



Case Study Overview: Pittsburgh

Facing decades of structural budget gaps and unsustainable legacy costs, the City of Pittsburgh entered two forms of state oversight in 2004. In the nearly ten years since, the city has turned structural deficits into annual positive fund balances, restructured its crushing debt load, streamlined an outsized government, and earned a triple-notch bond rating upgrade this summer. Still, with a \$380 million pension liability, many doubt that Pittsburgh is ready to graduate from state oversight – especially given the extra relief from restrictive state laws that Act 47 provides to city officials. Meanwhile, a task force comprised of high-level state and local officials, labor leaders, and other stakeholders has convened to develop reforms to the laws -- including Act 47 – that affect communities' fiscal sustainability.

City Snapshot. In 1950, Pittsburgh had a population of 678,806; in 2012, thanks to industrial job loss and suburbanization, the population was 306,211.¹ As residents left for suburbs and jobs elsewhere, they left behind the infrastructure and public sector workforce of a city built for a larger and denser population. The city has maintained its role as regional employment center: today the daytime population is over 40 percent higher than the resident population – with the ability to tax commuters and recapture some costs to the city a bone of contention surrounding Pittsburgh's fiscal recovery.

Fiscal Structure. Pittsburgh's operating budget was \$470 million in 2013. The three largest expenditures are public safety (over 50 percent of the budget in 2012), general government, and highways/streets. Most of this spending is on people – salaries, benefits, overtime, etc. – which comprised 85 percent of spending in 2008. On the revenue side, the three largest sources are the property tax, the earned income tax and the payroll preparation tax. A local services tax – a \$52 head tax levied on individuals who work in the city – contributes just 2.2 percent of revenue. State operating grants comprised 16 percent of city revenues in 2011; the state also provides aid for pensions based on a formula allocating funds among all distressed municipal pension funds.

Fiscal Circumstances. Pittsburgh's structural economic and fiscal decline came to a head in 2003, when Mayor Tom Murphy applied for help under the Pennsylvania Municipalities Financial Recovery Act, or Act 47. At the time, the city was facing a \$42 million hole on a \$398 million budget. In 2004, the gap was predicted to double to \$81 million. Murphy applied for Act 47 after the General Assembly refused to act on his package of proposed tax changes, forcing him to undertake mass layoffs and service cuts.

Role of the State. Act 47 was created in 1987 in response to a growing epidemic of distress among communities, particularly in former coal and manufacturing towns. The law calls for a municipality to meet one of 11 conditions for distressed status, at which point the Department of Community and Economic Development will work with officials to develop a plan for fiscal sustainability. These plans have two significant features that allow for relief from what many call onerous state laws: they allow for a commuter tax, and they shelter distressed municipalities during binding arbitration. The General Assembly also created a second form of oversight, the Intergovernmental Cooperation Authority. This body has budget-approval authority and control over a small pot of state funding. The enabling legislation also precluded use of a commuter tax in Pittsburgh – a caveat from suburban legislators.

Actions to Respond to the Crisis. Under the first recovery plan, the city was able to make spending cuts, generate revenue through a new tax package approved by the General Assembly and negotiate new cost-savings agreements with major unions. The second, amended recovery plan focused on restructuring and paying down the debt, implementing a new capital planning and budget process, and responding to the

pension shortfalls. The city has experienced positive fund balances every year since 2005, is set to pay off its debt by 2036, and has brought its pension funding level above 60 percent (though it is still considered distressed by Pennsylvania).

Analysis. Though making progress, Pittsburgh struggles under restrictive state laws which...

- **Limit local ability to raise revenue.** Pittsburgh's three largest sources of revenue are restricted in various ways. The property tax has strained against a growing share of tax-exempt property – currently 40 percent of the assessed value in the city, thanks to the sprawling presence of universities and hospitals. The earned income tax is inefficient given the heavy commuter presence; in Pennsylvania, a commuter's home jurisdiction has first claim on the EIT. The city has tried to make up the difference via its local service tax levied on all individuals working in the city (currently \$52, but was \$10 for many decades). Pennsylvania state law exempts many broad categories of businesses from paying the business privilege tax; by the 2000s, some 45 percent of Pittsburgh businesses were exempt.² State laws also limited Pittsburgh's ability to annex in order to increase the tax base and to tax non-residents.
- **Hurt local ability to control labor costs.** Act 111, which establishes binding arbitration for disputed public safety labor agreements, has been called the single greatest factor contributing to local government distress, in that it "stacks the deck" in favor of labor.
- **Fragment local governments.** Pennsylvania's fragmented local government system plays a role in distress. Communities are land-locked, unable to annex land, easily merge, or even enter shared service agreements. Allegheny County alone holds 130 municipalities, 101 special districts, and 44 school districts; the seven-county MSA has over 900 local governments – more per capita than any region in the US.³ This parochialism reaches a dangerous level when it comes to retiree pensions. Pennsylvania has over 3,200 local government pension plans, which now comprise over 25 percent of the public employee pension funds in the United States. Two in five Pennsylvanians live in a municipality designated distressed under the Act 205 pension reporting requirements.⁴ Pennsylvania local governments are required to offer defined benefit plans, which are much more costly than defined contribution plans.⁵
- **Do not create a path out of distress.** But some critics of the law posit that communities become dependent on the ability to operate outside of Act 111 and to levy the commuter tax. Critics complain that a key failure of the law is that it has no teeth when it comes to helping distressed localities do business smarter: while recovery plans frequently call for distressed communities to look into functional consolidation and shared service, there is nothing to force their more affluent neighbors to cooperate. Since the law was enacted, 28 municipalities have been declared distressed, and seven have had the distress declaration rescinded.

In early 2013, Mayor Luke Ravenstahl applied for rescission from Act 47. The request is outstanding with the Department of Community and Economic Development, but the likely incoming mayor – former Councilman Bill Peduto – does not support the city's exit from distress.

¹ U.S. Census Historic Table "Population of the 100 Largest Urban Places: 1950." Accessed June 30, 2013 at <http://www.census.gov/population/www/documentation/twps0027/tab18.txt>.

² "The Well that Dried Up," by Anya Sostek. *Governing*, October 2004.

³ "Government Consolidation and Economic Development in Allegheny County and the City of Pittsburgh," by Rae Archibald and Sally Sleeper. RAND Corporation, June 2008. Available at http://www.rand.org/content/dam/rand/pubs/technical_reports/2008/RAND_TR569.pdf.

⁴ Coalition for Sustainable Communities.

⁵ University of Pittsburgh Institute of Politics. 2009. *Pensions Subcommittee Report: What to Do about Municipal Pensions?* <http://www.iop.pitt.edu/documents/Pensions%20Subcommittee%20Report.pdf>.