LOS ANGELES COUNTY

ECONOMY AND EFFICIENCY COMMISSION

ROOM 163, HALL OF ADMINISTRATION / 5O0 WEST TEMPLE / LOS ANGELES, CALIFORNIA 90012/ 974-1491

January 14, 1976

Honorable Board of Supervisors
Los Angeles County
383 Hall of Administration
Los Angeles, California 90012

Gentlemen:

SUBJECT: <u>THE NEW YORK CITY CRISIS AND LOS ANGELES COUNTY GOVERNMENT</u>

On October 28, 1975, on motion of Supervisor Hahn, the Board of Supervisors asked the Auditor-Controller and the Economy and Efficiency Commission to review the factors leading to the financial crisis in New York City and make preventative recommendations to safeguard Los Angeles County from a similar disaster.

Our commission considers this request to be its highest priority. The issues and problems involved in the financial stability of Los Angeles County government are critical and complex, as they are in New York, as well as in other local governments. They cannot be dismissed lightly.

We have, therefore, established a task force, chaired by Leo Majich, and have instructed it to conduct a thorough and intensive study of the issues involved. We plan to issue a series of reports beginning in February containing the task force recommendations. This letter outlines the progress of the study to date and identifies the principal areas which the task force is addressing.

The New York Crisis

In his motion calling for the study, Supervisor Hahn pointed out:

> "We in Los Angeles County must examine New York to determine why, when, and how the financial crisis developed, so such a disaster can be prevented here."

The situation in New York City was precipitated by the refusal of some banks to refinance the city's debt. Without such refinancing, the city would be forced either to default on its debt or to suspend expenditures, thus eliminating some services. Debt was linked to operating expenditures in New York because public officials there borrowed money to avoid raising taxes to cover expenses.

It is only on the surface that the crisis in New York is debt related. The basic cause of the crisis in New York was that expenditures for government services increased more rapidly than they could be financed by taxes. Rather than raise taxes or reduce expenditures, New York officials borrowed to finance the revenue gap. In addition, they apparently took steps to conceal the real financial condition of the city from the public and its creditors.

Conditions in Los Angeles County

Some of the more bizarre aspects of the New York situation - such as hidden debt financing of deficit budgets - do not exist in Los Angeles County. No one so far has refused credit to County government, and there is no evidence of devious accounting practices being used to conceal the County's true financial condition. Nevertheless, Los Angeles County shares with New York City and other local governments many of the external and internal conditions that led to the crisis in New York.

Principal external factors are population migration, fluctuations in the economy, and the development of outlying areas. These conditions lead to shifts in the demand for County services to which the County must respond. In addition, Federal and State governments control major elements of the County's revenue through legislation and subventions. As in New York, the actions of these governments affect the County's financial position by placing conditions on participation, by prescribing administrative and operating procedures, and by providing specified levels of revenue.

Internal factors involve the County's entire system of management and control. While Federal and State actions influence and sometimes mandate how much the County will spend in major areas - particularly in the welfare area - the County itself to a large extent determines the resources it will use to provide services, regardless of how they are financed. In particular, it controls the number of people it employs, the salaries and fringe benefits which they receive, and the facilities which house them. The County also controls the manner in which it is organized to provide services.

The relative impact of these factors, external and internal, on the County's financial condition is difficult to determine. Regardless of the cause, the cumulative effect of these factors - similar to those which led to the New York disaster - has been to drive up County expenditures and taxes in the last decade during a period of stabilizing population. In 1965, the County employed 50,000 people and spent $936 million. In 1975, employment had increased to 85,000 and annual expenditures had increased to $2.7 billion. Thus, in the last ten years when the consumer price index increased by 63% and County population by 2.9%, total County expenditures increased by 186% and County employment by 70%.

Concurrently, financial danger signals are beginning to appear. In recent years, the County has been experiencing cash shortages. That is, it has spent more than it has received within the fiscal year. In the past, it has made up the difference by borrowing from revenue sharing funds in the County treasury. This year, as the Auditor-Controller points out, such funds may not be sufficient, and the County will probably have to borrow in the commercial markets.

In addition, although no one questions the County's ability to pay its current obligations, some authorities are beginning to question the soundness of the County's plans for future joint powers financing. In an evaluation of a recent joint powers bond issue, one financial analyst stated that while his firm did not expect "thresholds of high credit worthiness to be transgressed by Los Angeles County's managers," he warned:

> "Los Angeles County lists over $400 million of proposed debt through the lease-purchase vehicle for health facilities, courts, and public safety purposes - a sum which if issued without discrete budgetary planning could eliminate all margins of financial safety."

Clearly, if corrective measures are not taken, Los Angeles County officials, like their counterparts in New York, will soon find themselves unable to generate sufficient revenue through existing sources. The key question then is: What steps can the County take to control future expenditures within the limitations imposed by prudent use of taxes and other revenue sources, including credit?

County Action

An effective answer to this question will require a comprehensive County action program to neutralize the adverse effects of these external and internal conditions. In this regard we should emphasize that such a program must address itself to all contributing factors and their interrelationships. The reports to the Board of Supervisors from the Chief Administrative Officer and the Auditor-Controller indicate that the County is taking positive steps to improve its budgetary and financial control systems and to increase subventions from Federal and State governments. Our commission strongly supports their efforts and urges the Board to place a high priority on the actions they recommend.

Nevertheless, our findings indicate that problems remain. We conclude that the Board must take further action in those areas over which it has control to reduce expenditures and to improve the productivity and effectiveness of County services. Inaction will almost certainly force the Board into the untenable position now confronting New York City officials of choosing between abdicating their responsibility to solve local problems, borrowing to finance operations, or risking their political futures by raising taxes.

Scope of E & E Commission Study

Areas of concern directly controlled by the Board of Supervisors which we plan to address in future reports include:

- Management and control of expenditures, revenue, and debt;
- Collective bargaining, compensation practices, and personnel systems;
- County implementation of Federal and State programs;
- Productivity of County services
- Contracting and purchasing policies

On December 9, 1975, your Board asked our commission to review assessment procedures and reform proposals and report by January 6, 1976. On December 23, 1975, you also asked us to review proposed charter reforms regarding eligibility for veterans' credit in Civil Service examinations. We consider both of these requests to be relevant to our analysis of County finances and management. Therefore, we will comment on them in our next report scheduled for February.

We should note that we currently have 10 other requests pending from your Board. We consider these to be less critical than the three requests relating to the financial crisis, and have postponed our response to them until completion of our study of finances and management.

Sincerely,

ROBERT J. DOWNEY
Chairman

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