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The “20-20-20-20” Dilemma: The Need to Curtail New York City’s Legacy Costs

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A giant and rapidly growing slice of the New York City budget does not pay for current services. Instead, it pays for costs that are the legacy of commitments made in the past. These legacy costs already exceed 20 percent of the budget and will expand by 20 percent to more than $20 billion in annual spending by fiscal year 2020. Fortunately, there are some steps the City can take to deal with this “20-20-20-20” dilemma.

Legacy costs are not easily altered by current policy makers – unlike other expenses, which can be adjusted based on needs, priorities, and resources. Legacy costs are composed primarily of debt service (to repay bonds issued for past capital projects), pension contributions (to support benefits of current and future retirees), and health benefits for retirees. Together, legacy costs will increase 20 percent from $17.4 billion to $20.9 billion, while all other spending will increase less than 11 percent.

How can city leaders undo decisions of the past? It’s not easy.

Debt service payments are made according to a predetermined schedule, and failure to make a payment can lead to credit downgrades that make future borrowing more costly. Pensions are constitutionally protected; benefits cannot be reduced, and the City must make its payments each year to keep the funds solvent. There is somewhat greater flexibility when it comes to retiree health benefit costs. Changes can be made legislatively by the City Council and Mayor, but changes have historically been negotiated – in order to gain the approval of the Municipal Labor Committee (MLC).

Fortunately, the City and the MLC have partnered to achieve savings in the City’s overall health care costs, and these ongoing negotiations should include bringing retiree health benefits in line with those of other state and local governments. That could be done in several ways.

First, retirees should share in the cost of health premiums. Currently, most retirees are enrolled in plans that do not require a premium contribution; benefit eligibility kicks in with as little as 10 years of service and begins when the retiree collects a pension, regardless of age or other employment.

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Retiree health insurance is an increasingly rare benefit in the private sector, and most municipal governments that offer the benefit require retirees to share the premium costs, typically at rates greater than employees. Other state and local governments also prorate the subsidy according to length of service.

Second, reform of union welfare funds is needed. Based on negotiations with each union, the City makes per-employee and per-retiree contributions to the funds, which are administered by union officials who decide what benefits the funds will offer, typically for prescription drugs and vision and dental care. The funds are inefficient, poorly managed, and unaccountable. Consolidating supplementary health care benefits under the City's health plan would be more efficient.

Finally, Medicare Part B premium reimbursements should be eliminated. This benefit is unheard of in the private sector and uncommon even among public employers.

These three changes could provide savings totaling up to $1.6 billion by fiscal year 2020 – keeping total legacy costs under $20 billion and reducing the growth to a more reasonable 11 percent. It's time for City officials to take the needed steps to curtail the "20-20-20-20" dilemma.

The author is President of the Citizens Budget Commission. This article is based on a fuller analysis of the "20-20-20-20" dilemma conducted by the CBC and available at www.cbcny.org.