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Testimony of Preston Niblack, Deputy Director, Before the New York State Senate Democratic Task Force on Public Transit

April 29, 2004

Good morning. I am Preston Niblack, deputy director of the New York City Independent Budget Office. I am joined by Alan Treffeisen, IBO's senior analyst for transportation issues. Thank you for the opportunity to testify today on the impact of the Metropolitan Transportation Authority's (MTA) projected operating deficits. I will address three issues in my testimony this morning: (1) the accuracy of the MTA's budget projections; (2) the impact on the operating budget of the MTA's growing use of debt to finance its capital program; and (3) the effect on revenues and ridership of changes in the base fare or in the structure of fare discounts.

The MTA, like New York City and State, projects large budget gaps over the next few years. By law the MTA must present a balanced budget, and in the past, as each new fiscal year approached, the projected gaps tended to disappear. The important question is whether the gaps ultimately fail to materialize because the original financial projections are unduly pessimistic, or because the MTA takes effective cost-cutting and revenue-enhancing measures.

While it is difficult to provide a definitive answer to this question, we believe that financial trends underlying the MTA's budget are different now from what they were in the late 1990s, when large deficits were also projected. From 1999 through September 2001, passenger revenue, tax-supported subsidies, and surplus toll revenue continually surpassed expectations. Since 2002 these revenues have continued to be stronger than anticipated, but not enough to offset the rapid growth in expenses, especially debt service, pensions, and health and welfare benefits.

Disappearing gaps. In September 1999 the MTA released its 2000-2004 Financial Plan. This plan projected a modest $92 million surplus for 1999, but a deficit of $356 million in 2000 and $731 million in 2001. By 2004 the deficit was expected to reach $1.3 billion (which is coincidentally the gap that the MTA now projects for 2007).

The projected deficits of course never materialized: the MTA's latest estimate is that it will end 2004 with a positive cash balance of $36 million. A look at financial projections over time shows how the authority benefited from stronger than expected revenues. In part this was due to stronger than expected fare and toll revenue—aided of course by the fare increase in 2003. One time savings from the authority's debt service restructuring and an infusion of state aid in 2002 also helped close the gap in that year.

While stronger than expected fare revenues have aided the bottom line of New York City Transit and the MTA as a whole, subsidies—and in particular the tax-supported subsidies—have played an even more important role in closing the projected gaps. In September 1999 the MTA projected that the sum of government operating assistance and tax-supported subsidies for New York City Transit would increase only slightly over the next five years, from around $1.16 billion to $1.26 billion. In fact, total subsidies have increased substantially every year, even in the midst of recession, and reached $1.55 billion in 2003. The strength of mortgage recording tax receipts, in particular, was consistently surprising.

The MTA may not be so fortunate in the coming years. In February of this year the authority projected a deficit of $539 million in 2005, rising to $1.18 billion in 2006 and $1.31 billion in 2007. In its recent budget presentations the MTA has emphasized the role that increased debt service, pension costs, and health and welfare expenses will play in these large projected deficits. From 2004 through 2007 annual debt service is projected to increase more than $600 million, pension costs more than $300 million, and health and welfare expenses more than $200 million. Overall, expenses are now rising at a faster rate than they were in previous years. We believe that projections of these costs are less subject to error than were the earlier revenue projections. While revenues may ultimately prove to be stronger than the current forecast, there is no denying that the MTA faces rapidly escalating expenses.

One of the principal reasons for the rising costs is the MTA's debt service burden. The failure of the State Transportation Infrastructure Bond Act of 2000 left the MTA with a large gap in the funding for its 2000-2004 capital program. In response, the MTA undertook a restructuring of its existing debt, which it completed in 2002. While the restructuring provided interest rate savings and a short-term ability to issue additional bonds, the long-term impact was to stretch out the MTA's existing debt obligations. By the time the restructuring was complete, the MTA was committed to paying over $1 billion annually in debt service through the year 2032.

Any additional debt issued of course further increases annual debt service. Based on expenditure levels of recent years, IBO estimates that the MTA must invest over $2 billion per year in its capital program to ensure that its infrastructure reaches and remains at a state of good repair, and that rolling stock is replaced as needed. This estimate does not include money for system improvements, nor does it include network expansion projects such as the Second Avenue Subway or East Side Access.

Because MTA debt service is already fixed at over $1 billion per year during the coming decades, annual debt service payments will grow every year for the foreseeable future. Debt service is—and will likely remain—the fastest growing component of MTA expenses. The MTA's projected debt service costs for 2007 represent about 13 percent of projected fare and toll revenues. Without additional sources of funding, the MTA must continue to fund a large share of its capital program through debt. Again, unless other revenue can be found, this will inexorably place pressures on fares, on service levels, and on maintaining the significant advances of the last two decades in restoring the capital stock.

Effect of fare increases on revenue and ridership. The MTA's customers enjoy a wide range of fare options. New York City Transit riders may pay with cash (buses only), single ride tickets, regular or discounted pay-per-ride MetroCards, or one-, seven- or 30-day unlimited MetroCards.

Because of the range of fare choices, increases in the fare can be applied in such a way that not all riders are affected equally.

The structure of last year's fare hike clearly favored users of the 30-day unlimited MetroCards. The base fare on New York City Transit subways and buses was raised 33 percent, from $1.50 to $2.00. The prices of one-day, seven-day, and 30-day unlimited MetroCards were raised by 75 percent, 35 percent, and 11 percent, respectively.[1] The financial incentive to use the 30-day MetroCard, coupled with an insurance program that protects purchasers against the loss or malfunction of the card, has sharply increased the market share of this particular fare medium. In February 2004, 23.5 percent of trips on New York City Transit were made with 30-day unlimited MetroCards, compared with just 14.5 percent in February 2003. As a result, the average fare paid per trip has not grown as rapidly as the increase in the fare itself. In February 2004 the average fare paid per subway and bus trip (including transfers) was $1.16, only about 12 percent above the $1.04 average fare that riders were paying before the fare increases.

Subway and bus ridership, while still at very high levels by the standards of the last 30 years, has declined slightly since the fare increase. Total ridership in 2003 was 2.4 percent below 2002. However, some of this decline is probably due to the weak economy. There is strong evidence from the 2003 fare increase, however, as well as from previous increases, that the demand for New York City Transit's service (and to a lesser extent, that of the commuter railroads) is price inelastic. In other words, the decline in ridership resulting from a fare increase will not be large enough to cause total fare revenues to decline. In fact, they will increase.

The projected budget gaps faced by the MTA starting in 2005 are so large, however, that closing them through fare revenues alone would require fare hikes of an unprecedented magnitude. Closing the MTA's projected 2005 gap of $539 million would require a 12 percent increase in combined fare and toll revenues. Even if the MTA's 2005 gap was closed through a fare and toll increase, IBO estimates that, absent increases in other revenues, further increases in fare and toll revenues would be required to close the gaps in subsequent years, equal to 14 percent in 2006, and 3 percent in 2007. All of these estimates assume no decline in ridership or bridge and tunnel crossings in response to the fare and toll increases.

We can illustrate the magnitude of the fare increases discussed above using the example of the 30-day unlimited MetroCard. If the MTA were to eliminate its projected budget gaps through across-the-board fare and toll increases, the price of this card would have to rise to $78 in 2005, $89 in 2006, and $92 in 2007.

The MTA has in fact suggested that it may increase the price of unlimited MetroCards beginning in 2005, while maintaining both the existing base fare of $2.00 and the 20 percent bonus on per-ride MetroCards of $10 or more. We have not estimated what fare increase would be required to eliminate New York City Transit's deficits through changes in the unlimited cards alone. However, it is likely that the additional cash outlay required would cause some riders to switch back to a per-ride MetroCard, even if this entails a higher cost per ride. Any decision to increase fares must confront the balance between revenue maximization and equity concerns.

[1] The price of the one-day pass rose from $4 to $7, the seven-day from $17 to $23, and the 30-day from $63 to $70.

Conclusion. Five years ago the MTA predicted large and growing budget gaps during 2000-2004. Unexpectedly high fare and subsidy revenues helped to close these gaps, especially in 2000 and 2001. The debt restructuring and a one-time infusion of additional state aid were key factors in closing the 2002 and 2003 gaps, and beginning in May 2003 the fare increase contributed as well. The projected budget gaps for 2005-2007 are driven largely by increases in expenses, particularly debt service, pensions, and health and welfare costs. IBO believes that projections of these costs are less subject to error than were the earlier revenue projections.

Closing the MTA's projected budget gaps for 2005-2007 through fares and tolls would require that increases totaling close to 30 percent over the next three years. I am not suggesting that the MTA should or will close its gaps in this fashion. Past experience suggests that as each budget year draws closer, the MTA will find ways to cut costs, and some revenues may be higher than anticipated. Unlike in 2000 and 2001, however, eliminating the gaps will almost certainly require major initiatives on both the revenue and expense sides. Revenue measures could include fare hikes, additional operating assistance, or new dedicated taxes. Expense measures could include reductions in service, or negotiated changes in wages, pensions, and benefits.

Thank you for the opportunity to testify today, and we'd be happy to take any questions.