CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

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Statement of Ted Egan, PhD,
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Little Hoover Commission
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1. My job and background

My name is Ted Egan and I am the Chief Economist of the City and County of San Francisco. I direct the Office of Economic Analysis (OEA), which is a division within the City Controller's Office responsible for economic impact analysis of pending legislation.

2. The role of the OEA in San Francisco government

Proposition I and the formation of the OEA

The OEA was established by Proposition I, a ballot proposition passed by San Francisco voters in November, 2004. The office's primary role is the economic analysis of legislation introduced at the Board of Supervisors, by the Mayor, members of the Board, or City departments. Other than pending legislation, the OEA does not generally review any other regulatory or administrative actions of the City.

Proposition I gave the OEA the discretion to determine which legislation would likely have a material economic impact on the city, and directed it to report on that impact to the Board of Supervisors before the Board acted on the legislation. Prop. I also urged, but did not require, the Board to adopt rules of order which would prohibit it from considering important legislation before receiving a report from the OEA.

In fact, this issue was the subject of litigation, after the Board adopted rules that allowed the Board President to waive economic impact review at his or her discretion. The judgment in that case affirmed both the OEA's sole discretion to make economic impact determinations, and the Board's ability to act without interference from the OEA. Current Board rules allow it to act on legislation before the OEA completes a report, but requires it to hold a hearing on any OEA report completed within 30 days of the legislation's introduction. In other words, under its rules, the Board could be required to hold a hearing on the economic impact of legislation after it had already been approved. In practice, this has never occurred.

Political independence of the OEA

Independence from political considerations is vital to the OEA's work. A key element of its independence is its location within the Controller's Office. Under San Francisco's Charter, the Controller is an appointed position with a ten-year term. Appointed by the Mayor and confirmed by the Board, the Controller can only be removed from office by the Mayor, with cause, and with a two-thirds approval of the Board. As Chief Economist, I report to the Controller.

Prior to the establishment of the OEA, the Controller's Office had established a role within city government as a source of independent, respected policy analysis. The Controller is the City's Chief Financial Officer and Chief Auditor. Several other divisions of the office produce analytical reports that are widely seen as objective, and form the basis for political debate in the city. In practice, I believe it's fair to say that the prior reputation of the Controller's Office has facilitated the acceptance of OEA reports, and that in turn the reception of OEA reports has strengthened the Controller's office as a source of important policy analysis. In these respects, placing the OEA in a strong, non-political, office like the Controller has significantly contributed to its effectiveness.

An additional area of potential political influence over the OEA is its budget. Proposition I provided for a minimum of two economists, but any additional resources depend on the City's budget. Throughout its existence, the OEA has never had more than two economists and one intern, and it is now staffed only with the minimal two economists. The office does not have a dedicated funding stream. It is funded by the City's General Fund, and does not receive any budget set-aside, unlike some other functions in City government. The annual decision to fund the OEA thus rests with the Mayor and the Board, and not with the Controller. While this budgetary situation has not prevented the OEA from working independently to date, it is probably an unusual arrangement for an independent review function, and could lead to a weakening of the office's independence in the future.

In addition, initiatives passed by the voters are not normally subject to amendment, and this could have provided an additional level of political independence for the OEA. However, the language of Proposition I itself gave the Board the power to amend the measure "to promote or better achieve the underlying goal of comprehensive and professional economic planning and analysis". Any future Board and Mayor could therefore eliminate or restructure the OEA in any way they like, provided their actions furthered that stated "underlying goal".

Despite the fact that it creates the potential for political interference, I believe that, on balance, including this clause in Prop. I was a good idea at the time. The OEA was not only a new function for San Francisco government; at the time of its creation the Controller could not find any other city in the United States that regularly produced independent economic impact reviews of pending legislation. An excessively rigid approach to what was, in essence, capacity-building could have had unintended consequences. As we develop more experience with the function, and learn from the experiences of other jurisdictions, more refined models can be developed.

3. Implementing Economic Impact Review

The OEA's process for implementing Proposition I involves two main things. First, we review the complete list of legislation complied by the Clerk of the Board after each Board meeting, assess them for material economic impact, and report that information back to the Clerk. We also post our determinations on our website, so the public knows our opinion on each piece of legislation introduced. Secondly, we analyze and prepare reports on the legislation we have selected. These reports are also posted on our website, as well as delivered to the Mayor, members of the Board of Supervisors, the media, and members of the public.

On the first issue, the primary judgment we exercise is in determining which legislation to review. The language of Prop I requires the OEA to "identify and report on all legislation introduced at the Board of Supervisors that might have a material economic impact on the City" It does not provide any guidance as to what is meant by "material economic impact", however. Given the resource and time constraints under which the OEA has to operate, we have maintained that a "material economic impact" means a *net* economic impact, on the entire San Francisco economy, exceeding $10 million.

We estimate the overall size of the San Francisco economy, in GDP terms, is about $100 billion. Any legislation causing an impact of less than $10 million would therefore affect the economy, in positive or negative terms, by less than 0.01%. I do not consider an impact of this magnitude to be "material". In addition, the impacts we report on are *net* impacts, on the economy as a whole. A report is not necessarily triggered by an impact—even a large impact—on a single party.

This issue arose when the City enacted legislation that banned cigarette sales at most pharmacies in San Francisco. We determined this legislation would not have a material economic impact, because while it would reduce cigarette sales at the affected businesses, smokers would simply divert their business to non-affected businesses, who would benefit from increased sales. Thus the total amount of spending in the city would not significantly change. When one affected chain of businesses sued the City, it charged the OEA's "failure" to file a report as an abuse of discretion on our part. In their view, their individual reduction in sales was sufficient in itself for the impact of the legislation to be "material". Our view of Prop I, to the contrary, has always been that it is net economic impacts to the city that matter. The court incidentally found that we did not abuse discretion in our decision.

In addition, the OEA has not generally written economic impact reports on appropriations, such as the City's annual budget. Our opinion has been that since the City spends the revenue it has in the local economy one way or the other, there is no material impact in the decision to spend it on one form of service or another. On the other hand, legislation that increases the size of the City budget, such as new taxes and major fees, has regularly been analyzed by our office. The OEA has also not reported on fee increases that occur because of increases in the cost of providing services, nor on statements of policy or governance changes whose economic impact cannot be clearly determined.

These guidelines are simply our internal rules of thumb, which the office developed after many months of reviewing legislation and trying to explain to interested parties the issued we weighed in making determinations. We use them in the context of managing our workload, and they may change in the future. While Proposition I *requires* the OEA to report on legislation having a material economic impact, as we determine it, nothing in it prohibits us from reporting on other matters.

In terms of the second issue, preparing economic impact reports, we aim to describe precisely how the legislation would affect the economy as clearly and simply as possible. In general, legislation will affect the economy in both positive and negative ways. For example, a payroll tax reduction will tend to expand the economy because it encourages hiring by reducing the cost of labor. On the other hand, the resulting reduction in General Fund revenue will shrink the economy by reducing the amount of local government spending. In another example, an amendment to the Building Code to improve indoor air quality standards will increase construction costs, harming the economy in the short term. In the long run however, it will improve health and productivity, and reduce health care costs. Our chief analytical challenge is quantifying these conflicting effects to arriving at an overall net assessment. We have found both that a cut to the payroll tax would grow the economy despite the reduction in local government spending, and that indoor air quality legislation improves the economy over the long term, despite the upfront cost.

We have been greatly aided in this analytical work by the City's investment in an econometric model of San Francisco economy, developed by REMI Inc. REMI is the leading company specializing in producing economic models for states and local governments to simulate the impact of policy changes. Essentially, REMI is a system of equations that describes all of the major sectors of the local economy. Running the model "as is" generates a baseline prediction of key economic indicators like employment, spending, population, property values, and so forth. We then analyze legislation to determine how it could affect equations in the model—an increase in the cost of construction, for example—and then re-run the projections to see the difference. REMI gives us an objective, credible basis for quantifying, and thus weighing, the different positive and negative economic effects that legislative changes can have.

4. Thoughts on a State Economic Impact Review Function

Because Prop I was an initiative ordinance and not an amendment to the City's charter, it could not limit the Board's authority to pass legislation, regardless of the findings of any OEA report. The OEA does not grant approval to legislation, and in fact has no real authority at all, except to make a determination that pending legislation has economic impact, and to issue reports.

As a "weak" form of oversight, the OEA is useful only to the extent it produces new information that enlightens the policy debate in City Hall. This reality has meant that our reports focus on being thorough, deeply acquainted with the details of legislation, transparent, and quantitative wherever possible.

Some in San Francisco have had the opinion that the OEA should be issuing several reports per week, on any legislation that affected the economy in any minor way. According to this point of view, since it is relatively easy to develop a qualitative opinion on whether a piece of legislation is good or bad for private businesses, the OEA should be frequently issuing 1-2 page memos simply stating that fact.

The primary problem with this approach, in my opinion, is that it would do fairly little to affect the policy debate within City Hall. Economists are not valuable because they have opinions, they are valuable to the extent they can conduct analysis that clarifies economic questions for decision-makers. I think when we've succeeded, it's been because we've made decision-makers aware of unintended consequences and net impacts, after considering all points of view and all conceivable effects. I consider our reports

A related concern has to do with staffing and investment. Some have felt that the OEA function need not be staffed by professional economists, because its role was more a matter of cataloging the winners and losers that would result from a particular policy, and this is fairly straightforward work for any policy analyst. In fact, economic analysis is not the same thing as stakeholder analysis. Prop I requires the OEA to assess the impact on the net economic and employment impact on the entire city. As discussed above, doing so involves making a quantitative estimate of all of the economic impacts and then considering their combined effect to come up with a net assessment. Our office could not do that work had we not invested in the REMI model or something similar.

At a state level, it would seem the first question has to do with whether any desired review function be purely informational, like the OEA, or stronger, as part of a regulatory approval process. Legal issues aside, I believe the San Francisco experience would lead to the conclusion that a weak informational role can work, provided the conclusions are well-grounded, respected, and well-publicized. In fact, agencies may wish to work collaboratively with an economic analysis group prior to developing regulations, as sometimes happens with our group. I would recommend allowing an economic analysis group the authority to make its own decisions regarding legislation or regulation to be reviewed, perhaps augmented with additional recommendations from the Legislature, the Governor's Office, or state agencies themselves.

The location of the economic analysis is also vital to ensuring its independence, and a continuing investment in professional staffing and analytical capacity. Although I've not worked in State government and wouldn't claim to have a comprehensive understanding of its structure, four possible locations come to mind. The Legislative Analysts Office is certainly well-respected and has the sort of reputation for independence that can benefit a new government function, just as the prior reputation of the Controller's Office benefitted the OEA. Secondly, the State Controller's Office has already established a "Council of Economic Advisors". While this group is an outside advisory body that is more focused on providing insight on economic trends, as opposed to legislative and regulatory impact analysis, it could evolve into a peer review function that would be valuable in getting an economic analysis group off the ground. The Department of Finance has longstanding economic modeling and forecasting capacity, as of course does the Employment Development Department.

Finally, understanding resourcing and managing workload will be vital. From our experience in San Francisco, I would recommend establishing a clear and stable non-General Fund funding source; adequate attorney resources (simply to aid in understanding legislation), and some authority to establish timelines over when reports are required. In the process of balancing available staff resources, mandated reporting requirements, and aggressive timelines, analytical quality can suffer. In building a new government function, this should be prevented to the greatest extent possible.