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NEVADA'S PENDING 2014-2021 FISCAL DILEMMA: A CAUTIONARY TALE OF FEDERAL REVENUE REDUCTIONS

April 2013

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Overview

A diverse range of plans have been offered at the federal level to address federal deficit reduction as a response to what is considered an "unsustainable" national deficit.

Overall, almost 45 separate plans or proposals have been put forth suggesting solutions that vary across the political spectrum.[1] Although these diverse plans may differ in emphasis and design, it is critical for Nevada policymakers to be aware of a fundamental common idea: Significant reductions in nondefense federal spending to the state will occur due to both federal deficit reduction plans in general and specifically due to the Budget Control Act of 2011 ("BCA"). For example, between FFY 2012 and FFY 2013 post Sequester, there is the specter of federal cuts to important programs in Nevada as:

- Title 1 (Comp Ed-Low Income Families) Local Education Agencies: -$5,668,000
- Food Stamp Program: -$4,427,000
- Special Education Basic State Grant: -$3,764,000
- WIC (Women, Infants, Children) Supplemental Feeding Program): -$2,568,000
- Unemployment Insurance State Administration Base Allocation: -$1,964,000
- Head Start: -$1,600,000

While this white paper is Nevada-specific, a similar dilemma faces all states to varying degrees depending on the level of federal revenues to each state.

The terminology of federal deficit reduction may be wrapped in terms, such as redefining federal-state partnerships or exploring new efficiencies at the state level, but the practical reality is quite simple for

Overview

Nevada policymakers, funding from federal sources will decline from levels now taken for granted as part of the federal deficit reduction process.

The purpose of this white paper is to suggest the type of cuts that Nevada policymakers will likely need to address in the next budget cycle of FY 2015-FY 2017 (with projections through FY 2021) not as a temporary measure but rather as a permanent structural change in Nevada's relationship to federal budgets. This will require thoughtful planning now with respect to Nevada's revenue and expenditures.

There is simply no way to predict with certainty the exact nature of future reductions in federal funds to Nevada as to their depth and allocation across programs. However, it is important to note that the current level of funding reductions associated with what is popularly termed "Sequestration" are quite similar to those suggested in many of the most popular proposed federal deficit reduction plans.[2] Therefore, this research paper focuses on the BCA signed by President Obama on August 2, 2011) and the associated sequestration plan as the best possible template for Nevada policymakers to prepare for. In this respect, the discussion of sequestration is to be viewed as a "most likely" guide for future reductions rather than as a specific plan.

As noted above, the cuts discussed in this white paper focus on non-defense programs, which directly affect programs utilized by Nevada citizens and which are part of the Nevada state budget process.[3] However, an overview of (likely) proposed defense cuts for Nevada is shown in Appendix 2 to this report.

The potential reduction of federal transfers to the states, including Nevada, driven by federal deficit reduction plans will require a response by the Governor and the Legislature in the biennium starting FY 2015. The research below provides an overview of current year changes for illustrative purposes and a forecast of projected cuts from federal fiscal years ("FFY") FFY 2014 through FFY 2021.

Overview

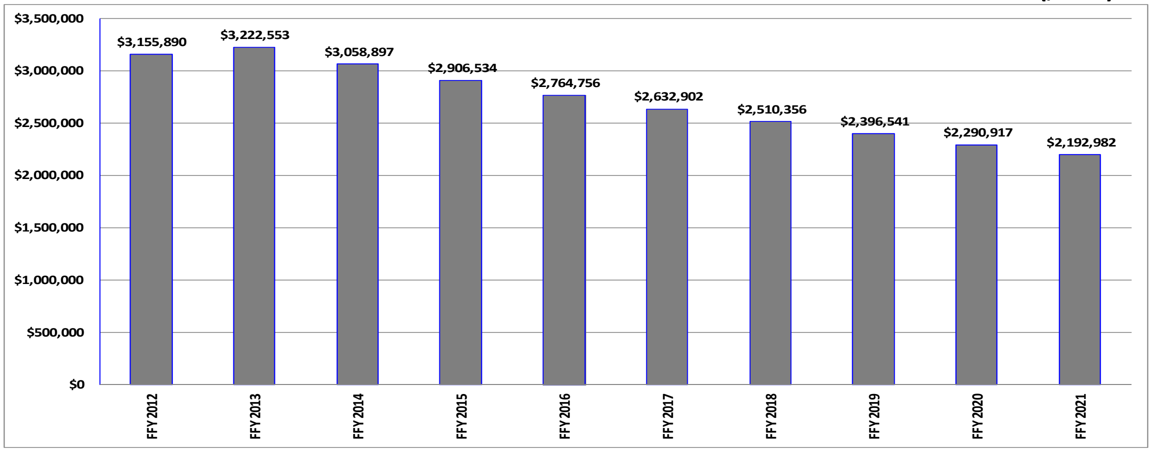
Federal revenue reductions will most certainly impact the delivery of a variety of primary government functions, including education, infrastructure, public health and public safety as noted above. **In simple terms, the analysis herein suggests a forecasted average annual reduction in non-defense transfers (federal base-budget lost) to Nevada of almost $124 million between FFY 2014 through FFY 2021 for total reduction of $865.9M (-28.3 percent).** However, if FFY 2012 (Note: the last enacted budget, October 1, 2012 to September 30, 2013) is used as the base fiscal year, the cumulative federal base-budget lost in non-defense federal spending (discretionary and mandatory) in Nevada through FFY 2021 will be -30.5 percent (-$962.9, or $107M per year).

The difference between the two scenarios is due to the 5.1 percent drop in federal transfers to the state between FFY 2013 and FFY 2014 compared to the FFY 2014-FFY 2021 annual average reduction of 4.6 percent (See Table A-1, Appendix 1). Whichever scenario is used, FFY 2014-FFY 2021 or FFY 2012-FFY 2021, federal spending reductions will require Nevada policymakers to accept revenue reductions "as is" or decide how to allocate reductions across programs in the state.

The annual base-budget losses from FFY 2012 through FFY 2021 are also illustrated in Chart 1 below.

Overview

CHART 1: TOTAL FEDERAL NON-DEFENSE FUNDING IN NEVADA: FFY 2012 to FFY 2021 (, 000)



These overall declines in funding over the forecast period are significant. In this report, our forecasts utilize the lower bound estimate of possible cuts in order to present a more conservative approach to this serious issue facing Nevada, its policymakers and its citizens. Thus, our discussion is not alarmist but meant to be a highly likely future scenario.

This report utilizes the accepted terminology of "discretionary" versus "mandatory" programs. In general, the bulk of the sequestration savings or future alternative cuts are likely to come from discretionary programs, which are related to federal pass-through funded by annual appropriations bills. These programs are contrasted to mandatory programs (also known as direct spending or entitlement spending) where the program's annual cost is generally determined by eligibility criteria established by law. For a simple discussion, see *"Frequently Asked Questions About Sequestration Under the Budget Control Act of 2011"*, September 2012, House Budget Committee, US Congress, Democratic Caucus.[4]

For the current year, specifically for a comparison of FFY 2012 and FFY 2013, it needs to be recognized that the revenue reductions are actually worse than they initially appear to be in Figure 1.

Overview

FIGURE 1: NEVADA'S NON-DEFENSE FEDERAL SPENDING CUTS

Type of Nondefense Spending Reduction due to BCA	FFY 2012 vs. FFY 2013	FFY 2012 vs. FFY 2021	FFY 2014 vs. FFY 2021
Discretionary	-3.0% -$31.6M	-14.3% -$153.0	-9.9% -$100.8
Mandatory	4.9% $95.2M	-38.6% -$750.0	-37.4 -$711.8
Discretionary/Mandatory	2.1% $3.1M	-41.1% -$59.9	-38.2% -$53.1
Total	**2.1%** **$66.7M**	**-30.5%** **-$962.9**	**-28.3%** **-$865.9**

Source: 2013 FFIS Federal Funds Information for States and the Consultant Team. Note: Numbers may not add due to rounding.

In simple terms, the increase in federal transfers is partially illusory between FFY 2012 and FFY 2013 due to the increase in funding for mandated (entitlement) programs. However, hidden in these figures is an actual one-year $31.6M loss in discretionary funding that will increase over time reaching $100.8M in discretionary spending reductions between FFY 2014 and FFY 2021. Additionally, it is estimated that mandatory transfers will be reduced by almost $712M during this period, along with $53.1M in discretionary/mandatory programs mostly comprised of Pell Grant. Nevada policymakers have to be careful not to be overly optimistic that "this year" is somehow okay, because the long-term trend is much more negative as shown in the forecasts shown in Table A-1.

Once full deficit reduction cuts occur, event with a possible best-case 2012-2013 "on-hold" assumption, the result is the $865.9M reduction in federal non-defense program spending between FFY 2014 and FFY 2021 noted above.

This white paper focuses on the potential reductions in discretionary and mandatory non-defense spending in Nevada resulting from potential federal revenue reductions and associated "sequestration". The data are also segmented by programs that are exempt and non-exempt by the current BCA/sequestration. Again, it bears repeating that the use of

Overview

BCA/sequestration numbers is a most likely template for future reductions. The Consultant Team also addressed how the state of Nevada might respond to these reductions. Since proposed cuts to Social Security and Medicare are relatively limited, federal transfers to the states are likely to bear the brunt of the cuts. How the state ultimately responds to these cuts will have significant and long-term implications for Nevada's economy and residents.

Background: Budget Control Act of 2011 and Sequestration: A Revenue Reduction Example

In addition to agreeing on raising the debt ceiling via the BCA, certain procedures were established to reduce future federal payments, including transfers to states and localities. The BCA designated caps on the amount of revenues that could be expended during annual appropriations process for the 10-year period ending in FFY 2021. The Congressional Budget Office ("CBO") estimates that this would lower federal expenditures by $917B during the period.

These caps were extensive and apply to the total amount of discretionary expenditures. For the first two fiscal years of the period, the caps affect two groups of payments: non-security (non-defense) and security (defense). By and large, decreases were to be applied evenly between the two types of expenditures. The compulsory cutbacks in the two groups were then applied to discretionary and mandatory expenditures proportionately. It is reasonable to assume that such a procedure or template will be utilized in any future federal deficit reduction plan.

In the case of the remaining years, a threshold on all discretionary expenditures was fashioned. Conclusions regarding the way these caps will impinge on particular agencies, departments or programs nationally and in federal grants to the states will be the responsibility of Congress and the President during the normal appropriations course of action. The BCA caps can't be put aside by a sole Congressional chamber. If the caps are surpassed, the BCA requires "sequestration", which is a programmed, mainly wholesale termination of budgetary assets.

The BCA agreement also established a Joint Select Committee on Deficit Reduction ("the Supercomittee") tasked to create legislation to lower the federal deficit by a minimum of an extra $1.5 trillion during the 10-year period. The Supercommittee was comprised of the same number of Democrats and Republicans from the Senate and the House of Representatives; It had broad power to write a plan to lower the federal deficit.

Additionally, if Congress and the President did not pass a joint committee bill lowering the deficit by a minimum of $1.2 trillion during the 10-year period ending in FFY 2021, there were unwelcome effects. Not ratifying such a bill by January 15, 2012 would initiate programmed spending cutbacks. These cutbacks involved the sequestration noted above. The result: if a Supercommittee bill were not ratified by January 15, 2012, on January 2, 2013 the spending power of numerous federal departments and agencies would be lowered. And this is exactly what happened and where we are today – A potential fiscal cliff in Nevada starting in the state's 2015 fiscal year. Annual (FFY 2013-FFY 2021) direct expenditure decreases were to be attained via sequestration. Decreases were to be realized the first year (FFY 2013) in the case discretionary expenditures. From FFY 2014 through FFY 2021, the decreases in discretionary expenditures were to be attained by lowering legislative thresholds on discretionary payments for security and non-security activities, not by automatic universal cuts to each group.

Starting in FFY 2014, Congress and the President will decide how spending cuts are achieved through the yearly appropriations process in the case of discretionary spending. It is important to note that a number of programs, like Social Security and Medicaid, were spared from sequestration. And in the case of Medicare, federal payment decreases were limited to two percent.

Background: Budget Control Act of 2011 and Sequestration: A Revenue Reduction Example

This automatic expenditure cuts process was supposed to help policy makers agree on deficit reduction to include defense and non-defense expenditures to persuade lawmakers to compromise on lowering the deficit, based on establishing specific priorities. It was hoped that the Congress would prefer this to universal cuts. Again, this did not happen. Thus, Nevada is faced with the template of sequestration.

Cost Shifting to Nevada: Why It Matters and a Summary of the Forecasted Revenue Reductions

Deficit reduction plans under all of the most likely scenarios tend to mirror current sequestration plans. These potential cuts lead to a variety of revenue reductions for Nevada. Using this template, details of the Nevada forecasts are shown in Appendix 1 and specifically Table A-1

It is important to note that Nevada faces these future revenue reductions while still dealing with the effects of the "Great Recession" which wreaked havoc on the state's economy and its residents. The state economy continues to struggle in its recovery, especially as it relates to the job market, and there are is absolutely no evidence that Nevada will enjoy a "V-style" recovery. Thus, Nevada will face potential revenue reductions at a critical time of slow economic growth.

- **Health and Human Services ("HHS") Funding Cuts**. Fortunately, HHS spending in Nevada will be partially spared from sequestration between FFY 2012 and FFY 2013. According to Federal Funds Information for the States ("FFIS"), this spending is scheduled to rise by 6.1 or by $84.7M, in FFY 2013 ($1.467B) compared the FFY 2012 ($1.382B). However, starting in 2014 this trend will reverse and cuts will begin to be significant.

- **Other non-defense spending in Nevada**. BCA/sequestration (excluding HHS) will reduce discretionary (i.e., non-entitlement) non-defense funding in Nevada by 1.1 percent in FFY 2013 to $1.756B from $1.774B in FFY 2012, and in our forecasts by an average annual rate of 3.5 percent ($52.5M/year) from FFY 2014 through FFY 2021 (See Table A-1). These cuts will affect a variety of non-defense payments to Nevada (i.e., non-entitlement spending for things like disaster response, education and infrastructure other than transportation and law enforcement). The Consultant Team estimates, that, cumulatively, the reduction in federal non-defense spending in Nevada, excluding HHS, will total around $351.5M for the FFY 2014-FFY 2021 period. This is projected to result in $1.336B in federal transfers in FFY 2021 compared $1.687B in FFY 2014.

- **Transportation is a special case**. It is interesting to note that much of the U.S. Department Transportation's ("DOT") spending is exempt from BCA/sequestration. The Consultant Team's research indicates that DOT funding in Nevada will only be reduced by .02 percent between FFY 2012 ($449.5M) and FFY 2013 ($449.4). See Table A-1. It is a bit a unclear from the Consultant Team's research how DOT spending in the state will be affected between FFY 2014 and FFY 2015, but applying a two percent annual increase results in DOT spending in Nevada to rise from $458.4M in FFY 2014 to $526.5 in FFY 2021 or by $68.2M (14.9 percent). We compared the average annual increase between FFY 2006 and FFY 2012 (5.5 percent) to the change between FFY 2012 and FFY 2013 (approximately.02 percent) and then adjusted the resulting average of 2.75 percent per year to two percent per year starting in FFY 2014 to be conservative and to account for any future funding uncertainties.

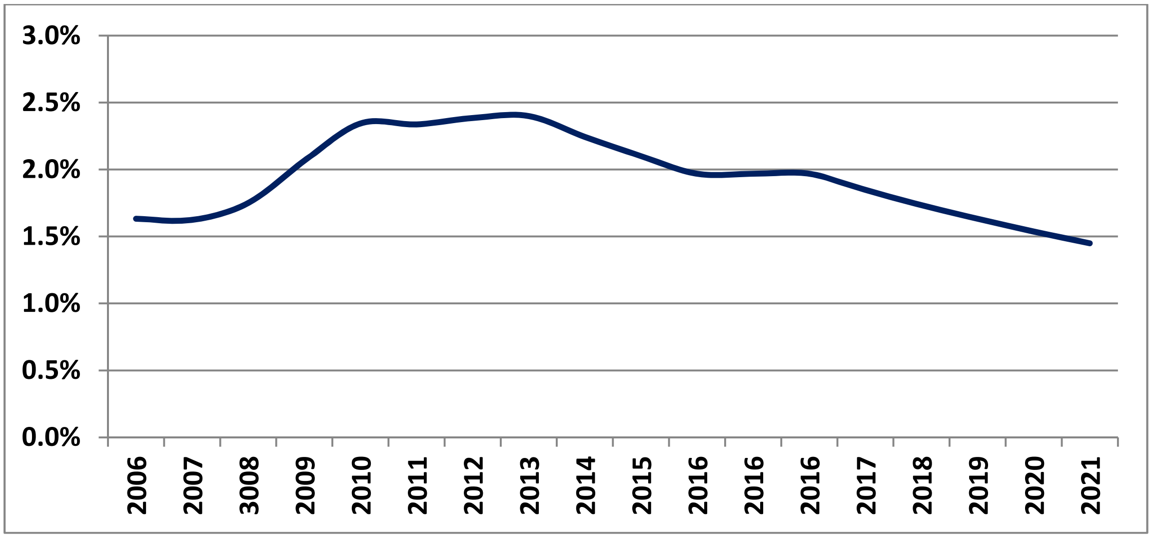
- **Discretionary vs. Mandatory Programs**. Both types of non-defense programs will be affected by proposed federal revenue reductions and the associated current sequestration. Discretionary programs will be negatively affected in FFY 2013 compared to FFY 2012. Specifically, discretionary spending was slated to be reduced by three percent in FFY 2013, with transportation funding only being reduced by just under.02 percent or $31.6M. On the other hand, mandatory programs will be increased by 4.9 percent or by $95.2M between FFY 2012 and FFY 2013. Between FFY 2014 and FFY 2021, discretionary spending in Nevada is projected to decline by an annual average of 1.56 percent starting from just over $1B falling to $913.2M (or by 10 percent. $100.8M). The level of discretionary cuts is partially mitigated, because transportation funding to the state is forecasted to increase by two percent per year during the period.

- **Cuts to Nevada vs. Solely Federal-Only Cuts**. One of the reasons that federal funding to the states, including Nevada, is scheduled to see such significant cuts is that it appears the White House and Congress are not going to allow profound reductions to entirely federal non-defense discretionary spending agencies like the Veterans Administration, the FBI, the Centers for Disease Control, Homeland Security and the Social Security Administration.

- **The Overall Effect: Non-Defense Funding for State and Local Services.** As a summary of the forecasts, between FFY 2006 and FFY 2011 federal non-defense spending in Nevada averaged two per percent of Gross State Product ("GSP"). These percentages are shown in Chart 2 below. Between FFY 2012 and FFY 2021, the Consultant Team projects that GSP will grow by 1.5 percent per year. In FFY 2012 and FFY 2013, the Consultant Team estimates that non-defense spending in the state will represent 2.4 percent of GSP in both years. Based on its non-defense federal spending forecast, the Consultant Team expects that by 2021, federal cuts/sequestration-related changes will reduce this spending to 1.4 percent of GSP.

Cost Shifting to Nevada: Why It Matters and A Summary of the Forecasted Revenue Reductions

CHART 2: ACTUAL & FORECASTS: NON-DEFENSE FEDERAL SPENDING IN NEVADA AS A PERCENT OF GROSS STATE PRODUCT: 2006-2021



Source: Bureau of Economic Analysis, International Monetary Fund's October 2012 annual average inflation 2011-2017 forecast for the US, FFIS and the Consultant Team.

While it is continuing subject of debate in Nevada, these reductions in federal payments to state will put additional stress on its budget, and, indirectly, to the budgets of local governments around the state. They will essentially lower the number of jobs that Nevada and its municipalities create, slowing the rate of Nevada's recovery, and putting pressure on the adequate delivery of services to residents.

Using modern tax elasticity models and base-level data on sources of tax revenues, a comprehensive statistical study of the Nevada tax system strongly suggests that normal growth of the Nevada economy will not provide additional revenues to replace lost federal funds. Based on issues of both growth and variability in the major tax instruments of Nevada, Schlottmann and Conklin found that revenue growth in the Nevada tax system tracks growth in the overall economy but it does not provide extra-normal sources of revenue.[5]

Federal Spending Reductions and Nevada's Response: No Easy Option

As noted above, Nevada policymakers will have to respond to the ongoing effects of long-term reduction in federal payments to the state brought about the BCA/sequestration, or alternative proposals which often mirror similar reductions in federal funding.

The Nevada policy response could take a number of forms: Tax increases, service cuts, re-prioritizing of spending or a combination of all three. There is no costless solution. In any case, if Nevada chooses to supplant lost federal funding by using state resources, this will represent a direct funding shift to the state due to federal cutbacks. Potential implications of these cuts are discussed below by federal department and agency.

As we have stated, federal policy makers are unlikely to allow deep cuts to Medicare and Social Security for current beneficiaries or those who will be retiring in the next few years. Additionally, while defense spending is also subject to the BCA, there is very little appetite by federal policy makers to reduce federal spending caps on defense since the BCA/sequestration is already calling for an average of 9.25 percent cuts per year between FFY 2014 and FFY 2021 cuts.[6] This means that's highly unlikely that the ~~BCA~~ future funding caps will be raised or that cuts will reduce to other types of non-defense spending. This is why federal transfers to the states are facing such large cuts – it appears to us that federal policymakers hypothesize that states can raise taxes to fill the federal spending gap.

Nevada's "Most Impacted"

In our opinion, there are two major concerns with future federal spending cuts to Nevada:

- Non-defense discretionary programs (e.g., primary and secondary education, assorted health care services (other than Medicaid) and infrastructure (other than transportation) directly benefiting Nevada that are appropriated by the federal government yearly to the states.

- Entitlements, excluding Medicare and Social Security, (e.g., Medicaid, Food Stamp State Administration, Children's Health Insurance Program ("CHIP") and Temporary Assistance for Needy Families).

Transportation funding to Nevada is essentially being held harmless since it is barely being affected by the BCA caps/sequestration cuts through FFY 2013, and is not subject to either the caps or cuts beyond FFY 2013. As noted, federal spending on transportation projects in Nevada will be reduced by only .02 percent between FFY 2012 ($449.5) and FFY 2013 ($449.4).

Growing Service Demands and Caseloads

As an example of rising service demands, according to the 2012 *"The Condition of Education 2012*" report released in May 2012 by the National Center for Education Statistics ("NCES"), public school enrollment in pre-kindergarten through 12th grade rose in 41 states between 1989–1990 and 2010–2011, with the largest jump in Nevada at 134 percent.[7] Between 2010–11 and 2021–22, Nevada is estimated to experience the second highest rise in total enrollment at 21 percent. From pre-kindergarten through 8th grade, enrollment in Nevada is forecasted to grow by nearly 21 percent. In grades 9 through 12, enrollment in Nevada is projected to rise by 8.2 percent by the 2021-22 school year. Obviously, any reductions in federal funding are a potential problem.

Regarding the share of school funding coming from the state, according to

The Condition of Education 2012, Nevada had the second lowest amount at 31 percent followed by Illinois at 28 percent report for the 2008-2009 school year (the latest available data). Unfortunately, as discussed below, this will be exasperated with the projected BCA/sequestration cuts.

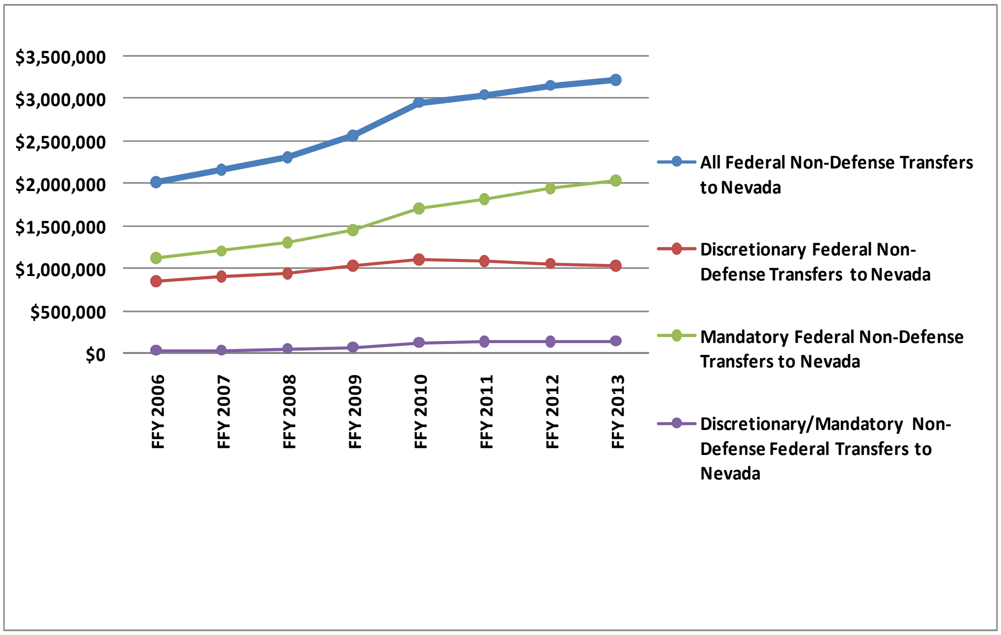
Nevada Revenue Declines: The Details by Federal Department

The following discussion presents the Consultant Team's review of FFY 2006 to FFY 2012, FFY 2012 to FFY 2013 and forecasted FFY 2014 to FFY 2021 non-defense federal funding in Nevada. It should be noted that the Consultant Team only developed forecasts at the department level, not for individual programs. These results can be found in Table A-1 and the following charts.

As a basis for the following discussion, the Consultant Team developed three charts to show the most recent (FFY 2012), and currently sequestered FFY-2013 share of non-defense federal spending in Nevada, by department. Chart 3 provides an overview of total spending, segmented by discretionary, mandatory and discretionary/mandatory, by year, from FFY 2006 through FFY 2013, while breakdowns by federal departmental funding for FFY 2012 and FFY 2013 are shown in Chart 4 and Chart 5.

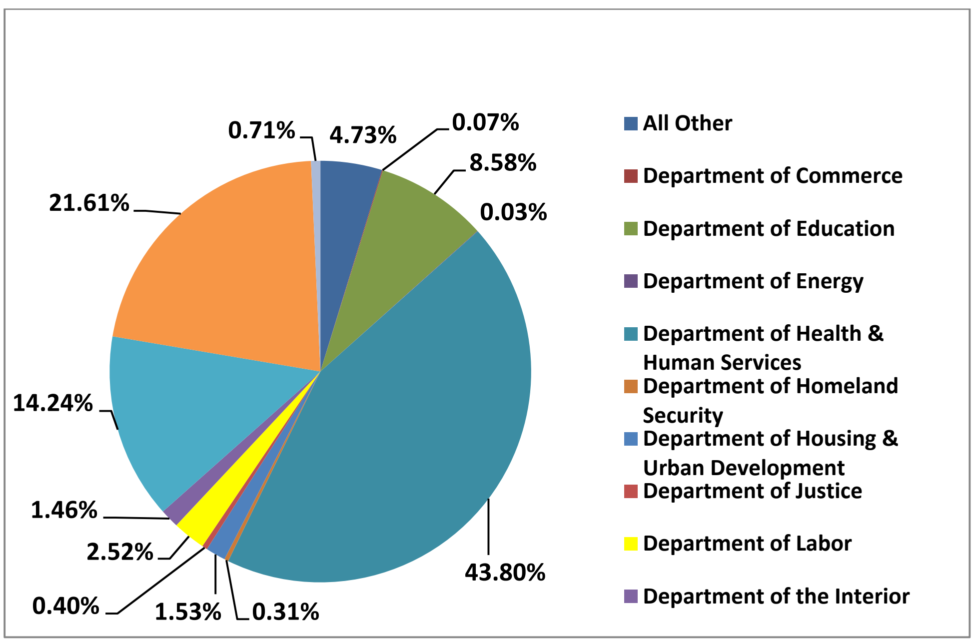
Nevada Revenue Declines: The Details by Federal Department

CHART 3: TOTAL NON-DEFENSE FEDERAL FUNDING TO NEVADA: FFY 2006-FFY 2013, BY TYPE (, 000)



Source: 2013 FFIS Federal Funds Information for States.

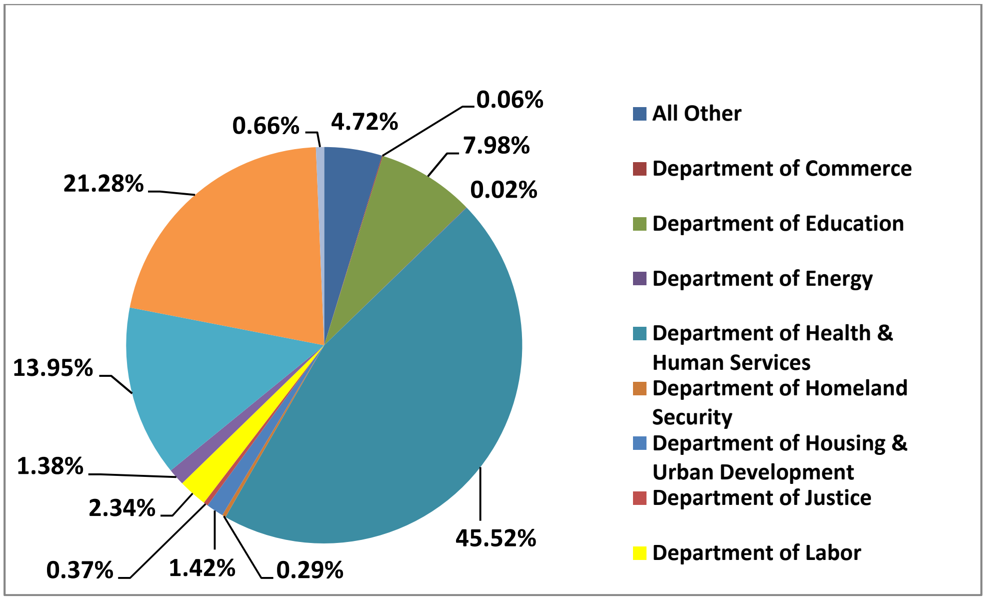
CHART 4: NON-DEFENSE NEVADA FEDERAL FUNDING, PERCENT BY PROGRAM: FFY 2012



Source: 2013 FFIS Federal Funds Information for States.

Nevada Revenue Declines: The Details by Federal Department

CHART 5: NON-DEFENSE NEVADA FEDERAL FUNDING, PERCENT BY PROGRAM: FFY 2013



Source: 2013 FFIS Federal Funds Information for States.

The charts above provide the frame of reference for the forecasts by departments which now follow. The federal fund transfers for each department represent major programs for Nevada partially funded by such federal transfers.

Department of Agriculture

According to FFIS, 21.6 percent or $682M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Department of Agriculture ("USDA"). Between FFY 2006 and FFY 2012, USDA funding in Nevada rose from $242.8M or by 181 percent. This massive rate of growth was largely due to the federal government responding to the severe needs of Nevada residents wrought by the Great Recession. For example, Food Stamp Benefits payments jumped by 292.5 percent between FFY 2006 ($124.3M) and FFY 2012 ($488M).

The top three programs in FFY 2012 were Food Stamp Payments ($488M), Child Nutrition-School Lunch ($77.9M) and WIC-Supplemental Feeding Program ($48.2M). Combined, they represented 90.0 percent of the USDA funding to Nevada in FFY 2012. The first of two of these programs are mandatory and the last is categorized as discretionary. From FFY 2012 to FFY 2013, USDA funding is slated to rise by .56 percent to $685.8M. By FFY 2021, USDA payments to Nevada are projected to decline, based on the CBO national forecasts and Consultant Team estimates, by an annual average of 6.53 percent starting in FFY 2014 to $399.7M in FFY 2021 (-41.3 percent from FFY 2012) under sequestration, a significant amount.

Because of sequestration or similar deficit reductions, Food Stamp Benefits payments are expected to be decrease to $483.5M in FFY 2013 or by .91 percent ($4.4M). Child Nutrition-School Lunch funding is anticipated to rise to $86.3M in FFY 2013 or by 10.8 percent ($8.4M). Federal payments to Nevada for WIC-Supplemental Feeding Program are estimated to fall to $45.7M in FFY 2013 or by 5.32 percent ($2.6M).

Department of Commerce

The FFIS data notes that .07 percent or $2.1M of the $3.156B in non-defense federal spending in Nevada in FFY 2012 came from the U.S. Department of Commerce (“DOC”). The largest portion (nearly $1.7M, 81 percent) of this funding was for infrastructure projects under the EDA-Public Works program.

Between FFY 2006 and FFY 2012, DOC spending in Nevada fell $1.3M (37.7 percent). Between FFY 2012 and FFY 2013, this funding is scheduled drop by 5.32 percent to just under $2M. By 2021, DOC transfers to Nevada, using the CBO national projections and Consultant Team estimates, are projected decrease by an annual average of 5.05 percent starting in FFY 2014 to $1.3M in FFY 2021 (a 30.4 percent drop).

Department of Education

According to FFIS, 8.6 percent or $270.8M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Department of Education (“DOEd”). The focus of much of this funding was on Comp Ed (Title 1)-Local Education Agencies ($106.5M) and for Special Education Basic State Grant ($70.7M). These programs represented 65.4 percent and are used to assist in the education of low-income and disabled (learning and physically) children.

Reductions in this category of federal transfers would largely affect high-poverty schools, since many of these federal transfers are largely focused on these types of schools. In the case of Title 1 funding, the BCA/sequester would reduce transfers to Nevada by 5.32 percent between FFY 2012 and FFY 2013 or by $5.7M. In the case of Special Education Basic State Grant, funding would also be reduced by 5.32 percent to $66.9M FFY 2013, a loss of $3.8M.

Between FFY 2006 and FFY 2012, DOEd funding in Nevada rose from $229.8M to $270.8M or by 17.8 percent. And between FFY 2012 and FFY 2013, this funding will drop by 5.1 percent to $257M. By FFY 2021, DOEd payments to Nevada, according to the CBO national forecasts and Consultant Team estimates, are expected decline by an annual average of 3.92percent starting in FFY 2014 down to $186.1M (24.4 percent) in 2021 with federal deficit reductions.

By way of background, *"The Condition of Education 2012"* report noted most administrators surveyed stated that sequestration funding reductions would "reducing professional development (69.4 percent), reducing academic programs (58.1 percent), eliminating personnel (56.6 percent) and increasing class size (54.9 percent)."[8] To reiterate, the current sequestration is not a limited one-of-reduction in funding but is directly related to long-term changes in funding to Nevada and other states.

Department of Energy

FFIS also reported that .03 percent or $834,000 of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Department of Energy ("DOE") for two areas – the State Energy Program and the Weatherization Assistance Program.

Between FFY 2006 and FFY 2012, DOE funding in Nevada dropped from $1,240,000 or by $406,000 (32.7 percent). This funding is planned to drop by 5.3 percent to $790,000 between FFY 2012 and FFY 2013equester-S. And by 2021, DOE payments to Nevada, according to the CBO national projections and Consultant Team estimates, will potentially decline by an annual average of 5.05 percent starting in FFY 2014 down to $522,000 (30.4 percent) because of sequestration.

Department of Health & Human Services

According to FFIS, 43.8 percent or $1.382B of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Department of Health and Human Services (“HHS”). The vast majoring of this funding was for Medicaid-Vendor Payments, followed by Medicaid-Administration, Vaccines for Children and Head Start. The first of three of these programs are mandatory and the last, Head Start, is discretionary.

Between FFY 2006 and FFY 2012, HHS funding in Nevada jumped from $980M or by $402.3M (41 percent). And between FFY 2012 and FFY 2013, this funding is expected increase by 6.1 percent to $1.467B. However, under sequestration or similar measures, between FFY 2014 and FFY 2021, HHS payments to Nevada, according to the CBO national forecasts and Consultant Team estimates, are projected decline by an annual average of 5.4 percent starting in FFY 2014 down to $857.1M in FFY 2021 or by $514.4M (37.5 percent), clearly a dramatic reduction.

With sequestration-type reductions, Medicaid-Vendor Payments are expected to be increased from $972.3M in FFY 2012 to $1.055B in FFY 2013 or by 8.5 percent (about $83.1M). Medicaid-Administration funding is anticipated to rise from $53M to $54.6M during the same period or by 2.9 percent ($1.5M). Federal payments to Nevada for Vaccines for Children are estimated to increase from $33.6M in FFY 2012 to $36M in FFY 2013 or by nearly seven percent ($2.4M). Temporary Assistance for Needy Families (“TANF”) is projected to stay FFY 2012’s $43.9M in FFY 2013. However, Head Start funding is expected to drop from $30.1M to $28.5M during this period or by 5.32 percent ($1.6M).

Department of Homeland Security

The FFIS calculates that.31 percent or $9.9M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Department of Homeland Security ("HS"). Approximately 43.4 percent ($4.3M) of this funding was for Emergency Management Performance.

Between FFY 2006 and FFY 2012, HS funding in Nevada dropped dramatically from $12.3M or by $2.4M or by 19.3 percent. Between FFY 2012 and FFY 2013, this funding is slated to drop by 5.1 percent to $9.4M. By 2021, HS payments to Nevada, according to the CBO forecasts and Consultant Team estimates, are estimated to decline by an annual average of 4.5 percent starting in FFY 2014 down to $6.1M (31.2 percent).

Department of Housing & Urban Development

Per the FFIS, 1.5 percent or $48.4M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Department of Housing & Urban Development ("HUD"). The majority of this funding was related to two programs – Community Development Block Grants-Entitlement (Local) at $15.4M and for Public Housing Operating Fund ($14.2M). These two programs represented 61.2 percent of HUD payments to the state. Both are slated to fall by 5.32 percent between FFY 2012 and FFY 2013. Reductions in federal funding for HUD programs will potentially shift significant costs to Nevada, depending on the cuts that actually will take place.

Between FFY 2006 and FFY 2012, HUD funding in Nevada fell from $58.4M or nearly $10M (17 percent). This funding is anticipated to decline by 5.32 percent to $45.9M between FFY 2012 and FFY 2013. By 2021, HUD payments to Nevada, per the CBO national projections and Consultant Team estimates, will drop by an annual average of 5.05 percent starting in FFY 2014 down to $30.3M (30.4 percent) because of federal deficit reduction.

Department of the Interior

According to FFIS, 1.46 percent or $45.9M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Department of the Interior ("DOI"). The vast majority ($23.9M, 52 percent) of this funding was for one program, BLM-Payments in Lieu of Taxes.

Between FFY 2006 and FFY 2012, DOI funding in Nevada jumped from $32.6M to $45.9M or by 40.7 percent. Between FFY 2012 and FFY 2013, this funding is expected to decrease by 3.3 percent to $44.4M. By 2021, DOI payments to Nevada, using the CBO national forecasts and Consultant Team estimates, is expected to fall by an annual average of 6.6 percent starting in FFY 2014 down to $25.7M (38 percent) with deficit reduction measures.

Department of Justice

According to FFIS, .40 percent or $12.8M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Department of Justice ("DOJ"). The majority of this funding was for the State Criminal Alien Assistance ($4.5M) and the Crime Victims Fund-Assistance ($3.9M) programs. These two programs accounted for 65.6 percent of FFY 2012 DOJ funding to the Nevada.

Between FFY 2006 and FFY 2012, DOJ funding in Nevada dropped from $17M or by $4.3M (25.2 percent). Between FFY 2012 and FFY 2013, this funding is scheduled to fall by 5.4 percent to $12.1M. By 2021, DOJ payments to the state, per the CBO national projections and Consultant Team estimates, will potentially decrease by an annual average of 5.52 percent starting in FFY 2014 down to $7.7M (32.8 percent) under sequestration.

Department of Labor

The FFIS reports that 2.5 percent or $79.5M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Department of Labor ("DOL"). The largest portion ($36.9M) of this funding was for payments to the unemployed via the UI State Administration Base Allocation program. The second largest DOL transfer to Nevada during FFY 2012 was for the Workforce

Investment Act-Dislocated Workers program at $14.4M. Combined, these two programs accounted for 64.5 percent of DOL spending in the state during FFY 2012.

Between FFY 2006 and FFY 2012, DOL spending in Nevada jumped from $47.1M or by $32.4M (68.9 percent) in an attempt to mitigate the impacts on the state's workforce resulting from the Great Recession. However, between FFY 2012 and FFY 2013, this funding is slated to drop by 5.32 percent to $75.3M. By 2021, DOL transfers to Nevada, using the CBO national forecasts and Consultant Team estimates, are projected to decrease by an annual average of 5.05 percent starting in FFY 2014 to $49.7M (30.4 percent) in FFY 2021.

Department of Transportation

The FFIS estimated that 14.2 percent or $449.5M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 was from the U.S. Department of Transportation ("DOT"). The largest share of this funding was for the FHWA-National Highway System ($90.5M) program, followed by the Surface Transportation ($83.9M) and Interstate Maintenance ($81.5M) programs. These three programs represented 56.9 percent of federal transportation spending in the state in FFY 2012.

Between FFY 2006 and FFY 2012, DOT spending in Nevada jumped $118.4M or 35.8 percent. Between FFY 2012 and FFY 2013, this funding is programmed to only slightly fall by .02 percent to $449.4M since transportation spending is exempt from sequestration. By 2021, DOT spending in Nevada, using the Consultant Team's forecast, is estimated to grow at an annual average of about two percent starting in FFY 2014 reaching $526.5M (a growth 14.9 percent for the period). This annual increase is based on the International Monetary Fund's October 2012 annual average inflation 2011-2017 forecast for the US.

Environmental Protection Agency

According to FFIS, .71 percent or $22.5M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the U.S. Environmental

Protection Agency ("EPA"). The largest share (nearly $9M) of this funding was for the Drinking Water SRF Grant program. The second largest program was Clean Water SRF Grants at $7M. Together, these two programs received 71 percent of all EPA transfers to the state in FFY 2012.

Between FFY 2006 and FFY 2012, EPA funding in Nevada grew from $19.3M or by $3.2M (16.7 percent). And between FFY 2012 and FFY 2013, this funding is slated drop by 5.32 percent to $1.2M. By 2021, EPA spending in the state, according to the CBO national projections and Consultant Team estimates, is forecasted to decline by an annual average of 5.05 percent starting in FFY 2014 down to $14.1M (30.4 percent) in FFY 2021.

All Other

According to FFIS, 4.7 percent or $149.3M of the $3.156B in non-defense federal grants to Nevada in FFY 2012 came from the Other Programs of various U.S. Departments ("OP"). The vast majority ($145.8M, 98 percent) was higher education-related Pell Grant funding.

Between FFY 2006 and FFY 2012, OP funding in Nevada jumped from $45.3M or by $104M (230 percent). This funding is currently planned to rise by nearly two percent to $152.3M, led by Pell Grants between FFY 2012 and FFY 2013. However, by 2021, OP payments to Nevada, according to the CBO national forecasts and Consultant Team estimates, are expected to decline by an annual average of 6.61 percent starting in FFY 2014 to $88.1M (38 percent) in FFY 2021 under sequestration. This will have a major impact on the ability to get tuition assistance by Nevada college bound students.

With education being a significant aspect of an economic development strategy for Nevada, these cuts have important implications for Nevada's future workforce and efforts at business recruitment. The series of white papers on education and economic development from UNLV by Schlottmann and RCG Economics strongly suggest a strong educational policy does directly link to both regional economic growth and a qualified workforce to foster economic development.[9]

Appendix 1: Forecasts and Revenue Declines for Nevada: Statement of Methodology

Premise: The approach undertaken by the Consultant Team focused on non-defense discretionary and mandatory transfers to the state of Nevada. A brief discussion of defense spending in Nevada is included in Appendix 2. Our research was largely based on data obtained from Federal Funds Information from the States (http://www.ffis.org)[10]. FFIS is "a subscription service jointly created by the National Governors Association and the National Conference of State Legislatures. Our primary mission is to track and report on the fiscal impact of federal budget and policy decisions on state budgets and programs. This information is maintained in a database of more than 200 federal grant-in-aid programs and is disseminated to subscribers through a regular series of reports and briefs."

It should be noted federal transfers to the state of Nevada for transportation are not considered as "discretionary". As was noted earlier herein, transportation funding was excluded from sequestration. Transportation funding generated by the Airport and Airways, Highway and Mass Transit Trust Funds was established by ongoing legislation initiatives emanating from House and Senate transportation authorizing committees, and has traditionally been classified as "mandatory". That said, the actual amount of these transfers accessible yearly is established by commitment restrictions ratified via yearly approved funding. The Consultant

Team's primary assumption for projected annual transportation outlays between FFY 2014 and FFY

2021 was to use the percent change in such funding between FFY 2012 and FFY 2013, two percent (rounded).

Baseline Assumptions:

In developing our analysis, the Consultant Team established an array of baseline assumptions to identify how sequestration is likely to affect the state of Nevada. Accordingly, using FFIS data, the Consultant Team selected FY 2012-E as its base-year, although we included federal funding data from FFY 2006-FFY 2011. Another important assumption was that the funding caps and percentage cuts identified in the BCA would be used as the base from which to develop FFY 2014-FFY 2021 federal funding forecasts for Nevada. It should be noted that even though the BCA also included defense spending caps, the amount of this funding allocated to the state is relatively small. This report does not address those grants.

Additionally, the caps identified herein are in nominal terms, meaning that they have not been adjusted for inflation. This was done to avoid confusion with comparisons to alternative federal deficit reduction plans, which often use forecasted federal budgets under a two-percent price increase (consistent with the stated price target of the Federal Reserve System). As previously noted, alternative plans are shown on the Committee for a Responsible Federal Budget website (see endnote 1 and endnote 2). Many of these plans appear to suggest a one-year temporary freeze to current levels of cuts during final formulation of the longer term deficit plan for some components. Thus, we present data for FFY 2012 and 2013 post Sequester but begin the forecast period in FFY 2014 to FFY 2021.

As noted throughout this report, the Consultant Team assumed that discretionary and mandatory funding to Nevada, with the exception of transportation funding, is forecasted at growth rates identified by the CBO from FFY 2013 through FFY 2021 and adjusted by the Consultant Team for that spending that is exempt from sequestration. The Consultant Team assumed that the projected rates of change in the exempt programs would be comparable to what is slated to be experienced between FFY 2012 and FFY 2013. The CBO report, *"Estimated Impact of Automatic Budget Enforcement Procedures Specified in the Budget Control Act"* dated September 12, 2011, was used to calculate BCA-driven non-exempt reductions in non-defense discretionary and mandatory spending.[11]

The Consultant Team calculated the changes in federal spending in Nevada due to of sequestration by using annual percent changes for non-defense discretionary and mandatory spending for 12 federal departments plus an "Other" category as identified by FFIS. This involved reductions relative to so-called "lump sums" for various mandatory programs versus reductions using standard percentages. Thus, as shown in Table A-1, revenue reductions to Nevada are more severe during the first four years of the forecast (FFY 2014-2017) than the last four years of the forecast (FFY 2018-FFY 2021).

As shown in Table A-1, the forecasted non-defense reductions in federal funds to Nevada begin in earnest as we pass in to FFY 2014. Using the more conservative approach of FFY 2012 as a baseline, these reductions represent a cumulative reduction of approximately $962.9B in federal funding (and associated services to Nevada residents) between FFY 2012 and FFY 2021. These levels of cutbacks pose Nevada funding issues that are simply too large to be ignored. Unless additional revenue sources are forthcoming, the implied service cuts will occur.

Conclusions

As noted above, Nevada policymakers will need to formulate a planned response to ongoing effects of a long-term reduction in federal payments to the state associated with proposed federal deficit reductions. The proposed cuts are simply too large in terms of their impacts on Nevada to ignore without either an explicit or implicit response. Even if the current BCA/sequestration does not become the official template for future cuts, it is important to note that alternative proposals often mirror similar reductions in federal funding.

Policymakers' response could take a number of forms: Tax increases, service cuts, re-prioritization of spending or a combination of the three. There is no costless solution. In any case, if Nevada chooses to supplant lost federal funding by using new state resources, this will represent a direct funding shift to the state due to federal cutbacks.

Appendix 1: Forecasts and Revenue Declines for Nevada: Statement of Methodology

TABLE A-1: ALL FEDERAL NON-DEFENSE TRANSFERS TO NEVADA, FFY 2006 TO FFY 2021 (PROJECTED)

FFY = Federal Fiscal Year
Source: 2013 FFIS Federal Funds Information for States.

Appendix 2: Defense Expenditures and Potential Reductions: An Overview

Defense Spending and the States

According to the Pew Center's "*The Impact of the Fiscal Cliff on the States*" report, "Federal spending on defense accounts for more than 3.5 percent of the total gross domestic product (GDP) of the states, but there is wide variation across the states. Federal defense spending makes up almost 15 percent of Hawaii's GDP, compared with just 1 percent of state GDP in Oregon."[12] In the case of Nevada, the 2010 share of GDP (GSP) associated with defense spending on purchases, salaries and wages was 1.8 percent, about 51 percent of the national average.

Scheduled Defense Spending Changes

The Sequester

Like non-defense reductions, the defense funding decreases resulting from sequestration will also affect Nevada's budget. However, unlike non-defense spending that will have to be addressed by the state in its budgeting process, defenses spending reductions will primarily impact the rate of economic growth in Nevada. This is especially true since the state has several military bases with notable amount of activity like Nellis Air Force Base, Hawthorne Army Depot, Creech Air Force Base and Fallon Naval Air Station. For example, the cover letter to the FFY *2012 Economic Impact Analysis* prepared by Nellis Air Force Base, states:

"In Fiscal Year 2012, our combined operations and maintenance outlays

Appendix 2: Defense Expenditures and Potential Reductions: An Overview

totaled more than $482 million. There were approximately 8,425 military and 4,065 civilians employed between the two bases and the NTTR with a combined payroll of more than $694.3 million. On any given day, one thousand temporary-duty personnel conducted business at Nellis, Creech, or the NTTR. There were an estimated 5,637 indirect jobs created with an approximate annual dollar value of $229.7 million.

Simultaneously, the Las Vegas metropolitan area counted a total of 28,029 military retirees among its residents. The combined retirement payroll of 14,036 Air Force; 5,474 Army; 6,527 Navy; 1,599 Marines; and 393 Coast Guard retirees amounted to a yearly salary of $673.8 million.

Using the prescribed parameters provided in this report, the total economic impact of Nellis, Creech, and NTTR operations in Fiscal Year 2012 amounted to more than $5 billion."

It must be noted that the White House reduced the defense budgets between FFY 2011 and FFY 2021 by $487B ($48.B per year), equating to a nine-percent cut per year. Over and above the $487B, BCA/sequestration required another $500B (9.4 percent) in discretionary defense reductions from FFY 2013 through FFY 2021 defense for a total drop of 18.4 percent in spending for the BCA period.

Using Congressional Research Service ("CRS") calculations regarding the national percent change in defense "base budget" spending between FFY 2010 and FFY 2011, defense spending in Nevada stayed at 2010's $2.369B (per FFIS). Between FFY 2011 and FFY 2012 ($2.383B), CRS calculated an increase of 0.57 percent rise in defense funding in Nevada. For FFY 2013, the Obama Administration is proposing a 1.3 percent cut to the national base budget. Applying this change to Nevada results in defense spending in Nevada being reduced to $2.35B.

Appendix 2: Defense Expenditures and Potential Reductions: An Overview

It is important to mention that sequestration-related defense reductions are targeted largely to discretionary spending. For example, while the OMB estimates that

mandatory defense payments, nationally, will be lowered by 10 percent, the cut will be relatively small-$100M. The costs associated with uniformed military personnel, which are discretionary, have been exempted from sequestration.

As mentioned above, Nevada's economy is at risk from reductions in defense funding on purchases, salaries and wages. These reductions have the potential of decelerating economic growth in the state, negatively impacting its budget by decreasing a variety of revenue sources, like sales and use tax revenues, and raising the demand for state services.

Below is a table provided by Center for Security Policy ("CSP") and adjusted by the Consultant Team. According to CSP, five Nevada counties will potentially be affected by most by the BSA/sequestration. They are:

TABLE A-2: TOP 5 NEVADA COUNTIES: PROJECTED CONTRACT REVENUE REDUCTIONS BASED ON NATIONAL AVERAGES

County	2000-2011 Nevada Discretionary Defense Spending	FFY 2011 Nevada Discretionary Defense Spending	2013-2021 Annual Revenue Reduced @	Under Sequestration: 2013-2021 Annual Revenue Reduced @	Total
			-9.0%	-9.4%	
Washoe	$3,896,769,883	$878,558,144	($79,070,233)	($82,584,466)	($161,654,698)
Clark	$5,134,060,514	$317,007,731	($28,530,696)	($29,798,727)	($58,329,423)
Mineral	$387,818,573	$94,648,421	($8,518,358)	($8,896,952)	($17,415,309)
Carson City	$159,761,248	$22,401,121	($2,016,101)	($2,105,705)	($4,121,806)
Douglas	$158,021,732	$9,601,812	($864,163)	($902,570)	($1,766,733)
TOTAL	$9,736,431,950	$1,322,217,229	($118,999,551)	($124,288,420)	($243,287,970)

Source: Center for Security Policy and The Consultant Team.

CSP also developed estimates of the numbers of small and minority business that will be potentially impacted by most by the BSA/sequestration. These businesses are listed below, by type. The Consultant Team segmented the CSP data to show both the FFY 2012 implemented cuts along with the proposed BCA/sequestration cuts.

TABLE A-3: NEVADA DEFENSE BUSINESSES PROJECTED REVENUE REDUCTIONS BASED ON NATIONAL AVERAGE: FFY 2013-FFY 2021

Type of Business	Numbers of This Business Type 2011	Revenue for This Business Type 2011	FFY 2013-FFY 2021 Annual Revenue Reduced @ -9.0%	Under Sequestration: FFY 2013-FFY2021 Annual Revenue Reduced @ -9.4%	Total
Minority Owned	69	$47,246,371	($4,252,173)	($4,441,159)	($8,693,332)
Small Businesses	28	$43,181,373	($3,886,324)	($4,059,049)	($7,945,373)
Small Disadvantaged	33	$10,379,187	($934,127)	($975,644)	($1,909,770)
Veteran-Owned	39	$22,253,142	($2,002,783)	($2,091,795)	($4,094,578)
Service-Disabled Veteran	38	$33,565,527	($3,020,897)	($3,155,160)	($6,176,057)
Black American	14	$15,093,068	($1,358,376)	($1,418,748)	($2,777,125)
Hispanic American	20	$4,101,803	($369,162)	($385,569)	($754,732)
Asian-Pacific Owned	25	$10,784,112	($970,570)	($1,013,707)	($1,984,277)
Women-Owned	99	$904,115,817	($81,370,424)	($84,986,887)	($166,357,310)

Note: Numbers were not totaled because some businesses fall in multiple categories.
Source: For the Common Defense.

Clearly, the FFY 2012 and BCA/sequestration will impact are variety of small and minority businesses. As noted above, the most direct impacts are to the state's economy and its rate of growth, and the associated reduction in tax revenues. Like the non-defense spending cuts, any action that reduces federal funding to the state directly or indirectly impacts the state's budget and the state's economy.

FFY 2013-FFY 2021 Defense Spending Projections: Nevada

While at the national level, the defense spending cuts are potentially quite severe, it's unknown how they will affect Nevada. An argument can be made that many of Nevada's military bases and installations are so important to the national security that they will be spared from the cuts and might even benefit from spending reductions at military facilities in other states. Accordingly, the Consultant Team found it too speculative to forecast defense spending for the BCA period from FFY 2013 through FFY 2021.

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Endnotes

[1] A list and interactive comparison matrix for these diverse plans is available at Committee for a Responsible Federal Budget [CRFP] (http://crfb.org/compare/).

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