



University of Nevada, Reno
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MEMORANDUM

December 1, 2008

To: Milton Glick, President

From: Elliott Parker, Professor of Economics

RE: Does Nevada have a Spending Problem?

According to the Chancellor's Aug. 13, 2008 letter to the Governor, the Governor has stated that we have a spending problem in this state, not a tax problem. It is an opinion I have heard expressed from a number of others, and this memo is intended to question the validity of this opinion.

First, does Nevada have too large of a government? Of course for some people any government is too much, so the answer is subjective, but we can compare Nevada's government to that of other states.

Using data from Table 451 of the most recent volume of the Census Bureau's *Statistical Abstract of the United States*, entitled "State and Local Government Full-Time Equivalent Employment by Selected Function and State: 2005," I calculated the number of state and local government employees as a percentage of the state's population. This is shown in the first attached chart, Figure 1.

In 2005, the most recent year available, Nevada had approximately 86,000 government employees, of which 22,000 were state employees and the rest local. Roughly 45 percent of this total were in K-12 education, 10 percent in higher education, 10 percent in local police and fire protection, 8 percent in administration, and the rest in corrections, parks and recreation, highways, hospitals, health, and public welfare. Based on a 2005 population of 2.4 million people, only 5.5 percent of Nevadans worked for state and local governments, which was 50th out of the 50 states, and significantly less than the national average of 7.5 percent.

By function, Nevada also has the smallest relative number of people in education and health. Only 1.6 percent of Nevadans worked in K-12 education, which was 49th out of 50. Even lower, only 0.4 percent of Nevadans worked in higher education, which was not only 50th out of 50, but was also more than 40 percent below the national average. The combined number of government employees in

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public welfare, health, hospitals, and highways, was 48th in the country as a share of the population. By contrast, the combined proportion of employees in police, fire, corrections, parks and recreation was 13th in the country, more than the national average, and the proportion in government administration was 28th in the country, roughly equal to the national average.

This first chart also suggests that the national average is not the appropriate standard for comparison, since economies of scale mean that smaller states tend to have a larger percentage of the population working for government. Wyoming and Alaska, for example, are ranked 1st and 2nd in the relative number of government employees, while California is ranked 45th. As a small state, we might expect that Nevada would have a *larger* government than the national average, not the smallest.

Second, it is not just that we have relatively few employees in state government. Nevada also spends relatively less on government services than other states in spite of the fact that our average income in the state is 10 percent higher than the national average, and our cost of living is also higher. We receive the least from the federal government, and we have the lowest tax burden except for Alaska, which receives the most from the federal government and also has substantial government revenues from petroleum production.

State and local governments, on average, spend about 15 percent of our Gross Domestic Product (GDP), roughly two-thirds of what the federal government spends. About ten percent of GDP is spent by states, and the remaining five percent by local governments. While the largest parts of the federal government budget are spent on the military, Social Security, Medicare, and interest on the national debt, state and local governments pay for our schools and state universities, parks, police, fire protection, and other things that affect our daily lives. Unlike the federal government, state and local governments are usually required to match their expenditures to their revenues, though about a fifth of their revenues – roughly the size of the federal budget deficit – comes from the federal government, so in a sense the federal government is indirectly financing state deficits.

So how does Nevada compare to the rest of the country in this regard? In Table 432 of the *Statistical Abstract*, there is data for state budgets showing that Nevada spent \$2,925 in 2005 per resident, which was 49th in the nation. As a share of GDP, Nevada's state government spent 6.4%, which ranks us dead last in the nation, as the attached Figure 2 shows. This share has also declined over the last decade or two. Combining state and local government spending, Nevada spent \$5,646 per-capita, or 12.4% of our GDP. This ranks us as 38th per-capita, or 48th as a share of GDP.

In August, the Tax Foundation released a report comparing the burden of state and local taxes. They ranked Nevada as having the next-to-lowest tax burden in the nation, just slightly above Alaska. If you look at the historical data, that ranking is roughly where we have been since the 1970s. We also received less federal aid than other states – only one state, Virginia, received less as either a share of GDP or per capita. Alaska, by

comparison, received the most from the Federal government per-capita, and spent the most except for Wyoming.

Even though our overall tax burden is low, since we don't have a state income tax, either personal or corporate, we have to collect it from somewhere. As a result, we pay about 60 percent more in both property taxes and sales or gross receipts taxes than the average person in other states, and our state collects about twice as much in license fees.

This tax structure also leads to a pretty regressive system, in which poorer Nevadans pay relatively more tax. According to a recent census estimate, a family of four in Los Angeles would pay almost ten percent of their household income in state and local taxes, regardless of whether they made \$25,000 per year or \$150,000 per year. In Las Vegas, by contrast, the poor household would pay the same ten percent in taxes, but the better-off family would pay only four percent in state and local taxes. In other words, a family earning six times as much in income would pay only 2.4 times as much in tax. In only four other states – Florida, Missouri, Wyoming, and Alaska – do the wealthier pay a lower share of their incomes to their state and local governments.

Third, are Nevada's state employees overpaid? By what I read in the newspapers, the Governor and the Las Vegas Chamber of Commerce seem to think so. The *Statistical Abstract* tells a different story, however. In Table 452, it shows that Nevada's state employees earned almost exactly the national average, even though the ACCRA Cost-of-Living Index calculates that Reno's cost of living is more than 10 percent above than the national average (and Las Vegas's was only slightly behind Reno). Local government employees, however, appear to earn considerably more than the national average, perhaps even more than the higher cost of living. Perhaps the inclusion of local government employees is confusing the issue somewhat.

A couple of weeks ago, I asked an assistant professor we hired a few years back from the University of Pennsylvania, a labor economist, to take a look at the report cited by the Governor's Sage Commission. His conclusion was that the report compared apples and oranges in trying to compare government employees to those in the private sector, and provided no substantive evidence that this assertion was true. It also did not consider the differential incomes of state and local employees.

He was able to find comparative data for the university, however, relative to other doctoral universities. His conclusion was that university employees were paid slightly better than those from comparable universities, but not enough to make up for the higher cost of living in Nevada. Anecdotally, I can say that in my department, our last couple of hires were very difficult because the salary we could offer did not match what other universities offered, and we lost several of our preferred candidates.

We have some smart students studying at the university, but Nevada is last in the percentage of its population graduating from high school. Nevada has only two public universities, and unlike most other states it has no private ones. As a result, only three states – West Virginia, Arkansas, and Kentucky – have a smaller portion of the

population with college degrees. While inadequate state funding is not the only reason for poor educational attainment, it does not help, and dramatic cuts in what funding we do get seem likely to leave us at the bottom.

As an economist, I have no particular love of taxes, but there are “public goods” that simply cannot be efficiently provided by the private sector, and taxes are thus necessary to pay for them. Like national defense, public education is one of these public goods. There is a significant amount of economic research consistent with the conclusion that too little government can be bad for economic growth (think of Somalia), just as too much can be equally bad, and my own research has found that for the United States there is no evidence that a smaller government would improve the economy. See my working paper at <http://www.business.unr.edu/econ/wp/papers/UNRECONWP07002.pdf>.

Though I think there is much Nevada needs to do to improve the education of its citizens, and the university system is a key player in our future economic development, I am not advocating more government. What I am arguing instead is that the common belief that we are somehow overtaxed and overburdened with a growing state government is a belief that is not justified by any research, or any comparable data. We already have the smallest government in the country, and we have a host of problems as a result. Further significant budget cuts will severely damage our economy. We should not make the problem even worse, not if we want Nevada to be someplace people want to be in the future. Virtually all research I have ever seen on educational spending, for example, concludes that the social return on investment in higher education is significantly higher than the cost. Unless we can better educate our workforce, we are simply not going to be able to compete.

Fig. 1: State and Local Employees (2005)

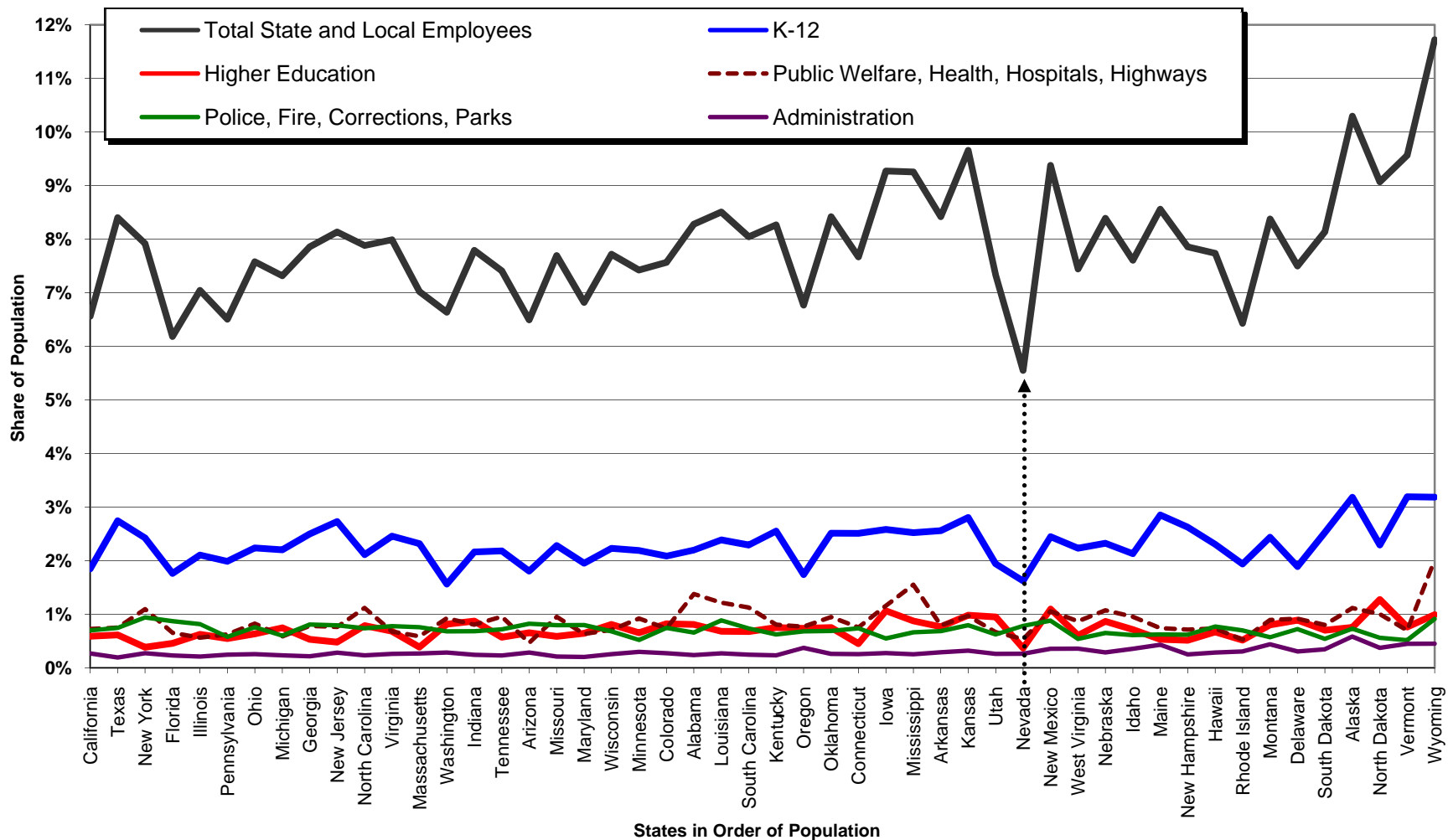


Fig. 2: State Budgets (2004)

