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Pittsburgh's Budget: Legacy Costs Have Large and Lasting Impact

For the 2009 budget and the years beyond, legacy costs—pensions, retiree health care, workers' compensation, and debt—will dominate the discussion about taxes, spending, the level of municipal services and who provides them in the City of Pittsburgh. Legacy cost problems have been building for some time and must be dealt with.

Indeed, legacy costs have figured prominently in recent developments. Bear in mind that (1) a good deal of the discussion over a proposed City-County merger hinged on what to do with the City's debt obligations; (2) the Mayor has made clear that he wants some type of statewide solution to pensions; and (3) the City's request to exit Act 47 (which was denied largely because of legacy costs) has instead brought a promise of renewed focus on the cost issue. According to the City's budget message, the Act 47 team's revision of the recovery plan is supposed to be an "exit strategy for the City, restoring long-term fiscal health and ensuring positive operating budgets well into the future".

Of more immediate concern are the impacts being felt in the 2009 budget and the Five Year Forecast. Legacy costs are playing a significant role. For instance, total expenditures for 2009 are budgeted to increase 5.1 percent from $416 million in 2008 to $437 million. This overall growth is much slower than the sub-category of outlays for pensions, health benefits and workers' compensation, which is budgeted to rise from $119 million to $130 million in 2009, an 8.9 percent increase.

Here are the five year forecasts for the five major sub-categories of expenditures in the budget:

Five Year Forecast of City Expenditures

Expenditures	2009 Budget Amount (000s)	% of 2009 Budget	% Growth, 2009-2013
Operating Departments	$205,308	47%	+ 7%
Pension/Benefits/Workers' Comp	$130,223	30%	+18%
Utilities/Judgments/Refunds	$16,353	4%	+18%
Miscellaneous Other Non-Dept	$3,840	1%	-98%
Debt Service	$82,250	19%	-22%

Although the category of utilities/judgments/refunds is projected to grow at the same rate as pensions/benefits/workers' compensation, the impact on the total outlays of utilities/judgments will be relatively small since that category represents only 4 percent of the 2009 budget while the benefits category represents nearly a third. More importantly, the unfunded liabilities of employee benefits will remain very large even with the projected increase in funding.

The dilemma for the City as it boosts legacy cost spending is that it still has to pay for day-to-day services while keeping an eye on tax burdens. Recall that the 2004 state reform package made many changes to the City's major sources of revenue: it shifted a share of the schools' wage tax to the City; it mandated cuts to the parking tax; it increased the occupational privilege tax from $10 to $52; it eliminated the mercantile tax and phased out the business privilege tax and replaced them with a payroll tax. Many of those changes have already been implemented or are in their final year of implementation. The tax rates of the new taxes are limited by state law. Presumably, unless the state legislature revisits the issue of City taxes, there will be no further changes in the near future to the taxes that can be collected or the allowable rates.

The City's largest revenue source, the real estate tax, was not touched by the reform package and remains under the City's control. At 10.8 mills, it is on the high side among municipal rates in the County. And since the reassessments of 2001 and 2002, there has been little appreciable growth in property tax revenue for the City. In fact, real estate tax revenue fell in both 2007 and 2008. The City is projecting a 1.2 percent increase for 2009, but the budget squarely places the blame for minimal growth on the County's base year assessment system. The Mayor noted in his budget message that "the City of Pittsburgh is faced with the prospect of little or no growth in this largest revenue source due to the County's use of a base year assessment system…[it] fails to reflect changes in property values, suppresses growth, and leads to inaccurate assessments and disproportionate taxation throughout the City".

Strong words indeed. Aside from the final shift of the schools' wage tax to the City's wage tax, there is not much in the way of revenue growth in 2009 or future years. The City could be waiting for a chance to levy a commuter tax. Recall that the statute that created the oversight board also prohibited the City from using the commuter tax provisions in Act 47 as long as the oversight board is in existence. However, by law, the oversight board ceases to exist in 2011 unless the General Assembly and the Governor approve an extension. If the oversight board is not extended, the City might well attempt to impose a commuter tax.

So how does the City fund its operations and start to reduce legacy costs given the prospects for limited tax revenue growth? It has already made some moves: the City ended retiree health care for police and fire personnel hired after June 2004 and it is not issuing debt for capital needs but instead moved to a "pay as you go" method. Beyond these steps, the City could move to set a date in which all employees hired after a certain date no longer get defined benefit pensions but defined contribution plans instead. There is no question that workers' compensation claims have to be lowered, an expenditure far out of line with other cities.

Painful as it will be, the City might have to make steep cuts in personnel that ultimately stem the future accumulation of legacy costs. The City should decide now to look at outsourcing and privatization efforts and where there is duplication and farm out services to the County. The need to undertake meaningful change is urgent and there will be no City-County merger in the foreseeable future to relieve any of the pressure to make necessary reforms.

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