Historical Overview of Nevada's Economy and Fiscal Policy: Statehood to 2010

By Dick Bartholet

Part 1

1918 Perspective: The Problems with Tax Reform

To understand Nevada's current economic and fiscal situation, an examination of Nevada's history in these matters adds a wonderful perspective. It is interesting how certain things seem to remain "constant" over the many decades in spite of significant changes in technology, the economy and the demographic make-up of the state.

Romanzo Adams wrote "Taxation in Nevada: A History", published in 1918 by the Nevada Historical Society. This book provides a fantastic window into the past, and is heavily relied upon for the early history presented in this paper.

Chapter 10 of Adams' book is entitled "The Problems of Tax Reform in Nevada". As you read the following excerpts written over 90 years ago, it is interesting to consider their current applicability.

> In many respects the problems of tax reform in Nevada are like those of other States, and these call for no extended discussion in this place. In the first place, this subject has to compete with many other important questions for public interest. Few persons give sufficiently sustained attention to the subject to permit of the development of sound judgments.
>
> * * *
>
> Then there are certain old theories of taxation . . . which are not valid in relation to present economic and political conditions. The fact that these theories are not based on any serious study of the subject of taxation, but are commonly taken as self-evident, and the fact that their chief support is custom, makes progress necessarily slow.
>
> No tax reform can be effective without modifying the situation for private interests. . . . As a rule the business interests likely to suffer from a change are represented by the more aggressive and alert members of a community, while the much greater number of people who stand to benefit from the reform are relatively passive and indifferent.
>
> * * *
>
> There has been some lack of continuity in financial policy because, with a constant change in the personnel of the Legislature and of administrative bodies, there has been too little experience and too little knowledge of their predecessors' experience on the part of officers responsible for financial policy.

> * * *
>
> The constitutional provisions relating to taxation are too rigid to permit of an orderly progress in the way of adapting our system of taxation to present day needs.
>
> * * *
>
> Moreover, Nevada has had an unusual experience in that the period of general social instability was not confined to the generation of early pioneering. After more than fifty years of statehood there persist many important elements of social instability.
>
> * * *
>
> The State is now confronted with this situation: In order to permit of an orderly progress along the lines of tax reform, we must abandon some of the constitutional restrictions and trust more to the discretion of the Legislature and the people.

Compare Adams' observations with some of the current challenges to fiscal reform:

- Fiscal reform is just one of the many concerns we must address.
- Few people take the time to understand fiscal and economic policy sufficiently to make good decisions.
- Old theories and "sound bites" are taken as self-evident without any basis in fact, making the process more difficult.
- There are many special interests, including big business and organized labor, influencing the process.
- Turnover in people involved in the decision processes means loss of experience and knowledge.
- Nevada's system has significant constitutional rigidity.
- Nevada has significant social instability.
- In order to make progress in reforming the system, we must abandon some of the constitutional rigidities.

As the old saying goes, the more things change, the more they stay the same.

Early Statehood Based on a Mining Economy: 1864-1914

In 1861, Nevada's population was estimated at 14,400 people, with 32% of that total residing in Storey County (Virginia City) and 51% residing nearby in Carson City, Douglas, Lyon and Washoe Counties. The primary economic activity was mining or support of mining.

> Here was a territory of great extent and scanty population with but one basic industry, gold and silver mining. All other industries were dependent upon mining and mining alone. Merchant, tradesmen, and teamsters were as truly and almost directly dependent upon the mines as were the miners themselves. What little agriculture there was, owed its existence to the demand of the mining camps for hay, vegetables, and milk and to the high prices of these commodities due to the absence of railroads. (Adams, p 24)

Taxation was a major concern to Nevada residents from the beginning. Following the first constitutional convention in 1863, Nevada residents rejected statehood by a large majority, with those opposed influenced primarily "on their belief that they had little or nothing to gain from statehood except higher taxes." (Adams, p. 21) However, there was a depression in Nevada's economy in 1864, caused in large part by significant litigation in the mining industry, with considerable development delays due to congestion of court dockets. In considering the balance between taxation and the benefits from public spending (i.e. on the judicial system), public sentiment shifted, and Nevada voters approved statehood following the second constitutional convention.

Uniform and equal taxation except mines and mining

The general approach to taxation was that the tax burden should be applied equally to all property. Here is Article 10 (Article X) of the Nevada Constitution as originally adopted:

> The Legislature shall provide by law for a uniform and equal rate of assessment and taxation, and shall prescribe such regulations as shall secure a just valuation for taxation of all property, real, personal, and possessory, excepting mines and mining claims, the proceeds of which alone shall be taxes, and also excepting such property as may be exempted by law for municipal, educational, literary, scientific, religious, or charitable purposes.

The special treatment for the mining industry represented, in effect, a substitute provision for the taxation of the mineral deposits representing the "uniform and equal" property tax burden that is paid on all other properties. The argument was that the actual value of a mineral deposit cannot be accurately or fairly determined when the minerals are still in the ground, and that the only way to fairly assess their value and assign a tax burden was upon their extraction and determination of the net value of those minerals. This eventually included deducting the costs associated with development of the mines, and extracting, transporting and processing the ores.

The economic and political influence of the mining industry at that time is still evident in the Nevada Constitution today.

Article 10. – Taxation,

Section 1. Uniform and equal rate of assessment and taxation: exceptions and exemptions; inheritance and income tax prohibited.

1. The Legislature shall provide by law for a uniform and equal rate of assessment and taxation, and shall prescribe such regulations as shall secure a just valuation for taxation of all property, real, personal and possessory, except mines and mining claims, which shall be assessed and taxed only as provided in Section 5 of this Article.

Section 5. Tax on proceeds of minerals; appropriations to counties; apportionment; assessment and taxation of mines.

1. The legislature shall provide by law for a tax upon the net proceeds of all mineral, including oil, gas and other hydrocarbons, extracted in this state, at a rate not to exceed 5 percent of the net proceeds. No other tax may be imposed upon a mineral or its proceeds until identity of the proceeds is lost.

Following the Comstock boom, Nevada's population began to decline from a peak of around 62,000 in 1880 to about 45,000 a decade later, and down to 42,000 by 1900. There were other mining booms and busts following the Comstock, with the economy remaining very dependent upon mining, and to a lesser degree upon agriculture and transportation (railroads). With the economic base being directly tied to real property (land and appurtenances), it made sense to have government revenues primarily generated from this base in the form of property taxes.

Interpreting and administering the tax laws

In the early years of statehood, there was substantial legislation and case law dealing with the interpretation of the constitution and administration of tax laws. Property tax burden was not equally distributed between counties or between taxpayers within the counties. Major property owners found numerous ways to circumvent the system and avoid or minimize their tax burdens. Since the constitution called for taxation of all property, there were issues with such assets as cash, bank deposits, mortgages, stock holdings, and intangible property. In regard to net proceeds from mines, there were issues as to what was to be taxed (ore or bullion), and how and when various costs were to be recognized.

Intangible property

In 1875, the Nevada Supreme Court ruled that the County Assessor, in determining assessed value, could consider all items of cost of construction of the railroads as well as the earnings and profits, and the connections of the railroads outside of the county boundaries, which was one of the early decisions of the court in dealing with values above and beyond the value of unimproved land and basic construction materials, thereby incorporating intangible value into property value.

In 1911, the Nevada Legislature enacted a law which allowed the County Assessors to determine the value of express companies (i.e. Wells Fargo Company) by "capitalizing their net earnings at 8%". (Adams p. 130) In 1913, the Nevada Tax Commission Act provided for the assessment of the property of public utilities, including both tangible and intangible property, as a collective unit and to apportion the value between counties on the basis of proportional mileage in each county. This act was the basis for centrally assessed properties in Nevada.

Licenses and other business taxes

> The first Territorial Legislature of Nevada enacted a revenue law embracing a system of license taxes for county purposes, the act being in large measure copied from the revenue laws of California. (Adams, p. 155)

When mining camps first came into existence, the easiest and best way to fund the necessary public services was to impose license taxes. Property values were minimal, and no one knew if the mine(s) would prove to be profitable nor how long the camp might last. The only entities that had a significant prospect of making money were the businesses that earned money from the prospectors and miners. Business license taxes were the practical solution.

Adams' interpretation of the nature of business taxes is quite interesting. Understand that in 1918, Nevada had not yet legalized gaming in the same manner as it did in 1931.

> License taxes are of two general classes: (1) Licenses for revenue pure and simple; (2) Licenses for regulation with revenue incidental. The regulatory license may, and often does, yield a larger revenue than the pure revenue license, but whether the yield be much or little, is determined by regulatory not revenue considerations.
>
> * * *
>
> . . . if a business is regarded as more or less harmful, tending toward disorder or public injury, the rate is made higher, partly with the idea of restriction, and partly to compensate the community for the special expenses of police and courts. The saloon license and some amusement licenses are of this character. (p. 145)

In describing the County regulatory licenses, Adams added the following:

> The first revenue act imposed a license tax for county purposes on billiards, bowling alleys, theaters, circuses, saloons, pawn brokers, intelligence officers, and peddlers. From time to time the list has been extended as follows: Gambling, 1869; drummers, 1877; hurdy-gurdy houses, 1887; prize fights, 1897; sheep, 1891; cigarettes, 1893; stationary engineers, 1905; automobiles for hire, 1909; fishing and hunting, 1909. (p. 146)

Adams included all of these under regulatory licenses, so it is assumed that he (and probably others of his time) viewed all of these categories as "more or less harmful, tending towards public disorder." Gaming license fees, considered to be merely a regulatory license fee in Nevada when Adams published his book in 1918, became one of the key revenue sources for the state within one generation, and the acceptance of gaming (and the revenue provided to government) in other jurisdictions occurred within 70 years.

Public expenditures

Adams addresses the relationship between taxation and public expenditures as follows:

> The subject of taxation cannot be considered wholly apart from that of public expenditures.
>
> * * *
>
> Public expenditures are directly related to the enlargement of governmental functions. The greater the number of things the people wish to have done by governmental agencies, and the higher the standards of efficiency in governmental service, the greater the cost. During the period of the early mining development, 1860-1880, the governmental functions were limited to those most essential to the existence of the State. There was no university, no hospital for the insane, no provision for the care of juvenile delinquents, little or no public expenditure for health, and most highways were maintained as toll-roads by private individuals.
>
> * * *
>
> During the next period of approximately two decades, the revenues of the State suffered a diminution due to decline of the mining industry, and the general tendency was to reduce public expenditures to a minimum. Salaries of officers were reduced, and certain offices were abolished.

It is interesting to consider the parallels between these times of which Adams speaks (1880-1900) and modern times. The "permanence" of the economic base provided by legalized gaming may actually be only a transient advantage, with the acceptance and growth of legalized gaming in new jurisdictions seeming to undermine Nevada's economic vitality.

Is Nevada facing a secular change in its primary industry – gaming, with the state to follow the pattern set by its initial primary industry – mining?

Will the current downturn, following the gaming boom of the last century, be as painful to the State as the mining "bust" of 1880-1900?

What can the State of Nevada do to mitigate the economic and fiscal pain, and to develop a new economic foundation to propel future growth in the State?

Part 2

1915-1978: Nevada's Economic Engines - Mining to Gaming Monopoly

Nevada's economy in the early 1900s was not significantly different from the first 36 years following statehood: mining booms and busts accompanied by ranching and farming, the presence of the railroads and their checkerboard section ownership along the rail corridor, and not much else. Property taxes continued to be the primary source of state revenue. Following the booms in mining in towns like Berlin, Goldfield, Rhyolite, Searchlight and Tonopah, the population went from 42,000 in 1900 to nearly 82,000 in 1910, declined to 77,000 by 1920, and then grew to 89,000 by 1930.

Gaming legalized and gaming tax implemented

In 1931, in the early stages of the Great Depression, the legislature legalized gambling in Nevada, with a tax on devices and table games collected and retained by local and county jurisdictions. Gaming licensing was handled at the local and county level as well. Around the same time, regulations pertaining to divorce were changed to make Nevada a mecca for those seeking divorces. Interestingly, many legislators expected the economic impact of liberalized divorce to exceed the economic impacts from legalized gaming.

Gaming began to have a significant economic presence in Nevada during the late 1930's and 40's. The state's population grew from 89,000 in 1930 to 109,000 in 1940, with Clark County representing about 40% of the state's growth during this decade. With the construction of Hoover Dam, growth in Clark County was stimulated, and the El Rancho became the first gaming property on what would become the Las Vegas strip. The Last Frontier (which later became the New Frontier) was built in 1942.

Gaming licensing and taxes shifted to the state

Following World War II, the gaming industry began to expand much faster, and Las Vegas was where most of the expansion occurred. Bugsy Siegel opened the Flamingo in 1946, and the late 1940's saw the opening of the Golden Nugget in downtown Las Vegas and The Thunderbird on the Las Vegas Strip. Harrah's Club, Nevada Club, and the Mapes opened in Reno, and the Wagon Wheel and Tahoe-Biltmore at Lake Tahoe. The state started to become more urbanized. The economy shifted and the tourism industry became a bigger component of Nevada's employment and spending. In 1945, gaming licensing shifted from local and county jurisdictions to the state and in 1946 the first state tax on gaming was levied at one percent of gross earnings.

Between 1940 and 1950, the population of Nevada grew from 109,000 to 159,000, with nearly all of this growth occurring in Clark and Washoe Counties as the state became significantly more urbanized. In the 1950s, transportation changed significantly with the construction of the first stretches of the interstate highway system, and inaugurations of the first commercial jet service. The movie and defense industries were driving growth in southern California, which was the primary feeder for southern Nevada's gaming industry.

By 1952, commercial gaming had surpassed mining and agriculture to become the largest revenue-producing industry in Nevada. The Nevada Gaming Control Board was established in 1955 as a division of the Nevada Tax Commission with the purpose to oversee the licensing and operation of Nevada casinos.

Implementation of the sales and use tax

As gaming-driven tourism continued to expand, the economic base of Nevada "grew away" from the historic tax base (property taxes). Not long thereafter, and in response to a fiscal emergency, the first sales and use tax was instituted in 1956 through the referendum process, with the rate set at 2% and with the proceeds going to the state's general fund.

Rigidity of the fiscal system

The statutory provisions contained in the Sales and Use Tax Act cannot be "amended, annulled, repealed, set aside, suspended or in any way made inoperative except by a direct vote of the people." This 2% sales tax rate still exists today, and changes to the "base" of what is taxed have required approval of the electorate. In short, changes to the basic 2% sales tax - be it changing the base of what is taxed, changing the rate, and/or changes in how the funds are dispersed - require a referendum process. Interestingly, as will be explained later, the Local School Support Tax (LSST), the City-County Relief Tax (CCRT) and the Supplemental City-County Relief Tax (SCCRT) did not require a referendum process.

Significance of gaming and sales & use tax revenues

In 1950, property taxes comprised 20.19% of Nevada's tax revenues, with gaming taxes comprising approximately 12.4%. In 1959 sales and use tax provided 30.3% of Nevada's tax revenues compared to gaming taxes at 21.9% and property taxes at 4.7%, with the balance from cigarettes, liquor, business and miscellaneous tax revenues. Highway and User Taxes were dedicated to the construction and maintenance of the state's highway system and not to the general fund.

Revenue Source	1950 Amount ($1,000s)	1950 % of Total		1959 Amount ($1,000)	1959 % of Total
Property Taxes	$ 1,978	20.2%		$ 1,699	4.7%
Gambling Taxes	$ 1,211	12.4%		$ 7,986	21.9%
Highway and User Taxes	$ 4,157	42.4%		$ 10,955	30.0%
Cigarette Taxes	$ 746	7.6%		$ 1,431	3.9%
Liquor Taxes	$ 510	5.2%		$ 1,052	2.9%
Other Business & Agr. Taxes	$ 477	4.9%		$ 1,587	4.4%
Misc. Licenses and Fees	$ 719	7.3%		$ 702	1.9%
Sales & Use Taxes	$ -	0.0%		$ 11,057	30.3%
Total State Taxes	$ 9,798	100.0%		$ 36,469	100.0%

The net proceeds from mines tax are included in, and represent a very small portion of, the property tax amount.

When combined state and local tax collections were also considered, the role (contribution) of property taxes was more significant. In 1959, property taxes accounted for 35.4% of all tax collections, followed by highway user taxes at 19.2%, gambling taxes and licenses at 17.6% and sales and use taxes at 16.5%.

On the other side of the ledger (spending), and considering combined state and local expenditures for 1959, education consumed the largest amount at 29.5%, followed by highways and streets at 29.2% and public health, welfare, safety and sanitation at 22.3%. General administration amounted to 9.2% of total expenditures.

The Gaming Control Act was passed in 1959, establishing the Nevada Gaming Commission.

The 1960's and 1970's

The 1960's and 70's were an interesting time in America: the Cuban missile crisis, the Vietnam War and public reaction to the war, the space race, the Arab oil embargo, Watergate, and the fall of the Shaw of Iran to name only a few of the key events that shaped the world and our country.

In 1960, total gross gaming revenue in Nevada exceeded $200 million and the state population surpassed 285,000. The state's monopoly of legalized casino gaming providing much of the impetus for this growth. In 1965 the state enacted a casino entertainment tax to enhance state revenues. Howard Hughes arrived in Nevada and acquired a number of gaming properties in the state and nearly all undeveloped land in the Las Vegas valley. In 1967, the State Legislature legalized ownership and operation of gaming properties by public companies without licensing of each shareholder. This event not only set the stage for vast expansion of gaming in Nevada, it also laid the groundwork for expansion of legalized gaming into new jurisdictions.

A new sales tax is not an amendment to the existing Sales and Use Tax Act

In 1967, the legislature passed the Local School Support Tax (LSST), consisting of a 1% "sales tax" levy that was later ruled by the Nevada Supreme Court not to be an amendment to the Sales and Use Tax Act (so that it did not require a referendum vote). This LSST relieved pressure on the state's general fund to support education. The same year, the legislature passed a Real Property Transfer Tax, with the revenues to be split between the state and local governments.

By 1970, the population of Nevada surpassed 488,000, with Clark County comprising over half of that total, and with tourism being Nevada's largest industry. During the 1970s, the Interstate Highway System was substantially completed. In 1972, Harrah's Entertainment became the first gaming company listed on the New York Stock Exchange, which was another development that set the stage for expansion of gaming into new jurisdictions. By 1975, gaming revenue topped $1 billion annually and nearly half of Nevada's budget was funded through gaming-based tax revenue.

Through the 1970's Nevada had become the fastest growing state in the United States. In 1976, New Jersey residents approved legalization allowing gambling in Atlantic City, with its first casino, Resorts International, opening its doors in 1978.

Part 3

1979-2008: Taxpayer Revolt and the Spread of Gaming

In November 1978, Nevada voters passed Question 6, an initiative intended to provide property owners with current and future property tax relief and require super-majority approvals for any future tax increases of any nature. Question 6 was Nevada's version of the "taxpayer revolt" that was part of the national wave following the approval of Proposition 13 in California.

California's Proposition 13

Proposition 13, officially titled the **People's Initiative to Limit Property Taxation**, was enacted in California in 1978. This was an amendment to the California constitution, approved by the voters in June of 1978 and later upheld by the United States Supreme Court in 1992 (*Nordlinger v Hahn*, 505 U.S. 1). Leading up to Proposition 13, the mood of taxpayers in California began to make a pronounced shift following California Supreme Court rulings in 1971 and 1976 in *Serrano v Priest*, which held that the property-tax based finance system for public schools was unconstitutional, in that the amount of funding going to different school districts was disproportionately favorable to the wealthy and, therefore, did not meet the requirements of the Fourteenth Amendment to the U.S. Constitution of equal protection under the law. This ruling, while achieving a more equal distribution of funding to public schools, also created a "disconnect" for voter/taxpayers regarding the perceived benefits to their school district from taxes they approved on their own property. The other significant factor preceding Proposition 13 was the rapid rise in residential property values, with the resultant rapid increase in property taxes. According to the Tax Foundation, in 1977 and 1978 California's national ranking was 4th and 3rd, respectively, in terms of combined state and local tax burden.

Nevada's Question 6

Even though Nevada had one of the lowest combined state and local tax burdens in 1977 and 1978 (ranked 49th in 1977 and 50th in 1978 by the Tax Foundation), Nevada voters "got on board" with the tax revolt with 78 percent approval of Question 6 in November 1978. The key provisions of Question 6 were:

1. Limit the amount of property tax that can be collected annually from the owner of real property to 1 percent of the property's appraised value.
2. Roll back appraised value of real property to the value shown on assessment rolls for fiscal year 1975-1976, and limit future increases in appraised value to 2 percent annually.
3. Require a two-thirds vote of the legislature to increase state taxes, none of which could be based upon the value of real property.

4. Require a two-thirds approval of voters to approve future increases in local taxes.

For Question 6 to become law as a constitutional amendment, it had to be passed by the voters a second time. The Nevada Legislature created an alternative to Question 6 in 1979, and as a result Question 6 failed to receive a majority vote when it came up before the voters in 1980.

Legislative response to Question 6 and the Nevada tax shift

In 1979 the Nevada Legislature enacted four bills that comprised the tax relief package intended to reflect the sentiment of the voters in regard to tax relief. Through Senate Bills 204 and 319 and Assembly Bills 616 and 268, the maximum constitutional property tax rate of $5 per $100 of assessed valuation was statutorily reduced to $3.64, with no net loss of revenues to local units of government. Additionally, household personal property was exempted from taxation (which was a recommendation made to the Legislature in the Zubrow Financing Study of 1960). Growth in state and local expenditures was limited to the combined rate of growth in population and inflation. Sales tax would no longer be charged on food for human consumption at home, with this portion of the legislation requiring a referendum approval since the original sales tax was passed by referendum. Finally, the cost of foster care for children not eligible for federal Aid to Dependent Children would be borne totally by the state rather than one-third of the cost being paid by the counties.

In 1981 the Legislature enacted another four bills and two joint resolutions that comprised the next component of tax relief and necessary adjustments to allow for continued funding of the various units of local government, which thereinafter has been known as “The Tax Shift”. Senate Bills 69 and 411, Assembly Bills 134 and 369 together with Assembly Joint Resolution 27 and Senate Joint Resolution 21 made the following changes to Nevada law:

a) state and local sales taxes were increased from a combined rate of 3.5% to 5.75%, with the increases all in the components known as the local school support tax (LSST), the city/county relief tax (CCRT) through the addition of a supplemental city/county relief tax (SCCRT), and with the increase made mandatory for all counties;

b) distribution of the amounts from the State to the various local units of government was to become accomplished by way of a formula that would be established by the Department of Taxation;

c) landlords were required to pass property tax savings on to tenants;

d) the basis for valuing residential properties was changed from a “market-value” approach to a bifurcated basis with the land value based upon market value and the improvements to be valued according to “taxable value”, determined using replacement costs less depreciation based upon the age of the improvements;

e) the limitation on local government expenditures was replaced by a limitation on local revenues and the growth rates of said revenues;

f) taxes and license fees were temporarily increased for several gaming-revenue sources;

g) the Nevada constitution was changed to permit the legislature to classify real property for taxation purposes; and

h) the state constitution was changed to permit the legislature to set the rate of taxation on net proceeds of mines not to exceed five percent.

In 1982, the tax package enacted by the legislature was ruled unconstitutional by the Eighth Judicial District Court of Nevada because it violated the "equal and uniform rates of assessment" provision of the constitution, and because the 1981 plan was an integrated plan, the whole package was unconstitutional. In 1983, the constitutionality problems were rectified by enactment of a constitutional amendment that provided for equal property tax exemption for all properties, and enactment of a constitutional amendment allowing the legislature to provide a separate system for the assessment and taxation of centrally assessed properties (utilities, railroads, and airlines).

Unintended consequences of 1979 and 1981 legislation

The changes to Nevada's fiscal system enacted by the Legislature in response to the taxpayer revolt were far reaching. The following are some of the consequences – many unintended and unanticipated - that have resulted.

<u>No assessment guidelines for "taxable value"</u>: Nearly three decades after moving from a market-based property tax system to a bifurcated system of market value for land and replacement cost less depreciation for improvements, the State has still not promulgated regulations defining appraisal methodologies. As a result, the various County Assessors have continued to lose one legal challenge after another, not because the values they place on properties were too high, but because assessors were using methodologies that had not been approved by the Nevada Tax Commission. The net result was that property taxes were rolled back.

<u>Depreciation creates a taxpayer equity issue</u>: The Nevada Constitution calls for "uniform and equal rates of assessment and taxation". With the depreciation factor, there can be two properties of equal market value, but one older than the other, and with the tax burden significantly lower for the older property.

<u>Elimination of going concern value for centrally assessed properties</u>: One of the consequences of the 1979 and 1981 changes was the elimination of going-concern valuations for centrally assessed properties. Instead, the utilities, railroads and airlines had to be treated like other properties and their assessed value had to be on the basis of land and improvements, less

depreciation. This change had significant impact on the property values and property tax revenues in a number of the rural counties in Nevada.

No depreciation “reset” provision: In California, assessed value resets when a property is sold. There is a problem in California for properties owned by corporations which are essentially transferred through the sale of corporate stock without an actual sale of the property (just as properties in Nevada avoid the Real Property Transfer Tax when corporations “change hands” without a sale of the real property). In Nevada, there is no similar provision to reset property values, so the buyers of real property acquire the “benefit” of the depreciation for determining the property tax burden. This circumstance provides an economic incentive for “slum lords”, and causes local units of government to value private new development over repair and maintenance of older properties.

Narrowing the tax base: The changes created by the 1979 and 1981 Legislatures significantly narrowed the tax base while, at the same time, the economy was “shifting away” from the tax base. For example, in regard to property taxes, the value of real estate as a percentage of the value of all property is decreasing. Intellectual property (patents, trademarks, and copyrights), going concern value, and other non-real estate properties continue to comprise an increasing share of total property value. In the realm of sales and use taxes, services continue to comprise an ever-increasing portion of the value of transactions, so sales taxes are being assessed on ever-smaller proportion of total economic transactions.   Rather than broadening the base for sales tax, the elimination of food for home consumption further narrowed the base while increasing the instability of future revenue streams. While eliminating food may make sense in terms of mitigating the recessive nature of the sales tax, the base was, none-the-less, narrowed considerably.

Increased rigidity of the tax system: Four aspects of the changes occurring in 1979 and 1981 meant that it would be much more difficult in the future for the Governor and the Legislature to deal with fiscal challenges: 1) placement of fiscal issues in the constitution; 2) making changes through the initiative and/or referendum process; 3) requiring a super-majority vote of the legislature or of voters to enact changes; and 4) earmarking revenues - especially when there was no “real connection” between the revenue source and the spending category.

In the Price Waterhouse/Urban Institute study conducted for the Legislature, “A Fiscal Agenda for Nevada” (Ebel, 1988), four themes of the report were set forth in the Executive Summary. One of these states:

> The state tax system produces revenues that are narrowly in balance with the present expenditure requirements of the state’s General Fund as defined by current policy. . . . One important implication of this analysis is that there is scant flexibility to expand the scope or quality of public services without increasing the level of taxation. (p. 7)

Again from the Price Waterhouse/Urban Institute study:

> The system has undesirable built-in rigidities. Because of constitutional constraints, extensive earmarking of revenues, and tight restrictions on local governments, Nevada is poorly positioned to confront unforeseen future economic developments. (p. 8)

Loss of simplicity, transparency and connectivity: Voters prefer a tax system that they can understand, wherein they can follow the spending priorities set by their representatives, and – particularly for the local units of government, where they can impose certain tax burdens upon themselves and see the direct benefit to their local units of government (school district, city and county, etc.). The changes enacted in 1979 and 1981 increased the complexity of the fiscal system in Nevada, certainly made it more difficult for voters and their representatives to understand the fiscal system, and created more of a feeling that government was a distant "third party" and not an instrument of the people. This seems to have resulted in less thoughtful consideration of the fiscal system with every succeeding biannual meeting of the Legislature and more reliance on "making adjustments to the last budget", as well as increasing levels of frustration with the system by the voters.

Constitutional Prohibition of an Income Tax

In 1988, there was a ballot measure to prohibit a state personal income tax and to make this prohibition a part of the Nevada Constitution. In 1988, voters approved this ballot measure by a vote of 276,976 in favor to 59,803 opposed. Two years later voters approved the ballot measure again by a vote of 226,079 to 86,335. Article 10, Section 9 of the Nevada Constitution now reads:

> No income tax shall be levied upon the wages or personal income of natural persons. Notwithstanding the foregoing provision, and except as otherwise provided in subsection 1 of this Section, taxes may be levied upon the income or revenue of any business in whatever form it may be conducted for profit in the State.

There may be some confusion over the exception for taxes on business income or revenues. If the business is in the form of a sole proprietorship, a partnership or a limited liability corporation, the income all "passes through" to the individual owners. The interpretation of this exception has not been tested in the courts.

Expansion of Legalized Gaming into New Jurisdictions

As previously noted, in 1976 New Jersey voters approved legalized casino-style gaming in Atlantic City. During the 1980's, state lotteries grew in popularity and several Indian tribes in Florida and California started bingo games offering larger prizes than authorized under their state laws. When the states tried to shut down their operations, the tribes filed lawsuits in federal courts and prevailed against the states (since gambling was not illegal within the states).

Gaming on Indian reservations was legalized and regulated with passage of the Indian Gaming Regulatory Act (IGRA) by the U.S. Congress in 1988. However, there were still disputes between state governments and Indian tribes, so Indian gaming remained fairly limited through the 1980's.

In the Price Waterhouse/Urban Institute Study (Ebel, 1988), two of the Tourism findings were as follows:

1. A healthy visitor industry is enormously important to the Nevada economy. In 1986, for example, the industry accounted for 45 percent of total earnings in the state, 64 percent of total full-time equivalent jobs, and nearly 55 percent of direct General Fund revenues. (p. 12)

   * * *

3. Although difficult to estimate, the available data suggest that competition from Atlantic City has had little long-term impact on the Nevada market. Similarly, although there is some anecdotal evidence that the California lottery may have diverted some gamblers away from Nevada when it began operations in 1985, there is no evidence of significant effect at present. (p. 12)

One observation is that like mining in Nevada's early days, gaming generated the economic activity that supported many other business functions. The indirect economic impacts of gaming were significantly greater than the direct impacts indicated in the PWUI study.

The impact of the spread and expansion of legalized gaming was not yet apparent in 1988 because the significant expansions had not yet occurred. In 1989, the first modern riverboat casino opened in Iowa. In 1992, an Indian-owned bingo hall in Connecticut known as Foxwoods added table games, followed by slot machines the next year with an agreement for sharing revenue with the state. Also in 1992 the first casino opened in Biloxi, Mississippi, with a casino opening in Illinois in 1993. These and other gaming expansions in the U.S. seemed to have the effect of introducing people to casino-style gaming, but without offering the full experience available in Nevada, thereby fueling demand for the full gaming experience, then available only in Las Vegas. In the 1990's there were several rounds of large expansions on the Las Vegas strip, including Luxor, New York-New York, MGM Grand and Bellagio. Reno saw the opening of the Silver Legacy.

Following the U.S. passage of IGRA, tribal-state compacts or agreements were required for the tribes to operate casino-style gaming facilities. In 1998, California's Governor Wilson negotiated a compact with the Pala Band of Mission Indians in San Diego County. Shortly thereafter, the tribes, not liking the limitations of the compact, sponsored Proposition 5 for the

November 1998 ballot, which would allow them to significantly expand their gaming operations. Proposition 5 was struck down by the California Supreme Court in 1999. Following this, Governor Gray Davis, who had received significant financial support from the tribes in his campaign for Governor, negotiated a new tribal-state compact which allowed Nevada-style gaming in California with video slot machines, but limiting each tribe to 2,000 machines. This new agreement was contingent upon passage of Proposition 1A, which appeared on the March 2000 ballot and was passed. Several California card clubs and charities asked the federal government to declare Proposition 1A invalid, but in December 2003, the Ninth U.S. Circuit Court of Appeals upheld Proposition 1A.

California's Governor Arnold Schwarzenegger negotiated a number of new tribal-state agreements and amendments to existing agreements, with several providing for unlimited numbers of gaming devices. This resulted in several California gaming operations expanding to offer essentially all of the amenities available in Nevada gaming operations.

Current evidence suggests that legalized gaming operations in the U.S., particularly in California, and in foreign jurisdictions, such as Macau, China, are having a pronounced negative effect on Nevada's tourism and gaming revenues.

Easy Money, the Real Estate Bubble and the 2005 Nevada Tax Cap

From 2000 to 2003, the Federal Reserve lowered the federal funds rate from 6.5% to 1.0%, first in order to soften the effects of the dot-com collapse, and then to help the U.S. economy following the September 2001 terrorist attack. In 1996, subprime mortgages comprised about 9% of mortgage loan originations, increasing to 13% by 1999, and to 20% by 2006. Mortgage qualification guidelines transitioned from "stated income, verified assets" (SIVA) to "no income, verified assets" (NIVA) to "no income, no assets" (NINA).

Large pools of money accumulated overseas due to trade imbalances, and investors were seeking returns better than those available through U.S. Treasury bonds, and special investment securities (mortgage-backed securities and collateralized debt obligations) were invented to accommodate theses needs and funnel money into the U.S. mortgage market. Debt rating entities standards were compromised and "insurance" in the form of credit default swaps made the investments seem much safer than they actually were.

Between 1981 and 2001, the national median home price ranged between 2.9 and 3.1 times median household income. By 2004, the ratio rose to 4.0 times and by 2006 it was 4.6 times. In 2005 and 2006, around 40% of home purchases in the U.S. were either for investment purposes or vacation homes. In Las Vegas and Reno, Nevada, the ratio of median home prices to median household income rose from around 2.7 in 2001 to over 5.1 in 2006. During this period, property taxes followed the rapidly escalating home values, and voters began complaining about the tax bill that accompanied the windfall increase in their property values.

The Federal Reserve's easy-money policy impacted Nevada's gaming industry. Beginning in 2005, there were a number of merger and acquisitions, funded with debt. MGM Mirage acquired Mandalay Resort Group, and Harrah's Entertainment acquired Caesar's Entertainment, and later the corporation transitioned from publicly held to a privately owned entity through a leveraged buyout. Wynn Las Vegas opened, as did the Palms. MGM Mirage launched the $7 billion Project CityCenter, and Boyd Gaming proceeded with Echelon Place, estimated to cost $4 billion. In Reno, Grand Sierra Corporation acquired the Reno Hilton. Financial leverage in the gaming industry was increasing rapidly, and the associated economic stimulus continued to help drive housing prices higher.

In 2005, the Nevada Legislature passed Assembly Bill 489, providing for a partial abatement on property taxes through the imposition of caps on the amount of increase that could occur compared to the prior year's assessment. Essentially, the maximum increase in the tax bill on residential property was three percent over the prior year, while the maximum increase in the tax bill of a commercial property was eight percent over the prior year. All operators of businesses were allowed to apply for a reduction in their property value based upon an income approach to "measure" any obsolescence of the property for tax assessment purposes. Further, local governmental units could not increase their total ad valorem tax rate for any fiscal year above the rates for the preceding year without approval of the Nevada Tax Commission based upon the recommendation of the Committee on Local Government Finance.

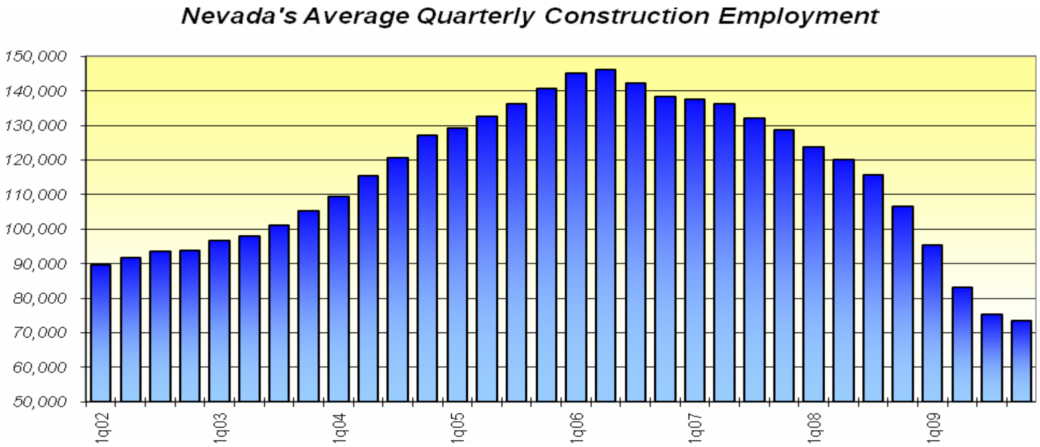
A few years later it seemed apparent that no one anticipated that property values might decline sometime in the future and that this legislation would limit the rate of recovery of property tax revenues, regardless of the recovery of actual market values. It seemed that no one anticipated the impact of this legislation on redevelopment districts with their tax-increment financing and the underlying debt service of these entities. This legislation increased the rigidity of the Nevada fiscal system and surprised many people with the unintended consequences.

Nevada's Economy and the 2007-2008 Recession

U.S. and Nevada house prices peaked in 2006 and began a sharp decline. The securitization market started to close down in the spring of 2007, and nearly shut down entirely in the fall of 2008. By February 2009, securitization markets were effectively closed with the exception of conforming mortgages. Federal bailouts were provided to some firms in the financial and insurance industries and to two of the big-three U.S. automakers to forestall a collapse of the U.S. economy.

In Nevada, the immediate impact of the collapse of housing values was a rapid decline of employment in the construction industry starting in mid-2006 (see Figure 1).

Figure 1: Construction Employment



Low unemployment rates bottomed out in the state around the same time period, initially driven higher by unemployment in construction, but with job losses in other industries soon contributing to the change (see Figure 2).

Figure 2: U.S. and Nevada Unemployment

State tax revenues changed direction in 2007, with the rate of change in taxable sales first turning negative in the second quarter of 2007, followed by the change in taxable gaming revenues in the fourth quarter of 2007 (see Figures 3 and 4). As can be seen, both of these measures continued to deteriorate throughout 2008.

Figure 3: Rate of Change in Taxable Sales

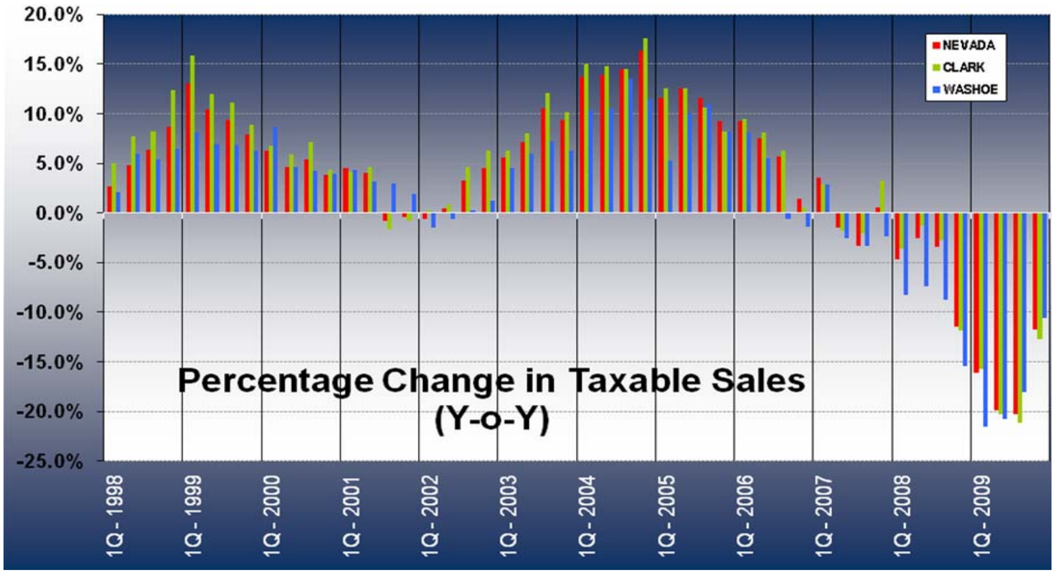
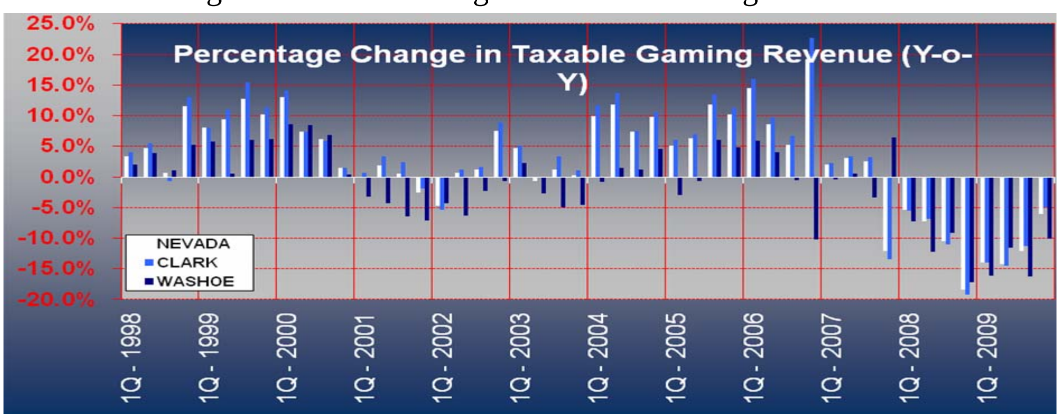


Figure 4: Rate of Change in Taxable Gaming Revenue



Most local units of government in Nevada also experienced significant deterioration of revenues during the recession. The decline in sales tax revenues had a direct impact, as did declining property tax revenues, which resulted from declining values of residential and commercial properties. County Assessors were faced with commercial properties seeking tax relief under application of the income method indicating obsolescence (lower value), while comparable sales valuation analyses were used to justify obsolescence for residential properties.

The Budget Gap and Short-Term Solutions: 2009 and 2010

During the 2009 legislative session, it became apparent that the deteriorating economy and resultant fall in tax revenues was creating a $2 billion budget shortfall, which amounts to about

30% of the general fund. The budget eventually adopted by the Legislature included the following measures to cover this gap:

- $1 million in salary cuts and program cuts accomplished through a 4% cut in teacher salaries, 12 furlough days for state workers (equates to a 4.6% salary cut), and a 12.5% cut to higher education;

- $350 million of federal stimulus money; and

- $781 million from "temporary tax increases" scheduled to sunset in 2 years, including a business payroll tax increase of $346 million, sales tax increase providing $280 million, vehicle registration increase providing $94 million, and business license fee increase (double) providing $61 million.

In 2010, Governor Gibbons called a special session of the Legislature to address an additional budget shortfall of approximately $800 million which had developed since the prior legislative session. The Legislature cobbled together a package consisting of the following measures:

- 7% cut to higher education;
- 6.9% cut to K-12 education;
- Reduced operating expenditures throughout state government - $304 million;
- Transfers from reserve accounts - $197 million;
- Money swept from Clark County capital project funds, the Millennium Scholarship fund and uncollected taxes - $129 million;
- Federal funding for various programs - $114 million; and
- Fee increases to mining, banking and Secretary of State services - $53 million.

Long Term Economic and Budget Solutions

Citizens and their elected representatives have some major problems and decisions on how to best address the problems facing Nevada.

When considering how to best deal with Nevada's current economic malaise, one has to make a basic determination as to whether they believe the excessive depth of Nevada's recession (relative to the rest of the U.S.) is essentially due to:

1) the U.S. and international economic cycle, made worse in Nevada by: a) excessive financial leverage in our primary industry (gaming), b) the extent of the housing bubble in Nevada related to the "newness" of our housing stock, and/or c) the relatively high contribution of the construction industry to Nevada's overall economy; or

2) a secular change in Nevada's economy due to the loss of its monopoly in gaming and the ever-increasing competitiveness of the gaming offerings in other jurisdictions, layered on top of the current economic cycle as outlined in 1) above.

If the answer leans towards the second alternative, the implications are considerable. Consider what might happen with a shrinking economic base, declining employment opportunities, and perhaps declining population. Declining population could have a significant impact on housing prices, further reducing the wealth of remaining homeowners. On the fiscal side, there could be increasing demand for social services, stubbornly high unemployment (with high unemployment taxes for surviving employers), and decreasing revenues from gaming, sales and use taxes and property taxes.

It would seem that one of Nevada's top priorities in the near future should be enhanced efforts at economic diversification and growth. If this is the case, one of the top considerations by citizens and elected officials should be the relationship between fiscal policy and economic development, based upon factual information.

Which programs and policies actually have had the best results in the United States for economic development and diversification? Which approaches and theories are not supported by results?