The Myth of the "Uncontrollables"

Citizens
Budget
Commission

Four Ways New York City Can Take Control of Its Financial Future and Save $2.5 Billion per Year

May 2005

What's the Problem?

For years New York City Mayors have bemoaned the fact that much of the budget is "uncontrollable." By this they mean that parts of the budget are not under the direct control of City leaders. The Mayor and City Council cannot act on them unilaterally. Other parties, including State and federal officials, impose important constraints on local officials. For example, the City's Medicaid bill is determined by State legislation specifying who is eligible and how much doctors and hospitals must be paid.

Different Mayors have used a variety of terms, including "unfunded mandates" and "non-discretionary spending," to describe these items. Typically they include:

- **Pension fund contributions –** because workers have already been promised benefits, and they are protected by the State Constitution;
- **Health insurance –** because health care inflation is a national phenomenon, and the City is obligated to insure its employees and retirees;
- **Medicaid –** because State law determines the cost of the program;
- **Debt service –** because the City is obligated to pay back money it has already borrowed.

The limited discretion over these items is a problem, because City officials make clear that it causes them to spend more than they otherwise want. In this situation the budget is not a tool for setting priorities but becomes a straitjacket that forces tax increases or cuts in other areas.

The reality is that City leaders have more options for controlling these expenditures than they acknowledge. The fact that other parties play a role does not mean that there is nothing the City can do. It simply means that City officials must be more creative and determined in their thinking and be willing to persevere over a multi-year time horizon.

The danger is that the rhetoric becomes accepted as a fact rather than confronted as a difficult but addressable problem.

Table 1
"Non-Discretionary" Spending, City Funds
(dollars in millions)

	2005	2009	AVERAGE ANNUAL GROWTH 2005-2009
"Non-Discretionary" Spending	**$19,097**	**$24,576**	**6.5%**
Pension Contributions	3,211	4,600	9.4%
Fringe Benefits	4,624	5,877	6.2%
Debt Service	4,228	5,826	8.3%
Medicaid	4,770	5,306	2.7%
All Other	2,264	2,967	7.0%
Agency Spending	**$15,767**	**$16,823**	**1.6%**
Total City-Funded Spending	**$34,864**	**$41,399**	**4.4%**

Source: The City of New York, Office of Management and Budget, *Executive Budget, Fiscal Year 2006*, May 5, 2005.

Why is this Important?

The issue is important, because this difficult-to-control category is big – consuming about half of the City's locally-raised revenues – and is expected to grow rapidly. As fiscal year 2005 ends, the Mayor views $19 billion as "non-discretionary." He projects that by fiscal year 2009, the sum will reach $25 billion – growing at an annual average rate of 6.5 percent. (See Table 1.) The fastest growing item is pension contributions, with an average annual growth of 9.4 percent. Debt service is the second fastest growth item increasing at an annual average of 8.3 percent.

As these items drive up spending, fewer resources will be available to meet other needs. The result is a financial plan in which all of the choices about spending growth are already made. Agency or discretionary spending must be frozen or reduced, while "non-discretionary" items consume an additional $5.5 billion. (See Figure 1).

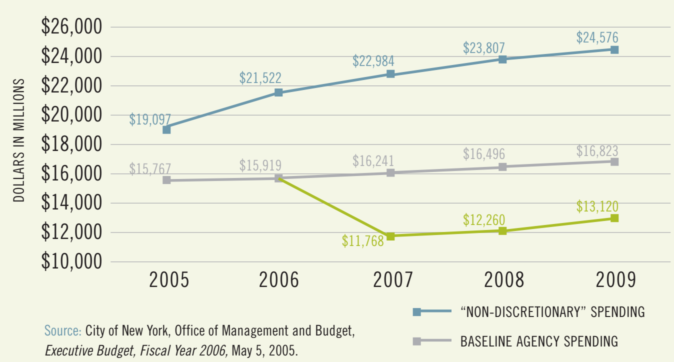
Even more disturbing is that the unabated growth in these items is expected in the context of a troubling financial outlook for the City. Over the next three years the City must grapple with closing annual budget gaps of about $4 billion. If these "non-discretionary" items are allowed to continue to grow unchecked, additional agency programs will have to be cut to balance the budget.

Better controlling these items would allow the resulting savings to be plowed back into services or provide for tax cuts. The CBC proposes four ways to reduce spending growth in these areas. If the growth of these items is halved, through these options, then an additional $2.5 billion would be freed for other uses. What would $2.5 billion buy in the City budget? Here are three alternatives:

- It would add 49,000 new teachers, lowering average general education class size from 28 to 12 students.
- It would cut the New York City personal income tax rate in half, reducing the average tax liability from $2,600 to $1,470.
- It would nearly close the out-year budget gaps, thus preventing painful program reductions.

These options require real leadership and difficult choices, but there is an even higher cost to doing nothing.

Figure 1
"Non-Discretionary" vs. Agency Spending Before and After Gap-Closing
Fiscal Years 2005 to 2009



Source: City of New York, Office of Management and Budget, *Executive Budget, Fiscal Year 2006*, May 5, 2005.

FOUR WAYS TO TAKE CONTROL

Reduce Pension Costs

#1

Pension benefits are set by the State Legislature, and current workers are protected from change by the State Constitution. But a new and more affordable pension plan could be established for new workers through State legislation. Given an annual turnover rate of 6 percent, by fiscal year 2009, the last year of the financial plan, about 22 percent of the workforce would be under the new plan. If employer contributions under the new plan were held to 10 percent of payroll, it would save the City $549 million by fiscal year 2009.

THE CASE FOR THIS OPTION

New York City offers more generous pension benefits than other large employers. Benefits are more generous in a number of ways.

- New York City offers a defined benefit plan. Only 20 percent of employees in private sector have defined benefit plans; most have a defined contribution plan.

- New York City counts more worker pay, including overtime, toward benefits. Nationally, only 6 percent of full-time state and local government employees can count overtime in their pension formula.

- In a unique practice, some New York City systems pay pensioners a bonus. For example, retired New York City police officers will receive a December holiday bonus of $12,000 on top of their monthly pension checks.

- New York City requires low contributions from its workers. About 74 percent of state and local government employees in other systems are required to contribute more than 3 percent of earnings into their pension plans while City employees typically contribute less.

Reduce Health Insurance Costs

FOUR WAYS TO TAKE CONTROL

#2

New York City offers more generous health insurance coverage than other employers. The vast majority of City employees pay no part of their premiums. Unlike most other workers, City employees have no deduction from their paychecks for health insurance. Similarly, retirees are not required to contribute to the premium, and the City subsidizes their Medicare insurance.

The City should more closely align its health insurance practices with those of other employers. It should share the cost of health insurance premiums with workers by requiring 10 percent for individual policies and 20 percent for family policies. Retirees should be required to pay 50 percent of their health insurance premiums, and the City should stop paying for their Medicare Part B premiums. The Mayor could make these changes via collective bargaining, and a local law could end the Medicare subsidy. This would yield savings of $1,197 million in fiscal year 2009.

THE CASE FOR THIS OPTION

The two principal reasons for this option are: 1) it would bring about cost consciousness among current employees and retirees and create pressure to bring costs down; 2) the City's contributions for health insurance are far more generous than those of other large employers.

- For current employees of large private employers, the typical practice is for the worker to pay 18 percent of the premium for individual coverage and 31 percent for family coverage. (See Table 2.) The City pays 100 percent in each of these instances.
- For retirees, only 38 percent of large private employers offer health insurance benefits, and only 9 percent pay any share of Medicare Part B premiums. Among those who do pay, the average share was about 60 percent. Again in each case the City pays the full cost.

Table 2
Typical Distribution of Private Sector Health Insurance Premium Costs

	CURRENT EMPLOYEES	RETIREES
Average Individual Premium Contribution		
Employer	82.0%	61.6%
Retiree/Employee	18.0%	38.5%
Total	100.0%	100.0%
Average Family* Premium Contribution		
Employer	69.0%	65.4%
Retiree/Employee	31.0%	34.6%
Total	100.0%	100.0%

* *"Family" for retirees represents retiree plus spouse contribution.*

Sources: Retirees' data from Kaiser/Hewitt 2004 Survey of Retiree Health Benefits, December 2004; Current Employees data from US Department of Labor Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2004, November 2004.*

FOUR WAYS
TO TAKE
CONTROL

#3

Reduce Medicaid Costs

New York State sets the rules for Medicaid, and it requires localities to pay a bigger share of total Medicaid costs than any other state. In fiscal year 2005 New York City's local share of Medicaid will cost an astounding $4.8 billion and consume 14 percent of locally-raised revenues. Based on State policies, the City projects that its Medicaid costs will grow to $5.3 billion by fiscal year 2009.

New York City is not alone in having difficulty financing Medicaid; in some counties the entire property tax levy is not sufficient to cover the Medicaid bill. Cries for reform this year have led the Governor and the Legislature to agree to a local growth cap, which will provide some local fiscal relief but not reduce overall costs. What is needed now is true cost containment. Major changes can be made that preserve benefits to the poor, while saving billions of dollars. The Mayor should join forces with the Governor, who has been an advocate for cost containment, to secure the necessary reforms in the State Legislature.

A recent CBC study of the issue, *Confronting the Tradeoffs in Medicaid Cost Containment*, identified four proposals:

- Limit eligibility loopholes. State laws and local administrative practices have created large loopholes in eligibility standards that enable many middle-class and wealthier individuals to qualify for Medicaid-financed long-term care including nursing homes and personal care at home.

- Pay only competitive costs to hospitals and nursing homes. Based on comparative data, New York State pays hospitals about 13 percent more than is necessary and nursing homes 29 percent more.

- More managed care participation. Managed care, when implemented properly, is a win-win arrangement under which taxpayers save money and needy clients get better care. However, New York State was slow to join the movement, and its participation rate trails the national average.

- Limit excessive personal care services. New York State's program of personal care for people living at home pays for many more hours of home attendant services for tasks such as housekeeping and shopping than is permitted in any other state – an average of 30 hours per week compared to 11 in the rest of the country.

FOUR WAYS
TO TAKE
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THE CASE FOR THIS OPTION

The CBC proposals are intended to restore New York State's Medicaid program to its original purpose – providing health care to the poor.

- This can be accomplished without reducing services to those in need, because New York State now spends in ways that are less efficient than in other states. New York State's services cost $8,031 per beneficiary, nearly double the national average and substantially more than its major competitor states. (See Table 3.)

- These proposals would save $4.6 billion statewide. Since New York City bears a large share of the local financing burden, about $454 million would be trimmed off New York City's costs in fiscal year 2009.

Table 3
Medicaid Expenditures
New York And Its Competitor States
Federal Fiscal Year 2001–2002

STATE	EXPENDITURES (IN MILLIONS)	EXPENDITURES PER BENEFICIARY		
		AMOUNT	PERCENT OF US AVERAGE	50-STATE RANK
NEW YORK	$31,489	$8,031	187%	1
CONNECTICUT	3,245	6,774	158%	4
MASSACHUSETTS	6,387	5,994	140%	9
NEW JERSEY	5,497	5,759	134%	10
OHIO	9,186	5,547	129%	11
ILLINOIS	9,122	5,268	123%	14
PENNSYLVANIA	8,524	5,238	122%	16
MICHIGAN	5,919	4,082	95%	34
TEXAS	11,121	3,767	88%	38
FLORIDA	9,827	3,672	86%	39
GEORGIA	4,796	2,929	68%	48
CALIFORNIA	23,636	2,541	59%	50
US TOTAL	$213,491	$4,291	100%	

Source: Centers for Medicare & Medicaid Services, MSIS Statistical Report: Federal Fiscal Year 2000, <http://www.cms.hhs.gov/medicaid/msis/tables2002.asp> (March 15, 2005). Total expenditures do not include payments for the Disproportionate Share Hospital (DSH) program.

FOUR WAYS
TO TAKE
CONTROL

Reduce Debt Service

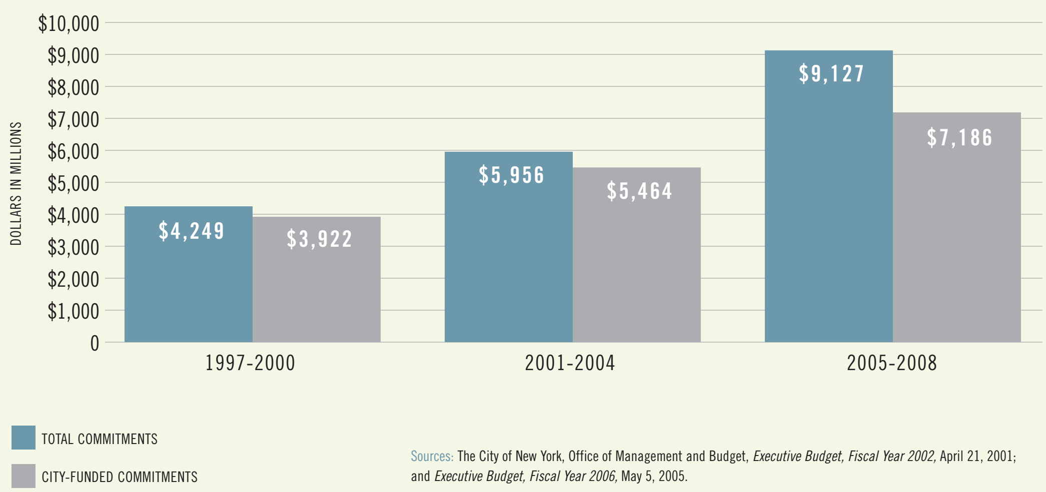
#4

New York City borrows money by issuing bonds to pay for large capital projects. Debt service, the interest and principal payment on these bonds, is part of the City's operating budget.

The amount of debt service due in future years can be lowered in three ways: 1) by refinancing to convert high-interest debt to low-interest debt; 2) by reducing capital spending or building more efficiently; 3) by paying off debt already issued, thus eliminating future repayments.

The City has refinanced much of its debt to take advantage of the favorable interest rates of the past few years. However, more should be done in the other two areas. The City can reduce its capital budget and pay off debt on its own, but State law creates inefficiencies that raise construction costs. These actions would yield annual savings of $290 million in fiscal year 2009.

Figure 2
City of New York
Average Annual Capital Commitments, Three Recent Capital Plans



Sources: The City of New York, Office of Management and Budget, *Executive Budget, Fiscal Year 2002*, April 21, 2001; and *Executive Budget, Fiscal Year 2006*, May 5, 2005.

THE CASE FOR THIS OPTION

The City's capital plan for fiscal years 2005 to 2008 increases average annual spending to $9.1 billion, up from $6.0 billion for the previous four years, and $4.2 billion for the fiscal year 1997 to 2000 period. (See Figure 2.) This sharp increase in capital spending will create a debt and debt service obligation that is highly burdensome. To reduce its burden the City should pay off debt with the large operating surplus it has accumulated in fiscal year 2005 – now being used imprudently to support recurring expenses in the proposed budget – and should focus on reducing construction costs by advocating for repeal of, or exemption of more projects from, the State's Wicks Law.

- A State law, the Wicks Law, requires that the City issue four separate contracts – electric; plumbing; heating, ventilation, and air conditioning; and all other services – for construction rather than using a general contractor. This is estimated to add at least 10 percent to the City's capital costs for affected projects.

- The City estimates it will have a surplus of more than $3 billion this year. Instead of being spent to increase next year's payroll, this money should pay off outstanding debt. The deficit financing used after September 11th, 2001 added $2.0 billion to the City's debt that can now be repaid in order to avoid burdening the next generation of New Yorkers with the cost of services consumed in 2001 and 2002.

What It's All Worth

These four proposals would yield the following annual savings in fiscal year 2009:

Pension Reform	$549 million
Health Insurance Reforms	$1,197 million
Medicaid Cost Containment	$454 million
Debt Service Reduction	$290 million
Total Savings	**$2,490 million**

The total savings of nearly $2.5 billion would leave the City with a much smaller budget gap or permit investments in other needs. (See Table 4.) Confronting the myth of "uncontrollable" budget items head-on is vital to the City's financial future.

Table 4
"Non-Discretionary" Spending After Savings, City Funds
(dollars in millions)

	2005	2009
Projected Budget Gap	$0	($3,703)
"Non-Discretionary" Spending	$19,097	$24,576
New "Non-Discretionary" Spending by Item		
Pensions	$3,211	$4,051
Fringe Benefits	$4,624	$4,680
Debt Service	$4,228	$5,536
Medicaid	$4,770	$4,852
All Other	$2,264	$2,967
Total New "Non-Discretionary" Spending	$19,097	$22,086
Total Savings	0	2,490
New Projected Budget Gap	$0	($1,213)

Sources: The City of New York, Office of Management and Budget, *Financial Plan Summary, Fiscal Years 2005-09*; *January 2005 Financial Plan Detail, Fiscal Year 2005-09*, January 2005; and *Executive Budget, Fiscal Year 2006*, May 5, 2005.

Founded in 1932, the Citizens Budget Commission (CBC) is a nonpartisan, nonprofit civic organization committed to influencing constructive change in the finances and services of New York State and New York City governments.

This report was prepared under the auspices of CBC's Budget Policy Committee. The members of the Committee are: Karen Daly, Co-chair; Heather Ruth, Co-chair; Lawrence D. Ackman, Richard H. Bagger, Stephen Berger, Lawrence B. Buttenwieser, Evan A. Davis, Stephen DeGroat, Cheryl Cohen Effron, Roger Einiger, Laurel FitzPatrick, Paul E. Francis, Bud H. Gibbs, Kenneth D. Gibbs, James F. Haddon, Jeffrey Halis, Walter Harris, Patricia Hassett, Fred P. Hochberg, Brian T. Horey, Eugene J. Keilin, Peter C. Kornman, Robert Kurtter, Bill Lambert, Rick Langfelder, Stephen Langowski, Richard A. Levine, Jeffrey Lynford, Norman N. Mintz, Robert E. Poll, Lester Pollack, Alfredo S. Quintero, Carol Raphael, Edward L. Sadowsky, Bart Schwartz, Teddy Selinger, Jonathan Siegfried, Adam Solomon, Joan Steinberg, Merryl H. Tisch, Lesley Daniels Webster, Kevin Willens, Nancy Winkler, and H. Dale Hemmerdinger, *ex-officio.*

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