Impact of Eliminating the Los Angeles Business Tax – Summary of Findings

- In 2011, the BTAC recommended that the business tax be eliminated. In response to the BTAC recommendation, the city's Office of Economic Analysis requested an analysis of the impact of the proposed business tax elimination. This report presents a summary of the results of that analysis.

- We analyzed the proposed elimination of the business tax using two distinct analytical approaches:
  - First, we apply the findings from the best available published research on the effects of local business tax cuts to the unique situation in Los Angeles.
  - Second, we model the effects of eliminating the business tax using the REMI model. REMI is a well-regarded economic modeling tool for estimating the effects of tax or policy changes on a region's economy, and is widely used by other jurisdictions for similar purposes.

- Using the results of the published economic research, we estimate that eliminating the business tax would result in an increase in economic activity in the City of Los Angeles of 0.96 percent (or an increase in economic output of about $2 billion annually and about 15,875 new jobs).

- Modeling the impact of the elimination of the business tax using the REMI model yields roughly similar results. According to our REMI analysis, eliminating the business tax would result in an increase in economic output of about 0.47 percent (or about $996 million and approximately 7,640 jobs).

- In order to translate these output changes into fiscal impacts for the city's budget, we performed a regression analysis. This analysis indicates that, for each additional $1,000 in output, the city's general fund revenues (excluding the business tax) increase by about $13.33. Applying this estimate, we find that eliminating the business tax would result in an increase in other general fund revenues of between $13.3 million and $27.1 million. However, because of the loss of business tax revenues, these increases in output and revenues would not be sufficient to offset the cost of eliminating the business tax. Using the larger of the two output increase estimates, we estimate that the overall net fiscal impact of eliminating the business tax would be an annual net revenue loss of nearly $400 million.

- Our work follows a 2011 report prepared by Professor Charles Swenson. Prof. Swenson's report concludes that elimination of the city's business tax would likely pay for itself through increased economic activity resulting in additional non-business tax revenue more than enough to replace the lost business tax revenue. We find Prof. Swenson's findings to be unreliable for the following reasons:
  - Professor Swenson's results are not supported by the body of published research. In fact, he reports a result more than 25 times larger than the average of the published research studies.
  - Professor Swenson's conclusions are based entirely on analyzing a single year (2001). He does not adequately control for economic changes occurring both outside of LA as well as during other time periods. Additionally, as explained in our report, Professor Swenson's methodology is very sensitive to the data source, measure of economic activity, and tax period analyzed.

- Our conclusion, supported by the body of published academic research and our own economic modeling, is that eliminating the business tax would result in an increase in employment and economic output, but this increase would not be large enough to offset the loss of business tax revenues. Instead, elimination of the business tax would lead to a net reduction in revenues of nearly $400 million annually.