



Committee of Seventy

Clean and effective government. Fair elections. Informed citizens.

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Philadelphia's Long, Hot Summer



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The Committee of Seventy is pleased to present "Philadelphia's Long, Hot Summer," an unfolding series of Questions and Answers for non-experts on the potentially devastating issues facing the City during its worst economic crisis in modern history.

Over the next few weeks and months, Mayor Nutter and City Council are making very difficult decisions that will impact everyone who lives, works and visits Philadelphia. It is more important than ever that people have trust in their government and public officials. Seventy's mission includes fighting for clean and effective government and informing citizens. [Philadelphia's Long, Hot Summer](#) is one way we are carrying out this mission.

Let us know what you think. E-mail Seventy at budget@seventy.org to tell us other questions you want answered or if we've got something all wrong.

Updated: July 3, 2009



The Committee of Seventy gratefully acknowledges

The following resources for providing the background information used to compile this Q&A: The City of Philadelphia, Pennsylvania Intergovernmental Cooperation Authority, The Philadelphia Inquirer, Philadelphia Daily News, Heard in the Hall, PhillyClout, The Pew Charitable Trusts' Philadelphia Research Initiative, City of Philadelphia's Board of Pensions and Retirement, Economy League of Southeastern Pennsylvania, Fraternal Order of Police Michael G. Lutz Lodge 5, Greater Philadelphia Chamber of Commerce, Economy League of Southeastern Pennsylvania, International Association of Fire Fighters Local 22, American Federation of State, County, and Municipal Employees (AFSCME) District Councils 33 and 47, WHYY, Phillywatch.com, Independent Budget Office of the City of New York, The New York Times, Patriot-News, The Philadelphia Bulletin, The Los Angeles Times, the U.S. Bureau of Labor Statistics, "It's Our Money," The Contra Costa Times, Chicago Tribune, The Newark Star-Ledger, The Economist, Deloitte Research LP and GOVERNING magazine.

Thanks especially to Sean Scully for putting this research together.



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Part I: Crunch Time on the Budget

A Desperate Budget for Desperate Times

I keep reading that Mayor Nutter and Philadelphia City Council are working on the “budget.” What budget is this?

Every year, the Mayor and City Council put together a financial document — called a budget — that outlines what money the City expects to bring in (revenues) and what it expects to spend to operate effectively (expenses). The budget you are reading about is for the next fiscal year, which in Philadelphia will begin on July 1, 2009. The City refers to this as the "Fiscal Year 2010" Budget (FY2010 budget).

Does Philadelphia have a budget crisis?

Yes. Like most of us, the City has lost money during the country's worst economic crisis since the 1930s. The losses are largely due to significantly fewer dollars in the employees' pension fund and tax collections coming in below expectations.

How large are the losses?

Last year, the Mayor was talking about a \$1 billion budget gap over five years. The gap is the difference between revenues and expenses. The Mayor and City Council first worked out a plan to close the gap last fall. They called it a “rebalanced plan” for Fiscal Year 2009. But now city officials say the gap has grown by an additional \$1.4 billion.

Could that number grow even larger?

Yes, if the economy gets even worse.

What are the “experts” saying about Philadelphia’s financial crisis?

Nothing good. On June 12, concern about the City’s fiscal crisis caused the well-respected worldwide Moody’s Investors Service to issue what they call a “negative” outlook on the City’s ability to repay its \$4.3 billion debt. If the outlook continues to drop, it could cost Philadelphia more to borrow money.

How did this crisis happen?

The national economy is largely to blame. But it’s not the only reason Philadelphia is in financial trouble. The cost of city government, for example, grew 40 percent between 2000 and 2008, despite the fact that the City dropped from 1.52 million residents to less than 1.45 million in that same period. Much of that growth has been in health care and pension costs. But some major city services have gotten much more expensive, such as the police force and prisons.



Why weren't City officials paying attention to these problems?

They were, but it turns out they were off the mark. The national economy began to cool in 2006 and 2007 when over-the-top housing prices started to fall. Although Mayor Michael Nutter and City Council built lower revenue projections into FY2009's budget, they never predicted that the entire country's economy would collapse. Mayor Nutter calls it "The Great Recession."

What's a good example of where the City's calculations didn't pan out?

Before the financial crisis, the City projected that sales tax revenue would rise from \$140 million in 2009 to nearly \$160 million by 2013. This made sense at the time since \$137.2 million was collected in 2008. Now the City projects that sales tax revenues will be \$120 million in 2009 and just over \$140 million by 2013. If anything, those numbers now may be wishful thinking.

I understand that projections can turn out to be wrong. What's another example of losses in actual dollars compared to what was expected?

In FY2008, \$184 million in real estate transfer taxes were collected. (These are taxes on selling, granting and transferring real property or an interest in real property.) One year ago, when the City put together its FY2009 budget, officials were expecting to bring in \$187 million in real estate transfer taxes. Now the City says they will probably only bring in \$110.6 million. That's a difference of \$76.4 million.

How big is the City budget?

The budget for what it costs to run Philadelphia – its operating budget - will be close to \$3.7 billion in FY2010 (\$3,693,829,000 to be exact). Here are the biggest chunks:

- About \$2.2 billion goes to salaries and benefits for City employees, including \$332 million in pension costs. (However, although the pension payments will be \$332 million, that is only because the City plans to defer \$150 million. The actual amount owed on pensions is \$482 million.)
- About \$1.1 billion goes to "public safety," including fire, police, courts, prisons, legal services and the District Attorney's office.
- About \$843 million goes to "Health & Opportunity," including a variety of social services, aid to the homeless, and public services such as the library and recreation systems.

Why is the budget so high?

It depends on what you are comparing it to. As the largest city in Pennsylvania, Philadelphia's budget is always much higher. Also, as both a city and a county, Philadelphia has to pay for the local courts, prison costs and some human services that are usually paid for by a county. Pittsburgh, for example, is only one city in Allegheny County.



I hate to split hairs, but if the city is going to spend \$3.7 billion, why are people talking about a \$3.8 billion budget?

Actually, both numbers are right. The City plans to bring in \$3,814,570,000 in revenue from taxes and fees and investments and spend \$3,693,829,000 to run the government. The difference is \$120,741,000.

What happens to the extra revenue?

It sounds better than it really is. Here's why: the City overspent its FY2009 operating budget (thanks largely to the economic collapse) by nearly \$60 million. That means FY2010 will start \$60 million in the hole, with the gap to be plugged by FY2010 revenue. That leaves the city with \$60.1 million left over at the end of 2010. After some complicated accounting (such as adjusting previous years' budgets after the fact), the City came up with \$24 million extra, making a total of \$85,262,000 they hope to have left in the bank at the end of 2010. This is known as a "Fund Balance" in budget talk.

That sounds like a lot of money to me.

Again, it sounds better than it probably is. It means the City's budget is balanced with a little room to spare in case of emergencies. But \$85 million isn't a lot to play with when the economy is so uncertain. Remember, the City ended FY2008 with \$119,524,000 in the bank and still managed to overspend the FY2009 budget by \$60 million. That shows things can go very wrong very quickly in a city budget this large.

Why is it so hard to create a budget?

One reason is that Philadelphia is legally required to have a "balanced" budget. That means it has to bring in at least as much revenue as it spends. This is difficult under the best of circumstances. But it's worse in the current crisis environment because what the City believes it needs to work well may be a lot greater than the dollars it is realistically able to bring in.

What happens if a City can't pay its bills?

Just like individuals, cities have bills to pay. They have to spend money on an ongoing basis to continue operating. But, as we have talked about, sometimes the money they expect to bring in to pay those costs (revenues) is less than they budget for. In addition, revenues such as property and business taxes tend to come in at the end of a fiscal year. That means those funds aren't always available when bills need to be paid, so the city sometimes needs to borrow money temporarily to bridge the gap. That's part of the reason why the city's credit rating, which we mentioned earlier, is so important – the worse our credit rating, the higher the interest we pay on short term loans.



The Shoe Keeps Dropping: Capital Costs, Public Schools

Are there any other budgets besides the operating budget?

Yes. There are two other important city budgets:

- Capital Budget: A Capital budget is different from an operating budget. It typically includes what the City thinks it needs to invest in its physical environment, such as road and building construction, improving the airport and buying and maintaining city property. The 2010 proposed capital budget is about \$2.5 billion.
- Philadelphia School District: There is also a budget for what it will take to run the Philadelphia public schools, which employ about 24,000 people, nearly the same as the entire city government workforce. The School District's FY2010 budget is \$3.2 billion.

Do the taxpayers have to pay for the Capital and School District budgets?

Thankfully, not the entire tab. State and federal sources are expected to contribute \$711 million of the \$2.5 billion Capital budget, with \$80 million coming from private sources. A variety of other funds, including bonds and loans taken on by the City, will make up the rest. As for the School District's \$3.2 billion budget, most of the money will come from the state and from city property taxes. Some money also comes from the federal government.

Do the Mayor and City Council have anything to do with the Capital and School District budgets?

The Capital budget is prepared and approved in the same way as the regular operating budget. The School District's budget only has to be approved by the School Reform Commission. But the budget has to be submitted to and reviewed by City Council in order for Council to pass taxes that bring dollars to the City, some of which go to the School District.

What is the School Reform Commission?

The state of Pennsylvania took over control of the City's public schools in 2001. A five-person School Reform Commission – three members appointed by Pennsylvania's Governor and two by Philadelphia's Mayor – govern the School District and has to approve its budget each year.

How much can the Philadelphia public schools expect from the City?

The School District's FY2010 budget estimates that Philadelphia will give about \$38.5 million from its general fund to the schools. A "general fund" is what the government uses for most of its operations except for those that are required to be separately accounted for.



Is that all the City gives the public schools?

On top of the \$38.5 million, the School District gets 60 cents for every dollar the City collects in property taxes. The fewer dollars collected, the less money there is for the schools. Through May 2009, the City collected \$397 million in property taxes. This is a 0.4 percent decrease over the same period last year, mostly because the recession has hurt the ability of property owners to pay what they owe.

Every year I get a School Income Tax bill. What is this all about?

The School District of Philadelphia taxes various types of unearned income that is not subject to the City's Business or Wage taxes. This includes dividends and certain rents and royalties. It does not include interest earned on checking and savings accounts.

Do other taxes support the public schools?

The public schools also get:

- Funds from the liquor sales tax that is imposed on every taxable retail sale of wine, liquor or malt and brewed beverages within Philadelphia at ten percent of the sale price.
- A portion of the business use and occupancy tax, which is a tax on the business, trade or other commercial use and occupancy of real estate located in Philadelphia.
- A small amount of parking fines collected by the Philadelphia Parking Authority.

What do all these various Philadelphia funds for the School District add up to?

They add up to about a quarter of the School District's budget, or approximately \$815.9 million according to the School District's FY2010 budget. This includes about:

- \$604 million from real estate taxes.
- \$105 million from a portion of business use and occupancy taxes.
- \$41 million from liquor sales taxes.
- \$38.5 million from the general fund.
- \$20.5 million from school income taxes.
- \$1.8 million from the Philadelphia Parking Authority.

How much can the Philadelphia schools expect from the state?

We don't know the exact number since the General Assembly hasn't approved the state budget. But the School District expects to get around \$1.7 billion from Pennsylvania.

What about federal money?

The School District also expects to receive \$578 million from Washington, including \$208 billion from President Obama's recent national fiscal recovery plan.



Is that all for the public schools?

The School District's budget includes another almost \$7 million that hopefully will come from selling extra property and equipment.

Thinking Five Years Ahead: The City and PICA

Getting back to the operating budget, why do City officials keep talking about spending over five years?

Back in 1991, when Ed Rendell was in his first term as Mayor, Philadelphia was in big financial trouble. To help the city get back on its feet, the state created the Pennsylvania Intergovernmental Cooperation Authority (PICA). PICA's job is to oversee the City's financial affairs. This includes the power to review and approve the annual budget. Philadelphia also is required to submit a five-year financial plan for PICA's approval.

Does a five-year plan make sense? Don't we have enough problems just planning for the next fiscal year?

There are pros and cons to having to think beyond one year. The City says that a five-year plan forces city officials to think beyond short term solutions. At the same time, they concede that it isn't easy to think about what the City will be able to raise and spend over a five-year period.

Does PICA still exist?

Yes. PICA will continue to exist as long as the bonds it borrowed to help Philadelphia in the early 1990s are not paid off. They are expected to be paid off in 2024. So PICA still has to approve the City's annual budget and five-year plan.

Who sits on PICA's Board?

Five voting members, and two *ex-officio* non-voting members, sit on PICA's governing Board. The Governor, President Pro Tempore of the state Senate, the Senate Minority Leader, the Speaker of the state House of Representatives and the House Minority Leader each choose one of the five voting members for a two year term. Pennsylvania's Budget Secretary and the City's Finance Director are the *ex-officio* non-voting members.

What does President Pro Tempore mean?

The President Pro Tempore of the state Senate (or President Pro Tem as it is often called) is the leader of that chamber's majority party. The President Pro Tempore is the third highest constitutional office in Pennsylvania, after the Governor and Lieutenant Governor.



What does *ex-officio* mean?

“*Ex-officio*” technically means “by reason of their office.” What that means in the context of PICA is that the two *ex-officio* non-voting members are on the organization’s governing Board because of the positions they hold in state and local government.

Has the City submitted the budget and five-year plan to PICA yet?

Yes, the documents were given to PICA on June 22.

How long does PICA have to look it the documents over?

PICA has to reject or accept the plan no later than 30 days after submission. In other words, they need to respond by July 22. If PICA says nothing, the budget and five-year plan are automatically considered accepted.

What if PICA rejects the annual budget and five-year plan?

If PICA Board were to reject the budget and five-year plan, the City would have 20 days to present a revision to address PICA’s concerns. PICA would then have another 15 days to review the revision. If it reaches the point where PICA feels that the City is not being responsive or willing to submit a reasonable budget and plan, its governing Board can inform the Pennsylvania Budget Secretary to cut off the flow of state funds to the City. This would ultimately lead to a cash crisis.

Could anything else bad happen?

A cash crisis of this magnitude would likely lead to a downgrade of the City’s bond rating by the large investor services that issue such ratings. Bond ratings affect how much it costs to borrow money. The lower the bond rating, the more interest the City is likely to pay on its debt. There is also a greater chance that the City can’t pay what it owes on time.

The Mayor and City Council: Friends or Foes?

What role does Mayor Nutter play in coming up with the budget numbers?

As the City’s chief executive officer, the Mayor is responsible for drafting an annual budget, estimating revenues and expenses and setting priorities for both the upcoming budget year and the five-year plan. He must submit this proposed budget to City Council at least 90 days before the start of every fiscal year, which in Philadelphia is July 1. The Mayor also has a role at the end of the budget process. He has to decide whether to sign the budget bills into law, allow them to become law without his signature or veto them.



What is City Council's role?

The budget has to be approved by the 17 members of Philadelphia City Council – 10 members who represent specific districts in the City and seven at-large members who represent the City as a whole. Council holds several weeks of public budget hearings each spring for virtually every taxpayer-funded unit of city government, including the Mayor's office. Council is the only part of government that doesn't have to air its own budget at a public hearing.

How many votes does it take to pass the budget?

It takes a simple majority (9 votes) to pass the budget.

What's the deadline for getting the annual budget and five-year plan done?

According to the Philadelphia Home Rule Charter – the City's permanent governing document – Philadelphia City Council has to adopt the annual operating budget ordinance for the next fiscal year at least thirty days before the end of the current fiscal year. Philadelphia's fiscal year starts on July 1.

What if the Mayor and City Council don't agree?

The Mayor can veto the budget. But City Council can override the veto by a supermajority (12 votes).

To Tax or Not To Tax?

Do the Mayor and City Council agree on the FY2010 budget?

They didn't at first. When the Mayor presented his initial budget and five-year plan to City Council in March, they were on opposite sides. The biggest disagreement was over the Mayor's proposal to raise property taxes for two years: 19 percent in 2010 and 14.5 percent in 2011.

What was the Mayor thinking? My property taxes are already too high!

Next to the wage tax, the property tax is the second highest money-maker for the City. The Mayor said his proposal would have raised \$271 million.

Who won the argument?

Council did. Council was concerned that higher property taxes would especially hurt senior citizens on fixed incomes and lower income residents. The Mayor gave up after he saw that Council would never support his property tax idea.



That's good, right? I hear that property taxes are a mess in Philadelphia anyway.

Philadelphia's property tax system is a complete mess. The taxes are based on assessments of how much your property is worth that are made by the City's Board of Revision of Taxes (BRT). A recent *Philadelphia Inquirer* series reported how unfair and uneven the assessments are – unless you're someone the BRT wants to do special favors for.

Can the City sneak in a property tax increase sometime later?

No. Once the new fiscal year starts, the City can't impose higher property taxes across the board. That doesn't mean your property taxes for 2010 won't be higher than in 2009 if your property assessment goes up.

OK. Let's forget about property taxes for now. Do I have to worry about other tax hikes?

Yes, you do. Although City Council didn't like the Mayor's property tax proposal, they agreed with the second part of his proposed plan: to raise Philadelphia's sales tax to 8 percent for the next five years. They say a sales tax hike would generate \$580 million.

Remind me what the sales tax is.

The sales tax is a financial charge on certain goods and services. Most sales taxes are collected by the seller, who then pays the tax to the government. Not everything is subject to a sales tax. For example, there is no sales tax on food or clothing in Pennsylvania.

Is this a better idea than raising property taxes?

Some say yes, because the sales tax would bring in dollars from everyone who buys taxable goods or services in the city – regardless of whether they live here. Increased property taxes only affect people and businesses who own city properties.

Is there a downside to raising the sales tax?

Business leaders worry that increasing the sales tax to 8 percent – even if only for a few years – may damage the City's economy and delay any financial recovery.

Doesn't Philadelphia already have a higher sales tax than other places?

Yes, Philadelphia and Allegheny County (which includes Pittsburgh) already impose a seven percent sales tax on many goods and services. This includes the six percent state sales tax and an additional one percent local sales tax. Delaware, on the other hand, imposes no sales tax. That's why many Philadelphians go to Delaware to buy big-ticket items like TVs and computers.

Doesn't Philadelphia try to make up for this lost revenue somehow?

Philadelphia residents who buy goods and services out of state, but use those goods and services in the city, are supposed to pay the City a "use tax," but this law is difficult to enforce.



When would the higher sales tax start?

If it were up to the Mayor and City Council, it would start on July 1, when the new fiscal year gets underway. But it's not up to them.

If not the Mayor and City Council, whose decision is it to raise the sales tax?

Since the sales tax was created by state law, a city or county cannot raise its own sales tax. It has to be approved by the 50 Senators and 203 Representatives who make up the Pennsylvania General Assembly.

Getting By With a Little Help from Our Friends in Harrisburg

Now I'm confused. I thought the budget process was pretty much over after the Mayor and City Council made peace on next year's budget.

After the Mayor and City Council settled their differences, Council unanimously passed the FY2010 budget on May 21, 2009. But because there are parts of the budget that can't happen without approval from the General Assembly, the process isn't over yet. And don't forget that PICA still has to approve the five-year plan too.

Let's go back to the General Assembly since the ball is now in their court. Will Philadelphia get the okay to raise the sales tax?

The best chance is in the House of Representatives because it is controlled by the Democrats. One of its most powerful members – Dwight Evans, who represents a part of the City and chairs the House Appropriations Committee – said he will support it if other counties are also allowed to raise their sales tax.

Doesn't it make sense to allow all counties to increase their sales tax if it would help avoid raising taxes?

We have to see what our legislators think. A bill has been introduced in the state House of Representatives that would give all of Pennsylvania's 67 counties the option to impose a one percent sales tax on top of the state's 6 percent sales tax. It's unclear whether or not the legislation will go anywhere.

Where does the Pennsylvania Senate stand?

The state Senate could be the biggest hurdle since Republicans outnumber Democrats by a 30-20 margin. The GOP leader Dominic Pileggi says that Philadelphia first has to show that it has taken every step possible to reduce spending to match revenues before his caucus will agree to a sales tax increase.



Philadelphia has 33 Senators and Representatives in the General Assembly. Can't they work together to make the sales tax hike happen?

They could try, but that's assuming everyone was on the same page. At the end of June, the Philadelphia *Daily News* polled the Philadelphia delegation and found that seven were ready to vote "yes," one was leaning towards "yes," two planned to vote "no," seven were undecided and one refused to comment. The other fifteen members didn't even respond.

Why would someone who represents Philadelphia be opposed?

Some legislators represent areas that are both within and outside the City. Counties that are just on the other side of Philadelphia's border have only a 6 percent sales tax.

When's the deadline for the General Assembly to make up its mind?

August 1. That's when City officials hoped to begin collecting money from the sales tax increase.

Why didn't they plan on July 1 since that's when the fiscal year starts?

Although state law says the Commonwealth's Fiscal Year 2010 budget should be in place by July 1, this hasn't happened since Governor Rendell took office in 2003. So the City knew better than to count on any money on that date.

This doesn't sound too hopeful. Does Harrisburg have a say over anything else?

Yes, since the pension system is governed by state law, the General Assembly also has to approve another plan the Mayor and City Council are proposing: a two year delay in making \$230 million worth of annual contributions to the City's employee pension plan. City officials say this could save up to \$254 million over five years. The City also wants 30 years instead of 20 to pay its obligation to the pension fund, City officials say this would save another \$330 million over five years.

What are the chances of this proposal being approved?

Just like the sales tax, the pension proposal isn't a slam-dunk. Some legislators say Philadelphia's pension system is already in such bad shape the city should not be allowed to tinker with it further. (We will talk more about pensions in Part III of [PHILADELPHIA'S LONG, HOT SUMMER.](#))

Do I have to worry about any other local tax increase?

Not at the moment. The only tax increase on the table is the sales tax. (Then, of course, there is Governor Rendell's proposal to raise the state income tax by 16 percent. We'll get to that later.)



But I thought some members of City Council were thinking about raising the wage tax?

Yes, they were, since the wage tax brings in more money than any other City tax. But the state law that approved casino gambling designated the City's share of gambling revenue to lowering the wage tax. The only way Philadelphia can raise its wage tax is if their revenues are down by 2 percent or more. The City says they aren't. So raising the wage tax is not an option right now.

Sacrifices within City Government

Does the budget have any solutions to the City's budget crisis beyond raising the sales tax and making changes in the pension fund?

Let's talk first about steps taken by Philadelphia last fall when they announced their initial \$1 billion budget gap projection. The FY2009 budget was "rebalanced" in November 2008 to include the following major cost-savings:

- Requiring furloughs (some unpaid time off) for non-union employees (\$1.7 million in FY2009 and FY2010)
- Reducing overtime budgets city-wide (\$18.5 million annually)
- Eliminating 800 vacant positions (\$33.6 million annually)
- Enhancing collections of delinquent taxes (\$8.2 million annually)
- Increasing fines and fees (\$4.8 million annually)
- Closing half of the city's pools (\$4.4 million over five years)
- Reducing library staff and budget (\$12 million over five years)
- Suspending scheduled cuts in wage and business taxes (\$230 million over five years)
- Reducing a number of city-operated vehicles (\$7.9 million annually)
- Reducing Arts and Culture funding (\$3 million annually)

The \$1 billion gap is yesterday's news. What about the additional \$1.4 billion budget gap?

There is. That's why the nearly \$3.7 billion operating budget City Council approved in May 2009 takes even more drastic steps than last November's "rebalanced" FY2009 budget.

How "drastic?"

The FY2010 budget approved by City Council calls for:

- Cutting more overtime pay (\$2 million annually)
- Reducing more city-operated vehicles (\$1.5 million annually)
- Cutting 250 additional full-time jobs (\$11 million annually)
- Eliminating the reserve for expected wage increases (\$180 million over five years)
- Increasing fire emergency medical services fees (\$5 million annually)
- Reducing costs for medications at City Health Centers (\$1.5 million annually)
- Reducing demolitions of vacant buildings (\$2.1 million annually)
- Imposing fees for commercial trash collection (\$7 million annually)
- Freezing civilian police hiring (over \$700,000 annually)



The FY2010 budget also counts on savings from actions that require the approval of the General Assembly – increasing the sales tax and making changes in the pension fund – and at least \$25 million in anticipated annual savings that city officials hope will result from concessions made by the four municipal labor unions.

What about reducing waste and making government operations more efficient?

It's hard to tell from the budget how much work is happening to make government leaner and more cost-effective. The FY2010 budget talks about \$2 million annual savings in "waste minimization efforts" and \$4.5 million over the next three years in energy efficiencies. Mayor Nutter says he will form a Committee on Government Efficiencies.

What sacrifices is the Mayor making?

When the financial crisis first hit in the fall of 2008, salaries in the Mayor's Office and the Office of the Managing Director were reduced by \$400,000 annually. Mayor Nutter cut his salary by 10 percent and members of his cabinet and senior administrators slashed their pay by 3.5 to five percent. The Mayor also required non-union employees earning more than \$50,000 to take five unpaid furlough days, and cancelled a scheduled \$1,100 bonus for non-union employees.

What is the budget of the Mayor's office in FY2010 compared to FY2009?

In FY2010, the approved budget of the Mayor's Office is almost \$4.6 million. This is a cut of almost 36 percent (down more than \$2.5 million) from FY2009, when the budget was \$7.1 million. But since the Mayor cut some spending after the financial crisis hit, he ended up spending about \$6.6 million in 2009.

What sacrifices are City Council members making?

Eight of the 17 Council members gave back 5 percent of their salaries for the second half of the current fiscal year, saving the city about \$23,000, and are likely to do so again next year. Council members also say they might allow unpaid furloughs for some of its 200-person staff during the upcoming summer recess.

What is City Council's budget in FY2010 compared to FY2009?

Council's FY2010 budget is a little north of \$16 million (\$16,048,973 to be exact). On paper, this is a 10 percent cut (worth \$1,783,520) from their FY2009 budget, which was more than \$17 million (\$17,832,493). But this doesn't tell the whole story - Council says that it added ten 10 percent to its budget in past years, even knowing it would spend less.

So how much is the REAL City Council cut?

In reality, Council is only cutting 5.26 percent, just shy of \$900,000 (\$891,910). You can see this by subtracting the new budget (\$16,048,973) from what Council actually spent in FY2009, which turns out to be just less than \$17 million (\$16,940,883).



But that's really confusing. Why does the Council pass a budget for itself that it higher than what it will spend?

Council President Anna Verna says Council needs the reserve just in case something unforeseen happens. For example, she says Council needed to spend \$650,000 to hire outside lawyers to defend against lawsuits over gun control and casinos. Because of the financial crisis, Council is not adding the 10 percent in FY2010.

Why is it so hard to pinpoint Council's spending?

City Council doesn't make the details of their budget, or the budgets of their 17 individual members, public. Only a one-page general summary is released.

Are other elected officials doing their part?

Some are making sacrifices and others are not. City Controller Alan Butkovitz reduced his pay by five percent last October. For the upcoming budget, all exempt employees in his office earning over \$50,000 will take a five percent pay cut and will take five days of unpaid furloughs. The Register of Wills and Sheriff agreed to reduce their pay by five percent during this fiscal year and next fiscal year.

Do elected officials still get to keep their perks, such as City cars?

Back in March, Mayor Nutter asked City Council members to give up their City-owned cars, but the 13 members that use official cars have been reluctant to do so. Tenth District Councilman Brian O'Neill expressed the opinion of some when he said "When we're the last 13 to take our cars home, then he can have my car."

What about other city cars?

The City has about 6,000 cars. In March, the Mayor cut 243 to reduce spending.

What sacrifices are City workers being asked to make?

In a nutshell: About 20,000 of the City's more than 23,000 workers belong to one of the four municipal unions whose contracts expired on June 30. Mayor Nutter wants to negotiate wage freezes and lower health care benefits. So far, the unions say "no way." Since about 60 percent of the city's \$3.7 billion operating budget is dedicated to salaries, benefits and overtime for union employees, the outcome of the union negotiations will have a big effect on the budget.

What happens if things go badly with the General Assembly and the unions?

Then the City has to move to Plan B, which will be very, very ugly. There will be huge cuts in city services and this will lead to massive layoffs. We don't know yet how huge or massive they will be. For example, in January 2009, Mayor Nutter said that even a 10 percent cut could result in the loss of more than 1,000 uniformed and civilian police employees, more than 160 firefighters, and 69 recreation department employees.



Can you tell me more about Plan B?

Not yet. The details of Plan B haven't been made public.

Does PICA have to approve Plan B too?

PICA's voting members said that they will ask the people who appointed them for advice about whether they should vote on a budget that depends on action taken by the state. The FY2010 budget and five-year plan the City submitted to PICA on June 22 did not include Plan B.

Will the libraries be safe?

When the financial crisis first hit last fall, Mayor Nutter proposed closing 11 Free Library branches. The public was outraged so he backed down. The FY2010 budget doesn't anticipate closing any libraries, although there have been cuts in staffing and supplies. But if Plan B happens, all bets are off.

How about the city's pools?

Last fall, the Mayor also talked about closing most of the city's 73 outdoor swimming pools. Again, he faced huge public anger. On June 8, he announced that \$429,141 in private corporate dollars, plus some City funds, will keep 46 outdoor pools open this summer.

Surely There Must Be Other Options

Why aren't there other big-ticket money saving options?

There are other ways to save money, but the likelihood of any of these happening is slim. Here are some examples:

- Back in 1987, the PA Supreme Court ordered the state to fund the entire local court system. The local courts cost Philadelphia more than \$100 million a year. But the state hasn't complied with the high Court's order in more than 20 years. With a projected \$3.4 billion state budget deficit, don't expect it to happen now.
- Releasing nonviolent prisoners would help. There are about 9,000 prisoners sitting in city jails and each one costs Philadelphia about \$100 a day. Prisons cost about \$230 million per year total, but the city can save \$35,000 a year for each prisoner released.
- The Committee of Seventy recommended eliminating the archaic elected offices (and salaries) of the Clerk of Quarter Sessions, Sheriff, City Commissioners and Register of Wills. These offices cost about \$200 million over five years, but it isn't clear how much cutting those offices could save since many of their duties and employees would have to be transferred to other parts of City government.
- There has been some talk in City Council about reducing the 10-year tax abatement on new construction, which was introduced in 1997 and is widely credited with the revitalization of



Center City and surrounding neighborhoods. But some people think the City can't afford to reduce revenues brought in by new residents.

Doesn't Philadelphia have funds in reserve to fill the budget gap?

Most cities have emergency reserves for just this kind of financial crisis. They call it a "Rainy Day Fund." Pennsylvania has a \$375 million rainy day fund. Philadelphia has never created one, notwithstanding PICA's recommendation that the City do so.

Can't the private sector bail us out?

Probably not much. Many companies have suffered major losses from the economic downturn and are cutting their charitable donations.

Can the state help Philadelphia out?

The state has its own problems – a projected \$3.2 billion budget deficit.

Will the state's efforts to solve its own budget crisis affect Philadelphians?

Governor Ed Rendell has proposed raising the state income tax for three years from 3.07 percent to 3.57 percent. That's a 16 percent increase. Someone earning \$50,000 would have to pay \$250 more per year, or \$4.81 more per week.

How much money would this save?

The Governor says this would save \$1.5 billion in revenue. It's not all that much when you consider that the Governor's budget proposes \$28.9 billion in spending for the next fiscal year. Like Philadelphia, the state's fiscal year starts on July 1.

Will the General Assembly go along with this?

Democratic leaders in the Senate and House say they will support it; the Senate Republicans say they are opposed. Many legislators campaigned on a no-new-taxes platform and are afraid a "yes" vote will hurt their chances for reelection. State representatives run every two years. State Senators have four-year terms.

We are into the new fiscal year. Now what?

The Governor and Republican leader of the state Senate, Dominic Pileggi, say they will consider a "stopgap" or partial budget until July 30. That would allow the state to pay its employees on July 17, the first day government workers are set to get paychecks in the next fiscal year. Legislative leaders say the state hasn't had a stopgap budget for over three decades.

How about using money from the federal government?

President Obama's national fiscal recovery plan calls for giving federal money to state and local governments as a "stimulus" to deal with their own financial crises. Mayor Nutter has said that



whatever stimulus money the City receives, about \$885 million as of the beginning of June, will not be used to plug the hole in the City budget. But clearly some of the money could ease the pain of planned cuts. In May, for example, Deputy Mayor for Public Safety Everett Gillison told City Council that up to \$13.5 million in federal money could be used to plug budget cuts for the Police Department and the District Attorney's office.

Residents Vent

Does the public have a say in any of this?

The Mayor got a lot of criticism after he announced library and pool closings last fall. So he held four budget workshops and dozens of smaller meetings - with at least 10,000 people all together, he says - to ask residents, city workers, and community leaders what they thought.

What did he learn?

The major themes the Mayor heard included:

- Although no one likes tax hikes, there is a need to raise revenue, perhaps by hiking certain taxes, such as those on parking and on tickets to concerts and other events.
- Root out inefficiency and waste in government before cutting services.
- Focus on long term structural reform so this won't happen again.
- Provide clear explanations to ease public distrust of government.
- Look to furloughs and hiring freezes before laying off city workers.
- Protect the most vulnerable programs and residents - cut recreation, health services, homeless aid, and similar public services last.

You can read the full report on what the public told the Mayor at:

<http://www.phila.gov/budgetUpdate/reformAgenda/PDFs/WhatWeHeard.pdf>

Sharing the Pain

Are other cities feeling the same pain?

According to a May 2009 report by The Pew Charitable Trusts, almost all major cities are also dealing with severe budget crises. Pittsburgh is the rare exception since they made a lot of painful cuts in services back in 2003, when the city almost went bankrupt.

What are other similar cities doing?

According to the Pew study, only a handful of cities, including Philadelphia and New York, are looking at tax increases. Most are eyeing severe service cuts and employee layoffs. Here are some examples:



- New York City faces a budget gap of about \$1.1 billion for 2010 alone, more than five times Philadelphia's gap. Without major changes, the number could soar to nearly \$6 billion in 2011. Mayor Michael Bloomberg is proposing budget cuts and a hike in the City sales tax, which would require the approval of the state legislature. He is also hoping to get wage and benefit concessions from the City's unions, and is planning to restructure the City's pension system to save money. Mayor Bloomberg isn't very popular right now. Los Angeles' budget deficit for 2010 is \$530 million. Mayor Antonio Villaraigosa wants to make budget cuts and restructure city agencies. He has proposed deferring raises and imposing brief unpaid employee furloughs to minimize layoffs. He has also proposed that employees contribute more to the City's pension system.
- Chicago is facing about \$300 million in deficits by the end of the year - on top of a \$20 million gap it closed in the budget passed last year. Mayor Richard Daley is locked in tense negotiations with city unions over his plan to force city workers to take 16 unpaid furlough days as a way to avoid 1,100 layoffs.

Basically most cities are in the same boat, right?

Philadelphia may actually end up in better shape, although that may be hard to imagine at the moment. Since the City has to develop a five-year plan, when other cities are dealing with a one-year budget, public officials are planning ahead over a longer time period. If the City's five-year projections falls into place, this could put us in a better position than some other cities who are still likely to face large deficits when they have to develop their FY2011 budgets.



Part II: The City and its Unions: Deal or Disaster?

Setting the Stage

All the recent talk is about the budget. Why are people now talking about labor contracts too?

That's what this Q&A is all about. In short: Most people who work in city government belong to one of four large unions whose contracts expired on June 30. New contracts have to be negotiated. The outcome of negotiations on the major issues in the contracts – wages, benefits and pensions – have an enormous effect on the budget.

How enormous an effect?

About 60 cents of every city tax dollar goes to pay employees' benefits, including salaries, pensions, and health care. In Fiscal Year 2009 (FY2009), this figure totaled about \$2.4 million of the nearly \$4 billion spent by Philadelphia. The Mayor is looking to decrease this figure in Fiscal Year 2010 through his negotiations with the four unions that represent approximately 80% of the City's workforce.

Let's start at the beginning: What exactly is a union?

A union is an organization made up of a group of employees who have common goals in areas such as wages, working conditions, benefits and other issues related to their jobs. Each union has a leadership team who talks on behalf of, and whose members are elected by, these employees. The employees are called "rank and file" members.

Does every city government worker belong to a union?

No, Philadelphia's government has about 23,000 employees. Nearly 20,000 belong to a union.

What about the 3,000 other employees?

There are about 3,000 employees who are not represented by a union. These include the Mayor, his senior managers and supervisors and other elected officials and their appointees. These people are called "exempt" employees.

Why don't exempt employees also belong to a union?

Higher level employees, including elected officials, are considered "management." The Mayor and City Council have much more flexibility in setting the salaries and work rules of exempt



employees than they do with the unionized employees, whose salaries and rules are negotiated by union leaders and are defined by contracts.

Do all unionized city workers belong to the same union?

They don't. There are technically three unions that represent most City workers, although one of the unions is represented by two separate bargaining units, known as "District Councils." Since the City talks about four unions, we'll do that here too.

What is a bargaining unit?

A "bargaining unit" is composed of individuals who negotiate with an employer about work-related issues that affect their "rank and file" employees. The negotiation process is called "collective bargaining" and usually results in a written contract that covers a specified time period.

Does the contract have a special name too?

The contract that results after collective bargaining is called a "collective bargaining agreement."

The City's Unions

What are the four unions that represent Philadelphia's government employees?

- The Fraternal Order of Police (FOP), Michael G. Lutz Lodge 5 represents about 7,000 police officers and sheriff's deputies. They also represent about the same number of retired officers and sheriff's deputies.
- The International Association of Fire Fighters (IAFF), Local 22 represents almost 2,200 active, and around 1,800 retired, fire fighters, paramedics and officers of the Philadelphia Fire Department.
- The American Federation of State, County, and Municipal Employees (AFSCME) District Council 33 represents almost 7,300 active city workers who have manual labor or "blue collar" jobs, such as sanitation workers and clerical employees. It also represents the City's prison officers.
- AFSCME District Council 47 represents 3,560 active city workers who have non-manual labor or "white collar" jobs, such as accountants and engineers.

Who are the leaders of these unions?

- John McNesby is the President of the FOP Michael G. Lutz Lodge 5.
- Brian McBride is the President of the IAFF Local 22.
- Pete Matthews is the President of District Council 33.
- Cathy Scott is the President of District Council 47.



Why do unions represent workers who are retired from the City?

Unions have a strong sense of loyalty to the employees they represent that does not end with retirement. And retired employees who have paid union dues believe they are entitled to continued benefits. Many unions have special programs for retirees that include elder care, legal services, nursing home placement and many other social services. Some unions ask active workers to voluntarily give a small dues payment to help retired union workers.

Are there other unions that represent City workers?

There are a handful of people who work for the city, such as contract janitors, who are not considered regular City employees. They are represented by other unions. And the School District of Philadelphia has its own completely separate set of unions. But for our purposes, we're just talking about the four unions listed above.

One-Year Extensions

How long are the union contracts?

Union contracts typically last for four years.

Didn't the contracts with the four City unions expire last year?

All four of the union contracts actually expired on June 30, 2008, but the four unions and the City agreed to a one year extension. So basically the unions were operating on one-year contracts. These expired on June 30, 2009.

What was the reason for the extension?

Mayor Nutter was in his first six months in office and wanted more time to examine ways to reduce the spiraling cost of health care insurance, a cost that rose 144 percent from 2000 to 2008.

Was the extension a good idea?

Given what has happened since last June – the collapse of the nation's economy and the city's cumulative \$2.4 billion budget deficit over the next five years – the unions may regret the extension. The gap between what the City thinks it can afford and what the unions want is much, much greater now than it was then.

Did the extension help the City?



In hindsight, it probably did. Since the economy was better last year, the negotiations between the City and the unions could have resulted in new four-year contracts that Philadelphia now can't pay for.

What did the one-year contracts include?

The contract negotiated last year included pay increases for police and fire fighters, and \$1,100 bonuses for the civilian employees in AFSCME District Councils 33 and 47. It placed limits on the City's contribution to the health insurance plans and created the "Joint Labor - Management Healthcare Evaluation Committee" to review the health care costs.

Why are health care costs so high?

That topic deserves its own Q&A. But one key reason is a good one: even people who are very ill are living and working longer because of better and better advances in medicine and technology.

I hear that the City's pension costs are high too.

They are. The City's pension costs also rose sharply - up 96 percent – from 2000-2008. (Part III of [PHILADELPHIA'S LONG, HOT SUMMER](#) talks about the City's pension costs.) The City doesn't pay the pensions for retired employees directly; that money comes out of a huge investment fund. "Pension costs" refers to the money the City is putting into that fund every year. Employees also put a portion of their salaries into the fund.

The FY2010 Battleground

Basically the Mayor wants the unions to make big sacrifices, right?

That's pretty much what it boils down to. The Mayor says the City can't afford to spend so much on wages, benefits and pensions for its employees – union and non-union. The Mayor also wants the unions to be more flexible about work rules, which he says are so strict that he can't make money-saving reforms.

Can the Mayor and City Council act on their own to cut wages or jobs?

It's much easier with exempt employees. But when it comes to wages, benefits, working conditions, work rules and other important details for union employees – which include the vast majority of the City's workforce – the City has to work it out with the unions.

Are the two sides talking already?

Usually talks start, at least informally, long before a contract expires. This year, discussions got off to a late start. On June 22, AFSCME District Council 33 met with City representatives for the first time since April. AFSCME District Council 47 met with the City on June 24. The FOP Lodge



5 and the City are said to be nearing an agreement, perhaps sometime in July, according to press reports. The fire fighters aren't expected to settle their contract until at least September.

I thought a deadline means something. Is there always a delay?

Let's use last year as an example. The terms of the one year contract between the City and IAFF Local 22 (fire fighters' union) were settled on October 17, 2008. The FOP Lodge 5's agreement was in July.

What is the City hoping to save in the FY 2010 budget?

The FY2010 budget approved by City Council in May calls for anticipated workforce savings of at least \$25 million annually, or \$125 million over five years. This includes giving no raises to city workers and requiring unionized employees to pay \$120 million more for health care coverage. The Mayor is also pressing for extensive work rule changes that will give him greater flexibility in assigning employees, paying overtime, and granting leave. He wants the right to impose up to 30 unpaid furlough days on city employees.

What are the unions saying?

AFSME District Council 33 is already running radio ads saying the Mayor wants "to punish [city workers] by cutting their jobs, health and pension benefits" and calling on him to offer a contract that "gives our members the respect they have earned." The Mayor's spokesman responded that the Mayor intends to agree to a contract that is fair to workers but "it must also be fair for the 1.4 million Philadelphians who will pay for it."

I hear the Mayor wants a different pension plan for new city workers. What is it?

On June 17, Mayor Nutter asked City Council to approve a new pension plan for employees hired after July 1. This plan would offer reduced benefits (compared to current employees) and allow employees to pay a higher percentage of their salary into the pension system.

What kind of pension plan do current city workers have?

Good question. Current Philadelphia employees have what is called a "defined benefit plan." A defined benefit plan guarantees a specific benefit for retired employees, and sometimes for that person's spouse, for the rest of their lives. Sometimes payments are given in a lump sum and other times they are spread out. Not every employee is automatically eligible to receive a pension. This is determined by age, years of service and levels of compensation.

How would the Mayor's proposed plan work?

The Mayor's plan is partially a defined benefit plan since new employees would also get guaranteed – although reduced – benefits. The second part of the Mayor's plan would give new employees the option to add to their future pension payment by contributing more of their paycheck to the City's pension fund. This is called a "defined contribution plan." This is similar to a 401(k) or 403(b), which many private sector employees have.



Is this a good idea?

The City says this would save \$500 million over 30 years.

Do we know what the unions think?

AFSCME District Councils 33 and 47 say they are opposed to different pension plans for the City employees they represent. You can expect them to lobby Council members to reject the Mayor's idea.

What do members of City Council think?

Councilman Darrell Clarke introduced legislation outlining the Mayor's plan on June 18. But Council is now on their summer recess. They aren't scheduled to return until September 17.

Can the unions be forced to accept it if Council passes the legislation?

According to City Solicitor Shelley Smith, if the Pennsylvania Employee Retirement Commission declares the City's pension plan "severely distressed," the City is required to establish a lower cost pension program for new hires. Once the union contracts have expired, Smith said the program will be set up right away. Then the City will negotiate with the unions to include it in their new four-year contracts.

What do the unions want in their new contracts?

You can't really talk about the four unions in the same breath since they don't necessarily want all the same things. Generally speaking, all four city unions are looking for pay hikes, better benefits and improved life insurance coverage.

Can you give me some specifics?

The FOP Michael G. Lutz Lodge 5 and AFSCME District Council 47 have made their proposals public. Although these could change during the collective bargaining process, here is what AFSCME District Council 47 is asking for:

- A "percentage increase in each step of each pay range" (the exact percentage isn't spelled out)
- One additional annual leave day
- An increase in accumulated time off for working overtime (called compensatory time) to 180 hours
- Allow unrestricted use of built-up compensatory time for 30 days before leaving City government
- City payment for the complete cost of current health and welfare benefits
- No layoffs during the term of the contract



What about the other unions?

AFSCME District Councils 33 and 47 want limits on privatizing city services. The FOP Lodge 5 is asking for a promise not to impose any layoffs.

Doesn't privatizing some City services make some sense?

Some think so, but usually not those who stand to lose jobs as a result of privatization. For example, in January, a Deputy Mayor floated a proposal to privatize trash collection. AFSCME District Council 33's President Pete Matthews said that would lead to an "epic" strike.

Does Mayor Nutter get along with the unions?

Mayor Nutter may not have been the unions' first choice for Mayor – for example, FOP Lodge 5 endorsed his primary opponent U.S. Representative Bob Brady. But relations seemed quite good when he first got into office. Things got ugly as the City's budget problems got worse. None of the unions like the Mayor's wage freeze and work rule plans. Things are particularly ugly with the fire fighters, who were furious when the Mayor announced a plan to shut down seven fire stations in November 2008, and changed the schedule for paramedics in March 2009.

Negotiating the Contracts

What is the process for negotiating a union contract?

Again, the process is different depending on which union you're talking about:

- The AFSCME District Councils 33 and 47 negotiate directly with the Mayor and his aides.
- The FOP Lodge 5 and IAFF Local 22 representing the police and fire fighters negotiate with the city through a three member arbitration panel, established by state law. Both sides are forced to accept the panel's decision. This is called "binding arbitration."

Who sits on the arbitration panel?

The arbitration panel consists of one member from the union, one member from the city, and a neutral chairman, picked jointly by both sides. Disputes are settled by a majority vote, meaning at least two panel members have to agree.



Summer Strike?

Can the police and fire fighters strike if they don't like what the arbitration panel says?

No. Under state law, police officers and fire fighters are not allowed to strike.

Can members of AFSCME District Councils 33 and 47 go on strike if they can't reach an agreement with the Mayor?

They can and have done so before. The worst in recent memory was when the City's trash collectors went on strike for 20 days in 1986, leading to vast piles of trash rotting in the blistering sun. It wasn't a pretty sight or smell.

What happens to the City's budget if the unions don't agree?

If you read Part I: Crunch Time on the Budget, you'll remember that there are major parts of the FY2010 budget approved by City Council that require approval from the 50 Senators and 203 Representatives that make up the state General Assembly. If that approval doesn't happen AND the union negotiations also break down, the Mayor has said there would be huge cuts in city services which would lead to massive layoffs. For now, the City is calling this "Plan B."

June 30 has come ... and gone. Are City employees just working without a contract?

As we said earlier, this happens all the time and is almost certain to happen this year. Once the official deadline passes, union employees will work under their current contract while talks continue. In fact, arbitration for IAFF Local 22 (fire fighters) is not scheduled to begin until September.

Do the unions have an emergency plan in case of a strike?

Unions that are permitted to strike usually make plans just in case their workers go on strike. We don't know any details yet.

Does the City have a plan in case of a strike too?

They are working on it. On June 16, city workers got an e-mail from the Mayor's office telling them that a strike could wipe out any vacation plans for exempt employees who would have to run the government if AFSCME District Councils 33 or District Council 47 go on strike.

Do contract terms for one union affect contract terms for another union?

That's an interesting question. After the arbitration panel issued a contract award for the IAFF Local 22 in October 2008, the City announced that its terms followed the basic pattern set by another arbitration panel for the FOP Lodge 5 three months earlier. The unions don't necessarily seek the same contracts, but it's hard to impose one set of terms on one union when another union's contract contains different – and perhaps better – terms.



Sharing the Pain

How do Philadelphia's city contracts compare with other cities?

According to the Pennsylvania Intergovernmental Cooperation Authority (PICA), the state agency that has to approve the City's annual budget and five year plan, Philadelphia's contracts with its unions are among the most generous in the nation. They say that union employees pay less than the national average for pension benefits and, depending on which part of government they work for, receive more paid holidays per year.

How many paid holidays do city workers get?

Police and fire fighters, for example, get 12 paid holidays per year, including their birthdays. Members of ASFCME District Councils 33 and 47 get 11 paid holidays. The City says that each holiday costs \$2.5 million in overtime to people who are willing to work on those days. These holidays are in addition to regular vacation time.

How are other cities handling union contracts during the crisis?

Virtually all city governments are desperate to make deals with unions representing city government workers in order to save money. For example:

- On June 2, New York City's Mayor Michael Bloomberg reached a tentative agreement to change the details of the City's health care plan for 550,000 unionized workers and retirees, including requiring co-payments of up to \$100 and limiting dental coverage. This is supposed to save \$400 million over the next two years. This is the first time some city employees have to make co-payments for emergency-room, inpatient and outpatient treatments
- In Los Angeles, Mayor Antonio Villaraigosa is pressing public unions to drop a promised cost of living raise and to accept higher pension payments and at least one unpaid furlough per week for its members. The City is also urging the police union to accept a 10 percent pay reduction when the old contract expires.
- In Chicago, Mayor Richard Daley is asking unions to agree to 16 unpaid furlough days for city workers as a way to avoid mass layoffs. As of mid-June, negotiations seem to have reached an impasse.

Why does it take a fiscal crisis to make big changes in union contracts?

When the economy is healthy, it is much harder for a City to say they can't afford raises or what workers would consider to be excellent benefits packages. The unions have accused Mayor Nutter of trying to use the current crisis to force permanent changes to the contracts.



Part III: Pensions: The Elephant in the Living Room

Framing the Problem

A lot of expenses make up the City's budget. Why does "pensions" deserve its own Q&A?

Along with health care, pension costs are the biggest ticket items in the City's budget. Pension costs more than doubled in the last nine years, from \$194 million in Fiscal Year 2001 to an anticipated \$476 million in Fiscal Year 2010. As a result, they make up a significant portion of the City's general operating fund. Pension issues are also a critical piece of the contracts that unionized City workers are currently renegotiating with City government.

Why do pension costs keep going up?

According to the Pennsylvania Intergovernmental Cooperation Authority (PICA), the state-created agency that has overseen the City's finances since 1991, costs are escalating because there are more retired City workers and retirees are living longer. PICA also says that the City has paid too little into the pension system and had unrealistically high estimates of the interest the system would earn on its investments. This leaves the City paying ever more to make up for the shortfall.

Is Philadelphia the only place with pension problems?

No, we're in very good company. Many state and local governments are trying to figure out how to deal with staggering and growing pension costs. With the Baby Boomer generation nearing retirement age, coupled with the national economic crisis, there are steep challenges ahead. An excellent report on these challenges in Philadelphia and nine other large cities was released in June 2009 by The Philadelphia Research Initiative of The Pew Charitable Trusts (see www.pewtrusts.org/philareresearch).

Will my taxes have to go up to resolve this?

They could, along with cuts in City services. But there is always a danger that raising taxes will encourage residents and business to move away. At the moment, there aren't too many places to go that aren't experiencing similar difficulties.



Understanding Philadelphia's Pension System

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Let's start at the beginning. I hear a lot of talk about Philadelphia's pension fund. Exactly what is a pension fund?

Philadelphia's pension fund is an account that is set aside to pay employees once they retire from City government.

How big is the Philadelphia's pension fund?

At the end of March 2009, the City had \$3.26 billion in its pension fund. At the same time last year, before the global financial crisis hit, the fund contained about \$4.66 billion. Just to put this drop in perspective, as of June 30, 2007, Philadelphia had nearly \$5 billion in its pension fund.



Who is in charge of the City's pension fund?

The Home Rule Charter, which is Philadelphia's permanent governing document, creates a Board of Pensions and Retirement that is responsible for administering the City's Public Employees Retirement System. In addition to City employees, the Board administers (but does not fund) a pension plan for the employees of quasi-public agencies (the Philadelphia Parking Authority, the Hospitals and Higher Education Facilities Authority of Philadelphia, the Philadelphia Municipal Authority, the Philadelphia Housing Development Corporation, and the Philadelphia Regional Port Authority).

Who sits on the Board of Pensions and Retirement?

The nine-member Board includes:

- The City's Finance Director, who is appointed by the Mayor and chairs the Board, is the City's Chief Financial Officer.
- The City Solicitor, Philadelphia's Chief Legal Officer, is appointed by the Mayor.
- The City's Managing Director, who oversees the City's operating departments to ensure that services and programs are delivered effectively and efficiently. The Managing Director is appointed by the Mayor.
- The City's Director of Human Resources, who oversees services, programs and policies pertaining to the City's workforce, is appointed by the Civil Service Commission.
- The City Controller, an independently elected position, has various responsibilities relating to the City's finances, which include auditing departments, commissions and agencies that receive City funds and making recommendations for greater efficiencies.
- Four members elected at large by active civil service employees. The four current members include a representative from each of the four municipal labor unions: the Fraternal Order of Police (FOP), Michael G. Lutz Lodge 5, the International Association of Fire Fighters, Local 22; the American Federation of State, County, and Municipal Employees (AFSCME) District Council 33 and AFSCME District Council 47. Each of these members serves a four-year term. (Part II of [PHILADELPHIA'S LONG, HOT SUMMER](#) talks about the City's relationship with its labor unions.)

Does the Board make actual decisions about how the pension fund is invested?

State and City law dictate the manner in which funds have to be invested, but the Board makes the major decisions on investment policy and strategy. They get a lot of help from an in-house investment staff and many outside consultants and pension fund managers.

What is the Board's investment strategy?

According to the Board's 2008 Annual Report, the City's overarching goal is to invest in funds in a way that "most efficiently balances the need for achieving an 8.75% rate of return with the desire to minimize the possibility of capital loss." That target interest rate is set by the Mayor and City Council (we'll talk more about this later - it will become important).



Where does the City invest its pension fund dollars?

Cities invest the money in their pension funds, just like individuals invest the money in their personal accounts. For the fiscal year ending June 30, 2008, the latest year where we have complete information, the major investments were in domestic stocks (27%), international stocks (20%) and global fixed income bonds (24%).

How many people are in the City's pension and retirement system?

In FY2008, the latest complete information we have, the Public Employees Retirement System had 30,253 active members and 34,168 retired members, including 8,613 survivors and 4,384 people receiving disability benefits. Active members are those who will receive payments from the pension fund after they retire from City government.

Who puts money into the pension fund?

The pension fund has three major sources of income:

- Government contributions
- Employee contributions
- Earnings on investments

How much does City government contribute compared to employees?

The government pays the lion's share of the contributions. For example, in FY2008, City government contributed about \$412.5 million compared to around \$51.7 million from employees.

Shouldn't employees pay a larger share?

According to PICA, in 2004, the average city employee paid 3.63 percent of salary into the pension system, which the City matched with 5.41 percent, for a total of 9.04 percent of salary. PICA surveyed other major cities, however, and found that the median rate was more than 12 percent. The recent study by The Philadelphia Research Initiative of The Pew Charitable Trusts reports that Philadelphia's firefighters and police contribute five or six percent, and non-uniformed union and non-union workers pay 1.85 percent or 3.75 percent. Workers in the nine other large cities surveyed generally contributed more.

Why doesn't the City insist on its employees contributing a larger share of their paychecks?

The City would like this, but can't make it happen. This is one of the major issues that will be negotiated between the City and the four unions that represent City employees.

Do we know what the unions will propose?

To get a taste of what the negotiations will involve, take the proposal issued by the Fraternal Order of Police (FOP), Lodge 5 in December 2008. The FOP wants to:

- Provide an annual cost of living increase for existing and future retirees in an amount equal to the increase in the Consumer Price Index (a measure of the average change over time in the



price paid by urban households for a set of consumer goods and services) for Philadelphia as measured from July 1 to June 30 of the preceding year.

- Provide that all members of the bargaining unit shall participate in the pension plan under the same terms and conditions and receive the same benefits as are applicable to all employees who were hired on or before June 30, 1988.
- Provide that officers shall receive a normal pension equal to the highest three years of "final compensation."
- Provide that the final compensation of a bargaining unit member that is used to compute that member's pension benefit shall include all W-2 income received from the City by that member during the year preceding retirement.
- Provide for a normal pension benefit payable, regardless of age, to a bargaining unit member of 50% of that member's annual compensation as defined at 20 years of service and of 75% of that member's annual compensation as defined at 25 years of service.
- Permit bargaining union members to elect Social Security participation on an irrevocable basis for the duration of his/her career.
- Permit the FOP to designate its member on the Pension Board in accordance with its own internal procedures.
- Permit a bargaining unit member to "buy up" to a pension benefit equal to the next highest rank, but not less than 14%.
- Provide for the establishment and administration of a Section 457 plan (a retirement plan that allows employees to defer compensation into the plan on a pre-tax basis) for members of the bargaining unit.
- Provide a pension at 30 years of service equal to 100% of the officer's final compensation.

When can city employees retire?

Currently, civilian employees can retire at age 60 with 10 years of service, while uniformed employees such as police can retire at age 50 with 10 years of service. The pension payment formula is complicated: the payment is 2.2 percent of the average of the employee's three highest earnings years in their first 10 years in government (or 20 years for uniformed employees), plus 2 percent of the average of the three highest earning years after 10 years (or 20 for those in uniform).

What the Numbers Mean

Is \$3.26 billion enough to cover the City's commitments to its retired workers?

No. Right now, the City's pension fund is on the hook for an estimated \$8.4 billion in pension costs - that's the combination of real payments to retired workers and what the City has promised to pay employees who are still working but will retire some day. But at the end of FY2008, the city had only 55 percent of that amount in the pension fund. And this was before the stock market crashed. Now City officials say the pension fund is less than 50 percent funded.



Wait - \$3.26 billion isn't even close to 50 percent of \$8.4 billion. What's going on?

Just to confuse things that are already confusing, there are actually two different official values for the pension fund:

- The first is "Market Value." This is the real value today of all the stocks, real estate, and investment fund shares owned by the City.
- The second is "Actuarial Value." This is what the assets in the pension fund are worth if you look at the pension fund over the course of many decades. The "actuarial value" includes the "market value" figure, plus some estimated costs and some income in the form of money that will come in later (such as interest on investments in the pension fund). (This is why the City's official estimate for the interest it expects to earn is important - we'll talk about that later.)

Which of the two values is used in this Q&A?

Unless we say otherwise, the figures in this Q&A refer to "market value."

What are the two numbers now?

When we said earlier that the City had \$3.26 billion in its pension fund at the end of March 2009, we were talking about "market value." We won't know what the "actuarial value" was on the same date until the Board publishes its 2009 annual report.

What were the two numbers at this time last year?

The official market value of the pension fund on July 1, 2008 was almost \$4.4 billion, but the actuarial value was more than \$4.6 billion. So you can see that numbers are different depending on which "value" is used.

Why have two different values for the same fund?

Pensions are paid out over a long period of time and there are a lot of workers in the system today who won't retire for many years. Therefore, pension fund managers need to take the long view of both what they owe to future retirees and what the value of the pension fund's assets may be. Since "actuarial value" is a longer-term number, it is more difficult to calculate accurately since there are so many variables to estimate.

Are actuarial values always higher than market values?

Not always. For a variety of reasons, the actuarial value can actually be lower than the market value sometimes. For example, it was lower in 2007 but higher in 2008.

This sounds pretty exotic. Does actuarial value really matter?

Yes, because it is the number that accountants use to figure out how short the pension fund is compared with its estimated costs, which includes the real money it is paying out to today's retirees and the estimated money it will have to pay out to workers who have not yet retired. When we say that the pension fund was 53 percent funded in 2007, for example, that is based on the actuarial value (which was \$4.4 billion that year), not the market value (which was \$4.9 billion that year).



So tell me what the pension fund actually owes?

Again, there are two answers - short term and long term. The pension fund pays out about \$585 million per year in pension payments. That's the short term answer, and the pension fund has enough money to cover this amount for the moment. But if you add up all the money it is likely to owe to all of the current retirees and workers for the rest of their lives, you come up with the long term answer: \$8.4 billion at the end of 2008. The City only has a fraction of what it needs to cover that amount.

Ok, enough numbers. Can you sum this up?

The bottom line is that the assets in the pension fund aren't even enough to cover half of the City's obligations to retired workers and future retirees. That doesn't mean it can't pay its bills today, just that it can't pay for all the promises to its workers over the long haul. In technical language, that's known as an "unfunded liability."

Meeting the Needs of Future Retirees

Is it normal for cities to have an unfunded pension liability?

Yes, up to a point. It is not all that unusual for local governments to have less in the pension fund than the benefits they need to pay out over time. But the lower the amount of money in the fund today, the harder it is to see where all that money will come from to pay bills in the future. And there is no reason to think the situation will improve in the current economy.

How long has Philadelphia's pension fund been so underfunded?

Philadelphia's system has been getting progressively worse - in 2001, it had 77 percent of what it needed in the pension fund, but this dropped to only 53 percent by the end of 2007. There was a slight increase to 55 percent by the end of Fiscal Year 2008, but now the City has less than 50 percent of what it needs.

How did things get so bad?

According to PICA, the major reason is that the City tried to save money in the short term by paying less into the pension system. A December 2005 PICA report raised warning flags about City's decision to make only the minimum allowable payment under state law.

What should the City be paying into the pension fund?

In 2008, the pension fund estimated that Philadelphia would need to pay \$548.8 million per year by 2010 to keep the system healthy. But, according to state law, local governments are allowed to pay less than what they owe and still qualify for certain state matching funds. In FY2010, that payment would be about \$482 million (this includes interest on the Fiscal Year 1999 pension obligation bonds).



What is a pension obligation bond?

Pension obligation bonds are often issued by cities as a way to manage their debt. Here's how it works: A City borrows money to invest in the pension fund. City officials hope the investments will earn more than the interest it has to pay on the bonds.

Doesn't Philadelphia want to pay even less than their minimum obligation?

As we talked about in Part I of [PHILADELPHIA'S LONG, HOT SUMMER](#), the City is asking the General Assembly to approve a proposal to allow it to pay even less than the minimum in Fiscal Year 2010. They want to defer \$150 million and only pay \$332 million in FY2010.

But won't that just dig us deeper in the hole?

Yes. That is the heart of the City's long term pension crisis.

We will have to pay eventually, right?

Yes. If the pension fund's accountants have estimated correctly, the City will eventually have to pay all of the \$8.4 billion in liabilities, although not all at once. That money will have to come from somewhere, through higher taxes, cuts in services, or borrowing. Otherwise the City won't be able to honor its promises to retired workers.

Why does state law allow the City to pay less than the fund needs?

Local officials argue that paying less makes sense because the accountants' estimates are highly speculative and may well be wrong. Even if they are right, they usually include bills that won't come due for many, many decades.

Ideally, shouldn't the pension fund be 100 percent funded?

That would be nice, but realistically it's difficult, particularly in bad times. It is almost like saying you should have enough money in a savings account to meet your bills for the rest of your life. But remember, those future bills will come due eventually, so the less you have now, the harder it will be to pay them off later.

Who decides how much money the fund will need in the future?

The pension fund relies on accountants and people called "actuaries" who try to calculate how much the City will owe based on a bunch of assumptions, particularly how long the retirees will live (the longer they live, the more the City has to pay them). The actuaries also have to estimate how much the City will earn on investments, how much money employees will pay into the pension fund, and how much employees will be earning when they retire. They have to predict these factors for decades into the future.



Isn't this unscientific guesswork?

To some extent it is. And sometimes there are miscalculations that affect individuals or even, on occasion, an entire system. For example, New Jersey is still trying to get out of a hole caused by relying on a mid-1990s opinion by a state actuary that resulted in severe underfunding of its pension fund. But, generally speaking, actuarial numbers are based on real data from the past, so their guesses about the future are usually reasonably accurate.

Growing the Pension Fund

Is there any hope for more money in the pension fund anytime soon?

Probably not. If anything, the amount in the fund is likely to dip even lower than 50 percent if the value of investments remains depressed. Now that the 2009 fiscal year is over, the Board of Pensions and Retirement should be issuing a formal report soon.

It sounds like the pension system is in big trouble.

Yes. Major trouble. The City reports that it expects to lose about 30 percent of the value of its pension fund investments in 2009, on top of a 24 percent loss last year, due to the near collapse of the American economy.

Didn't anyone see the investment problem coming?

Even before the economic crisis hit, PICA cautioned that the City was overestimating how much interest the pension fund's investments would earn and contribute to the pension fund. According to the June 2009 report from the Philadelphia Research Initiative of The Pew Charitable Trusts, earnings on investments ranged between 55 percent and 64 percent of the additions to the pension fund. But the investments lost money in fiscal year 2008. And we are holding our breath waiting to see the losses for fiscal year 2009.

Digging Our Way Out

What is the City doing to get us out of this mess?

The City is asking the state's Pennsylvania Employee Retirement Commission to declare the City's system "Severely Distressed," the highest possible level of distress. If this happens, it will give the Mayor the right to put in place a new, less expensive pension system without the agreement of the four City unions. We talked earlier about his idea for a new pension plan for City employees hired after July 1, 2009 that proposes reduced benefits and asks employees to pay a higher percentage of their salary into the pension system.



Can the state do anything else to help out?

The state Public Employers Retirement Commission, which monitors retirement plans across the state, is recommending legislation that would move pensions with less than half the assets required to meet long-term obligations into a state-run pension plan. Long-term obligations include what the pension plan is required to give to current retirees plus City employees who will retire in the future.

What other steps is the City taking?

As we talked about in Part I of [PHILADELPHIA'S LONG, HOT SUMMER](#), the Mayor and City Council are also proposing big changes to the pension fund: a two-year delay in making \$230 million worth of annual contributions to the fund. City officials say this could save up to \$254 million over five years. The City also wants 30 years instead of 20 to pay its obligation to the pension fund. City officials say this would save another \$330 million over five years.

Exactly how would this help?

If the City can spread out its debt and take longer to reduce the shortage in the pension fund, it can pay it off in smaller chunks. It's the same idea as taking out a 30-year mortgage on a house rather than a 15-year one – the monthly payments on the longer mortgage are lower, even if you wind up paying more in interest over the life of the loan.

Is there a downside to delaying payments and spreading out the debt?

The downside is the long term costs associated with delaying payments. Delaying \$230 million in pension payments for two years will cost about \$55 million in interest when the bill does finally come due.

Can the City just make these pension changes on its own?

As we talked about in Part I, since the pension system is governed by state law, the changes have to be approved by the Pennsylvania General Assembly. This hasn't happened yet.

Do we have any hints about what the General Assembly is thinking?

Some state legislators have expressed skepticism about allowing the City to reduce the amount it pays to the pension fund since the system is already so badly underfunded. The four union members on the Board of Pensions and Retirement have asked the Board to hold a special session to determine the impact of the delayed payments and the legal liability of Board members if the City's savings estimates don't work out.

I've heard a lot about DROP. What is it?

The "Deferred Retirement Option Plan (DROP)" was designed in 1999 to help the City keep experienced or specialized employees who might have retired before their replacements were ready. It's essentially a succession plan. Eligible employees can enroll in DROP, but remain on the job for up



to four years. Their pension payment is put into a savings account earning a fixed 4.5 percent interest per year. The employee gets the funds at the time of retirement.

Does DROP have an impact on the pension fund?

PICA says that DROP may factor into why the City's required contribution to the pension fund has increased since people are retiring earlier and living longer (therefore getting retirement payments for a longer time). While PICA hasn't estimated the cost specifically, it says that DROP also is partly responsible for pushing up the number of retirees drawing from the system - from 17,989 in 2002 to 19,243 in 2004, and up to about 34,000 in 2007.

Can changing DROP save money?

Yes. The Mayor has asked City Council to change the fixed 4.5 percent interest rate on pension payments for employees enrolled in DROP. He wants a rate that will fluctuate to match the actual return the pension fund gets on its investments. That would lower the cost of interest payments in years when the stock market is weak.

I heard the Mayor also wants to change the Pension Adjustment Fund. What is this Fund?

It is a fund used to pay for cost of living adjustments for current retirees. The pension fund has put \$65 million in this fund over the last two years.

Can changing the Pension Adjustment Fund save money?

Yes, at least in the short run. The Mayor has asked City Council to allow the pension system to suspend payments to the Pension Adjustment Fund in any year when the fund has less than 76 percent of the money on hand that it needs to pay off its pension obligations. Since the pension fund now has less than 50 percent of the money it needs, this would impact the pension system's payments immediately.

What are the chances the Mayor will get Council's approval for the proposed changes?

The DROP proposals are probably dead on arrival, especially since the Mayor has also proposed prohibiting elected officials from participating in DROP after January 1, 2010. As for changes to the Pension Adjustment Fund, we haven't heard from Council members yet.

Can't Philadelphia borrow money to fix this problem?

It already has. The City has relied on a series of "Pension Obligation Bonds" over the last decade to shore up the pension fund. While those bonds help relieve pressure on the City's budget in the short run, the long term cost of the interest on those bonds is soaring. It is expected to rise to nearly \$120 million per year by 2016, up 60 percent from 2006, according to PICA.



A National and Global Problem

What are other local governments doing?

As PICA has pointed out, although Philadelphia's pension problems are particularly severe, plenty of other local governments are also in big trouble. As in Philadelphia, other cities have a combination of short term and long term problems: paying too little money into the pension fund, the increasing lifespan of retired workers, and the devastating crash in the economy over the last year. Here are some examples of what's going on:

- Los Angeles is looking at making workers pay more into the pension plan. Workers hired before 1983 pay only 2 to 4 percent of their salaries, while more recent hires pay 6 percent. The Mayor and City Council are proposing to boost older workers' payments to 6 percent and newer workers to 6.75 percent. The City is studying other ways to reduce the soaring cost of the pension plan. In May, City officials warned that without major changes, the amount Los Angeles must contribute to the pension fund could more than double by 2014, from \$660 million this year to around \$1.6 billion.
New York City has seen its annual payments to the pension fund rise from \$1.4 billion eight years ago to \$6.3 billion this year, swallowing up nearly 10 percent of the city's entire budget. Mayor Bloomberg has called the system "out of control" and blamed state lawmakers for the increase, saying they had forced governments to give ever more generous retirement benefits. A New York Times study, however, concluded that most of the increase is due to generous pay hikes the Mayor has agreed to for City workers. The Mayor has lately been pushing City unions to agree to less generous pension plans for new employees.
- New Jersey's state pension system, which also covers municipal workers and teachers, lost almost a third of its value in the last year, down \$23 billion to \$58 billion, only about 49 percent of what it needs to honor all its promises to workers. As part of the severe budget crisis, however, Governor Jon Corzine and the state legislature agreed to skip some payments and reduce others, further shortchanging the system by about \$4.7 billion over two years.

What's happening in other countries?

The crisis is not limited to the U.S. The June 2009 issue of *The Economist* reported that most developed nations spend around 8 percent of their annual economic output on pensions, including for government workers and for public systems similar to Social Security. Because of the increasing life expectancy in most countries, that percentage is expected to rise to 15 to 20 percent by 2050, meaning virtually every nation will have to consider reducing benefits or boosting taxes to pay for retirement costs.



Looking to the Future

I can see Philadelphia's financial problems will not be resolved for a very long time. How can I stay on top of what's going on?

The Committee of Seventy is committed to providing regular updates on all of the issues addressed in [PHILADELPHIA'S LONG, HOT SUMMER](#). Come back to www.seventy.org to keep up the latest news.