LA Streamlining Government Commission

Testimony of:

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December 1, 2009

Tax Burden: How does LA rate?

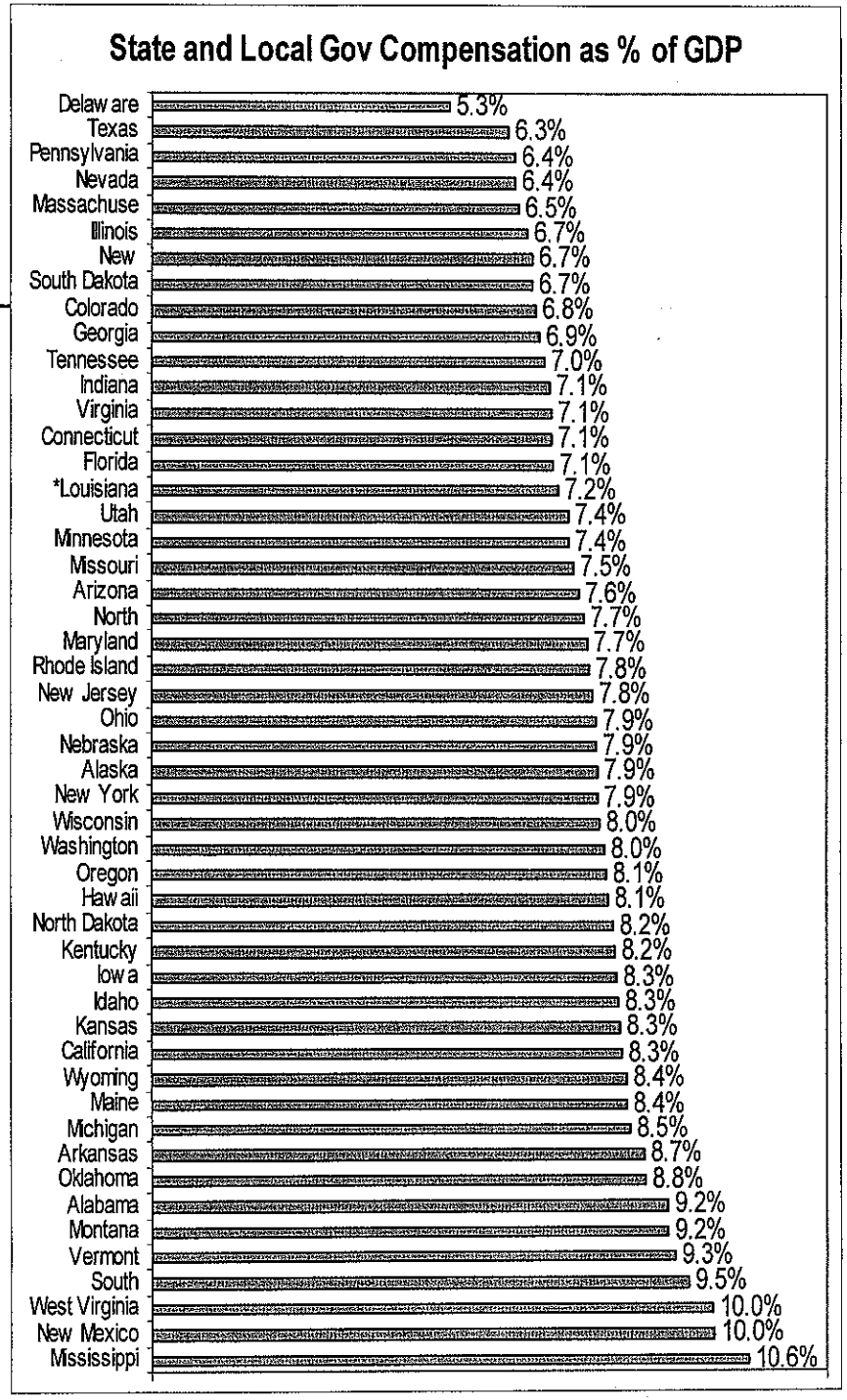
- State and local combined (1st being lowest)
  - LA – 17th, 8.5% of GDP, national average 9.3%
  - FL - 35th (Note comparison to LA)
  - MS - 39th
  - AR - 31st
- State taxes only (1st being lowest)
  - LA – 16th, 5.3% of GDP, national average 5.5%
  - FL - 15th (Note comparison to LA)
  - MS - 43rd
  - AR – 46th
- Structural difference between LA and FL

Source: Census 2007 State & Local Government for Taxes, Bureau of Economic Analysis Regional Economic Accounts for GDP

State & Local Gov Compensation as % of GDP

- Average - 7.8%
- LA is ranked 16th, at 7.2%
- Does not square with Commission's table showing number of state workers per 10,000 residents
  - Comm. table makes CA (4th), NY (5th), and IL (2nd) appear to be libertarians
  - Why? Population? Economies of Scale?

Source: BEA Regional Economic Accounts
http://www.bea.gov/regional/gsp/
Based on 2007 Data – Latest available on Compensation of State and Local Gov Employees



Explanation of Headcount vs. Compensation Discrepancy

- Headcount is a poor measure, does not consider:
  - Compensation levels or
  - How responsibilities are divided among states and local govs

- Difference is attributable to either:
  - LA public sector workers are compensated far below other states, or
  - LA delivers more services at state-level
  - Or, a combination of the two…

Tax Expenditures

- LA produces comprehensive 400-page report, filled with special tax breaks for various causes
  - Many are logical & efficient, many are not
  - Getting same critical eye as other spending?
    - 56.3% of Corporate Income exempt from taxation

- The report is filled with statements that:
  - "This exemption is achieved in a fiscally effective manner", while noting that
  - "We are unable to estimate the fiscal effect… no reporting requirement for the data"
  - Both statements <u>cannot be simultaneously true</u>

Review Existing State Contracts

- Contract awards had jumped from $2 billion to $4.7 billion in two years ending 2007-2008
  - What did LA get for this increase?
- Number of contracts only increased from 5,608 to 7,295 over that time
  - Costs going up?
- $2.5 billion in contracts for consultants alone?
  - Nearly doubled in 2007-2008
  - What has extra $1.2B in advice gotten LA?

Review Existing State Contracts

- Economic Downturn could be used to squeeze private providers on prices, just as it is used to pressure public servants
- CPI has been negative – Costs falling
  - Cost of materials should be falling for things like pavement and building supplies
  - Firms will likely accept lower margins in other areas, too
- LA Government should get more 'bang for their buck' wherever possible from its material and service suppliers

Privatization: Be Careful

- Typically, a firm will bid below costs to show large savings in privatization
  - Once established and gov dismantles its ability to provide service, price goes up!
- Gov loses control of work quality
- Many never account for cost of contract monitoring and enforcement
  - Costs a lot, but more costly to fail in this duty
- Caution: Selling assets to contractor makes it cost prohibitive to exit contract if/when it fails

Privatization: How Would it Save?

- Often, privatization schemes end up costing more
- Increasingly, its the same workers
- If it cost less, usually due to:
  - Cutting Benefits
  - Off-shoring
  - Declining Quality
  - Cutting Services

  While avoiding public responsibility
- These are public policy questions – not efficiency ones
- Ask: Where will savings come from?

Span-of-Control Laws: Gaining Momentum

- Governments add workers and managers during good times, and cut mostly workers in recessions.
  - After a few business cycles, end up top-heavy
- Iowa: passed law limiting ratio at 13:1
- Texas is phasing in a law with ultimate target of 11:1
- Washington State is now disclosing ratio semi-annually, to 'shine a light' on issue
- Seattle's ratio is 5.9:1; 82% of workers have 5 or more layers of management above them
  - An expensive problem!
- Kansas City took lesser steps to fix 4.6:1 ratio

Span-of-Control Ratios: How Does LA Compare?

- My understanding: LA has a ratio of around 5:1
- I have not been able to find data to confirm
  - Health and Welfare did cut 964 classified EE's, added 499 unclassified since 2003
- Not 'just a labor issue': About efficiency and maximizing public services per tax dollar.
- Ratio should vary, but organization-wide goals are appropriate
- This commission would be well served by taking a close look at this issue, as it has the power to get better information for decision making
- I've attached a handout on considerations

Corrections Already Stretched Thin?

- Incarceration Rate:
  - LA rate is 1-in-88
  - US average is 1-in-133
  - LA should have a high cost burden (about 50% higher)
- Percent of State Workforce in Corrections
  - LA – 8.7%
  - US average – 11%
- General Fund Spending on Corrections
  - LA – 7.5%
  - US average – 6.8%
- These figures suggest the LA incarceration rate would imply spending per inmate is already low

Source: Bureau of Justice Statistics (2006 data), Census Bureau

Revenues Down Everywhere

- State Revenues are down 8% (Full Year ending on June 2009), below the prior year
- Income taxes down 14%
- Corporate income taxes down 11%
- Property taxes level
- Sales taxes down 5%
- Other taxes down 7%
- Only tobacco and alcohol taxes up, as many states have raised these tax rates

Source: Census Bureau

Economic Momentum – LA vs. US Average

- LA was rated #1 in State Economic Momentum Index (as of June 2009) by State Policy Reports
- Index includes Income, Unemployment, Population, and House Prices
- LA rated #1 Overall, by category:
  - #5 - Income trend (2.57% incr., US avg 0.82%)
  - #3 - Employment change from June 2008 –2009, (LA: -0.6%, US avg: -4.0%)
  - #9 - Unemployment rate (LA 6.8%, US avg 9.5%)
  - #23 - Population (0.9% incr, LA and US avg)
  - #12 – House prices (LA –1.66%, US avg –7.14%)

Conclusion

- LA is not alone, 49 states are running deficits
- The deficit is a revenue problem, stemming from the recession – a nationwide trend
- LA tax burden is relatively low, as is its state and local employees' compensation
- Study tax expenditures like other spending
- Review existing contracts and maximize opportunities in existing contracts
- Use this situation to fix issues, such as a top-heavy organizational structure
- LA's economy is actually faring better than most

Thanks for the opportunity to visit with you