Does Pittsburgh Deserve PICA-West?

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Prepared Testimony before the
Committee on Finance
Pennsylvania Senate

A Special Hearing
on the City of Pittsburgh's
Financial Condition

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Molotov Cocktail and Brick-throwing incident... Philly Mayoral Campaign gets Physical

A brick and unlit Molotov Cocktail was thrown through the window of the Cecil B. Moore Avenue and 22nd Street North Philadelphia regional campaign office for Republican Mayoral candidate Sam Katz. According to KYW, the device came through the front window sometime overnight, after a heated argument between the building's owner, Louis Harris, and a companion of Mayor Street's son Sharif -- later identified by a neighbor as Joey Temple.

Mayor Street: *"The facts of this incident seem to be changing by the minute, but I have asked the police to investigate fully and take all appropriate steps."*

Source: PoliticsPa.com 9/1/2003

"To do what's right is easy, to know what's right to do is another matter."
---attributed to LBJ

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1. Introduction

Chairman Earll, and members of the Senate Finance Committee, I want to thank you for the invitation to comment today on the City of Pittsburgh's financial condition, and to comment on the advisability of legislation recently introduced in the Pennsylvania Senate and House to establish a Review Board that would provide some sort of oversight of the City of Pittsburgh's expenditure and taxing activities.

I do think that, if the current mayoral campaign in Philadelphia is any indication of what a PICA-West can lead to in Pittsburgh, there is merit in your encouraging combatants here (elected officials, City employees, City voters, taxpayers and residents) to find some sort of local or Home Town Solution. On balance, this would be superior to asking you to do Pittsburgh the sort of favor that was fashioned for Philadelphia in 1991. Municipal politics by Molotov Cocktail seems more appropriate for places like Baghdad than the Pittsburgh I like to think I remember when we lived here. Another reason to favor a Home Town Solution has to do with the propriety of having the judicial branch of government running increasing amounts of local government. As you may know, a local judge, admittedly an elected one, is still in charge of the real estate tax assessment system in Allegheny County. Going to a PICA-West strategy, with appointees setting Pittsburgh's taxing and spending, and perhaps a local judge agreeing to impose by fiat a commuter tax would seem to be a fairly grave indictment that much of routine democracy is no longer workable in South West Pennsylvania. The demise of routine democracy is something that I hope can be avoided.

Indeed, your benign neglect of the City's pleas for State help through the balance of this year might result in the Mayor and City Council doing in December, 2003 what they forgot to do in December, 2002 ---- pass a budget composed of spending and revenues, plausibly measured with spending less than revenues, that are permitted under current state law, and without resort to multi-year debt to finance operating services. These sorts of public acts would give hope that routine democracy is still possible in the City.

To the Mayor and Council I suggest they both dramatically cut spending on a permanent basis, and dramatically increase taxes for a foreseeable, limited period of time, say two or three years, and predicate subsequent budgetary balance on new non-resident taxes that you empower later on for them to adopt. In this manner, the Mayor and Council will have demonstrated finally they understand their primary responsibilities. Also, resident taxpayers who have been getting services financed by giving away the future will wind up paying for them now, and the state can reasonably say that it helped both locally elected officials and resident voters through "tough love" to keep each other honest. Obviously, if the voters do not like this political and financial bargain once it is priced in terms of lower spending and higher taxes, they can support "regime change" through the democratic process, or talk with their feet if they can find those who want to buy their real estate and move into the City.

There is more than a little irony in the Nation shedding the blood of our young men and women and spending our public treasure to enable the people of Iraq to regain their personal freedom and the political right to elect a government that decides what to tax and what to spend, while we meet today to discuss the advisability of turning over these rights to some sort of appointed board because of the local collapse of governance. Perhaps even more ironic is the reality that there has been far more media and political attention, until today's hearing, to the former than the latter.

My remarks are organized as follows: Section 2 provides some personal disclosures; Section 3 takes a first look and Section 4 a somewhat closer look at the City's financial condition. It is very hard to know with confidence what the City's finances are, because they have been so creative in taking advantage of the latitude accorded them in terms of accounting and financial reporting requirements of state law. Section 5 discusses various policy options, ranging from the Home Town Solution to Letting a Federal Judge Decide. Section 6 provides some concluding remarks.

2. Some Disclosures

As you may know, I have some practical expertise in matters of public finance as well as various scholarly credentials in that area that resulted in being invited and becoming a tenured professor at CMU's School of Urban and Public Affairs in 1979.

During the 1970's, while on public service leave from the University of North Carolina and working for the non-partisan Staff of the Joint Committee on Taxation, US Congress, I was given the responsibility of devising, first, how to tax under the Internal

Revenue Code federally guaranteed debt of the City of New York[2], and second, how to allow New York City's various qualified pension plans to purchase very substantial amounts of New York City and Municipal Assistance Corporation debt without violating prohibitions contained in the Internal Revenue Code against such large investments in their employer's securities. That was a tumultuous time, and there are both significant parallels between what happened then, and why you are here today, and significant differences.[3]

Here in Pennsylvania, upon joining the faculty of SUPA in 1979, CMU President Richard Cyert asked (and I accepted) that I direct the research of the Pennsylvania Tax Commission[4] that Governor Richard Thornburg had asked him to chair. During the period of that Commission, I had the privilege of meeting a large number of concerned Pennsylvanians, and closely studied the Commonwealth's state and local tax structure. A number of the Commission's state tax recommendations were enacted.

In the mid 1980's, Pennsylvania Senate President Jack Stauffer, recovering from triple bypass and barred by his physicians from taking on additional activities in the summer of 1987, asked that I replace him as a voting member of Governor Robert Casey's Local Tax Reform Commission.[5] While significant legislation was enacted and signed as a consequence of the efforts of Senator Stauffer and Representative David

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[2] My first contribution to that effort involved discovering that the House Committee on Banking violated the jurisdiction of the Ways and Means Committee by reporting their loan guarantee legislation, with a tax title, to the floor of the House without any consideration via a sequential referral to the Ways and Means Committee. House Banking Committee Chair Henry Reuss of Wisconsin was particularly apologetic to the Ways and Means members for this oversight, and it did not happen again during the three years (1975-8) I served on the Staff of the Joint Tax Committee. It is fair to say that the federal taxation of interest paid on federally guaranteed NYC debt sent shock waves through the municipal bond market. Until that federal legislation, the prevailing legal wisdom for several hundred years was that interest on state and local debt was *constitutionally* immune from federal taxation. Obviously, the successful imposition of federal income taxes on such interest income made the absence or presence of federal tax exemption a matter of statutory discretion by Congress.

[3] Appendix 1 of this statement contains an August 31, 2003 guest column in the Pittsburgh Tribune-Review.

[4] See *Final Report of the Pennsylvania Tax Commission.*(Harrisburg, Pennsylvania: March, 1981).

[5] The invitation to become a voting member of the Commission in 1987 came as quite a surprise, since I was initially under the impression that, as the Commission was being formed, there was simply need for some research that I could provide from the University. However, Senator Stauffer explained that his health precluded his participation in something he had long been involved in---the reform of Pennsylvania's complex local tax structure—and he asked me to serve directly on the Commission and simply use my best judgment on how to rationalize and modernize Pennsylvania's complex system of local taxation. As it turned out, not only was I a voting member of the Local Tax Reform Commission, but the role of devising language for others' proposals (which I did not necessarily endorse) that we voted on also fell to me, as did the drafting of the *Final Report*. The integrity of final wording and views on these matters in the *Final Report* were sufficiently controversial that I personally had to supervise the printing of the *Final Report* in order to ensure that majority voted agreements, some of which I voted against, were not subsequently undermined in the printing process. Pressure to change final, printed words by some outside the appointed Commission, after they were agreed to by the appointed Commission, also occurred in the earlier tax study effort, and were also effectively resisted.

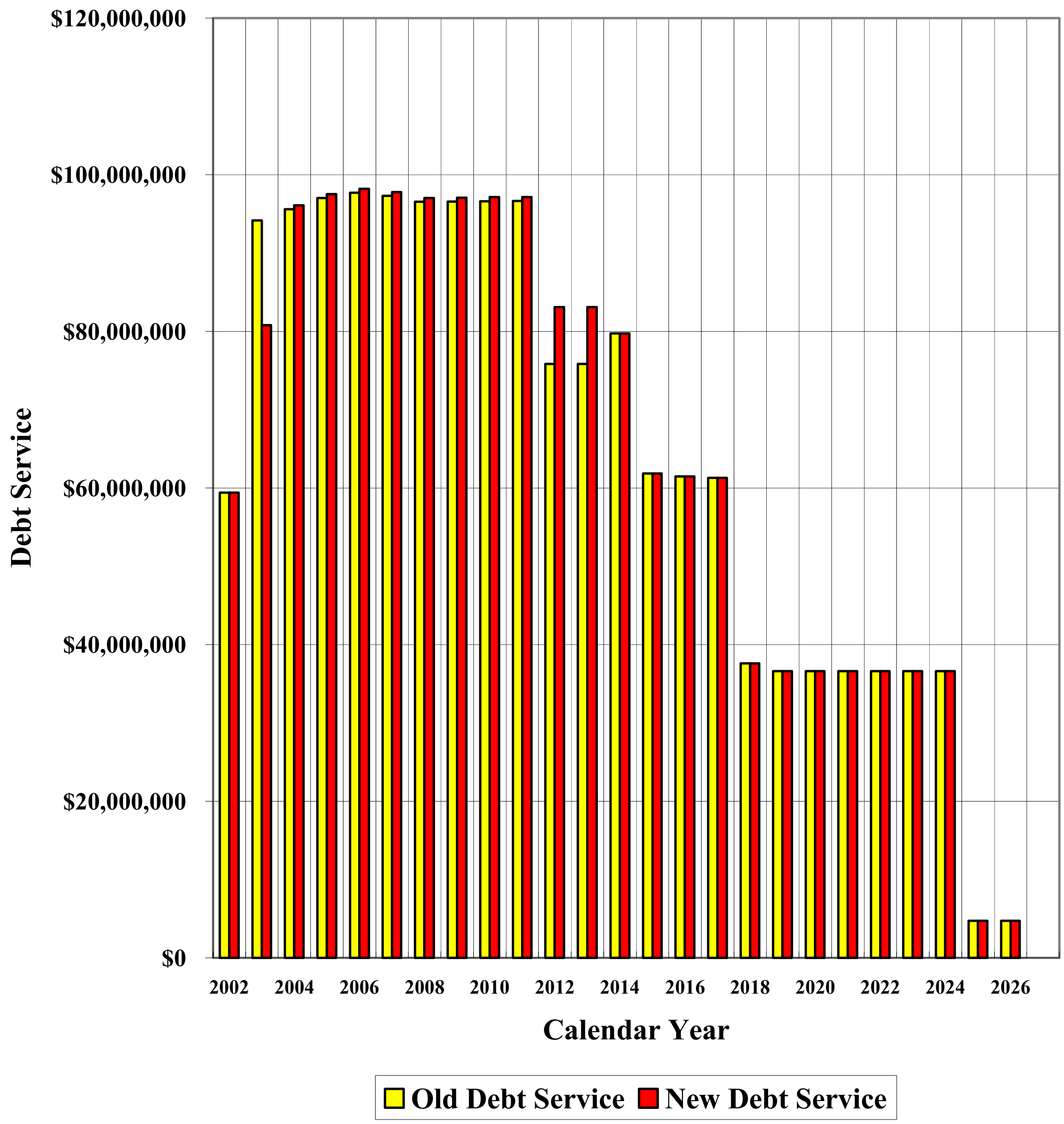
Sweet of Washington County, the constitutional amendment that was crucial to implement what had been passed was defeated in a statewide referendum.

Both tax study commissions grappled with the revenue-side problems that beset Pittsburgh today: sluggish tax bases, non-resident use of municipal services that are not paid for via commuter taxes or state grants, substantial amounts of tax exempt property whose public service costs are borne by other local real estate, and a school finance system that relied too much on poorly administered real estate taxes. Unfortunately, finding political agreement on solutions that in fact work is as difficult today as it was 20 years ago. Municipal government in Pennsylvania, compared to how they function in other states, is generally left alone by state government, so that when the municipal governance process collapses as it has in Pittsburgh, bad things, even really bad things can happen.

3. A First Look at the City of Pittsburgh's Financial Condition

The financial problem that the City of Pittsburgh faces is age old: its commitments outstrip both its financial resources and its political willingness to limit or reduce its appetite for spending and borrowing to spend has been weak at best. Figure 1 displays what the City's current financial advisor, PNC Capital Markets, reports the City's mandatory debt service (interest + principal) was in 2002, what it was in 2003 before the $14 million debt transaction (the lighter column), and what it will now be for 2003 through 2027 (the darker column).

Figure 1
City of Pittsburgh Annual Debt Service



Source: PNC Capital Markets, April, 2003 Presentation to City Council

What Figure 1 tells the casual reader is that there is a debt service "hill" of about $95 million/year that begins in 2004 and that continues through 2011--- 8 years of extraordinary debt service, and then 3 more years of debt service of about $80 million/year. These contrast with 2002 debt service of $59 million/year. Given there are about 327,898 people living in the City, this translates into about $290/year or $180/year in per-capita debt service. If the debt service is not paid, then the creditors have recourse to the courts to get paid and in that process access to the bond insurance itself.

Whether or not this $95 million/year is truly a lot of money (e.g. is this a hill or a mountain?) for the City and its taxpayers requires that we compare these annual amounts to something else. Typically one compares debt service to the size of the operating budget and then compares the resulting "debt service percentage" to standard benchmarks. Three such benchmarks come to mind:

- A debt service percentage considered to reflect best practice,
- The debt service percentage of the Pittsburgh Public Schools which serves and taxes essentially the same population[6]
- The debt service percentage of New York City during its period of financial disarray in the 1970's

The widely respected Municipal Finance Officers of America recommends that the ratio of debt service to operating budget be 10% *or less*. This is considered a "best practice" allocation of resources. Mt. Lebanon, a well-to-do suburb south of Pittsburgh has a ratio of about 5%. Obviously, municipalities with low debt service percentages enjoy very good credit ratings, and pay lower interest rates on their borrowed funds than do those with high debt service percentages.

The 2003 Budget of the Pittsburgh Public Schools reported budgeted 2003 debt service of $49.5 million to be 10.3% of planned spending of $480.9 million.[7].

What is Pittsburgh's debt service percentage?

In 2002, Pittsburgh's debt service as reported by its financial advisor, PNC Capital Markets, was 16% of expenditures of about $370 million. It was going to be 24% in 2003 before the refinancing in May, and dropped back to 21% after the refinancing; however, note that it rises to and stays at 24% for several years and slowly declines to 21% by 2011. (See Figure 2).

Of course, if my expenditure projections are incorrect, the precise debt service percentage will be different; however, nobody would dispute that the City's debt service is at least 20% of the budget, or twice what the upper bound on what MFOA recommends, twice that of the Pittsburgh Public Schools, and four times the debt service percentage of Mt. Lebanon. Debt service of 20% is usually thought to be not sustainable. On a household basis, you are likely aware that mortgage lenders balk when interest, principal, taxes and insurance for a household approach 25%.

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[6] Mt. Oliver is within the boundary of the Pittsburgh Public Schools but not the City of Pittsburgh; however it is very small.

[7] See page 58 of the 2003 Budget of the School District of Pittsburgh, December 2002.

The effect of Pittsburgh's extremely high debt service percentage has been predictable, for lenders to municipalities are not stupid. The bond market has required that Pittsburgh insure its debt for some years in order that the City sells its bonds, and also maintain cash reserves that are a sizeable fraction of annual debt service. Press reports indicate that the City promised to keep $40 million available, or about ½ of annual debt service in 2003 after it sold $14 million in bonds in May/June.

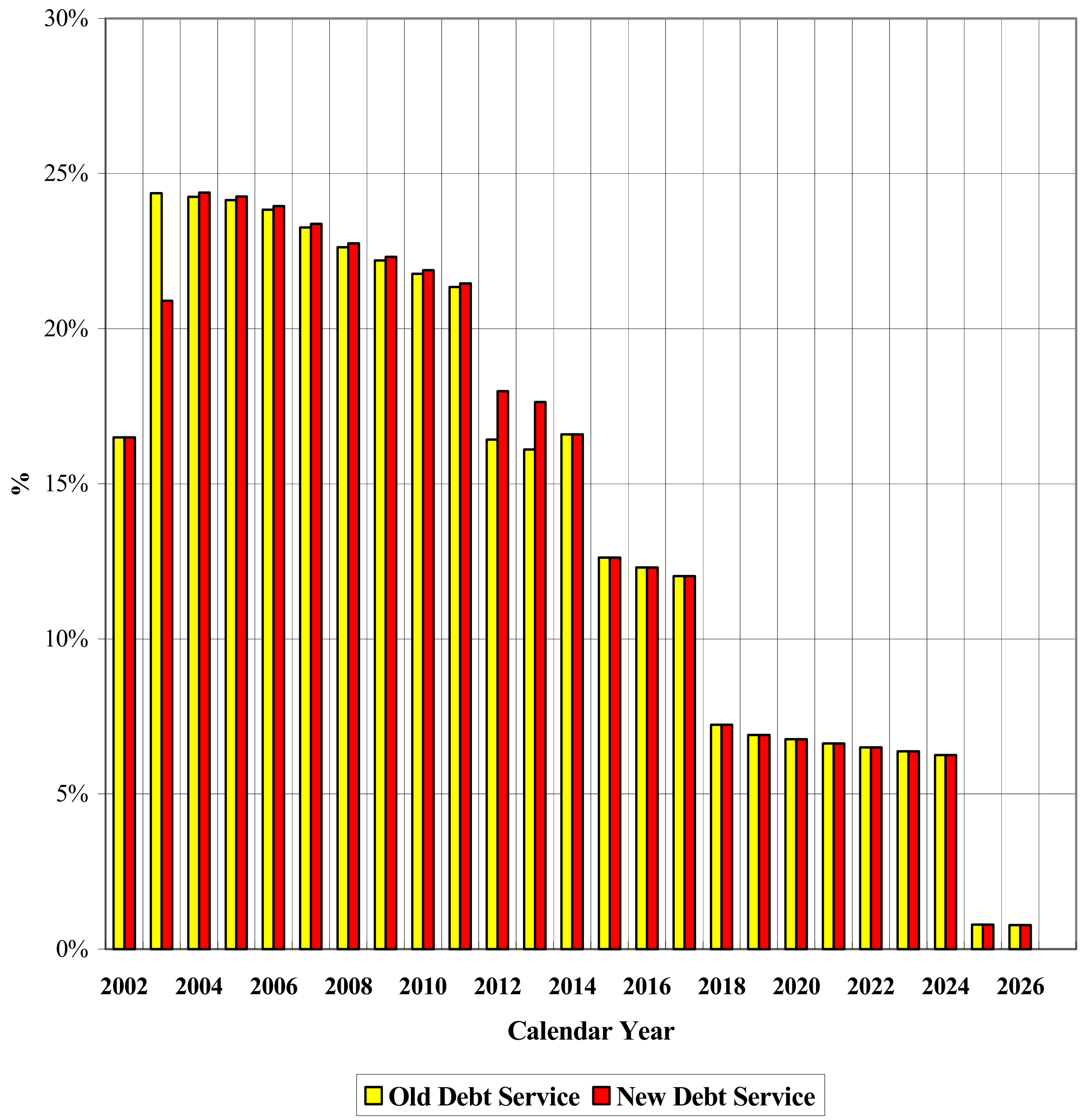
While these debt service percentage figures are staggering when compared to the way a personal household is viewed in the capital market, they are positively chilling when compared to those of New York City in the 1970's. As you know, the large commercial New York banks balked in 1975 in further rolling over NYC short-term debt; this precipitated New York's failure to pay interest and principal. In 1974, the year immediately preceding the "moratorium" in payment of interest and principal, NYC debt service was 12.2% of gross revenues, and 19.6% of net revenues.[8] In 1975, debt service as a percentage of respective gross and net revenues was 15.8% and 25.4%. These figures do not compare precisely to the percentages in Figure 2, but they give you an order of magnitude idea of where the Pittsburgh's indebtedness and debt service obligations stand.

At that time, NYC's outstanding notes were a considerable portion of the total municipal bond market, and because they were uninsured encouraged the banks, along with the City and New York state to put together a very complicated set of federal and state initiatives of first loan guarantees and then second certain safe harbors for the various pension funds to buy NYC and Municipal Assistance Corporation paper without

[8] Tom Boast and Eugene Keiland, *Setting Municipal Priorities,* Table 4.5 at p.93.

violating the self-dealing prohibitions in the Internal Revenue Code..

Figure 2
City of Pittsburgh
Debt Service as % of Estimated Expenditures



Source: PNC Capital Markets, April, 2003 Presentation to City Council,
Author's estimates of Pittsburgh's expenditures

4. A Second Look at the City of Pittsburgh's Debt

Above I described inferences that a "casual reader" might draw from these facts that PNC presented to Pittsburgh City Council in April, 2003 and that I have graphed. I want now to explain this remark as a way to introduce a more dire view of the current financial position of the City of Pittsburgh. The question here has to do with precisely what the City of Pittsburgh is, and what is its indebtedness and other long-term obligations are. In turn this will lead to certain distinctions that rating agencies and state law make about debt that the City of Pittsburgh stands behind directly, and other debt that has been sold by organizations the City set up. The other, less visible long-term liabilities of the City, in an economic rather than a literal or legal sense, involve:

- The City's public authorities and their debt,

- The City's long-term liabilities reflected in future retirement benefits that have not been covered by investments, and,

- The City's long-term labor contracts that severely limit its financial flexibility and have the economic effect of long-term debt

Public Authorities

After World War II, it was fashionable in Pennsylvania and many other states to allow municipalities to create separate public corporations, called public authorities, that were governed by boards appointed by elected municipal officials (usually the mayor, president of council etc.), and that could issue "revenue" debt. This was done through new state law.

Such authorities in Pennsylvania do not have the authority to levy any taxes, because the Pennsylvania Constitution requires that taxes must be levied by elected representatives. "Revenue" debt is debt whose principal and interest is repaid through various fees associated with the sale of services related to the capital constructed with the debt. The debt of these public authorities is usually not counted when measuring municipal indebtedness, since technically the cities or counties do not issue the debt and do not pledge their full faith and credit behind the debt. Because the authorities can generate revenue through the sale of services, the bond market usually views these bonds favorably, especially since the prices of such services (e.g. water rates) are not subject to record votes by elected city councils; they are merely adopted by appointed boards.

In Pennsylvania, there are two kinds of authorities relevant to understanding the City of Pittsburgh's finances: those created under the Public Authorities Act of 1947, and those created under specific acts of the General Assembly. Authorities created under the general legislation must report statistical data to the Department of Community and Economic Development (DCED) on DCED forms, and must attach an independent audit report. This information is reviewed by DCED; however, they are not audited by DCED. There is not much oversight of authority activities in Pennsylvania, compared to how other states deal with their local governments and local public authorities. Entities created by specific acts of the General Assembly (Pittsburgh's Urban Redevelopment Authority or URA and Pittsburgh Housing Authority), do not have to report their activities to

DCED, but instead to the local court and City Council. Public oversight of these second kind of authorities is weaker, especially since the financial information surrounding them can be very difficult to locate, and need not be in any specific form.

Public authorities may in turn create subsidiary organizations, and the Pittsburgh Urban Redevelopment Authority has created three. In turn, such subsidiary corporations may sell indebtedness, either to the parent, the URA, or to the public.

Pension Plans

Employee retirement plans are the other major long-term obligation of any organization. Because a retirement plan is a long-term contract between the employer and the employee, it is reasonable to consider the financial position of the pension plan when examining the overall financial position of the municipality. If enough money is put aside into the pension trust to pay the long term retirement obligations of the City, then the plan is said to be actuarially sound, and "fully" funded. If the present value of the assets are less than the present value of the liabilities (future retirement benefits), then the plan is said to be under-funded. If the plan is under-funded, then retirement benefits have to be paid out of the current budgetary revenues of the City rather than the income generated from the pension trust. The present value of the short-fall in assets can be viewed as a long-term liability or in effect another sort of bond that has to be serviced.

Long Term Labor Contracts

There is another possible form of long-term municipal liability that relates to contractual employment relationships that I have not been able to analyze numerically, but is relevant to your understanding of Pittsburgh's financial situation. This has to do with the financial implications of job guarantees. If a municipality agrees to an employment contract that prohibits layoffs, and guarantees that salaries and benefits actually *grow* in financial cost over time by, say the rate of inflation, then the municipality has incurred something more onerous than bonded indebtedness for capital purposes. It has agreed to a *growing* long-term liability.[9]

In the case of a bond, one promises to pay fixed amounts of interest and principal for a known number of years, and thus one faces a fixed liability. Bankruptcy occurs when interest and principal cannot be paid because of cash shortfalls, and creditors demand that they get paid ahead of anybody else. Such employment contracts can be a strong push

[9]Years ago, General Motors agreed to guarantee employment for its hourly employees who were members of the UAW, and agreed further to increase wages by the cost of living. In return it got a no-strike clause in the labor accord. While it bought labor peace, it agreed to a growing wage bill that was unrelated to productivity, and was rumored to be overstaff by as much as 20 to 30% in its plants. This growing liability was also coupled with a health care package that grew much faster than overall inflation. As a result of such increased labor costs, GM priced its cars well above those of their competitors with the obvious result that market share and ultimately profitability both declined. If one is to believe GM's current advertisements, one of its responses was to cut quality and hope nobody would notice. At one point in the not too distant past, GM was near insolvency.

towards bankruptcy since they put inexorable upward pressure on budget costs; however, salaries unpaid will be in line *after* bondholders for satisfaction of their contracts. The point is that the only budgetary relief available from such employment contracts occurs through retirement or premature death of employees that are coupled with a positive decision not to replace vacated positions. This dramatically reduces budgetary flexibility and makes retrenchment very slow.

Index bonds (interest and principal are denominated in inflation-adjusted values), usually found in situations of hyper-inflation in developing countries, are financially equivalent to the above sort of guaranteed employment contract that grows in cost over time. Limitations of time precluded any analysis of whether any of Pittsburgh's employment contracts are financially equivalent to such index bonds; however, there have been recent press reports that some of the City's labor contracts contain no layoff clauses and also provide for automatic salary increases.

It is certain that, when employment contracts expire and a collective bargaining impasse occurs for uniformed municipal employees (police, fire, emergency medical service and some court employees), Pennsylvania labor law under Act 111 requires that failed collective bargaining negotiations be turned over to an arbitrator who must decide on *which* final offer (that of the employer, or that of the union) to choose. Under this mandatory scheme, the arbitrator cannot choose a settlement that represents a compromise between the two offers. When the arbitrator favors the union offer this has the effect of raising the salary costs of that activity, and, if the budget was earlier in balance, to either require cuts in other public services, or simply an increase in real estate or wage taxes.

Importantly, Act 111 does not allow the arbitrator to consider the financial implications to the municipality of any award in reaching a decision. The result of this mechanism for a union is to encourage union wage demands that are unacceptable to the City, and simply go into binding arbitration. If pro-union arbitrators are routinely chosen, then the expensive option will get chosen by the arbitrator, and some combination of spending cuts in other areas, higher taxes, or even the issuance of bonded indebtedness to cover the higher labor costs will occur. It should be pointed out that final offer binding arbitration of this sort only applies to a limited subset of municipal collective bargaining situations, and does not, for example apply to private sector collective bargaining relations in Pennsylvania or state public sector collective bargaining situations.

When PICA was enacted in 1991, Act 111 was amended for Philadelphia so that the arbitrator *could* take into account the financial impact of the award on Philadelphia when choosing between the final offer made by Philadelphia and the final offer made by the particular union. Since Act 111 applies to failed collective bargaining negotiations, it follows that the relief provided to Philadelphia was only prospective. However, it is my understanding that you recently eliminated this safe harbor for Philadelphia to the consternation of Governor Rendell and Mayor Street. Should you provide the same sort of safe harbor from final offer binding arbitration for Pittsburgh, do recognize that because the City has just had its major contracts settled, such help will not provide any fiscal relief for several years.

As you know, the teachers in school districts throughout Pennsylvania are represented by one of two unions, and that as I speak the two unions are in the process of merging into one teacher's union. Everyone here today can agree, I think, that these two unions are not shy, and can be very aggressive in reflecting their member's interests. However, no teacher's contract in Pennsylvania currently obligates a district to maintain teacher employment should enrollment decline across school years. Teacher employment follows the typical last-hired, first-fired pattern in other unionized settings, and the decision to furlough is not completely restrained by union contract.

An Attempt to Add Up All of theNet Debt and other Long Term Liabilities

This past Spring, in conjunction with teaching a graduate course in state and local finance at the University, I worked with students in the course to try to profile the debt of the City's various authorities and unfunded pension liabilities of the City's pension plans. Because state laws governing the accounting and reporting of public authorities is very weak, and also very slow, the data we collected, and that I have subsequently collected by traveling to Harrisburg to review the files of DCED are incomplete, and old. However, they are what an interested citizen can garner, and are worth looking at for they tell a more precarious story than was viewed above.

Table 1 shows the City of Pittsburgh, its seven public authorities, including the three component units of the URA, and the major City pension plans, and attempts to add up the debt of each of the units. I say "attempts" because nowhere is the accounting information for all of these entities brought together on an audited, consolidated and consistent basis. State law does not require it, and it is simply not done.

There are two places where one can find data on the City and its authorities combined: the annual CAFR prepared by the City Controller, and those financial data supplied when the City goes to the bond market to sell its bonds. The annual report of the City Controller brings together many but not all of the related entities of the City, and does not declare or show numerically what parts of authority activity are *not* consolidated. As of August 22, 2003, the most recent CAFR publicly released by the City Controller relates to calendar 2001 financial results of the City. While the 2002 CAFR may have just become available, I have not had the time to obtain, let alone carefully review it.

The extent that the Controller's CAFR uses national accounting standards is not dictated by state law or the Home Rule Charter, but by the requirements of the bond rating agencies. For example, the bond rating agencies have stated that they will not issue a bond rating for any jurisdiction that does not comply with GASB 34, and that jurisdictions the population size of Pittsburgh are due to comply by the close of August, 2003.[10]

The May/June, 2003 bond offer statement shows how much debt the City is immediately responsible for as a consequence of its pledges, and shows how much of such debt the City has issued in relation to limits imposed by Pennsylvania's Unit Debt Act.[11] Note that the Unit Debt Act does not limit the debt of the City's authorities when their debt is not assured by City pledges of various types.

From an economic perspective and the perspectives of City residents, voters and taxpayers, as well as my purpose here, there is merit in looking at the *overall* debt position of entities under the direct and indirect control of the City, because whether the payment of such debt is from taxes levied by the City or user fees or rents collected by, say the URA, they constitute a drain of economic resources from within the City boundaries for various public purposes that elected officials have ultimately agreed to.

Whether or not meeting the reporting requirements dictated by national bond rating agencies also meets the informational needs of various local stakeholders deserves comment, and underlines the importance of improved financial transparency. Those who rate municipalities for the bond market simply want to assure those who buy the particular bonds being offered that they will be repaid. Local stakeholders, such as voters and taxpayers, have a different but related and broader interest in knowing what is going on throughout the City, and whether or not there is a reasonable relationship between what is provided in terms of services in relation to what is being supported by taxes and user fees. The absence of financial transparency means that this second interest is not likely to be served.

Unfortunately, much of the data we were able to assemble is old, and it is likely, especially in the case of the pension plans whose investments have probably declined in

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[10] Should Pittsburgh be precluded from selling debt in the future, it would no longer have to be publicly rated. A corollary to this is that the level of financial reporting to the public could easily decline because state reporting rules governing municipalities are so modest. School districts in Pennsylvania are subject to both greater reporting requirements, and greater audit oversight by the Pennsylvania Department of Education and the Pennsylvania Auditor General, largely because significant state monies are transferred to local school districts. Some may argue that if the City does not receive significant state monies, there is little or no state interest, and through the philosophy of Home Rule, no need for state oversight of municipal finances.

[11] The Unit Debt Act implements the Commonwealth's obligation to the General Assembly to limit the amount of debt that can be issued by local government. Debt approved through voter referenda or "electoral debt" are not subject to limit, while other debt secured by lease rental or otherwise are so limited. Limits for various classes of municipal debt are defined as multiples of a three year moving average of net City revenues. This moving average was $354.4 million in 2003 for the period 2000-2002. Non-electoral debt, composed of lease rental debt and other debt of the City are limited to 350% of this moving average, and non-electoral, non-lease rental debt is limited to 250% of this moving average. If debt is subsidized by another governmental agency, Pittsburgh Housing Authority debt is subsidized by the federal government, such debt is not limited by the Unit Debt Act. Debt issued to fund the unfounded liability of pension plans is not subject to the Unit Debt Act.

absolute value since 2001, that the un-funded pension liabilities are probably now 10 to 15% greater than at the close of 2001.[12] Also, it is possible that some of the figures in Table 1, for example the $224 million of net debt for the URA (not counting that of its subsidiary units), may be in part counted in the City's $596.1 million. Since the URA does not have to report publicly in any systematic manner, and there is no reconciliation of the URA's *overall* activities in the City Controller's Consolidated Annual Financial Report, it is difficult to be sure. Also, I have made a very rough estimate of what the City's share of the Stadium and Exhibition Authority Debt is.[13] This Authority's statistical report to DCED has been late, and the current financial situation of this Authority is really not discernible to somebody outside of City or County government. What is knowable is that they changed their fiscal year from year end of June to year end of December in 2001 by announcement to DCED. It is unlikely that they could to do this sort of thing in many other states without prior state approval. At the federal level, no corporation may change its accounting period for federal tax purposes without the prior approval of the IRS.

With these limitations in mind, what does adding up the debt from various sources tell us? Table 1 begins with what the City states is its net debt subject to the Unit Debt Act; this is $596.1 million and includes the $14 million debt offering in late May. If we add up various authority debt, including a portion of the Stadium Authority debt attributable to the City, one finds another $954.8 million. It is possible that of the $225.4 million debt that the URA discloses on its balance sheet, some amount is already included in the $596.1. The pension reports filed with the state pension oversight authority indicate there is an additional unfunded pension liability of $365.4 million at the close of 2000. As noted earlier, it is quite likely that this is an optimistic estimate of what that amount would be today, since market performance has hardly equaled the 9% return that these funds assume in making their actuarial projections. Adding up these various long term liabilities totals $1.9 billion, which is substantially larger than $596 million.

Pittsburgh City taxpayers also are responsible for paying taxes and servicing the indebtedness of the School District of Pittsburgh which had $386.9 million in outstanding net debt according to its June 20, 2003 bond offer statement. If we thus add up these measures of direct, indirect, and overlapping debt in Table 1, we find it totals $2.3 billion. This is considerably (76%) above the $1.263 billion in direct and overlapping debt contained in Appendix B of the City's May/June bond offer statement.[14] Of course, the City is not legally behind this much larger debt amount; however, were these authorities forced to raise their prices, or fees, it is likely that it would affect the economy

[12] Perhaps the most worrisome aspect of the major City pension funds is that the ratio of retirees to employed workers, a typical measure of "support" for a pension plan is now about 1:1.

[13] Technically, the stadium debt is being paid out of dedicated portions of the regional sales tax, and not by the City. From an economic perspective, these allocated sales tax receipts could have been devoted to paying for City services, and are thus an indirect drain on the City budget.

[14] Table B-6, page B-5, offer statement City of Pittsburgh, General Obligation Bonds, Series A of 2003, June 1, 2003. It should be noted, however, that one can find many of the components of Table 1 in the footnotes to the City's offer statement.

of the City. Whether or not these bonds are unfunded themselves depends on the extent to which sinking funds and other monies have been put aside to pay them off.

Table 2 puts the various aggregate amounts of debt on a per-capita basis. The narrowly defined per-capita City debt is $1, 818. Philadelphia's per-capita debt at the time the capital market refused to buy its short-term notes in 1991, brought to 2003 levels by correcting for inflation, amounted to about $2,000 per-capita. If you add the other long-term liabilities contained in Table 1, you see that total per-capita debt is $7,062, or extraordinarily high in comparison to the inflation adjusted per-capita debt of Philadelphia.

If you look around the country you will find that these sorts of city per-capita debt figures make Pittsburgh Number 1.

**Table 1 Debt of City of Pittsburgh, Authorities,
Unfunded Pension Liabilities and Pittsburgh Public Schools**

	City of Pittsburgh Net Debt Subject to Unit Debt Act:	Debt ($millions)	Period of Data	Data Source:
		$596.1	1-Jun-03	2003 Offer statement p18
	+ **Separate City Public Authorities Net Debt from Various Sources:**			
1	Water & Sewer	$435.0	2001	DCED Report
2	Urban Redevelopment +	$225.4	2001	URA Audit Report
A	URA Housing Corporation	$3.8	2001	URA Audit Report
B	Pittsburgh Economic & Industrial Development Corporation	$46.2	2001	URA Audit Report
C	Pittsburgh Housing Development Corporation	$2.3	2001	URA Audit Report
3	Pittsburgh Housing Authority	?	?	?
4	Pittsburgh Parking Authority	$77.6	2001	DCED Report
5	Stadium Authority (3 Rivers)	$21.0	2002	2003 Offer statement, p. B-5
6	Sports & Exhibition Authority (Joint Venture with Allegheny County)	$130.0	2001	Author's estimate
7	Equipment Leasing Authority	$0.0	2001	DCED Report
	Auditorium Authority (Shared by agreement with Allegheny County)	$13.5	2002	2003 Offer statement, p. B-5
	Total Authority Net Debt	$954.8		
	+ **Unfunded Pension Liabilities:**			
	Policemen's Relief & Pension Fund	$154.4	2000	Act 205 Report
	Firemen's Relief & Pension Fund	$150.3	2000	Act 205 Report
	Municipal Pension Fund	$60.7	2000	Act 205 Report
	Total Unfunded City Pension Debt:	$365.4	2000	
	Total Debt of City Activities :	$1,916.3		
	School District of Pittsburgh Net Debt:	$386.9	20-Jun-03	Pgh Schools Offer Statement p. B-3
	City + School Debt	$2,303.2		

Table 2
Percapita Debt of City of Pittsburgh and School District

Per Capita Debt subject to Unit Debt Act (2002 Population = 327,898)	$1,818
Per Capita Authority Debt	$2,912
Per Capita Unfunded Pension Liablity	$1,114
Per Capita School Debt	$1,180
Total Per capita Debt	$7,024

Source: Derived from Table 1

5. Now What?

In one sense I have simply proven the obvious; the financial position of the City of Pittsburgh is precarious. What I hope I have also shown is that the debt service obligations of the City over the next 8 years are staggering to the point that using the insurance provision of the bonds may be the most responsible thing to do for the citizens of the City. There are experienced, responsible people who have looked at the City's debt, and at its debt service percentage, and simply observed that it's over. This point of view holds that there is no local political scenario that would support adequate spending cuts, tax rate increases in existing taxes, and reorganization of labor contracts that could forestall using the bond insurance and/or going into some complex form of distress or subsequent federal bankruptcy.

Before one reaches this conclusion, however, there is merit in discussing the options that the City and other local stakeholders might pursue, and what things the Senate, House and Governor might consider that would make a lasting difference so that the City of Pittsburgh could become financially sound in the foreseeable future.

Policies divide into two types: i) those policies that I hope you and the City will undertake regardless of whether or not the bond insurance gets immediately used, the City declares itself distressed and/or then goes into actual bankruptcy, and ii) the different ways that the City may move towards financial stability.

A number of changes seem fairly meritorious to me, although achieving them will require a radical change in political culture, and likely will be viewed as politically not doable.

5.1 Things That Should Get Done Regardless

Common Policy Change # 1:

Put City- School District Relations on Same Basis as others in Pennsylvania

The financial positions of the Pittsburgh Public Schools and Allegheny County, *per* se, are extremely strong, and their bond ratings are very strong. As you may know, the City Controller is obligated under the School Code to perform certain financial functions for the Pittsburgh Public Schools, and the City Treasurer is obligated to be the real estate tax collector for the Pittsburgh Public Schools. Given the known low real estate collection rate that the City Treasurer has accomplished, I see merit in allowing the Pittsburgh Public Schools, like all the other 499 school districts in Pennsylvania to be responsible for its own real estate tax collection. Similarly, I see merit in focusing the audit and performance evaluation attention of the City Controller on just the City. These are statutory changes that need be effected by the General Assembly by amendments to the School Code, and do not impact whatsoever the City's Home Rule status.

Common Policy Change # 2:

Make Pittsburgh Financially Transparent

Regardless of whether the City goes to federal bankruptcy court for resolution of its problems, or finds the political will now to fashion its own solutions, achieving financial transparency is going to be central to ensuring that whenever and whatever the City does to solve the financial problems it is in, is credible to both the capital market, to its citizens, and to the Commonwealth. Below I identify some policies that seem warranted regardless of the underlying strategy that is pursued.

Given the City's Home Rule status, these changes require, to the best of my understanding, amendments to the City's Home Rule Charter:

GAFR, GAAP Required; Focus the Role of the City Controller

Right now, by design and action, the real financial position of the City is not knowable. State law does not obligate any local government or entity to follow Generally Accepted Financial Reporting (GAFR) practices, or follow Generally Accepted Accounting Principles (GAAP). One only has to try to make year to year comparisons with the City Controller's CAFR to realize that he is under no stricture to systematically report on a comparable basis year to year, and follow best accounting practices. In fact, because he is obligated under the City's Home Rule Charter to keep the books, approve payments, and then audit the books, he cannot perform the federally required independent, single audit. Pittsburgh has a two-headed executive branch that is inherently conflicted: an elected Mayor, and an elected City Controller.

This statutory tension distracts both the Mayor and the City Controller from efficiently meeting their respective responsibilities of running the daily operation of the City on a professional basis, and evaluating both the financial position and performance of the City's wide ranging activities. Making the City Controller the truly independent auditor of the City will eliminate the need to obtain a private audit each year. Unburdened with the responsibility to keep the books and approve the checks, the City Controller can perform truly independent audits through his office. It is likely that this refocusing of responsibilities will entail moving some of the Controller's accounting staff, and those who are involved in approving payments, and the do internal audits into the City under the control of the Mayor's chief financial officer. Also, the Mayor would need to appoint his own controller who would then supervise, as his counter part does elsewhere in the private sector, accounting and finance functions.

To achieve this realignment will require an amendment to Section 404 of the City's Home Rule Charter of 1974 to redefine the powers and duties of the City Controller.

Meaningful Financial Consolidation and Consistent Reporting of City Authorities

Even a federal bankruptcy judge will want to know precisely what the City's financial position is, in order to decide how to pay creditors. While there may be a legal immunization from the debt of some of its authorities, at some point their financial interdependencies are difficult to ignore. Let me give you an example of what can be involved. Based on its 2001 statistical report to DCED, one can observe that the Water and Sewer Authority had negative retained earnings. Is this because water rates were too low, or because the Authority transferred monies to the City so that its end of year results looked better? Other authorities in 2001 displayed considerable, positive retained earnings. It is not possible without real financial transparency to understand the financial position of each of the authorities.

Certainly, significant positive retained earnings across the various authorities raises a question about how cash-strapped the City was in 2001. Given that the Mayor ultimately controls their financial decisions, one can imagine transferring some of these positive retained earnings to the City to pay the City's debt service, payroll and so forth.

Presumably a federal bankruptcy judge would want to see an independently audited consolidated financial report of the City and *all* of its authorities to understand the cash position of the City before ordering that insurer's pay angry creditors. Certainly, putting the City and all of its authorities on the same fiscal year is an absolutely essential first step in achieving financial transparency.

How this change gets effected is not clear to me at this point. I suspect it may not be something that the General Assembly can simply obligate the City to do, but is something that could be included in a Home Rule Charter amendment that defined how the City should keep its books, and how the City Controller should perform financial and performance audits.

Free and Ready Public Access to Records

Public confidence in the activities of the City would be materially improved if any citizen of the Commonwealth were able to inspect public records of the City during normal business hours, and make copies of public records at commercial rates ($.05/page). To do requires that Section 810 of the City's Home Rule Charter of 1974 be so amended. Now, any administrator can bar access by stipulating without Council review regulations governing time, place and manner that public records can be inspected. Further, "public record" is not properly defined in the Charter.

Common and Controversial Ideas # 3:

Perhaps my most controversial ideas involve how the City might begin to get some sort of control and balance in its collective bargaining agreements. Unfortunately, I have not reviewed the various collective bargaining agreements and compared them to those of other public sector unionized workers or unionized private sector workers. Certainly the possibility of long-term fixed labor costs that can not be adjusted as the City slips into bankruptcy is not a pretty one, and one that taxpayers, voters, and elected officials need better tools than currently available.

It is common in such municipal financial crises for management and labor to sit down to see what can be accomplished to forestall layoffs and resulting unemployment, and diminution of vital public safety services. Earlier today you will have heard witnesses talk about efforts to date, but likely no-one has asked for what I suggest below:

- The voluntary opening up of all collective bargaining agreements and their public renegotiation on the public cable channel;

- The obligatory referenda adoption of any collective bargaining agreements through an Amendment to the Home Rule Charter that result from their renegotiation.

- An experimental 10 year safe haven for the City of Pittsburgh from Act 111 enacted by the General Assembly

Each of these ideas is designed to begin to protect taxpayers from weak or non-existent resistance to collective bargaining demands that Act 111 has ensured will be won. It is very easy to understand how a Mayor and City Council, entirely sympathetic to the plight and wishes of their employees and unions, can forget that they are spending somebody else's money when they agree to automatic wage increases that are greater than the rate of inflation, work rules and personal leave policies that could well be the envy of all in the region. Given the history of the region and its predisposition to support organized labor, the idea of redefining labor relations and making them far more transparent seems to me to be crucial in getting expenditures under control. The above three ideas untie the negotiating hands of the Mayor and Council, and provide to all voters an opportunity to decide what a fair bargain is in terms of wages and benefits for their public servants.

In the course of greater public disclosure, the problems and inefficiencies caused by particular work rules and the savings that will be accomplished by subjecting them to public discussion could well be healthy, and materially improve the climate of labor-City relations. From where I view events of the past month or so, something has to be done constructively to begin creating win-win discussions about public employment costs and move away from lose-lose discussions.

5.2 The Dimensions of A Hometown Financial Solution

It is difficult, without precise numbers about the consolidated financial position of the City, to speculate about how the Mayor and Council could actually fashion their own solution so that they would not be told by an Act 47 appointed supervisor, local judge or later a federal bankruptcy judge what they could do and not do with tax monies they raise. Let me make a few assumptions, and indicate what they might imply for some Hometown Solutions.

Raise the Earned Income Tax from 1 % back to 2 %, +$49 million

First, let us assume that the City requires a cash balance of about $40 million/year to be able to maintain some sort of access to the capital market. By most accounts it will not have any such spare cash in 2004 Some years ago the City's earned income tax was 2%, but was reduced to 1%, and I suspect that much of the City's structural deficit is due to this tax reduction. Returning to a 2% rate would likely double earned income tax collections from about $49 million/year to about $99 million/year.

Raise Real Estate Millage 20%, and Cut City Spending on Payroll by $22.5 million/year.

Second, the City needs to get debt service costs down in 2004 from $95 million to $52 million for a considerable period of time to calm capital markets. Even though the bonds are not callable[15], it is imaginable that at a premium, bond holders will surrender their bonds. Now, in very rough numbers, this entails finding for 2004-2012 or 10 years about $418 million or about $45 million/year. Here I suggest that City expenditures on salaries be cut by $22.5 million/year, and that real estate taxes go up by $22.5 million/year.[16] Had no TIFS been granted, that increase would be much smaller,. but since 10% of the real estate tax base has been given away in the name of economic development, those promises will have to be met. This would be something on the order of a 18 to 20% increase in real estate taxes. Now it's imaginable that cutting police, fire, general municipal employment by $22.5/year million will cause enormous unhappiness; however, the promised $15 million/year in savings from merger of fire and EMS has yet to be initiated, let alone experienced.

$52 Occupation Tax Contingent on Above Policies, Including Amendments to Home Rule Charter, being Continuously in Place, +$12 million

The last piece in the puzzle is to do something about non-resident financing of their use of Pittsburgh services. This requires changes in state law (Act 511), and I would suggest that it be contingent on the above policies being in place annually. Then, I would enable a $52/year occupation tax that would raise perhaps $12 million. I would actually prefer a commuter tax levied at 1/3 of the resident earned income tax rate (on the theory that there are 8 work hours in a day out of 24 hours in the day) with ½ of the tax being credited against one's own city earned income tax; however, this would likely make resident municipalities very unhappy, since they would be getting .005 - .02*.33 * .5 = .0017 rather than .005 from their commuters and be forced to raise real estate taxes on everybody.[17]

This sort of fiscal arithmetic entails a fiscal swing of something like $100 million which should be sufficient to avoid bankruptcy or even distressed status in 2004. These changes can be made in the context of the development and adoption of the 2004 budget in the next several months, and would be a very clear signal, when coupled with the Home Rule Charter amendments discussed above, that the City has made a forthright effort in both raising taxes on residents, and cutting spending. Obviously, if there is reliable evidence that spending can be cut more deeply without affecting public safety and the core services the electorate expects, then other formulations that still result in

[15] Questions can be immediately raised about why the City issued non-callable, insured bonds. Certainly the absence of a call provision lowers borrowing costs. On the other hand, any back of the envelope calculations had to allow anybody with a four function calculator to conclude that the debt service percentage would ultimately need to be addressed, and some sort of stretch-out worked through. I am told that the absence of a call provision doesn't mean it's impossible to achieve, it simply means that the bond holders will need to be offered yet a better deal to give up the City bonds.
[16] If net real estate collections are about $115 million in 2003, then a 20% increase in millage will raise about $23 million in additional real estate taxes.
[17] This is the classic Sterling Act problem of course.

about $100 million in fiscal changes can take place. Raising the resident wage tax back to where it was is a crucial first step.

One way that the Mayor and Council can signal to the General Assembly that they expect relief through the safe haven from Act 111 now, and greater taxing authority of non-residents in the future is to make the earned income and real estate tax rate increases for two years only. If they wish to be more courageous, they can adopt lower real estate and wage tax rates at the same time for the third year in stated anticipation of expanded taxing authority of non-residents.

5.3 Sitting Tight and Let Act 47 Get Used

The second strategy available to the city of Pittsburgh is to declare itself a distressed municipality under the 1987 Financially Distressed Municipalities Act, P.L. 246, Number 47. The purpose of this act was to "enact procedures and provide powers and guidelines to ensure [the] fiscal integrity of municipalities…"[18] In order to ensure the fiscal integrity of a municipality this act requires that all municipalities submit a Survey of Financial Conditions to the Department of Community and Economic Development of the Commonwealth each year whose purpose is allow the department to assess the fiscal status all municipalities, or as a sort of early warning system. In addition, using the information provided in the annual survey, a municipality may request a determination of municipal financial distress.[19] If a municipality meets at least one of the following 11 criteria, that municipality may be deemed to be a distressed municipality:

1. The municipality has maintained a deficit over a three-year period, with a deficit of 1% or more in each of the previous fiscal years.
2. The municipality's expenditures have exceeded revenues for a period of three years or more.
3. The municipality has defaulted in payment of principal or interest on any of its bonds or notes or in payment of rentals due any authority.
4. The municipality has missed a payroll for 30 days.
5. The municipality has failed to make required payments to judgment creditors for 30 days beyond the date of the recording of the judgment.
6. The municipality, for a period of at least 30 days beyond the due date, has failed to forward taxes withheld on the income of employees or has failed to transfer employer or employee contributions for Social Security.
7. The municipality has accumulated and has operated for each of two successive years a deficit equal to 5% or more of its revenues.

[18] Financially Distressed Municipalities Act. P.L. 246, No. 47. (as amended P.L. 336, No. 69) § 102.
[19] The Financially Distressed Municipalities Act establishes who may seek the determination of municipal financial distress from the Secretary of Community and Economic Development of the Commonwealth. They include, the department itself if they judge financial distress on their own review, a creditor with a mature claim, employees of the municipality who have not been paid, elected auditors, a trustee of a municipal pension fund which has not received payment, electors from the municipality, the chief executive, and others.

8. The municipality has failed to make the budgeted payment of its minimum municipal obligation as required by… the Municipal Pension Plan Funding Standard and Recovery Act…to a pension fund during the fiscal year for which the payment was budgeted and has failed to take action within that time period to make required payments.
9. A municipality has sought to negotiate resolution or adjustment of a claim in excess of 30% against a fund or budget and has failed to reach an agreement with creditors.
10. A municipality has filed a municipal debt readjustment plan pursuant to Chapter 9 of the Bankruptcy Code (11 U.S.C. 901 *et seq.*).
11. The municipality has experienced a decrease in a quantified level of municipal service from the preceding fiscal year which has resulted from the municipality reaching its legal limit in levying real estate taxes for general purposes.[20]

If at least one criterion is present and DCED assesses that it is a valid indication of municipal financial distress, the municipality is determined to be "distressed." Within 30 days of this determination, a "coordinator is appointed to prepare a plan addressing the municipality's financial problems."[21] The coordinator will then have 90 days to formulate a plan for relieving the municipality's financial distress. The plan includes projections of revenues and expenditures, determination of amounts needed to satisfy past due accounts, determination of amounts needed to eliminate deficits, the establishment of a capital budget, and recommendations for the municipality.

The plan may also allow *prospective*[22] changes in collective bargaining agreements and permanent and temporary staffing level changes in organizations. Additionally, once a municipality has been determined to be distressed, it may apply for emergency financial aid in the form of small grants or loans from the Department of Community and Economic Development of the Commonwealth, and may petition the court of common pleas for an increase in tax rates above the maximum rates provided by law, and in certain circumstances seek court-approved imposition of a commuter tax.

Note, too, that there are some serious draw-backs to the city in becoming distressed under Act 47. First, and most obviously, the city government relinquishes control to the coordinator established by the Department of Community and Economic Development. Although the city must either accept or reject the proposal submitted by the coordinator and there are provisions allowing for revisions to be considered and even an alternative

[20] Ibid. § 201.
[21] Ibid. § 221.
[22] Section 252 of Act 47 prohibits a collective bargaining agreement or arbitration settlement agreed to after a municipality has been "distressed" and under a financial plan from violating the financial plan. Thus, if a municipality is distressed and under a plan that freezes salaries in 2004, and has a contract that expires on December 31, 2003, no collective bargaining agreement agreed to after the date of adoption of the plan or any arbitration settlement can undo the wage freeze. On the other hand, if contracts were just renewed or arbitration awards just issued, as is the situation with the City of Pittsburgh, merely becoming distressed under Act 47 and adopting a plan will not provide any fiscal relief from collective bargaining agreements that were in force at the time the plan was adopted. Such agreements take precedence until they expire.

plan to be created by the chief executive office of the city, the selected coordinator holds the cards in the strategy. They determine what will be included or excluded in the plan for the city. In fact, if a municipality is deemed "distressed," a coordinator is established and a plan created and the municipality's government rejects it, the municipality could be in and even worse situation as the Financially Distressed Municipalities Act strictly forbids certain monies from being provided to the municipality (grant, loan, entitlement, or payment) from the Commonwealth or any of its agencies until the certification of a distressed municipality is rescinded.

5.4 PICA-West Strategy

As has been discussed above, special legislation, PICA of 1991, was enacted when Philadelphia was unable to sell short term notes in 1991. Recently, legislation was developed and I believe introduced as Senate Bill 894 by Senator Costa that would establish special legislation for Pittsburgh that parallels, at least in part, the sort of legislation enacted for Philadelphia in 1991. SB94 establishes a nine member Financial Review Board that is authorized to review and approve a five year financial plan and also to approve the proposed operating budget prior to the City being authorized to levy or spend two new taxes:

- .45% payroll expense tax imposed on employers other than non-profit employers;

- $52 per-capita occupation tax in lieu of the current $10 per-capita occupation tax; and,

- Reduction of the current Business Privilege Tax and Mercantile Tax.

The Review Board is to be composed of 9 members, 7 of whom may vote, and all but The state Secretary of the Budget must be residents of the City of Pittsburgh and either own a business or be gainfully employed in the City:

Voting Members:

2 appointed by the Governor
1 appointed by the President pro tempore of the Senate
1 appointed by the Minority Leader of the Senate
1 appointed by the Speaker of the House
1 appointed by the Minority Leader of the House
1 appointed by the Mayor

7 +

2 *Ex Officio* members (the State budget director and City Director of Finance)

Unfortunately, the proposed legislation does not address any of the financial transparency issues raised earlier, and provides no standard of consequence that the Board should utilize in approving or disapproving the five year plan and annual budget proposed by the Mayor. Under SB 94, the Board must vote up or down within 30 days of receiving the annual operating budget and 5 year financial plan. The criteria the Board must apply is two-fold:

i) whether or not the operating budget has been prepared using sound budgetary practices, and

ii) whether or not the operating and capital budgets are substantially consistent with the approved 5 year plan. If the Board fails to act, the budget and plan are deemed approved.

The concept of "sound budgetary practices" is quite vague, and the reference to the financial measurement standards to be employed in putting the budget together is "generally accepted governmental accounting practices" which is not GAAP or GAFR, but an undefined term of art to the best of my knowledge. There is no reference to how the Board should consider the financial activities (operating and capital) of the City's various public authorities, and there is no guidance about whether or not all components of the City must be on the same fiscal year. Finally, the presumption that failure for the Board to act leads to a positive, permissive conclusion that the budget and plan are approved seems unduly generous, and inconsistent with the notion that state oversight is being imposed. Clearly, political squabbling and Board member absenteeism might easily turn out to be a way for the City to return to its prior financial practices since the absence of a quorum would preclude any voting.

The benefits to the creating a Pennsylvania Intergovernmental Cooperation Authorization Authority Act for Cities of *Second* Class, an idea termed PICA-West, is very similar to the impetus behind establishing the original law. It avoids the problems faced with the Financially Distressed Municipalities Act of allowing options but not requiring them.

5.4 Let a Federal Bankruptcy Judge Decide

The final option available to the City is to file for bankruptcy under Title 11 Chapter 9 of the United States Code.[23] Under Chapter 9, any city "specifically authorized" to be a debtor by state law, that "is insolvent" and "desires to effect a plan to adjust such debts" and "has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;" or "has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;" or "is unable to negotiate with creditors because such negotiation is impracticable;" or "reasonably

[23] 11 U.S.C. § 901 et seq.

believes that a creditor may attempt to obtain a transfer that is avoidable" can declare bankruptcy.[24]

If the City were to declare bankruptcy, the City would first file a petition in federal bankruptcy court. This petition stays any attempt by creditors of the City to collect their debts and allows the City to recover certain kinds of assets. Next, the chief judge of the court of appeals for the circuit embracing the district in which the case is commenced would designate the bankruptcy judge to conduct the case.[25] Once a presiding judge is appointed, the City must prepare a list of all known creditors with a plan "for the adjustment of the debtor's debts,"[26] and present it to the judge. The plan must provide a complete statement of how the City will resolve all outstanding debts. The City has at its disposal a wide array of options when formulating its plan. It propose that the Court abrogate contracts and revise obligations of the City; however, the City is unable to change local law when resolving their debts. In other words, the City would be unable to adjust tax rates fixed by law or to enact the new taxes in their plan and have the federal bankruptcy judge enforce a recommendation for higher tax rates.

All creditors have the opportunity to review the plan and accept or reject the proposal. After the adversely affected creditors have accepted the plan,[27] the case proceeds to a confirmation hearing. At the confirmation hearing, the judge determines whether "all amounts to be paid by the debtor…have been fully disclosed and are reasonable;" whether "the debtor is not prohibited by law from taking any action necessary to carry out the plan;" and whether "the plan is in the best interests of creditors and is feasible."[28] If all of these criteria are met the court will confirm the plan and it will become binding, even to those who voted against the plan.

It is likely that in the case where bond insurance exists, the bankruptcy judge would seek to avoid using the insurance by forcing budgetary and contractual actions that would precede such an allocation of resources.

Bankruptcy presents a host of new possibilities and problems to the City. While the City is able to draft its plan to resolve its financial crisis as long as it ensures that the interests of the creditors are met, it must still convince the federal judge of the wisdom of its proposal. Absent would be any wrangling between the Mayor and City Council in this circumstance. Also absent would be any wrangling with the sort of appointed review boards appointed via a PICA or PICA-West process.

Although proposing a coherent plan before a federal bankruptcy judge appears to be the most straight forward way to overcome historical political resistance to changes, the

[24] 11 U.S.C. § 109 (c)1-9.
[25] 11 U.S.C. § 921 (b).
[26] 11 U.S.C. § 941.
[27] A plan is considered accepted once two-thirds in dollar amount and more than one-half of the number of claims voted to accept the plan.
[28] 11 U.S.C. § 943 (b)3,4,7.

inability to change local tax law to support a new package could prove cumbersome and unrealistic if some sorts of tax increases seem arithmetically necessary. The idea of eliminating debt from its books through default or use of bond insurance seems at firs liberating; however, either action will close the capital markets to the City for a long time until trust can be rebuilt. Another problem with the bankruptcy strategy is the amount of adverse effects this strategy will have on the City itself and neighboring municipalities. Filing for bankruptcy could have negative effects on property values and corporate incentives to move to the area. The City could possibly be in a financial situation worse than when it entered bankruptcy by eliminating the possibility for long-term growth.

It should be noted that if the City were to arrive at federal bankruptcy court first, Act 47 constructively recognizes that federal action viz. a viz. such a claim, and thereby satisfies the federal requirement that state remedies be first exhausted.

6. Summary and Concluding Observations

My task before you has been to try to measure the nature of the City's financial problems, and analyze the sorts of alternatives, including some sort of customized review board for the City that would review annual budgets. I wind up where I started---things look grim. I suspect the severity of the financial distress I have reviewed may surprise many members of the Committee.

One thing I hope the Senate and House will take seriously is the lesson that history teaches us: the collapse of municipal governance that precipitates a municipal financial crisis requires structural attention. Otherwise, history will simply repeat itself. The travails of the District of Columbia are emblematic of this observation. The success that New York City has had in getting out of its crisis in the 1970's and weathering the financial storms brought on by the collapse of the stock market and then 9/11 underline the importance of financial transparency at the outset. Nobody in New York City disputed the estimates of what was happening to the City's finances as a result of the collapse of the stock market bubble that preceded 9/11. The financial position of New York City was reported without any ingenuity, and those who sought political office argued over different ways to solve the revenue problems that economic duress caused. As the economic and financial effects of 9/11 were felt, they were again understood, and those seeking elected office openly described what policies they would pursue. Voters had informed choices.

These are important lessons to learn, because I suspect the next witness, from DCED and who is responsible for monitoring what lies ahead in the next couple of years, likely has some predictable, but bad news for the Committee. There are more and more financially distressed communities out there, and whatever framework gets developed for Pittsburgh, and whatever solutions Pittsburgh finally fashions for itself, will be closely watched by the many cities and counties in the Commonwealth that are increasingly at risk.

Time and space limitations precluded my explaining why the Unit Debt Act was passed, and why Pennsylvania's constitution precludes the Commonwealth taking on the indebtedness of local governments. There are many history books available that detail what the economic development excesses of the 19th Century led to. The only way back into the credit market was to constitutionally assure lenders that mistakes made constituted lessons learned.

Let me close with a few observations about what the worse case might look like in March, 2004 if routine democracy is not demonstrated in this Chamber by the close of the year. Payables will slow, receivables will be accelerated, and at will employees will be put on part-time employment. Repairs and maintenance will falter and then cease. If indeed there are no layoff clauses for fire and other unionized employees, a circus atmosphere will evolve with some services atrophying, and others, perhaps now overstaffed, will simply persist. The burgeoning employment in the authorities will be noticed, and the unevenness with which emergency measures impact City services will be noted.

Vendors and creditors will get impatient, and perhaps media attention will go beyond the immediate to begin enquiring of elected officials what their plans are for the City that they are willing to vote for, and to enquire of various public employees just what it is they do for their guaranteed jobs.

Should debt service not be covered, then there will be a period of confusion, perhaps like New York City's 'moratorium' in which creditors rush to take the City into federal court. Hopefully along the way, democracy will be rekindled, and others who seek public office will begin to voice their opinions and ideas about other paths that the community could travel besides slowly emerging chaos.

Throughout this process there is very little the Senate and House can do by way of giving the City large quantities of money to pay its bills with. It is very unlikely House and Senate members outside of Allegheny County will see much advantage in raising taxes on their constituents to finance further folly here in the City. Life in Pittsburgh will go on, but it will become increasingly grim, and certainly increasingly acrimonious. Perhaps then one can conclude that the Wolf came home, not to the steel industry, but to the City that this once great industry built, and which got squandered by a polity that dishonored the greatness of its people.

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Annual Financial Report of the Water and Sewer Authority of Pittsburgh, 2000-01

Annual Financial Report of the Stadium Authority of Pittsburgh, 2000-2001

Annual Financial Report of the Equipment Leasing Authority of Pittsburgh, 2000-01

Annual Financial Report of the Public Parking Authority of Pittsburgh, 2000-01

Redevelopment Cooperation Law
Municipal Authorities Act of 1945

2001 Act 205 Actuarial Valuation Report: Sports & Exhibition Authority of Pittsburgh and Allegheny County 401(a) Pension Plan

2001 Act 205 Actuarial Valuation Report: Urban Redevelopment Authority of Pittsburgh Retirement Savings Plan

2001 Act 205 Actuarial Valuation Report: Housing Authority of the City of Pittsburgh Pension Plan

2001 Act 205 Actuarial Valuation Report: Public Parking Authority of Pittsburgh Pension Plan

2001 Act 205 Actuarial Valuation Report: City of Pittsburgh Policemen's Relief and Pension Fund

2001 Act 205 Actuarial Valuation Report: City of Pittsburgh Municipal Pension Fund

2001 Act 205 Actuarial Valuation Report: Firemen's Relief and Pension Fund

Allegheny Regional Asset District, 2003 Operating and Capital Budget

Legislation Affecting City of Pittsburgh's Finances

Various Specific Public Authority Laws

Pennsylvania Convention Center Authorities Act of 19XX

Financially Distressed Municipalities Act, 1992 P.L. 336, No. 69

Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class, 1991 P.L. 9, No. 6

Allegheny Regional Asset District Act, 1993 P.L. 723, No. 659

Tax Incremental Financing Act, 1990 P.L. 991, No. 2179

Federal Bankruptcy Act, 11 U.S.C. § 901 et seq.