NEVADA ISSUES

A publication of the Nevada Taxpayers Association, serving the citizens of Nevada since 1922.

ISSUE 3 APRIL 2000

WHAT'S INSIDE:

ECONOMIC DIVERSIFICATION IN NEVADA

A REVIEW & ANALYSIS

Over the last ten years, there has been a great deal of discussion about the impacts of growth. Too frequently, when the discussion turns to the costs associated with growth, there is a lack of qualitative and quantitative support for the broad generalizations made about all segments of the economy and population. Intuitively, it would seem that economic diversification is important to the fiscal well being of Nevada and its residents.

NTA retained Hobbs, Ong & Associates and Applied Market Analysis, LLC to review the impacts of diversification on the State of Nevada. This study has been completed as of March 15, 2000. The salient findings of their research are provided in this edition of *Nevada Issues.*

OVERVIEW

This summary reviews the fiscal and economic impacts of economic diversification. It relies on data published by state and local governments, economic and demographic reports, professional treatises, historical accounts and other third party data. It considers both state and local impacts.

This report does not attempt to answer all of the questions that a topic of this magnitude presents. Rather, it attempts to shed some light on the issue and allay some common misconceptions and misunderstandings.

For example, there is often confusion about the terms *economic impact* and *fiscal impact*. For the purposes of this report, *economic impacts* refer to the jobs, wages and business activity generated at the state and local level. By comparison, *fiscal impacts* refer to revenues generated by state and local governments as well as the costs associated with providing services to their respective residents. Often reports dealing with this issue tend to group all impacts under the term *economic impact*. This has the affect of confusing the two distinct issues.

There has also been some confusion about the term *economic diversification*. For the purposes of this report, economic diversification is defined as structural changes in the economy that result in new businesses or industries entering the market or existing businesses or industries exiting the market. The relative share of employment that each sector contributes to the overall employment base is often used as a measure of *economic diversification*. The level of *economic diversification* can also be measured by the relative share of total wages paid by each employment sector. The latter measure is often preferred when dealing with fiscal issues. This is because of the relationship between wages paid, disposable income, spending and tax contribution, as well as the inverse relationship between wages paid and the demand for some government services (e.g., health and welfare programs).

This report is divided into two sections, they are:

1. Is economic diversification necessary?
2. Does economic diversification work in Nevada?

Is Economic Diversification Necessary?

> "History has taught us well that narrow economies, or those that are highly dependent on a single industry, are more susceptible to economic turmoil."

IN SHORT: Historical evidence and the weight of economic research both support the need for economic diversification as a sound policy to protect communities against sharp and elongated economic downturns.

The Consultant Team reviewed historical and current economic conditions in a number of jurisdictions and reviewed several technical reports and professional papers on economic diversification as a foundation for our analysis. The findings of our research are summarized in the *Historical Perspective* and *Recent Research* sections that follow.

Historical Perspective

History has taught us well that narrow economies, or those that are highly dependent on a single industry, are more susceptible to economic turmoil. Moreover, economic downturns that occur where narrow economies exist tend to be more far reaching and long lasting than those where the economy is more diverse. This is generally because the narrow economy becomes susceptible to the business cycle of a single industry. When that industry is up, prosperity stretches across sectors; when that industry is down, it ripples through the community.

Much of this "ripple effect" can be explained by the direct, indirect and induced relationship of jobs, wages and output within an economy. Direct jobs are those that are generated by a business itself. For example, a teller would be the *direct* employee of a bank. Indirect employment includes those jobs that are required as a result of a business being in operation. Using the bank example, if a Brink's truck driver is employed to transfer money for the bank, he would be an *indirect* employee. Finally, induced employment are those jobs that are supported by the spending of direct wages paid by a business. If the bank teller buys groceries at the neighborhood supermarket, he is supporting (at least in part) the employment of a checkout person. The checkout person would be considered an *induced* employee.

Generally, this is referred to as an input-output system. It attempts to explain that the "outputs" of one industry are the "inputs" of others, and vice versa. It makes sense that were our entire economy dependent on the bank used in the previous example, and should that bank close, the teller, the Brink's truck driver and the grocery store checkout person would likely all be unemployed. While this example may appear extreme, it is not that far removed from the observed declines of communities dependent on single industries.

Take for example Texas' dependence on the oil industry in the 1970s. An estimated 28 percent of the state's economy was dependent on the oil industry at the height of its reign.[1] According to Bernard Weinstein, Director of Southern Methodist University's Center for Enterprising, the industry's downturn in the late-1970s required nothing less than a "structural transformation," which he estimated could take as many as 20 years.

[1] *Texas Rises Slowly from Hard Times 'Can-Do' Spirits Battle Adversity With Diversity*, The San Diego Tribune. (May 1988)

“THESE LAYOFFS, WHICH WERE LARGELY THE RESULT OF CYCLICAL CHANGES AFFECTING BOEING’S BUSINESS, RIPPLED THROUGH THE ECONOMY WITH SUCH A FORCE THAT ONE WALL STREET JOURNAL OBSERVER DESCRIBED IT AS ‘WORSE THAN THE HEIGHT OF THE GREAT DEPRESSION.’”

Looking back, one observer noted that “there was so much money coming into [Texas] that it became an intoxicant.” He continued by stating, “***People started believing that it would never end.***”[emphasis added].[2] The similarities to the current economic condition in Nevada are apparent.

A second example of the problems that can arise in economies that lack diversity is Seattle, Washington in the 1960s, 1970s and 1980s. The area’s economy was largely dependent on Boeing Corporation, which represented approximately 19 percent of the region’s workforce in 1970.[3]

Boeing executed major layoffs around 1970.[4] These layoffs, which were largely the result of cyclical changes affecting Boeing’s business, rippled through the economy with such force that one Wall Street Journal observer described it as “worse than the height of the Great Depression.” A billboard placed on the main highway that announced, “[i]f you are the last person to leave Seattle, please turn of the lights,” perhaps best exemplified the magnitude of the impact.

This event was not isolated. By the 1980s, Seattle had diversified to the point that less than 15 percent of the region’s employees worked directly for Boeing Corporation. When Boeing again laid off a significant portion of its workforce, the region’s unemployment rate followed suit by more than doubling, from five percent to 11 percent. It was not until the 1990s, when four-fifths of the area’s economy was directly and indirectly “independent of the aerospace giant” that diversification efforts were given credit for helping “offset Boeing cuts.”[5]

Again, the parallel to the Nevada economy does not go unnoticed. Where Boeing represented an estimated 19 percent of the Seattle area’s workforce at the height of its dominance, the gaming/hospitality industry currently represents between 22 and 27 percent of Nevada’s employment base. Including direct, indirect and induced employment impacts, the gaming/hospitality industry supports an estimated 50 to 60 percent of the workforce. If any portion of the Seattle experience can be translated to Nevada, a cyclical downturn in the gaming/tourism industry would be nothing less than devastating.

The tourism sector is not immune to cyclical changes. This is perhaps best illustrated by Hawaii’s troubled economy, specifically in the island of Maui. The island’s downturn in tourism that lagged on after the national recession in the early 1990s reportedly doubled the area’s unemployment by 1994. The impact of the tourism industry’s downturn not only reported social impacts, including increasing instances of homelessness and an estimate that “one out of every five Mauians [was] suffering some food deprivation,” but economic

---

[2] Id. Quoting Mr. Steve Klinkerman, financial writer for the Dallas-Times Herald; See Halkais, M. and Brown, S., *Healthy & Wealthy in the Dallas-Fort Worth Area, Economic Diversity is the Rule and a Major Reason for Growth.* The Dallas Morning News. (August 1984); See also, *Accent on Diversity Spells Growth for San Antonio Economy*, Los Angeles Business Journal. (June 1994)

[3] Wallace, J. *A New Beginning How They Battled Back From the Big Boeing Bust of ‘70s.* Seattle Post-Intelligencer (March 1993); See *Boeing Layoffs Threaten to Cripple Seattle’s Economy*. Dow Jones Service-Edited Wall Street Journal Stories (April 1982); See also, *Seattle Braces for Boeing Slump*, Chicago Tribune (1993).

[4] It was estimated that for every one Boeing employee another 2.5 employees were generated in service and related industries.

[5] *Seattle Braces for Boeing Slump*, Chicago Tribune (1993).

"THE TOURISM SECTOR IS NOT IMMUNE TO CYCLICAL CHANGES."

turmoil translated into serious fiscal ramifications for the local government. [6] Specifically, falling real estate values were cited as having "slashed" the island's tax revenues.

The cases of Seattle, Maui and Texas shed some meaningful light on the potential problems that can arise due to a lack of economic diversity. These are by no means isolated or unusual scenarios, however. Narrow economies have lead to economic instability in several other jurisdictions including:

- Military base closures in Northern California during the late 1980s and early 1990s;
- Downturns in the Arizona's real estate markets in the 1980s and 1990s;
- Oil dependency in Lousiana and Oklahoma during the 1970s;
- Automobile plant relocations/closures in Michigan and other Midwestern states during the 1970s and 1980s.
- Financial market reliance in New York in the 1980s and 1990s;
- Declines in Pittsburgh's steel industry during the 1980s; and
- West Virginia's dependence on the coal industry throughout the mid-1900s.

The historical evidence is overwhelming. It shows clearly and decisively that economies that are dependent on a single industry have a greater vulnerability to elongated and more severe economic downturns. Moreover, because of the interdependent nature of local and regional economies, all sectors become susceptible to the business cycle of the principal industry. To use an Old West analogy -- *when the mine dries up, so does the town*.

This economic trend has not gone unnoticed by scholars, government officials, economist and other learned market observers. In the section that follows, we will turn to some of the studies that have been conducted that address the relationship between economic diversification and economic vitality.

[6] Ybarra, M.J. *Tourists Find Maui Heavenly, but Locals Tend to Disagree*. Dow-Jones News Service-Edited Wall Street Journal Stories. (May 1994); See *Jones, T., Resisting Progress in Molokai: Hard Times in Paradise. Los Angles Times* (February 1988); See also, Blackford, M., *Business, Government, Tourism, and the Environment: Maui in the 1980s and 1990s.* Business & Economic History. (October 1998).

Modern Research

To a great extent, Western economies that evolved during the nineteenth and mid-twentieth centuries were built around monocultures. That is to say, single industries – mining, cattle-raising, wheat-growing, railroading, etc. Economic specialization promoted growth and founded cities. The evolution of the city has shown us that successful modern economies do not abandon the specialization that stimulated growth, but view diversity as the presence of multiple specializations.[7]

> "The evolution of the city has shown us that successful modern economies do not abandon the specialization that stimulated growth, but view diversity as the presence of multiple specializations."

It has long been theorized that the more diverse a region becomes, the less sensitive it becomes to fluctuations from outside of the region.[8] Several studies have since added substance to this theory, showing that diversification not only promotes stability but also promotes the broader goals of economic vitality, growth and low rates of unemployment.[9]

In *Measuring the Effects of Economic Diversity on Growth and Stability*, John Wagner and Steven Deller used a series of econometric equations to show that growth and stability can be simultaneously achieved. The authors suggest that this can occur where policy makers approached the long-run goal of diversification through a series of short-term growth strategies.[10] The analysts used a complex regional input-output modeling framework, which considered both the size and shape of the regional economy as well as the level of inter-industry linkages to perform their study. The results are cited as establishing a "wider range of policy options," including vertical and horizontal integration through targeting "value-added" industries. Where some of these policies were historically seen as an economic liability, they are shown to simultaneously promote stability and growth in the long term.

Nevada's need for economic diversification has increased due to its phenomenal rate of growth during the last 15 years. Reports have decisively shown that there is a relationship between city size, economic diversification and economic instability.[11] Smaller cities tend to have less economic diversification and therefore greater economic instability. In general, larger cities tend to diversify and become more stable. Where they do not, the impacts of economic downturns can be drawn out by the high level of dependence on the core industry.

In a study that measured the relationship between diversification and regional economic stability in most U.S. metropolitan areas between 1972 and 1988, the authors similarly concluded that "metropolitan areas that are more diverse experience lower unemployment rates and less instability than areas which are less diverse."[12] This study further argued that both diversity and competitiveness within a region are major factors influencing metro-area

---

[7] Malizia, EE. et. al. *The Influence of Economic Diversity on Unemployment & Stability*. Journal of Regional Science (1993)

[8] Norse, H. *Regional Economics*. New York: Praeger (1968)

[9] Wagner, J., and Deller, S., *Measuring the Effects of Economic Diversity on Growth and Stability*. Land Economics. (November 1998); Malizia, EE, et. al. *The Influence of Economic Diversity on Unemployment & Stability*. Journal of Regional Science (1993); Siegel; P. et. al., *Regional Economic Diversity and Diversification*. Growth and Change. (Spring 1995); Kort, John R., *Regional Economic Instability and Industrial Diversification in the U.S.*; Land Economics (November 1981).

[10] Wagner, J., and Deller, S., *Measuring the Effects of Economic Diversity on Growth and Stability*. Land Economics. (November 1998).

[11] Kort, John R., *Regional Economic Instability and Industrial Diversification in the U.S.*; Land Economics (November 1981).

[12] Malizia, EE, et. al. *The Influence of Economic Diversity on Unemployment & Stability*. Journal of Regional Science (1993).

growth. These factors were cited as operating through "multiple specializations" in diverse economies, where greater diversity led to increased stability.

The Corporation for Economic Development publishes an annual economic "report card" for all 50 states. The analysis grades states on more than 70 economic measures, grouped into *business performance*, *development vitality* and *development capacity*. Those states that ranked highest in the Corporation's 1999 analysis (receiving "As" in each category)[13] were cited as generating a diverse industry base. By comparison, Nevada received a "C" and two "Ds" for *business performance*, *development vitality* and *development capacity*, respectively.

"IN CONCLUSION, BOTH HISTORICAL EVIDENCE AND THE WEIGHT OF AUTHORITY SUPPORTS THE CONCLUSION THAT ECONOMIC DIVERSIFICATION IS A SOUND AND PRUDENT PUBLIC POLICY."

Scholarly studies, professional papers and economists' analyses are not the only sources where the need for economic diversification has been identified or its benefits recognized. A number of states and policy makers have taken a long look at economic diversification. The results of these analyses have largely been substantial capital investments in economic diversification programs. These programs are generally charged with two goals: 1) protecting long-term stability of the region's economy, and 2) promoting growth.

Conclusion

In conclusion, both historical evidence and the weight of authority supports the conclusion that economic diversification is a sound and prudent public policy. Narrow economies have been shown to be more susceptible to economic turmoil. To believe that the experiences of Texas, Seattle or Maui cannot be repeated in Nevada is to turn a blind eye to historical precedent. To believe that the conclusions of scholars and urban economics professionals do not apply to Nevada is an equally perilous position.

We do recognize that Nevada has a unique economy and fiscal structure, which must be considered in any analysis. Moreover, we recognize the majority of the authority cited in this section deals with the *economic impacts* of diversification and only alludes to or touches on the *fiscal impacts*. This is largely the result of the historical case studies being an analysis of economies in decline, where the impacts of unemployment, homelessness and out-migration were the focus. In addition, data on economic impacts is easier to obtain for multiple jurisdictions; and therefore, lends itself more readily to economic studies.

Nevada's economy is distinguished by the fact that it is not currently in decline and the latest projections suggest continued, but slower, growth. While we caution the reader to not discount the increased vulnerability inherent in Nevada's relatively narrow economy, we recognize that closer look at the State's economic and fiscal structure is warranted. The section that follows addresses economic diversification, specifically in Nevada, in light the evidence presented above.

[13] Colorado and Utah.

DOES ECONOMIC DIVERSIFICATION WORK IN NEVADA?

"THERE IS LITTLE ARGUMENT THAT THE NEVADA ECONOMY LACKS DIVERSITY."

IN SHORT: Analysis of the Nevada economy clearly establishes a need for diversification from an *economic impact* viewpoint. This is true at both the state and local level.

A review of the *fiscal impacts* of diversification suggests that local governments will derive substantial benefits from economic diversification, while the State's dependence on gaming/tourism revenues makes the long-term fiscal benefits of economic diversification less clear at the state level.

The Nevada economy was reviewed relative to its economic and fiscal structures. This was done at the state and local level. The salient finding of our research are summarized in the *Nevada's Economy and Diversification* and *The Fiscal Impacts of Economic Diversification* sections that follow.

NEVADA'S ECONOMY AND DIVERSIFICATION

There is little argument that the Nevada economy lacks diversity. At the end of 1999, the Hotel, Gaming & Recreation sector, directly employed 24 percent of the states 973,000 employees.[14] Direct "hospitality-related" employment, which includes a percentage of retail sales and trade, transportation and service employment, has been estimated at as high as 35 percent of the workforce.[15]

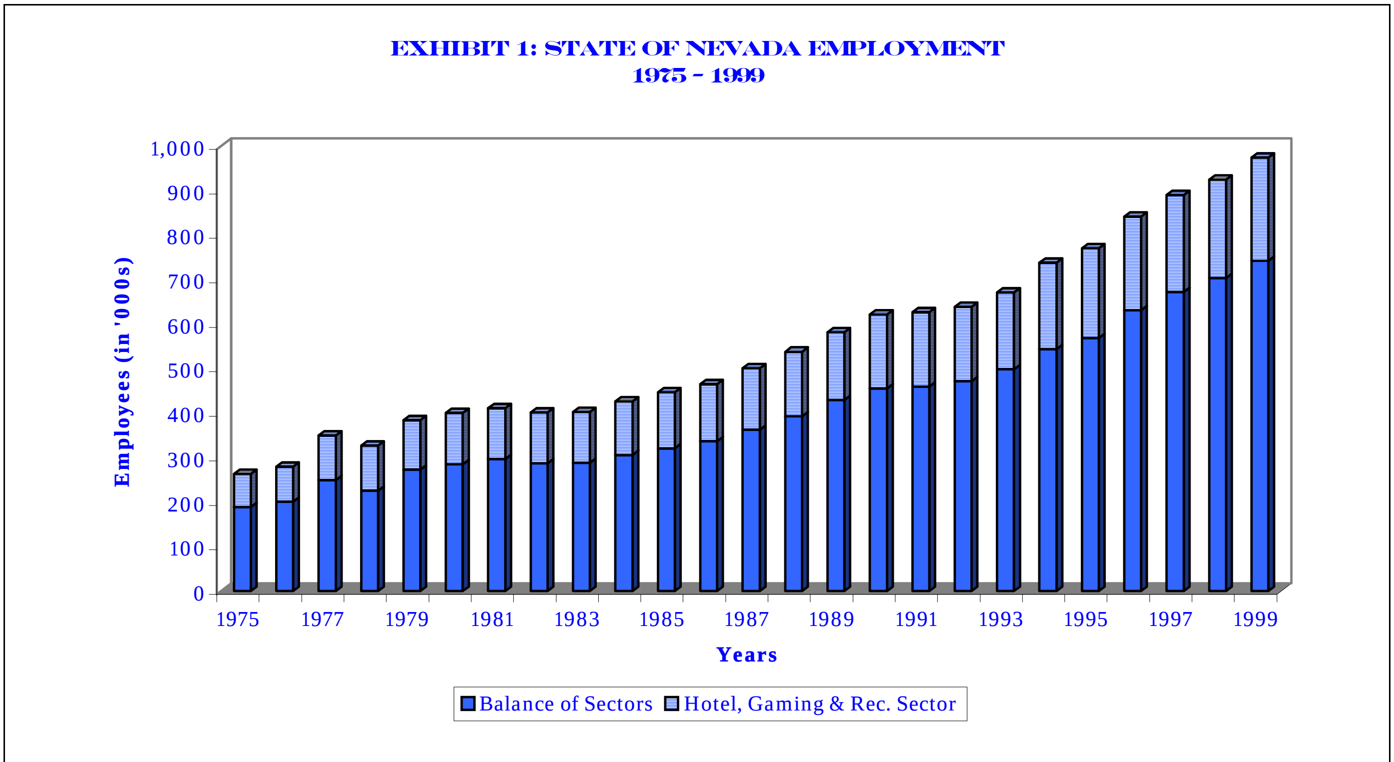
Including direct, indirect and induced employment, the Hotel, Gaming & Recreation sector has been estimated to support between 50 and 60 percent of the State's labor force. This means that an estimated one-half of all employees depend on the health of Nevada's tourism industry for their jobs. This arguably makes Nevada the narrowest economy in the U.S. for its size.

Economic diversity can also be measured via wages paid. The Hotel, Gaming & Recreation industry pays an average wage that is approximately 15 percent below the State average;[16] as such, it represents a smaller share of gross wages paid than it does of total employment, 24 percent and 20 percent respectively.

An econometric analysis analyzing the relationship between Hotel, Gaming & Recreation employment and the State's total employment, suggests that more than 90 percent of Nevada's employment growth between 1975 and 1999 can be explained by growth in the Hotel, Gaming & Recreation sector. While this may seem extreme, it offers some valuable insight into Nevada's relative dependence.

There is some evidence that the Nevada economy has taken some small steps toward diversification. Hotel, Gaming & Recreation employment represented

[14] The Nevada Department of Employment, Training & Rehabilitation, Research and Analysis Bureau, *Nevada Employment and Unemployment Reports*. See also, www.state.nv.us/detr/index.html. (1999).
[15] Nevada Commission on Tourism. *Discover the Facts*. Selected Issues. Estimated cited is based on the last issue made available, fourth quarter 1997.
[16] The average wage of the Hotel, Gaming & Recreation sector was estimated using the State of Nevada *1998 Quarterly & Total Payrolls in Covered Employment with Annual Average Wages*. The Hotel, Gaming & Recreation sector was assumed to account for 100% of the Hotels, Motel (S.I.C. 70) and Amusements/Recreation (S.I.C. 79) sectors aggregate wages. The remaining employment, an estimated 3,000 jobs, was assumed to earn the statewide average wage.



as much as 31 percent of the State's workforce in 1978. Today, it represents approximately 24 percent.[17] From a wage standpoint, the Hotel, Gaming & Recreation sector accounted for 21 percent of the states' total wages in 1992; today, they account for just over 20 percent.

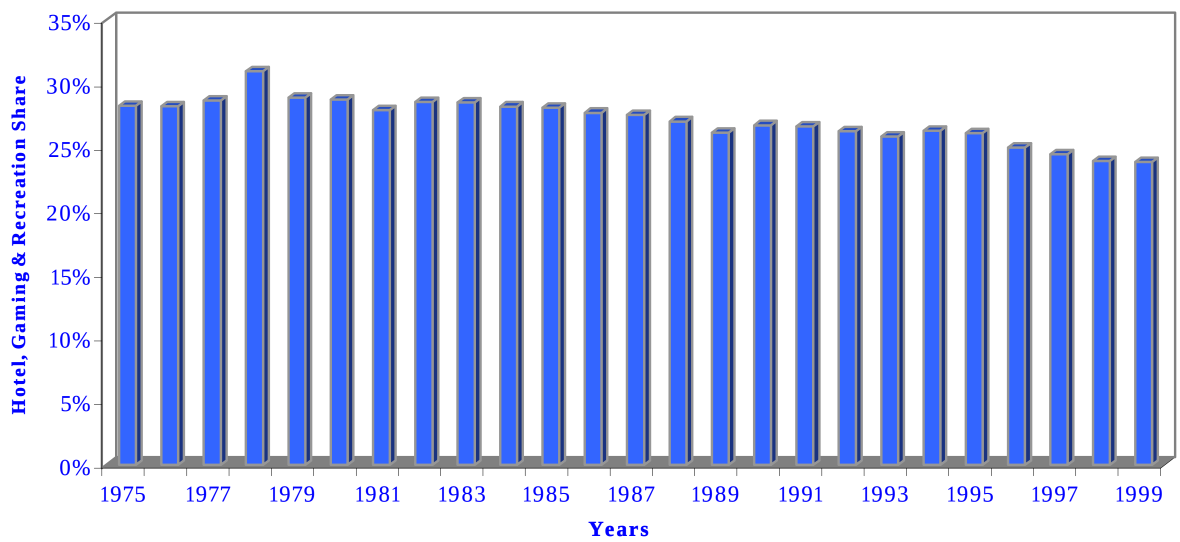
We recognize, however, that these declines not only reflect changes in the overall structure of the State's economy, but also in the structure of the gaming/tourism industry itself. The evolution of Nevada's gaming/tourism industry has resulted in more non-gaming expenditures than in years past. The result is that tourism dollars are supporting a relatively higher number of jobs in peripheral industries like retail sales and food and beverage businesses. These numbers are not fully reflected in the State's Hotel, Gaming & Recreation estimates, and must account for at least some of the reported decline in the sector's share of total employment.

A second, and perhaps stronger argument, is that non-gaming/tourism business and industry have keep pace with the State's hospitality sector. Where the Hotel, Gaming & Recreation sector has grown at a compounded annual growth rate of 4.3 percent during the last ten years, other employment sectors have seen growth at average annual rates of between 5.2 and 7.2 percent.

This must be qualified by understanding that the size of Nevada's Hotel, Gaming & Recreation sector, is considerably larger than most other sectors. For example, a ten percent increase in the State's manufacturing sector would generate approximately 4,300 new jobs; a similar increase in the Hotel, Gaming & Recreation sector would generate more than 23,000 jobs.

[17] The Nevada Department of Employment, Training & Rehabilitation, Research and Analysis Bureau, *Nevada Employment and Unemployment Reports*. See also, www.state.nv.us/detr/index.html. (1999).

EXHIBIT 2: HOTEL, GAMING & RECREATION EMPLOYMENT AS A SHARE OF TOTAL EMPLOYMENT 1975 – 1999



This point notwithstanding, the fact that non-gaming businesses have not decreased in prominence considering the remarkable gaming/tourism growth reported during the last ten years is a noteworthy consideration.

Understanding that there are indications that the State's economy is more diverse today that it was ten, 15 or 25 years ago, it is impossible to conclude that Nevada has attained any level of economic diversification that would significantly insulate it against a downturn in the gaming/tourism sector. The simple fact is that gaming/tourism industry not only drives the economy, *it provides the bus that most of us ride to work*.

The Fiscal Impacts of Economic Diversification

Answers to questions relating to the *fiscal impacts* of economic diversity are less straightforward than those that deal with its *economic impact*s. **The common premises of the argument opposing economic diversification are as follows:**

1. Tax payments made by Nevada residents and non-gaming businesses are subsidized by the gaming industry;
2. Economic diversification encourages non-gaming businesses and industries to move to Nevada;
3. New businesses and their supporting population demand additional public services;
4. Additional public services require additional revenues;
5. Because the gaming industry subsidizes tax payments by non-gaming businesses and residents, the level of services provided must decline, OR additional tax revenues must be generated (from existing or new sources).

> "THE KEY TO PROMOTING BOTH GROWTH AND DIVERSIFICATION, WITHOUT GENERATING A STRUCTURAL IMBALANCE IN THE EXISTING TAX SYSTEM, IS TO SELECTIVELY TARGET INDUSTRIES THAT COMPLEMENT NEVADA'S ECONOMY AND FISCAL STRUCTURE."

Some portions of this argument have merit. Specifically, the gaming industry does appear to offset some of the tax liability that would otherwise be generated by residents or non-gaming businesses. However, this is not true for all businesses (and the residents supported by the wages they pay), nor can it be equally applied at the local and state level.

It is also important to note that considering the additional demand for services generated by visitors, the gaming tax contributions made by residents and the potentially higher-than-average demand for services generated by gaming/tourism employees the industry's subsidization of resident and non-gaming businesses payment is much less than is often suggested. This subsidy is even smaller at the local level, where the tax base is broader.

It is also noteworthy to remember the axiom noted in the previous section – *diversification in successful modern economies is the presence of multiple specializations*. The key to promoting both growth and diversification, without generating a structural imbalance in the existing tax system, is to selectively target industries that complement Nevada's economy and fiscal structure.

While it is beyond the scope of this report to determine which businesses are and are not fiscally self-sustaining, the factors likely to obtain this balance are reflected in businesses that:

- Pay higher-than-average wages;
- Provide substantial benefits packages for employees;
- Retain the majority of their revenues in the state;
- Are property/equipment intensive;
- Generate relatively large amount of retail sales; and/or
- Are completely independent of Nevada gaming/tourism industry.

In the sections that follow, we briefly review the premises of the argument presented above.

Premise 1: Tax payments made by Nevada residents are subsidized by the gaming industry.

In Nevada, there are generally three groups that benefit from public services: 1) residents, 2) businesses and 3) visitors. These groups are also the primary sources of state and local government revenues, which are generated through taxes, fees and other charges.

"In Nevada, there are generally three groups that benefit from public services: 1) residents, 2) businesses and 3) visitors."

At the state level, a large share of revenues is generated by the gaming/tourism industry. In 1999, gaming taxes, fees and licenses contributed more than $635 million, or approximately 26 percent to the State's total own-source revenues.[18] By own source revenues, we are referring to those taxes, fees and charges that are generated by the State's collection powers.

Gaming taxes, however, are not the largest generator of revenue for the State. Retail sales and use tax generated nearly $646 million, or 27 percent of the State's own source tax revenues.[19] Where gaming taxes grew at a compounded annual rate of six percent between 1989 and 1999, sales tax grew at a rate of more than nine percent.

Much of this change in the revenue stream can be explained by the changes in visitor spending patterns mentioned above. A relatively smaller share of visitor dollars is being expended in gaming activities, and a larger share is being spent in retail, eating and drinking outlets.[20] The result is substantial sales tax revenues being derived from travelers. Visitor contributions to the tax base have been estimated at between 25 and 30 percent of total collections.

The remaining 47 percent of State revenues are generated through a number of other taxes, fees, permits and charges. They include, mining tax, insurance premium tax, excise taxes, the business tax, business license fees and several others. The gaming/tourism industry's contributions to gaming taxes, retail sales taxes and the various other levies, fees and changes has generated estimates that its total contribution to the State's own-source revenues is as high as 50 to 60 percent.

Based on these facts, the argument is then presented that the gaming/tourism industry accounts for only 24 percent of employment, yet pays more than 50 percent of the taxes, fees and charges that fund the State's expenditures. Therefore, they must be subsidizing revenues that would otherwise have been generated from residents and non-gaming business.

While we cannot argue that gaming dollars have supported much of Nevada's growth since the 1930s, or that some level of subsidization takes place, this argument significantly overstates the industry's role in Nevada's fiscal system. In doing this, it suggests that nearly all additional businesses will be a liability for Nevada. *This is not necessarily the case*.

---

[18] *State of Nevada Comprehensive Annual Financial Report, For the Fiscal Year Ended June 30, 1999*. Kathy Augustine, State Controller.
[19] Id.
[20] See the Las Vegas Convention and Visitor's Authority, *Las Vegas Visitor Profile* 1989 through 1999.

"WHILE RESIDENT SPENDING REPRESENTS LESS THAN ONE-FIFTH OF NEVADA'S MORE THAN $8.1 BILLION DOLLARS IN GROSS GAMING REVENUE, IT GENERATES IN EXCESS OF $100 MILLION IN STATE TAX COLLECTIONS ANNUALLY."

**TABLE 1:
PERSON DAYS STAYED IN NEVADA – RESIDENTS & VISITORS, 1998**

	Residents	Visitors
Number of Persons	1,874,760	44,694,744
Avg. Number of Days Stayed	365	3.6
Total Person Days in Nevada	684,287,400	160,901,078
Share of Total Person Days	**81%**	**19%**

The first issue that is not addressed is that of the visitor's demand for services. Even though the average visitor stays in Nevada less than four days, they still utilize services like roads, police and fire protection and water and sewer.[21] In effect, the more than 45 million visitors that Nevada welcomes annually operate, at least in part, like residents.

Assuming that the 1.9 million Nevada residents never vacationed during the year and the 45 million visitors stay an average of 3.6 days per trip, tourists account for 19 percent of the adjusted gross population of the State each year. We recognize that visitors do not demand the full gamut of public services; however, to assume that they represent zero draw on public services would be discounting reality.

A second consideration omitted in the discussion of gaming's subsidization of residents' and businesses' payments for public services is the portion of gaming taxes paid by residents. It is estimated that Nevada residents spend as much as $2 billion annually in gaming activities each year. While resident spending represents less than one-fifth of Nevada's more than $8.1 billion dollars in gross gaming revenue, it generates in excess of $100 million in State tax collections annually.

As an aside, the remaining dollars spent by residents are gross revenue to Nevada's gaming licensees. At least some consideration should be given to the number of neighborhood or resident-oriented gaming operations that are supported, at least in part, by these dollars. We are not attempting to forward the argument that economic diversification should be supported because more residents will generate more gaming revenues (and taxes). Rather, we suggest that economic diversification contributes to the inter-relationship of Nevada's existing economic structure.

A third consideration is the higher potential for social service cost stemming from gaming industry employees. As noted previously, the gaming industry pays wages approximately 15 percent below the State average. Lower-income families tend to demand a greater level of public services, and there is some evidence that the gap between the amount of services demanded by gaming/tourism employees and non-gaming business employees widens over time.[22]

This point is particularly noteworthy, when one considers the types of business that have been attracted to Nevada through its economic diversification programs. These businesses pay an average annual wage of $30,500, slightly above the State average.[23] In addition, these businesses often provide benefit packages (e.g., family insurance programs) that are superior to those offered by the average employer. In contrast to lower-income families, those with higher-incomes tend to require fewer public services.

---

[21] We recognize that some of these services are those provided by local governments as well as the State. This issue will be discussed in the text that follows.

[22] Commission on Economic Development, Research Division, *Does Economic Development Pay for Itself in Nevada*.

[23] Nevada Development Authority; the Nevada Commission on Economic Development; Econonic Development Authority of Western Nevada. See also, the The Nevada Department of Employment, Training & Rehabilitation, Research and Analysis Bureau, *Nevada Employment and Unemployment Reports*. See also, www.state.nv.us/detr/index.html. (1999). Average annual wages was used because the information was readily available and comparable for analysis purposes.

> "BECAUSE LOCAL REVENUE BASES ARE BROADER THAN AT THE STATE LEVEL, THEY TEND TO RELY LESS ON GAMING/TOURISM CONTRIBUTIONS."

Fourth, and perhaps most importantly, the premise that gaming subsidizes the payments of residents and non-gaming business generally takes a myopic view, considering only the State's fiscal system. It fails to address that a significant amount of revenues collected and public services provided occur at the local level.

Although the implied amount of the subsidy can be disputed, the evidence does support that some tax liability may be offset by the contribution of the gaming/tourism industry at the State level. Similar evidence does not exist at the county and local level.

In Clark and Washoe Counties alone, own-source revenues were more than $900 million dollars in 1999.[24] Adding in the taxes, levies, charges and fees of the Cities of Henderson, Las Vegas and Reno, that amount well surpasses $1 billion.[25] While it is beyond the scope of this report to assess the combined own-source revenues received by all of Nevada's local governments, it is important to note that they receive a substantial amount of revenue each year.

This point is particularly important when applied to the question of economic diversification. Because local revenue bases are broader than at the state level, they tend to rely less on gaming/tourism contributions. Where the State receives the lion's share of its revenues from gaming and retail sales taxes, local governments are more heavily supported by property and sales taxes.

Some local governments do impose taxes or fees on the gaming/tourism industry. Most notable is the lodging tax. These fees and taxes notwithstanding, gaming/tourism contribute a relatively smaller share to local governments aggregate tax collections.

While gaming/tourism companies are some of the State's largest property tax payers,[26] they do not account for the majority of property tax collections. In fact, an analysis of 1998 Clark County Assessor's database files indicates that tourist commercial uses accounted for only 15 percent of total assessed value.[27] [28]

The majority of property tax assessments are attributable to residential dwellings, which accounted for 63 percent of the County's total assessed value. This being the case, one must also consider the relationship between income and expenditure on housing. The fact that the Hotel, Gaming & Recreation sector pays lower-than-average wages suggests its employees expend less on housing; and therefore, contribute fewer dollars to local government property tax collections.

It should also be noted that non-gaming businesses pay considerably more taxes and fees to local governments. In an analysis of several non-gaming businesses that relocated to Nevada, it was shown that annual tax collections

---

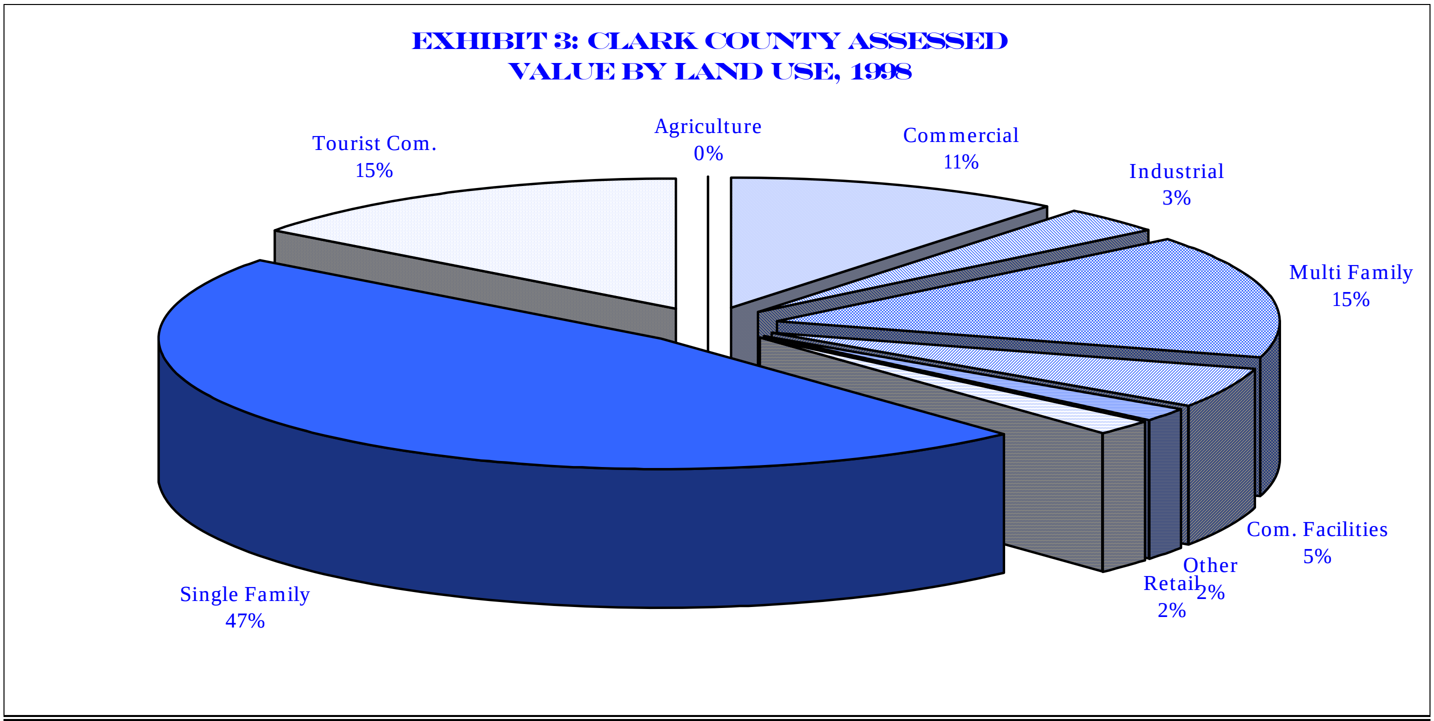
[24] *Clark County Comprehensive Annual Financial Report.* Year ended June 30, 1999; *Washoe County, Nevada Comprehensive Annual Financial Report.* Year ended June 30, 1999;

[25] *City of Henderson, Nevada Comprehensive Annual Financial Report.* Year ended June 30, 1999; *City of Reno, Nevada Comprehensive Annual Financial Report.* Year ended June 30, 1999.

[26] *Clark County Comprehensive Annual Financial Report.* Year ended June 30, 1999.

[27] Clark County Assessor's Roll Database, 1998. Land uses segmented by source and use codes. Tourist commercial uses were code 310* through 325*;

[28] Note that Clark County was used in this example because the data was readily available.



totaled more than $8 million and $14 million at the state and local level, respectively. In a five-year analysis, the margin increased. These businesses are projected to generate an estimated $69 million in local tax revenues, with $20 million projected to go to the State.

This analysis is not intended to suggest that the gaming/tourism industry does not contribute significantly to county and local revenues. In fact, it does. While property taxes are one of the largest sources of revenue for Nevada's county and local governments, there are several other taxes, fees and charges that are paid by residents, visitors and businesses (including gaming/tourism).

The question here is one of subsidy. Visitor demands on services, resident contributions to gross gaming taxes and potentially higher demands on social services made by lower-paid gaming/tourism employees all suggest that the subsidy is much smaller than a simple "employment-to-industry contribution analysis" would imply.

The relative narrowness of the State's fiscal system is not duplicated within local revenue systems. City and county governments tend to distribute their respective tax burdens more broadly through the use of additional sources of revenue, in particular, through property taxes. In addition, non-gaming businesses contribute significantly more to the revenue bases of local governments than at the State level. As such, there appears to be no evidence of a subsidy at the local level.

Premise 2: Economic diversification encourages non-gaming business and industries to move to Nevada.

This is true; and in-fact, it is the primary goal behind a policy of economic diversification. However, it should be noted that the firms that Nevada has targeted are those that pay higher-than-average wages, offer substantial benefits programs and operate entirely independent of the gaming industry.

"IF THE GAMING TAX-GENERATING BUSINESSES WERE SIGNIFICANTLY SUBSIDIZING THESE NON-GAMING TAX-GENERATING BUSINESSES, ONE WOULD EXPECT THAT THE SUBSIDY WOULD BE REFLECTED IN LOWER STATE REVENUES PER CAPITA."

Premises 3 & 4: New businesses and their supported population demand additional public services, which require additional revenues.

These points are also true; new residents create the demand for additional public services, and those services cost money to provide.

However, two points must be considered. First, businesses that expand into Nevada do not generally bring the majority of their employees with them. It is estimated that approximately 90 percent of the employment at businesses targeted by Nevada's economic diversification programs are hired locally.

Second, as noted in Premise #2, these businesses also pay higher-than-average wages and offer substantial benefits programs. As such, their employees would be expected to require relatively fewer public services.

Premise 5: Because the gaming industry subsidizes non-gaming business and resident tax payments, the level of services provided to residents must decline, OR additional tax revenues must be generated (from existing or new sources).

It was suggested in the previous section of this report that there is some evidence that the Nevada economy has diversified. This was supported by declines in the Hotel, Gaming & Recreation sector's share of total employment and accompanying declines in the sector's share of total wages paid.

We noted that this shift in the State's economy could have been related to growth in non-gaming/tourism businesses, changes in spending patterns by visitors or some combination of the two. In either case, this "shift" operates as economic diversification from a *fiscal* standpoint. That is to say that there are fewer "gaming tax" generating businesses relative to those that do not generate gaming taxes.

TABLE 2: STATEWIDE POPULATION, REVENUE & EXPENDITURE COMPOUNDED ANNUAL GROWTH RATES: 1989 - 1998

	1989	1998	Inflation Adjusted 1998	Unadjusted CAGR	Inflation Adjusted CAGR
Population	1,162,340	1,874,760	1,874,760	5.46%	5.46%
State Revenues	$1,542,271,000	$3,465,695,000	$2,540,956,303	9.41%	5.70%
State Expenditures	$1,445,526,000	$3,415,230,000	$2,503,956,694	10.02%	6.29%
State General Fund Expenditures	$813,089,000	$2,097,300,000	$1,537,685,126	11.10%	7.34%
State Revenue Per Capita	$1,327	$1,849	$1,355	3.75%	0.24%
State Expenditures Per Capita	$1,244	$1,822	$1,336	4.33%	0.80%
State General Fund Expenditures Per Capita	$700	$1,119	$820	5.36%	1.78%

Sources: State of Nevada Comprehensive Annual Financial Report, Consumer Price Index, http://www.dismal.com., CPI Calculator.

> "THE FACT THAT TOTAL STATE REVENUES PER CAPITA HAVE REMAINED RELATIVELY CONSTANT WHILE GAMING TAX REVENUES PER CAPITA HAVE DECLINED, FURTHER SUGGESTS THAT NON-GAMING TAX GENERATING BUSINESSES ARE NOT NECESSARILY FISCAL LIABILITIES."

If the gaming tax-generating businesses were significantly subsidizing these non-gaming tax-generating businesses, one would expect that the subsidy would be reflected in lower state revenues per capita. However, between 1989 and 1998, inflation adjusted per capita State revenues remained relatively unchanged, at $1,327 and $1,355 per capita, respectively.

The point is furthered when one looks at gaming tax revenues per capita. Between 1989 and 1998, inflation adjusted gaming tax revenues have declined from $286 per person to $238 per person. The same trend is true if one adjusts the total population to reflect the impact of visitation. In 1989, roughly $630 was generated in gaming taxes for every 1,000 person days stayed in Nevada. By 1998, that amount had dropped to $530 collected for every 1,000 persons days stayed. The fact that total State revenues per capita have remained relatively constant while gaming tax revenues per capita have declined, further suggests that non-gaming tax generating businesses are not necessarily fiscal liabilities.

This analysis does not explain the full relationship between economic diversification and fiscal balance. However, it does suggest that changes in the economy are not necessarily creating the structural deficit that the premise would imply.

TABLE 3: STATE OF NEVADA GAMING TAX COLLECTIONS PER CAPITA, PER VISITOR & PER PERSON DAY IN NEVADA, 1989 -1998

Year	Population	Visitors (1)	Person Days In Nevada (2)	Gaming Taxes (in 000's)	Gaming Taxes Per Capita	Inflation Adjusted Gaming Taxes Per Capita	Gaming Taxes Per Visitor	Inflation Adjusted Gaming Taxes Per Visitor	Gaming Taxes Per Person Day	Inflation Adjusted Gaming Taxes Per Person Day
1989	1,162,340	29,400,000	530,094,100	$332,074,000	$286	$286	$11.30	$11.30	$0.63	$0.63
1990	1,236,900	30,500,000	561,268,500	$377,194,000	$305	$289	$12.37	$11.73	$0.67	$0.64
1991	1,297,910	31,000,000	585,337,150	$416,546,000	$321	$292	$13.44	$12.23	$0.71	$0.65
1992	1,343,940	31,800,000	605,018,100	$426,621,000	$317	$281	$13.42	$11.86	$0.71	$0.62
1993	1,398,760	34,100,000	633,307,400	$453,084,000	$324	$278	$13.29	$11.40	$0.72	$0.61
1994	1,493,000	39,400,000	686,785,000	$490,166,000	$328	$275	$12.44	$10.40	$0.71	$0.60
1995	1,582,280	40,500,000	723,332,200	$517,524,000	$327	$266	$12.78	$10.39	$0.72	$0.58
1996	1,638,015	41,500,000	747,275,475	$566,834,000	$346	$273	$13.66	$10.79	$0.76	$0.60
1997	1,740,897	42,200,000	787,347,405	$566,079,000	$325	$251	$13.41	$10.36	$0.72	$0.56
1998	1,874,760	44,700,000	845,207,400	$586,186,000	$313	$238	$13.11	$9.97	$0.69	$0.53

Sources: *State of Nevada Comprehensive Annual Financial Report*, For the Year Ended June 30, 1999; Nevada Commission on Tourism; Consumer Price Index; www.dismal.com; Las Vegas Convention & Visitors Authority.

Notes:

(1) Statewide visitor volume was adjusted in 1989 through 1992. This is because visitor volume statistics were not available for all counties during that period. The Consultant Team estimated visitor volume in non-reported areas based on their respective share of total visitor volume in the years they had reported statistics.

(2) Person days in Nevada are calculated based on the assumption that residents are in the State 365 days per year and that visitors stay an average of 3.6 days per trip.

CONCLUSION

"TO APPLY THE THEORY NOTED ABOVE, WE MUST NOT ABANDON NEVADA'S SPECIALIZATION IN GAMING AND TOURISM, BUT WE MUST LOOK TO SPECIALIZE IN OTHER INDUSTRIES AS WELL."

The scope of the analysis set out to review one fundamental question – *is economic diversification good for Nevada*? To answer this question, the State's economy and the economic and fiscal impacts of diversification were analyzed and reviewed.

From an economic standpoint, there is no doubt that diversification is a sound and prudent public policy. A review of the historical fluctuations in economies that were dependent on single industries clearly shows that they were more susceptible to economic turmoil. Specifically, these economies appear to suffer longer and more severe economic downturns when their primary industries experienced trouble.

Analysts, urban economics professors and others have used a series of econometric models to empirically show that there is a relationship between economic diversity, stability and growth. In addition, they have shown that successful modern economies do not abandon the specialization that led to growth; but rather, they view diversity and the presence of multiple specializations.

There is no doubt that Nevada's economy lacks diversity. While there are some signs that it is more diverse today than it was ten, 15 or 25 years ago, 24 percent of the State's workforce is directly employed in the Hotel, Gaming & Recreation sector, and that sector pays the lion's share of wages. Moreover, significantly more jobs are indirectly dependent upon this single industry. As such, from an economic viewpoint, Nevada appears vulnerable. To suggest that it is not is to dispute the overwhelming weight of historical evidence and modern research.

Nevada, however, is unique. It is not an economy in decline. Rather, it has led the nation in population and employment growth for the last several years, and it is projected to continue to benefit from continued, but slower, growth in the near future. At the state level, Nevada has a unique tax structure, which relies heavily on gaming taxes and the contributions of visitors. The combination of the State's unique economic and fiscal structure makes the question of economic diversification a complex one. Specifically, it requires that a diversification policy look to complement the existing structure, without dampening growth or overburdening the existing fiscal system. To apply the theory noted above, we must not abandon Nevada's specialization in gaming and tourism, but we must look to specialize in other industries as well.

Economic diversification will not necessarily lead to an overburdening of the tax system. The State does rely heavily on gaming taxes, which tends to limit its diversification options. However, local governments do not have the same reliance on gaming taxes, and thus, derive greater benefits from a wider range of economic diversity. While these fiscal concerns are valid and should be monitored, there is no indication that economic diversification has led to lower state revenues per capita during the last ten years.

In closing, the study and its related reviews and analyses leads to the conclusion that economic diversification is not only good for Nevada, but it is necessary for Nevada. Placing all of our "economic eggs" into a single basket is clearly a dangerous proposition. Gaming and tourism have been very good for Nevada, but it would be a utopian fantasy to believe that the phenomenal growth it experienced during the last 12 years will be repeated in the next 12 years.

Selective economic diversification is a sound public policy that should not be treated lightly because the economy is prosperous. There is every reason to be optimistic that Nevada's economy will continue to grow. However, prudence and realism demand that we take notice of the communities that have risen and fallen during the twentieth century, learning from both their successes and failures. If we do not, we are betting that our economy is so unique that the rules of economics do not apply to Nevada. In this proposition, the odds are against us.