CITIZENS BUDGET COMMISSION

One Penn Plaza Suite 640 New York, NY 10119

TESTIMONY BEFORE THE
NEW YORK CITY COUNCIL FINANCE COMMITTEE
Monday, March 6, 2006 – 3:00 p.m.

GIVEN BY ELIZABETH LYNAM
DEPUTY RESEARCH DIRECTOR – CITIZENS BUDGET COMMISSION

Good afternoon and thank you for the opportunity to testify. I am Elizabeth Lynam, Deputy Research Director at the Citizens Budget Commission. The Citizens Budget Commission is a nonpartisan, nonprofit civic organization that since 1932 has been devoted to influencing constructive change in the finances and services of New York City and New York State government.

I have a few brief comments to share with you today on the preliminary budget and financial plan from fiscal years 2006 to 2010. And, of course, I am happy to take questions after my remarks.

The first point I would like to make concerns the use of surplus funds. In general, it is the Commission's position that surplus resources are unanticipated and should not be treated as recurring by being used to support recurring operating expenses. Following that principal, appropriate uses would include deposits to "rainy day" funds, reduction of long-term obligations such as debt either by paying off bonds or capital spending on a pay-as-you-go basis that reduce planned borrowing, and one-time investments in technology that have the potential to maintain service levels while lowering ongoing labor costs.

That being said, once again this year the City finds itself in the advantageous position of having a sizeable projected year-end surplus. This presents City leaders with the opportunity and challenge of using these resources appropriately and well—to benefit the future rather than be expended next year to support unsustainable and ongoing operating expenses. The proposals the Mayor has set forth in the preliminary budget and financial plan begin to seize the opportunity, but also pose a challenge.

The health trust fund proposed by the mayor is the opportunity. By establishing it, the City can begin to deal prudently and prospectively with what poses a potential future risk—the new GASB 45 requirement, effective in fiscal year 2008, that the City report on its books the full future cost of retiree health insurance. Initial estimated valuations of this liability are $50 billion in total and $3-4 billion annually if converted to an actuarial calculation similar to the one that sets annual pension costs. The Mayor has proposed initial deposits to the trust of $2 billion over two years. In addition, the City plans to transfer about $1 billion starting in fiscal year 2007 for the annual cost of retiree health insurance.

The Commission strongly supports the formation of a health insurance trust fund to finance retiree health obligations into the future. The measure will start the City on a course toward permanently accounting for—in a separate and discrete fund—a cost that heretofore has been less than

transparent. The $2 billion, although a drop in the bucket against a $50 billion liability, will surely be regarded by bond-raters and credit markets—to name just a couple of entities following the impact of GASB 45 closely—as a proactive and more-than-timely initial response. We urge the Council to work cooperatively with the Mayor to establish the trust and to fund it at at least the level proposed in the preliminary plan.

Now let me turn to the challenge—the $3.3 billion surplus projected to materialize by the end of fiscal year 2006. In his preliminary plan the Mayor has proposed rolling it into fiscal year 2007 and using it to support operating expenses. An alternative use for these funds should be developed—one that recognizes that they are non-recurring. Preferable alternatives include additional deposits to the health insurance trust or an increase in the amount of pay-as-you-go capital included in the budget. The City's current $200 million per-year pay-go commitment is too low.

The second point I would like to make concerns the large growth in spending—about 12.8 percent on a city funds basis in fiscal year 2007. The driver of the increase is the rising cost of the so-called "uncontrollables." These items – pension contributions, health insurance, Medicaid, and debt service – have often been referred to as uncontrollable because the City has less immediate control over them that it does other parts of the budget. Indeed, more limited discretion over the items is problem but the fact that other parties play a role does not mean that the City should throw up its hands. With an average annual rate of 14 percent for the past four fiscal years, compared to only 4.5 percent average annual growth for the rest of the budget, the City has plenty of motivation to tackle them.

Failing to take them on will have consequences for other program spending or could force a tax increase in a City whose taxes remain relatively high. To illustrate, over the life of the current financial plan the rest of the budget will grow at an average annual rate of less than 1 percent to support uncontrollables growth of 6.5 percent annually, on average.

To tame these costs City officials must be more creative and determined in their thinking and be willing to persevere over a multi-year time horizon. In this plan the Mayor has announced he will be more aggressive about addressing these high-growth items. He has begun an advocacy effort in Albany. Changes that must be made through collective bargaining should begin also. At this point there are no financial targets for the effort established but the plan refers to pension and health insurance changes. Medicaid cost containment and debt service reduction are also a high priority.

The Council should join the Mayor in working with the appropriate parties to achieve the necessary changes—adding a new "tier" on the pension system, sharing the cost of health insurance premiums with City employees, campaigning to decrease the overall cost of the State's Medicaid program, and investing more selectively with borrowed funds to minimize the growth in debt service. The savings to the financial plan, if all four were implemented, would not be insignificant. Last year the Commission released a piece—*The Myth of the "Uncontrollables"*—that offered proposals for controlling the growth in these items that were estimated to save $2.5 billion per year. I've brought some copies of that piece with me today for your review.

In closing let me thank you again for the opportunity to testify before you today.