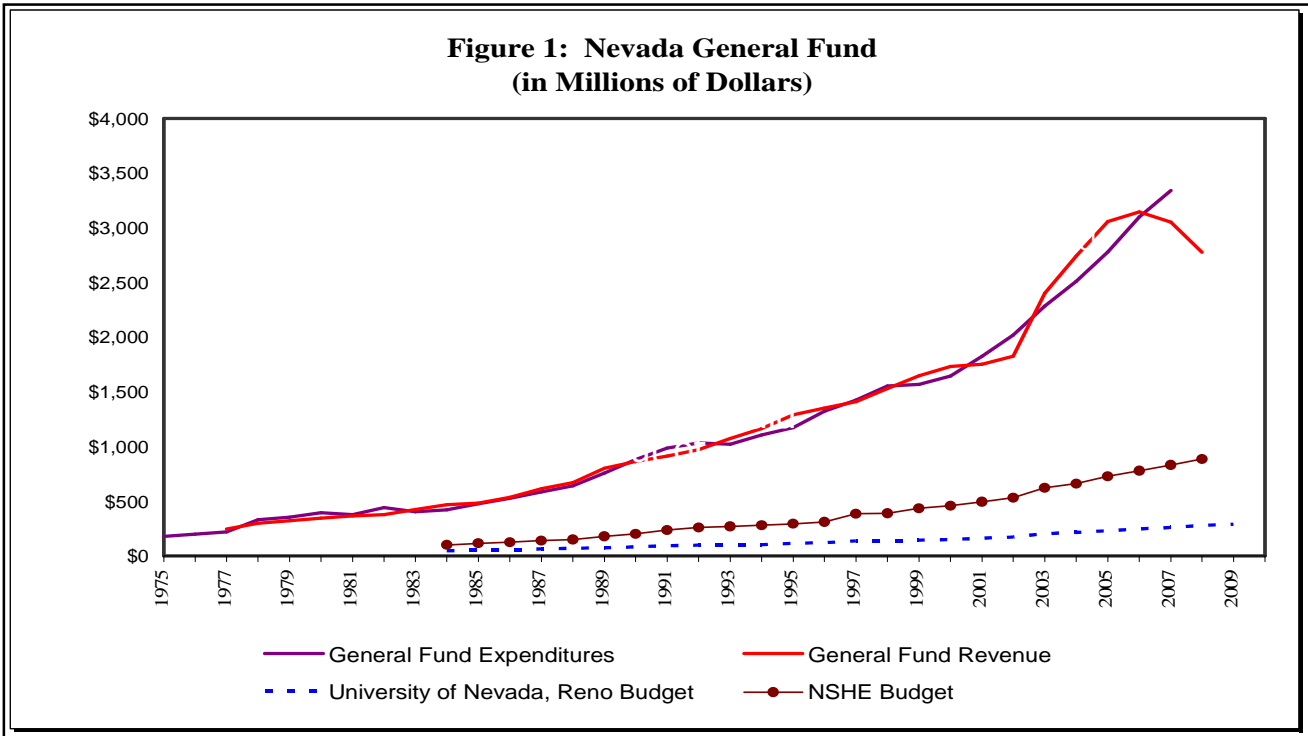


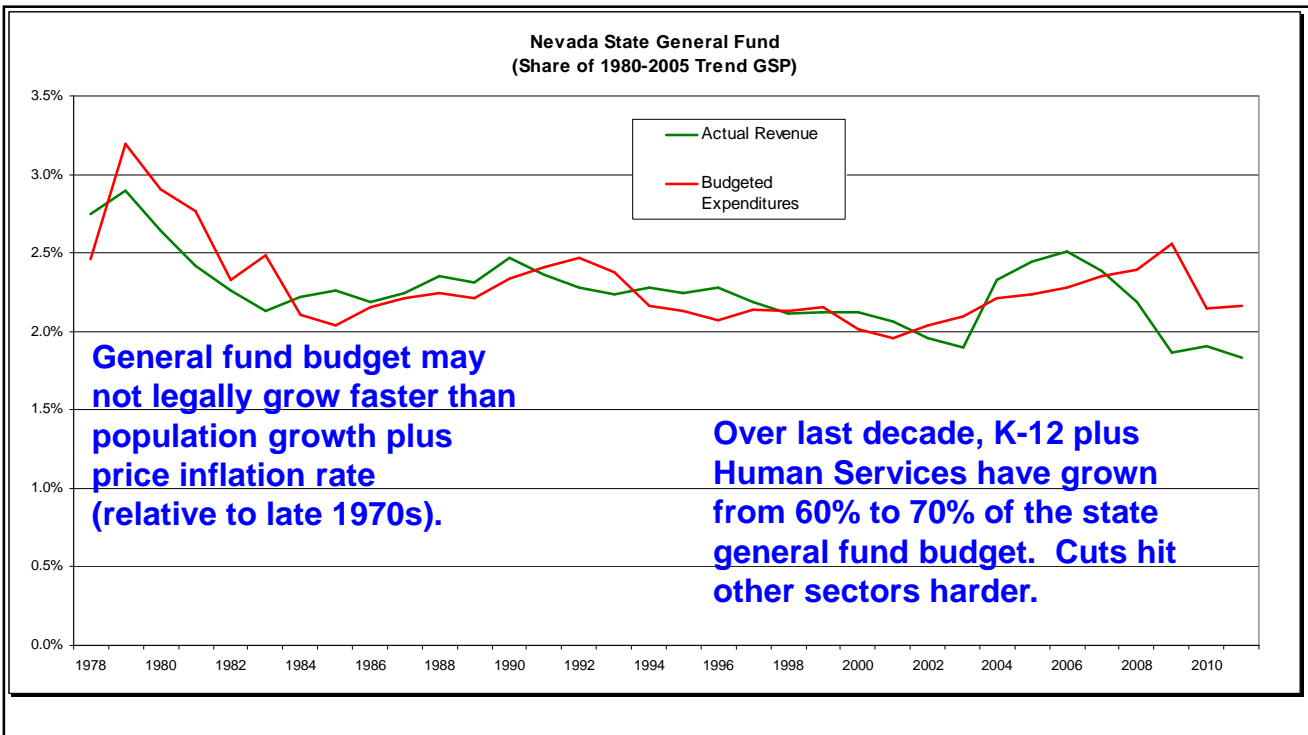
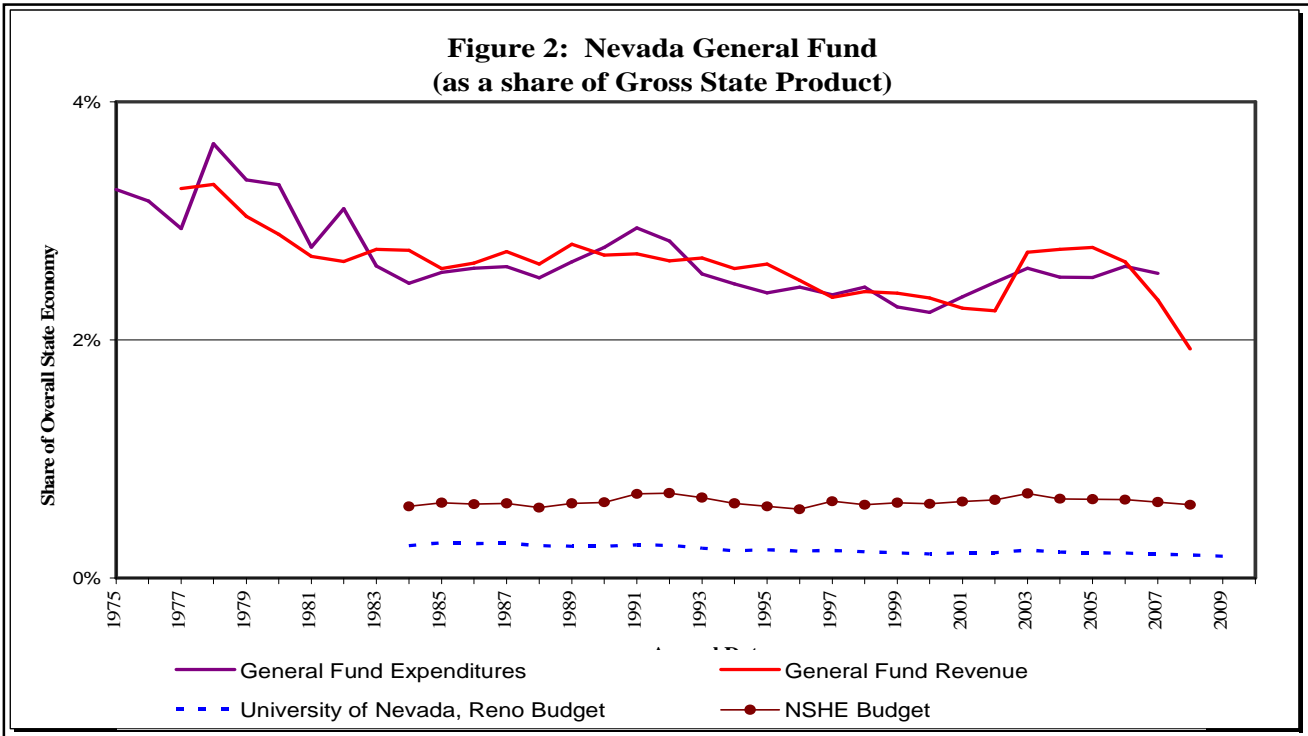
## Nevada's Fiscal Crisis

- Economic Forum revenue projections lower for 2009-2011 biennium than for 2007-2009.
- Sales tax revenues continued to fall.
- Gaming win continued to fall:
  - +8.4% in 2006, +1.8% in 2007 (was \$12.8 billion).
  - 9.7% in 2008, -10.4% in 2009 (now \$10.4 billion).
- Cuts of 8% to state budgets in 2008.
- Legislative Cuts of 12% to NSHE budget for 2009-2011 biennium, net of ARRA funding.

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## Components of the Budget

- The state budget consists of the General Fund, plus other funds that are either paid for through special taxes (e.g., the highway fund) or through federal funding or matching (e.g., Medicaid).
- In the General Fund:
  - K-12 – grew from 35% of 2000-01 budget to 40% of 2010-11 budget.
  - Human Services – grew from 25% to 31%.
  - NSHE – stable at 19% (about 0.6% of GSP) until 2008, now 15%.
    - UNR's share of NSHE budget fell from 45% to 32%.
  - Public Safety – fell from 12% to 10%, now 7%.
  - Everything else fell from 10% to 7% of budget.

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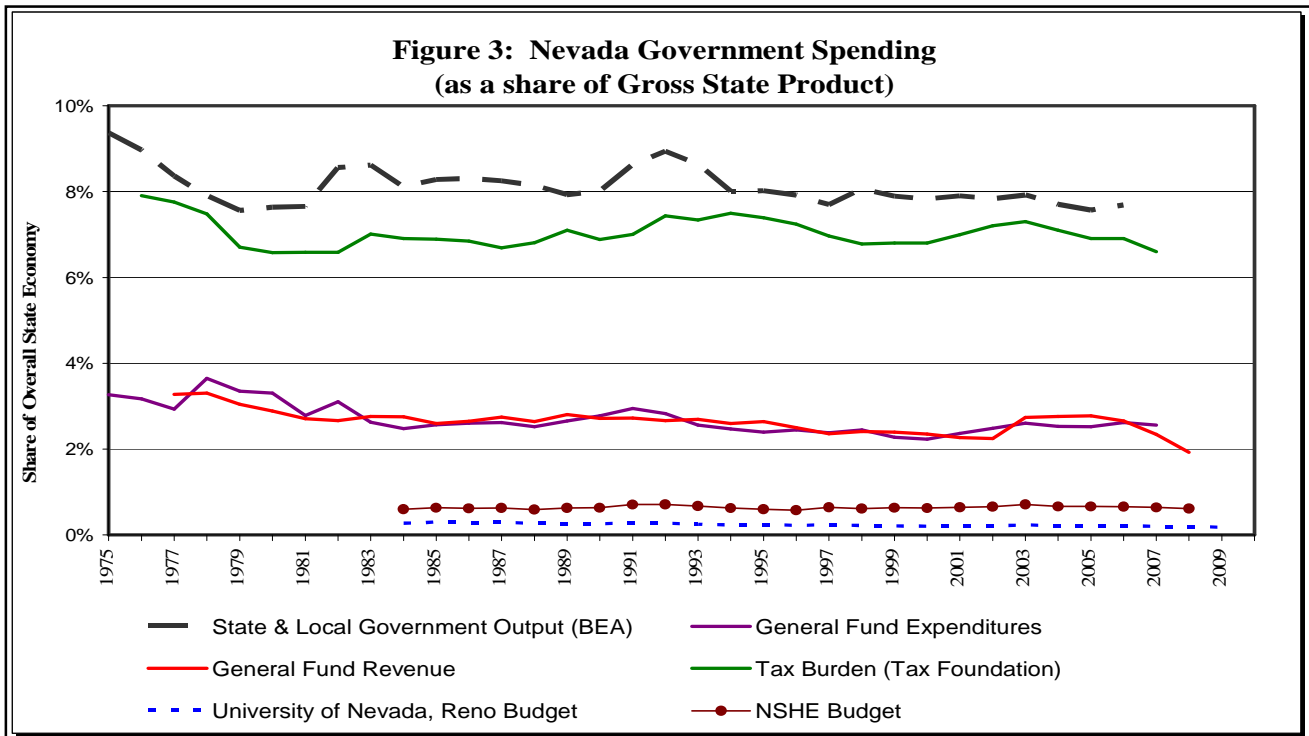


## Different ways to measure the size of government

- General Fund
- Federal and Local vs. State.
- Total Spending, including federal pass-throughs.
- Total purchases of goods and services, including state employee income.
- Tax Burden
- Number of state (or state & local) employees.

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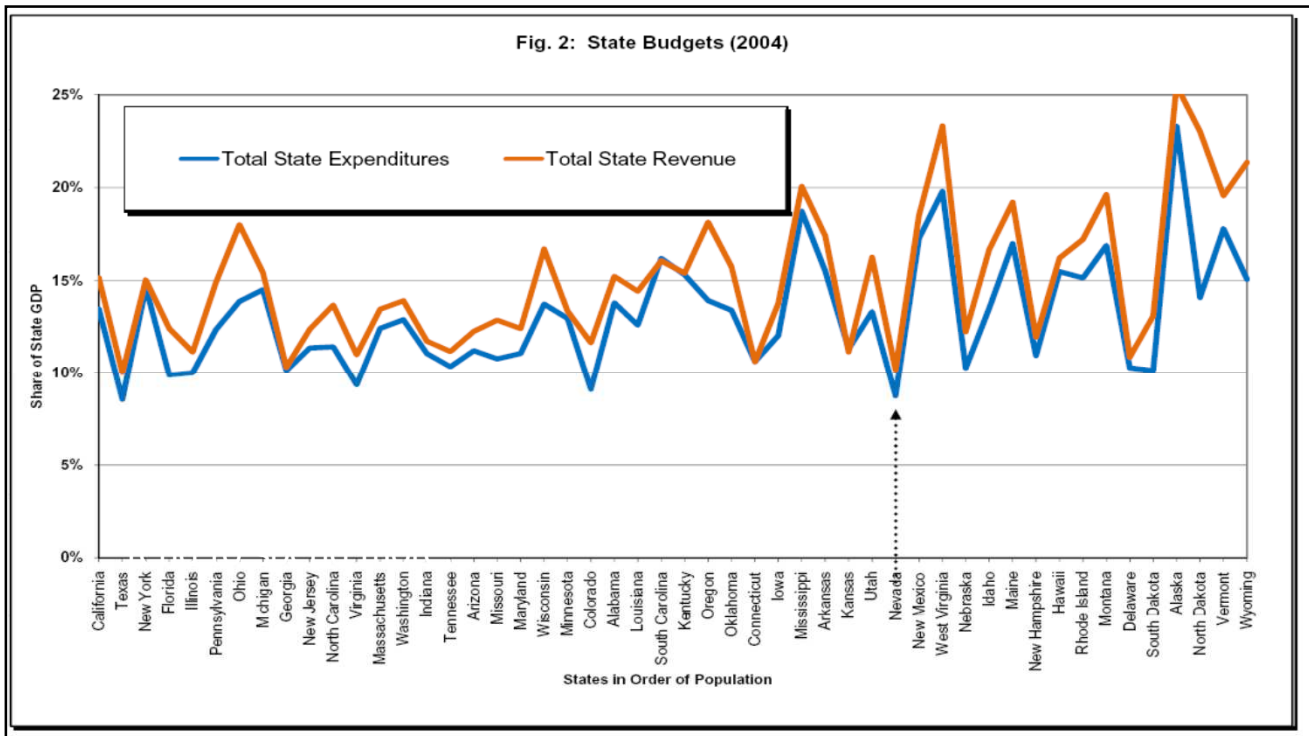


## How does Nevada compare?

- Nevada has the second-lowest tax burden in the country (Alaska's was lowest, but their expenditures were much higher), and we export taxes to tourists.
- Nevada has the smallest general fund in the country, as a share of GSP – less than 2.5%.
- Nevada's state government spent 6.4% of GSP in total, lowest in the country.
- Combining state and local government spending, Nevada spent 12.4% in 2005, 38th in per-capita terms, 48th as a share of GSP.

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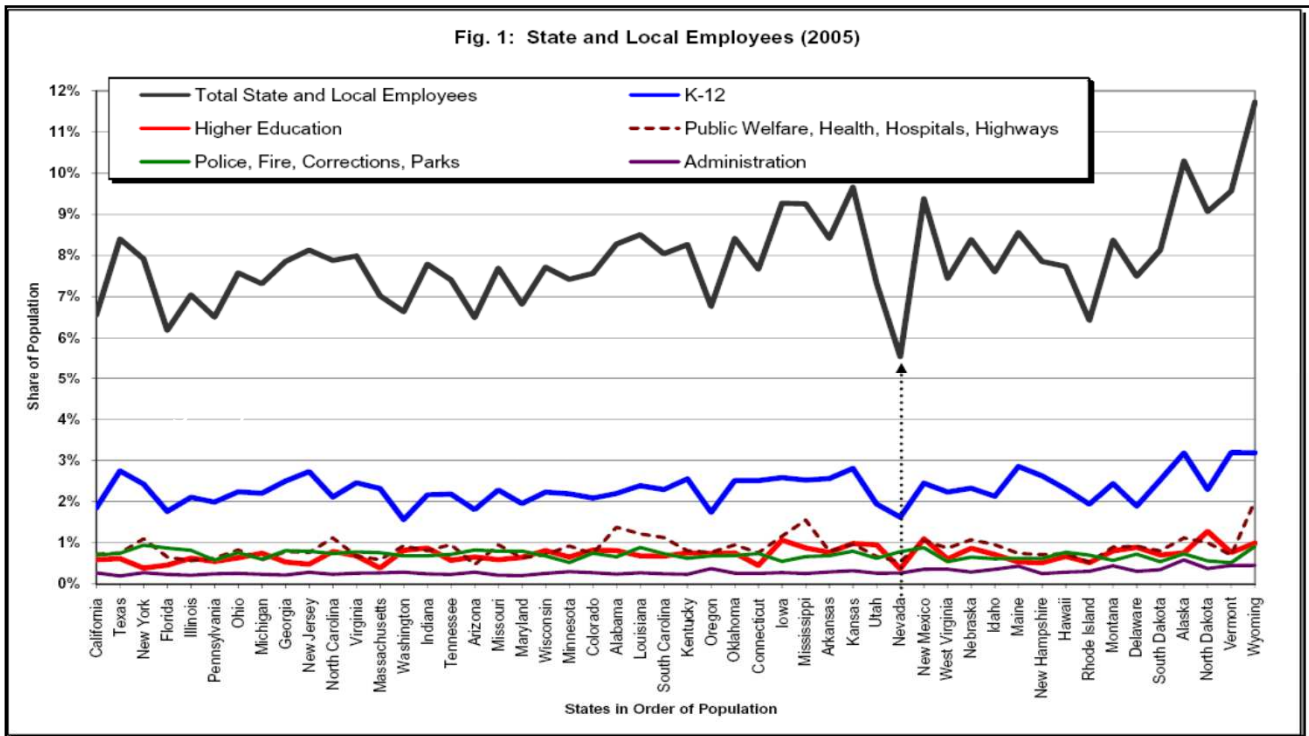


## Nevada's SLG Employment

- In 2005, Nevada had approximately 86,000 government employees, of which 22,000 were state employees and the rest local.
  - 45% in K-12, 10% in higher education, 10% in local police and fire protection, 8% in administration, and the rest in corrections, parks and recreation, highways, hospitals, health, and public welfare.
- Only 5.5% of Nevadans worked for state and local governments – lowest amount of the 50 states.
  - Average of all states = 7.5%.
- Nevada was also 50<sup>th</sup> in the number of state employees in higher education, and 49<sup>th</sup> in the number in K-12.

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## SLG Wages and Benefits

- Before the fiscal crisis began, Nevada’s state employees earned slightly more than the national average – but cost of living was about 10% higher than average.
- Nevada’s city and county employees earned more than 10% above national average, but K-12 teachers earn close to median.
- University of Nevada, Reno paid the average salary for comparable universities. Currently less than national average.
- Are benefits comparable?

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## Is more government spending good?

- Relative efficiency of private sector.
- Sometimes markets fail.
- Public Goods – provided or paid for.
- Examples: roads, ports, bridges, schools, national defense, courts, police, firefighters, bank auditors, cloud seeders and even a social safety net or a functioning health care system.
- State & Local vs. Federal.
- U-shaped relationship.

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## Fiscal Effects

- When spending is falling, this leads to more cuts in spending. Government spending can help stabilize overall spending.
- Tax hikes are bad for an economy in recession, but spending cuts are worse.
  - Kilkenny, Harris, and Fadali – In Nevada, last cuts in state government spending will lead to \$1 billion less in private spending (tax hikes \$0.5 billion).
  - My own estimates: effect of changes in SLG GSP significant.
- Role of states in the Great Depression.

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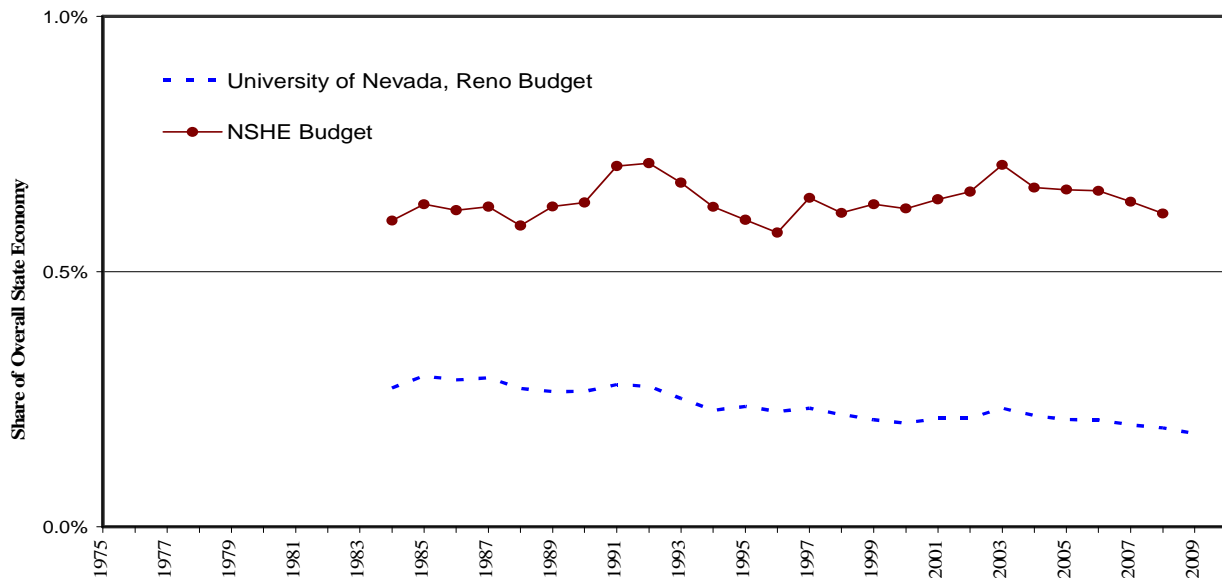
## Is Nevada especially generous to Higher Education?

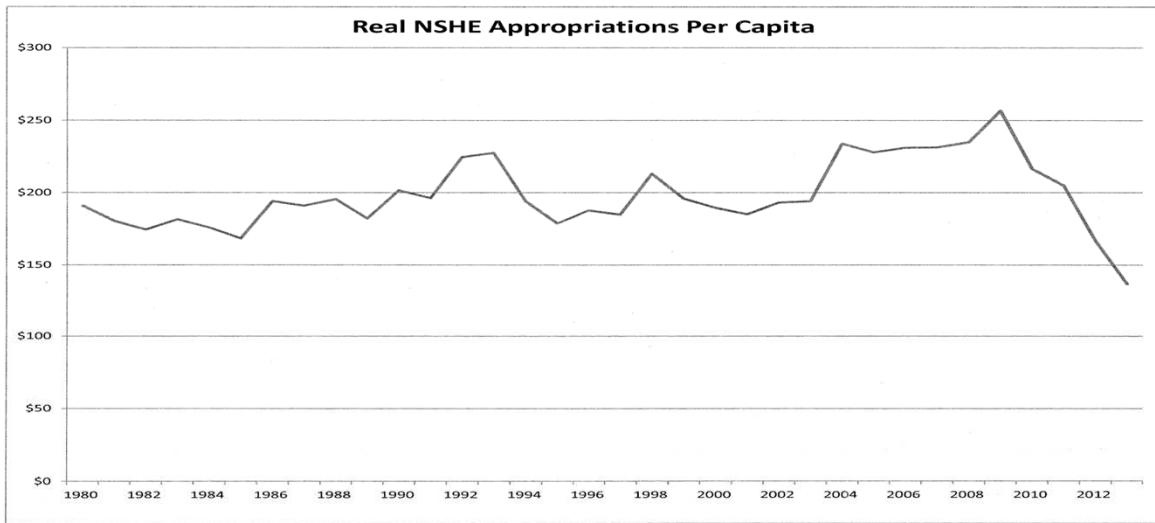
- The state pays a greater share of higher education than in most states – but state law (NRS 396.540) says it should be free for most Nevadans.
- The state spends a larger portion of the general fund on higher education than in most states – but that general fund is small, and there are few true private universities that compete for students.
- *Just because a poor man spends more of his money on food does not mean he eats better.*

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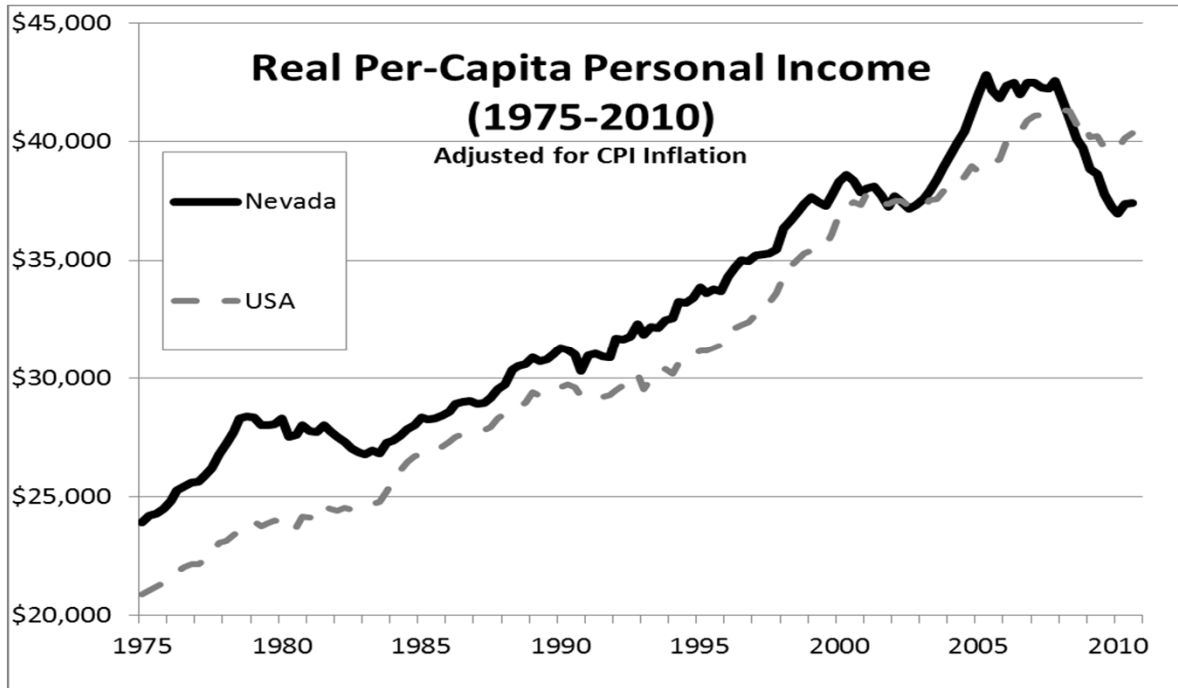


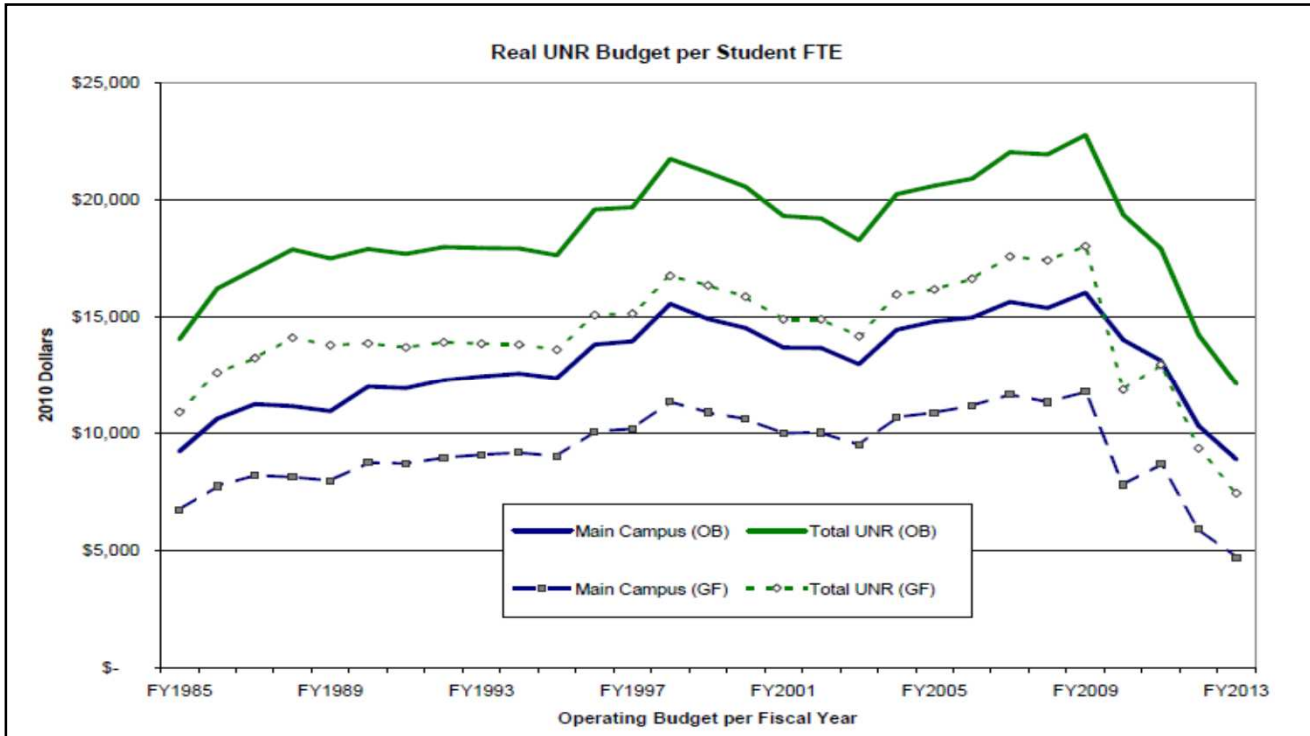
**Figure 4: Nevada System of Higher Education Budget (as a share of Gross State Product)**





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## The Gibbons Cuts

- Biennial budgets, from July 1 to June 30.
- Expenditures matched to Economic Forum projections for tax revenues.
- Biennial budget for 2007-09 = \$6.8 billion (about 2.6% of 2007-08 GSP), but only \$6.3 billion spent as spending was cut in special session.
- State Government faced a \$2 billion shortfall last time.

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## Budget for 2009-11= \$6.9 billion

- Federal stimulus funds (\$350m).
- Many K-12 teacher salaries rose due to contracts.
- NSHE budget cut by 12.5% (15% at UNR).
- Business payroll tax for large businesses (\$346m).
- Sales tax increase (\$280m).
- Clark County room tax (\$220m).
- Furloughs.
- Share of Clark and Washoe property taxes.
- State is borrowing to pay for unemployment benefits.

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## The Sandoval Cuts for 2011-13

- Total revenue currently projected = \$5.3 Billion for biennium – about 2.1% average of current GSP.
- Budget augments revenues with \$0.5 Billion in diversions and securitization.
- Budget diverts county property taxes to replace some General Funds for universities, and pushes many social service responsibilities to counties.
- Net budget cuts of 23% to higher education, 29% compared to FY2009. UNR operating budget cut 26% (35% cumulative), and General Fund contribution falling 37% (50% cumulative).

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## Are there options?

- On the table now:
  - A Business Margin Tax of 0.8% to replace the Modified Business Tax.
  - A Transactions Tax of 1% on services not already covered by Sales & Use Tax, or other taxes.
  - More service fees, including tuition.
- What could be on the table:
  - Corporate profits tax; reducing deductions for mining net proceeds tax; streamlined sales tax agreement for internet sales tax collection.
  - Borrowing to get through the biennium, from internal funds and delayed contributions, securitizing future revenues, or general-purpose bonds.

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## National Prognosis?

- Housing prices are stabilizing nationwide.
- There is still a significant inventory of foreclosures and forced sales which are waiting to go on the market.
- Officially, the recession is over, but national recovery is slow. Banks still have significant excess reserves.
- Unemployment lags growth, and acts as a brake.
- Congressional efforts to cut spending would dampen recovery, if they were more than symbolic.

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## What about Nevada?

- Nevada appears to have hit bottom, now showing some signs of stabilizing in gaming and sales.
- But Nevada continues to lose jobs, losing people to match.
- California is adding jobs, which will help in Nevada.
- Nevada underinvests in education and public investments, and is poised for more major cuts. Potential for brain drain.
- People continue to hope for one more magic bullet: green jobs, Yucca Mountain, mining severance tax, et cetera.

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## So What Shall We Do?

- Nevada is a low tax state, no matter what NPRI says. The projected budget gap is only 1% of GSP.
- Basic state services necessary for a decent present, but education is necessary for our economic future.
- We can trade reforms (e.g., collective bargaining, benefits, pensions) which reduce the growth of future spending in return for tax restructuring now.

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