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N.Y. Faces $200 Billion in Retiree Health Costs

By MARY WILLIAMS WALSH

The cities, counties and authorities of New York have promised more than $200 billion worth of health benefits to their retirees while setting aside almost nothing, putting the public work force on a collision course with the taxpayers who are expected to foot the bill.

The total cost appears in a report to be issued on Wednesday by the Empire Center for New York State Policy, a research organization that studies fiscal policy.

It does not suggest that New York must somehow come up with $200 billion right away.

But the report casts serious doubt over whether medical benefits for New York's retirees will be sustainable, given the sputtering economy and today's climate of hostility toward new taxes and taxpayer bailouts.

The daunting size of the health care obligation raises the possibility that localities will be forced at some point to choose between paying their retirees' medical costs and paying the investors who hold their bonds. Government officials aim to satisfy both groups, and have even made painful cuts in local services when necessary to keep up with both sets of payments.

Only a few places have tried to rein in their costs, by billing retirees for a portion of the premiums, for example. Retirees have responded with lawsuits, but ratings agencies and municipal bond buyers have shrugged off these warning signs.

“So far, the market doesn’t care,” said Edmund J. McMahon, the director of the Empire Center. “The market seems to assume, on the basis of nothing, that at some point all of these places are simply going to stop paying retiree health benefits.”

The health benefits are entirely separate from the pensions that New York’s public workers have earned. Governments have reported their pension obligations for years, but their retiree medical obligations have been building up unseen, because governments were not required to account for them. The information is starting to come to light because of a new accounting requirement.

One city, Schenectady, found the cost too overwhelming to calculate, warning that it “will be astronomical, with the potential of bankrupting municipalities.”

The city even said in a document accompanying a recent debt offering that it did not know whether it was really required to comply with the new accounting rule.

The $200 billion that New York State and its localities owe retirees in the aggregate is less than the amount they owe their bondholders, about $264 billion. But health costs are rising, and in some places the obligations have already eclipsed the value of the government’s outstanding bonds. Most credit analysts seem to expect that if a municipality has to default on something, it will default on its retiree health promises, not on its bonds. Pensions, meanwhile, are considered protected by the New York State constitution.

But no one knows for sure, and no one is predicting that retirees will take the loss of a valuable health plan lying down.

“It will be a mess. There will be a lot of disputes, a lot of litigation,” said Jerry A. Webman, chief economist for OppenheimerFunds. He said that defaults and bankruptcies by governments were still so rare that there was little legal precedent, and no way of knowing which pledges would survive a court challenge.

Retiree health benefits in New York consist of an indemnity plan plus optional managed-care plans.

There is no central source of information, but Mr. McMahon found governments paying 35 percent to 100 percent of the premiums. Retirees can further reduce their share by paying their premiums with unused sick time.

The vast majority of the work force can start drawing benefits at age 55. When retirees turn 65 and join Medicare, their former employers reimburse their Medicare premiums and supplement the federal program.

The cost pressures are by no means unique to New York. States and cities across the country have promised retiree health benefits without identifying a way to pay for them, leaving taxpayers on the hook. Mr. McMahon said he thought his group's new study was the first to aggregate the obligations in a single state.

In practice, each municipality pledges to pay its own retiree health obligations. But if one were in distress, the state could step in through the Financial Emergency Act, passed in 1975 for the rescue of New York City, and might backstop some costs.

The state already stands behind the bonds of some authorities as well. Some officials and bankers worry that the state might be unable to make good if a number of towns and authorities got into trouble at the same time. New York State does have a solid AA rating on its general obligation bonds, however.

New York City has the biggest retiree health obligation, having promised benefits worth $62 billion as of June 30, 2008 — roughly what the state of California has promised, and more than New York City's outstanding debt on its bonds.

The city's five pension funds also have big holes, which have been calculated in various ways. The last time the city's chief actuary, Robert C. North, assessed their status, in June 2008, he found a shortfall of about $75 billion between what the workers had earned and the money that had been set aside.

The new accounting rule for retiree health plans lets governments disclose a little at a time, but New York City reported its entire obligation. The combination of the unfunded pension and retiree health obligations gives New York City a negative net worth, but that does not mean it is about to collapse, just that it will have to bring its finances back into balance. New York City's general obligation debt is rated AA.

The obligation to employees of New York State was only slightly less than the city's, $60 billion. Third place went to the Metropolitan Transportation Authority, which has promised health benefits worth about $13 billion.

Mr. McMahon of the Empire Center drew the numbers primarily from local government reports, ferreted out from obscure documents, bond offering statements and audited financial statements.

He then tried to determine where the burden was heaviest. He found that every resident of New York City was responsible for $7,343, in today's dollars, for health care for retired city workers. What's more, they owe a big share of the costs for retired state workers, an additional $3,082 for each person living in New York state.

Among the state's smaller cities, Mr. McMahon found unusually large per capita amounts owed in Buffalo, Syracuse, White Plains and Niagara Falls.

"You've got a lot of cities whose growth prospects are murky, to put it best," Mr. McMahon said. "You're looking at a G.M.-type situation, a struggling company that's trying to remake itself, but it has this huge legacy cost."

Buffalo also has the distinction of paying more for health care for its retirees than for its current employees, a situation Mr. McMahon called "exceptional."

This article has been revised to reflect the following correction:

Correction: October 13, 2010

An earlier version of this article included a Web summary that misstated the amount of health benefits that have been promised. It is $200 billion, not $200 million.