ACTIONS TAKEN BY FIVE CITIES TO RESTORE THEIR FINANCIAL HEALTH

HEARING

BEFORE THE

SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MARCH 2, 1995

Printed for the use of the Committee on Government Reform and Oversight

U.S. GOVERNMENT PRINTING OFFICE

20-994 CC WASHINGTON : 1995

For sale by the U.S. Government Printing Office
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402
ISBN 0-16-052163-7

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ACTIONS TAKEN BY FIVE CITIES TO RESTORE THEIR FINANCIAL HEALTH

THURSDAY, MARCH 2, 1995

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE DISTRICT OF COLUMBIA,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:33 a.m., in room 2154, Rayburn House Office Building, Hon. Thomas M. Davis (chairman of the subcommittee) presiding.

Present: Representatives Davis, Gutknecht, LaTourette, Flanagan, Norton, and Collins of Michigan.

Staff present: Ron Hamm, staff director; Roland Gunn, Al Flezenberg, professional staff; Howard Denis, counsel; Ellen Brown, clerk; and Cedric Hendricks, minority professional staff.

Mr. DAVIS. The meeting will come to order.

I want to welcome all of you to this hearing. Last week this subcommittee, in conjunction with the District of Columbia Subcommittee of the Appropriations Committee, held a joint hearing on the fiscal crisis confronting the District of Columbia. We discovered that the city's plight is worse than we had thought. The city's financial practices have made it impossible to deliver the core functions of government. The across-the-board failure to deliver essential municipal services is particularly tragic because of the devastation that it brings to the lives of the city's most vulnerable residents.

A number of thoughtful people have shown outstanding leadership by suggesting ways to bring the District's critical situation under control and prevent its reoccurrence. I will mention only two. On February 7 Councilman Kevin Chavous began the discussion when he proposed the creation of the District of Columbia Financial Review Board. My esteemed colleague, Ms. Norton, moved the discussion along even further when on February 16 she too called for the creation of a financial oversight board.

Today our subcommittee is taking the next step in the process. We are going to hear from a GAO team about what other cities in crisis have done. The District of Columbia's financial crisis is special, but unfortunately it is not unique. The District is special because of the deep and abiding affection that all Americans have for our Capital City. It is special because of its relationship to the Federal Government. Because the District lacks the normal State or regional government to assist it with its affairs, Congress does some of the things a State legislature would do.

Unfortunately, the District's problems are not unique. The situation the District finds itself in, mirrors much of what urban America has experienced in the past three decades. In that time, New York City, Yonkers, Cleveland, Philadelphia, and Chicago all teetered on the brink of default. All found their way back with the help and assistance from their respective State and regional governments. It is Congress's responsibility to fill the oversight and assistance role for the District.

Before acting, it is incumbent upon us to consider what has been tried elsewhere, which approaches have been most successful, and how these remedies may be best adopted to the District of Columbia's special situation. We don't want to take a "one size fits all" approach. A plan that is effective in New York will not necessarily be effective for Washington. Today's hearings provide an important opportunity to educate the Members of Congress and the people of the District. This will also enable everyone to participate in this process. This participation will occur in many different ways.

In the time since Delegate Norton proposed an oversight board for the District, there has been much speculation in the press and elsewhere as to what such boards do and whether and to what degree they encroach upon the powers of home rule. I am not interested in eliminating home rule. A financial control board is not an undercover attack on home rule. In fact, the greatest threat to home rule comes from the city's financial crisis. By successfully resolving this crisis home rule will be enhanced. A failure to act decisively and responsibly on the part of the home rule government will be the biggest threat to home rule that could ever exist.

Successful financial control boards must have real power. The GAO will explain that they share two common characteristics wherever they are attempted. First, the solutions they offered were long rather than short term in nature. They recognized that the city's problems were not of 1 day's or 1 year's or even of one administration's making. Usually they embarked on a strategy that first replaced short-term debt with longer-term bonds so the cities could catch their breath. Then they embarked on a course of serious restructuring of the city's financial mechanisms. Once the immediate crisis had been dealt with, they retained standby authority, monitored city finances steadily, and established a mechanism through which to intervene should the city revert back to its past practices.

Several of these bodies remain in operation years after the crisis is abated. In New York, for instance, it will remain in place until 2008 when the last long-term bond issued under its hegemony is retired. Philadelphia's board will also remain in a monitoring and standby mode until all of its debts have been repaid.

The second feature most control boards have shared was their determination that "tough love" was a better means of breaking cities of their deeply rooted habit of overspending than bailouts. Like therapists who treat other forms of addiction, control boards have figured out that the best way to discourage bad practices is to make their continuance simply too painful.

Too much has been said about the tough side of this approach, too little has been said about the love aspect. Have we really helped the poor and the needy by making it too easy to gain access to public assistance? Are we helping them now that we are, by ne-

cessity, cutting back on the very programs that have caused municipal deficits to soar? I can think of nothing more heartless than policies that subsidize bad practices, encourage dependency on government handouts, and abandons people once the addiction has taken hold.

In the short time I have been chairman of this subcommittee, I have pointed out on several occasions that all Americans benefit from a strong and vibrant National Capital City. While it is important to all of America, the Capital City has an added importance to the people of the Metropolitan Washington Region. All of us who live within commuting distance of downtown Washington know that the health of the surrounding suburbs depends on a healthy inner city. Our interests are closely intertwined.

The citizens in my district—I have held three town meetings this weekend—want to know that their Capital City will one day get its finances in order. We want the Nation's Capital to be worthy of the strongest, freest, and greatest Nation on earth. They want to see its streets safe, schools improved, and quality of life the envy of the rest of America. They have a right to expect no less.

It is my pleasure to call upon this morning's single witness, Mr. Johnny Finch, Assistant Comptroller General, to explain to us how cities get into this situation and some of the methods and markers, those who have traveled this road before us, have left.

I would like to now yield to our ranking minority member, Ms. Norton.

[The prepared statement of Hon. Thomas M. Davis follows:]

PREPARED STATEMENT OF HON. THOMAS M. DAVIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

I want to welcome all of you to this hearing. Last week, this subcommittee, in conjunction with the D.C. subcommittee of the Appropriations Committee, held a joint hearing on the financial state of the District of Columbia. The purpose of that hearing and the one the Appropriations Subcommittee held last Friday was to ascertain precisely how bad the City's fiscal situation was.

We discovered that the city's plight was worse than we had thought. The bottom line, according to the General Accounting Office is that the District of Columbia is not only currently running an operating deficit of hundreds of millions of dollars, is spending hundreds of millions of dollars in excess of its mandated budget cap, but, in fact that the District will run out of cash to pay its bills this spring.

A number of thoughtful people have shown outstanding leadership by suggesting ways to bring the District's critical situation under control and prevent its reoccurrence. I will mention only two. On February 7, Councilman Kevin Chavous began the discussion when he proposed the creation of the District of Columbia Financial Review Board. My esteemed colleague, Ms. Norton, moved the discussion along even further when, on February 16, she too called for the creation of a financial oversight board and laid out many of the important criteria of such a body. Today our subcommittee is taking the next step in the process. We are going to hear from a GAO team about what other cities in crisis have done.

Our purpose today is to ascertain precisely what options are available to Congress as the nation's capital city struggles with this crisis. We also want to determine how to end what has become an annual occurrence of overspending, poor service delivery, faulty record keeping, and inept management.

Let me say at the outset, that however unprecedented the District's overspending may be for a city of its size and however high the percentage of its deficit is over its entire budget, the District's financial and social problems are not unique. Unfortunately, they parallel much of what urban America has experienced in the past two decades. In that time, New York City, Yonkers, Cleveland, Philadelphia, and Chicago (primarily its school district) all teetered at the brink of default. All found their way back, with the help and assistance of their respective state and regional governments.

The District of Columbia's financial crisis is special; but, unfortunately, it is not unique. The District is special because of the deep and abiding affection that all American's have for our capital city. It is special because of its relationship to the Federal government. Because the District lacks the normal state or regional government to assist it with its affairs, Congress does some of the things a state legislature would do. It is Congress's responsibility to fill this role. Before taking legislative action, it is incumbent upon us to consider what has been tried elsewhere, which mechanisms have been most successful, and how these remedies may best be adapted to the District of Columbia's special situation. It is important that this be done in public so that the people who will be most affected by the decisions we make—those who reside and work in the District—or visit it—have an opportunity to participate in the deliberations surrounding the creation of a financial control board. None of the approaches that will be outlined today will succeed without the cooperation and support of the public that has entrusted this body with the right to act in the name of all the people of the United States.

The financial condition into which so much of urban America has fallen in the last third of the twentieth century is rooted in a common cause and can be remedied by similar solutions. The cause is best summarized in two titles, one of a book the other of a newspaper column I encountered not long ago. In 1980, Charles R. Morris called his detailed study of the New York fiscal crisis of the 1970's *The Cost of Good Intentions: New York City and the Liberal Experiment, 1960–1975.* Just last month, Pulitzer Prize winning journalist William Raspberry described Washington, DC as the "City that Couldn't Say No." In the column under that heading, he likened the City's spending practices less to those of a drunken sailor than to a poor- but compassionate mother with a credit card.

Both accounts described how various city administrations, acting out of concern for the most disadvantaged of their constituents, enacted some of the most generous social welfare and spending practices in the nation. As these programs attracted poorer residents from other places, they drove away both jobs and middle class residents, who felt themselves besieged by climbing tax rates. The cities accelerated this process by raising taxes on well to do and other residents that remained and embarked on newer and newer schemes to increase revenues from newer and unconventional sources. However they tried and however successful they were, their spending always managed to exceed whatever revenues they took in. Social scientists and accountants who study this phenomenon refer to it as a city's "structural deficit."

"Structural deficits" drove the cities to follow unsound financial practices. They tended to finance their current spending by borrowing heavily. Deficits climbed and expenditures continued to rise. The cities in question began to cover their short term borrowing with supposed "one shot" budget gimmicks designed to get them through one year at a time. A favored practice in several places was to classify operating expenses as capital expenses and fund them with long-term borrowing.

Short term debt was rolled over and interest payments became a significant portion of the operating expenses of the city. As the capital borrowing grew, short term debt was further piled on to finance legitimate capital expenses so as to avoid upfront cash expenditures required for long term borrowing. Situations like this continued until the state imposed debt ceiling was reached or approached and creditors began to dump city notes. Bond ratings were lowered and cities ran out of cash to pay both its bills and the interest it owed on its debt. Each time, action by the respective state government—and in the case of New York, the federal government as well, was required to avert the dreaded "D word: "D-E-F-A-U-L-T." More often that not, the practice through which the states chose to head off disaster and begin the necessary financial restructuring was through a control board.

In the time since Delegate Norton proposed an oversight board for the District of Columbia, there has been much speculation in the press and elsewhere as to what such boards do and whether and to what degree they encroach upon the powers of home rule. I am not interested in eliminating home rule. A financial control board is not an undercover attack on home rule. In fact, the greatest threat to home rule comes from the City's financial crisis. By successfully resolving this crisis, home rule will be enhanced. The only real threat to home rule would be a failure by the home rule government to act decisively to deal with this crisis. As we shall discover today, they have varied greatly in scope, size, and power.

They did however share two common characteristics wherever they were attempted. First, the solutions they offered were long rather than short term in nature. They recognized that the city's problems were not of one day's or one year's or even of one administration's making. Usually, they embarked on a strategy that first replaced short term debt with longer term bonds so the city could catch its breadth. Then they embarked on a course of serious restructuring of the city's finan-

cial mechanism. After the immediate crisis was dealt with, they retained stand-by authority, monitored city finances steadily, and established a mechanism through which to intervene should the city revert back to past practices.

Because of the deeply ingrained pattern of fiscal mismanagement and the control board's role in borrowing, financial control boards are in existence for the life of the bonds they issue. This means these bodies can remain in operation for years after the crises that created them have passed. In New York, for instance, it will remain in place until 2008, when the last long term bond issued under its hegemony is retired.

Just last year, when the City of New York approached an anticipated $450 million to $750 million budget gap (which was less than what Washington now expects), at least one powerful state official called for scrutiny by the Control Board. Now having already cut more from his first year's budget than Congress ordered the District to do, Mayor Giuliani has proposed the deepest spending cuts since the 1930's. Proclaiming that the city had been "too generous for too long", the Mayor proposed cutting the city's budget of $30.5 billion by $1.3 billion, a four percent reduction. He also proposed eliminating the city's sales tax on clothing that costs less than $100 and unveiled the first phase of a plan to reduce property taxes on co-ops and condos and reduce business taxes in order to stimulate shopping, savings, and investment. He also proposed cuts in virtually every city expenditure, including and especially Medicaid.

The second feature most past and existing control boards have shared was their determination that "tough love" was a better means of breaking cities of their predilection to overspend than "bailouts." Like therapists who treat other forms of addiction, control boards have figured out that the best way to discourage bad practices was to make their continuance simply too painful.

Too much has been said about the "tough" side in this approach. Too little has been said about the "love" aspect. Have we really helped the poor and the needy by making it too easy to gain access to public assistance. Are we helping them now that we are, by necessity, cutting back on the very programs that have caused municipal deficits to soar? I can think of nothing more heartless than policies that subsidize bad practices, encourage dependency on government handouts, and abandons people once the addiction has taken hold.

In the short time I have been chairman of this subcommittee, I have pointed out on several occasions that all Americans benefit from a strong and vibrant national capital city. While it is important to all of America, the capital city has an added importance to the people of the metropolitan Washington region. All of us who live within commuting distance of downtown Washington know that the health of the surrounding suburbs depends on a healthy inner city. Our interests are closely intertwined.

Over the past weekend, I held three separate town meetings in my Congressional district. In Burke, Fairfax City, and Woodbridge, I received many questions about the District of Columbia and its problems. People want to know that their capital city will one day get its finances under control. They want their nations capital to be worthy of the strongest, freest, and greatest nation on earth. They want to see its streets safe, schools improved, and quality of life the envy of the rest of America. They have a right to expect nothing less.

I anticipate that shortly, Congress will take the first step of what will be a long, hard, but worthy journey to assist our great national capital toward that destination. Once we have helped "stop the financial bleeding", we can turn our attention to often mentioned, but seldom tried long term remedies such as privatization, contracting out of services, and some of the bold solutions to some of the social problems Speaker Gingrich, Jack Kemp, and other people of good will have identified.

I want to thank Congressman Joe McDade (R-PA) of the Appropriations Committee for requesting that GAO undertake this work presented here today and the work they are yet to complete. If it had not been for his initiative as the Ranking Republican on the Appropriations Committee last year we would not be having this hearing and this invaluable material would not have been gathered. He and the current Appropriations Committee leadership have kindly shared this information with us and have allowed the GAO to testify on it here. I thank them for their courtesy. I also want to thank the entire GAO team that has worked on this project. They should be commended for their diligence and their coordination with all the offices involved and with the other GAO team working on District matters.

It is my pleasure to call upon this morning's single witness, Charles A. Bowsher, Controller General, US General Accounting Office, to explain to us some of the markers some those who came before us have left.

Ms. NORTON. Mr. Chairman, if I might suggest, since the bell has rung, that perhaps we go to the vote first and then come back, if that is agreeable?

Mr. DAVIS. All right. Is there objection to that among members?

All right. We will be in recess and reconvene here in about 15 minutes.

[Recess.]

Mr. DAVIS. The meeting will come to order, and I would like to now recognize the distinguished delegate from the District of Columbia, Ms. Norton.

Ms. NORTON. Thank you very much, Mr. Chairman.

May I thank Chairman Davis for calling this hearing so promptly, for putting the oversight board on a fast track, and for his very fair and collegial approach to what he has called a consensus bill.

We certainly do not want to risk the possibility that, despite notice from our own investigation arm, the GAO, the capital of the United States could default, nor should the mayor and the council be left to shift accounts, draining the treasury until it is drained dry, damaging and demoralizing residents and employees, and injuring already fragile services while bringing grave harm to vendors.

Thus, the chairman and I have agreed to try to come to some agreement among ourselves, other members, and District of Columbia officials after tightly scheduled hearings. The GAO testimony we will hear today is important to help us sort through existing experience with oversight boards in other cities.

The District is unique, but attention to prior efforts can keep us from not only reinventing the wheel but also from reinventing the mistakes of others. I appreciate that Chairman Davis is quickly trying to put together another hearing to get testimony from leaders of similar boards. I have specifically requested that Dr. Bernard Anderson, the former chair of the Pennsylvania board that saved Philadelphia, be called as a witness. Dr. Anderson, now Assistant Secretary of Employee Standards at the Department of Labor, is right here in Washington.

As the Member who represents the District, I have been meeting with local officials and others. Like Chairman Davis, I believe that the careful preparation and participation of those who will be directly affected is necessary for this process to succeed. After all, we are about to introduce an unprecedented entity into the life of a city that has always had to struggle for the most elementary democracy freely available to every other American jurisdiction as a matter of right. Staff and members owe District officials and residents sensitivity. I am very pleased by the mature and serious responses and suggestions of District officials and residents.

The Members involved in this process have been at pains to avoid needless controversy and polarization. Nobody needs to force anything on anyone. This process will continue to go well if we follow the chairman's collegial lead. I want to thank Chairman Davis once again for his intelligent focus, his persistent courtesy, and his participatory approach.

Thank you very much, Mr. Chairman.

Mr. DAVIS. Thank you very much, Ms. Norton.

It is our privilege now to recognize the distinguished gentleman from Ohio, Mr. LaTourette.

Mr. LATOURETTE. Thank you, Mr. Chairman, and at the outset let me add my voice to those that have already been raised today in praising both you and also Delegate Norton for the bipartisan manner in which you are proceeding in this particular issue.

Mr. Chairman, I want to thank you first for convening this hearing to enable us to better determine how the Congress may assist the District to deal with its current financial crisis and, second, let me also thank Mr. Finch and the others from GAO who worked on this project to study how other cities in similar situations have been able to revitalize their economies. I look forward with great anticipation to their upcoming testimony.

As a native of the Cleveland area, I have seen firsthand the devastating effect that a fiscal crisis can have on a community. In the late 1970's, because of years of hiding financial shortfalls by borrowing bond funds, selling off city assets, and borrowing from construction accounts, the city of Cleveland found itself faced with a financial crisis much like the one facing the District of Columbia today. Eventually the city defaulted on approximately $15 million worth of notes owed to local banks when the banks refused to roll the notes over.

However, I have also seen firsthand the manner in which a city can pull itself up by its bootstraps and return itself to fiscal stability. The Cleveland Financial Planning and Supervision Commission, one of the oversight boards that will be discussed here today, went to work on solving Cleveland's financial woes in 1980, and while the commission did not resolve every management and structural problem which faced the city, within a period of just 7 years they had eliminated Cleveland's deficit, balanced the budget, and restored the city's access to its credit markets. In fact, the commission did such a good job, it put itself out of a job. At this time, Cleveland has eliminated all of its fiscal emergency conditions.

Cleveland did not rejuvenate its economy overnight, nor will the District of Columbia. However, the sooner definitive actions are taken to try and avert the financial crisis I believe we can all agree is looming right around the corner, the sooner the District can begin its own recovery. I would only ask, as we begin the deliberative processes, with the words of the mayor of the city of Cleveland, who took over following default, and is now the Governor of the State of Ohio, Governor Voinovich. I think his words would be well remembered by all participants when he said, "This is a tough job, and I'm not going to submit to the political pressures that mayors have in the past. If it means I don't get reelected 2 years from now, tough."

Thank you, Mr. Chairman. I yield back my time.

Mr. DAVIS. Thank you very much.

The distinguished gentleman from Illinois, Mr. Flanagan.

Mr. FLANAGAN. Thank you, Chairman Davis. I have just a short statement in the interests of brevity.

I am happy to see today that the panel has chosen the great city of Chicago, my home town, as one of the five cities it studied. The city of Big Shoulders has a long history of fiscal soundness, and we have not endured the agonizing pain of bankruptcy that other great

cities have endured because of our ability to watch the pennies, permitting the dollars to watch themselves, the school system notwithstanding, and it is nice to see that Chicago is held up as an example for doing something right. I hope we can take lessons learned from Chicago's oversight board and apply them successfully to the District of Columbia.

I agree with many aspects of the oversight board set up in Chicago to deal with our school system's financial crisis. As you know, our board was formed in 1980 and still operates today if a certain threshold of budget performance is not achieved. All of our unpaid board members are appointed, and none are elected officials. Each member serves 3-year terms and is eligible for reappointment, and frequent reporting periods are routine.

I also commend the dedication of all of Chicago's board members and would like to mention the five currently serving by name—Chairman Martin Coledike, Don Hider, Cerus Berlack, Ramon Romero, and Christopher Gardner.

I want to thank everyone for contributing to this discussion and to the subcommittee staff here for their tireless work on this effort to revitalize Washington, DC, and I especially congratulate Chairman Davis and Ms. Norton for their leadership concerning the District's future and the bipartisan effort and attitude that they have taken thus far.

Thank you, Mr. Chairman.

Mr. DAVIS. Thank you very much, Mr. Flanagan.

The gentlelady from Michigan, Miss Collins.

Miss COLLINS. Thank you very much, Mr. Chairman.

First of all, I would like to commend you for holding these hearings, and I would like to commend you for the sensitivity and the compassion you have shown in dealing with this problem which is not unique among urban centers of America. I think that it is very appropriate and clever to call in the other cities who suffered the same fate that the District of Columbia is now suffering, and I hope not only that we find a solution to help the District of Columbia but also to help the city of Detroit, and perhaps we can actually build a framework of how to help the budget problems in urban centers with low tax bases and high unemployment.

I thank you very much for calling this hearing.

[The prepared statement of Hon. Cardiss Collins follows:]

PREPARED STATEMENT OF HON. CARDISS COLLINS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. Chairman, I wish to commend you and the Subcommittee's Ranking Member, Congresswoman Eleanor Holmes Norton, for proceeding with dispatch and in a collegial and bipartisan manner to seek an effective remedy for the financial crisis in the District of Columbia.

Today's hearing will clearly establish that the situation the District finds itself in is not a unique one in America. Several cities, including my own home town, Chicago, have confronted serious financial difficulties, but have worked through their problems with the assistance of their respective state governments. What does set the District apart, however, is the fact that it cannot turn to a state government for assistance.

The Federal government which, under the Constitution has exclusive legislative authority over the District, must step up to the plate and provide the needed assistance in this case. That assistance includes quick action on the legislation being developed by the Ranking Member and the Chairman to establish a financial and management oversight board, that is respectful of Home Rule, but sufficiently em-

powered to regain access the capital markets and restore confidence in the city's future. By respectful of Home Rule, I believe it is important that the people of the District retain some form of representation on the board, and that the residents are allowed to maintain their dignity.

The legislation should also include funding for the board and, if necessary, an infusion of funds to put in place a state-of-the-art-financial management system, and meet other critical short term needs.

The work done by GAO thus far on this matter has been extremely helpful to the Members who serve on this Subcommittee. You are to be commended for it. All of us share the desire to see the District put this problem behind and reclaim its deserved prestige as our nation's capitol. You have brought us very close to the point where we can take action to make that possible.

Mr. DAVIS. Thank you very much.

Mr. Finch, now would you and those accompanying you at the table please rise with me and raise your right hands. It is the policy of the committee here to swear in all witnesses.

[Witnesses sworn.]

Mr. DAVIS. Thank you. Be seated.

I wonder, Mr. Finch, before you start if you would please identify those at the table with you. I know they have worked with you in preparing this testimony, and I just want to say the committee is very impressed with the work that the GAO has provided us to date.

STATEMENT OF JOHNNY C. FINCH, ASSISTANT COMPTROLLER GENERAL, GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY: JOHN W. HILL, DIRECTOR, FINANCIAL MANAGEMENT POLICY AND ISSUES, ACCOUNTING INFORMATION MANAGEMENT DIVISION; FRANCES P. CLARK, ASSISTANT DIRECTOR, FEDERAL MANAGEMENT ISSUES, GENERAL GOVERNMENT DIVISION; AND JAN B. MONTGOMERY, ASSISTANT GENERAL COUNSEL, OFFICE OF GENERAL COUNSEL

Mr. FINCH. Thank you, Mr. Chairman.

It would be my pleasure to introduce the people at the table. They represent a wide range of expertise on the issues at hand today. The gentleman to my right I think really needs no introduction to the committee, John Hill, who is Director of our financial management and policy issues in our Accounting and Information Management Division. To my left is Ms. Frances Clark. Ms. Clark is an Assistant Director in our General Government Division, and Ms. Clark was responsible for the day-to-day work that was done on this particular project. She managed the whole project, so she has really detailed knowledge that she can provide. To her left is Ms. Jan Montgomery, who is Assistant General Counsel in our Office of General Counsel.

With that, Mr. Chairman and members of the subcommittee, we are pleased to be here today to discuss the actions taken by five nearly insolvent cities to improve their financial health. Recent congressional hearings and GAO reports have identified severe financial management and structural problems in the District of Columbia similar to those in the five cities. Such problems include inadequate financial systems, inefficient city operations, and changing demographics.

To identify actions the District government and Congress might take to improve the District's financial health, we reviewed past ac-

tions taken by five cities that had experienced similar problems. These cities—Boston, Chicago, Cleveland, New York, and Philadelphia—and their States made management changes that improved the cities' financial conditions. As a result of these changes, they are now better able to manage their financial affairs.

Based on information obtained from these cities and their respective States, our discussion today centers on the following three areas: First, problems experienced by all five cities; second, actions taken by State established boards to oversee city finances and by the cities to improve the cities' financial health; and, third, common characteristics of these boards. We relied on available data and evaluations provided by city and board officials. We did not independently evaluate the information provided.

The five cities we visited experienced similar problems. Some of the problems were caused by the cities' changing demographics; others were due to the cities' inability to make the hard financial decisions needed to live within their means. Over the past few decades these cities, like other Eastern and Midwestern cities, faced a migration of tax-paying residents and employers, both individuals and jobs, to the suburbs and other locations. Their remaining populations contained an increasing proportion of residents, such as the poor and the elderly, who needed relatively more services but could pay little for them. During this same period, the Federal and State governments sharply reduced aid for social and other city programs. Collectively these changes—shifting demographics, increased needs for costly services, and reduced Federal and State aid—resulted in a declining revenue base.

Even as the revenue bases continued to decline, the cities were reluctant to take the hard financial and managerial steps necessary to adjust to these changes. According to studies on the cities' finances, the cities in general did not want to disclose the severity of their conditions. Therefore, according to current and former city officials, the cities often resorted to accounting and budgeting schemes. These schemes included paying for operating expenses from capital budgets, accumulating deficits from 1 year to the next, and understating expenses.

City officials told us that when the State governments, local businesses, and bond rating agencies discovered the cities' true financial positions, the cities began to lose their credibility. The officials said that this loss of credibility created an environment of distrust and confrontation. In general, this loss of credibility caused the bond rating agencies to lower the cities' bond ratings. As a result, the cities that received lowered bond ratings lost their ability to borrow and began defaulting on prior loans. Eventually each city was faced with such unstable financial conditions that a financial crisis either occurred or was imminent.

As conditions worsened, Boston and Chicago had sufficient financial discipline to restore their credibility and their financial health without direct oversight. However, Ohio, New York, and Pennsylvania wanted some assurance that financial discipline would be rerestored and maintained in Cleveland, New York City, and Philadelphia. Illinois wanted similar assurance for Chicago's school district. To achieve such assurance, these States established oversight boards for the three cities and Chicago's school district. The boards

helped the cities take actions that resulted in the cities being better able the manage their financial affairs. In addition, the cities began to improve city management and operations and address their structural problems.

To help improve financial stability, Cleveland, New York, and Philadelphia worked with their oversight boards to obtain needed funds. Chicago worked with the school district's oversight board to obtain additional funding for the school district. Boston also obtained State aid, although it did not require the assistance of an oversight board. In addition, Boston sold a convention center and a parking garage for $40 million in 1982. All five cities at times through their boards obtained additional funds either by raising taxes or issuing bonds. Cleveland, New York, and Philadelphia set aside sources of revenue, usually new or increased taxes, to repay the borrowed funds.

In addition, the cities took immediate actions to establish credible budgeting and accounting numbers. Getting credible numbers generally with the help of independent accounting firms was essential for the cities and their oversight boards to determine the extent of the cities' financial difficulties. Getting such numbers also was essential for showing areas for cost reduction and the extent to which existing financial systems needed improvement.

Once their financial difficulties were identified, the cities took immediate cost-cutting measures. All five cities cut costs by reducing the number of their full-time employees. For example, by 1978 New York reduced its work force by about 20 percent, which amounted to about 60,000 employees, primarily through involuntary layoffs. When it improved its financial health in the 1980's, the city increased its work force to previous levels.

Philadelphia did not reduce its number of employees through involuntary layoffs. However, Philadelphia negotiated with labor unions which led to immediate reductions in benefits and a freeze in wages. To quickly reduce costs, some of the cities also restricted overtime, froze wages and hiring, and tightened controls over new contracts. So a host of different actions were taken when you look at the cities across the spectrum.

Another important action that each city took was to improve its working relationships with others that had a stake in the cities' future. Local businesses offered managerial and technical support and advice to improve city management and operations. City employees, through their unions, in general became more willing to negotiate lowering wages and benefits. During the cities' financial difficulties, strong city leadership was essential to restoring financial health and promoting cooperation. For example, the new mayor of Philadelphia worked with the president of the city council to shape and implement an agenda of city reform.

While improving their financial stability, all five cities realized that if they were to avoid more financial difficulties they also would have to improve the efficiency of city management and operations. In fact, the cities realized that their periods of financial instability could be used as opportunities to make some strong reforms. Accordingly, they began to restructure the way they did business. They did so by improving their financial and work force manage-

ment and by introducing productivity initiatives throughout the city government.

The cities often hired new financial managers and gave them authority and responsibility to strengthen the cities' accounting, budgeting, and cash management operations. In addition, the cities installed or upgraded their financial management systems and improved their financial reporting. The cities also introduced or strengthened budgeting of their capital accounts. In addition, Boston and Chicago included reports in their annual budgets of how well city departments performed against preestablished performance measures.

In general, these improvements provided the cities with new and better financial information so that they can actively monitor their cash balances and their outstanding debt. The cities also were able to monitor differences between budgeted and actual spending among their departments. This monitoring enabled the cities to examine how costs, such as a multi-year labor contract, for example, could affect future budgets in the out years.

The financial improvements permitted the cities to identify areas in city operations where costs could be reduced. The cities made their most significant cost reductions in the area of work force management. Personnel costs generally represented about 40 to 75 percent of the cities' operating costs. The cities reduced these costs by such actions as voluntary and involuntary layoffs, transfer of staff, changes in work rules, and better controls over overtime, leave, and Workmen's Compensation. For example, between 1990 and 1994 Chicago reduced the cost of its health benefits by a total of $225 million.

In addition, the cities that administered their pension programs—Boston, New York, and Philadelphia—reduced their pension costs in various ways. In 1988, Boston began to eliminate its unfunded pension liability by establishing an updated funding schedule that based payments to its pension fund on independent actuarial estimates. The city reduced its pension costs through a better investment return from its pension assets and by a work force reduction of about 2,000 employees. As a result of these efforts, according to city estimates, Boston's pension costs decreased from $130.5 million in fiscal year 1988 to $112 million in fiscal year 1993. New York reduced pension costs by requiring increases in employee contributions. In addition, Philadelphia raised retirement ages.

Cities also began to implement productivity initiatives often with help from their local businesses. For example, in Philadelphia a group of executives and managers from 130 businesses worked with the mayor's task force on productivity to identify and track productivity initiatives. In its fiscal year 1995 to 1999 financial plan the city estimated that it had saved a total of about $450 million in fiscal years 1993 and 1994 through these initiatives. According to the plan, Philadelphia increased productivity across city operations through more contracting out, better use of technology, and consolidation of previously fragmented services such as building, fleet management, and information services. Boston, Chicago, Cleveland, and New York identified and implemented similar productivity initiatives.

The strong reforms introduced by the cities such as more credible information, reduced operating costs, and increased productivity stabilized the cities and made them healthier financially. However, these reforms did not eliminate the cities' structural problems that led to their restricted and declining revenue base. The five cities could no longer simply raise taxes for local residents and businesses to pay for rising costs. New York, for example, reduced local taxes by about $1 billion between 1978 and 1981 to keep residents and businesses in the city. In addition, studies showed that raising city taxes beyond a certain point in Philadelphia could cause some residents and businesses to leave the city, thus resulting in a loss of total revenue.

To address their structural problems, the cities adopted three strategies: One, identifying new revenue sources; two, shifting city functions to other sectors; and, three, establishing sound economic development programs. To obtain new revenue some of the cities introduced nontax alternatives. Boston and Philadelphia began requiring certain tax-exempt institutions to make annual payments to the city. For example, Philadelphia reported that the assessed value of nonprofit property was $3.1 billion in fiscal year 1993. The city estimated in June 1994 that by having nonprofit institutions pay 40 percent of what they would have been taxed, these institutions would pay the city and its school district more than $40 million annually. Philadelphia subsequently implemented this payment for nonprofit institutions.

Cities also resorted to introducing or increasing taxes such as hotel and motel and parking taxes. The cities also established new or increased fees for certain city services. Further revenue was obtained through more efficient revenue collections in Boston, Chicago, and Philadelphia, operating efficiencies.

However, because the cities had few prospects of raising additional revenue on their own, they had either reached or were near what one city described as revenue lock. The cities began to question what should be the core activities of a municipality. When the cities viewed their operations as being better provided by States, counties, or the private sector, they sought to either have these activities so transferred or to seek better cost sharing arrangements. For example, the State of New York assumed the local cost of New York City's court system, City University, and Supplemental Income Security following the city's financial crisis. New York has requested that its State and the Federal Government reduce the city's share of Medicaid costs. According to city estimates, Medicaid is expected to cost the city about $2.4 billion for the current fiscal year. City budgets indicate that this program was a significant contributor to the city's escalating cost growth in the 1970's. City officials in Boston and Chicago told us that not have been responsible for traditional State and county functions such as prisons, welfare programs, and universities has been a contributor to their cities' improved financial health.

To better prepare for the long-term future of the cities, the cities, especially in Chicago and Cleveland, strengthened their economic development programs to revitalize neighborhoods and to retain or attract businesses. According to city estimates, Chicago leveraged $150 million in city funds to provide more than $1 billion in eco-

nomic development between 1990 and 1994, with additional funding provided through low-interest loans from the business community. Chicago's development was often targeted to neighborhoods most in need. Cleveland formed public-private partnerships with local businesses, neighborhood organizations, and foundations. These partnerships have stimulated housing development in poor and blighted neighborhoods and built Cleveland's new sports arena and convention center, earning national praise.

The oversight boards established for Cleveland, New York, Philadelphia, and Chicago's school district played key roles in improving the cities' and school district's financial stability. These boards had some common characteristics. Each board contained from five to seven members. In general, the board members were committed to the cities' or school district's future and qualified—that is, had a strong background in financial and business management. Often the board members included partners of law or accounting firms and business executives from the private sector.

In addition, State legislation tied changes to the board's duration or power to specific improvements in the city's financial condition. For example, the period of active control by the New York board ended in 1986 after the city was able to balance its budget for 3 years and improved its access to the credit markets. The New York board continues to monitor the city's budgets and financial plans. The board's period of active control can be reactivated if the city fails to maintain its improvements, and certain statutory criteria exist such as having a deficit of more than $100 million. Philadelphia's board is to exist for no more than 1 year after all its liabilities, including its bonds, have been paid. The board that oversees Chicago's schools is to be reactivated if the school district fails to adopt a balanced budget by the beginning of each fiscal year or achieve a balanced budget for 2 consecutive fiscal years.

All the boards required certain financial reporting from their respective city or school district. In general, the cities and the school district were required to provide the boards with annual balanced budgets and multi-year financial plans. The boards then either approved or disapproved these budgets and plans. If any of the cities or the school district did not submit an acceptable financial plan or meet the approved plan, certain enforcement action could occur. For example, by law in Cleveland, failure to submit a financial plan by the stated deadline could have resulted in the city's spending being limited to 85 percent of the prior year's spending. Cleveland's spending was to be limited only until a new financial plan was approved. Cleveland's board was terminated in 1987. Philadelphia's board will withhold State money and certain bond proceeds from the city if the city fails to comply with its financial plan. New York's board can recommend that either the Governor or the mayor, both of whom are board members, remove city officials if they fail to comply with the board's direction.

During our visits, city and school officials acknowledged the value of these boards in helping the cities and school district improve their financial discipline in three ways: First, by requiring adherence to approved plans; second, by providing leverage that helped the cities or school district to negotiate cost reductions with employees and contractors; and, third by increasing public disclo-

sure of and confidence in the financial condition of the cities and the school district.

In summary, either on their own or with the assistance of State oversight boards, the cities all took actions to improve their financial discipline and their stability. They increased credible accounting numbers to clearly identify their financial situations and needs. They also took immediate cost-cutting measures and began longer-term efforts to improve management and operations. The cities are also addressing their structural problems and finding them particularly difficult to solve.

Mr. Chairman, this concludes my statement. My colleagues and I will be glad to answer any questions you or other members of the subcommittee may have at this time.

[The prepared statement of Mr. Finch follows:]

PREPARED STATEMENT OF JOHNNY C. FINCH, ASSISTANT COMPTROLLER GENERAL, GENERAL GOVERNMENT DIVISION, GENERAL ACCOUNTING OFFICE

SUMMARY OF STATEMENT

GAO visited five cities—Boston, Chicago, Cleveland, New York, and Philadelphia—that experienced problems similar to those faced by the District of Columbia. The problems were similar in that some were caused by the cities' changing demographics. Others were due to the cities' inability to make the hard financial decisions needed to live within their means. The cities began defaulting on loans and losing their ability to borrow. Eventually, each city was faced with such unstable financial conditions that a financial crisis occurred or was imminent.

As conditions worsened, Boston and Chicago had sufficient financial discipline to restore their credibility and their financial health without state aid or oversight. However, Ohio, New York, and Pennsylvania wanted some assurance that financial discipline would be restored and maintained in Cleveland, New York City, and Philadelphia. Illinois wanted similar assurance for Chicago's school district. To achieve such assurance, these states established oversight boards for the three cities and Chicago's school district. The boards helped the cities take actions that resulted in the cities being better able to manage their financial affairs. In addition, the cities began to improve city management and operations and address their structural problems.

The cities' and the school district's boards shared some common characteristics. Each board contained from five to seven members. In general, board members were (1) committed to the cities' or school district's future and (2) qualified, that is, had a strong background in financial and business management. Often, the board members included partners of law or accounting firms and business executives from the private sector. In addition, state legislation tied changes to the boards' duration or power to specific improvements in a city's financial condition.

All five of the cities have now improved their financial stability, management, and operations. The cities are also addressing their structural problems and are finding them particularly difficult to solve.

Mr. DAVIS. Thank you very much, Mr. Finch. We very much appreciate the work that you and the staff have done.

I am going to start the questioning if I can.

It looks to me like there is some good news here for the District. That in point of fact, they are not the first city in crisis to have gone through this. With some tough decisions, other cities have worked themselves out of their problems and have gone on to much greater things. The other good news is that Congress doesn't have to reinvent the wheel, that there is a lot out there in some of these control boards that have already been established, a lot of precedence, some trial and error that give us a good menu of activities that we can consider for this board. Would you agree with that?

Mr. FINCH. I would agree wholeheartedly with each of those points, Mr. Chairman.

I think one of the things that struck us was that when we looked at the different boards they were all truly different, there were different things about them, and I think what happened was that the boards were configured based upon the conditions and the particular crises and situations that occurred at the time.

So I think you are right, there are a lot of things out there to choose from, and the thing that we observed was, there wasn't a given cookie cutter kind of approach.

Mr. DAVIS. I would also say the good news is that we don't have to reinvent the wheel, and neither does the District government have to reinvent the wheel. Other governments have been through this, and have made tough decisions and helped themselves get from under the burdens of these boards or the threat of the boards. Is that correct?

Mr. FINCH. That is correct, sir. There are a lot of good examples out there that the city might look to in terms of things to try.

Mr. DAVIS. That was a good presentation.

Let me get to one of the issues, which is members of the governing bodies in these different cities serving on the control boards. Is New York the only one that employed that?

Mr. FINCH. Well, let me just run them down for you, Mr. Chairman.

Mr. DAVIS. OK, that would be fine.

Mr. FINCH. Perhaps that would be helpful.

Mr. DAVIS. This has been asked of me a lot, and I think we need to understand the precedent here.

Mr. FINCH. OK. Good. In New York there were a total of seven members. The seven members were comprised of the Governor as the chair, the State comptroller, the mayor, the city comptroller, and then three appointed people. The three appointments were appointed by the Governor with the advice and consent of the State Senate. The Chicago School Finance Authority, there were five members, and two were appointed by the Governor with the approval of the mayor, two by the mayor with approval of the Governor, and one jointly by the mayor and the Governor, but the school board had nothing to do with any of the appointments, but the school board, which was the control device there, had no appointments or representations.

In Cleveland there were a total of seven. They were comprised of the State treasurer, the director of management and budget, the mayor, the presiding officer of the city legislative authority, and the appointments. The way the appointments came about, the mayor and the presiding officer of the city legislative authority nominate five persons to the Governor who selected three with the advice and consent of the State Senate, and if the list that was provided wasn't satisfactory that it provided enough well qualified candidates, the Governor can ask for additional names in terms of going over that.

In Pennsylvania the board was comprised of five members. They were appointed, one by the Governor, one by the president pro tempore of the Senate, one by the minority leader of the Senate, one by the Speaker of the House, and one by the minority leader of the House.

Mr. DAVIS. OK. Thank you.

In the New York case, wasn't there a constitutional requirement that you have elected officials, do you know?

Ms. CLARK. Yes, there was.

Mr. DAVIS. OK. Thank you.

What about in the Ohio case? Was there a constitutional requirement that elected officials be involved?

Ms. CLARK. I don't believe so.

Mr. FINCH. I don't recall that, sir.

Mr. DAVIS. All right. I wanted to know that. That is one of the issues that has been raised. The point of authority issue is one which right now is very much up in the air. The airports authority has had some legislative history and has been up a couple of times to the courts and down again. There is pending legislation to give Congress the ability to appoint officers. Have you looked at that issue as it concerns this board?

Mr. FINCH. We think, Mr. Chairman, that that issue could raise severe constitutional questions perhaps. Let me ask counsel to respond to that.

Mr. DAVIS. That will be fine.

Ms. MONTGOMERY. First question out of the box, Mr. Chairman, as Mr. Finch indicates, is whether Members of Congress or its agents can participate in this oversight board raises significant constitutional issues. The court, in addressing such questions in other contexts, reviewed the structure of the board, including the procedures for appointment and removal of members in relation to the powers they perform, to determine whether they comply with principles in the Constitution, including separation of powers concepts and the appointments clause.

Several judicial decisions over the last 20 years have held that constitutional principles preclude Members of Congress from either serving on or appointing members of boards or agencies that exercise executive functions. These decisions make clear that officials who perform executive functions must be appointed in accordance with the appointments clause of the Constitution, and as you all are aware the appointments clause requires that the power of appointment in the Federal Government rests with the President.

Therefore, depending on the extent of the functions you all would decide to invest in a control board, specifically if the control board was performing executive functions, then clearly a congressional appointment in this context could subject the board to constitutional challenge under the appointments clause and separation of powers concepts.

In addition, congressional membership on the board would similarly subject the board to the significant likelihood of constitutional challenge under the separation of powers doctrine.

Mr. DAVIS. OK. I could ask some more questions, and I may do that later. Some other Members may have some questions too, later.

Ms. MONTGOMERY. In addition, if you would like us to submit something for the record, if that would be more appropriate, that would be fine too.

Mr. DAVIS. That would be fine, to make that more complete.

Ms. MONTGOMERY. These issues are very complicated in the context of the District.

[The information referred to follows:]

Congress must be careful in establishing a board to ensure that the composition of the board, including the appointment and removal of members, when viewed in relation to the powers conferred on the board, is consistent with the principle of separation of powers embodied in the Constitution. A number of cases over the last 20 years have prohibited the Congress from participating on boards or commissions exercising significant executive, quasi-legislative or quasi-judicial functions. The prohibition preclude members of congress or its agents from sitting on the boards or selecting those who may sit on the boards. Simply stated, the cases stand for the proposition that Congress or its agents may not exercise executive powers and Congress may only exercise legislative powers in conformity with the Constitutional requirement of bicameralism and presentment to the president for approval or veto.

For example, in *Metropolitan Washington Airports Authority* v. *Citizens for the Abatement of Aircraft Noise,* 501 U.S. 252 (1991), the Supreme Court held unconstitutional a statute that required that the board of directors of the Metropolitan Washington Airport Authority (MWAA Board) appoint a board of review composed of members of Congress possessing a number of powers, including veto power over the decisions of the MWAA Board. The Court held that if the review board's powers were viewed as executive in nature, the Constitution does not permit an agent of Congress to exercise it. On the other hand if the review board's powers were viewed as legislative in nature, Congress was required to exercise it in conformity with bicarmeralism and presentment, that is to act through legislation presented to the President for approval or veto as set forth in *INS* v. *Chadha,* 462 U.S. 919, 959 (1983).

Thereafter, Congress amended the law to permit noncongressional membership on the review board and eliminate the review board's veto power over MWAA Board. However, it also required that review board members be selected from lists submitted by the Speaker of the House and the Senate pro tempore and set qualifications that few but members of congress could satisfy. It also expanded the the review board's power to include contracts, authorized members to participate as nonvoting members in meetings of the board of directors, and authorized the review board to make recommendations regarding matters reviewed that if the board of Directors failed to comply with, had to be presented to Congress for review. The Court of Appeals for the District of Columbia Circuit struck these amendments down as a violation of the principle of separation of powers. *Hechinger* v. *Metropolitan Washington Airport Authority,* 36 F. 3d 97 (1994), cert. den. The court held that the review board was clearly an agent of Congress exercising significant federal powers that failed for the same reasons as set forth in the Supreme Court's opinion.

Further in *Buckley* v. *Valeo,* 424 U.S. 1, 137–140 (1976), the Court ruled that the Federal Election Commission, comprised of two members selected by the President, two by the Senate and two by the House, with confirmation of all six members vested in both the House and the Senate violated the Appointment clause and the principles of separation of powers with regard to exercising powers to flesh out the statute, i.e., rule making and advisory opinions, and functions to ensure compliance with the statute and rules, i.e., informal procedures, administrative determinations and hearings, and civil suits.

Mr. DAVIS. All right. I just have one other question within my allotted time. This goes to the borrowing authority of the city and its bond rating which right now, as you know, has been downgraded to a junk bond status. Have you looked at the District being able to continue to issue bonds with a government guaranty—or would a control board be better, at this point given the precedent in these other jurisdictions?

Mr. FINCH. I will defer that to my accounting expert.

Mr. DAVIS. OK. Mr. Hill.

Mr. HILL. We haven't looked at that issue, specifically whether or not the District could continue to do borrowing with a guaranty, but certainly from some of our discussions with people who were in the market, they would definitely consider that guaranty in deciding whether or not to provide money to the District. We could specifically look at that and give you an answer.

Mr. DAVIS. That would be helpful. I think they currently have a guaranty, don't they, basically for the bonds they send out to some

extent? All the District has to do is present something to the Treasury to honor it. Or am I wrong on that?

Mr. HILL. Well, they—it is not the same as a guaranty. However, we do believe and the rating agencies have told us that that is considered in deciding what the District's credit would be, the fact that they can access the Treasury window to pay those bills.

Mr. DAVIS. OK. Thank you very much.

Mrs. Norton.

Ms. NORTON. Mr. Chairman, if I might, I would like to defer to Miss Collins who has to go to another committee meeting.

Mr. DAVIS. Without objection.

Miss Collins.

Miss COLLINS. Thank you, Mr. Chairman. I have a very brief question.

I am fascinated by the fact that Philadelphia was able to find some way to tax their nonprofit institutions, and I just wonder, how can you do that? Are churches included in that, nonprofit institutions?

Mr. FINCH. I don't think churches were included in the ones that are making payments to Philadelphia. This was more along the lines of universities and hospitals and those kinds of things, and these were agreements that were struck with the non-tax-exempt entities.

Miss COLLINS. How did they pay it? I understand that they had them pay 40 percent of what their property taxes would have been.

Mr. FINCH. Right.

Miss COLLINS. And it says—your statement—these institutions would pay the city and its school district more than $40 million annually, and Philadelphia subsequently implemented this payment. Was this by authority from the State? How did they pay it? Did they pay it directly to the city? Did the State assess them what it would be, and what happened if they didn't pay it?

Mr. FINCH. Fran, do you want to take that?

Ms. CLARK. Certainly.

These were organizations that ordinarily were exempt from city taxes, and they had a list of criteria that you had to pass in order to be qualified as a nonprofit organization. If you didn't pass any one of those criteria, you were not considered to be a nonprofit organization and you were required to pay the full tax.

Miss COLLINS. That is property tax?

Ms. CLARK. Property tax and any other taxes that they might have to pay, but primarily property tax.

If you passed all the criteria the city had established and you were genuinely a nonprofit organization, then they entered into negotiations with the organization and negotiated that the organizations would pay approximately 40 percent of what they would have paid in taxes, so that they still could retain some of the benefit from being a nonprofit organization but also contribute to the city and the support the city provided to them in terms of other services.

Miss. COLLINS. What would happen if the nonprofit institutions refused to negotiate or refused to pay that 40 percent? Was there a penalty? Were there any penalties, or did the State come down

on these nonprofits? What was the hammer? Was it all by—what do I want to say—cooperation? Negotiation?

Ms. CLARK. By and large it was through cooperation and negotiation.

Miss COLLINS. Because it benefited them to have the city solve that.

Ms. CLARK. That is correct.

Miss COLLINS. Thank you very much.

Mr. DAVIS. Miss Collins, thank you very much.

Mr. Gutknecht, the vice chairman of the subcommittee.

Mr. GUTKNECHT. Thank you, Mr. Chairman.

I have been following this whole story with interest, and as we talk about this board I think we have to almost go back a little bit and talk about what happened here in Washington and what happened in some of the other cities, and I think if we don't learn from history I am afraid that we are going to only be once again doomed to repeat it. One of my favorite economists was Milton Friedman, and he probably put it as simply as anybody that I have ever heard. He said if we tax something we will get less of it, and if we subsidize something we will get more of it, and it seems to me—and I would like to get some response from any or all of the members of the panel—if in fact part of the reason that we reached this juncture here in Washington and subsequently—or previously, I should say, in some of the other cities was that they sort of pursued this notion that you can tax wealth and you can tax productivity and you can oversubsidize nonproductivity; in fact, in some respects you might even say here in Washington dependency and even illegitimacy.

I am wondering if you can talk a little bit about that basic philosophy and if, as some editorial writers around the country have said, this is a classic example of the failure of the welfare state. I wonder if you can comment on that.

Mr. FINCH. Well, I think in the cities that we looked at sir, a common problem that they faced was a declining revenue base, which gets at your point.

Mr. GUTKNECHT. Which is a nice way to say that they have driven the wealth out of the city.

Mr. FINCH. There was an urban flight. There was an urban flight, both individuals and jobs that left the city. There may have been a number of reasons for that, and in terms of which reason is the most prevalent reason I am not real sure, as to whether it was increasing taxes or whether it was crime or whether it was congestion or city services or what, but the point is that the revenue base declined as individuals and jobs left the city, and it was a common problem.

Mr. GUTKNECHT. It's a common problem, but I mean if you don't really define how the problem got that way, how are you going to solve it? I mean how did they deal with it in New York?

Mr. FINCH. In New York they did a number of things, and No. 1 in terms of the structural part of the problem, which is what I think you are addressing, sir, comes in two parts really. One part are the functions that the city performs, and in New York they were able to transfer some of the functions that they had been performing to the State. For example, the State took over the Superior

Court of the city, the State took over the hospitals as a result of the crisis, and the universities, the City University, as a result of the crisis.

The revenue base problem is a much more difficult problem. The cities are finding that much more difficult to address than the functional part of the problem. Cleveland, I think, is a good example of this. I think in the fifties Cleveland had a population of about—I'm sure I can get some help up here from the panel—Cleveland had a population of about a million, and they went into a decline. They went down to about 500,000 by the seventies, and this was part of what led to their crisis. They have been able to try to combat that by creating some fairly innovative economic development programs where the city has worked in cooperation with the private sector to try to create some economic stabilization programs in the poor areas and that sort of thing, and they have managed to stabilize that decline. They are still now at about 500,000, but they haven't been able to start their trend upward, to increase back to a million, so it is a very difficult issue.

Mr. GUTKNECHT. So you are saying that there is some hope that this board ultimately can find some solutions to those kinds of problems?

Mr. FINCH. I think—yes. What the board's role really is, I think, is to help the city get back on its feet financially, give it the opportunity to really make some reforms in the way it goes about its operations and managing itself and to look for opportunities to try to attack the economic development issue.

Mr. GUTKNECHT. But you see the board essentially as having—there are two phases, at least two phases in this discussion. The first is, how do you solve the immediate problem and keep the——

Mr. FINCH. Right.

Mr. GUTKNECHT [continuing]. Keep the water running and so forth.

Mr. FINCH. Right.

Mr. GUTKNECHT. But long term, it seems to me that this board and maybe this Congress has failed if we don't begin to look at some of those underlying problems and find long-term solutions, and part of what I'm really trying to say is, you can't really solve the problems until you properly define them, and if we just gloss them over with, you know, terms such as "structural problems," "confrontational environments," "overwhelming fiscal dilemmas," I mean those are all nice sounding words, but they don't really get at what the problems are.

Mr. FINCH. I would agree wholeheartedly that in order to solve the problems, you really need to know what the underlying cause is—you have to know what the underlying cause is.

Mr. GUTKNECHT. Thank you.

Mr. DAVIS. Thank you, Mr. Gutknecht.

Ms. Norton.

Ms. NORTON. I just want to note for the record that I have introduced a bill to exempt District residents and business from taxes, and I think if we did that we might really see this city come alive with the stroke of a pen.

I want to also say that I think almost everybody in the District has finally realized that taxing its residents and businesses has

run its course, or more than run its course, but I do note that in your testimony, Mr. Finch, that you note that New York City reduced local taxes by $1 billion in only 3 years and they did it because they wanted to keep residents and businesses in, according to your testimony, and I applaud that, but I note for the record that New York has continued to lose middle-income residents in no small part because there are many reasons that people decide to leave the city and move elsewhere.

Nevertheless, I think that one thing we have basic agreement on in the District is that the tax well is dry, and I note the interest of the Speaker in my bill and in building upon that bill for tax purposes and relief for the District.

Let me first ask, how quick have jurisdictions been able to set up these boards? And then, how quickly to get into the market, back into the market?

Mr. FINCH. I think the big—the longest part of that timeframe, Ms. Norton, was getting the boards set up, if it required legislation and that sort of thing to do that.

Ms. NORTON. But I mean once the legislation is enacted.

Mr. FINCH. OK. Once the legislation is enacted, the boards come together fairly quickly, and usually funding can be arranged within a matter of weeks.

Ms. NORTON. Within a matter of weeks.

Mr. FINCH. Yes.

Ms. NORTON. Could the cities you looked at have reined their crisis without the existence of a board, in your opinion?

Mr. FINCH. Well, that is a difficult question. I think—I think it is safe to say that Chicago and Boston were—they were either ahead of the curve in terms of recognizing their problem and taking action. They were proactive in terms of addressing that situation and taking action.

Ms. NORTON. So they didn't get boards at all, right?

Mr. FINCH. They did not get boards at all.

Ms. NORTON. I'm talking about the cities that required boards.

Mr. FINCH. The cities that required boards, the legislatures of those States made the decision that the cities really needed some discipline in order to get them through the financial times, and so it was a political decision to put those boards in place. I will say that the cities that had boards faced the more severe crises.

Ms. NORTON. Well, let me ask Mr. Hill as well, in light of—when you compare the crisis in the District of Columbia with the crisis in the cities you have looked at, do you believe that the District of Columbia could pull itself back from this crisis without an oversight board?

Mr. FINCH. Let me answer that first, and then I will turn it over to John.

I would—I would put the District's situation up in the most severe category of the ones that we looked at.

Mr. HILL. I would agree with that. I think that if you compare the criteria that brought the boards in, in those other cities, you will find that the District probably meets most, if not all, of the criteria that those cities used to bring in boards, and in some cases there would be a more severe condition in the District.

Ms. NORTON. Now the major problem with a city—a city that gets this far down has is a cash problem, a straight out cash problem. Do you think that an oversight board can be set up in time to meet the short-term cash problem the District has?

Mr. FINCH. I think an essential ingredient to that answer, Ms. Norton, is how fast the Congress can move the legislation. I think once the legislation is in place the rest of it can come together very quickly.

Ms. NORTON. Now in each case you have looked at cities that didn't have any access to the Treasury and they had to go to the market, and yet you say that this was done in fairly short order. Would there be any reason for the District not to follow the pattern that has been set by these jurisdictions of trying to use the board in order to go back to the market?

Mr. FINCH. I think that was the objective of all of the boards that were put in place. One of the big things that the creation of a board did was to restore confidence on the part of the markets. The boards would initially—one of their first tasks would be to identify and dedicate a stream of revenue that would be dedicated to servicing the debt, and that went an awful long way toward restoring market confidence so that they were able to proceed with funding issues fairly quickly.

Ms. NORTON. Mr. Hill, can you identify any revenue streams that would be analogous to that used by other cities, any revenue streams here that would be analogous to those used by other cities that went back into the market?

Mr. HILL. I'm not sure that I understand the question. I know that there is one revenue stream that the District has attempted to use, which would be the public safety fee, which is obviously a tax——

Ms. NORTON. I'm sorry. No. Mr. Finch has just testified that essentially—I guess for collateral purposes, revenue streams were identified by the jurisdiction that could be dedicated and collateralized in order to allow the jurisdiction to get back into the market, and all I'm looking for are analogies, not direct testimony as to what should be done but analogies to similar collateral or revenue streams that already exist in the District of Columbia.

Mr. HILL. Certainly the property tax is one that is currently—is currently used to collateralize some of the debt that the District currently has outstanding, such as the $250 million in TRANS, so that that would be a stream of revenue.

The key would have to be that it was a stream of revenue that has a history of collection, and then that would determine how the markets would look at that—that revenue—how the markets would value that revenue in terms of the rating that would be given to the debt.

Mr. DAVIS. Thank you.

The time of the gentlewoman has expired.

The gentleman from Ohio, Mr. LaTourette.

Mr. LATOURETTE. Thank you, Mr. Chairman.

Mr. Finch, I noticed during your testimony that you went over the composition of the boards in those cities that had boards, but that there appeared to be a mixture in those boards of individuals from the public sector together with individuals of the private sec-

tor. My question is—and it is based upon my understanding of the congressional inquiry that took place after the default occurred in the city of Cleveland. There was some discussion that obviously shoddy financial handling of the city matters participated to the situation. However, there was also consideration that people in public life are sometimes put under such intense pressure that there is an avoidance actually of the tough things that need to get done to make sure that the—well, let me put it this way. There is so much emphasis on covering your backside and not doing something unpopular so you can be reelected that it somehow impedes the process for the very reason that you need a board to begin with.

My question and a rather, I have gone around the block to get back to you type of way is that—did you notice during the course of your study that boards that had a more private flavor than public flavor, remembering Ms. Montgomery's prohibition as to who gets to appoint people—that one worked better than another?

Mr. FINCH. I don't think anything like that came to our attention particularly, Mr. LaTourette. I think more what we saw was that the board—the board's objective was to help the city or the school district or whatever restore their financial health, and their interest in that regard was in creating the revenue that was needed to do that. So the interest of the board was consistent with the interest of the purchasers of the debt. Both had the same interest of seeing to it that the debt was serviced.

Mr. LATOURETTE. Would it be a fair observation that, based upon your studying the boards, that all of the boards, regardless of where they came from, made the tough decisions necessary to get through the crisis in an expedient manner?

Mr. FINCH. I think, sir, that I would characterize the results of what we saw along the lines of, we think each of the boards that we saw made a positive contribution to the situation that they faced.

Mr. LATOURETTE. One thing that I recognized, that each city is different; some of the problems may be different, there were some common threads, however, in not only the situations you found in each of these five cities but also the present crisis that now exists in Washington, DC.

Are you aware, did you become aware during your study, that any of these cities had some unique difficulty or problem that wasn't shared with the others that may or may not exist in the District of Columbia area?

Mr. FINCH. I think I would probably maybe turn that one around and say there are more unique characteristics about the District of Columbia than there are in the other cities.

Mr. LATOURETTE. OK. And the reason I ask that question is that some of the experiences that may have led to the crisis in a Cleveland or New York City may exist here but they will be plus other things here in the District.

Mr. FINCH. Plus other things here.

Mr. LATOURETTE. OK.

The last one, and maybe this is for Mr. Hill, and the observation, even though Mr. Hill wasn't the primary witness today, I do want for the record to note that I have enjoyed every time Mr. Hill has appeared before this subcommittee and that I found his testimony

to be like a hot knife through butter, he always gets down to the nub of things; and I have very much appreciated that, and it goes back to the gentlelady's question about the not-for-profit property, understanding that there needs to be a consent agreement or voluntary payment and so forth and so on.

In any of your studies, and maybe it is just that I forgot from when you were here the last time, but I know the mayor when he was here was discussing perhaps we need to look at—I think he wanted to look at Federal buildings, but it also—not-for-profit property also was under discussion. Has there been any analysis to determine what a 40 percent contribution from not-for-profit tax-exempt properties would mean to the District?

Mr. HILL. We have not done that analysis ourselves. I do know that there are some numbers where people have looked at what the number of properties that are off the tax rolls, if they were on and they were charged the same rates of other properties on the tax rolls, what that amount would generate. I don't have that number in front of me, but we can certainly provide that information for you.

Mr. LATOURETTE. If you would be so kind, I would appreciate that.

[Due to the high cost of printing, the information referred to has been retained in the subcommittee files.]

Mr. LATOURETTE. And last, Mr. Finch, you were kind enough to bring up Jacobs Field and Gund Arena in Cleveland, and I would certainly agree with you that the introduction of those sports facilities, if you will, into the greater Cleveland area—I don't know whether they are a symptom or a result of the economic revitalization of downtown Cleveland—and just as an outsider, I guess my question would be, do you have any thought as to whether or not the proposed convention center and arena that are under discussion for the District would be expected to have a similar revitalizing impact upon the District's tax structure?

Mr. FINCH. I would make one comment on that, and then I will defer to John again.

The Cleveland arena was built after and those arrangements were entered after the city had entered crisis and was on its way out. I think we have kind of a different situation here, but I know John has looked at the sports arena issue here, so let me ask him if he has anything he wants to add to that.

Mr. HILL. Certainly the project plans for both the sports arena and the convention center indicate that there would be substantial economic growth as a result of those projects. However, those projects are in such an early stage of development that they don't have many of the architectural studies that would be done. The amount of development would be a function of the cost that would be determined as a result of engineering studies and so forth, and so it is really hard to say that they are going to produce the results that they intend to, but the plans right now certainly show quite a bit of economic development as a result of those projects.

Mr. LATOURETTE. Thank you, Mr. Hill.

I thank the chair.

Mr. DAVIS. Thank you very much.

Before I turn it over to Mr. Flanagan, let me just note for the record our appreciation for Mrs. Jarvis and Ms. Mason from the city council for being with us in the audience today and members from the school board Karen Shook, Jay Silverman, and Valencia Mohammed. We appreciate your presence in the room. Thank you for being with us.

Mr. Flanagan.

Mr. FLANAGAN. Thank you, Mr. Chairman.

Being from Chicago and having witnessed the crisis that we averted there, although we marched headlong toward it through the late seventies and early eighties, perhaps there are many lessons that can be learned there in the context of an oversight board. In the context of an oversight board, I believe what was the major cause of the difficulty that Chicago experienced at the end was the site, on needing immediate dollars and consequently taxing business and then putting through the odious head tax which chased business into the suburbs and then taxed them for coming from the suburbs to Chicago and chased them further away still.

I believe—and I think Chicago has learned this lesson well and hard, and Mayor Daly in Chicago works very hard to make sure their lesson stays remembered—is that private interest, whether it be community interest in the neighborhood or whether it be industry business or some other financial concern in Chicago, is the key to economic revitalization of any great city. There is no other way around it.

However many layers of bureaucracy, however many boards we can set up, however we can structure a tax or a bond, whatever else can happen, if you don't have people working and living in the community and taking an interest in the community, there is no hope for it. Consequently, in that context I ask this question. In coming to Washington, I remark constantly at the number of people who live here and the absence of industry and business in the District of Columbia and in the area generally. Is there a reason for this apart from the enormity of regulation in the Federal Government and the heavy tax burden that continues to exist?

Mr. FINCH. I think there may be—this gets back to Mr. Gutknecht's question before about what are the causes of the problem, and I think there may be a number of causes of the problem. I am not sure exactly what they are or what priority I would put those causes in, but I think we have touched on a number of those causes today as to why the District has lost both jobs and individuals.

Mr. FLANAGAN. And also in that light, community interests are absolutely paramount in the revitalization in Chicago, the city of neighborhoods.

Mr. FINCH. Absolutely.

Mr. FLANAGAN. And certainly here in Washington where the interests are diverse and eclectic.

Mr. FINCH. Right.

Mr. FLANAGAN. Because of the enormity of the transient population of the District of Columbia and indigenous population that has grown here, where their parents grew up here and their grandparents are from here, having that being somewhat diminished as opposed to other great cities that you looked at, is that an impact

particularly in the context of cost sharing ventures that you discussed in Chicago where the city will come in and spend a few hundred million to rejuvenate literally billions in a neighborhood by cooperation with industry and local councils and people who have lived there all their lives and grandparents live there? Is that something that has diminished efficacy here, or is that something——

Mr. FINCH. Well, I think it is a special—I think it is a special issue for the District of Columbia, particularly as compared to Chicago or Cleveland for that matter, and Cleveland—Cleveland has been able to do something in the economic area and has been able to stabilize their declining population, but a lot of it is because of the factors, the same kinds of factors that you just mentioned in terms of Chicago. I think the structural problem is particularly difficult for the District of Columbia.

Mr. FLANAGAN. I agree, and the difficulty that I continue to have with the discussion we make here is that we are all extremely well intentioned and we want to do the best we can here, but I do not believe that we have arrived at what the problem is yet, apart from a short-term need for a huge pile of cash, and I think we have to have a longer sight look at curing the problems of this great city and the regional area, and I firmly believe that the only way we are going to do that is with deep cooperation of private interest, whether it be community, industrial, or whatever else it may be.

I find the number of high quality people here who are jobless merely because they cannot—an employer will not come here or has left here still is appalling, and I think that is something that the Congress must address directly.

Mr. FINCH. OK, and I would agree with you completely that there is both a short-term and a long-term problem and the short-term problem is the cash needs and the cash-flow and trying to get the financial health restored which will—which will help provide a foundation for really getting at some of those structural issues, but the structural problems are going to take a lot longer to fix, I think, than is the financial health issue.

Mr. FLANAGAN. I agree, but I continue to be concerned as to whether a near-term solution will exacerbate the long-term problem, and we must construct an immediate solution to this problem right now that is not going to make curing a long-term ill impossible, and so my last question and probably the one most directly affecting to you, a board that could be set up—we have yet to hear a recommended structure for it, for the District of Columbia—if you could just take a swag at it and what you think it ought to look at?

Mr. FINCH. I am going to back away from that one, sir. In fact, I'm going to back away from that one very quickly. The work that we did was really to go out and look at the other existing boards in terms of the composition of this board and all of that. We can share the information that we got.

But I am not sure that GAO is in a position now to recommend a structure for the board or membership or any of those kinds of issues. I think we are in a position to say that, given what we have seen in the other cities, that boards did make a positive contribution to those cities both in terms of helping them with their finan-

cial health, the short-term problems, plus giving them a breather so that they could start addressing those structural issues.

Mr. FLANAGAN. I want to thank you for coming here today. It has been very enlightening.

I thank you, Mr. Chairman and Ms. Norton, for calling this, and I yield back.

Mr. DAVIS. Thank you.

Let me say, that was great, how you sidestepped that question. I thought that was excellent.

Mr. FINCH. I learned to dance at an early age.

Mr. DAVIS. I had asked the same thing privately, and he didn't want to touch it.

You lay out the facts and leave the decisions to us, as we try to work out a consensus bill.

If I could just follow up on one of Mr. Flanagan's comments in terms of looking over the long term instead of the short-term cash infusion to solve the problems. In each of these jurisdictions, obviously, there were some short-term cash needs that had to be met. Was this money put in escrow, and was it put out as a loan, or was it a direct grant or appropriation? Or did it differ from jurisdiction to jurisdiction?

Mr. FINCH. I think it differed from jurisdiction to jurisdiction.

Fran, can you speak to some of the specifics?

Ms. CLARK. Sure.

In New York, Philadelphia, and Chicago, there was separate bond issuing authority that came along with the establishment of the board, and those bonds that were issued for the city, as Johnny mentioned before, did come with dedicated revenue streams, and there were escrow accounts set up as part of that bonding process.

In New York, there was also a direct loan from the State government for a period of time. In New York, there was some Federal support as well.

In Cleveland, there was no separate bonding issuing organization that was established. Rather, they borrowed from city banks and from the State. The State actually bought some of the city's bonds until they were ready to get it back into the national credit market.

So you saw a range of solutions, and in many cases they were combinations of both new bond issuances, loans, the ability to raise new taxes, and the cities mixed and matched to meet their particular needs.

Mr. DAVIS. OK. But no direct infusion of money without substantial strings and hope of some payback?

Ms. CLARK. The closest to that was a loan that New York State gave the city of New York for about $800 million.

Mr. DAVIS. And did the city have to pay it back?

Ms. CLARK. They were supposed to. I don't know if they have yet or not.

Mr. DAVIS. At least in terms of the structure, that gives us a clue in terms of what the precedent was.

Ms. CLARK. This was not a grant.

Mr. DAVIS. I would like to follow up on one of Mr. LaTourette's comments, when he talked about the issue being local decisionmakers, local elected officials, having the courage to make

tough decisions over the short term that were unpopular and may jeopardize their reelection for the benefit of the long term.

It reminds me, in Virginia, of course, Patrick Henry, one of our native sons, who fought against the principle of no taxation without representation. We like to note that because they had never tried taxation with representation, and if they had tried that, it might have been a different result.

But to the extent that cities were unable to make those decisions, these control boards basically, as I understand it, came in and forced the local decisionmakers to make decisions, giving them political cover to make the decisions that they didn't before have and the courage to make them standing alone. Is that a fair analysis?

Mr. FINCH. I think that is a fair characterization, Mr. Chairman, yes.

Mr. DAVIS. Was there some resistance to making those decisions with these control boards? What kind of clout does a control board need to be able to force the local decisionmakers to make tough, tough but solid, long-term decisions?

Mr. FINCH. Again, I think the conditions varied all over the board, and if I could draw an analogy it would be that the more severe the crisis, the more authority given the board in terms of what they did and what powers they had and that.

For example, when I think all of the boards—all of the boards required annual budgets and multi-year plans. Now in terms of actions that the boards could take on those things, it would vary from either approving and rejecting—approving or rejecting the plan, or some boards were even given the power to modify the plan. You know, if an acceptable plan was not submitted, the board could modify the plan.

Mr. DAVIS. The board could, in essence, implement its own plan?

Mr. FINCH. Well, the plan had to be—you could probably say that, yes, sir, given the implications of that in terms of the modification.

Mr. DAVIS. Was that ever used, or was it that they had the authority to do so?

Mr. FINCH. It was basically that they had the authority to do that.

Mr. DAVIS. And that incited the local officials to come to grips with the issues?

Mr. FINCH. Right.

Mr. DAVIS. I think one of the issues we get concerned about is, trying to have some kind of standoff between the control boards saying do this, and the local officials, whoever they are, saying, well, we're not going to do this, and all of a sudden nothing gets done, and you have to be able to cut the heightening of the deficit further and make some decisions. You want people to get paid, you want the city to go on and operate, and I'm sure there is a balance there somewhere, and that's what I'm trying to get at.

Mr. FINCH. And it is the balance that is a very sticky issue, and that is the decision that the Congress has to come to grips with, and it is a difficult issue, it is not one that is easily reached.

Mr. DAVIS. Have the local control boards had the ability to hire and fire people, or have they vested that with the local authorities?

Mr. FINCH. I think there were—there was an example of one where New York, I think, had the authority to—to ask people to step down, if you will.

Mr. DAVIS. OK. So I guess there was one where, if the local officials didn't do it, they could actually be removed by the State?

Mr. FINCH. Yes, there was at least one.

Mr. DAVIS. And you could talk in the aggregate about number of employees, but you could never talk about specific employees. The decision over specific employees and agencies would rest generally with the—still with the elected body. Is that right?

Mr. FINCH. Still with the elected bodies.

What the boards would do, like in the instance of a renegotiated labor contract or—let's use that as an example, the way the boards would get involved with that. It would be up to the cities to renegotiate the labor contract, but the board would look at and see whether or not the labor contracts made sense in terms of the budget and the multi-year plans. They might get at the labor contracts or the renegotiated contracts that way.

Mr. DAVIS. OK. Thank you.

My time has expired and I'll go to Mrs. Norton.

Ms. NORTON. Thank you, Mr. Chairman.

In the cities that you studied, I gather that the elected officials continue to do what they always were doing and that that was not modified and their self-government powers remained intact.

Let me ask you a question that comes out of your own earlier reports, the work of Mr. Hill. It is no secret, because the Members have said it in many different ways, that we have had enormous difficulty convincing the Congress that the District has revenue needs, this despite the fact that 1 in 4 people is on Medicaid, this despite the fact that we alone pay for prisons, unlike other cities, and there are a number of reasons for this.

One, the Congress is not convinced that the District has a revenue problem, and the city is on a combined budget, if you take appropriated and nonappropriated funds, of almost $5 billion for a city that is—where there is no city that has anything like that, and some States don't have anything like that. This has been the tough matter to get through, and I am now looking for whether or not the board itself can be useful in straightening out that controversy that exists between the District and this body.

Now Mr. Hill has testified that it is impossible to know anything real about the District in data terms because of the absence of a financial accounting and management system that is reliable and up to date. In essence, it is garbage in when it goes in and garbage out as far as the GAO and the Congress is concerned. Nobody believes any figure that comes up here unless it is verified by the GAO, and the GAO tells us the shortcomings it has had in verifying figures.

If that is the case, it would seem that we are not going to get anywhere unless this board helps the District to establish some kind of reliable financial management—accounting and management system. But I have heard figures floated all around about the cost of such a system. I recall a figure about $40 million and the rest. I would like to know, one, what you think such a system

would cost and, two, how long you think it would take to set up a system that you believe would be reliable?

Mr. FINCH. Let me make just an opening comment and then turn it to John.

There were some, like in New York—I think it was New York; they were forced to set up—you know, to really create basically a new accounting system, but that was back in the seventies, and that was pretty costly for them to do it. There have been a lot of technological innovations since then in terms of some packaged program systems and that sort of thing. I am not sure what the costs might be, but John may well.

Mr. HILL. We have not looked at the cost of such a system and how long it would take to implement that system in the District. However, I would say that that would be, I think, one of the No. 1 priorities that the city should look at and that the board should consider, is, does it have the information that it needs in order to evaluate some of the plans that might come out of the District, and does the District have the information they need to construct those plans and make them usable and also reliable? Right now we know that the answer to that is no, that they do not have that information.

One thing that we are considering doing is helping to identify a list of items that a new control board might want to look at, just a suggestion of what they might want to look at in terms of information needs as a result of looking at the information that other control boards had when they came in or, later on, after they were in place for a while, to have some clues as to what information would be useful in their work.

Ms. NORTON. Did these other cities have this same problem? You just didn't have enough information to know anything reliable?

Mr. FINCH. Yes, to differing degrees of severity, this was one of the first actions that was taken in each of these cities was to try to get better numbers. You really need that in order to make funding decisions, and you really need that to restore the market's confidence.

Ms. NORTON. Let me ask—you have spoken about structural reforms, and I am interested in the extent to which problems this deep can be remedied by downsizing and service cuts alone. Let me indicate my concern. Governments of any kind don't usually deal in productivity and efficiency terms. I mean businesses do because they have a bottom line that helps discipline them. As a result, some money is obviously spent redundantly necessarily because governments are usually not run like businesses.

District of Columbia has an abundant number of court orders. The existence of a court order indicates an underlying operational problem, and our court orders in places from foster care to prisons specifically speak to that problem, not to mention public housing.

Have these other cities had underlying operational problems as well? If they have, have these control boards been useful in getting at those problems?

And I ask that in the context of the following example. If you say to the Department of Human Services, or whatever it is called that deals with foster children, "Just downsize," you will exacerbate a problem and the receiver will say you can't do that. So how, if at

all, have these boards got at underlying operational problems that may be part and parcel of the fiscal problem the city is having?

Mr. FINCH. One way they did was by—through their review of the budgets and the annual operating plans and the multi-year financial plans and asking tough questions and really putting pressure on the cities to try to come up with some of those operational efficiencies.

Most of the cities, when faced with the establishment of a board, recognizing the crisis that they were under, really did some outreach and did some soul searching and some evaluation to look for operational efficiencies and did some innovative things, and I think that would be true—hopefully that would be true in the District as well.

Ms. NORTON. Mr. Hill.

Mr. HILL. I think with the specific issue about the court orders and what would need to be done in those situations, in looking at some of the court orders certainly they are trying to bring about a specific result, and although many of them have mandated levels of employment, have also mandated specific levels of service, they were all geared toward bringing about a specific objective.

I think that what needs to be done is to look at those court orders in conjunction with the courts to see if there may be a more efficient way from an operational standpoint to bring about the ultimate result of the court order and to—in that way I think that the control board could be used as a mechanism to help the District to develop plans that would address their court orders perhaps in a more efficient way.

Ms. NORTON. I see my time is up, Mr. Chairman.

Mr. DAVIS. Thank you.

The gentleman from Ohio, Mr. LaTourette.

Mr. LATOURETTE. Thank you, Mr. Chairman.

Mr. Finch, I have one question that I forgot to ask the last time. In your testimony, I don't recall which cities specifically you mentioned, but as I understood your testimony, there has been previous testimony here that the District is unique in that it has responsibility that no other city in the United States has and so forth and so on. If I understand your testimony correctly, there were other cities in your study that had municipal functions or nontraditional municipal functions such as Medicaid, corrections, mental health, and so forth and so on, and as I recalled your recitation, there was an indication that there was some realignment of those responsibilities in some of those cities where the State or the county came in and assumed some of those functions.

The question that I have is, did the board, in dealing with those programs—was there a give and take, a tradeoff, or was it pretty much a one-way street where all the benefit flowed to the city because some other entity offloaded their responsibilities under those programs?

Mr. FINCH. I think there was a give and take, sir.

Mr. LATOURETTE. OK. Do you remember what the city may have given?

Mr. FINCH. I think in New York the State took over the Superior Court. In New York also the State took over the hospitals and the City University. So it—you know, they were really trying to help

the city out, and it was a transfer of functions that the State could better provide those services than could the city.

Mr. LATOURETTE. OK. I guess in that situation all the benefit then flowed to the city.

Mr. FINCH. All that—yes, in that sense, right.

Mr. LATOURETTE. OK. When I was talking about the city giving anything, there was nothing that the city gave up except for control, I suppose, of the hospital—to get the State to agree to run their Superior Court system or to agree to run their hospital system.

Mr. FINCH. No.

Mr. LATOURETTE. The city came in to bail out the city—or the State came in to bail out the city.

Mr. FINCH. The State came in to bail out the city, right.

Mr. LATOURETTE. OK. And just one followup question to Mr. Hill, if I might.

Since our last hearing and the discussion in my last questions and Miss Collins's questions about tax-exempt properties, we have been provided with a document that lists the tax-exempt properties in the distribution. As you might expect, the biggest belong to the Federal Government followed by the District of Columbia. There is a line item for miscellaneous, and it is 425 parcels or properties with a total assessment of over $2 billion. Do you know from your review of the District's books or operations what type of properties would be listed in the miscellaneous section for tax-exempt?

Mr. HILL. No, I don't, but, again, we can look at that if you would like us to.

Mr. LATOURETTE. If you could. We have the District religious institutions, educational, charitable, hospitals, libraries, foreign governments, cemeteries, the United States, and there is—that is a pretty exhaustive list. I am just wondering what is left to be miscellaneous.

Mr. DAVIS. Mr. LaTourette, let me just add, we have a complete printout of everything, but it is not categorized the way you would like it. I think our committee staff, working with the GAO and the city, can come up with that information.

Mr. LATOURETTE. I would appreciate that. Thank you very much.

[Due to the high cost of printing, the information referred to has been retained in the subcommittee files.]

Mr. DAVIS. Thank you very much.

I have just a few more questions for the record. The first is on the residency requirements imposed on these financial control boards. I take it it was different in the different jurisdictions we visited.

Mr. FINCH. That is correct, sir. Let me flip a page here and find it so I don't—in New York the requirement was that at least two private members should be city residents or have principal place of business in the city. The Chicago school board, there wasn't a specific provision in that regard. In Cleveland, residents of assisted city or have primary business in the city. So there was a requirement there.

Mr. DAVIS. Residents or business.

Mr. FINCH. Residents or business or have the primary business, right, and in Pennsylvania residents—residents of the assisted city or have their primary business in such city.

Mr. DAVIS. So that is almost universal?

Mr. FINCH. It was, yes.

Mr. DAVIS. I just wanted to understand that.

Were the members paid in any instance, or were all of the control board members unpaid positions?

Mr. FINCH. I believe all the members were unpaid, the staff was paid.

Ms. CLARK. That is correct.

Mr. DAVIS. And could you just tell us how the staff was constituted in these different cases? Were they contracted out for the most part? Were they in-house staff? How many people were involved?

Mr. FINCH. I think each board with the exception of Cleveland, had a small dedicated staff, but like in New York there was a special State deputy comptroller named to assist the board, and the board also has the authority to hire consultants to supplement its staff.

In the instance of the Chicago school authority, staff was optional, and really in practice in that one the school finance authority relied very heavily on outside consultants to supplement a very small core staff.

Mr. DAVIS. I am just trying to get a range for the record so everyone understands what the experience has been in these other jurisdictions.

Mr. FINCH. OK.

Mr. DAVIS. The criteria for lifting the control board or to moving it into an oversight committee, is fairly standard in the sense that you are looking at the bonds being repaid, having a couple of years or 3 years of balanced budgets and those kinds of issues.

Mr. FINCH. They were all triggers—well, you are right, they were all triggers tied to improvements in the city's condition.

Mr. DAVIS. OK, and in every case the city met those and moved into an oversight mode?

Mr. FINCH. Right—well, the boards are still in existence, all but one.

Mr. DAVIS. They moved to oversight roles.

Mr. FINCH. Yes. As the city improved, the boards backed off in terms of—in terms of hands-on control, if you will.

Mr. DAVIS. Exactly, yes.

Ms. CLARK. New York was the only one that had in legislation a distinction between a control period and an oversight period.

Mr. DAVIS. OK.

Ms. CLARK. And in New York's case the triggers were set to move it from a control period where it had greater powers to an oversight period where it had less powers, and those triggers were returned access to the market, balanced budgets, those kinds of things. To eliminate the board completely in New York, they have to retire all the debt that they incurred as part of getting themselves out of the crisis.

Mr. DAVIS. OK. Thanks. When we talk about structural deficits in these different governments, it seems to me, they include a cou-

ple of things. One is the powers that the local jurisdictions have: Hospitals, Medicaid, prison system, and court system in some of these cases. It could be a structural deficit, but also could it be the taxes are just out of sync with the economic region, taxes are too high, the high crime rate, schools that make it noncompetitive, and you get into a cycle where you are getting a fleeing of the revenue from the area? When you talk about a structural deficit, would you include both of those?

Mr. FINCH. I would, both, the two parts, the functions that are done and the declining revenue base resulting from the urban flight.

Mr. DAVIS. That's fine. I think that squares with my understanding of it, but I just wanted to understand your perspective, and I think I will at this point call on Ms. Norton for any additional questions that she might have.

Ms. NORTON. Thank you, Mr. Chairman.

I am very interested in what you said happened to New York City with a very rapid reduction, a huge reduction in employees, that simply moved back again.

The District had a 50 percent, or almost 50 percent, increase in the number of employees between 1962 and 1972 before home rule, an increase obviously approved by, if not ordained by, the Congress of the United States. It has about the same number of employees it had at the time of home rule. In 1972 it had about 40,000 employees, and we are still piddling between 40, 42, and the rest of it.

So essentially the District's sin is in not reducing its employees in keeping with the reduction in its population, and of course that is something that cities perhaps don't do as well. They get a greater concentration of poor people. But the fact is that the base of taxpayers is reduced and the number of employees have stayed about the same.

Now in the case of New York City, the notion of in 3 years letting off 60,000 employees is extraordinary 20 percent of the employees is quite extraordinary. But your testimony, Mr. Finch, says that as the conditions—as the economy of the city improved, they simply grew back those employees, so there was no permanent downsizing, and Mr. Giuliani is back to doing what his predecessor of the 1970's was doing. He is doing it, to hear New Yorkers I know speak about it, quite intelligently. Unlike the District of Columbia, he understood to go at buy-outs right away. Even tough unions in New York compliment him for having early sense that the way to do downsizing is to do buy-outs, and he is a Republican mayor who hasn't had a lot of problems with his union.

But I'm interested in the fact that it grew back and wonder whether permanent downsizing results from this process generally, whether New York is an exception, and whether it was prudent for New York to have its work force grow back, whether the control board or the MAC board approved that. I would just like your comments on whether we are doing something that could just come back to haunt us again.

Ms. CLARK. Yes, I'll take a stab at it.

I think in the other cities we visited we saw decreases in employment as well, maybe not quite as dramatic as the ones you saw in

New York, and they have stayed at the lower amounts. For example, in Cleveland they have reduced about 1,500 people from the height of the crisis, and it has stayed about stable at 8,000 employees for a number of years.

I think in New York's case it may be unique. The inflation of the late seventies followed by prosperous economic times for the city in the eighties I think allowed the city to mask its operational problems and some of its underlying structural problems.

Ms. NORTON. But a control board was in place, you say, and the MAC board has continued to be in place.

Ms. CLARK. That is correct, but I think the boards themselves are primarily focused on the financial aspect of the city and making sure that the budgets balance. It then becomes the city's responsibility to decide how it is going to balance those budgets.

Ms. NORTON. I want to stop you, Ms. Clark, because this is very important. What happened in the 1980's was exactly the same thing here in the District of Columbia. The tax base was fleeing, and all of these underlying structural problems were there, but downtown was being rebuilt, and the economy was better. So the District really did have a balanced budget. So if all you look at is whether or not you can pay for the government you have at the moment, then this could come back to the District of Columbia, even if we do something about it, the way it has come back to New York.

Mr. DAVIS. Can I just interject?

Ms. NORTON. Do you want me to yield?

Mr. DAVIS. If you would yield for just a moment.

But most of these control boards put 5-year plans in, did they not, have longer-term plans at the same time?

Ms. CLARK. That is correct. At the time New York had a 3-year plan it was extended to a 4-year plan.

Ms. NORTON. But they have been there forever. Still the fact is that they have had these plans. Did the plans extend into the eighties, or were they just monitoring in the eighties?

Ms. CLARK. They added a year, dropped a year, every year.

Ms. NORTON. They did what, I'm sorry?

Ms. CLARK. With the 5-year plans, every year they would add another year and then drop the one they were just in, so they were kind of continuing 5-year plans.

But I think the role of—it is in how you design the control board, and if the primary focus or the sole focus is to balance the budget, you may get different results than if there are other objectives as well in terms of reforming the way the government operates and manages itself, and if the primary focus is just on balancing the budget then it is up to the discipline and the—and the city government to decide that they are going to improve the organization of the city in order to get to a balanced budget, and the board itself only has indirect control over that.

Ms. NORTON. I just want to say for the record, I don't know about the rest of you all but I'm not going through this more than once. The notion that at sometime—that the Democrats would come back to power and we would have boom times again in the country which would encourage the growth of the government again is very, very scary to me. I just think that is something we have to look

at. We have to look beyond this simple criteria of whether or not you have been able to scrape enough money together this year to balance your budget.

Ms. CLARK. And I think you will see in the other cities that they are taking more stringent actions to have those changes in the budget carry through to changes in the city operations.

Ms. NORTON. My time has expired.

Mr. DAVIS. Right, I was just reminding you, I think the President is a Democrat right now, so we are back in these boom times.

We are going to keep this—this is not a partisan issue, we are just—kidding aside, any other questions? If there are no other questions.

Ms. NORTON. Wait a minute. I do have some other questions if I could.

Mr. DAVIS. Please go ahead. Why don't you conclude.

Ms. NORTON. Thank you, Mr. Chairman.

Did any of these other cities pay as much as 10 percent of their operating budgets out of their pockets every year for pensions for employees?

Mr. FINCH. Do you know?

Ms. CLARK. I don't have that information here. We can provide it.

Mr. FINCH. We can try to get that for you, Ms. Norton, if you want it.

Ms. NORTON. I would appreciate knowing how they dealt with pensions, because the reason I ask also is because of the interesting paragraph on page 8 of your testimony in which you say that the city reduced its pension costs two ways, better investment—we are already getting better investment and work force reduction. Obviously there is going to be some work force reduction, and then you say as a result of these efforts, according to city estimates, Boston's pension costs decreased from $130.5 million in 1988 to $112 million in 1993. This is such a major part of our own crisis and one that is, for once, not the city's fault because the debt was created before home rule, that that would be information that would be very useful.

[The information referred to follows:]

BOSTON

Boston is a member of the state retirement system. The city's system is called the State-Boston Retirement System (S–BRS). The S–BRS serves all city employees. including the School Department, the Department of Health and Hospitals, the Boston Water & Sewer Commission, the Boston Redevelopment Authority, and the Boston Housing Authority. City employees do not participate in the federal Social Security System.

According to the city's Consolidated Annual Financial Report, dated June 30, 1994, the S–BRS system membership is 35,633 employees. This membership is made up of 21,701 active participants, 13,679 pensioners and 253 members that are vested in the system but are not active.

System Administration

The State-Boston Retirement System is administered by a Retirement Board of three members: (1) the City Auditor, who serves ex-officio, (2) a person elected by members of the system, and (3) and a person chosen by the other 2 Board members, or appointed by the Mayor if the 2 Board members do not agree on a selection within 30 days of a vacancy.

System Contributions

The S–BRS is a member of the Massachusetts Contributory Retirement System. Accordingly, all retirement benefits are paid from a fund supported by contributions from employees, the city of Boston and the state.

Active members contribute either 5, 7, or 8% of their gross regular compensation depending on the date their membership began. In addition, members who joined the System after Jan. 1, 1979 are required to contribute an additional 2% of regular compensation over $30,000.

The city, or its related agencies or authorities, is required to contribute the remaining amounts necessary to pay the benefits when due. Accordingly, each year members of the system are required to fund an amount equal to the actuarially determined normal cost[1] plus an amount to fund the unfunded liability by June 30, 2020. As of its fiscal year ending June 30, 1994, the city's contribution to the S–BRS system was $100 million, which included $33 million for teachers. The city's contribution represented about 95% of all employer contributions to the S–BRS system. Of the city's contributions, $24 million was used to cover normal costs and $76 million was used to amortize the unfunded actuarial liability.

Under Massachusetts law, the state is required to reimburse Boston for the costs of teachers' pension benefits who constitute approximately one-quarter of all city employees. The state currently reimburses the S–BRS system for the portion of the pension benefit payments owing to cost-of-living increases granted after the implementation of Proposition 2 1/2. Proposition 2 1/2, a state law passed in 1980, capped the amount of revenue a municipality could raise through property taxes.

System Funding

Boston's pension fund is underfunded by about 41 percent, a shown in Table 1.

Table 1: Status of Boston's Pension Funds as of June 30, 1994

[Dollars in thousands]

Employee Pension Fund	Net Assets Available for Benefits, at market	Total Pension Benefits, Obligations	Overfunded (Underfunded) Pension Obligations	Overfunded (Underfunded) Pension Obligations (as a % of Total)
State-Boston Retirement System	$1,450,059	$2,474,352	($1,024,293)	(41.4)

Source: City of Boston Massachusetts Comprehensive Annual Financial Report For the Year Ended June 30, 1994. Percentages computed by GAO.

Adjustments to Boston's Unfunded Pension Fund Obligations

The underfunded pension obligation of $1,024,293 was calculated before adjustments. To arrive at the unfunded accumulated benefit obligations, as reported in Boston's financial statement, certain adjustments are made. Boston's unfunded pension fund obligations are reduced for projected salary increases. In addition, two types of state reimbursements are also deducted. Specifically, Massachusetts reimburses Boston for the (1) cost of pension benefits for city teachers and (2) the portion of the benefit payments owing to cost-of-living increases. These adjustments are shown on Table 2.

Table 2: Unfunded Accumulated Pension Obligations Due to State Reimbursements and Reduction for Projected Salary Increases

State Reimbursements & Adjustments to Unfunded Pension Benefit Obligations as of June 30, 1994	Totals
Unfunded Pension Benefit Obligation	$1,024,293
Less: Adjustment to Reduce the unfunded pension benefit obligation for projected salary increases	(164,826)
Less State Reimbursements:	
(1) Cost-of-Living Adjustments	(270,897)
(2) Estimated Reimbursement for Teacher Pension Benefits, Net of Related Assets	(306,079)
Unfunded accumulated benefit Obligations	282,491

Source: City of Boston Massachusetts Comprehensive Annual Financial Report For Fiscal Year Ended June 30, 1994.

Pension Reform

In 1988, to comply with the state's Pension Reform Act, Boston began funding the S–BRS system based on a schedule approved by the S–BRS and actuary. Based on this schedule, the city pays (1) the current year's estimated present value of pension

[1] Normal cost is the current year's estimated present value of benefits earned during the year.

benefits earned during the year and (2) an annual contribution toward reducing the unfunded accumulated pension obligations to zero by the year 2020. The City further reduced its pension costs through a better return from its pension assets and by a workforce reduction of about 2,000 employees. As a result of these efforts to reduce its pension liability, Boston's pension costs decreased from $130.5 million in fiscal year 1988 to $112 million in fiscal year 1993, according to City estimates.

CLEVELAND

According to Cleveland's Comprehensive Annual Financial Report (CAFR), dated December 31, 1993, Cleveland employees are covered by two state administered pension programs: (1) the Public Employees Retirement System (PERS) and (2) the Police and Firemen's Disability and Pension Fund (P&FDPF).

According to the CAFR, the pension benefit obligation is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date.

The Ohio Revised Code requires employees under PERS to contribute 8.5 percent of their salary to the plan. The city's contributions are determined by the state actuary to meet normal costs and fund the city's share of the system's unfunded accrued liability over 37 years. The city's contribution is currently set at 13.55 percent of covered payrolls, of which 8.44 percent is used to fund the pension obligations with the balance being applied towards the health care program for retirees.

Employees under P&FDPF contribute 10 percent of their salary to the plan. The city's current contribution to this fund is set at 19.5 percent of policemen salaries and 24 percent of firemen's salaries, with 6.5 percent of this contribution being applied toward the health care program for retirees.

Table 1 summarizes the status of the state of Ohio's pension liabilities under PERS and P&FDPF as of December 31, 1993.

Table 1: Status of Ohio's Pension Funds as of December 31, 1993

[dollars in thousands]

Employee Pension Fund	Net Assets Available for Benefits, at Cost (in 1993 dollars)	Total Pension Benefit Obligations (in 1993 dollars)	Overfunded (Underfunded) Pension Obligations (in 1993 dollars)	Overfunded (Underfunded) Pension Obligations (as a % of Total)
PERS	$20,783,200	$21,579,000	($745,800)	(3.5%)
P&FDPF	4,027,500	5,132,800	(1,105,300)	(21.5%)
Total	24,810,700	26,711,800	(1,901,100)	(7.1%)

Sources: City of Cleveland's Comprehensive Annual Financial Report for the year ended December 31, 1993; Percentages computed by GAO.
Note: The total pension benefit obligation for PERS is as of December 31, 1992 and for P&FDPF as of January 1, 1993.

In addition to the above contributions, Cleveland is obligated to pay the state for its share of the $1.1 billion underfunded pension obligations for the P&FDPF. The city's allocated share of this obligation is $104,686,400, which is payable in semi-annual installments of $2,696,243.50 through May 15, 2035. However, instead of making these semi-annual payments the city and the P&FDPF have entered into an agreement which permits the city to make a one time payment to eliminate this liability. This was accomplished on June 2, 1994, through the application of the proceeds from a $74.5 bond million issuance.

CHICAGO

According to Chicago's Comprehensive Annual Financial Report (CAFR), for the year ended December 31, 1993, city employees participate in one of four pension plans. These plans are: The Municipal Employees'; the Laborers' and Retirement Board Employees'; the Policemen's; and the Fireman's Annuity and Benefit Funds.

The funding policy mandated by Illinois law requires city contributions at statutorily, not actuarially determined rates. The rates are expressed as multiples of employee contributions made in the calendar year two years prior, multiplied by a fixed rate. This fixed rate ranges from 1.37 percent to 2.26 percent of employees' contributions. The law also requires covered employees to contribute a percentage of their salary, ranging from 8.5 percent to 9.125 percent.

According to the CAFR, unfunded pension liability are based on two accounts: Net Assets Available for Benefits and Total Pension Benefit Obligations. Total Pension Benefits Obligations are a standardized measure of the present value of credited projected benefits, estimated to be payable in the future as a result of employee

service to date. The following table shows the status of each of the city pension funds as of December 31, 1993.

Table 1: Status of Chicago's Pension Funds as of December 31, 1993

[dollars in thousands]

Employee Pension Fund	Net Assets Available for Benefits, at Cost (in 1993 dollars)	Total Pension Benefit Obligations (in 1993 dollars)	Overfunded (Underfunded) Pension Obligations (in 1993 dollars)	Overfunded (Underfunded) Pension Obligations (as a % of Total)
Municipal Employees	$2,800,810	$3,546,162	($745,352)	(21)
Laborers	871,897	757,005	114,892	15.2
Policemen	1,856,426	3.464,300	(1,607,874)	(46.4)
Firemen	623,192	1,266,795	(623,192)	(49.2)
Total	6,152,325	9,034,262	(2,881,937	(31.9)

Sources: City of Chicago's Comprehensive Annual Financial Report for the year ended December 31, 1993; Percentages computed by GAO.

The Civic Federation, a civic group that represents Chicago businesses, has identified the city's unfunded pension liability as an area of Federation concern. During testimony before Chicago's City Council in November 1994, the Federation President said that the Federation was particularly concerned with the Policemens' and Firemens' Funds. According to the testimony, these funds had remained below 60 percent funding over the last 10 years (1983–1993).

To address this concern, the Federation President recommended that the Illinois Economic and Fiscal Commission develop strategies for addressing the unfunded liability. Specifically, he recommended that the Commission determine adequate levels of contributions for local governments, the types of benefits which can be awarded retirees by local governments, and solutions to decrease outstanding unfunded liabilities. At the time of our city visit in January 1995, no action had been taken by the Commission.

NEW YORK CITY

The majority of employees for New York City are members of one of five major pension systems that are maintained by the city. The five Pension systems are

- New York City Employees' Retirement System (NYCERS), a cost-sharing multiple-employer public employee retirement system, for employees of the city not covered by one of the other pension systems and employees of certain component units of the city and certain other government units.
- New York City Teachers' Retirement System (TRS), a cost-sharing multiple employee retirement system for teachers in the public schools of the city and certain other specified school and college employees.
- New York City Board of Education Retirement System (BERS), a cost-sharing, multiple employer public employee retirement system, for non-pedagogical employees of the Board of Education and certain employees of the School Construction Authority.
- New York Police Department Pension Fund (POLICE), a single-employer public employee retirement system, for full-time uniformed employees of the Police Department.
- New York Fire Department Pension Fund (FIRE), a single-employer public employee retirement system, for full-time uniformed employees of the Fire Department.

New York City's pension systems provide benefits to retired employees based on salary and length of service. Subject to certain conditions, members become fully vested as to benefits upon the completion of 10 or 15 years of service. Under the New York State Constitution, New York City guarantees the payments of benefits to members of the retirement systems. For the city's five major retirement systems, table 1 shows the pension benefit obligation, the net assets available for benefits, and the overfunded (unfunded) pension benefit obligation as reported in the city's Comprehensive Annual Financial Report for fiscal year ending June 30, 1994.

Table 1: Overfunded (Unfunded) Pension Benefit Obligation for the Five Major Pension Systems of New York City Employees for Fiscal Year 1994

[dollars in millions]

Pension System	Total Pension Benefit Obligation	Net Assets Available for Benefits	Overfunded (Unfunded) Pension Benefit Obligation	Overfunded (Unfunded) Pension Benefit Obligation (as a % of total)
New York City Employees' Retirement System	$21,501	$22,789	$1,288	6
Teachers' Retirement System	18,190	17,862	(328)	(2)
New York City Board of Education	916	856	(60)	(7)
Police Department Pension Fund	9,658	8,096	(1,562)	(16)
Fire Department Pension Fund	4,464	3,280	(1,184)	(27)
Combined	54,729	52,883	(1,846)	(3%)

Source: The City of New York Comprehensive Annual Financial Report of the Comptroller for the Fiscal Year Ended June 30, 1994; percentages computed by GAO.

The city's funding policy for its pension programs is to provide for periodic employer contributions at actuarially determined rates that are designed to accumulate sufficient assets to pay benefits when due. The method used to determine pension expense and the employers contributions to the five major pension systems is the frozen entry age actuarial cost method. Under this method, the excess of the actuarial present value of projected benefits of members of the retirement system, over the sum of the actuarial value of assets plus the unfunded actuarial accrued liability, is allocated on a level basis over the future earnings of members who are on the payroll. Actuarial gains and losses are reflected in the employer normal contribution rate. The employer contributions for the pension systems amounted to about $1.5 billion for fiscal year 1994.

Analysis of the changes in the pension benefit obligation over a period of years may give an indication of whether the pension system has become financially stronger or weaker. Table 2 shows the changes in the combined unfunded pension benefit obligation for the city's five major pension systems from fiscal year 1990 to 1994.

Table 2: Combined Overfunded (Unfunded) Pension Benefit Obligation for the Five Major Pension Systems of New York City Employees for Fiscal Years 1990 through 1994

[dollars in millions]

Fiscal Year	Total Pension Benefit Obligation	Net Assets Available for Benefits	Overfunded (Unfunded) Pension Benefit Obligation	Overfunded (Unfunded) Pension Benefit Obligation (as a % of total)
1990	$46,805	$40,708	($6,097)	(13)
1991	47,452	43,289	(4,164)	(9)
1992	49,855	47,184	(2,671)	(5)
1993	52,490	52,005	(485)	(1)
1994	54,729	52,883	(1,846)	(3)

Source: The City of New York Comprehensive Annual Financial Report of the Comptroller for the Fiscal Year Ended June 30, 1994; percentages computed by GAO.

According to New York City's financial plan for fiscal years 1995 through 1998, the city's planned annual pension expenses are based on numerous factors including the investment performance of pension assets and actual and planned staffing levels of city employees. The city's financial plan beginning in 1996 provides for annual reserves of $400 million as a result of a recently published actuarial audit conducted on behalf of the city. This audit of the city's retirement systems included an evaluation of various actuarial assumptions such as demographics, inflation, mortality, and turnover. The audit concluded that additional city contributions may be required.

PHILADELPHIA

Philadelphia maintains three employer-defined benefit plans for its employees: (1) the Municipal Pension Plan (Municipal Plan), (2) the Philadelphia Gas Works Plan (PGW Plan), and (3) the Redevelopment Authority of the City of Philadelphia's Retirement Plan (RDA Plan). The State of Pennsylvania contributes about 3 to 3.5%

of covered payroll,[1] or $30 million to $35 million annually, to the Municipal Plan. The state does not contribute to the PGW or RDA Plans.

Board of Pensions and Retirement

Philadelphia's Board of Pensions and Retirement was charged under Philadelphia's Home Rule Charter with the creation and maintenance of an actuarially sound retirement system providing benefits for all city employees. The Board plays a very active role in the determination of investment policy and strategy for all three of the city's pension plans. All major decisions with regard to the pension assets portfolio are approved by the Board based on recommendations from its investment consultant, portfolio managers and investment staff.

Municipal Plan

The city is required by the Philadelphia Home Rule Charter to maintain an actuarially sound pension and retirement system. The Municipal Plan, a single employer plan, covers all uniform personnel—Police and Fire—and municipal employees that work for the city of Philadelphia.

The Plan's pension funding policy provides for periodic employer contributions at actuarially determined rates. These rates, as expressed as percentages of covered payroll, are computed to be sufficient to accumulate sufficient assets to pay benefits when due. The city contributions in 1993 amounted to 21.3% of the covered payroll. Employee contributions to the Plan that year were 3.9% of the covered payroll.

Philadelphia Gas Works (PGW) Plan

The Philadelphia Gas Works has a noncontributory public employee retirement system covering substantially all PGW employees. The Plan is funded with contributions by the Gas Works to the Gas Works Retirement Reserve Fund. These contributions include amortization of the unfunded pension benefit obligation over a 40-year period, which began in 1967. In addition, current payments to retired PGW employees and other beneficiaries are being made directly by the Gas Works.

The pension funding policy of the PGW Plan provides for periodic employer contributions at actuarially determined rates, as percentages of annual covered payroll. The rates for these contributions are computed to accumulate sufficient assets to pay benefits when due. The Philadelphia Gas Works contributed 12.4% of its covered payroll to the PGW Plan during 1993.

Redevelopment Authority (RDA) Plan

The Redevelopment Authority contributes to the RDA Plan. The RDA Plan's pension funding policy provides for actuarially determined periodic contributions at rates that increase gradually over time so that sufficient assets will be available to pay benefits when due. In 1993, the Authority contributed 6.8% of its covered payroll and the employees contributed 5.4% of the Authority's covered payroll.

Table 1 summarizes the status of the Municipal Plan, the PGW Plan and the RDA Plan as of June 30, 1993.

Table 1: Status of Philadelphia's Pension Plans As of June 30, 1993

[dollars in Thousands]

Pension Plans	Total Pension Benefit Obligation (PBO)	Net Assets Available for Benefits, At Cost	Overfunded (Underfunded) PBO	Overfunded (Underfunded) PBO as a Percentage of Total
Municipal Plan 07/01/92	$4,236,009	$1,848,182	($2,387,827)	(56)
PGW Plan 09/01/92	299,484	259,911	(39,573)	(13%)
RDA Plan 01/01/93	30,916	37,628	6,712	21
Total	4,566,409	2,145,721	(2,420,688)	(53)

Source: City of Philadelphia Comprehensive Annual Financial Report, Fiscal Year Ended June 30, 1993; percentages computed by GAO.

City planned actions to reduce unfunded pension liability

Table 1 shows that Philadelphia's pension plans are underfunded by 53 percent of the total pension benefit obligation. To reduce this liability, the city has requested that the state increase its contributions to the city's pension plans.

In addition, Philadelphia is taking additional actions to reduce its pension costs. These actions are to reduce pension benefits through new labor agreements, adopt-

[1] Covered payroll is the payroll for employees covered by the pension plan. For example, the covered payroll for the Municipal Plan for the year ended June 30, 1993 was about $1 billion.

ing stricter investment standards and policies, and modifying the city's pension asset allocation stratagy.

In its Five-year Financial Plan for fiscal years 1995–1999, Philadelphia reported that it had negotiated labor agreements that resulted in reducing its pension costs. For example, by successfully holding the line on employee wages—particularly through arbitration with the Police and Fire unions—the city estimated that significant savings will be realized in the allocation the city makes to its pension plans. In fiscal year 1995, the total savings are projected to be $15.9 million dollars. Over the next five years, the total savings due to the new labor agreements are projected to be $139.6 million.

Another action taken by the city was the adoption of strict investment standards and policies for the plans' investments. Instead of requiring managers' performance to meet or exceed general benchmarks, such as Standard & Poor's index, city pension managers are now required to meet or exceed the performance of a pool of over 3,000 pension managers nationwide. These pension managers are responsible for ensuring high growth of their pension assets.

Finally, the city, through its Pensions and Retirement Board, has modified its asset allocation strategy to favor small-sized companies and international equities. In addition, the Board is taking steps to strengthen the weakest component of the pension plans' portfolio, the 6 percent of the pension funds invested in real estate and venture capital.

With the help of increased state contributions and the above city pension reforms, the city estimates that its unfunded pension benefit obligation should begin to decrease in the year 2003, and be eliminated by the year 2019.

Ms. NORTON. Could I ask another question? We have an arena and a convention center that has been proposed by the good graces of our own private sector. These are two miracles in the middle of this crisis. I wonder if any of the cities where you investigated were able to make investments in their long-term future to do long-term capital borrowing to enable projects to go forward. Did they require the board? Any light you could shed on that would be useful to us.

Mr. FINCH. I think there were some projects in Cleveland where there was public and private partnership that got together to do some things. I don't think there was anything on the scale of the convention center at that time—Cleveland's convention center came in a little bit later.

Ms. NORTON. Do you think a board could help the District? The District will have to have access to the bond market in order to continue with these projects for long-term borrowing.

Mr. FINCH. Right.

Ms. NORTON. Do you think that a board could be useful in that respect?

Mr. FINCH. I do. I think a board would go a long way toward restoring the market's confidence in the District.

Ms. NORTON. Could you say something about how detailed these multi-year plans were? Were they general outlines, or were they long, detailed documents? And also how involved the local officials were in designing the documents?

Mr. FINCH. Can you address that?

Ms. CLARK. Sure.

There were a number of components to the financial plans that the city prepared, and it was the cities that prepared the plans, the boards did not prepare the plans.

Ms. NORTON. In every case the city prepared the plans?

Ms. CLARK. The city was the responsible party in preparing plans. The board's job was to review and approve those plans.

The plans would include the typical financial information that you would see, revenue projections, expenditure projections, discus-

sion of what types of projections, cash-flow analysis, and projections of those kinds of things, but in addition to the financial portion of a financial plan there was very long and detailed discussion on what the city proposed to do to be able to achieve the plans that they had, and oftentimes those would address the management-related issues on how they planned on reorganizing or restructuring or re-engineering an organization in order to meet the plans that they set forward.

Ms. NORTON. I don't know if you have copies of those plans.

Ms. CLARK. We do.

Ms. NORTON. If you do, I would like copies included in our record. I think that would be useful to us too.

[Due to the high cost of printing, the information referred to has been retained in the subcommittee files.]

Ms. NORTON. Suppose the District did what one might expect it to do in a crisis like this, and, even better, let's say, downsized its government, improved its operations, and the rest. With the growth of Medicaid in the city, the concentration of poor people here, 80 percent of the poor of the region living here, could the District of Columbia permanently solve this crisis without some relief on Medicaid, on prisons, and on pension?

Mr. FINCH. I'm not sure we are in a position to answer that, Ms. Norton.

Ms. NORTON. Mr. Hill, you have done a lot of work on the District. Don't you come up blank?

Mr. HILL. There are a lot of other factors there. You know, one of the things that we have found in all of the information that we have looked at is that—the first thing that we would have to decide is whether or not those services are being provided at the lowest cost possible.

Ms. NORTON. No. Wait a minute. My hypothetical said that—assumes that, quote, the District had done everything it should do. Let's say it reduced—it already, for example, has done it with AFDC. Let's say it does it with Medicaid, and Medicaid is no higher than in the region, and we clean up Lorton because—because the chairman is going to make us do so and take over some of the costs—that the District does what it is supposed to do. After it does all it is supposed to do as a city of under—of about 570,000, with the tax base it has, using the single strategy of downsizing, put itself in a position so it can pay rising Medicaid costs, pension costs, and prisons, after it has gotten itself in the position it by itself can get itself in.

Mr. HILL. Well, let me give you some additional items that would have been considered in looking at that question: What the impact of an arena or convention center would be in terms of the revenue base for the city, what additional business that would bring in additional revenue. You would have to also know the amount of money that you are talking about in terms of how much the District saved on its own in order to then add that in and find out whether the revenues and the expenditures would balance.

Clearly there is a growing gap between revenues and expenditures that, if the District does nothing, the problem only gets worse. Whether you can close that gap by the things that the District does is a function of those developmental perhaps programs,

the additional revenue that the District can bring in on its own, and so forth, and I don't know those numbers. I would have to know those numbers to give you an answer on that.

Ms. NORTON. Finally, I have one last question. You testified that in each of the cities you investigated there was strong city leadership. Does it take strong empowered city leadership in order for an oversight board process to work?

Mr. FINCH. Yes, I think it does.

Ms. NORTON. Thank you very much.

Mr. DAVIS. Thank you very much.

I again want to thank the GAO witnesses who appeared before us today for their hard work and diligence. There is a lot more to do on this project, and I know they will not be slacking in their efforts. At the same time, I want them to know that they have already—what they have already done has been very invaluable to this subcommittee, and we thank you and appreciate very much the professional job you have done.

Today we have heard that the District of Columbia has followed in the footsteps of other great American cities by overextending its resources, in trying to do too much for too many. This generosity, combined with outdated structures and systems and an oversized work force, has finally caught up to the District. Today the District of Columbia finds itself in a fiscal situation that it appears unable to deal with effectively.

We will move quickly but calmly to consider what Congress can do that would be of the most benefit to the District of Columbia government in its efforts to solve its problems. Congress must be willing to act on both the short-term and long-term basis. I know we are prepared to do both. I know many others are as well. Nothing that we do will be done in a vacuum. There will need to be a continuum of activity both in Congress and by the city to successfully meet the challenges before us.

As we end today, I want to announce that this subcommittee will hold another hearing next Wednesday, March 8, in this same room. The subject will be the experience of working on financial oversight boards and governing while one is actively in place. We do not have a final witness list yet, but we do have at least tentative commitments from Governor Hugh Carey of New York who engineered New York City's mechanism; Dr. Carl McCole who is the State comptroller of New York; Ned Regan who is a former State comptroller; Mayor Rudolph Giuliani of New York; Mr. David Cohen, the chief of staff to Mayor Rendell of Philadelphia; and Mr. Bernard Anderson, the first chairman of the Philadelphia board. We are attempting to obtain other representatives from the affected cities from the board's perspective, the local government's perspective, and the local citizens and business perspective. We will release a witness list as soon as it becomes final.

Thank you all very much. The hearing is adjourned.

[Whereupon, at 12:42 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows:]

CRS REPORT FOR CONGRESS—FINANCIAL CONTROL BOARDS FOR CITIES IN DISTRESS

Nonna A. Noto, Specialist in Public Finance and Lillian Rymarowicz, Analyst in Public Finance, Economics Division, March 3, 1995

SUMMARY

Financial control boards (FCBs) have been created by State legislatures to oversee the financial recovery of several large U.S. cities since the mid-1970s. This report reviews five such occurrences: the Chicago school district and the cities of Cleveland, New York, Philadelphia, and Yonkers. The purpose is to identify general patterns and guidelines that might be useful if a control board were to be established for the District of Columbia or elsewhere.

In the cases reviewed, the critical event that most commonly led to the establishment of a control board was the city losing access to borrowing from the municipal bond market. The paramount concern of the FCBs has been establishing the creditworthiness of the new borrowing authority (created in 3 cases) and the associated city. One or more revenue sources were earmarked to service the debt issued under the auspices of the control board. This dedicated revenue was kept separate from other city funds, in a State or trustee account.

A control board is intended to be temporary—to exist only so long as the city is considered to be in financial emergency or, at most, as long as debt issued under the Board's auspices remains outstanding. However, experience suggests that an expected involvement of 3 years can turn into 10, 20, or more years. The board composition differed among the cities, for example, in the degree to which it was dominated by State (versus city) appointees and ex-officio members, whether city employees were represented, and whether minority parties in the State and city were represented. The in-house staff of the oversight boards has typically been quite small—6 positions or fewer. The largest examined, the New York City FCB, had 27. Each board typically contracts with outside accountants and auditors to review the financial accounts of the city.

Most of the FCBs focused on "macromanaging" by setting total spending limits based on estimated revenues, rather than "micromanaging" details of the city's budget. Among the ways control boards have helped cities restore their budgets to balance are by: requiring the city to prepare and adhere to a multiyear financial plan that is in balance; restricting the amount and purpose of borrowing; providing city officials with the political cover to cut expenditures; persuading city employee unions to accept wage freezes, staffcuts, and increased flexibility in work rules; overriding local citizens' resistance to raising local taxes; getting the State to loosen its restrictions on the city's ability to levy taxes; and obtaining permission from the State to restructure the city's debt obligations from short to long term. The boards have taken control of the expenditures to be made from State grant monies, new borrowing, surpluses in dedicated debt service accounts and, in extreme cases, all revenues.

The FCBs examined can be credited with accomplishing a temporary, but not permanent, improvement in their cities' financial situation. The same State legislatures which created the FCB may have undercut long-term solutions by continuing to limit the city's ability to levy non-property taxes, mandating certain types of spending (e.g., for specific school programs), and setting local matching requirements for welfare, Medicaid, and other programs.

FINANCIAL CONTROL BOARDS FOR CITIES IN DISTRESS

In an effort to identify general patterns and guidelines which might be useful if a control board were established for the District of Columbia, or elsewhere, this report reviews the experience of five cities which had financial oversight control boards imposed on them in the two decades since 1974. The five jurisdictions, and their corresponding control boards, reviewed include:

A. Chicago School District—the Chicago School Finance Authority;

B. Cleveland—the Financial Planning and Supervision Commission;

C. New York City—including both the New York State Financial Control Board and the New York State Municipal Assistance Corporation for the City of New York (popularly known as MAC or "Big Mac");

D. Philadelphia—the Pennsylvania Intergovernmental Cooperation Authority (PICA); and

E. Yonkers—the New York State Emergency Financial (Control Board for the City of Yonkers.

The analysis is based upon a review of the State statutes which created the control boards and some subsequent information about the actual experience with these boards.[1] This does not purport to be an exhaustive study of financial control boards.

The body of the report highlights major aspects of the financial oversight control boards established in these five cities. This is followed by five appendices describing the experience of each city (in the alphabetical order listed above) in somewhat more detail. The final appendix, F, lists an address and telephone number to contact for further information about the control boards in these five cities.

The analysis focuses on eight aspects of financial control boards:

1. summary of the crisis that prompted the establishment of the board;
2. duration of the board;
3. board composition and appointment authority;
4. staffing;
5. enforcement authority, mechanisms, and penalties;
6. actions taken by the board, with special note of actions that overturned or amended policies proposed by elected officials;
7. effectiveness of the board in placing the jurisdiction on a sound financial basis; pros and cons of establishing a financial oversight control board;
8. enabling legislation.

To facilitate cross-references, both the summary overview and the appendix on each city are organized in this numbered sequence.

1. SUMMARY OF INSTIGATING CRISIS

CITY LOSES ACCESS TO THE BOND MARKET

In this survey, the event or circumstance that most often led to the establishment of a financial control board was the city (or school district) losing access to the municipal bond market. That is, the city was no longer able to borrow money on its own in the private capital markets. In most cases this occurred when the financial market decided that the city was no longer creditworthy.

When the private market refused to refinance notes or bonds coming due, a default occurred on the old issues, as in the case of Cleveland. In other cases, the market refused to finance new issues for capital improvements or to fund operating deficits with long-term debt. The latter has been the more common situation and describes the experiences of New York City, Yonkers, Philadelphia, and the Chicago School District. In any case, without access to borrowing to cover shortfalls in its cash or operating budgets (whether revenue anticipation notes, bond anticipation notes, or borrowing to cover fiscal year deficits), the city was financially paralyzed.

In his study of New York City, political scientist Robert W. Bailey distinguishes this type of "financial crisis" (referring to borrowing and cash flow) from a "fiscal crisis" (the imbalance between expenditures and revenues) or an "economic crisis" (the deterioration of the employment and tax base).[2] Bailey also refers to the "politics of creditor intervention" as a distinguishing feature of this type of crisis.[3] The point is that underlying economic and fiscal fundamentals of the city may not have changed much in nature, although they may have worsened in degree. What changed was creditors deciding to draw the line on the city's ever-increasing dependence on borrowing and unrealistic revenue estimates.

SITUATION DEEMED AN EMERGENCY; UNDERLYING PROBLEM OF SEVERAL YEARS' DURATION; LITTLE OPPORTUNITY FOR THE CONTROL BOARD TO INTERVENE PREVENTIVELY

It is considered highly unusual for a State to intervene in the affairs of its subjurisdictions. Intervention is typically reserved for situations that can be classified as emergencies or disasters. In all five of the cases examined, the State waited until the crisis in the bond market occurred before taking steps to intervene by establishing a financial oversight control board. In retrospect, signs of the underlying problem were evident for three to ten years before the crisis erupted. Because they

[1] Throughout the text, the term "control board" or "board" is used in a generic sense to refer to the financial oversight authority. There is room for confusion, however. Only in the case of New York City and Yonkers is the entity actually named the "financial control board." In the case of the Chicago School District and Philadelphia, it is an "authority;" in the case of Cleveland, it is a "commission;" and in the case of New York's MAC, it is a "corporation." These entities, in turn, refer to their own boards in the sense of board of directors. Finally, the case of Chicago involves the Board of Education or school board.

[2] Bailey, Robert W. *The Crisis Regime: The MAC, the EFCB, and the Political Impact of the New York City Financial Crisis.* Albany, State University of New York Press, 1984. p. 3–5.

[3] Ibid., p. 9.

were established after the crisis had already occurred, the financial control boards did not have the opportunity to engage in "preventive intervention."

Ohio adopted legislation in 1979 specifying the financial distress conditions under which the State could step into the affairs of any municipality.[4,5] This laid the groundwork for subsequent intervention in Cleveland. In all of the other cases, the State adopted emergency legislation particular to the city in distress.

In the cases of both Yonkers and the Chicago School District, the powers of the oversight boards were suspended at some point (when the jurisdictions in question achieved a balanced budget for the number of years specified by the governing legislation), only to be reinstated a number of years later when the city failed to submit a balanced budget. In Chicago, even though the financial control board was still in place during the intervening years, it was effectively denied the opportunity to intervene preventively during the years immediately preceding the second crisis.

NEW ENTITY CREATED BY THE STATE TO ISSUE BONDS ON BEHALF OF THE CITY; THE FINANCIAL OVERSIGHT BOARD MAY BE PART OF THAT BORROWING ENTITY, OR A SEPARATE ENTITY

For the city to regain access to the credit markets, in some cases a new borrowing entity was established, distinct from the jurisdiction in financial distress. The new borrowing authority was a creation of the State Government, often characterized as a special district. In some cases, the borrowing agency itself exercised the functions of a financial oversight board (as in the case of the Pennsylvania Intergovernmental Cooperation Authority or the Chicago School Finance Authority). In other cases, the borrowing agency worked in conjunction with a separate financial oversight control board (as with New York's Municipal Assistance Corporation as borrowing authority working with the New York State Financial Control Board).

In many cases, the triggering event of a financial crisis has been the city's reaching a State-imposed constitutional or statutory restriction: a debt limit, tax rate limit, or other budgetary provision such as adequately funding a stabilization or cash reserve fund. The creation of a special borrowing authority by the State has been a way to circumvent the debt and tax limits and effectively increase the amount of permissible borrowing for the city. It also avoided the need for local voter approval of bond issues.

No separate borrowing authority was set up for Yonkers or Cleveland. In the case of Yonkers' first crisis (1975–78), the city was able to reenter the bond market once the emergency financial control board was established and the State comptroller was empowered as fiscal agent of the city. In Yonkers' second crisis (1984), New York State loaned Yonkers the money through the State insurance fund. In the case of Cleveland, the local banks which normally financed Cleveland's operating and capital needs agreed to lend the money once the city agreed to certain budget requirements.

NEW BORROWING ENTITY HAS A SEGREGATED REVENUE SOURCE, DEDICATED TO SERVICING ITS DEBT

The paramount concern of the financial control boards has generally been establishing the creditworthiness of the new borrowing authority. To that end, a revenue source was often earmarked to pay the interest and principal on the debt issued by the new borrowing authority. This may be either a new (or increased) tax, or an old revenue source (including State aid) that would otherwise have gone into the general revenues of the city. The money collected from that dedicated source was deposited into a special account, often maintained by the State, or by a private bank named as trustee. The money to service the debt was, most importantly, kept separate from other funds of the city in distress. The debt issued by the new authority was explicitly not the responsibility of either the city or the State.

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[4] "Local Fiscal Emergencies," OHIO REV. CODE ANN. ch. 118 (Page 1990).

[5] Illinois amended its School Code in 1994 to permit the State Board of Education to establish a financial oversight panel to oversee the financial affairs of school districts in communities with population under 500,000 (every Illinois community other than Chicago) that are judged to be in financial difficulty according to criteria set forth in the law and which have failed to comply with the financial plan they had submitted to, and had approved by, the State Board of Education. The oversight panel could be installed even if the State is not providing emergency financial assistance. 105 ILL. COMP. STAT. ANN. 5/1A and 1B. State of Illinois, Public Act 88–618, H.B. 504, 88th General Assembly, 1994 Regular Session, effective Sept. 9, 1994, amending provisions of P.A. 86–954 and 87–1014.

THE CITY'S DEBT IS RESTRUCTURED, FROM SHORT TO LONG-TERM

A common component of a financial rescue plan has been to convert short-term into long-term borrowing to save the city money in the short run. This debt restructuring, however, may require special permission from the State under the terms of the financial rescue agreement.

It is generally considered fiscally imprudent to use long-term debt to finance current operating deficits. Long-term debt is instead usually reserved to pay for capital investment projects which pay back benefits over numerous future years. In the special case of a city in fiscal distress, exceptions were sometimes made to "buy time" to get the city's finances back in order. Because the repayment of principal was stretched out over more years, the annual carrying costs of a long-term bond could be lower than for a short-term note of similar principal amount, and more so if long-term rates were lower than short-term rates. (However, cumulative total interest costs are likely to be higher with a longer payback period.)

REASONS MOTIVATING THE STATE TO GET INVOLVED

Two main types of concerns have motivated and been used to justify State intervention into the affairs of their cities. One was the fear that the city's poor credit rating would spill over to the State itself or to other subjurisdictions and agencies in the State. This could lower the credit rating and thereby raise the interest rate that those entities have to pay on their own borrowings. In the worst case, access to the bond market might be closed for them as well.

The other was the State's responsibility for the health and welfare of the citizens of both the distressed jurisdiction and other jurisdictions in the State. Negative economic ramifications from the distressed jurisdiction could hurt the economic well-being of other parts of the State.

2. DURATION OF CONTROL BOARD

ACTUAL EXPERIENCE

In terms of duration, the financial control boards examined fall into three groups: short term (three to seven years); long term (10 or more years); and interrupted term (terminated or suspended once but later reimposed).

Short term. Cleveland's oversight board was in existence for seven years, from 1980 to 1987. Philadelphia's, the newest control board, established in June 1991, has now been in place for three and a half years; the city administration hopes that the board can be terminated within two years.

Long term. For New York City, the Municipal Assistance Corporation, established in 1975, remains in existence twenty years later, albeit with reduced duties. The New York State Financial Control Board (FCB), also established in 1975, had most of its powers expire eleven years later, in 1986, but remains on standby authority.

Interrupted term. The Yonkers control board existed for three years, from 1975 to 1978, when it terminated; the control board was reinstated in 1984 and remains in existence as of February 1995. The Chicago School Finance Authority can be characterized as both long term and interrupted term. First established in 1980, it remains in existence in 1995, fifteen years later. For the period from 1988 to 1993, however, while it continued to monitor, its review and approval authority with respect to the school district's financial affairs were substantially reduced; the Authority was given added duties related to implementing the State's educational reform plan (these school reform duties were later repealed, effective June 30, 1994). But in September 1993, when the school board failed to adopt a balanced budget, the financial powers of the School Finance Authority were reinstated and enhanced. Thus, its two terms of active involvement were 1980–88 and September 1993-present.

GENERAL PROVISIONS FOR EXPIRATION OF BOARD

The conditions that will permit a control board to expire are typically set forth in the enabling legislation. The expiration date of the board has often been set as six months or one year after the end of the "emergency period" or after all the liabilities (bonds and notes issued or loans taken) have been fully paid and discharged.

The end of the emergency period is defined as the city meeting one or more financial conditions. One condition is that the city's budget has been in balance for a specified number of years: for example, the requirement was one fiscal year in the 1975 Yonkers legislation, revised to three fiscal years in the 1984 Yonkers legislation, and six successive years of balanced budgets in the case of the Chicago School Finance Authority. Another condition is that the city has presented a multi-year

prospective financial plan with operating and capital budgets in balance. The number of years required in the financial plan ranged from two for the Chicago school board (recently reduced from three years), to three for New York, four for Yonkers (replacing the initial requirement of only one year), and five for Philadelphia. The Ohio law did not specify a number of years.

Some statutes also require that all bonds and notes or other loans involved in the rescue are fully paid for and discharged or otherwise provided for before the board can be fully dismantled (Chicago School Finance Authority, Philadelphia, NYSMAC, NYSFCB, and Yonkers 1984). These same statutes, however, may provide that, although some bonds might still be outstanding, the board's powers are to be scaled back to stand-by monitoring authority if the city has achieved a balanced budget for a certain number of years and is projected to continue to have a balanced budget for a certain number of future years.

The maximum maturity period of the bonds issued becomes particularly relevant in those cases where the liabilities must be fully discharged before the board can terminate. (The maximum term of the bonds is not typically specified in the enabling legislation; it appears to be left to the discretion of the borrowing authority.) In the case of the Chicago School Finance Authority's 1994A series, the maximum maturity was 15 years. In Philadelphia, the maximum maturity of any PICA bonds issued was 30 years. New York's MAC issued bonds with maturities up to 30 years.

In some cases a "no-later-than" termination year is specified in the enabling legislation. For New York's Financial Control Board and MAC, it was 2008. (This corresponded to expecting the emergency period to end in 1978, plus a 30 year maximium maturity of PAC bonds.)

3. BOARD COMPOSITION AND APPOINTMENT AUTHORITY

The control boards examined had more differences in composition than features in common.

FEATURES IN COMMON

The number of voting members of the control board has always been odd: five for Chicago and Philadelphia; seven for Cleveland, Yonkers, and the New York FCB; and nine for New York's MAC.

The members of the board have typically served without compensation but were entitled to reimbursement for actual and necessary expenses.

Most members of the boards have been appointed persons rather than publicly elected officials. All of the boards have had appointed members. In addition, four boards have had ex-officio members, but many of those people hold appointed—rather than elected—State or local positions. The ex-officio member of a control board most likely to be an elected official has been the city mayor (Cleveland, New York FCB, and Yonkers). None of the members of the MAC board is permitted to be an employee of a Federal, State, or local government. In Ohio, the appointed members are not to have held public office for five years prior to their appointment, or to become a candidate while serving as a member of the commission.

Most but not all of the financial control boards have been required to have one or more ex-officio members with budgetary expertise. This may be the State comptroller, treasurer, or secretary of the budget, and the city comptroller or director of finance.

DIFFERENCES AMONG BOARDS

The board composition differed among the five cities examined, in several aspects of political interest:

- whether the membership of the board was determined largely by the State versus whether the city had significant representation; relatedly, what offices the ex-officio members of the board held (whether State or city offices);
- how the chairman was determined (whether the chairman is beholden primarily to the State Governor or was selected by the board itself);
- whether there were also non-voting members and who appointed those non-voting members;
- whether city employees were represented; and
- whether the minority parties in the State and the city were represented.

STATE VERSUS CITY APPOINTMENT AUTHORITY

On the Cleveland and Chicago boards, approximately half of the appointment authority was shared by the State with the city. Of five directors in Chicago, two are appointed by the Governor with the approval of the mayor; two are appointed by

the mayor with the approval of the Governor; the chairman is appointed jointly by the mayor and the Governor. Of seven commission members in Cleveland, the three appointed by the Governor and approved by the Senate came from a list of five submitted by the mayor and chairman of the city council. Of the four ex-officio members, two were from the State and two from the city. The Cleveland commission elected its chairman and vice chairman from among its own members.

At the other extreme, the Philadelphia board is almost entirely appointed by State executive and legislative officials. The only representative of the city is ex-officio, the City Director of Finance. Of the five appointed voting members, one is appointed by the Governor, and one each by the majority and minority leadership of the State House and Senate. The members of the board select officers from among themselves.

In the three New York State cases, the State, particularly the Governor, maintains strong control. But the city is guaranteed some representation. For the NYSFCB, of the three members appointed by the Governor with the advice and consent of the Senate, two must be residents of or have their principal place of business in New York City. Two of the four ex-officio members are from the city: the mayor and the comptroller. The State Governor, an ex-officio member, is designated by law as chairman.

For New York's MAC, of the nine members appointed by the Governor, four are appointed upon written recommendation of the mayor. The Governor designates the chairman of MAC.

Under the law governing the Yonkers Financial Control Board, the secretary of state—a State official appointed by the Governor and an ex-officio member of the board—is designated as chairman. The four appointed members are all appointed by the Governor with the advice and consent of the State Senate. The only voting member representing the city is ex-officio, the mayor of Yonkers.

NON-VOTING MEMBERS

There are no non-voting members in the cases of Chicago, Cleveland, and New York's MAC. Two members of Philadelphia's board are non-voting, but they are ex-officio (the State secretary of the budget and the city director of finance).

The two financial control boards created by New York State allow for a large number of nonvoting members: nine for New York City (compared with seven voting) and six for Yonkers (compared with seven voting). Exactly which State or city official may appoint a non-voting member is specified in the legislation. The non-voting members provide for representation of the minority as well as majority parties of the New York State House and Senate. In addition, in the case of New York City, both the minority and majority parties of the city council are represented. In the case of Yonkers, the county executive of Westchester may appoint a representative and the Board may designate a representative for Yonkers city employees.

LENGTH OF TERMS

In Ohio, a person named serves for the life of the board. The term for the Chicago School Finance Authority is three years, and for MAC is four years.

IMPORTANT CHARACTERISTICS OF INDIVIDUAL MEMBERS

In the case of New York City, the role of a single individual, Felix Rohatyn, chairman of MAC, was of overarching importance in getting the various parties to work toward a solution. Mr. Rohatyn, coming professionally from the investment banking community, had then and still maintains an extremely high level of credibility in the financial markets.

It is considered important that the individuals serving on a board be qualified in terms of expertise and be committed to the endeavor. They should be effective both in convincing the city to reform its financial practices as well as in representing the city's interests before the State legislature, executive agencies, and other officials.

Several of the statutes specify that the appointed (not ex-officio) members of the control board should have their residency, office, or principal place of professional or business activity situated within the municipality.

4. STAFFING

The in-house staffs of oversight boards have typically been quite small—six positions or fewer, including secretarial and administrative support staff. The largest, the New York Financial Control Board, had a staff of 25 in 1976, its first full year of operation, and 27 in 1986, the year when most of its powers expired.

Each board typically has had an executive director, a deputy executive director who may also be a financial analyst, a financial analyst, and two administrative as-

sistants or support staff. In addition, there has generally been a general counsel (legal advisor), who may be either in-house staff or on outside contract.

Each board has usually contracted with outside accountants and auditors to review the financial accounts of the city in question, and with outside financial advisors (underwriters) and bond counsel to manage bond issuance by the oversight board. Substantial powers were delegated to the outside accountants in some cases. This was particularly true under the Ohio law's provisions concerning the "financial supervisor"—the CPA firm to be retained by the financial planning and supervision commission for the city in distress.

When the Chicago School Finance Authority (CFSA) had its financial powers reinstated and enhanced in 1993, the new position of inspector general was created to investigate allegations of waste, fraud, and financial mismanagement by employees of or contractors with the Board. The CFSA also has a corporate secretary, but no financial analyst.

Some control boards were authorized to request the loan of staff from the State or the local government. Some were also authorized to request that the city (or school district, in the case of Chicago) provide the control board with office space.

5. POWERS OF SUCCESSFUL BOARDS

Technically speaking, in some cases the power or rule to be mentioned below has been part of the law that established the financial oversight control board rather than being a power of the control board per se.

The new borrowing authority and the financial oversight control board have been intended to be temporary, not permanent institutions. The goal is to get the city back on its own financial feet within a reasonable number of years (specifically, to be able to reenter the bond market on its own). The root of the problem, however, has been the city's inability to obtain sufficient revenue sources or to adequately control spending on its own. Consequently, in exchange for receiving temporary fiscal relief from the new borrowing authority, the city has given up some independence in shaping its own budget.

To be successful, the oversight sanctions have had to be sufficiently unpleasant to motivate the city government to clean up its own financial house to the degree needed to throw off the yoke of oversight. The very existence of the oversight board may have served as an adequate threat for the city to get its budget finances in order, even if the board itself did not take direct actions.

There are several main ways in which control boards have contributed to removal of the obstructions cities face in trying to balance their budgets. They have:

- provided city officials with the backbone to cut expenditures;
- persuaded the city employee unions to accept wage freezes, staff cuts, and increased flexibility in work rules;
- overridden local citizens' resistance to raising local taxes;
- gotten the State to loosen its restrictions on the city's ability to levy taxes; and
- obtained permission from the State to restructure the city's debt obligations from short to long term and relax conditions related to tax and revenue anticipation notes.

An important design question has been whether it was necessary or helpful for the financial control board to manage the city's budget in detail in order to accomplish the necessary discipline. Or, was it sufficient for the oversight board to set aggregate requirements, such as requiring a balanced budget and limiting the amount that the city could borrow. Most of the control boards reviewed here have focused on macromanaging by setting aggregate spending limits, determined by the estimated revenue available.

In terms of attracting the attention of the city to the gravity of the situation, two of the most important powers for an oversight board seem to have been:

- the authority to enable the city to borrow or to prevent it from borrowing; relatedly, the authority to determine the amount of debt the city may issue; and
- the authority to prevent the jurisdiction from spending any money whatsoever if it is not operating under "an approved financial plan," that is, a balanced budget plan approved by the board as required under the enabling law.

In terms of guiding the city toward reformed behavior, some of the most important powers for an oversight board seem to have been:

- authority to review the city's revenue estimates; if the board does not approve the city's estimates, the board makes its own revenue estimates; the approved revenue estimates set the aggregate limit on permissible spending;
- authority to review the city's budget, requiring quarterly or, if more serious, monthly reporting by the city;

• authority to require the city to improve its accounting practices, normally by adopting Generally Accepted Accounting Principles (GAAP);[6] and

• authority to require the city to submit multi-year financial plans that are in balance to the board for its review and approval.

In terms of forcing the city to reform its behavior, some of the most important powers for an oversight board seem to have been:

• authority to take over control of the city's budget, as "fiscal agent," collecting all revenues (including withholding State grant monies) and making all disbursements—power of the purse strings;

• power to override old contracts; to negotiate or disapprove new contracts; to extract concessions from contractors;

• authority to review and approve or disapprove collective bargaining agreements with the city workers' unions; to achieve bargaining agreements with no automatic cost-of-living increases (or at least a wage freeze); to secure agreements that increase the flexibility in union work rules;

• authority to order cuts in the number of staff; and

• authority to levy higher taxes on the city's existing tax bases, without voter approval.

In terms of getting help for the city from additional revenue sources, some of the most important powers for an oversight board seem to have been:

• authority to ask to State for increased State aid;

• authority to ask the State to approve new non-property tax revenue sources for the city;

• getting the city to hold a referendum on increasing a local tax; and

• getting the State legislature to adjust the rules concerning the city's issuance of long-term debt as well as the conditions applying to short-term tax and revenue anticipation notes.

6. ACTIONS TAKEN

In terms of protecting the bondholders, a very important action has been establishing a specific revenue source dedicated to servicing the debt. In most cases, there was an increase in the rate of an existing local tax (sales, personal income, or real property). Revenue associated with that rate increase was deposited in a separate account, maintained by the State or a private bank named as trustee.

One of the most important powers of the Philadelphia Intergovernmental Cooperation Authority (PICA) is the ability to withhold State grant monies and excess monies from borrowing activity from the city, if the city is not in compliance with the financial plan.

In most cases, the cities were required to submit to the financial control board a multi-year financial plan, with the current year and each future year in balance. This multi-year horizon pressured the cities to taking a more serious long-run approach to putting their finances in order.

The Chicago School Finance Authority prevented the opening of the schools when the Chicago school district did not have a balanced budget and multi-year financial plan approved by the Authority.

Several boards have ordered temporary wage freezes (New York City, Yonkers). Some have ordered layoffs of city workers.

The New York City and Yonkers Financial Control Boards have ordered indefinite postponements or cancellations of popular capital improvement projects like libraries.

7. EFFECTIVENESS

All of the financial oversight control boards examined can, at a minimum, be credited with accomplishing a temporary improvement in the financial situation of the city (or school district) for which they were responsible. But none can be credited with achieving a permanent solution. Witness the fact that financial control boards have been reimposed on Yonkers and the Chicago School Board, New York City again faces a huge budget deficit, Cleveland also faces budget woes, and the long-term future of Philadelphia finances remains open to doubt.

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[6] According to ACIR, charter cities (e.g., cities granted home rule either by constitutional or statutory provisions) have been slow to adopt generally accepted accounting principles (GAAP) without State mandates to that effect. U.S. Advisory Commission on Intergovernmental Relations. *City Financial Emergencies: The Intergovernmental Dimension.* Report A–42. Washington, ACIR, July 1973.

Nevertheless, even without permanent financial recovery, it is still worth asking whether the cities could have accomplished as much financial improvement on their own, absent a financial oversight control board.

Still, it is not clear how much credit for financial policy changes should go to specific actions taken by the control board (nor how much blame for failure). What is perceived to be the effectiveness—or lack of effectiveness—of the control board, may have been influenced to a large degree by other accompanying factors.

The threatening presence of a control board and its stand-by powers may in itself be sufficient to spur city officials into taking corrective actions on their own.

In the cases of New York and Chicago, in particular, the control board's effectiveness was enhanced by research or advocacy provided by watchdog groups to both the oversight board and the city council or school board.

One oversight institution on its own may not be enough. In the case of Yonkers, New York, the creation of the State Financial Control Board was not sufficient to restore investor confidence. In addition, the State comptroller had to be appointed as fiscal agent before Yonkers could reenter the bond market. Similarly, in the case of New York City, the creation of the Municipal Assistance Corporation was not enough. The New York State Financial Control Board had to be added before investor confidence was sufficiently restored. And, for a period, New York City also needed Federal loans and loan guarantees.

State legislatures may thwart the effectiveness of the financial control boards by continuing to limit the options and flexibility that cities are permitted under State law to solve their own fiscal problems. The State legislature may create the control board and permit additional borrowing, but not address the underlying structural and fiscal problems facing the city. State laws may severely circumscribe a city's authority to tax. States like Illinois and Ohio have been hesitant to grant authorization for levying local non-property taxes without approval by local referenda.[7] Being limited to property taxes and State aid is a particular problem for school districts.

The Chicago School Finance Authority's powers are seriously circumscribed by the Illinois legislature. The State legislature has restricted the Authority's ability to raise additional revenues, has diminished the Authority's effectiveness in enforcing spending cuts, and has not seriously addressed the underlying structural problems facing central city school districts. It has not permitted either the School Finance Authority or the Chicago School Board access to any new tax revenue sources other than the property tax and has not significantly increased State aid. Chicago, like other Illinois school districts, still faces long-term fiscal problems. Part of the solution may be a new source of revenue other than increases in the local property tax.[8]

The cities in distress have frequently faced exacerbating circumstances emanating from mandates imposed by the Federal or State governments or by court order. Cities may have little control over the amount of State or Federal aid they receive, or the mandated local percentage matching requirement for certain expenditure functions. In New York State, local governments are responsible for 25 percent of Medicaid and AFDC costs. Cities were under other outside pressures during the 1980s, namely court-ordered desegregation of schools and, in the case of Yonkers in particular, desegregation of housing. While protesting the housing court orders, Yonkers incurred substantial fines, exacerbating the financial distress. Chicago was under the pressure of a school education reform effort enacted by the State of Illinois in 1988 which mandated many changes in the delivery system.

The financial control board may represent an additional expense for the jurisdiction in distress. The expenses of the Chicago School Finance Authority are paid from the general State school aid that would otherwise be payable to the Chicago Board of Education for school purposes. In Philadelphia, the expenses of PICA are to be paid by the city. In contrast, in Ohio, expenses of the Financial Planning and Supervision Commission for a city are ". . . payable solely from appropriations made by the general assembly."

The ability to achieve financial reform may be thwarted by conflicts within a city's own political structure, or between the city and the financial control board. If the mayor and city council are in serious disagreement, it appears more difficult to make progress. If city officials have not agreed to the need for reform and if they have an antagonistic relationship with the control board, it is more difficult to make progress.

City officials tend to resent micromanagement of city affairs by the control board, more than macromanagement. City officials would typically prefer that the control board set the total spending limit but let the city decide specifically where to cut expenditures. In cases where city officials face intransigence in gaining agreement

[7] ACIR, *City Financial Emergencies*, 1973.
[8] See references in Appendix A.

to budget cuts from city employees or program divisions within the city bureaucracy, the officials may find the presence of a financial control board helpful in providing them needed additional bargaining power. In such cases, micromanagement by the control board might be regarded as helpful. Micromanagement may also be more favorably received by the city if the control board and the city are dominated by the same political party. Under the New York State law, the Financial Control Board was prohibited from setting expense priorities for the city; MAC, however, is known to have put conditions on the city's use of surplus debt service funds.[9]

Finally, the finances of a city are influenced by the business cycle and shifting voter attitudes toward taxation and spending. These in turn influence the ability of the city to raise its own revenues and to receive assistance from higher levels of government, particularly the State. A State is more likely to offer assistance to its cities when the State itself is in better financial shape.

8. ENABLING LEGISLATION

This is a summary list of the major State statutes that created the financial control boards and defined their powers. There have also been numerous amendments to these statutes in the ensuing years, but these are not listed.

CHICAGO SCHOOL DISTRICT

School Finance Authority Act, 105 ILL. COMP. STAT. ANN. 5/34A–5/34B–15 (Michie 1993 & Lexis Supp.) or P.A. 81–1221. Enacted January 16, 1980.

Chicago School Reform Act (P.A. 85–1418), adopted by the Illinois General Assembly on December 2, 1988.

PA. 88–618, An act relating to education. Approved September 9, 1994; enacted January 1, 1995.

CLEVELAND

Local Fiscal Emergencies, OHIO REV. CODE ANN. § 118.01 et seq. (Page 1990). Enacted November 29, 1979.

NEW YORK CITY

Financial Control Board

New York State Financial Emergency Act for the City of New York (1975). N.Y. UNCONSOL. LAWS (VOL. 65) §§ 5401–20 (McKinney 1979 & Supp. 1994) or 1975 N.Y. LAWS 868–869. Enacted September 9, 1975.

Municipal Assistance Corporation

New York State Municipal Assistance Corporation Act, N.Y. PUB. AUTH. LAW (VOL. 42) § 3001 et seq. (McKinney 1981 & Supp. 1994) or 1975 N.Y.LAWS 168. Enacted June 10, 1975.

PHILADELPHIA

Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class. Commonly known as "The PICA Act", 53 PA. CONS. STAT. ANN. § 12720 (Purdon 1991). Enacted June 5, 1991.

Intergovernmental Cooperation Agreement by and between Pennsylvania Intergovernmental Cooperation Authority and The City of Philadelphia. Dated as of January 8, 1992.

YONKERS

New York State Financial Emergency Act for the City of Yonkers, N.Y. UNCONSOL. LAWS ch. 23 §§ 1–13 (Consol. 1983) or 1975 N.Y. LAWS 871, as amended. Enacted November 14, 1975.

The Special Local Finance and Budget Act of the City of Yonkers, also known as the "special fiscal act" or "fiscal agent act," 1976 N.Y. LAWS 488–489. Enacted June 30, 1976.

New York State Financial Emergency Act of 1984 for the City of Yonkers, N.Y. UNCONSOL. LAWS §§ 1–14 (Consol. Supp. 1990) or 1984 N.Y. LAWS 103, as emended. Enacted May 2, 1984.

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[9] See references in Appendix C.

APPENDIX A. CHICAGO SCHOOL DISTRICT: CHICAGO SCHOOL FINANCE AUTHORITY

1. SUMMARY OF INSTIGATING CRISIS[10]

There were early signs of financial trouble during the mid-1970s when the Chicago Board of Education was managing to meet its cash requirements only by increasing its short-term outside borrowings and borrowing internally from several of its nonoperating funds, including debt service funds, in order to cover operating expenses. Cash in the various Board funds had been pooled in a single account. To cover its operating deficit the school district had spent money that should have been set aside to repay an $84.3 million bond issue coming due in 1979.

A crisis emerged in November 1979 when Moody's lowered its rating on the Chicago Board of Education, impairing the Board's effort to market short-term notes. The school superintendent informally asked the city of Chicago to back the School Board to help sell its notes. Mayor Jane Byrne hired outside financial experts to analyze the school fiscal crisis and a special task force was formed to work on the crisis. The schools' superintendent and the School Board president both resigned.

In fiscal year 1980, the Board of Education failed to meet its payroll and was denied access to the bond market. The 1980 bailout by the State of Illinois included subjecting many of the school district's financial decisions to the review and approval of a newly created oversight board, the Chicago School Finance Authority.

The school district for the city of Chicago had reached its State-imposed debt limit (five percent of total assessed valuation). The Chicago School Finance Authority was created by the Illinois General Assembly as a separate unit of local government (a special district) with an additional debt ceiling to issue short-term and long-term obligations secured by a property tax levy to be voted by the Chicago City Council. Although the city of Chicago collects the property tax and transmits it to the Authority, it is not classified as a city tax revenue but rather as a tax levied by the Authority.

The Chicago Board of Education regained its independent access to the bond market in 1989, nine years after the Authority was first created.

A serious crisis emerged again in September 1993 when the School Board failed to have a balanced budget approved by the Authority and, as a consequence, the schools were closed. The State Assembly designed a bail-out plan in November 1993. The plan involved no serious effort to address the underlying structural problems, even though operating deficits were projected for fiscal years 1993, 1994, and 1995. Instead, the crisis was deferred for two years by additional borrowing through the oversight authority. Reflecting their concern, in December 1993, Moody's and Standard and Poor's lowered their credit ratings on both the Chicago Board of Education and the Chicago School Finance Authority.[11]

In recent years, the opening of Chicago schools has been threatened each Fall by either a teachers' strike or a deficit in the school district budget. With bargaining contracts for the teachers' union and the trade employees up for renewal and a deficit already forecast, September 1995 is likely to mark another such year.

EXACERBATING CIRCUMSTANCES

During the period from 1980 to 1994 the school district was also under pressure to address the provisions of a school desegregation lawsuit filed in 1980 and an educational reform effort enacted by the State in 1988.

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[10] The entire appendix draws heavily upon information presented in: Chicago School Finance Authority. Official Statement of Chicago School Finance Authority Relating to $405,380,000 General Obligation School Financing Bonds Series 1994A. Bond issue prospectus, February 17, 1994.

[11] The bonds issued in February 1994 were, however, triple-A rated, based on the insurance purchased from the Municipal Bond Investors Assurance Corporation. Hattori, April. Shades of 1980 as School Finance Authority Sets Bond Sale to Bail Out Chicago Board. *The Bond Buyer*, Feb. 15, 1994, p. 1.

2. DURATION OF CONTROL BOARD[12]

The School Finance Authority Act[13] provides that the Authority shall remain in existence until one year after all bonds and notes are fully paid for and discharged, or otherwise provided for.

The Authority has been in existence from 1980 to the present with three distinct Phases: 1980–88 1988–93 and 1993-present. The Authority was created by the Illinois General Assembly in 1980 to assist in financing and to provide oversight of the finances of the Board of Education of the city of Chicago. The original act was amended in 1984, 1988, and 1993.

The initial mission of the Authority was to provide the School Board with access to the credit market in order to retire its maturing short-term debt and cover its continuing deficits amounting to $460 million. In subsequent amendments, the Authority was empowered to finance construction and rehabilitation of school facilities (1984), to provide oversight with respect to certain aspects of the Chicago School Reform Act of 1988, and to implement the borrowing in 1994 of $405.4 million authorized by the 1993 amendments (to cover the School Board's fiscal years 1993 and 1994) as well as to assume additional oversight of the Board's operations.

The second phase began in 1988. Certain oversight and control powers of the Authority were suspended when the Authority certified that the Chicago Board of Education had completed six successive years of balanced budgets, in accordance with the accounting and other principles that had been prescribed by the Authority (5/34A–411(a)). For the period from 1988 to 1993, the Authority's review and approval authority was scaled back. It did continue to monitor, through annual reviews of the Board's budgets to determine that they were balanced, and to make sure that the Board continued to pay off the large, bonded indebtedness incurred to bail out the school system from 1980 through 1982.

Also, in 1988 the Authority was given a role in implementing Chicago's major education reform effort, aimed at improving student educational performance and decentralizing control from the district superintendent's office to the individual schools. The 1988 Chicago School Reform Act required the Board of Education to submit to the Authority and gain approval of an annual plan for reforming the school system.[14] The Authority was not well equipped to handle this responsibility and did not accomplish much in this area. The education reform function of the School Finance Authority was repealed effective June 30, 1994.

The third phase began in 1993 when the Chicago School Board failed to adopt a balanced budget for fiscal year 1994 (Sept. 1, 1993–Aug. 30, 1994). As a consequence, the Chicago School Finance Authority had its financial powers reinstated and enhanced, effective September 1, 1993.[15] (5/34A–411(b))

3. BOARD COMPOSITION AND APPOINTMENT AUTHORITY

The Authority is administered by a board composed of five directors: two appointed by the Governor with the approval of the mayor of Chicago; two appointed by the mayor with the approval of the Governor; and a chairman appointed jointly by the Governor and mayor. The directors may establish other offices and appoint officers as they deem appropriate. Directors are appointed to serve three-year terms and until their respective successors have been appointed. The directors serve without compensation but are entitled to reimbursement for actual and necessary expenses incurred in the performance of official duties.

4. STAFFING

The Authority has a full-time Executive Director and Administrative Assistant. The Authority also has a Corporate Secretary. The 1993 amendments established a new position of Inspector General, with a four-year term, to investigate allegations of waste, fraud, and financial mismanagement by employees of or contractors with the Board. The Inspector General has a limited staff of about three.

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[12] For the sake of consistency, the same section headings have been used throughout the report, even though "control board" may not be the official name of the oversight authority for that city. In the discussion of Chicago, the financial control board is known as "the Authority" and the word "Board" is used to refer to the Chicago Board of Education or school board. In section 3, "board" also refers to the board of directors of the Chicago School Finance Authority.

[13] School Finance Authority Act, 105 ILL. COMP. STAT. ANN. 5/34A–5/34B–15 (Michie 1933 & Lexis Supp.) or PA. 81–1221. Enacted January 16, 1980. Section numbers referred to subsequently (in parentheses) refer to subsections of this statute.

[14] Hess, G. Alfred, Jr. School Restructuring: Chicago Style. Chicago Panel on Public School Policy and Finance, 220 South State Street, Suite 1212, Chicago, IL 60604, March 1990. p. 10.

[15] Illinois General Assembly's 1993 amendments to the School Finance Authority Act.

The Authority does not have a financial analyst on staff but does appoint the chief financial officer of the School Board.

The Authority also utilizes the services of outside consultants and professionals including a general counsel, a financial advisor (in conjunction with the issuance of its bonds and other financial matters), an accounting advisor (to assist the Authority in reviewing the budgets of the Chicago Board of Education and in carrying out its other financial oversight responsibilities), and a trustee (under the bond resolutions). In addition, the Authority may retain various other consultants to assist in carrying out its oversight responsibilities.

The Authority may request services and the transfer of officers and employees from State agencies, the local government, or the school district. The School Board is expected to provide services and the use of its facilities and resources upon the Authority's request, at no charge.

The operating expenses of the Authority are paid from the general State school aid that would otherwise be payable to the Chicago Board of Education for school purposes. The Authority must certify the budget for its operating expenses to the State Board of Education.

6. ENFORCEMENT AUTHORITY, MECHANISMS, AND PENALTIES

Under the School Finance Authority Act (adopted in 1980 and subsequently amended) the Chicago School Finance Authority was given broad powers of oversight and control with respect to the financial affairs of the Chicago Board of Education. Among the current oversight and control powers of the School Finance Authority with respect to the Board of Education are:[16]

- the Authority can either approve or reject the School Board's estimates of revenues; if it rejects them, the Authority may prepare its own estimates of the revenues available to the Board, upon which the Board must base its financial plans, annual budgets, and provisional budgets;
- the Authority must either approve or reject the annual budget of the School Board for each fiscal year; the budget must contain detail prescribed by the Authority and be based upon revenue estimates approved or prepared by the Authority;
- in the absence of a balanced budget and financial plan approved by the Authority, the Board is prohibited from making any expenditures other than for its debt service obligations; (this means that the Authority can prevent the opening of schools if the projected budget for the upcoming school year is not in balance;) the Authority may approve a provisional budget if it determines that the School Board's appropriations for operations will not exceed an annual expenditure limitation established by the Authority; the Authority may establish and enforce monitoring and control measures to ensure the Board's expenditures conform to any such expenditure limitation;
- the Authority must either approve or reject financial plans of the Board which must be submitted every two years, covering a period of two fiscal years; (the original statute provided for a three-year financial plan; it was reportedly changed recently to two years to avoid disclosure of information during and State and local election year;)
- all contracts and other obligations of the Board must be consistent with its budget and the financial plan in effect; no contract or other obligation can be legally binding on the Board unless it has been approved by the Authority; (this includes collective bargaining agreements and contracts creating any obligation for borrowed money);
- the Authority must approve or reject the annual staffing plan of the Board for each fiscal year (this requirement was added in the 1993 amendments); the Authority is required to monitor the Board's compliance with statutory requirements which limit expenditures for administrative, support, and other non-instructional services;
- the Authority is to initiate and direct a management audit of the Board and its operations at least once every two years; this audit determines if the Board is utilizing and managing its resources in an economical and efficient manner and the cause of any inefficient or uneconomical practices;
- the Authority approves the appointment of a chief financial officer of the School Board and has the power to remove such officer;

[16] The information in this section was drawn primarily from: Chicago School Finance Authority. Official Statement of Chicago School Finance Authority Relating to $405,380,000 General Obligation School Financing Bonds Series 1994A. Bond issue prospectus, February 17, 1994. p. 16–19.

• the Authority has the power to direct the Board to reorganize its financial accounts and management systems in whatever manner the Authority deems appropriate to achieve greater financial responsibility and to reduce financial inefficiency;

• the Authority has the power to assume exclusive administration of, and to withdraw funds for, the lawful expenditures of the Board from the cash accounts and bank accounts of the Board; and

• the Authority prescribes an accounting system and procedure for the Board according to which the Board's budget for each fiscal year must be balanced.

The 1993 Illinois amending legislation gave the Authority increased oversight powers, including the power to initiate management audits of the school district. It created a position of Inspector General at the Finance Authority to review the School Board's spending practices. It moved up the date by which the Finance Authority must approve a balanced spending plan for the schools each year, to August 15 from August 31.[17] The Authority was directed to undertake a financial and management assessment of the Board's special education program and an analysis of potential cost savings from its physical consolidation.

6. ACTIONS TAKEN

BONDS ISSUED

Under the School Assistance Bond Resolution, adopted April 29, 1980, the Chicago School Finance Authority issued four series of school assistance bonds in 1980, primarily to provide financial assistance to the Chicago School Board for its operating and working cash needs. A fifth series of School Assistance Bonds was issued in 1984, primarily to provide financial assistance to the School Board for its capital needs. Between 1984 and 1993 the only bonds issued were to refund previously issued School Assistance Bonds.

In the 1993 Amendments to the School Finance Authority Act adopted by the Illinois General Assembly and effective in November 1993, the Chicago School Finance Authority was mandated to issue the 1994A bonds to provide the Board of Education of the city of Chicago with money to defray a portion of the Board's operating expenditures for its fiscal years ending August 31, 1994, and August 31, 1995. As of February 1, 1994, the Chicago School Finance Authority announced a new offering of $405,380,000 in general obligation school financing bonds, a series of bonds (series 1994A) due from 1996 to 2009. The bonds are payable out of dedicated taxes levied on all taxable property in the city of Chicago, and from certain funds and accounts (from amounts on deposit in the Debt Service Fund). Upon collection, the taxes are to be deposited with the Trustee (The First National Bank of Chicago). The bonds are issued pursuant to the School Financing Bond Resolution of the Authority, adopted February 17, 1994 and the 1994A Series Resolution of the Authority, adopted February 17, 1994.[18]

"DISCIPLINARY ACTIONS" TAKEN BY THE STATE AND THE SCHOOL FINANCE AUTHORITY

In 1980 the school system was forced to cut more than 8,000 positions. The cuts fell disproportionately on teachers and other student contact staff, and not administrative staff.[19]

One of the most potent tools of the School Finance Authority is the ability to close the schools down if the Chicago School Board does not conform with the requirements of having a balanced budget approved by the oversight authority. As of September 1, 1993, when the School Board failed to adopt a balanced budget approved by the Authority, the Board was prohibited from making any expenditures. Following provisions of the School Finance Authority Act, the school system was closed. The Illinois General Assembly had to enact special financing arrangements in order for the schools to reopen.

7. EFFECTIVENESS

The Chicago school district budget was returned to balance within two years after the School Finance Authority was established in 1980. By 1988, the school district had accomplished the six years of balanced budgets needed to have the oversight powers of the Authority relaxed. The budget continued to be in balance through fis-

[17] Bradley, Ann. Lawmakers Back Plan to Balance Chicago Schools' Budget. *Education Week*, Nov. 24, 1993.

[18] Chicago School Finance Authority, Bond issue prospectus of February 1, 1994, p. 1–2.

[19] Hess, School Restructuring: Chicago Style, p. 1,4.

cal year 1993. Thus, there had been eleven years of balanced budgets before the relapse into financial crisis in September 1993.

By State legislative action, the Chicago School Finance Authority had been reduced to budget monitoring functions (in contrast to active review and approval of plans) for the five years preceding the 1993 crisis. The Authority was not given serious responsibility to act preventively during this interim period. During the period of weakened Authority powers, the school board approved a three-year labor contract (for fiscal years 1990–93) that called for a 7 percent per year increase in employee compensation; the board subsequently had to renegotiate the agreement because there was not sufficient revenue to cover it.

The Chicago School Finance Authority's powers are seriously circumscribed by the Illinois legislature. The State legislature has restricted the Authority's ability to raise additional revenues, has diminished the Authority's effectiveness in enforcing spending cuts, and has avoided seriously addressing the underlying structural problems facing central city school districts.

The State legislature has not permitted either the School Finance Authority or the Chicago School Board access to tax revenue sources other than the property tax and has not significantly increased State aid. The school district's dominant source of local revenue is the property tax. The State of Illinois sets the maximum permissible level of local property tax rates for four of the school district's operating funds. To service and repay the bonds issued by the Chicago School Finance Authority, the State's 1980 Act permitted the Authority to levy a separate, additional property tax exclusively for that purpose. In the case of the new bonds authorized by the State in 1993, however, the State lowered the tax rate that could be levied to pay for the Board's Educational Fund to offset the special property tax imposed to finance the new bonds; in effect, the State arranged to pay for the new bonds by shifting and earmarking property tax revenues that would otherwise go to the School Board for general operating purposes (approximately $48 million).

Since 1985, the Authority has not been permitted to reject multi-year contracts if the first year of the contract is consistent with the financial plan, even if later years of the contract are not. In 1993, the legislature reduced the time frame of the multi-year financial plan from three to two years.

Chicago, like other Illinois school districts, still faces long-term fiscal problems. It arguably needs a new source of revenue other than increases in the local property tax. Some favor an increase in the State income tax as a source of more State aid funds. Mayor Richard M. Daley has promoted casino gambling in Chicago as a new source of local revenue for the schools.

The Authority's ability to enforce spending cuts to achieve a balanced budget has been circumscribed by relief measures enacted by the Illinois General Assembly. The State has dealt with the various financial crises by "bending" the rules previously set by the Authority that forbade expenditures if the budget was not balanced. Instead, the legislature permitted the school district to cover its operating expenses by further borrowing through the Authority and diverting State school aid intended for special programs to cover general operating expenses.

The Chicago school district has been described as being subject to "micromanagement" by the Illinois General Assembly which establishes various requirements for the expenditure of State aid funds and the delivery of educational services.

The 1993 rescue plan basically postponed any serious attack on the school district's financial problem for two years and overrode certain balanced budget requirements of the 1980 Act. The 1993 bailout involved having the Chicago School Finance Authority issue $378 million in bonds over the next two years to help cover operating expenses, to be paid off from the tax-levy revenue of the Authority. (It did not involve borrowing $110 million from the Chicago teachers' pension fund, another controversial proposal supported by the School Board.) The 1993 rescue plan also diverted $32 million from the State compensatory aid program for schools serving low-income children into the school district's general operating budget. This action was later characterized as illegal by the Chicago Panel on School Policy, and was described as diverting funds from programs for low-income children to pay for the central school district bureaucracy.

The 1993 amendments also provided that the Authority could not require the Board to maintain a "reserved fund balance" in excess of $100 million which is not available for appropriation by the Board. The effect of this is to permit the Board to appropriate in its budget for a fiscal year certain accrual-basis revenues when the cash supporting those revenues will not be received by the Board until the following fiscal year. On February 1, 1994, the Authority amended the accounting system and procedure to require that the Board's operating funds be balanced for each fiscal year on a cash basis, both fund-by-fund, as well as on a combined basis, as

had been previously required. Little progress was made in modifying union work rules, contrary to what some had hoped. The legislation authorized the Chicago School Board or City Council to place a property tax referendum on the ballot in 1995.

The State General Assembly has not yet adopted a permanent financing plan for either the school district or the School Finance Authority. The 1996 session is expected to act on recommendations submitted by various "watchdog" organizations.

8. LEGISLATION

The Chicago School Finance Authority (CSFA) was created by Article 34A of the School Code of the State of Illinois, known as the School Finance Authority Act (P.A. 81–1221), effective January 16, 1980.[20] Article 34A applies only to school districts in cities with population over 500,000—in effect, only Chicago.[21]

In 1984, the School Finance Authority Act was amended to authorize the Authority to provide additional financial assistance to the Board with respect to the construction and rehabilitation of school facilities.

In 1988, the School Finance Authority Act was amended again, effective May 1, 1989 (reenacted effective Jan. 11, 1991, but subsequently repealed).

Under the 1988 amendments, the Chicago School Finance Authority was given primary responsibility for approving and monitoring the development and implementation of the Chicago School Reform Act (P.A. 85–1418) that had been adopted by the Illinois General Assembly on December 2, 1988.[22] Briefly, the school reform is an effort to improve student achievement and to decentralize financial resources and authority within the Chicago school system from central administration towards the individual schools. The statute authorizing the School Finance Authority's involvement with the implementation of the Chicago School Board's school reform plan was repealed effective June 30, 1994.[23] In 1988, certain oversight powers of the board were suspended because the School Board had met the condition of six successive years of balanced budgets.

In 1993, the Act was amended to require the Authority to provide additional financial assistance to the Board through new bond issues and to provide the Authority with additional oversight powers with respect to the Board's financial and operational affairs.

APPENDIX B. CLEVELAND: FINANCIAL PLANNING AND SUPERVISION COMMISSION

1. SUMMARY OF INSTIGATING CRISIS

The city of Cleveland started to show signs of financial difficulty in 1971 when a temporary property tax levy expired and the revenue was not replaced. The State permitted the city to issue five-year general obligation bonds in 1972 to cover the shortfall in the operating budget. The State did not demand corrective action on the expenditure side, nor did it expand the city's revenue-raising powers. The city stayed afloat in the mid-70s by shifting money from special accounts and capital-improvements to operating expenses and selling off city assets such as the park system, zoo, sewer system, and transit system to suburban systems.

Cleveland eventually reached its State-imposed debt limit.[24] As of early summer 1978, the bond market was closed to Cleveland. The city's financial accounts were in such disarray that the city was unable to meet disclosure requirements and provide the timely and accurate information required for refinancing. The controversial Mayor, Dennis Kucinich, and the city council disagreed on how to solve the fiscal dilemma. The State passed legislation that allowed distressed cities like Cleveland to pay up to 10 percent interest and take advantage of special financing provisions in order to help sell their bonds in the municipal market.

The city finance director said that the city would have been able to meet its obligations until January 1979, but it was unclear how long the cash reserves would

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[20] School Finance Authority Act, 105 ILL. COMP. STAT. ANN. 5/34A–101 (Michie 1993). Also referred to as, 1981 ILL. LAWS 1221.

[21] Other parts of the Illinois School Code deal with the establishment, by the State Board of Education, of Emergency Financial Assistance and "Financial Oversight Panels" for school districts in jurisdictions with less than 500,000 population. (105 ILCS 5/1A and 1B.)

[22] Chicago School Reform Act, 1985 ILL. LAWS 1418.

[23] 105 ILCS 5/34A-201a.

[24] For Cleveland, the general obligation debt limit is up to 10.5 percent of assessed valuation on voter and non-voter approved bonds; however, nonvoter approved bonds cannot exceed 5.5 percent of assessed valuation.

hold out to pay city workers. The city wanted the authority to borrow long-term in order to fund the cumulated deficits, thus avoiding the disruptive cutbacks that would occur if it did not get credit within a short period of time. However, the holders of the city debt were not receptive to market reentry without additional evidence of restraint by the city governmental structure.

On December 15, 1978, the city defaulted on $15.5 million in short-term notes. (This was the first default of a major city in the United States since Detroit defaulted in 1933.) This debt was owed to special funds of the city treasury and to six local banks, which could have given the city more time to meet its obligations. Neither the Governor nor legislature took action at the State level for another year.

Before the default, the mayor had proposed the appointment of a fiscal overseer with strong powers over the city's fiscal activities, as part of a larger financial package. The city did not have a strong executive system. Before the crisis the positions of mayor and city councilmembers had only a two-year term.[25] As part of the reform, they were all changed to four-year terms.

2. DURATION OF CONTROL BOARD

Prior to 1979, Ohio law for chartered cities prohibited the State from intervening in local affairs without a formal invitation. Under another Ohio law, however, the State can intervene if a municipality's action affects other communities. A new Ohio statute governing all municipal corporations in the State became effective November 29, 1979.[26]

On January 4, 1980, under the terms of the State's new Local Fiscal Emergencies law, the auditor of the State of Ohio announced that a financial emergency existed in Cleveland and a Financial Planning and Supervision Commission was created for Cleveland. Thirteen months later, by February 5, 1981, the city was declared out of default. The Commission, however, remained in place until 1987.

Under provisions of the Local Fiscal Emergencies law, the Financial Planning and Supervision Commission is to remain in existence until the municipality has met the following three conditions:

> "(1) Planned, and is in the process of good faith implementation of, an effective financial accounting and reporting system (in according with sec. 118.10 of the Revised Code), and it is reasonable expected that such implementation will be completed within two years;" (the progress of this implementation is to be subsequently supervised by the State auditor);
>
> "(2) Corrected and eliminated all of the fiscal emergency conditions determined pursuant to section 118.04 of the Revised Code, and no new fiscal emergency condition has occurred;"
>
> "(3) Met the objectives of the financial plan described in section 118.06 of the Revised Code."
>
> (section 118.27 of the Revised Ohio Code)

The determination that these conditions have been met may be made either by the State auditor or by the Commission. The Commission must prepare a final report of its activities. All of the books and records of the Commission are to be delivered to the State auditor for retention and safekeeping. (118.27)

3. BOARD COMPOSITION AND APPOINTMENT AUTHORITY

A State-sponsored "Financial Planning and Supervision Commission" was created for Cleveland, in accordance with the Local Fiscal Emergencies law. (A separate commission is to be appointed for each Ohio city determined to have a fiscal emergency.) There are four ex-officio members: the State treasurer, the director of budget and management, the mayor, and the presiding officer of the legislative authority (city council) or certain permitted designees. Three members are appointed by the Governor from a list of five submitted by the mayor and the presiding officer of the legislative authority. The appointed members must be approved by the State Senate. The term of the appointed member is for the life of the commission, unless the person is removed by the Governor ". . . for misfeasance, nonfeasance, or malfeasance in office."

If the Governor does not find the five persons submitted by the mayor and city council chairman to be qualified, he may request up to three more nominees. If the Governor does not find three among all the submitted nominees to be well qualified,

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[25] U.S. Library of Congress. Congressional Research Service. *Cleveland's Financial Emergency: Description and Analysis of the Short Term and Long Term Causes.* CRS report no. 79-50 E, by Stacey M. Kean, Feb. 12, 1979. Washington, 1979.

[26] "Local Fiscal Emergencies," OHIO REV. CODE ANN. Ch. 118 et seq. (Page 1990). Section numbers cited subsequently refer to this statute within the Ohio Revised Code.

he may appoint other persons who meet the qualifications enumerated in the legislation. This includes an individual:

"(a) Who has knowledge and experience in financial matters, financial management, or business organization or operations, including at least five years of experience in the private sector in the management of business or financial enterprise, or in management consulting, public accounting, or other professional activity;

(b) Whose residency, office, or principal place of professional or business activity is situated within the municipality;

(c) Who has not at any time during the five years preceding the date or appointment held any elected public office."

Nor shall an appointed member of the Commission become a candidate for elected public office while serving as a member of the Commission. (118.05)

All seven Commission members may vote. Five members constitute a quorum. Five votes are necessary for any action. The Commission elects one of its members as Chairman and another as Vice Chairman. The Commission may also appoint a Secretary and any other officers, who need not be members of the Commission. (118.05)

The members of the Commission shall service without compensation, but shall be paid by the Commission their necessary and actual expenses incurred while engaged in the business of the Commission. (118.08)

The Commission may delegate many of its powers to the "financial supervisor." (118.07)

4. STAFFING

The Financial Planning and Supervision Commission retains a "financial supervisor," defined as a firm of certified public accountants with demonstrated relevant professional competence. The Commission may request the assistance of personnel from the State auditor's office or from the administrative heads of any State agency with skilled budget and accounting employees to temporarily assist the Commission or the financial supervisor. The financial supervisor's (CPA's) salary is paid by the Commission pursuant to a contract approved by the State Controlling Board. The city is to provide office space for the Commission, in the principal building housing the city government. (118.05).

Expenses of the Commission are payable solely from appropriations made by the Ohio General Assembly. (118.09)

5. ENFORCEMENT AUTHORITY, MECHANISMS, AND PENALTIES

The powers discussed in this section are selections from a longer list set forth in the Ohio Local Fiscal Emergencies law. The same powers would be available to any financial planning and supervision commission established to assist an Ohio city in financial emergency. Not all of these powers were necessarily invoked in the case of Cleveland.

The city mayor is required to submit to the Commission a detailed financial plan to eliminate the fiscal emergency conditions, balance the budgets, avoid future deficits, and restore the ability of the municipality to market long-term general obligation bonds, together with a time plan for accomplishing these objectives. If the Commission rejects the plan, the mayor must submit a revised plan within 30 days. (118.06)

The municipality must promptly bring its financial accounting and reporting system into compliance with chapter 117 of the Ohio Revised Code, under the review of the State auditor. It must supplement this with a system to report its fiscal activities in a timely manner in order to facilitate effective management of the municipality's affairs and implement the financial plan. The State auditor may order the municipality to take specific actions. (118.10) The municipality must cooperate in providing information requested by the Commission relevant to the financial plan. (118.11)

The legislation grants certain powers, duties, and functions to the Financial Planning and Supervision Commission, or when authorized by the Commission, to the financial supervisor. These include reviewing all tax and spending budgets; approving (118.15) and assisting in the issue of debt obligations; making recommendations for cost reductions or revenue increases to achieve balanced budgets and carry out the financial plan. During the fiscal emergency period, the Commission is to "review and determine" the adequacy of revenues to meet expenditures. The Commission may require the municipality to establish monthly levels of expenditures and encumbrances consistent with the financial plan. The Commission may then monitor those monthly levels of expenditures and require justification documents to substan-

tiate any departure from the approved level. The Commission may bring civil actions, including mandamus, to enforce the provisions of the Local Fiscal Emergencies Act. (118.07)

Annually during the fiscal emergency period the Commission is to make reports and recommendations to the speaker of the (State) House of Representatives and the president of the (State) Senate concerning progress of the community to eliminate fiscal emergency conditions, failure of the municipality to comply with the Local Fiscal Emergencies law, and recommendations for further actions to attain the objectives of the law or to enhance revenue raising or financing capabilities of municipalities. (118.07(E))

If the municipality fails to submit a financial plan by the deadline (within 120 days after the first meeting of the Commission, 118.06), expenditures from the general fund of the municipality cannot exceed 85 percent of general fund expenditures for such month in the preceding fiscal year unless authorized by the Commission based on justification of need by the municipality. No expenditures may be made by the municipality that are contrary to the approved financial plan. (118.12)

The revenue estimates are not to include revenues conditioned upon future favorable action by the electorate of the municipality or by the (State) General Assembly or the (national) Congress, other than appropriations of moneys for existing and continuing programs at current levels. The estimate of revenues for any month must separately state and designate as "conditional" those revenues which are conditioned upon the future issuance of debt obligations, transfers of funds, advances from funds, payments or reimbursements from the sale of debt obligations, sale of capital assets of the municipality, increases in utility rates and other charges, or imposition or increase in taxes, and must be accompanied by documentation showing that the council or official with authority to act has acted in time for realization of such revenues in the month or months indicated. (118.13)

For bond anticipation notes issued during a fiscal emergency period, the Commission may approve a later maturity date than otherwise provided by law, a date the Commission estimates to be not more than one year following the termination of the fiscal emergency period. (118.16)

The Local Fiscal Emergencies Act lays out the conditions for a municipality to issue "local government fund notes." The principal and interest on these notes would be payable solely from the portion of State aid to local governments that would otherwise be apportioned to the municipality in question, for a period of no more than eight calendar years. The notes would specifically not be payable from or require the levy of any unvoted ad valorem property taxes or other taxes, and would not occupy any portion of the municipality's indirect debt limit. The notes could only be used for a restricted set of purposes, basically to satisfy debts incurred in the past and not to finance future deficits. The local government fund distributions pledged to the repayment of these notes would be deposited with a fiscal agent or trustee. The amount so deposited would not be counted in the municipality's tax budget and appropriation measures or its certificates of estimated revenues for that year. (118.17)

The Act provides measures to make future debt obligations to be issued by the municipality, with Commission approval, appear more secure to investors. In particular, the law provides the ability to pledge particular revenues, to designate a fiscal agent (who may be the purchaser of such debt obligations), and to deposit the pledged receipts in separate account established with the fiscal agent, who then is responsible for disbursing the payments when due. (118.20) The law also provides for the rights and remedies of holders of the municipality's debt obligations. (118.21)

The Local Emergencies Act makes special provisions for short-term borrowing by a municipality during a fiscal emergency period. This includes current revenues notes (a form of tax anticipation note), advance tax payment notes (whereby taxpayers who pay in advance of a due date receive a certificate with interest), and provisions for the State treasury to invest in the current revenue notes of the municipality. (118.23, 118.24, and 118.25)

Officers and employees of the municipality must forfeit their office or employment if convicted of knowingly violating certain requirements that they adhere to the financial conduct required under the law. (118.29)

6. ACTIONS TAKEN

The Cleveland commission exercised mainly oversight functions. While the commission may not be identified with specific rescue actions, its presence purportedly gave the mayor additional bargaining power that helped the city accomplish changes on its own.

7. EFFECTIVENESS

Cleveland was declared out of default just 13 months after the date that financial emergency was declared and the oversight commission established by the State, although the Commission remained in place for an additional 6 years. The brief, one-year duration of the financial emergency suggests that the problem may not have required the effort involved in setting up an oversight control board. In the end, the Cleveland banks entered into a 15-year agreement with the city which required that the city balance its budget, keep accurate books and deposit pension funds into an escrow account.

Bolstered by the presence of the Commission, however, the city itself took actions to raise revenues in 1980 and 1981. Cleveland voters had turned down referenda to increase taxes in November 1970, February 1971, and November 1974. In the referendum on February 27, 1979, Cleveland's voters turned down the proposal to raise the city's personal income tax from 1.0 percent to 1.5 percent and to sell the municipal electric power system to a private company. (Both measures had been opposed by Mayor Kucinich in his 1977 campaign for election.)

Effective March 1, 1979, the city wage tax was increased from 1.0 to 1.5 percent by city ordinance, following a State statutory waiver of the voter referendum requirement. In November 1980, the voters rejected a proposal to increase the tax rate an additional 0.5 percent, to 2.0 percent. The city of Cleveland was again in financial distress. In February 1981, threatened by serious cuts in services and made aware that, at the time, 75 percent of the city's wage and salary income was earned by suburbanites, Cleveland voters approved an increase in the city wage tax from 1.5 to 2.0 percent effective March 1, 1981. The increase solved the city's immediate problem, enabling the city to pay off accumulated debts without borrowing.

The 0.5 rate increase in the wage tax added $35 million in revenues, relative to a city budget of $200 million. Provisions stipulated that half of the new revenue would be committed to capital improvements instead of wages for city workers. At the same time the city unions agreed to a total benefits increase of 8 percent for that year and the next, less than the prevailing rate of inflation.[27]

In November 1979 Republican George Voinovich was elected mayor, while the city council remained Democratic. Voinovich was more cooperative than his predecessor Kucinich in addressing the city's financial problems.

Cleveland's schools are independently administered and have not been as successful as the city in increasing the income tax for school purposes. In 1981, the city rejected another income tax increase and the schools closed for two months.

8. LEGISLATION

"Local Fiscal Emergencies," OHIO REV. CODE ANN. Ch. 118 et seq. (Page 1990). Enacted November 29, 1979.

APPENDIX C. NEW YORK CITY

To meet the New York City financial crisis of 1975, three levels of intervention were required:

1) creation of the New York State Municipal Assistance Corporation for the City of New York, popularly known as "MAC" or "Big Mac";
2) creation of the New York State Financial Control Board; and
3) first, short-term loans and, later in 1978, loan guarantees from the Federal Government.

The Municipal Assistance Corporation (MAC) was created in June 1975. From June through September 1975, MAC was only marginally successful in marketing its "moral obligation" bonds. Another default-threatening deadline led to the legislation creating the New York State Emergency Financial Control Board in September 1975. The new agency provided additional credit enhancement for MAC and, it was hoped, would draw not only New York State assistance, but also Federal assistance in the form of direct loans or loan guarantees.

In December 1975, President Ford signed into law the New York City Seasonal Financing Act of 1975 (P.L. 94–143) which provided for Federal short-term loans to the city in an aggregate outstanding amount not to exceed $2.3 billion. This Act expired on June 30, 1978. On August 8, 1978, President Carter signed into law the New York City Loan Guarantee Act of 1978 (P.L. 95–339). Under the 1978 law the Federal Government gave New York City loan guarantees on principal and interest

[27] Lippman, Thomas W. Cleveland's New Commuter Tax. *The Washington Post*, March 9, 1981, p. A1, A4. Because a large fraction is paid by suburban residents who work in the city, Cleveland's wage tax is often referred to as a commuter tax.

for long-term debt. The total guaranteed debt specified over four fiscal years, was not to exceed $1.65 billion.

These three interventions are now discussed in turn.

NEW YORK STATE MUNICIPAL ASSISTANCE CORPORATION FOR THE CITY OF NEW YORK (MAC)

1. SUMMARY OF INSTIGATING CRISIS

New York City showed evidence of fiscal distress for at least ten years prior to the crisis of 1975. During the 1960s and early 1970s New York City experienced the flight of many affluent city residents to the suburbs, an influx of the disadvantaged, and rising expectations for public services which the city provided at a higher range and level than most American cities. The city borrowed heavily to finance its operating costs and built up a large debt. Ultimately, the 1974–1975 recession caused a substantial decline in city revenues from the sales and income taxes, while the demand for social services rose.[28]

Following the creation of MAC and the Financial Control Board by the State of New York, the U.S. House Banking Committee asked the Securities and Exchange Commission (SEC) to investigate the conditions that led to the withdrawal of the borrowing privileges of the City of New York. The SEC put 1964 as the starting point. This was when the bond rating agencies lowered the city's ratings by one step. It was found that the city did not provide full or complete information on the ways in which the city balanced its budget. Operating expenses were classified as capital outlays and funded by long-term borrowing. Short-term debt was rolled over. Interest payments became a significant portion of the operating expenses of the city.[29]

Between 1965 and 1975 at least seven major studies were undertaken by the city and the State of New York on various aspects of the financial situation in New York City. The conclusion of all these studies indicated that the rate of growth in the city's revenues was far below that of the increase in the city's expenditures. Adjustments were needed either from additional tax resources or a reduction in the level of public services.[30]

At the end of fiscal year 1974, New York City faced the prospect of having to refinance a large amount of short-term debt (bonds maturing within one year or less) and other maturing serial debt. The city had used short-term debt in order to finance capital improvements outside of its long-term debt ceiling set by the State constitution and had used bonds with maturities shorter than the statutory useful life of projects to avoid the up-front "down payment" requirements that otherwise accompanied borrowing for capital improvements. Additional borrowing was also required to smooth seasonal gaps between revenues and expenditures; this included tax anticipation notes (TANs) for real property taxes; revenue anticipation notes (RANs) issued largely due to the city's need to finance welfare and Medicaid payments "up front" while waiting for reimbursement of the State and Federal shares; and bond anticipation notes (BANs) for Mitchell-Lama housing projects.[31] The city also had deficits in its required cash reserve funds.

For the approaching fiscal year 1975, the revenue needs exceeded the amounts the city could raise under its constitutionally set tax rate limit. Altogether, the city wanted to borrow approximately $8 billion.[32] Investors, however, increasingly became unwilling to purchase the city's bonds, beginning in February and March of 1975.[33] The perception of New York City's borrowing needs "swamping" the municipal bond market was an important element leading to the creation of the Municipal

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[28] U.S. Library of Congress. Congressional Research Service. *Overviews of the Lockheed, New York City, and Chrysler Loan Guarantee Programs.* CRS Report No. 80–97E, by James M. Bickley, May 29, 1980. Washington, 1980. p. 9.

[29] U.S. Congress, House of Representatives, Committee on Banking, Finance and Urban Affairs, Subcommittee on Economic Stabilization. *Securities and Exchange Commission Staff Report on Transactions in the Securities of the City of New York.* 95th Congress, 1st Session, August 1977. Cited in: Feldstein, Sylvan G. and Fabozzi, Frank J. The Dow Jones-Irwin Guide to Municipal Bonds. Homewood, Illinois, 1987. p. 144.

[30] Bailey, Robert W. *The Crisis Regime. The MAC, the EFCB, and the Political Impact of the New York City Financial Crisis.* Albany, State University of New York Press, 1984. p. 3.

[31] Smith, Wade S. *The Appraisal of Municipal Credit Risk.* New York, Moody's Investors Service, Inc., 1979. p. 315–16.

[32] CRS, *Overviews of the Lockheed, New York City, and Chrysler Loan Guarantee Programs.* CRS Report No. 80–97E, by James M. Bickley, p. 9.

[33] The New York State Urban Development Corporation defaulted on its bonds in February 1975. This made lenders more skeptical toward other New York entities trying to borrow.

Assistance Corporation (MAC).[34] The bankers wanted a separate borrowing authority created which would have authority to collect revenues and would answer to the State. Reflecting the urgency of the city's borrowing needs, the State created MAC before the end of the city's fiscal year (June 30, 1975).

2. DURATION OF CONTROL BOARD

The New York State Municipal Assistance Corporation for the City of New York (MAC) was created by the State as a public benefit corporation (special district) on June 10, 1975.[35] MAC remains in existence in 1995. Unlike the New York State Financial Control Board, MAC is considered a permanent agency. The statutory requirements specify that MAC should continue as long as any MAC-guaranteed obligations are outstanding. That should be at least until 2008.[36]

The MAC Act provided that no bond or note of the corporation should mature more than thirty years from the date of the original issue of the bond, and in no event later than July 1, 2008. No bonds or notes could be issued later than Dec. 31, 1984, unless the bond or note was a renewal or refunding of an outstanding bond or note (see historical note under § 3033). (This cutoff date for new issues was subsequently extended by amendments to the act. See examples in section 6, Actions Taken.)

3. BOARD COMPOSITION AND APPOINTMENT AUTHORITY

The board of directors of the Municipal Assistance Corporation consists of nine directors (§ 3034), none of whom may be officers or employees of the Federal, State, or local government. The board of directors is appointed by the Governor of New York (§ 3011) with the advice and consent of the State Senate. Four directors are appointed upon written recommendation of the mayor of New York City (§ 3034). The Governor designates one of these appointees to be the board chairman, who is to preside over all board meetings. The first board members served staggered terms (see § 3034); directors appointed after these serve for four years. If a member is appointed to fill a vacancy, he may serve only until the expiration of his predecessor's term (§ 3034).

4. STAFFING

In its earliest days, in September 1975, MAC had a staff of five. It had expected that the staff would increase to 40 to cover the budgetary oversight functions conferred in the founding legislation. However, with the creation of the Emergency Financial Control Board to handle those functions, the staff was expected to remain at five.[37]

As of 1994, MAC staff officials included an executive director, deputy director/treasurer, and counsel. MAC contracts with an outside auditing firm.

5. ENFORCEMENT AUTHORITY, MECHANISMS, AND PENALTIES

The statutory powers of MAC reflect the main functions it was designed to serve. These were (1) to restructure the city's debt, issuing longer-term bonds to repay maturing short-term obligations, (2) to provide the State some facility to monitor the city's financial position, given the potential financial threat to the State itself, and (3) to protect new as well as old creditors, including the State.[38] This section describes a number of the important statutory powers and provides some commentary (in parentheses) on how they were applied in practice.

MAC is empowered to issue and sell bonds and notes and to pay or lend funds received from such sales to the city. (In its early years, MAC released the money to the city in small transfers rather than one lump sum in order to better monitor the city's finances.[39])

MAC was empowered to exchange MAC's obligations for those of the city (§ 3012.1(a–e)), (§ 3035.1–3). (Requiring this exchange was later ruled to be unconstitutional. See further discussion in section 6, Actions Taken.)

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[34] Smith, *The Appraisal of Municipal Credit Risk*, p. 317–18.

[35] MAC was created by the New York State Municipal Assistance Corporation Act, N.Y. 42 PUB. AUTH. LAW § 3001 et seq. (McKinney 1981 & Supp. 1994) or 1975 N.Y.LAWS 168. Section numbers cited in this discussion of MAC refer to this statute, as amended.

[36] Bailey, *The Crisis Regime*, p. 17.

[37] Ferretti, Fred. M.A.C. Forced into Role of Selling City, With Its Budgetary Functions Unused. New York Times, September 16, 1975, p. 81.

[38] Bailey, *The Crisis Regime*, p. 27–29.

[39] Bailey, *The Crisis Regime*, p. 31.

The State law gave MAC review power over each proposed city expense budget and the revenue estimations on which it was based. If it found the budget not in balance, MAC was to notify the mayor and review possible corrective action with him. The MAC statute placed a new debt limit on total MAC and New York City short-term obligations. MAC approval was required for any short-term borrowing by the city.[40]

The State law also gave MAC extensive auditing and information-gathering powers. This provided an important alternative to the city itself as a source of information about the city's finances.

MAC was given advisory powers regarding the city's finances, management practices, and budgetary processes.

Among MAC's financial enforcement powers, as the city's refinancing agent, MAC could refuse to advance cash to the city and thereby force it into default, under certain conditions. These conditions were related to the city's failure to meet predicated standards, for example: lack of improvement in the city's accounting system, failure to remove operating expenses from the capital budget, and exceeding new aggregate debt limit on city short-term notes and MAC bonds. The penalty, which has never been exercised, consists of forcing the city into default and paying back MAC bondholders.[41]

Although, at the time of its creation, MAC's oversight powers were viewed as harsh, they did not include powers later granted to the Emergency Financial Control Board. These included the power to reject any budget, forecast, plan, contract, or financial pattern of the semiautonomous agencies of the city government; impose a wage freeze on city employees; and remove from office any official violating its policies or regulations.[42]

6. ACTIONS TAKEN

The Municipal Assistance Corporation set up special funds, with dedicated revenue sources, to secure the payment of principal and interest on bonds of the Corporation. A "Special Tax Account" was established under the State Finance Law, in the custody of the State comptroller. The State legislature declared the city stock transfer tax and the city sales tax to be State taxes, to be deposited in the Special Tax Account.[43] These monies are in turn transferred to MAC for deposit in the Corporation's debt service funds,[44] capital reserve funds, and operating fund at such times and in such amounts as the chairman certifies are necessary to meet its requirements as established by the Act and by the Corporation bond resolutions. In addition, per capita State aid for New York City went into a special aid account (within the Municipal Assistance State Aid Fund) dedicated to servicing MAC bonds.

The amount of bonds that could be issued by MAC was limited by a ratio of revenues from the sales and stock transfer taxes to the debt service requirements of those bonds.[45] The dedicated monies were to be first applied to the debt service and administrative costs of MAC. Any surplus funds remaining can be turned over to the city for its regular expenditures.[46] There has been a surplus in years when the dedicated revenues were strong. Also, when interest rates fell and MAC could refinance its outstanding bonds at a lower interest rate, there was more likely to be a surplus in ensuing years. In practice, MAC has put conditions on the city's use of these surplus funds.[47] As of 1996, MAC continues to allocate the surplus funds for particular city functions.

The New York State legislature declared a "moratorium" on debts previously issued by the City of New York. The 1975 Debt Moratorium Act denied use of the State courts to note holders wanting to enforce their debt contracts with the City of New York.[48] Instead, the State offered those note holders a new MAC issue in exchange. This was at some cost to the note holders, including a later redemption

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[40] Bailey, *The Crisis Regime*, p. 28.
[41] Bailey, *The Crisis Regime*, p. 29.
[42] Bailey, *The Crisis Regime*, p. 29.
[43] *Moody's Municipal and Government Manual, Vol. 2, 1994*, p. 4116 and 4254.
[44] MAC bonds had no lien on the dedicated revenues, nor were the revenues pledged to the bonds. The bonds' claim was against the special fund. Smith, *The Appraisal of Municipal Credit Risk*, p. 320.
[45] Moody's *Municipal and Government Manual, Vol. 2, 1994*, p. 4116.
[46] Bailey, *The Crisis Regime*, p. 28.
[47] Liff, Mark. The $600 Million Man. *Empire State Report*, August 1988, p. 23–27.
[48] New York State Emergency Moratorium Act for the City of New York. 1975 N.Y. LAWS 874–875. McKinney's Session Laws, of New York (St. Paul: West Publishing Co.), 1975 Extraordinary Session. Enacted in November 1975. Cited in Bailey, *The Crisis Regime*, p. 167, and note 7, p. 209.

date. Many noteholders accepted the exchange, but the Flushing National Bank of the Borough of Queens, New York, took the matter to court. After a lengthy battle, through several courts, on November 19, 1977, the State Court of Appeals, the highest court in New York State, declared the moratorium unconstitutional. The court's order required renegotiation of the city's original notes, with payment in full as soon as possible. The city had to find the money to pay off the defaulted notes not already exchanged for MAC issues.[49]

A July 1980 amendment empowered MAC to issue bonds and notes in an aggregate principal amount not exceeding $10 billion, under certain conditions and excluding refunding bonds and notes payable within the fiscal year in which issued.

In a July 1990 amendment, the corporation was authorized to issue an additional $1.5 billion of bonds and notes to fund a portion of the capital programs of the New York City Transit Authority and the New York City School Construction Authority. That law provided for a reduction in the issuance authority to the extent such capital programs are funded by the city.[50]

7. EFFECTIVENESS

The original authorization was for MAC to issue up to $3 billion in State general obligation bonds ($1 billion each in July, August, and September 1975).[51] These were "moral obligation" bonds and did not have the traditional "full faith in credit" backing of the State. In this way, the State avoided potential problems with its own debt limit. MAC was only partially successful in selling these moral obligation bonds. Additional intervention, through creation of the Emergency Financial Control Board and ultimately loans and guarantees from the Federal Government, was needed to restore participation by the credit markets.

At first, MAC was a refinancing agent and an advocate for New York City in the money market. Following the poor reception of its initial bond offering, MAC instead became an advocate for the bond market with the city. In this revamped role, MAC joined others in pressuring the city to reduce its deficits.[52] The budgetary oversight powers originally granted to MAC were effectively given over to the Emergency Financial Control Board when its was created in September 1975.[53]

By the end of the city's fiscal year 1986—eleven years after the Corporation began its work—MAC's control of allocations of cash funds helped result in a balanced budget and financial plans according to generally accepted accounting principles (GAAP).

8. LEGISLATION

New York State Municipal Assistance Corporation Act, N.Y. PUB. AUTH. LAW (VOL. 42) § 3001 et seq. (McKinney 1981 & Supp. 1994) or 1975 N.Y.LAWS 168. Enacted June 10, 1975.

NEW YORK STATE FINANCIAL CONTROL BOARD

1. SUMMARY OF INSTIGATING CRISIS

The creation of the Municipal Assistance Corporation (MAC) in June 1975 was not sufficient to restore investor confidence in the City of New York. There was another default-threatening deadline just three months later.

While MAC was mainly a financing institution, the Emergency Financial Control Board (EFCB) was a political institution with much broader legal powers than the MAC. The primary function of the original EFCB was to oversee the creation and execution of a financial plan aimed at forcing on the City of New York a budgetary process that would result in balanced budgets within the three fiscal years ending June 30, 1978.[54]

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[49] Bailey, *The Crisis Regime*, p. 167. Smith, *The Appraisal of Municipal Credit Risk*, p. 321. U.S. Library of Congress. Congressional Research Service. *The New York City Financial Crisis: Important City, State, and Federal Considerations*. CRS Report no. 76–147 E, by Stacey M. Kean, Aug. 2, 1976. p. 7–8.

[50] See § 3037–a 1994 Supp.

[51] Smith, *The Appraisal of Municipal Credit Risk*, p. 320.

[52] Bailey, *The Crisis Regime*, p. 31.

[53] Ferretti, Fred. M.A.C. Forced Into Role of Selling City, With Its Budgetary Functions Unused. *New York Times*, September 16, 1975, p. 81.

[54] Bailey, *The Crisis Regime*, p. 2, 36. Smith, *The Appraisal of Municipal Credit Risk*, p. 320.

2. DURATION OF CONTROL BOARD

The New York State Emergency Financial Control Board was established on September 9, 1975.[55] It was designated as a governmental agency and instrumentality of the State. According to provisions of the Financial Emergency Act, it was to stay in place until the earlier of (a) July 1, 2008 (§ 5401, see historical note, and § 5418)[56] or (b) the date when

i. all bonds and notes containing the pledge or agreement under the Act (see § 5415) are refunded, redeemed, discharged or otherwise defeased, or

ii. there is no longer any outstanding guarantee by the United States Government to pay the principal of or interest on any bond issued by the city or a State financing agency,

whichever of (i) or (ii) shall occur later (§ 5418).

The State legislature permitted the city to continue to use bond proceeds to pay operating expenses for up to ten years, through FY 1986.[57] On June 30, 1986, the city met the conditions necessary to activate the sunset provisions of the law.[58]

The Board remains on stand-by authority until the outstanding debt is retired. This arises from its power to reimpose a "control period" when it determines that certain fiscally risky conditions exist.

The "control period" was defined as the period of time from the effective date of the Act until the date when:

(a) condition (ii) above held (there is no longer any federally guaranteed debt outstanding);

(b) for the three immediately preceding fiscal years the city's budget (other than the capital budget) had been in balance; and

(c) the comptroller of the State and of the city jointly certify that securities sold by or for the benefit of the city in the general public market (i.e., without special favors or considerations) for the preceding and current fiscal year can satisfy the capital and seasonal financing requirements of the city.

However, after the termination of the control period, but until there are no longer any outstanding notes or bonds protected under the Act, the Board can reimpose a control period ". . . upon a determination at any time that any of the following events has occurred or that there is a substantial likelihood and imminence of such occurrence:"

(i) the city has failed to pay the principal of or interest on any of its bonds or notes when due or payable (other than certain MAC notes);

(ii) the city shall have incurred a operating deficit of over $100,000 during its fiscal year;

(iii) the city shall have issued notes in violation of the Act;

(iv) the city shall have violated any provision of this Act in a way that substantially impairs its ability to pay principal or interest on its bonds or notes or to balance its operating budget; or

(v) the city and State comptrollers cannot certify (c) above.

The Board is to terminate the reimposed control period when it determines that the condition that triggered it no longer exists. The Board is to annually review conditions (i) through (v) to determine whether any of the items have recurred (§ 5402.12).

3. BOARD COMPOSITION AND APPOINTMENT AUTHORITY

The seven voting members of the Control Board include four ex-officio members: the State Governor, State comptroller, mayor of the city, city comptroller; and three members appointed by the Governor with the advice and consent of the State Senate. Two of the appointed members must be residents of, or have their principal place of business in, the City of New York. All appointed members serve at the pleasure of the Governor. The Governor is Board chairman and he or his representative presides over all meetings of the Board. (Every member of the Board who is otherwise an elected official of the State or city is entitled to designate a representative to attend, in his place, and vote or otherwise act in his behalf; these representa-

[55] From the date of its inception through June 30, 1978, the Board was known as the New York State Emergency Financial Control Board. Subsequently, "Emergency" was dropped from the name. The period from 1975 to 1978 was considered by the State legislature as the "Financial Emergency Period." Bailey, *The Crisis Regime*, p. 7.

[56] Section references in this part of the discussion are to the New York State Financial Emergency Act for the City of New York (1975), as amended, N.Y. UNCONSOL. LAWS (VOL. 65) §§ 5401–20 (McKinney 1979 & Supp. 1994).

[57] Smith, *The Appraisal of Municipal Credit Risk*, p. 320.

[58] *Moody's Municipal and Government Manual 1992*, Volume 2, p. 3791.

tives may not delegate this responsibility to any other person.) The Board acts by majority vote of these seven members.

In addition, the Lieutenant Governor, temporary president of the Senate, minority leader of the Senate, speaker and minority leader of the Assembly, the president of the City Council of New York City, a designee of the city Board of Estimate, and the vice-chairman and the minority leader of the City Council may appoint nonvoting representatives to the Board. (§ 6407.1).

Members of the Board serve without compensation but are entitled to reimbursement for actual and necessary expenses. (§ 5407.3)

4. STAFFING

An executive director is appointed jointly by the Governor and mayor. He serves at the pleasure of the Control Board and may be removed by the Board. His power and duties are set by the Board (§ 5407.4).

The Financial Emergency Act also provided for the appointment of a special deputy State comptroller for New York City who would report to the State comptroller. Initially, in 1975, the special deputy State comptroller was to function as the Control Board's operations officer.[59] The special deputy State comptroller's office was to provide support staff and financial analysis for the MAC and the Emergency Financial Control Board.[60]

By 1976 the EFC Board had its own staff of about 25 professional members. In fiscal year 1977, it had a budget of $750,000.[61]

As of December 1986, the State Financial Control Board listed a staff of 27. This included the executive director, four deputy directors (including one for economic and revenue analysis, one for expenditure and covered organization analysis, one for finance and capital analysis, and a first deputy director), a general counsel, a secretary to the board/public relations officer, 11 analytic staff, and 9 administrative and support staff.[62]

As of January 1, 1993, the State Financial Control Board for New York City had 23 full-time-equivalent (FTE) employees.[63]

Under provisions of the enabling statute, the city (not the Control Board) contracts for a nationally recognized certified public accounting firm (or a consortium of firms) to perform an annual audit of the city's finances (§ 5409).

5. ENFORCEMENT AUTHORITY, MECHANISMS, AND PENALTIES

The five major functions from which the Board's legal powers are derived are as follows:

a) oversight of the creation and enforcement of a financial plan for New York City which results in balanced budgets;

b) ruling on the acceptability of all city borrowing;

c) supervision of application of reorganization in the event of default;

d) administration of the Emergency Financial Control Board Fund which can control most city revenues and expenditures if necessary; and

e) administer a State-imposed wage freeze on city employees.

According to the New York Financial Emergency Control Act for the City of New York, the Board's actions and responsibilities are as follows:

(1) After October 20, 1975, it collects all city revenues (unless exempted by the Board) into a Board fund. Exceptions to this are noted in § 5411.1. All funds and accounts of the city also become the funds and accounts of the Board fund.

(2) Establishes a debt service repayment account in which it deposits enough money to meet the debt service requirements of covered organizations on their bonds and notes (§ 5411).

(3) Consults with the city and covered organizations in the preparation of a financial plan and certifies revenue estimates approved therein.

(4) Prescribes the form of the financial plan and the supporting information required. (The city itself is expected to develop the financial plan (§ 5409).)

(5) Exercises the right of approval, disapproval and modification of the financial plan and the revenue estimates contained in it.

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[59] Ferretti, Fred. M.A.C. Forced into Role of Selling City, With Its Budgetary Functions Unused. *New York Times*, September 16, 1975, p. 81.

[60] Bailey, *The Crisis Regime*, p. 17. Smith, *The Appraisal of Municipal Credit Risk*, p. 320.

[61] Bailey, *The Crisis Regime*, p. 125.

[62] New York State Financial Control Board, New York City Financial Plan, FY 1987–1990, *First Quarter Review*, Dec. 11, 1986, frontspage.

[63] 1994 New York State Statistical Yearbook. 19th Edition. Albany, The Nelson A. Rockefeller Institute of Government, State University of New York. Table E–52, p. 200.

(6) Reviews the operations, management, efficiency and productivity of city operations and covered organizations and audits compliance with the financial plan in any area.

(7) Recommends improvements to reduce costs and improve services, and obtains information of the financial condition and needs of the city.

(8) Reviews proposed regulations presented by the mayor for the acceptance of contracts and other obligations. The Board, within a specified amount of time, may disapprove any contract it deems to be inconsistent with the financial plan and forbid the city to enter into it. No borrowing may be done by the city after October 15, 1975, unless approved by the Board. (§ 5408).

The city comptroller must submit to the Board and the State comptroller quarterly reports on debt service requirements on all bonds and notes of the city for the following quarter. The Board also shall receive from the city monthly and quarterly financial reports. (These could be the same reports submitted to the U.S. Department of the Treasury.) The reports must indicate any variance between actual and budgeted revenues, expenses or cash for the period covered by the report (§ 5408(1)(g)).

If the city defaults on any bonds or notes, the Board is authorized to take any action it deems necessary pursuant to Title 6–A of Article 2 of the local finance law, and may direct the city to take any action that it is authorized to take under the same law (§ 5408(2)).

The Board was prohibited from setting expense priorities within approved aggregate limits and from interfering with the rights of employees to bargain with the city (§ 5405–5404).

6. ACTIONS TAKEN

The Financial Emergency Act of 1975 required the city to submit a plan for balancing the city's budget by FY 1978. A three-year plan was approved by the Board in November of 1975. But the deadline for reaching a balanced budget had to be extended for another four years (until FY 1982).[64]

The Financial Emergency Act appropriated $750 million in aid from State funds ($250 million for the city and $500 million for MAC). This was contingent on other monies being obtained from the city and State employee pension funds, the banks, and other sources. The Act authorized and directed the purchase of MAC bonds by the State and city pension funds, for a total of $825 million.

As part of its negotiations with the banks, the Board required that the city's pension funds purchase some of the securities. The labor unions protested, and the courts later overturned the Board's requirement.

The Board increased the amount of State appropriations for the city for AFDC and Medicaid. However, the Board would not consider supporting permanent relief for the city from the welfare and Medicaid burden.

Increases in salaries of any kind were forbidden, unless union and management worked out a wage deferral agreement that would contribute toward alleviating the fiscal crisis.

Among the numerous belt-tightening measures undertaken in New York City during the 1975–1978 period (some prior to the creation of the EFCB) were the following: 1) a cut in the city's workforce by 60,000, from 360,000 to 300,000; 2) a wage freeze on remaining city employees; 3) $200 million in additional taxes were assessed; 4) tolls and transit fares were increased; 5) road and bridge maintenance was deferred; 6) capital projects were delayed or canceled; 7) hospitals were closed; 8) the tuition-free policy of the City University of New York ended; and 9) fire protection, police patrols, sanitation pickups, daycare facilities, and the school day were reduced.[65]

7. EFFECTIVENESS

The Board's method of "macromanagement" (§ 5405) succeeded in changing the city's mode of operation without drastic changes in the city's charter. In practice, the city had some of its home rule powers revoked by the State. While Mayor Abe Beame lost his leadership role to the State, he remained in office and the public at least outwardly accepted a diminished level of services.[66] State domination of the budget planning process did result in a lowered rate of growth of city revenues, expenditures, and debt.

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[64] Smith, *The Appraisal of Municipal Credit Risk*, p. 321.
[65] Bailey, *The Crisis Regime*, p. 1, 38.
[66] Bailey, *The Crisis Regime*, p. 8, 10.

The Financial Control Board was slow to authorize non-property tax increases which city officials wanted to implement. The Board did not favor increasing sales or income taxes.

The City of New York's books are still kept in accordance with GAAP. As a result of the reforms imposed during the 1975 fiscal crisis, it is illegal for New York City to have a deficit. The city is required to submit a four-year projections in the annual financial plan prepared by the Mayor's Office of Management and Budget (OMB). These estimates are revised quarterly.[67] The Financial Plan's projections of revenues and expenditures are made on the basis of current policies (not proposed policies that would require legislated changes) with regard to tax rates, tax bases, aid formulas, or expenditure mandates. If any of the forecast years has a projected deficit, then the mayor's OMB must present a gap-closing program as part of the financial plan.[68] There have been *ex ante* projected deficits for each fiscal year since 1982, but they had been closed *ex post* through FY 1993.

In a November 1991 report, the office of the State comptroller noted that in FY 1990, the city had refunded outstanding debt (including MAC debt) in a way that reduced debt service costs for the first two years, but increased aggregate debt service costs over the life of the new bonds. The city continued this practice of seeking short-term budget relief in its bond refundings during FYs 1991 and 1992.[69] Apparently neither the Control Board nor State comptroller's office took steps to discourage or prevent this type of short-sighted practice by the city.

The Financial Control Board last met in July 1994 and projected a budget shortfall of at least $1 billion, close to the actual year-end gap of $1.1 billion (out of a budget of $31.6 billion) for fiscal year 1994. In January 1995, New York State Comptroller, H. Carl McCall, proposed to the new Governor, George E. Pataki, that a special meeting of the Financial Control Board be convened to review the city's budget for fiscal years 1995 and 1996. The comptroller felt that the city's projected budget gap of $450 million to $750 million for the fiscal year ending June 30, 1995, called for the Control Board's scrutiny. In response to this proposed review by the Control Board, New York City Mayor Rudolph W. Giuliani, a Republican, criticized the State Financial Control Board, labeling it "a partisan political operation" and "an anachronism." (The new Republican Governor had not yet made his new appointments to the Board.) Giuliani argued that the Board had approved budgets submitted by the previous mayor, David Dinkins, a Democrat, which had increased spending and helped to create the current deficits, and the Board was now criticizing parts of the Giuliani administration budget which cut spending.[70]

8. LEGISLATION

New York State Financial Emergency Act for the City of New York (1975). NY. UNCONSOL. LAWS (VOL. 65) §§ 5401–20 (McKinney 1979 & Supp. 1994)

The legislation was passed on the declaration of a financial emergency (§ 5403 of the Act) and was an assertion of the State's police powers typically reserved for such serious events as war, civil unrest, or natural disaster.[71]

NEW YORK CITY: FEDERAL ROLE

The Federal role in the New York City fiscal crisis of the 1970s had two parts, sometimes referred to as New York I and New York II.

New York I. In December 1975, President Ford signed into law the New York City Seasonal Financing Act of 1975 (P.L. 94–143). This provided for Federal short-term loans (up to one year) to the city in an aggregate outstanding amount not to exceed $2.3 billion. The loans were to be repaid by the last day of the fiscal year in which they were issued, and they were. The Federal Government was in essence providing the tax and revenue anticipation loans for the duration of the initial three-year fi-

[67] Brecher, Charles, Raymond D. Horton, and Dean Michael Mead. Budget Balancing in Difficult Times: The Case of the Two New Yorks. *Public Budgeting & Finance*, vol. 14, no. 2, summer 1994, p. 88.

[68] Drennan, Matthew P. The Present and Future Fiscal Problems of the Two New Yorks: What Happened This Time. *Public Budgeting & Finance*, vol. 14, no. 2, summer 1994, p. 106

[69] Brecher, Horton, and Mead, Budget Balancing in Difficult Times, p. 99.

[70] Myers, Steven Lee. Budget Worsening, May Criticizes State Fiscal Board. *New York Times*, January 13, 1995, p. B3.

[71] Bailey, *The Crisis Regime*, p. 39.

nancial plan. The authority to make loans under this act expired on June 30, 1978.[72]

New York II. On August 8, 1978, President Carter signed into law the New York City Loan Guarantee Act of 1978 (P.L. 95–339). Unlike the short-term loans under the 1975 law, the 1978 extension authorized guarantees for the principal and interest on long-term loans. The total amount of guaranteed debt that New York City could issue was $1.65 billion, allocated over four fiscal years: $750 million for fiscal year (FY) 1979, $260 million for FY80, $325 million for FY81, and $325 million for FY82.[73]

The loan guarantees could last for as long as fifteen years and would be available only for bonds sold to city or State pension funds. The guarantees formed an important part of a $4.5 billion financing package consisting of funds from both public and private sources.[74]

APPENDIX D. PHILADELPHIA: PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY (PICA)

1. SUMMARY OF INSTIGATING CRISIS[75]

The city of Philadelphia had not had a truly balanced budget since 1987. The city of Philadelphia was on its way to a fourth year of revenue shortfall over expenditures in fiscal year 1991 with no remaining authorization to ease the cash crisis with short-term borrowing. The city reached its debt limit in June 1991.[76] Access to the bond market closed for the city. State legislation was needed to fund the fiscal year deficit and finance capital projects.

2. DURATION OF CONTROL BOARD

By action of the State legislature, the Pennsylvania Intergovernmental Cooperation Authority (PICA) was established June 5, 1991, and is still in existence.[77]

The term of existence of the Authority was not to exceed one year after all of its liabilities have been fully paid and discharged (sec. 204).

Final dates were set for the issuance of bonds by the Authority: for a capital project or a deficit other than cash flow, December 31, 1994; for a cash flow deficit, December 31, 1996 (sec. 319). The bond issues typically have serial maturities of up to 25 years. (See section 6 on "Actions Taken" for information on bonds issued.)

3. BOARD COMPOSITION AND APPOINTMENT AUTHORITY

The governing board includes five appointed, voting members and two ex-officio, nonvoting members. The five members are appointed, one each, by the Governor, the president pro tempore of the Senate, the minority leader of the Senate, the speaker of the House of Representatives, and the minority leader of the House of Representatives. They serve in the following offices, elected among themselves: Chairperson, Vice Chairperson, Secretary, Assistant Secretary, and Treasurer, and such other officers as they may determine. The two ex-officio, non-voting members are the ex-officio representative of the Commonwealth of Pennsylvania—the secretary of the budget—and the ex-officio representative of the City of Philadelphia—the director of finance (sec. 202(a)–(g)).

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[72] U.S. Library of Congress. Congressional Research Service. *The New York City Financial Crisis: Important City, State, and Federal Considerations.* CRS Report No. 76–147 by Stacey M. Kean, August 2, 1976. Washington, 1976.

[73] U.S. Library of Congress. Congressional Research Service. *Overviews of the Lockheed, New York City, and Chrysler Loan Guarantee Programs.* CRS Report no. 80–97 E, by James M. Bickley, May 29, 1980. Washington, 1980. p. 9–14.

[74] U.S. General Accounting Office. *Guidelines for Rescuing Large Failing Firms and Municipalities.* GAO/GGD–84–34, March 29, 1984. Washington, 1984. p. 14.

[75] For a helpful compilation of information on PICA, see: Official Statement relating to $178,675,000 Pennsylvania Intergovernmental Cooperation Authority Special Tax Revenue Refunding Bonds (City of Philadelphia Funding Program) Series of 1993A. Bond issue prospectus, August 19, 1993.

[76] Philadelphia's State-imposed general obligation debt limit is 13.5 percent of the average assessed valuation of taxable realty for the 10 preceding fiscal years.

[77] Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class. (Note: Philadelphia is the only "City of the first class" in Pennsylvania.) Commonly known as "The PICA Act," 53 PA. CONS. STAT. ANN. § 12720 (Purdon 1991). Enacted June 5, 1991. Section numbers referred to subsequently (in parentheses) refer to subsections of this statute. In addition to this statute, another important document is the "Intergovernmental Cooperation Agreement by and between Pennsylvania Intergovernmental Cooperation Authority and the City of Philadelphia," dated January 8, 1992.

All members of the Authority board should have had experience in finance or management. All members of the board should be residents of the Commonwealth of Pennsylvania and, except for the secretary of the budget, should either be residents of the assisted City (Philadelphia) or have their primary places of business or employment in the city.

4. STAFFING

The staffing is to be determined by the board, subject to a possible limit on operating expenses by the State General Assembly (secs. 206(b), 202 (g), 203(c)(14)–(15). In 1994 the staff numbered six, including the executive director, deputy executive director, senior analyst, analyst, and two administrative and support staff. There are also outside professional advisors: a legal counsel and independent auditors.[76]

5. ENFORCEMENT AUTHORITY, MECHANISMS, AND PENALTIES

Among the specific powers of the Authority enumerated in the PICA Act are:

"(8) To exercise, while any bonds issued by the authority to assist the City remain outstanding, powers of review concerning the budgetary and fiscal affairs of that City consistent with this act and the City's home rule charter or other optional plan of government."

"(21) To borrow money for the purpose of assisting a City, or in anticipation of the receipt of income of the . . . assisted City; make and issue bonds of the authority; secure the payment of such bonds or any part thereof, by pledge of or security interest in all or any of its revenues, receipts, accounts, tangible personal property, and contract rights. . . . ;" and

"(23) To enter into agreements with an assisted City that receives funds or other financial assistance from the authority pursuant to which such City may pledge assets, rights, revenues and receipts, including tax revenues, to secure the repayment of such funds or assistance by such City if such security is required by the authority." (sec. 203(c)).

There must be an approved 5-year financial plan before the proceeds of the bond issue will be made available to the city (sec. 209).

Dedicated revenues are to be paid into special accounts, and not to the city receiving assistance (sec. 314).

There is a limit on the amount of tax and revenue anticipation notes that the city may issue in any one fiscal year (sec. 402).

There is authorization for an optional local sales and use tax, including an excise tax on hotel rents, of 0.5% or 1.0%, to be paid over to the Commonwealth of Pennsylvania (sec. 503).

There is authority to impose an Authority tax, to be collected by the Commonwealth, to remain in effect until all the outstanding bonds are paid off (secs. 601–604).

Other provisions are detailed in the "Intergovernmental Cooperation Agreement by and between the Pennsylvania Intergovernmental Cooperation Authority and the City of Philadelphia," dated January 8, 1992. The city is expected to submit a financial plan to the Authority, with projected revenues and expenditures for five fiscal years (the current year and four subsequent years). This covers the initial plan as well as the revised plan to be submitted at least one hundred days prior to the start of each fiscal year, so long as any bonds of the Authority are outstanding. The financial plan includes the operating and capital budgets of the city plus other "covered funds."

The mayor faces regular periodic reporting requirements. Within 45 days of the end of each fiscal quarter (or monthly, within 30 days of the end of the previous month, if a variance from the financial plan has been determined to have occurred), the mayor must provide the Authority with a report describing actual or current estimates compared with budgeted revenues, expenditure and cash flows by covered funds (excepting the grants revenue fund), for the previous quarterly or monthly period and the year-to-date period of the fiscal year.

At least 60 days prior to the beginning of each fiscal quarter, the mayor is to provide the Authority a report certified by the city controller describing for the following quarter the debt service requirements on all bonds and notes of the city and all lease payments of the city securing the bonds of other government agencies.

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[76] Philadelphia Intergovernmental Cooperation Authority. Staff Report on the City of Philadelphia's Five-Year Financial Plan for Fiscal Year 1995–Fiscal Year 1999. Philadelphia, May 2, 1994. Frontspage.

A "variance" from the financial plan is deemed by the Authority to have occurred if 1) there has been a net adverse change in the fund balance of a covered fund of more than one percent (1%) of the revenues budgeted for the fund for that fiscal year, and 2) if the actual net cash flows of the city for a covered fund are reasonably projected to be less that ninety-five percent (95%) of the net cash flows for the fiscal year originally forecast at the time of adoption of the budget.

The Authority may at any time issue recommendations as to how the city may achieve compliance with the financial plan.

One of the most important powers of PICA is the ability to withhold State grant monies and excess monies from borrowing activity (from the "City Account) from the City if the City is not in compliance with the financial plan. By the vote of a qualified majority of its board, the Authority may certify to the State's secretary of the budget the city's noncompliance with a financial plan. If the Authority certifies that the city is not in compliance, then each grant, loan, entitlement or payment to the city by the Commonwealth of Pennsylvania, or any of its agencies, of Commonwealth funds and payment to the city from the City Account, shall be suspended pending compliance with such financial plan. When a qualified majority of the Authority board determines that the reasons for noncompliance have ceased to exist, they notify the secretary of the budget who shall release State funds held in escrow, together with interest; disbursements from the city account shall resume within one business day following the secretary's release action. (Section 4.12 of the Agreement, withholding of funds.) There are exemptions for funds for certain purposes which the Commonwealth may not withhold from the city (section 4.13 of the Agreement).

6. ACTIONS TAKEN

Since its inception in 1991, PICA has issued a total of $1.419 billion in long-term bonds, in four installments. The "Series of 1992" was for an original aggregate principal amount of $474,555,000; the "Series of 1993," $643,430,000; the "Series of 1993A" for $178,675,00; and the "Series of 1994" for approximately $122,000,000.

Of the total amount of issued as of June 30, 1994 (prior to the 1994 series), $1.207 billion of special tax revenue bonds was specified for the following purposes: liquidate the general fund deficit ($332 million), refund (refinance) certain general obligation debt ($475 million), and fund capital improvement projects ($400 million).[79] In addition, some proceeds from the 1992 Bonds were also used to repay the Commonwealth of Pennsylvania for amounts advanced to pay the initial operating expenses of the Authority, to finance a portion of the Authority's first fiscal year operating budget, and to pay the costs of issuing the 1992 Bonds. A portion of the 1992 Bonds was used for grants to the city of Philadelphia to reduce court backlogs and accelerate the disposition of litigation pending against the city and for a grant to enhance productivity in the operation of city government. A portion of the 1993 Bonds was for capital improvements to the city's criminal justice and correctional facilities.[80]

On December 1, 1994, PICA marketed another $122 million in 1994 Bonds,[81] to be used primarily for financing capital projects. The money was expected to finance the renovation of a variety of city buildings, including fire stations, libraries, and recreation centers. Because PICA's bonding authority for capital projects or deficits other than cash flow ended December 31, 1994, this was expected to be the Authority's last such issue for capital projects.[82]

The bonds were issued in serial form, with maturities ranging up to 30 years. The last maturity date in the 1993A series is 2022.

A PICA "authority tax" was approved by the Philadelphia city council effective June 5, 1991 (Bill no. 1437). This is a 1.5 percent tax on wages, salaries, commissions and other compensation earned by residents of the city and on the net profits earned in businesses, professions or other activities conducted by residents of the city of Philadelphia. The revenue goes into a Special Revenue Fund collected by the Commonwealth of Pennsylvania. A portion of the PICA tax is used to cover PICA debt service and other Authority expenses, with the remaining revenues going to the city through the "City Account." At the same time, the rate of the wage tax otherwise levied on city residents by the City of Philadelphia was lowered by 1.5 percent-

[79] Dollar amounts from State of Pennsylvania, Office of the Budget, Bureau of Revenue, January 1995.

[80] Series of 1993A, Bond issue Prospectus, August 19, 1993, p. 1–2.

[81] Loeb, Vernon. PICA approves sale of bonds, saves money. *Philadelphia Inquirer*, December 2, 1994, p. B2.

[82] Pretto, Christina. Philadelphia Issue Delayed as Players City Weak Market, Fed Meeting Fears. *The Bond Buyer*. November 15, 1994.

age points (from 4.96 percent to 3.46 percent).[83] In effect, city residents pay the same amount of tax, but a portion (corresponding to the 1.5 percent tax rate) is now dedicated to PICA instead of the general funds of the city. (Note that the authority tax is not levied on non-residents earning income in Philadelphia. The city wage tax, however, is levied on nonresidents, or "commuters," at a rate of 4.3125 percent—lower than the 4.96 percent combined rate paid by city residents.)

In addition, a 1 percent local sales tax was adopted in FY92, though not by action of PICA.

Under the terms of the Intergovernmental Cooperation Agreement between PICA and the city, a "City Account" was established with a private bank. This is considered a trust fund for the exclusive benefit of the city. The account receives the proceeds of taxes or other revenues pledged by the Authority or the city to secure any bonds of the Authority or secure any payments due from the city to the Authority, in excess of amounts due to the Authority as enumerated in the Agreement. These excess amounts are to be disbursed (upon request by the city and agreed to by the Authority) to the city's general fund for the general expenses of the city's government.

The Agreement also provides that the city will not reduce the Authority Tax until the principal amount and interest of all bonds of the Authority secured by the tax are fully paid or provision for payment is made. The revenues from this tax are revenues of the Authority and not the city.

With regard to collective bargaining agreements and arbitration awards, any already in effect at the time the financial plan is approved can remain in effect until its term expires. However, after a financial plan has been approved, the city must execute collective bargaining agreements in compliance with the plan. Neither a collective bargaining agreement or arbitration award is to be considered void or voidable solely by reason of noncompliance, but the city is required (no later than 15 days after such agreement or receipt of arbitration award) to submit to the Authority a proposed revision to the financial plan which demonstrates to the reasonable satisfaction of the Authority that revenues sufficient to pay the costs of such collective bargaining agreement or such arbitration award will be available in the affected fiscal years of the financial plan (sec. 5.07(b)).

Any determination of the board of arbitration providing for an increase in wages or fringe benefits of any employee of the city under the financial plan (applying to collective bargaining for policemen and firemen) is to "take into consideration and accord substantial weight to" the approved financial plan and the financial ability of the city to pay the cost of such increase in wages or fringe benefits without adversely affecting levels of service (sec. 5.08).

One of the supporting documents to be submitted by the city with the financial plan is a schedule that will help the Authority understand the implications of the city's bargaining agreements with its employees. This includes the number of authorized employee positions (filled and unfilled), an estimate of wage and benefit levels for various groups of employees, and an analysis of the financial effect on the city and its employees of changes in compensation and benefits (sec. 4.04(h)).

In general, within the limits of the funds available to it, the city retains the ability to determine the purposes for which expenditures are to be made by the city and the amounts of such expenditures permitted under the financial plan.

7. EFFECTIVENESS

The beginning of the city of Philadelphia's financial rehabilitation is marked by the first five-year plan (the FY92–FY96 Plan), approved in 1992. Two years later, when the FY95–FY99 plan was submitted (and modified with PICA approval on May 2, 1994), it was expected that the city would report a substantial operating surplus for FY94 and that the FY95 budget would be balanced.

Philadelphia's audited general fund surplus as of June 30, 1993, was approximately $3 million. The unaudited preliminary general fund surplus as of June 30, 1994, was approximately $15.3 million.[84]

Credit for this turnaround is given to tightened managerial control by the city. There is still a threat of deficits in future years, because external forces continue to drive up future expenditures faster than revenues. In addition, a major part of

[83] Series of 1993A, Bond issue prospectus, August 19, 1993, p. 4.
[84] State of Pennsylvania, Office of the Budget, Bureau of Revenue.

the PICA rescue effort was solving the immediate cash flow crisis by issuing long-term debt.[85]

8. LEGISLATION

Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class. Commonly known as "The PICA Act," 53 PA. CONS. STAT. ANN. § 12720 (Purdon 1991). P.L. 9, No. 6. Enacted June 5, 1991.

Intergovernmental Cooperation Agreement by and between Pennsylvania Intergovernmental Cooperation Authority and The City of Philadelphia. Dated as of January 8, 1992.

APPENDIX E. YONKERS, NEW YORK STATE EMERGENCY FINANCIAL CONTROL BOARD FOR THE CITY OF YONKERS

1. SUMMARY OF INSTIGATING CRISIS

Yonkers had shown signs of financial difficulty since the mid-1960s. Like New York City, Yonkers had been rolling over expenses from one fiscal year to another and paying some operating expenses from the capital budget, financing them through the sale of short-term notes and bonds. A crisis finally erupted in November 1975. The municipal bond market would not refinance $16.8 million in maturing notes or lend the additional $60 million in short-term debt that Yonkers would need within five months to cover current operations, even at a premium interest rate.

New York City and Yonkers were the only two municipal corporations in New York State with financial problems so severe in the mid-1970s that the standard State deficit funding authorization did not apply.[86] City officials, State aides, and officials of banks that normally underwrote obligations for Yonkers put together a proposal for a 60-day "bridge loan" of $35 million. The State's half of the loan was to come from State pension funds. However, Arthur Levitt, the State comptroller, also responsible for the pension funds, rejected the proposal. (The default of the New York State Urban Development Corporation in March 1975 and the concurrent difficulties in New York City and elsewhere in the State probably added caution to the comptroller's response.) Instead, at the insistence of the banks, on November 13, 1975, State legislation was sought for the creation of an emergency board similar to, but simpler than, the one for New York City.[87] The legislation passed the next day.

2. DURATION OF CONTROL BOARD

1975–78

The New York State Emergency Financial Control Board for the City of Yonkers was first created by the New York State legislature effective November 14, 1975.[88] However, the creation of the Control Board and a segregated debt service fund alone were not sufficient to restore the investor confidence needed to complete the bond sales.

In June 1976 the State passed additional legislation that named the State comptroller as "fiscal agent" for the city of Yonkers, with power to approve the city's budgets, control a special segregated debt service account with earmarked revenues, segregate the bond proceeds, and approve the issue of notes.[89] This legislation effectively transferred supervisory powers from the Control Board to the State comptroller. The powers of the fiscal agent (the State comptroller) were to remain in effect until the bonds issued to cover the deficit were retired. (In subsequent years, powers of the State comptroller have been expanded through provisions included in bond covenants.) With the combination of the Control Board and the fiscal agent legislation, Yonkers was able to reenter the bond market in July 1976.[90]

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[85] PICA, Staff Report on the City of Philadelphia's Five-Year Financial Plan For FY95–99, May 2, 1994.

[86] U.S. Advisory Commission on Intergovernmental Relations. *Bankruptcies, Defaults, and Other Local Government Financial Emergencies.* Washington, ACIR, Report A–99, March 1985. p. 33–34.

[87] Feron, James. Levitt Rules Out Loan to Yonkers. *New York Times,* November 13, 1975, p. 1.

[88] New York State Financial Emergency Act for the City of Yonkers. N.Y. UNCONSOL. LAWS ch. 23 §§ 1–13 (Consol. 1983) or 1975 N.Y. LAWS 871.

[89] Special Local Finance and Budget Act of the City of Yonkers, also known as the "special fiscal act" or "fiscal agent act." 1976 N.Y. LAWS 488–489. Enacted June 30, 1976.

[90] ACIR, *Bankruptcies, Defaults,* p. 34.

In the 1975 law the "emergency period" was defined as the period of time from the effective date of the act until the date when the Board determines that the operating and capital funds of the city have been in balance for one fiscal year in accordance with the accounting methods prescribed in the general municipal law. The Board was to terminate six months after the end of the emergency period.

The 1975 legislation had planned that the city's operating and capital funds would be balanced for FY1977. Legislation in 1977 extended the period for submitting a balanced operating and capital budget for an additional fiscal year, through June 30, 1978. The original Control Board remained in existence until December 31, 1978.

1984–PRESENT

From 1979 to 1984 (while under the watch of the State comptroller as fiscal agent) Yonkers was again having financial difficulty and needed State loans in order to balance its budget. At the request of city officials and in conjunction with a State financial bailout of the city, the State legislature reimposed a State emergency financial control board as of May 2, 1984.[91] In the 1984 law, the "emergency period" was defined as the period of time from the effective date of the act until the date when the board determines that (a) the operating and capital funds of the city have been in balance for three fiscal years; (b) the amount of all loans made by the State to the city to fund the operating deficits incurred by the city in FY84 or later have been repaid in full; and (c) the city has presented a four-year financial plan that projects operating and capital funds in balance. The Board again was to terminate six months after the end of the emergency period.

The city of Yonkers recently achieved three years of balanced budgets: fiscal years 1992–94. However, its four-year prospective financial plan does not yet have a reasonable expectation of being in balance. Consequently, the Control Board remains in existence as of February 1995.

3. BOARD COMPOSITION AND APPOINTMENT AUTHORITY

The composition of the New York State Emergency Financial Control Board for the City of Yonkers is currently as follows: three members ax-officio: the State comptroller, the secretary of state, and the mayor; and four members appointed by the Governor with the advice and consent of the State Senate. The four appointed members serve at the pleasure of the Governor. The secretary of state (also appointed by the Governor) serves as chairman. Both the secretary of state and comptroller may designate representatives to act in their place, but the members appointed by the Governor may not. These seven constitute the voting number, the majority of which prevails.

(During the 1975–78 period, the State comptroller served as the chairman of the board. During 1984–85, the Lieutenant Governor held the slot subsequently filled by the secretary of state. Before 1991, the city manager was a fourth ex-officio member of the Control Board and there were three, instead of four, appointed members.)

In addition to the voting members, six non-voting members intended to represent the public (known as the "public representatives") may be appointed by the following New York State and county officials: the temporary president of the Senate, the speaker of the House, the minority leaders of the House and Senate, the county executive of Westchester County, and a person designated by the Control Board to represent Yonkers city employees.

Board members receive no salary or per diem allowance, but are entitled to reimbursement for actual and necessary expenses. The Board may delegate powers and duties to one or more of its officers, employees, or agents.

4. STAFFING

During the initial 1975–78 period, the Yonkers Board relied heavily upon the staff of the State comptroller's office.

The Board is authorized to hire up to ten staff members, but has not had more than six. Currently, those six positions include executive director, general counsel, deputy executive director (who also serves as a financial analyst), financial analyst, and two clerical secretaries.

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[91] New York State Financial Emergency Act of 1984 for the City of Yonkers, N.Y. UNCONSOL. LAWS §§ 1–14 (Consol. Supp. 1990) or 1984 N.Y. LAWS 103.

5. ENFORCEMENT AUTHORITY, MECHANISMS, AND PENALTIES

In addition to the City of Yonkers, the Board has authority over "covered organizations." This includes the board of education and from time to time has included the city housing authority. The Board may exempt a covered organization from review if it feels that would not jeopardize the city's ability to adopt and maintain a balanced budget.

According to the 1975 legislation, the Board was to develop a financial plan in conjunction with the city for fiscal years 1976 and 1977. The city's operating and capital funds were to be balanced. The aggregate principal amount of outstanding short-term obligations was limited to a dollar amount. The act favored attrition as the primary way to achieve a stabilized work force. The Board was to estimate city revenues. The city was to prepare the financial plan and submit it to the Board for approval or disapproval; if the city did not submit or adopt an approved financial plan, the Board was to formulate and adopt one. The financial plan was to provide for the payment in full of debt service requirements and to operate within the constraints of its projected cash resources. The annual increase in aggregate expenditures was based on the FY76 budget with an increase limited to 2 percent or additional increases to meet substantial inflation, if increased revenues permitted. The Board was responsible for the revenue estimates. The revenue estimates were to govern the amount of aggregate expenditures permitted.

The 1975 legislation temporarily froze wages. In the 1984 legislation, those responsible for recommending wage increases were expected to take into serious consideration the financial ability of the city or covered organization to pay the cost of an increase in wages or fringe benefits. The Board was given the authority to declare a fiscal crisis and order all increases in salary or wages to be suspended if it determined that a wage freeze was essential to the adoption or maintenance of a city budget that was in compliance with the Emergency Act. The suspensions of wage increases would last for one year and could be extended, if necessary, to no later than the end of the emergency period.

The city was not to borrow or spend, except in compliance with the terms of the 1975 or 1984 Financial Emergency Act. The Board can disapprove proposed contracts if they are inconsistent with the financial plan. The Board can order the city to cut expenditures which, in effect, means cutting the payroll. Because approximately 80 percent of the city budget is payroll, control over payroll and the number of employees (hiring and firing) is considered a most important power.

Both the 1975 and 1984 legislation created an "emergency financial control board fund" for the City of Yonkers. This includes a "debt service repayment account." For the duration of the "emergency period," all revenues received or to be received by the city or any "covered organization" are to be revenues of the fund. Disbursements from the fund are to be made by the Board in accordance with the approved financial plan. The Board can authorize the city to make disbursements of city revenues from the fund. The legislation specifies the priorities of expenditures if funds are insufficient: 1) debt service; 2) liabilities with statutory or contractual priority; 3) other obligations on an allocated or pro rata basis, determined by the Board if the city fails to so specify.

The 1984 Financial Emergency Act laid out prohibitions and penalties for officers and employees of the city who violate the financial plan or orders of the Board. Possible discipline includes suspension from duty without pay or removal from office by order of either the Governor or the city manager, and being convicted of a misdemeanor.

The 1984 legislation provided that the Board should perform the following functions: a) estimate revenues and consult with the city and its covered organizations on the financial plan, prescribe the form and information required, and approve, disapprove, or modify the plan; b) establish procedures with respect to deposit of revenue to and disbursement of monies from the emergency financial control board fund for the city; c) review operations, management, efficiency, and productivity; make reports and recommendations; audit compliance with the financial plan; d) receive and review financial statements, budgetary data, and management reports from the city and State comptroller; audit books and records of the city as necessary; e) approve all contracts for compliance with the act and the financial plan; f) review the terms of each proposed long-term and short-term borrowing of the city; borrowing is not permitted without Board approval; g) receive quarterly reports from the State comptroller setting forth the city's debt-service requirements; h) issue binding orders to city officials in order to accomplish purposes of the act and to implement an approved financial plan in a timely and satisfactory manner; the officials are subject to the penalties if they fail to comply; and i) coordinate with the State comptroller to review and monitor the city's revenues and expenditures. In the event of any de-

fault, the Board is authorized to take any action as directed pursuant to Title 6–A of Article 2 of the New York Local Finance Law and to direct the city to take any action the city is therein authorized to take.

The Board reviews quarterly financial statements submitted by the city (comparing actual with previously projected revenues, expenditures and workload) and meets with the city's budget team in anticipation of actions to be taken by the State legislature. For example, the City of Yonkers may request exceptions to specific criteria on terms of bonds issued, tax limits, local school aid, and city budget expenditures mandated by New York State law.

6. ACTIONS TAKEN

An emergency control board fund was created for the City of Yonkers to receive all revenues collected by or accruing to the city or "covered organizations." While the disbursement from the fund was to be made in accordance with the approved financial plan, the Board was authorized to and did delegate authority to the City of Yonkers to make disbursements from the fund through most of the period since 1984. However, during the crisis in 1988 surrounding the city council's defiance of a housing desegregation order, when fines were mounting, the Control Board did take over writing the city's checks and, in late summer, ordered the city to fire all city employees.[92, 93]

The 1975 New York State legislation establishing the Yonkers control board authorized a 1 percent increase in the city's sales tax.

The Financial Emergency Act froze all city government salary and wage levels as of November 20, 1975. All salary or wage increases were suspended for one year, later extended through FY 1977.[94] The Board has ordered a wage freeze each year that the budget was not in balance. (Wage freezes, however, simply defer payment of the promised wage increase; they do not eliminate the obligation to pay it eventually.) Through its authority to review city contracts, the Board has disapproved some collective bargaining agreements in recent years, and not permitted any wage increase whatsoever. (That action provides some permanent saving.)

In 1976 State legislation liberalized Yonkers's ability to issue tax anticipation notes.[95]

In the 1984 Financial Emergency Act, the legislature announced its intention to provide significant State assistance in cooperation and conjunction with significant local actions. Yonkers was given a State appropriation and the State Insurance Fund was authorized to assist the city in bonding out certain long-term obligations; the Insurance Fund loaned the city $10 million.

Yonkers was also given new revenue-raising authority. Separate legislation authorized Yonkers to impose an income tax surcharge at a rate of up to 19.25 percent.[96] However, since it began, effective January 1, 1985 (applicable to tax years beginning after 1983), the city income tax surcharge on Yonkers residents has been imposed at a rate of 15 percent of their net State income tax, below the maximum permitted. Nonresidents pay a tax of 0.5 percent on wages and net earnings from self-employment within the City of Yonkers. The income tax is administered by the State commissioner of taxation and finance and is subject to withholding. In September 1994, the surcharge, scheduled to expire on December 31, 1994, was extended for another year.

New York State Session Laws of both 1993 and 1994 extended the authorization for Yonkers to issue "negotiated sale" bonds and notes for another year.[97] However, the Financial Control Board directed the city to put up the bonds for "competitive bid" during 1994. (Experience has indicated negotiated sales to be more advantageous for financially troubled cities because private placement provides a more focused opportunity to educate potential lenders about the city's ability to repay the debt.)[98]

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[92] Conversation with James Marrin, Acting Executive Director and General Counsel, New York State Emergency Financial Control Board for the City of Yonkers, December 22, 1994.

[93] The layoffs were averted in early September 1988 when the council agreed to follow Judge Sand's order to approve the financial incentives required to begin development of the housing remedy. Pizzurro, Frank. Judge Breaks 10-Year Deadlock on Controversial Housing Case. Empire State Report, August, 1991, p. 38.

[94] ACIR, *Bankruptcies, Defaults*, p. 34.

[95] Effective Mar. 18, 1976, pursuant to L. 1976, c. 59, sec. 4; sec. 24 Local Finance Law.

[96] 1984 N.Y. LAWS 345.

[97] 1994 Session Laws of New York, Ch. 414, City of Yonkers—Sale of Bonds and Notes (S. 8526) an amendment to section 54.40 of the local finance law.

[98] Craig, Susan. To Bid or Not to Bid? *Empire State Report*, March 1989, p. 38).

The Control Board has rejected city labor contracts several times; in 1992, this led to a riotous union demonstration at City Hall. In 1993 the Board disapproved plans for a new city library because of its projected cost. In 1994 the city council sued the Control Board for limiting the city's application of surplus funds from one year to close the following fiscal year's budget gap.[99]

Both the original 1975 and the subsequent 1984 legislation provided that the city had the power to determine the specific purposes of its own expenditures, within the aggregate limit on expenditures permitted under the financial plan approved by the Control Board. In recent years, however, the Yonkers Financial Control Board has been characterized as micromanaging the city's finances, interfering with the elected officials' priorities.[100] City officials would prefer the Control Board to set aggregate parameters for revenues and expenditures rather than directing specific program cuts or additions. City officials feel that having the Control Board pay attention to such detail may not be as necessary now that the city has a "strong mayor" (see discussion of "exacerbating circumstances" in section 7).

In addition to the powers of the Control Board, Yonkers's finances are subject to other State controls. For example, under State rules, the city may not send out its real property tax bills until its budget has been certified by the State comptroller, acting as the city's fiscal agent. (The property tax rate is calculated to make up the revenue difference between projected expenditures and all other anticipated sources of revenue.) The city's projected revenues beyond fiscal year 1995 depend upon the State legislature approving an extension of the personal income tax surcharge and the mortgage recording tax.

7. EFFECTIVENESS OF BOARD

The Advisory Commission on Intergovernmental Relations (ACIR) concluded that during the 1975–78 emergency period, the Yonkers Control Board had less direct control over the city's revenues and contracts than the New York City Board and thus had trouble enforcing compliance with any financial plans. Nonetheless, the city succeeded in meeting the required conditions of a balanced budget and the Control Board was disbanded at the end of 1978.

ACIR also concluded that the State comptroller, as fiscal agent, did not exercise political or institutional power comparable to the New York City Control Board, and was unable to impose sufficiently strict financial budget discipline on Yonkers to solve the city's financial problems during the 1979–84 period.[101]

In May 1984 the city was found to be in sufficient financial distress that a State Emergency Financial Control Board was reimposed. Eleven years later, in 1995, the Board remains in existence.

EXACERBATING CIRCUMSTANCES

Since 1986, Yonkers has been under a Federal court housing desegregation order that required it to build subsidized housing in predominantly white neighborhoods. In the summer of 1988, Yonkers was pushed to the edge of bankruptcy when city officials defied the judge's order and the city was subject to steep contempt-of-court fines that reached over $800,000. The city spent an estimated $7 million to $23 million in legal fees defending itself against discrimination charges.[102] The mayor during 1990 and 1991, Henry J. Spallone, focused on fighting the public housing requirement and failed to deal with other issues, including the city's troubled finances and economic development needs. In 1991 his administration submitted to the Emergency Financial Control Board a four-year financial plan with a $110 million revenue shortfall.[103]

In 1990, Yonkers voters approved a change to a "strong-mayor" form of government, effective in 1992. Prior to 1992, the position of mayor of Yonkers was primarily titular. The mayor was a member of the legislative branch, elected city-wide as a seventh city council member. Real power over day-to-day operations was held by a hired city manager. Under the new law, the mayor's term was increased from two to four years and the mayor was given enhanced power over the budget and political appointments, previously vested in the city manager. The mayor was also

[99] Dentzer, Bill. City Awaiting New Faces on State's Control Board. *The Herald Statesman.* December 1, 1994, p. 1A–2A.

[100] Ibid.

[101] ACIR, *Bankruptcies, Defaults,* p. 34.

[102] Pizzurro, Frank. The "Strong Mayor" in Yonkers. Also, Judge Breaks 10-Year Deadlock on Controversial Housing Case. *Empire State Report,* August, 1991, p. 37–39.

[103] Foderaro, Lisa W. Yonkers Winner Benefits from Republican Split. *New York Times,* November 7, 1991, p. B9.

given new veto powers over legislation and certain aspects of the budget. The position of city manager was abolished. Three-way controversies among the city manager, mayor, and city council were judged to have hindered efforts to deal effectively with the budget.[104] The current Mayor, Democrat Terence Zaleski, elected in 1991, is the first to serve under the new rules.

Part of the city's recent difficulties in obtaining the required certification of its budget by the State comptroller stems from political differences between the Republican council and the Democratic mayor—which each propose their own version of the city budget—and between the Republican council and the State Control Board, appointed by the Governor—from 1982 to 1994 a Democrat, Mario Cuomo. After the November 1994 elections, the city council's GOP leader said that he hoped the new board (to be appointed by newly-elected Republican Governor George Pataki) would ". . . abide by their proper role in this town, not get into politics and micromanagement." The outgoing chairman of the Financial Control Board (secretary of state Gail S. Shaffer, chairman from 1985 through 1994) dismissed that criticism and said the new Board would have to deal with the inherent conflict created when an appointed body is in a position to review, and occasionally reject, actions taken by local officials.[105]

8. LEGISLATION

New York State Financial Emergency Act for the City of Yonkers, N.Y. UNCONSOL. LAWS ch. 23 §§ 1–13 (Consol. 1983) or 1975 N.Y. LAWS 871, as amended. Enacted November 14, 1975.

The Special Local Finance and Budget Act of the City of Yonkers, also known as the "special fiscal act" or "fiscal agent act," 1976 N.Y. LAWS 488–489. Enacted June 30, 1976.

New York State Financial Emergency Act of 1984 for the City of Yonkers, N.Y. UNCONSOL. LAWS §§ 1–14 (Consol. Supp. 1990) or 1984 N.Y. LAWS 103, as amended. Enacted May 2, 1984.

APPENDIX F. CONTACT DIRECTORY

Chicago School Finance Authority, 310 South Michigan Avenue, Suite 1440, Chicago, IL 60604, Phone: (312) 939–1860.

City of Cleveland, 601 Lakeside Ave. NE, Cleveland, Ohio 44114, Finance Director, Kathryn Burrer-Hyer, (216) 664–2536, Financial Reporting and Control, Michael Abouserhal (216) 664–2667.

Municipal Assistance Corporation for the City of New York, 1 World Trade Center, Room 8901, New York, NY 10048, Phone: (212) 775–0010, FAX: (212) 775–0042.

New York City: New York State Financial Control Board, State Comptroller's Office, New York City Division, 270 Broadway, 23rd Floor, New York, NY 10007, Tel: (212) 417–5444.

Pennsylvania Intergovernmental Cooperation Authority (PICA), 1429 Walnut Street, 14th Floor, Philadelphia, PA 19102, Phone: (215) 561–9160, FAX: (212) 563–2570.

James Marrin, Acting Executive Director and General Counsel, New York State Emergency Financial Control Board for the City of Yonkers, 45 So. Broadway, Yonkers, NY 10701, Phone: (914) 969–8206.

William R. Thomas, Commissioner of Financial Services, City of Yonkers, Department of Finance and Management Services, City Hall, Room 212, Yonkers, NY 10701–3889, Phone: (914) 377–6100, FAX: (914) 964–0417.

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[104] Pizzurro, Frank. The "Strong Mayor" in Yonkers. *Empire State Report,* August, 1991, p. 37–39.

[105] Dentzer, Bill. City Awaiting New Faces on State's Control Board. *The Herald Statesman.* December 1, 1994, p. 1A–2A.

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