

# Hobbs, Ong & Associates APPLIED ANALYSIS

# PUBLIC FINANCE

## R E P O R T

*This Public Finance Report includes results from the recent meeting of the Economic Forum and commentary on the forthcoming final days of the 2011 Regular Session of the Legislature.*

### STATE REVENUES RE-PROJECTED

**S** On May 2, 2011, the Economic Forum met to re-project revenue from major state general fund taxes. Based on recent data reflecting slight recovery in taxable sales and most other sources, but partially offset by slack in collections of gross gaming taxes, the Forum estimated that the major taxes would generate an additional \$119.7 million in revenue for the general fund over the next two years. When added to the estimated impact for current fiscal year, the total rose to \$217.7 million because proportionally greater adjustments were made to the current year, the majority of FY

2011 collections having already been deposited. As an extension of this process, legislative staff re-projected sales taxes received outside the general fund based on the same parameters, such that the total estimated gain became \$330 million. Despite these projected gains – and they are only projected – the state’s budget issues are not solved, and further reductions from current service levels are virtually certain. The estimated direct general fund gain is only 2 percent of the general fund budget over the next two years. Even if all gains from the present year are swept forward to the next biennium, the gain is barely 3 percent. When the State’s statutory obligation to fund public school is accounted for – the gain is less than 3 percent. Considering that both sales and gaming tax collections have dropped approximately 22 percent since 2007, the recent progress is modest, to say the least.

Overall, the Forum gravitated to the conservative side of the estimates presented by staff of the Governor, the Legislature, the collecting agencies, and Moody’s Analytics. The final result fell below the midrange between high and low estimates presented by staff, and excluded consideration of the bullish estimates presented by Moody’s.

While it remains to be seen whether the economy will continue its gradual progress, it is certain that the revenue levels enjoyed by state government prior to the Great Recession will not return in the next biennium, or perhaps even the one following that.

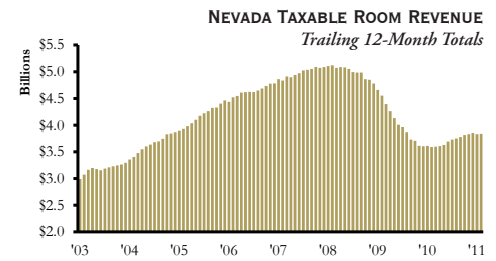
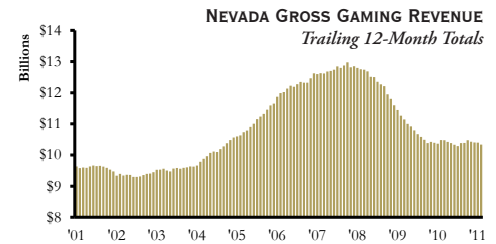
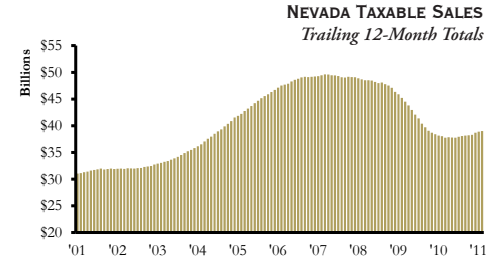
### THE LEGISLATURE

As the Legislature digests the adjustments to revenue, the focus now falls back on the expense side, and the related debate over raising taxes has

been opened. Some legislators have welcomed the increase in estimated revenue as the final piece in funding services at a level which may be acceptable, at least for the present. However, others say the additional revenues will not sufficiently support public services.

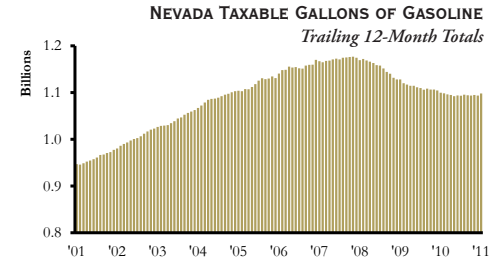
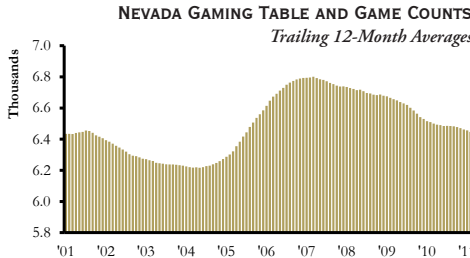
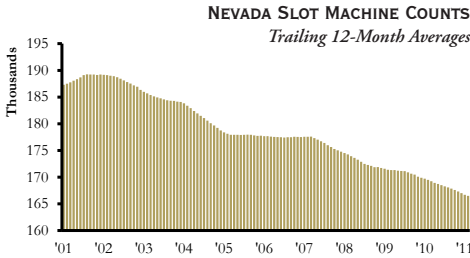
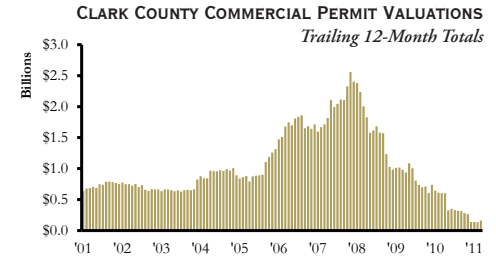
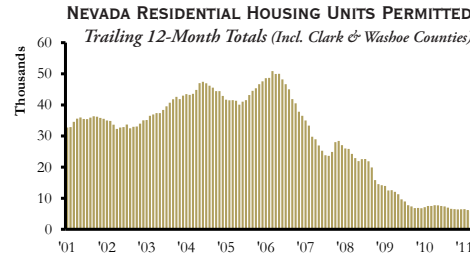
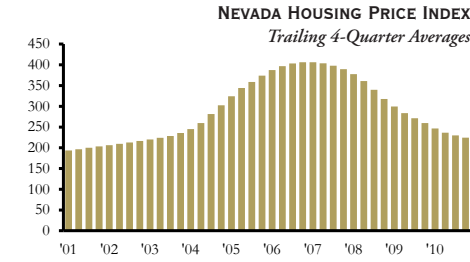
With 33 days left in the 2011 Regular Session, a tax proposal has emerged including business franchise and service taxes, phase-out of the Modified Business Tax, and extension of sunsets. Both sides have now staked out what they want, but neither says what they might concede. On the other hand, the Governor has stated both what he wants and what he does not intend to concede - taxes.

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TRAILING 3-Months/Quarterly Series	Most Recent Data Available	INDICATOR VALUES			GROWTH RATES	
		Current 3-Month Period/Qtr.	Previous 3-Month Period/Qtr.	Same 3-Months/ Quarter Prev. Yr.	VS. Previous Period	VS. Same Period Prev. Yr.
Nevada Taxable Sales (1)	Feb-11	\$9,996,045,613	\$10,169,833,996	\$9,281,929,299	-1.7% ▼	7.7% ▲
Nevada Gross Gaming Revenue (1)	Feb-11	\$2,597,718,687	\$2,537,987,410	\$2,689,241,824	2.4% ▲	-3.4% ▼
Taxable Rooms Revenue (1)	Feb-11	\$859,531,075	\$852,489,056	\$856,322,061	0.8% ▲	0.4% ▲
Nevada Housing Price Index	Q4 2010	218.6	223.3	240.4	-2.1% ▼	-9.1% ▼
Nevada Residential Housing Units Permitted (1)	Mar-11	1,496	1,499	2,069	-0.2% ▼	-27.7% ▼
Clark County Commercial Permit Valuation (1)	Mar-11	\$37,664,756	\$31,342,629	\$13,405,330	20.2% ▲	181.0% ▲
Slot Machines in Nevada (2)	Feb-11	166,203	165,848	169,522	0.2% ▲	-2.0% ▼
Gaming Tables and Games in Nevada (2)	Feb-11	6,403	6,380	6,499	0.4% ▲	-1.5% ▼
NV Taxable Gasoline Gallons of Gasoline (1)	Jan-11	265,580,000	268,170,000	260,860,000	-1.0% ▼	1.8% ▲
NV Private Sector Establishment-based Empl. (2)	Mar-11	952,133	954,067	949,333	-0.2% ▼	0.3% ▲
Quarterly Wage Payments	Q3 2010	\$9,767,582,914	\$9,520,200,014	\$9,748,977,986	2.6% ▲	0.2% ▲
Cigarette Packages (1)	Feb-11	27,997,800	30,252,600	28,835,100	-7.5% ▼	-2.9% ▼
Gallons of Liquor (1)	Feb-11	19,590,115	20,599,329	19,840,678	-4.9% ▼	-1.3% ▼
Estimated Value of Real Property Transferred (1)	Feb-11	\$4,909,120,927	\$4,981,263,927	\$5,252,952,327	-1.4% ▼	-6.5% ▼
Estimated Value of Vehicles (1)	Feb-11	\$2,027,543,004	\$2,099,417,207	\$2,161,003,919	-3.4% ▼	-6.2% ▼

NOTES: (1) Trailing 3-month totals. (2) Trailing 3-month averages.



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Thus far, he is the given in this equation, and virtually every scenario assumes he will back his earlier statements. Each side has always had its view of taxes versus reforms; but, heretofore, legislators who oppose or are skeptical of additional revenue have had some place to go, while supporters of additional revenue have not.

Since failure to pass a budget could lead to government shutdown, but failure to pass reforms would not, the Governor's budget is considered by some as the high ground, with reforms as a sweetener for those believing they hold the advantage.

Since the February State-of-the-State message, revenue opponents and skeptics have stood on a complete, though disputed, budget aligned with their tax philosophy, and a general agenda for reforms in collective bargaining, retirement benefits, and construction defects. This is not necessarily due to anyone's cleverness, but rather to the fact the Governor has "first serve" in the budget process. In contrast, supporters of additional revenue had not, until recently, detailed either the magnitude or the composition of a tax package, and the expenditure side of their case remains a work in progress. In highly simplified terms, a few potential scenarios include the following:

1. Revenue advocates pass a budget by simple majority, but revenue opponents refuse to fund it, leveraging the supermajority requirement. The regular session ends with no budget, leaving the Governor to call a special session on his terms, with no more than three weeks remaining before July 1st, when state funding will run out for state agencies, K-12, and higher education. In 2003, arguments were made that government might operate for some number of days after July 1st without state funding; but, as in 2003, both legal restrictions and cash flow issues would be raised in opposition to such proposals. The subject of continu-

ing resolutions may arise; but, for such measures to approximate government cash flows after the temporary taxes sunset and before the Governor's recommended reallocations would take effect, spending levels would perhaps have to be set below those in the Governor's recommended spending plan. Although contingencies such as these may seem arcane and unlikely, 2003 is still vividly remembered.

2. Revenue advocates garner enough votes among revenue skeptics by agreeing to significant reforms in collective bargaining, pensions, or construction defects to enable supermajority support for additional taxes. The definition of "significant" is important here. Governor vetoes. Veto is overridden; or, if not, return to Scenario 1.

3. Seeking to avoid Scenario 1, but not agreeing on revenue measures, parties agree to place a ballot question before the voters, either to implement or gauge public support for a tax package. Agreement on some reforms may be necessary to enable this discussion. Drafting such a ballot measure would be a major undertaking; since tax issues draw opposition, including legal challenges, regardless of whether the question is open-ended or detailed.

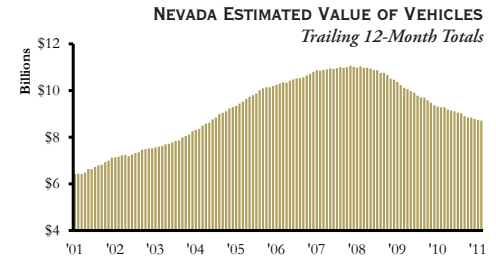
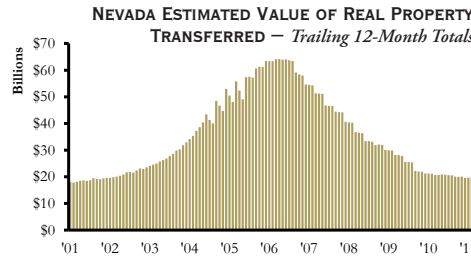
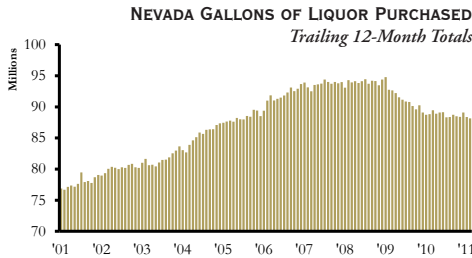
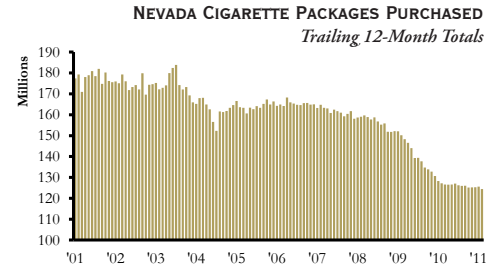
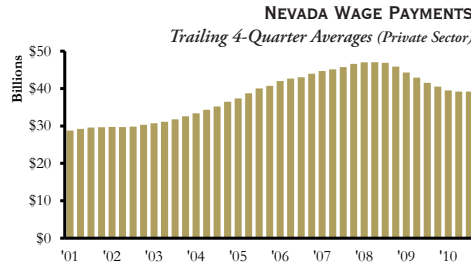
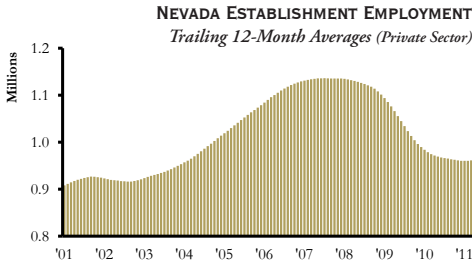
4. Seeking to avoid Scenario 1, but not finding agreement on either the budget or reforms, the parties pass the Governor's budget — one side claiming victory, the other claiming opportunity to later say "I-told-you-so" while at least minimally funding public services.

In addition, any of these situations could give

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TRAILING 12-Months Series	Most Recent Data Available	INDICATOR VALUES			GROWTH RATES		
		Current 12-Month Period	Previous 12-Month Period	Same 12-Months Previous Year	VS. Previous Period	VS. Same Period Prev. Yr.	
Nevada Taxable Sales (3)	Feb-11	\$39,016,273,356	\$38,896,298,187	\$38,043,149,850	0.3%	▲ 2.6%	
Nevada Gross Gaming Revenue (3)	Feb-11	\$10,333,704,322	\$10,398,490,102	\$10,478,953,010	-0.6%	▼ -1.4%	
Taxable Rooms Revenue (3)	Feb-11	\$3,834,790,192	\$3,830,416,976	\$3,590,440,061	0.1%	▲ 6.8%	
Nevada Housing Price Index	Q4 2010	224.5	229.9	259.7	-2.4%	▼ -13.6%	
Nevada Residential Housing Units Permitted (3)	Mar-11	5,884	6,207	7,540	-5.2%	▼ -22.0%	
Clark County Commercial Permit Valuation (3)	Mar-11	\$161,694,598	\$134,340,698	\$604,121,062	20.4%	▲ -73.2%	
Slot Machines (4)	Feb-11	166,491	166,702	169,494	-0.1%	▼ -1.8%	
Gaming Tables and Games (4)	Feb-11	6,447	6,456	6,510	-0.1%	▼ -1.0%	
NV Taxable Gasoline Gallons of Gasoline (3)	Jan-11	1,098,290,000	1,093,620,000	1,099,960,000	0.4%	▲ -0.2%	
NV Private Sector Establishment-based Empl. (4)	Mar-11	961,308	960,525	974,633	0.1%	▲ -1.4%	
Quarterly Wage Payments	Q3 2010	\$39,176,385,634	\$39,157,780,706	\$41,504,672,497	0.0%	▲ -5.6%	
Cigarette Packages (3)	Feb-11	124,389,600	125,581,500	127,147,800	-0.9%	▼ -2.2%	
Gallons of Liquor (3)	Feb-11	88,155,287	88,378,798	88,840,909	-0.3%	▼ -0.8%	
Estimated Value of Real Property Transferred (3)	Feb-11	\$19,709,526,864	\$19,680,082,318	\$21,198,722,855	0.1%	▼ -7.0%	
Estimated Value of Vehicles (3)	Feb-11	\$8,711,532,784	\$8,746,825,103	\$9,285,421,922	-0.4%	▼ -6.2%	

NOTES: (3) Trailing 12-month totals. (4) Trailing 12-month averages.



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rise to initiative petitions, not generated by the Legislature but by interest groups, either proposing taxes which the Legislature has not enacted or seeking repeal of taxes which it has. Lately, most initiative petitions involving taxes have faltered in the courts, and have either failed or been rewritten due to legal technicalities. Unless crafted by skilled attorneys and public policy technicians, initiative petitions for new taxes are often highly vulnerable to legal challenges.

“EDUCATION FIRST”

The two-thirds supermajority requirement is easily understood by even casual observers, as the vote is posted, and is not subject to interpretation. Another constitutional provision, called “Education First”, is based more on semantics than substance, but still may become a factor in partisan haggling. In 2004 and 2006, voters approved Ballot Question 1, a measure ostensibly designed to prevent “holding the children hostage” by requiring that:

“...before any other appropriation is enacted to fund a portion of the state budget for the next ensuing biennium, the Legislature shall enact one or more appropriations to provide the money the Legislature deems sufficient, when combined with the local money reasonably available for this purpose, to fund the operation of the public schools.....”

Some, disheartened by the legislative theatrics and the controversial K-12 funding decision by the Nevada Supreme Court in 2003, may have thought this measure could reduce political chicanery, which it has not. Others might have wishfully read “Education First” as a substantive expression of spending priority, which it is not. Since enactment, “Education First” has been an absolute non-factor, since the Legislature found

it could comply merely by passing its K-12 funding bill only moments before other spending, and by deeming its action as “...ensuring sufficient funding for K-12 education...” – cosmetic compliance with a cosmetic requirement. Nevertheless, 2011 might see “Education First” emerge in the discussion.

For the legislative majority to exercise its inclinations, spending measures must be passed by June 1st, to maintain the opportunity to override a gubernatorial veto before the end of the regular session. The Constitution empowers the Legislature to determine the “sufficient” level of K-12 funding. If, hypothetically, the Governor is presented a funding bill found “sufficient” by the Legislature, but which requires more revenue than available under current law; the parties will certainly criticize each other; either for failing to approve a measure found “sufficient” under the Constitution, or for busting the budget.

While it cannot be predicted at this point whether “Education First” will play a role in the rhetoric, it is one possible ingredient in a number of standoff scenarios facing the new fiscal year July 1st.

CONCLUSION

Raising the bar to two-thirds for approval of taxes prevents the momentary alignment of the Governor and a bare majority of both houses from raising taxes. That said, disconnecting legislative approval of spending from that of taxes creates a schizophrenic gridlock which might serve some meaningful purpose, but which is most ungainly to observe. Imagine, if you will, serving on a corporate board of directors under rules requiring a different level of majority support for adding workforce than for setting prices, with the same members voting on both.

“Education First”, the other constitutional provision treated here, was presumably intended to reduce the “politics” in funding education. Instead,

it has not yet fulfilled any of its promise, and it may actually fan the flames if called into play.

Though we might find either dismay or delight in the dynamics of the supermajority requirement, or the illusory benefits of “Education First”, we can neither blame nor praise today’s elected officials for the existence of these provisions. Rather, we should remember that both were adopted through initiative petitions overwhelmingly supported by Nevada voters; and that at the forefront of both campaigns for passage was a Nevada Assemblyman and Congressman who later served a term as our 28<sup>th</sup> Governor. In a democracy, we generally get what we vote for. ■

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