Testimony: Senate and House Urban Affairs Committees

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Thank you for the opportunity to provide testimony regarding issues surrounding Pennsylvania's cities and the pressing need for reforms to foster their sustainability and avoid the looming danger of tax increases and service reductions that will result from inaction.

The Pennsylvania Economy League has a 77-year history of conducting independent, non-partisan research and is committed to sound public policy that enhances the competitiveness of the Commonwealth. I am the executive director of the Pennsylvania Economy League of Greater Pittsburgh, and in my 26-year career at PEL, I have worked to make Pennsylvania local government more efficient, more effective and more competitive economically.

It is in the light of PEL's tradition of researching and promoting good government management practices and structures that we have been engaged in an ongoing analysis of the distressing situation that Pennsylvania's cities face. We believe that reforms on a number of fronts are critical to the financial health of Pennsylvania cities and central to Pennsylvania's future generally. I would like to convey to the committees some of the highlights of our research and offer some conclusions on sound public policy that is indicated by the research.

The incidence of financially stressed municipalities is geographically widespread in Pennsylvania. A map at the end of this testimony shows municipalities that PEL has identified as suffering from some category of financial distress, whether it be inclusion in the Act 47 program, inclusion on PERC's pension plan distress list or identification in the annual PEL Municipal Stress Index. According to our analysis, over one-third of Pennsylvanians live in a municipality with a high degree of financial stress. Indeed, there are few counties that do not have at least one distressed municipality.

Why are so many of the Commonwealth's cities as well as boroughs and townships struggling to maintain financial health? I would submit that the problem stems fundamentally from outdated and intrusive state laws. Systemic shifts in the U.S. economy have devastated the tax bases of such former industrial centers as Duquesne, McKeesport, Johnstown and Reading, but it is largely the lack of flexibility that Pennsylvania law offers to local government to act in the best interest of its constituents that undermines the financial health of many municipalities.

State law hamstrings municipal financial health in two fundamental ways:

- It artificially and counterproductively increases costs; and
- It segregates municipalities into those that can generate adequate revenues and those that cannot.

For example, rigid state pension laws escalate municipal costs. Pennsylvania law requires cities to offer defined benefit pension plans to police and fire fighters: they are not authorized to offer hybrid systems that would introduce defined contribution plans into the retirement mix. While Americans now live longer, healthier lives and frequently elect to continue to work into their 60s and 70s, cities are required to offer retirement to police and fire fighters at age 50 with 20 years of service regardless of the health of the city's police and firefighters or the city's public safety and financial needs.

The Commonwealth is poorly positioned to provide additional financial assistance to municipalities to help pay pension obligations: its own share of pension cost for SERS and PSERS are projected to increase to about $4 billion in 2016. This will increase the share of the Commonwealth's general expenditure budget taken up by pension obligations from 6 percent to 13 percent (see the charts at the end of this testimony).

PEL is convinced that pension health is essential to Pennsylvania's viability as a location to live, work and invest. If we do not correct the problem, everyone will suffer. State, school district and municipal pension distress leads to higher taxes and reduced services, hurting businesses and residents. Ever increasing shares of public sector budgets are devoted to legacy costs. And financially stressed pension plans threaten the employment security of working people.

The growing pension crisis needs to be addressed legislatively. We need to bring reality to our pension practices lest our municipalities fail. For new hires, we need to shift from defined pension benefit plans to a hybrid plan, such as the cash balance plan. We need to eliminate "spiking" and require pensions to be calculated on base pay only. We need to remove pension benefits from the collective bargaining process. We need to freeze benefits for existing public safety personnel. And we need to decrease the vesting period, increase the retirement age and increase the length of service.

Binding arbitration provisions likewise tend to escalate municipal public safety costs. The selection process of the neutral third arbitrator, the requirement that arbitration costs not be shared with labor but fall solely on the municipality, and the failure to require arbitration panels to consider the financial ability of the municipality to pay the arbitration awards all place municipalities at a disadvantage in the Act 111 process.

To be clear, we do not advocate the curtailment of collective bargaining rights. We do, however, think that the playing field has been tilted for too long to the disadvantage of the employer, who in the end, of course, is the taxpayer. As a chart at the end of this testimony shows, police arbitration awards are substantially higher than the rate of inflation. Pennsylvania will not be able to restore municipal financial heath and sustainability in the absence of reforms to the significant cost drivers of pensions and binding arbitration.

On the revenue side of the equation, the Commonwealth has established a taxation policy that pits municipality against municipality, creates winners and losers, and fosters a system in which “have not” municipalities host public services from which they are forbidden to derive tax revenue and that residents of “have” municipalities enjoy at no cost.

Established “core” municipalities, frequently the county seat or settled borough within a county sub-region, typically host a variety of non-profit or governmental institutions, including hospitals, libraries, parks, churches, post offices, schools, colleges and universities and county, state and federal buildings. As such, these municipalities carry a disproportionate burden of hosting property that is tax exempt. Yet to one degree or another, such tax exempt property generally still requires public services. As a result of significant portions of property being tax exempt yet requiring municipal services, our older, more established cities and boroughs are compelled to establish tax rates at higher levels than those of their less intensively developed neighboring municipalities. If Pennsylvania is to solve municipal financial distress, it must address the issue of tax exempt institutions.

Furthermore, many of these non-profit or governmental institutions serve residents beyond their own boundaries, resulting in a free rider situation where non-residents enjoy the services a city or borough is required to provide as a result of hosting these tax exempt institutions but they do not share in paying for those necessary municipal services. Pennsylvania should consider some form of regional or countywide tax revenue sharing.

In another example of the Commonwealth policy creating inequities between classes of municipality, Pennsylvania State Police provide police coverage to municipalities that have not otherwise provided for police protection. It is not just small, low density, rural areas where crime is low and traffic accidents rare that receive State Police coverage. Over a hundred urbanized municipalities have no police forces of their own, nor do they share in joint police forces with other municipalities, nor do they purchase police protection from nearby municipalities. Instead these densely populated, developed municipalities get their police protection from the Commonwealth of Pennsylvania. Twenty of them are large, thriving townships with populations of more than 10,000 residents each. According to a 2012 report by the Center for Rural Pennsylvania, 22 percent of Pennsylvania’s urban municipalities are patrolled by the State Police.

The largest of these is a heavily developed, commercially successful township with a population of over 43,000. The township hosts numerous active shopping complexes and big box stores. It surrounds a city of the third class, which has a relatively high degree of financial stress. Yet the city not only pays for its own public safety needs out of its own scarce tax revenues, but it also serves as backup for the State Police when thefts occur at the big box stores of the township or accidents occur in their parking lots.

Pennsylvania municipalities, regardless of size or ability to pay, are able to disband their local police forces and avail themselves of State Police protection at no cost. We permit financially healthy communities to feed at the State's trough while financially struggling communities subsidize with their tax support the very municipalities that lure away their residents and potential business investment. This situation is inequitable and unconscionable. Such irrational behavior must end if we are to level the competitive playing field between rich and poor communities. Even if the Commonwealth were not facing serious budgetary issues and finding it difficult to keep the State Police adequately staffed and funded, it would be a simple matter of fairness and common sense to end the subsidizing of public safety in municipalities that have other options.

Stepping back from the current way Pennsylvania organizes local government and looking at it from a 40,000 foot level, it seems readily apparent that were the Commonwealth to start with a clean slate, it would not establish all the mandates and prohibitions that exist and impede municipal financial health. Nor would we establish the boundaries that are currently in place. In some cases, the original reason for incorporation of a municipality and the economic base that sustained it no longer hold up. In short, there are some municipalities that the march of progress has left behind and rendered obsolete.

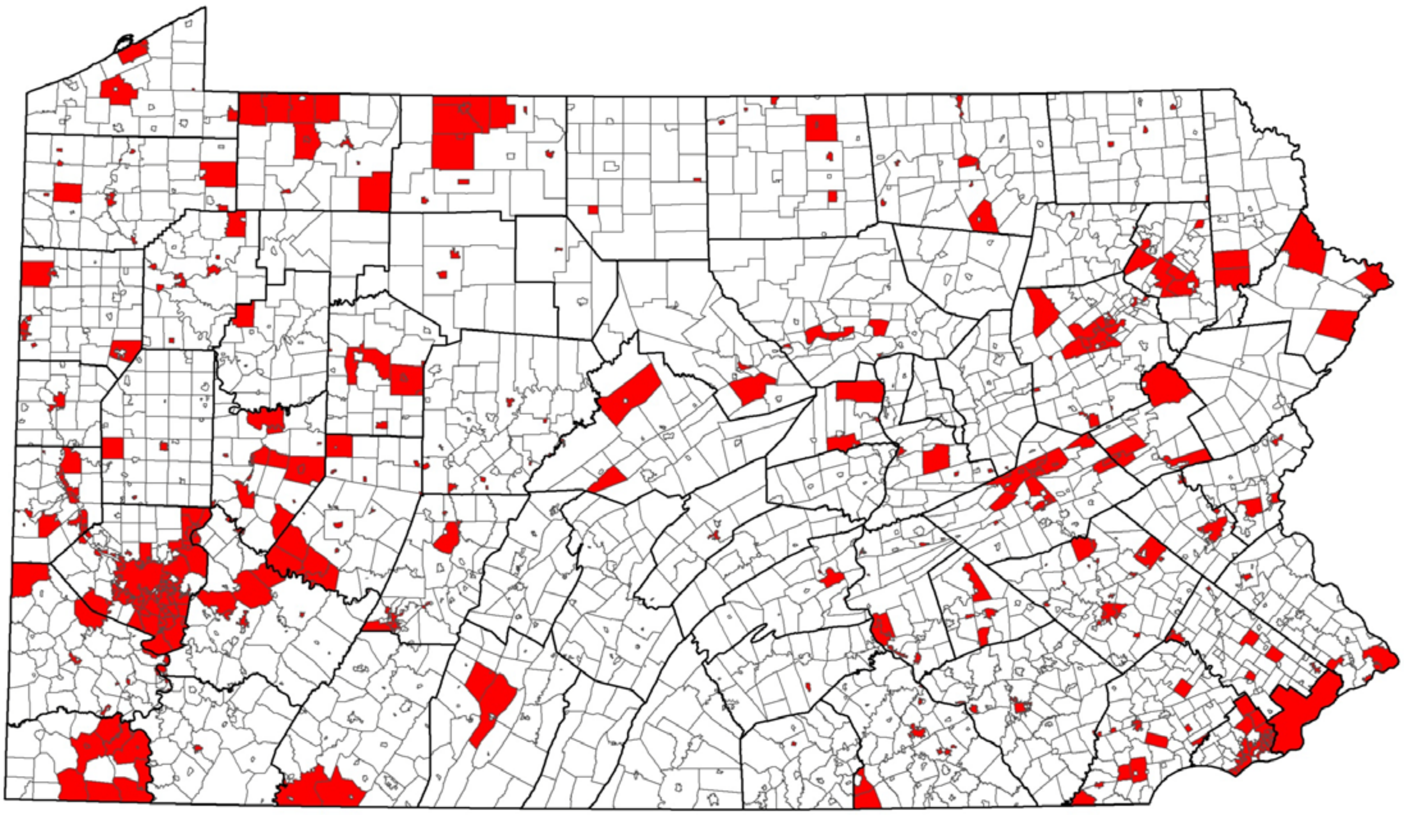
In these cases, almost no amount of assistance can restore financial viability, and in these cases, the Commonwealth should have a mechanism for liquidating their assets and liabilities and merging them into a neighbor. We would suggest that the General Assembly revisit the recommendation of the State Planning Board to establish a Boundary Review Commission to assist planning the long term disposition of municipalities that are chronically and seemingly permanently financially unviable.

Finally, with very limited and shrinking resources the Governor's Center for Local Government Services does a commendable job on a complex set of important issues. If the Commonwealth is to retain the capacity to provide vital services to its municipalities, it must be willing to appropriate funds sufficient to the responsibility.

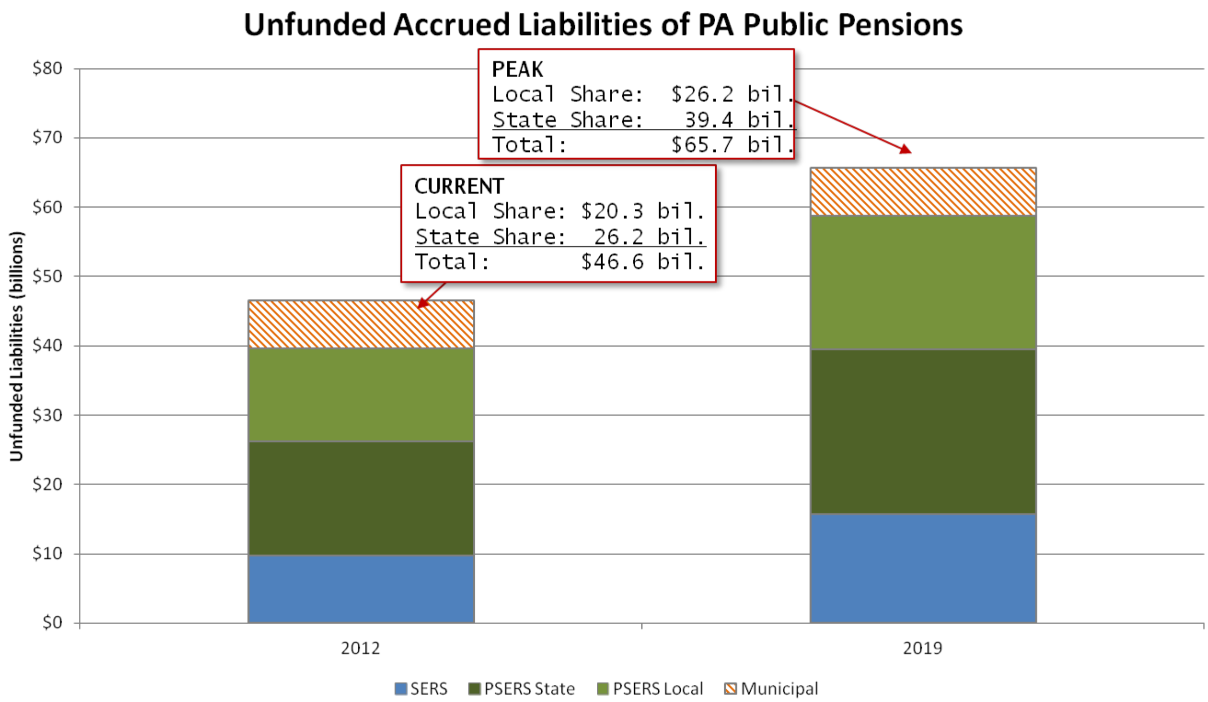
The Allegheny Conference on Community Development and the Pennsylvania Economy League are proud to be members of the Coalition for Sustainable Communities, a large and growing coalition of more than 30 chambers of commerce and municipal and other business organizations committed to promoting legislative reforms to strengthen our communities. Public policy that promotes sustainable municipalities, particularly in the areas of public pension and binding arbitration reform, is the key goal of the Coalition for Sustainable Communities. Thank you again for the opportunity to express our views on the problems of Pennsylvania's cities.

Pennsylvania Municipal Financial Stress

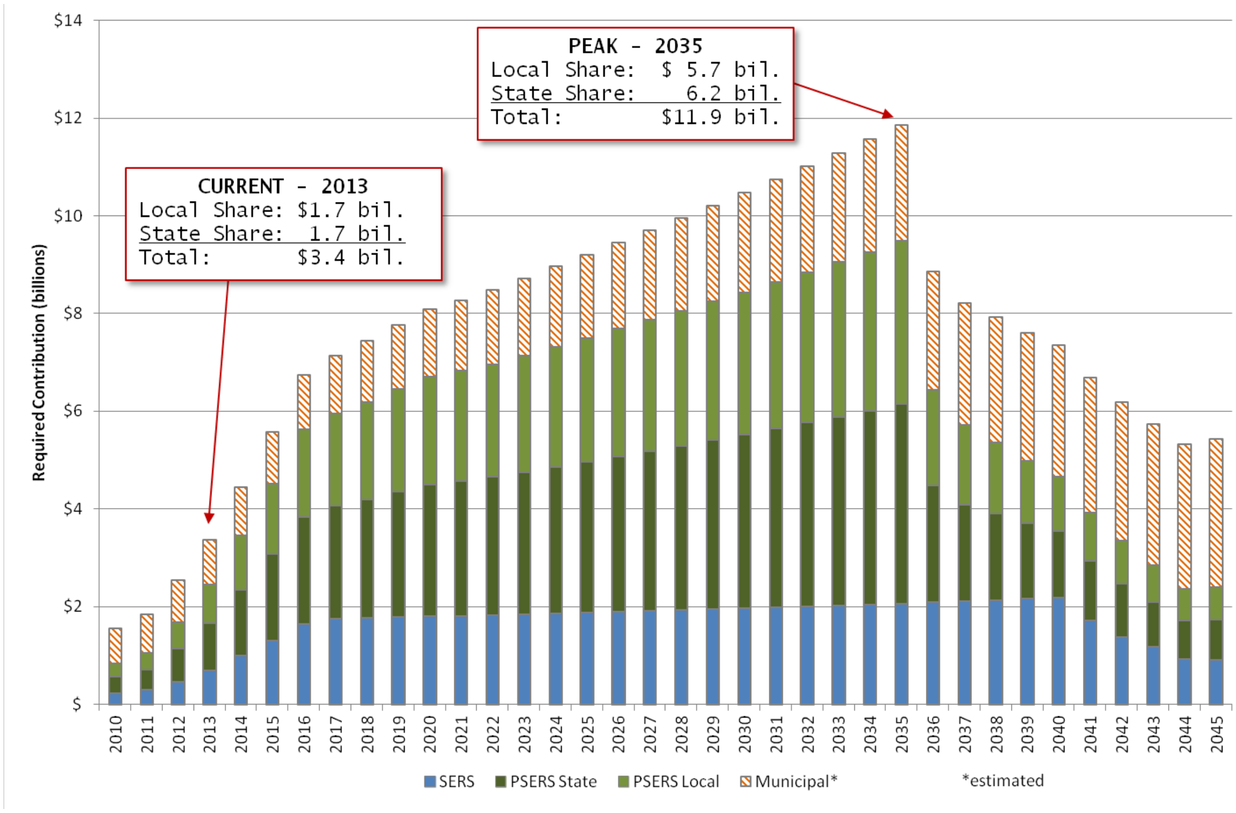
(Act 47, Pension Distress, PEL Stress Index)



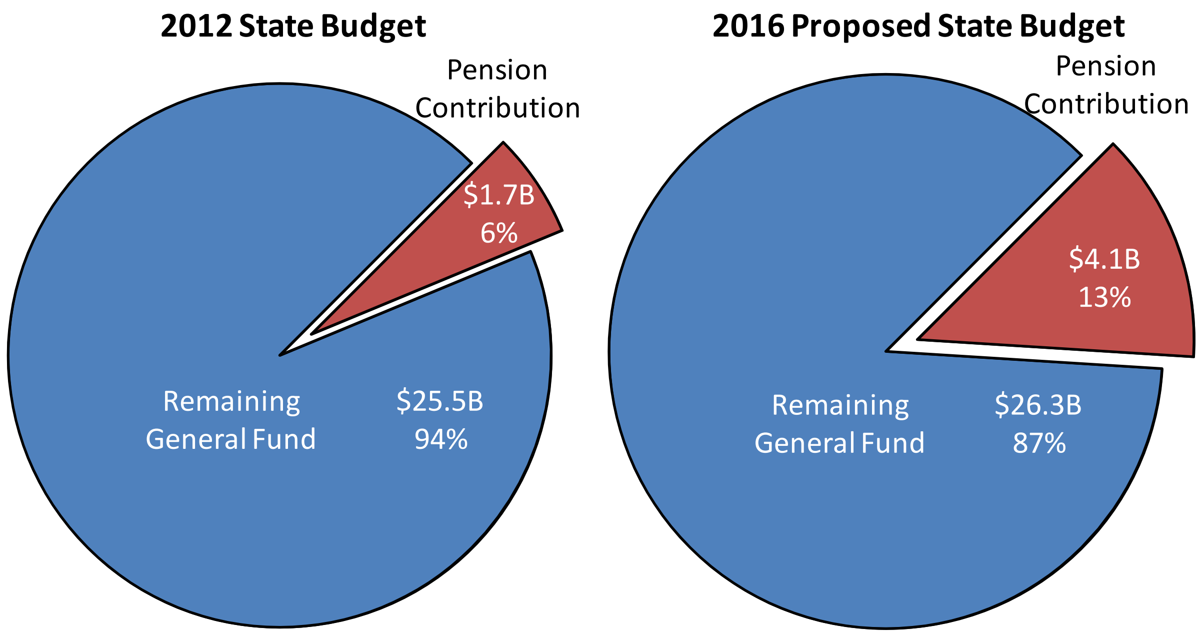
Pennsylvania Economy League of Greater Pittsburgh - April 26, 2013


Unfunded Accrued Liabilities of PA Public Pensions
PEAK
Local Share: $26.2 bil.
State Share: 39.4 bil.
Total: $65.7 bil.
CURRENT
Local Share: $20.3 bil.
State Share: 26.2 bil.
Total: $46.6 bil.
Unfunded Liabilities (billions)
$80
$70
$60
$50
$40
$30
$20
$10
$0
2012
2019
SERS
PSERS State
PSERS Local
Municipal

Pennsylvania Public Pensions Annual Required Contribution Projections



State Pension Contribution as Share of General Fund Budget



Average Annual Police and Fire Fighter Pay Increases