Fifty Years of Advice to Nevada on Economic Development and Taxation

By Dr. Glen Atkinson

The Nevada Legislature has commissioned Moody's Analytics to prepare a report on state and local tax policy and the quality of life in Nevada. This report is meant to guide the 2011 legislative session agenda for tax reform, against the backdrop of a severe recession exacerbated by Nevada's lack of economic diversification. We believe that this is an opportune time to review the options and recommendations that out-of-state consultants have offered since 1960 relative to economic development and tax policy recommendations.

It has been an article of faith in Nevada that low taxes, especially on business firms, is the key to economic development. Each of the three reports reviewed here addressed the question of taxes and development.

The first report is known as the Zubrow Report and was published in 1960. Zubrow and his colleagues examined the issues that affect decisions of firm to locate their operation, and specifically the importance of taxes and other government incentives. Zubrow found that the access to markets and the growth potential of those markets is the most important criterion for relocation of firms. The availability of materials, quality labor and sites were next in importance. Only a small portion of firms have the "freedom to relocate", and when they do, a low state and local tax environment is not a primary driver of that decision.

Specifically on taxes, Zubrow concluded "state and local taxes represent a significantly smaller burden to firms than might be assumed, and therefore it is reasonable to contend that these taxes also play a relatively minor role in the location of industrial activity" (page 52). The report also found that the federal income tax system tends to minimize any differences in state and local tax environments.

This conclusion is reinforced by the fact that most business taxes can be shifted to other parties and that firms have little freedom to relocate because the other factors listed are more important to the firms. Zubrow also found that when taxes are used to finance public infrastructure and other services important to business, public spending that lowers the cost of production could offset the cost of taxes. The report stated: "While high taxes does not necessarily mean that a community is enjoying an adequate level of government services, low taxes invariably indicates the absence of such services" (p.52)

The Legislature funded another comprehensive review of Nevada's fiscal situation for the 1989 session, which was to guide fiscal policy over the 1990s. That study was conducted by the Urban Institute and Price Waterhouse. The authors provided options and specific recommendations regarding alternative sources of tax revenue. They took into account the changing structure of the economy, the desire for economic diversification and the need to remain competitive with surrounding states. They provided a framework to implement a new tax structure while pursuing the twin goals of diversification and competitiveness.

The authors noted the because of our low taxes, special incentives were generally unnecessary. They expressed the concern that "new entrants to the state may receive special tax advantages that may not be available to existing businesses whose gradual expansion is a major source of employment growth" (p. 216). They also noted "that tax policy is only one of many public policies that can contribute to economic development strategy." They warned that "the quality of public services, such as education and transportation systems, are also significant."

The Economic Development Authority of Western Nevada commissioned Angelou Economics of Austin Texas to prepare a report to direct economic development strategy for western Nevada. The first report was delivered in February 2006.

The consultants expressed concern over the region's reliance on a low cost strategy for development. They provided evidence that western Nevada's economy has been developed on a low wage labor force with low educational attainment. This low cost strategy included a promotional stress on low taxes. The authors warned: "By positioning itself as a 'low cost' location, Northern Nevada runs the risk of losing its business base to a lower cost region in the United States or abroad." They recommended that the region focus on specific industries that are less susceptible to higher costs. "These industries also tend to be those that are higher value added, higher growth, and support higher wage jobs. Because their profit margins are thicker, they tend to be less concerned about operating costs than they are about access to a high quality workforce, R&D assets, and high quality of life."

The low tax strategy has contributed to an attraction of firms that are less likely to bring real economic value to the area. Firms attracted by low taxes attract a low wage, poorly educated workforce that does not contribute as much to the tax base as they do for the demand for public services. When these firms move on to lower cost regions, they leave behind the debt of the infrastructure they needed and the high public-cost population.

The consultants observed that Nevada's lack of such taxes as corporate and personal income taxes or inventory tax has led to an over-reliance on sales taxes. State and local governments must balance their budgets. Therefore, they need to encourage the kind of development that adds to their tax base. Unfortunately, this induces officials to pursue shopping malls and other retail firms instead of the high value-added firms mentioned above.