

Pennsylvania Intergovernmental Cooperation Authority



Philadelphia Government Costs: Additional Reductions Required

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PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY

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Philadelphia Government Costs: Additional Reductions Required

Philadelphia has managed to produce annual budget surpluses for the last four years without the need to reduce service levels or to resort to “one-shot” or non-recurrent actions to close deficits. This success, as compared to the \$225 million accumulated deficit from the previous five years, required creativity and a commitment to balanced budgets.

In spite of this success, the cost of city government has not been significantly reduced. The city spends more of its own funds on certain major categories of city services than it did prior to the mid-1980s. While significant amounts of nonproductive costs have been eliminated, social services, core municipal services, and fixed costs receive more local funding than prior to the mid-1980s.

Given the continuing economic decline of the city and drastic changes to state and federal programs, revenues will become harder to generate and demands on city services are expected to escalate. Philadelphia needs to reduce its net costs in line with the local economy’s long-term ability to pay for them.

Background

The city began Fiscal Year 1993 with a clean budget slate, after PICA eliminated a \$225 million accumulated deficit. The city built on that base, obtaining favorable labor contracts, instituting major management and productivity reforms, and increasing tax enforcement.

Even with these successes, the city is losing ground. Federal government statistics indicate that during 1995 the city lost over 900 jobs each month and 425 residents each week (see PICA White Paper No. 1). Most significantly, underlying economic trends continue to bode ill for the city. Since Fiscal Year 1988, the city’s tax base adjusted for inflation, absent the effect of new taxes and collection efforts, has fallen to below its Fiscal Year 1985 level (see PICA White Paper No. 2). Simultaneously, drastic reductions in revenues from the state and federal governments are expected as a result of programmatic changes.

Social service expenses continue to rise, even as state and federal funding for these services is threatened. Numerous city services remain geared toward serving the city’s peak population of two million, even though the population is now estimated at less than 1.5 million, the lowest it has been since the early 1900s, and continues to decline.

State and federal assistance to the underprivileged and to other public entities in Philadelphia, such as SEPTA, is also being reduced. The city can expect to feel the consequences of these reductions as these individuals and entities turn to the city for greater assistance and as the local economy reacts to the loss of this income.

Unless dramatic action is taken soon, Philadelphia will likely continue to lose both people and jobs, leaving behind an increasingly poor and unemployed resident population. In addition to reducing the city's ability to generate revenue, a greater concentration of residents in poverty will confront the city with a growing demand for social services and a concurrently decreasing ability to maintain the city's aging infrastructure.

Expenditure Categories

For this analysis, expenditures have been divided into four categories. The largest is social services, which includes four agencies: the Departments of Public Health (DPH), Human Services (DHS), and Prisons and the Office of Emergency Services (OES; formerly the Office of Services to the Homeless and Adults). The Prisons Department, which was part of DHS before Fiscal Year 1989, is included in this category for comparison purposes.

The second category is core services, which includes the Police, Fire, and Streets Departments. These three departments provide public safety and sanitation services, considered the most basic of municipal services.

Not all costs associated with these two categories are captured in this analysis. For comparison purposes, this report attributes estimates of fringe benefit and fleet management costs to the above two categories. However, the city does not yet "charge-back" to departments either these indirect costs or utility, lease, and indemnity costs. PICA again calls on the city to move expediently toward charging departments for all of their indirect and overhead costs so that budgetary data for departments will portray full costs.

Fixed costs, the third category, include debt service and long-term leases. For this analysis, fixed costs also include PICA debt service and the city's net subsidy to the Pennsylvania Convention Center, which helps to cover the convention center's debt service.

The final category, other costs, includes all other city cost centers, such as Recreation, the Free Library, utilities, the First Judicial District¹, and the Community College subsidy. Due to the complexity of dealing with so many disparate departments and other cost centers simultaneously, this category is not analyzed below.

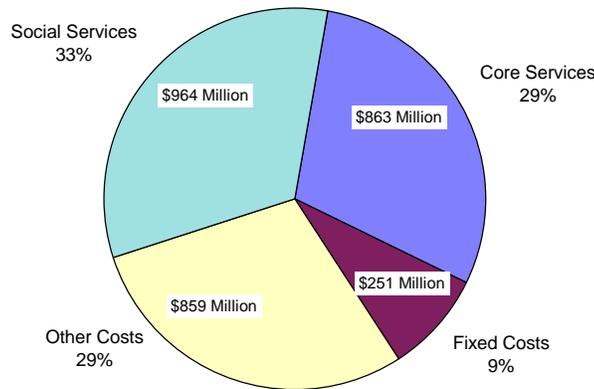
Methodology

This report takes two steps in analyzing city spending on the above four categories of expenditures. First, total expenditures are allocated by category, regardless of the source of funds. The pie chart below shows this breakdown.²

¹ PICA is aware that the city is considering an alternate funding status for the First Judicial District as a result of recent Supreme Court rulings regarding how state courts are funded.

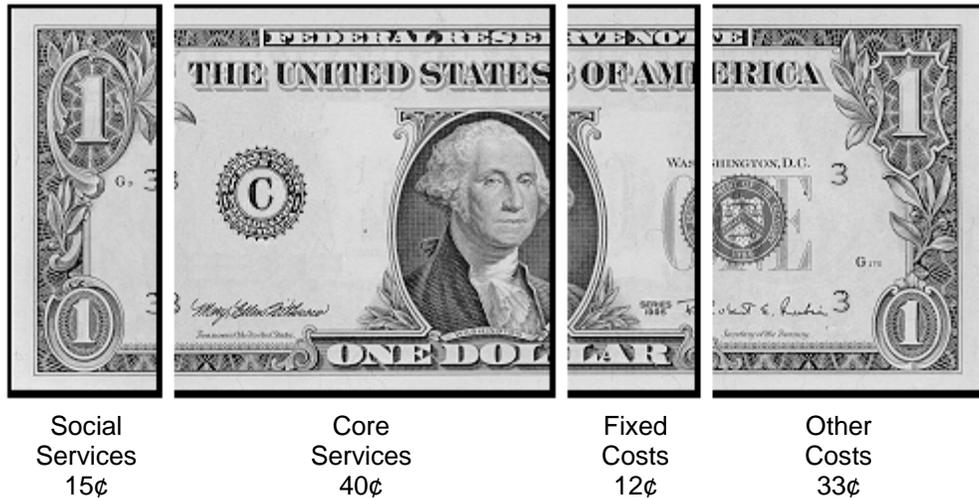
² As with PICA's White Paper No. 2, [this report combines the General and Grants Funds](#). Over the years, various programs and funding streams have been shifted between these two funds to such a degree that adjusting the General Fund for the impact of such shifts is nearly impossible.

**Total City Expenditures
General and Grants Funds
Fiscal Year 1996³**



The second step calculates net city costs (costs paid from unreimbursed, locally-raised funds) by subtracting expenditures made with state and federal money from the total. State and federal funds cover 66% of social service costs, 2% of core service costs, and 20% of other costs. They do not cover any fixed costs. This step provides insight as to where the city spends its locally-generated money (primarily tax revenues), the dollars over which it exercises primary discretion. The illustration below demonstrates how much of each locally-generated dollar is spent on each expenditure category.

**Use of a Locally-Generated Dollar
Fiscal Year 1996³**



³ Social Services includes DHS, DPH, OES, and Prisons. Core Services includes Police, Fire, and Streets. Fixed Costs includes General Obligation and PICA debt service, long-term leases, and the net subsidy to the PA Convention Center. Estimated fringe benefit and fleet management costs are charged back to departments. Fiscal Year 1996 data is unaudited.

The following table displays net city costs for each expenditure category.

**Net City Costs
Fiscal Year 1996**

Social Services	\$327 Million
Core Services	\$845 Million
Fixed Costs	\$251 Million
Other Costs	\$687 Million

Note: See footnote 3.

Social Services

Social service expenditures adjusted for inflation have almost doubled since Fiscal Year 1985. Whereas in Fiscal Year 1985 social services accounted for less than 23% of city (General and Grants Funds) expenditures, in Fiscal Year 1996 they accounted for 33%.

This dramatic growth in expenditures is made possible primarily by increased funding from the state and federal governments, which has more than tripled since Fiscal Year 1987 to \$637 million in Fiscal Year 1996. The table below shows the total amount spent on social services in Philadelphia and how much was paid for with state and federal funds versus locally-generated city funds.

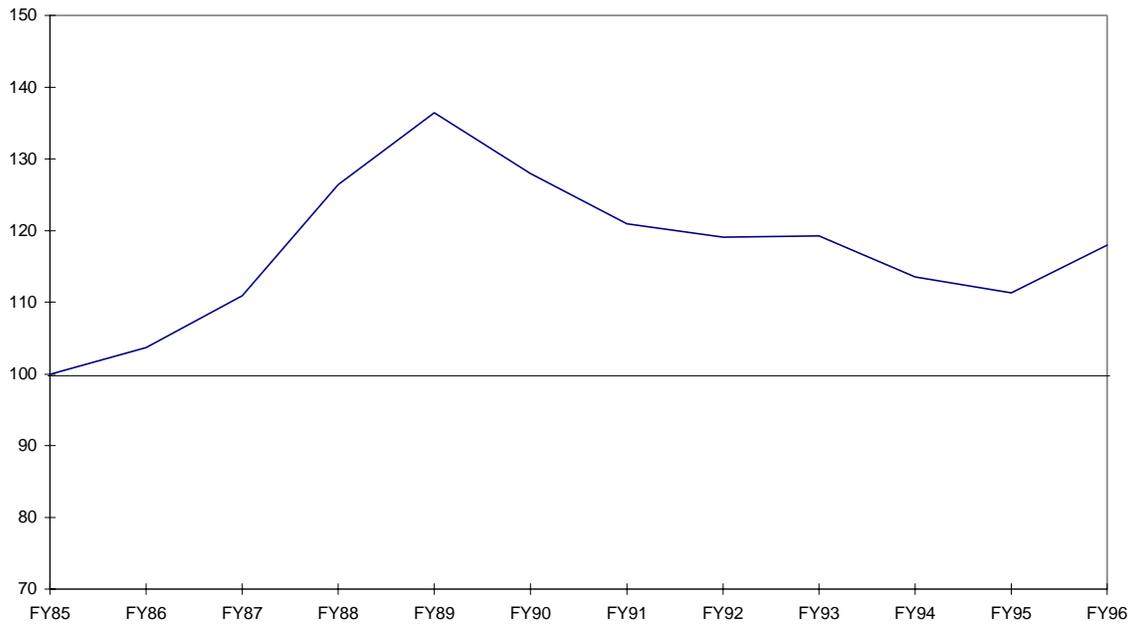
**Total Social Service Expenditures
with State/Federal and City Portions**

	FY8 5	FY8 6	FY8 7	FY8 8	FY8 9	FY9 0	FY9 1	FY9 2	FY9 3	FY9 4	FY9 5	FY9 6
Total	\$364	\$390	\$432	\$497	\$567	\$597	\$651	\$732	\$785	\$840	\$903	\$964
State/Fed	\$178	\$193	\$210	\$234	\$268	\$303	\$359	\$433	\$480	\$541	\$602	\$637
City	\$186	\$197	\$222	\$263	\$299	\$294	\$292	\$299	\$305	\$299	\$301	\$327

Note: See footnotes 2 and 3.

The above chart demonstrates that Philadelphia has not used the increase in state and federal social service funding to significantly offset the amount of its own funds it spends on such services. The graph on the following page shows that net city costs for social services declined or remained stable from Fiscal Year 1989 through Fiscal Year 1995. The increase in Fiscal Year 1996 is primarily due to personnel costs, many of them one-time, associated with the opening of the new Curran-Fromhold Correctional Facility.

**Indexed Net City Costs for Social Services
Adjusted for Inflation (FY85=100)**



Note: See footnote 3.

The above graph demonstrates that, on an inflation-adjusted basis, the city continues to spend between 10% and 20% more of its own money on social services than it did in Fiscal Year 1985, a year in which such funding was already higher than previously.

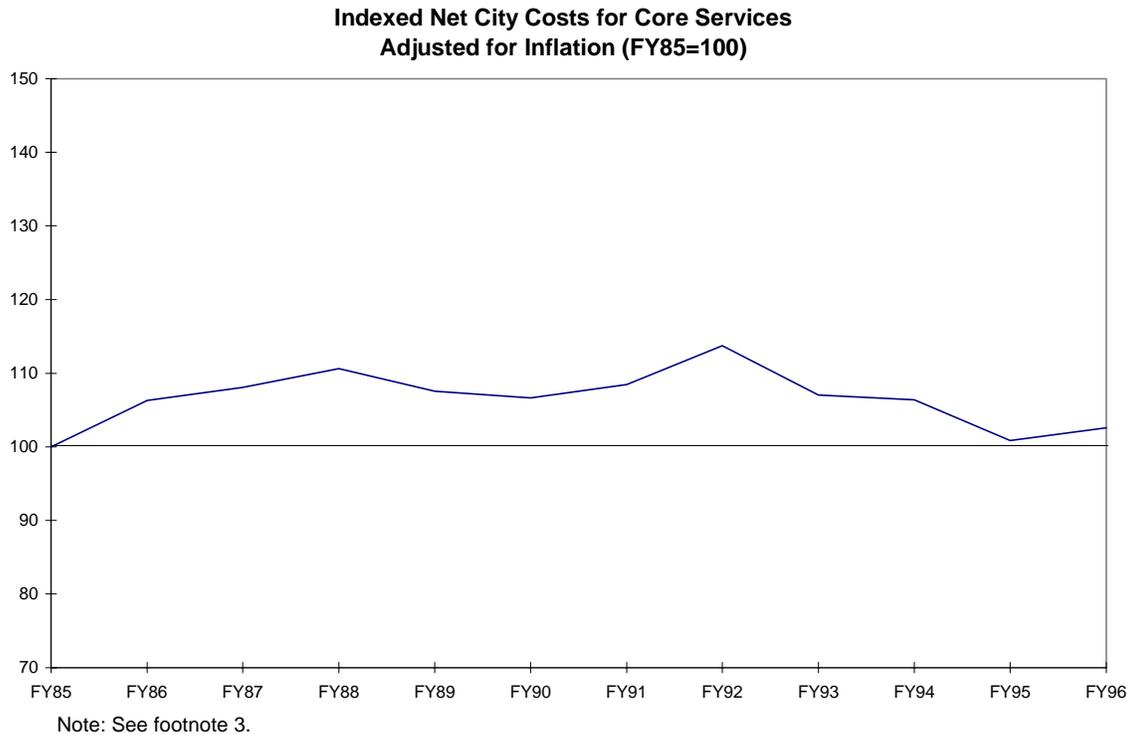
As mandated welfare reforms take effect, the burden for social service costs is expected to shift more to the city, even as demands for services are expected to increase. The city needs to plan for the challenges that lie ahead so that the city budget is not further burdened with these costs.

Core Services

Total expenditures on core services have fluctuated over the years but declined significantly between Fiscal Year 1992 and Fiscal Year 1995. In Fiscal Year 1996 costs increased, primarily as a result of Streets Department costs associated with the Blizzard of January 1996 and increased indemnity payments by the Police Department. Absent these two non-recurrent events, costs for core services have followed a similar trend as previously.

The decline in core service costs is driven overwhelmingly by expenditure reductions in the Streets Department, which has reduced its staffing by approximately 20% and cut its trash disposal fees by over one-third. Adjusted for inflation, expenditure levels for Police and Fire have also declined, but not as significantly as in the Streets Department. Even so, expenditures on core services remain high on an historical basis.

The graph below demonstrates that in Fiscal Year 1995, the most recent low point in core service expenditures, Philadelphia spent about the same inflation-adjusted amount in locally-generated revenues on core services as it did in Fiscal Year 1985. While this was an improvement from the height of the city’s fiscal crisis, it is not a reduction from historic levels.



Some of the decline in core service expenditures may be attributable to the decline in the city’s population. A smaller population theoretically generates fewer demands on these services, such as in the case of trash collection. Part of the challenge of efficiently serving a declining population is to shrink service costs, particularly for core services, in line with population decline so that the shrinking tax base does not have to support an infrastructure designed for a more populous city.

Available evidence indicates that the city has managed to eliminate a significant amount of nonproductive costs from its core service departments. However, there is no compelling evidence that the city has as yet begun to address how it plans to “downsize” its service infrastructure in line with its declining population.

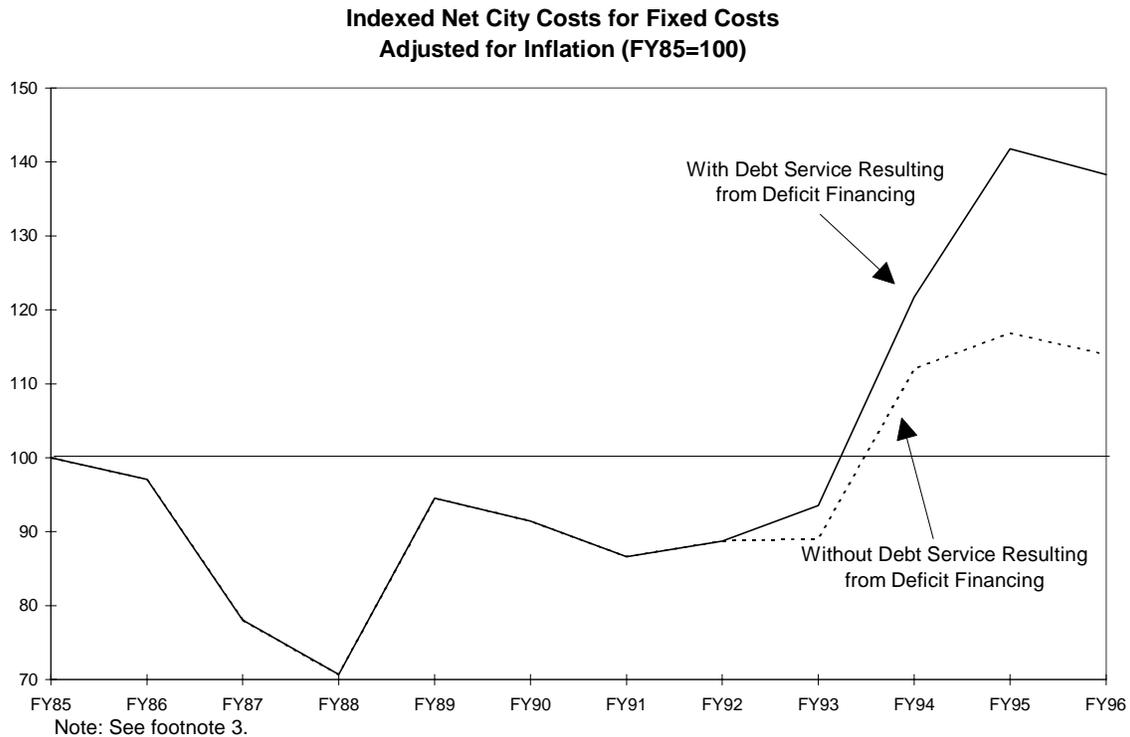
Fixed Costs

Expenditures related to fixed costs have increased greatly since Fiscal Year 1993. A number of factors contribute to this increase, including long-term leases associated with the newly constructed Curran-Fromhold Correctional Facility and Criminal Justice Center, a jump in the city’s contribution to the Pennsylvania Convention Center, an accelerated

capital program, and debt service attributable to PICA's financing of the city's \$225 million accumulated deficit.

The acceleration of the capital program followed an extended delay in capital investments because of the city's inability to borrow money. At the city's request, PICA borrowed \$437 million for city capital projects over a three year period. Two years after the last borrowing, over \$150 million remains unspent. Even given this remaining balance, as well as another \$90-\$150 million in unspent city capital funds, the city borrowed an additional \$110 million for capital projects in December 1995. PICA again calls on the city to improve its capital program process so that either a more appropriate amount of money is borrowed or expenditures are incurred in a more timely manner.

The difference between the dotted line and the solid line in the graph below demonstrates the extra burden placed on the city's residents as a result of having to fund the \$225 million deficit with ten-year PICA debt. This extra burden should serve as a deterrent to allowing a recurrence of that experience.



While the increase in debt service costs can be largely attributed to positive developments in the city's capital investment program and its return to fiscal solvency, the city needs to be vigilant in not overburdening itself unnecessarily with debt service by borrowing more funds than are needed.

Conclusion

By generating a surplus in the General Fund, the Rendell Administration has demonstrated its ability to keep expenditures in line with and increase available revenues. However, the evidence presented above demonstrates that the administration has not yet significantly reduced the net costs of running city government.

On an inflation-adjusted basis, the city is spending more of its own funds on social services, core municipal services, and fixed costs than it did prior to the mid-1980s. While further efficiencies may be attainable, they are unlikely to be of sufficient magnitude to compensate for potential future reductions in revenues.

Given the continuing decline in its tax base and potential disruptions in state and federal funding streams, Philadelphia must recognize the need to reassess all the services it offers, calculate the true costs of those services, and begin to plan how to tailor its budget to an appropriate magnitude for a city of Philadelphia's current and expected future size and resources.