Economic Impact of $900 million State of Nevada spending

Why is it so hard to turn rising unemployment around? It’s because when payrolls shrink, households spend less and pay less taxes, making payrolls shrink further. The cycle of decline multiplies downward.

How do we turn this downward cycle around? We turn things around by spending more, so that others earn more, spend more, and we all return to a cycle of growth.

But who has the guts to keep spending? It’s unreasonable to expect individual households to spend when they would rather save for an uncertain future. By the same token, what business should expand its workforce when it expects fewer customers? Neither households nor businesses can guarantee both the income and expenditure sides of their spending decisions. *Only one sector can guarantee that what it spends will end up as earned income in the pockets of Nevadans: our state government.*

When our private sector economy shrank, so did the level of taxes we paid. Nevadans and visitors are paying at least $900 million less taxes than expected. If we cut spending now unemployment will rise even further. Economists at the Center for Economic Development (UCED) calculated the effect on our state’s economy if the state also cuts spending by $900 million, given that the cut would lay off teachers and agency staffs, and so on, who then spend less, leading to further waves of reductions in economic activity. The ‘circular flow’ of spending, income, spending, income is formalized mathematically by what is called an “input-output” model. Here is what the mathematical model shows:

- *A cut of $900 million in state spending multiplies to a $1.04 billion reduction in state value added (or state “GDP”) and 14,800 more unemployed persons*, raising Nevada’s unemployment rate\(^1\) to 14%.

- People laid off due to a $900 million cut in State of Nevada spending include construction workers, waitresses, truck drivers, ..., all kinds of workers in addition to the public employees that would have to be laid off.

The figure to the right shows the private sector distribution of unemployment associated with the cut in State of Nevada spending.

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\(^1\)*relative to December 2009 Nevada employment and the estimated January 2010 unemployment rate; data source [http://www.bls.gov/news.release/laus.nr0.htm](http://www.bls.gov/news.release/laus.nr0.htm)*
To avoid the further deterioration of our state’s economy due to this reduction in state spending, Nevadans could pay the level of taxes that was originally expected. Taking into account the negative effects of taxes, the net effect of not reducing state spending is $564 million more state value-added and about 8,100 more persons employed; lowering Nevada’s unemployment rate to 12.3%.

The net effect of $564 million additional state GDP consists of an estimated $1.04 billion value-added gained from $900 million state spending minus an estimated $478 million private sector value-added lost because household spending is lower by the $900 million collected as taxes.

Why are there more jobs and more income if the expected level of taxes are collected and the state does not cut spending? Because government spending is the only spending that goes directly to Nevada employees no matter what. As discussed above, households are afraid to spend. And businesses can’t justifying hiring more people, until some sector – the government -- starts spending.

Second, the net effect is positive because none of the first round of State of Nevada spending goes to profits, dividends, royalties or rents to out-of-state owners, landlords, foreigners, or out-of-state stockholders. In contrast, a large part of the first round of Nevada household spending goes out-of-state to the factory and company that made or shipped the goods that households purchase with their after-tax income. A smaller portion of a retail dollar goes to salaries for employees in Nevada. Sales taxes and other small percentages go to the government. The rest goes to rents, profits, and dividends, sometimes to absentee landlords and out-of-state owners.

Because the larger portion of a dollar of State of Nevada spending goes directly into Nevada household income, which is then also spent on other goods and services in Nevada, State of Nevada government spending has a larger “multiplier” than Nevada household spending. That is why right now the upside effect of State of Nevada spending is higher than the downside effect of taxes. In sum, although allowing State of Nevada spending to fall will worsen this recession, the good news is that raising tax rates to keep total taxes at the budgeted level can turn our state economy around.