FINANCIAL CONTROL BOARDS

HEARING

BEFORE THE

SUBCOMMITTEE ON THE
DISTRICT OF COLUMBIA

OF THE

COMMITTEE ON GOVERNMENT
REFORM AND OVERSIGHT
HOUSE OF REPRESENTATIVES

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FINANCIAL CONTROL BOARDS

WEDNESDAY, MARCH 8, 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 10:10 a.m., in room 2154, Rayburn House Office Building, Hon. Thomas M. Davis III (chairman of the subcommittee) presiding.

Present: Representatives Davis, Gutknecht, LaTourette, Flanagan, Norton, Collins of Michigan, Clinger [ex officio], and Collins of Illinois [ex officio].

Also present: Representative Molinari.

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

Mr. DAVIS. The meeting will come to order.

I want to welcome all of you to our third hearing on the financial and budgetary crisis faced by the District of Columbia, our Nation's Capital. These hearings are designed to educate the subcommittee, Congress, the residents and government of the District of Columbia, and the Nation on the true financial situation of the District and what other cities in similar situations have done to deal with their problems.

Today we will hear from people from three great American cities that experienced tough financial times in recent years: Cleveland, New York, and Philadelphia. By taking the time to be with us today, these distinguished Americans demonstrate their concern for Washington, DC, as not only another great American city in trouble but also as our Nation's Capital. They have come to share their experiences so that we in Congress can learn and hopefully benefit from them.

All of the people who will testify shortly have greater experience with control boards and other forms of urban rejuvenation than we have. That is the purpose of today's hearing, to gain insight from people who have actually been there and who can tell us how these mechanisms work or don't work.

Last week we learned that Washington's problems are not unique. All the other cities we have examined stumbled into the abyss the same way Washington has. They attempted to do too much and lived well beyond their means.

The titles of a book and a newspaper article I encountered recently succinctly summarize the cause of these problems. In 1980

Charles R. Morris called his detailed study of the New York fiscal crisis of the 1970's "The Cost Of Good Intentions." Indeed, Mr. Morris found that the problem was right there in his title. Good intentions alone, without limit or control, are as harmful as bad intentions.

Last month Pulitzer Prize winning journalist William Raspberry headlined a column on Washington, DC, as the city that couldn't say no. He likened the city's spending practices not to those of a drunken sailor but to a compassionate parent with a credit card. As Mr. Raspberry wrote, a huge amount of the city's stupendous debt is the result of the local government's effort to do good things it can't afford. Those days must be gone forever.

The testimony of so many credible people before us in these three hearings serves as evidence that the people of Washington, DC, and the people of the surrounding region all have a stake in the vitality of this city, and that this can be a beginning rather than an end. The people who are with us today will show that a control board is not a monster or a cure worse than the disease that it is designed to fight.

The people and governments of this region as well as of the District of Columbia itself need to help resolve the present difficulties. Without the vitality and culture of a healthy Washington, DC, the Maryland and Virginia suburbs cannot expect their good times to continue unabated either.

Control boards in and of themselves cannot solve some of the most pressing ills that plague most of our cities today—high crime, excessive taxes, shrinking tax bases, poor schools, and the loss of the middle class. That will require a partnership of local people from both the public and private sectors with the courage, vision, and imagination to break with past practices, devise new and better ways of serving the people who live, work, visit our urban centers.

I know of no other current issue where we can better apply Benjamin Franklin's advice to the Continental Congress: "We must all hang together, or we will most assuredly all hang separately."

I would yield now to Ms. Norton, the ranking member of the subcommittee, for an opening statement. I would like to ask other members of the panel to hold any statements they have until later, but I want to acknowledge the presence of the chairman of our full committee, the Honorable William Clinger, for once again being with us today.

The mayor is on a very tight schedule, and we are just very grateful that he could take time to be with us today.

Ms. Norton.

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

I want to thank Chairman Davis for his leadership in producing two vital hearings in short order as we move to address a fiscal emergency and to prevent default by the District of Columbia.

The chairman's course and pace are dictated by dramatic events. Last month the bond rating agencies downgraded the District's credit rating so severely that, for all practical purposes, the District has lost the ability to borrow the money necessary to stay in business. Yet on February 22, a week after the first of three agencies downgraded the District's bonds, Mayor Barry testified that the

District would need to borrow cash within weeks. At the same joint hearing of this subcommittee and the DC Appropriations Subcommittee, Mayor Barry testified that the District needed an oversight board. The GAO appeared at that hearing as well and testified that the District is technically insolvent.

Emergency conditions are compounded by a deficit significantly larger than previously suspected and by congressionally required cuts that now appear impossible to fully achieve by September 30, the end of the fiscal year. Thus, the subcommittee is working quickly to establish a recovery board for three reasons: The District is insolvent; the District must borrow soon; and the District has a deficit that is now so far out of control that it cannot be tamed within a single fiscal year.

Chairman Davis has said that he believes that the House and the Senate must complete their work by the April recess in case the District must borrow while Congress is out of session. Therefore, he has established a timetable necessary to get the job done. I know that I speak for District officials and residents alike when I express my thanks to the chairman for taking the action necessary to avoid an untenable result. We are racing against the clock. If Congress is to do the job right in so short a period of time, we must submit to a quick study of the real life operational experience of cities that have established boards.

We are enormously grateful that so many of the principal figures who have been active in making their boards work have agreed to testify today. Their testimony is a tangible and invaluable contribution to the Nation's Capital and thus to the Nation itself. I welcome all of today's witnesses and express my sincere gratitude to them.

Thank you, Mr. Chairman.

Mr. DAVIS. Thank you, Ms. Norton.

I would now yield to the Representative from Staten Island, the former minority leader of the New York City Council, Susan Molinari.

Ms. MOLINARI. Thank you, Chairman Davis.

Chairman Davis, members of the committee, it is a great honor and a privilege to introduce to you the mayor of the greatest city in the world, the mayor of New York City, Rudolph Giuliani. Rudy is the best thing that has happened to New York City since Mayor Fiorello LaGuardia cleaned up Tammany Hall.

Since taking office in January 1994, Mayor Giuliani has done what many people claimed was impossible: He has made city government more efficient, thereby allowing him to reduce the size of government while greatly improving our quality of life. In fiscal year 1995, the city has implemented plans for an absolute decline in city spending for the first time in over 16 years; and to date the city-funded work force has been reduced by over 12,300 employees.

I know Mayor Giuliani's leadership and experience in New York City will be helpful to your committee as you work through the District of Columbia's problems to help solve their fiscal crisis because the truth is, Mr. Chairman, if you can do it in New York, you can do it anywhere. It is my great honor to introduce to the members of this committee the mayor of the city of New York, Rudolph Giuliani.

Mr. DAVIS. Thank you, and let me thank you, Susan, for introducing the mayor, and we appreciate your interest and availability to be with us this morning.

Mayor Giuliani, it is a requirement of the committee that all witnesses must be sworn before they may testify. Would you please rise with me and raise your right hand.

[Witness sworn.]

Mr. DAVIS. Thank you. You may be seated and proceed with your testimony, and I would just say it is an honor to have you here today, and we appreciate your taking the time out of your very busy schedule.

STATEMENT OF RUDOLPH W. GIULIANI, MAYOR, CITY OF NEW YORK

Mr. GIULIANI. Good morning, Mr. Chairman, members of the committee. It is in fact a privilege for me to be here.

Mr. Davis, you are quite correct, all Americans have an interest in Washington, DC, as a capital and as a great American city, and as one who has had the privilege of living in Washington, DC, I have a particular interest in it and real fondness for it.

I have come here today with two purposes. The first is to address the advisability of implementing a financial control board for cities in crisis, the situation New York faced in the mid-1970's. The second is to discuss the steps my administration has taken to reorder New York City's economy, to reduce government spending, to promote private sector growth, and to improve the quality of life in New York City.

The spirit in which I offer both sets of comments are as suggestions. We don't have all of the answers by any means. We are struggling with very similar problems that Washington, DC is struggling with, and I offer these suggestions as some that might be applicable, some that might not, and being completely supportive of the work of this committee and of the Mayor in trying to get control of a very difficult problem that built up over a long period of time, and I'm sure that if you all work together you will be able to get control of it.

On the subject of a financial control board, it certainly can provide service during a time of extreme financial distress like the situation New York City faced during its fiscal crisis 20 years ago, and it can certainly also provide a great many ideas and the ability and the mechanism to make very, very tough decisions that sometimes elude the political process and, unfortunately, cannot be made as part of the political process.

However, a financial control board should have a very strict beginning and a very strict end. Once the city has regained fiscal discipline, the financial control board can easily become just another layer of bureaucratic oversight and it can itself become a political tool just as much as a mayor, a city council, or any other group can become a political tool.

I think really the art to doing it correctly is to have a very strict, tight sunset period so that the control board would exist during the time of emergency and then at a fixed point it would be dissolved so that a city can quickly regain its self-sufficiency.

When I came into office I was determined to change the direction of New York City and set it on a course for growth and prosperity. The key to accomplishing this was to reorder the city's economy by restoring the proper balance between our public and private sectors. In short, New York City had the largest government economy in the United States, and its private economy was shrinking, hemorrhaging. We had lost over 400,000 private sector jobs in a 4-year period. Those are numbers that matched the Great Depression.

In order to restructure our economy, we engaged on a very deliberate course of reducing the size of the public sector, reducing the size of government, and taking some of the money that we save from that and putting it back into the private sector so that we can restore a more balanced economy in the city with a somewhat smaller government and a growing private sector.

Last year our first budget for fiscal year 1995 moved to restore the balance by, for the first time in 16 years, reducing spending in the city of New York. It was the first budget in 16 years in which the city spent less money in one fiscal year than in the year before. In fact, the city had been on a course over a 40 or 50-year period of each year spending more money than in the year before.

Part of the reason why the city created a structural deficit is that, if you go back and trace each one of those periods, what you see is that as the mayor and the city council would get ready to set the budget for the next year, they would increase the budget, and then during the year they would spend even more than the amount by which they increased it.

So let's say they agreed to increase the budget by 6 percent. That would be voted by the city council, agreed to by the mayor, and then over the course of the year that 6 percent increase, in one way or another, would become an 11 or 12 percent increase in spending. That had occurred roughly for 16 consecutive years. It had been interrupted by 2 years of a financial control board, in essence, running the affairs of the city, and that had gone on for the previous 20 or 30 years.

The problem of it is, in almost every single year the increase in spending was greater than the increase in the size of the economy. So the city was outspending the growth of its economy. If the economy of the city was growing by 5 percent, the city would somehow find a way to spend 10 percent. If the economy was growing in a bad year by 2 or 3, even then the city would find a way to spend 5 or 6 percent.

All of that converts itself into a kind of technocrat label called structural deficit, but structural deficit means that you are spending considerably more money than your tax base can really allow you, and then we would do things like raising taxes, raising fees, raising fines, and we were crushing the private sector, in essence giving it a very strong message to get out of New York City because if you stay in New York City you are going to continue to pay for our inability to spend within our means.

So we embarked on a three-pronged approach to redress the city's imbalance, and the first one might seem a little bit—a little bit off the point but probably has the most to do with creating economic redevelopment. The first priority was to make our streets and neighborhoods safer, to increase policing, to increase it as dra-

matically as possible, and to show that New York City could reduce crime and reduce it quickly.

Over the last year New York City experienced one of the largest reductions in crime in its history, and in two categories, murder and felonious assault, it achieved the largest reduction ever in the history of the city, and New York City now is below the top 50 cities for crime in the United States. That is vitally important, because no matter what you do with the taxes and no matter what you do with the balance in the economy, if people believe that a city is not safe they are going to leave it, and you can't have economic development when people are fleeing.

The second thing that we did was to create an aggressive probusiness environment, because businesses mean jobs and the fact is that we were looking to the wrong place for jobs. The city was promising jobs from government. New York City has 7½ to 8 million people officially. We employ—when you consider our employment and the number of people that come into the city every day to work, you are talking about more like 10 or 11 million people. Even a government that was as large as New York City's and New York State's can only supply jobs for a couple of hundred thousand people. It is the private sector that can supply the job needs of millions and millions of people, and, offering the false promise of government jobs, the city was crushing the real hope of jobs in the private sector, and the changes that we made in the budget have reversed that trend.

The third thing that we did was to restore fiscal stability in our city government by substantially reducing the actual dollars spent and by reducing the size of the work force to bring the private—the public economy in line with the private economy, and all three of these priorities really work together.

By working cooperatively with the unions and not engaging in layoffs but implementing a severance plan, we were able to reduce the size of the city work force by now approximately 15,000. By the end of this fiscal year the reduction will be somewhere in the range of 20,000. When the city went through the fiscal crisis of the 1970's, that is approximately the amount that the city reduced the work force by in the same period of time. Then it was 21,000. But at that time the city did it through layoffs. What they did was, using civil service rules and seniority rules, just across the board reduced dramatically the size of city agencies by firing people, but when the city does that, given the civil service rules we operate under, you can't make choices about who you remove and who you don't remove, you have to do it by seniority, and sometimes half the people you are removing are your very best workers.

Instead of doing that, we entered into very, very intense negotiations with all of the city unions, and we offered severance programs, dollars and help to people to encourage them to leave city service. By doing that, we were able to target the agencies we wanted to reduce rather than having to reduce all agencies. We were even able to go one step further than that, which was to target the areas where we felt we had excess employees rather than having to reduce across the board. Across-the-board reductions really just end up creating more expenses later because you have to hire back the people that you fired or laid off.

So I would suggest, in determining how you are going to reduce a work force, that you have to be able to negotiate or create the legal mechanism in which there is the flexibility to make different choices. You may not want to reduce the size of a police department when you have hundreds of thousands of felonies in a year, so you may want to keep the police department at roughly the level that it is at. There may be another agency in which you want to make reductions, and even within an agency you don't necessarily want to do it across the board.

So the end result is, we have been able to reduce the city work force by the most that it has been reduced probably in any year in a very, very long time, and we believe we have been able to do it so far without having to fire anyone or lay anyone off, and the process is continuing.

For example, we successfully negotiated two contracts with two different unions, one the Sanitation Workers Union and the other the School Custodians Union. One of those unions had a clause in its contract that prevented even consideration of privatization, the Sanitation Workers Union. We negotiated, had that clause removed, said that we were willing to discuss and look at privatization, and I can tell you that the result of that has been more productivity, much harder work, and a great many benefits that the city has been able to get back from the union as a result of being willing to consider privatization. The city had previously put itself in the untenable position of agreeing to contractual language that said not only would the city not privatize the sanitation services, but for some strange reason the language read something like the city would not even consider privatization. This was even—this was sort of an attempt to even stop thinking.

So by opening again the possibility of privatization, the very best result that you can actually bring about happened. The thought of competition has led to significant productivity gains, actual dollar savings to the city, and a number of other things that increased service.

In our first year we have privatized 60 different areas of city government, including parks maintenance, street resurfacing, vehicle maintenance, school custodian and maintenance services, fire house cleaning, and all the homeless services that previously had been owned and operated by New York City we are now aggressively moving out to the private, not-for-profit sector.

As I pointed out before with sanitation workers, we don't always make the choice in favor of privatization. Sometimes the thought of privatization or the competition that it offers means that public employees work much more effectively, much more efficiently, and you get the same savings or even more, but in order to create that mechanism you have to be willing to privatize and you have to be willing to make the choice in favor of privatization. If you take it off the table and you don't do it, then the negotiations aren't going to happen.

Consolidation can work just as well. For example, New York City has the largest police department in the United States, and then it has two other separate police departments. We had a New York City Police Department of 31,000, a transit police, and a housing police. Sometimes they worked together, sometimes they didn't

work together, and they triplicated administrative functions, so that we had three different budget offices, three different personnel offices, three different public relations offices, which I should point out to you, in the case of the New York City Police Department, the public relations and press office was larger than the President's public relations and press office, the State Department, or the mayor's, it was twice the size of the mayor's, and then the other two police departments had their own.

By achieving a merger of the three police departments, we will be able to significantly downsize the number of police officers that are used as public relations people, budget experts, labor negotiators, and move them out into functions that have them policing, which ultimately saves the city money.

We recently presented the budget for fiscal year 1996, and that budget also once again offers a reduced level of city spending, significantly reduced level of city spending; and, again, the reason for that is because we have to reduce the size of city spending so that we can invest some of that money in the private sector.

We have so far reduced several taxes in the city that were significant inhibitors of economic growth, the most significant of which was probably the hotel occupancy tax, and it is a good object lesson in what targeted tax reduction can do.

New York City's hotel occupancy tax was the largest in the country, 21.25 percent. For 18 straight months one of the magazines that services the travel industry each month had an advertisement in it that said you should boycott New York City because it has the highest hotel occupancy tax in the world. Many, many people and many agents did boycott New York City, and we lost hundreds of millions, if not billions, of dollars in business.

The city and State last year reduced the hotel occupancy tax. Our hotel occupancy tax now is competitive with the hotel occupancy tax in the 20 largest cities in the United States, and I'm very, very happy to say that the end result is that we had our best year for tourism in a long time last year. We are on our way to our best ever, and with the lower hotel occupancy tax we will collect more money than we did with the higher hotel occupancy tax, which is a good object lesson in what tax reduction can do if you do it in a targeted and sensible way.

I could give you similar examples with the commercial rent tax and some of the other areas in which we have either reduced taxes or we are planning to do it.

During this period of time, a significant reduction of government jobs, which was about 15,000, so far, it's going to go up to 20,000—a very interesting thing happened on the private side of the economy. For the first time in 4 or 5 years, New York City experienced job growth on the private side of the economy of about 30,000, so for the first time in a long time New York City government decreased but the private sector began to grow, and ultimately that is the place in which you are going to supply the job needs of young people. That process is a process that has to be considered in what you are doing, because a city can't just downsize, a city has to downsize for the purpose of restoring its economy and creating economic growth. Otherwise, the downsizing just becomes a constantly escalating process, and the choices have to be made in favor of not

only downsizing but taking the money you save from that and putting it back into the private economy so that you keep jobs, retain jobs, and have a good argument for people bringing businesses to your city because they can make and see the possibility of making a profit.

So these are some of the things that we have done that I think have worked well so far.

Starting on January 1st of this year, we began taking on the second part of New York City's budget that helped to create the structural deficit, which is the enormous expenditures on entitlement programs which are out of line with the rest of the country, sometimes by factors of 3 and 4 to 1, sometimes as high as 6 to 1.

On January 1, we initiated a Workfare Program, the first really in New York City, where we now hire able-bodied individuals to work 20 hours a week in exchange for their benefits. That again was also negotiated with the municipal labor unions because, what we had to do given the very extensive collective bargaining agreements that we have, we had to convince them that we were going to assign people who were on welfare to jobs that wouldn't otherwise be available for union workers, jobs that actually weren't being done by the city any longer. We found those jobs in the Transportation Department in dealing with roads and public spaces, we found those jobs in the Sanitation Department dealing with snow removal and trash removal, we found those jobs in the Parks Department in cleaning and maintaining the parks of the city, and in many, many other areas, so that when a person applied for welfare benefits, unless that person was disabled or there was some other reason, if the person was an able-bodied person who could work, the person would be assigned to a work assignment the next day, and that work assignment would be for about 20 or 23 hours a week, which is the limit that is imposed by State law. This is the largest Workfare Program in the United States, ongoing Workfare Program in the United States, and although it has only been in operation for a few months we are already seeing very, very dramatic results as a result of it.

We are also very confident that if we can demonstrate that workfare can work in New York, workfare can work anywhere, given the climate in New York and the difficulty in people accepting it to start with.

Nothing is more fundamental to the philosophy of my administration than the goal of providing jobs for people because I think jobs are the only—is really the only social program that ultimately really works to complete someone's life, and I think that a city has to understand that, in the way you make choices, with the size of your government, you can either retard or expand the possibilities of jobs.

Finally, maybe the most important area in which we have made a good deal of change is in convincing the bureaucracies in the city and the commissioners who run those bureaucracies that they in fact can manage more effectively with considerably less people, that the notion that you could not reduce the number of government employees and maintain services or even improve services is a notion that ignores the fact that city government is inefficient.

Let's assume that everyone—everyone in my city, I think, would be willing to agree, no matter what their political philosophy or attitudes, that city government was operating at a rate of inefficiency of at least 15 or 20 percent, and the art of governing is to find that 15 or 20 percent and remove it, and what you find when you do that is, people do find that they can manage with fewer people, that they then start initiating different ways of managing where they can get more out of it and they can deliver better services at a lower price. It creates a dynamic of people taking on more initiative for themselves.

The area in which we have had the most dramatic change is in crime reduction, and one of the reasons for that is that the New York City Police Department today is managed differently than it was managed 1½ years ago. It is managed for the specific purpose of reducing crime.

Previously we used to use crime statistics as a historical device. Every 3 months or every 6 months we would put out statistics that explained whether murders were going up or down, whether rapes were going up or down, whether assaults were going up or down, then the FBI would do it once a year, and the city would either look like it was getting safer or getting more dangerous.

Now we use crime statistics to manage the New York City Police Department in the same way that you would use a profit and loss statement to manage a corporation. Every single day, the police commissioner has presented to him the crime statistics for every precinct in the city. It shows up to that point in the year whether there were more murders or less murders, more assaults or less, more robberies, car thefts, or less. Each week he and I review it, and then we make choices about deploying our police department specifically for the purpose of reducing crime. If we see that there is a growth in felonious assault in a particular area, we then will put more police officers there. If we see there is a growth in car theft in a particular area of the city, we will put more police officers there.

It is important because previously the police department was really managed from the point of view of just making arrests, and if you are managed from that point of view then the fact is, you make arrests that may or may not reduce crime and you don't deploy police officers, let's say, just for policing in particular areas where they are not going to make arrests but where they may have the effect of reducing crime.

By now changing that to managing for the purpose of reducing crime, a precinct commander has a strong incentive to put police officers in areas where he may not come back with the result of arrest but he will come back with a 10 or 12 percent reduction in the number of deaths that take place or the number of assaults that take place or the number of car thefts that take place. I think that is one of the reasons why the city had historic reductions in crime last year, and I can tell you, because I see the statistics once a week, that those numbers are getting greater this year.

Part of accomplishing what has to be accomplished in American cities is incorporating in the way in which we manage cities the principles that you would learn from private business. Many American corporations have gone through massive turnarounds in the

last 3, 4, or 5 years. The principles that they have utilized are the principles that we are utilizing: Severance programs rather than firing; determining the results that you want to achieve; and managing and setting up statistical indicators so that you manage for that purpose; and, finally, getting over the hurdle and the fear that takes place so that the idea of doing more with less becomes a very exciting dynamic of how you can actually deliver better services, how people can take on more responsibilities, do more things, and actually turn around the way government views itself.

Much of what we are doing is incorporated in Osborne's book called "Reinventing Government." We think that we are moving in the right direction. We do know that there is a tremendous amount more to be done, and we are very, very happy to help in any way that we can either with the things that have worked that might help in the District of Columbia, or we are certainly happy to tell you the things that don't work, because not everything works, so that you can avoid some of our mistakes.

Mr. DAVIS. Mr. Mayor, thank you very much. That is inspiring testimony and good news for citizens here that there is hope at the end of what is, right now, a very very difficult time for the city.

I want to ask just a couple of questions before I pass it over for questions from some of our committee members.

I take it you are saying that the control board, if it stays too long, can get in the way of innovation and stop you from doing your job. Is that fair?

Mr. GIULIANI. Anything that stays too long gets in the way of innovation, and control boards are no different than anything else.

The fact is that for a year or 2 years or 3 years a control board operating in an emergency can be enormously valuable. It can offer good ideas, it can offer the support and even be the mechanism for making unpalatable political choices. Then after a while it becomes part of the whole process and becomes a player in the political process, and therefore I think it is an excellent idea but it's one that, if you do it, you should have a strict sunset provision and you should review it frequently to make sure you still need it, because if you keep it too long it becomes a political mechanism and then it deprives a city of showing that it can be self-sufficient.

Mr. DAVIS. Thank you very much.

In your talk about making sure the government is not the employer of last resort but instead letting the private sector do more, your tax initiatives have helped keep business in the city which has been a net creation of jobs; whereas, it looked like in the old days with the city as the employer of last resort, you were losing jobs each year. Is that correct?

Mr. GIULIANI. Absolutely. I mean American corporations and businesses are very sophisticated, they do very detailed analyses of where they should be located, and if a city is presenting a financial picture in which the debt of the city is the thing that is increasing the most, well, if you run a business or I run a business, we look at that and we come to the conclusion that we are going to pay for that debt, and you see a city that is going in the other direction, you are kind of inclined to move your business there continuing.

Mr. DAVIS. But the pro-jobs initiatives that you put forward in the city, is that at the expense of the suburbs, or does that help the whole region, as you take a look at it?

Mr. GIULIANI. It no doubt helps the whole region. New York City accounts for 40 percent of the income of people who live in the two surrounding counties of New York State, Westchester and Nassau County. So in essence—and we tax it so this is a two-way street—Nassau County and Westchester County——

Mr. DAVIS. You didn't need to mention that. [Laughter.]

Mr. GIULIANI [continuing]. Benefit, and we—and we get resources from it. But we are in this together, and one of the things that I did shortly upon being elected is set up a Metropolitan Regional Council. I meet on a regular basis with the county executives in the surrounding suburban counties—Nassau Suffolk, Westchester, and Rockland—and what we try to do is have as many areas of agreement as possible so that we deal with the State government together, very often, for things that are of benefit to all of us.

Mr. DAVIS. But the way it has worked out, is that the whole region in terms of net jobs for the region goes up. You are not just raiding each other, you are making the region more economically attractive.

Mr. GIULIANI. Absolutely. If jobs grow in Manhattan it helps the suburban counties, because many of the people that work in Manhattan live in those counties, many live in the city. By the same token, if jobs grow in Nassau County, even if the people are living in Nassau County, they come to shows in New York City, they come to restaurants in New York City; when we have baseball, hopefully again, real baseball, they come and watch the Mets and the Yankees play in large numbers. So this is something where we benefit each other.

Mr. DAVIS. That's great. Thank you very much, and I could spend all day just talking to you. I think it's great what you are doing there, and I appreciate your being here.

I am going to yield now to ranking minority member, Ms. Norton.

Ms. NORTON. Thank you, Mr. Chairman.

I want to get straight, Mayor Giuliani, about what your relationship is to what I would almost call a post-control board period. What is the continuing relationship between New York City and the control board or the Big MAC?

Mr. GIULIANI. I think along with my two predecessors, Mayor Koch and Mayor Dinkins, I don't see any need for the financial control board any longer for the city of New York. The measures that I just described to you in reducing spending in the city, reducing jobs in the city, was something that we brought about as part of my administration. The control board didn't recommend it, the control board didn't bring it about.

There was a control board for 10 or 12 years before I took office, and they weren't able to bring about any of those changes and kind of watched while the city—city spending grew way out of line with the level of the economy in the city.

So I think the control board performed an enormously valuable function during the emergency the city faced in the 1970's, but I

think at some point it became just another part of the political apparatus of the State and either performed no particular useful function—sometimes it would perform a political function, and if it politically agreed with the mayor it would be very laudatory, and if it didn't it would be derogatory. So I think that the caution that I would give is, control boards work very well during emergencies, then they become like every other political apparatus.

Ms. NORTON. Are they on a standby basis essentially for all practical purposes now?

Mr. GIULIANI. Yes, they are on a standby basis, but most people don't realize that and recognize that, so when they issue analyses, some of which are helpful and some of which are useless, those analyses get the same weight that they would get during the period of time in which there was an emergency.

Ms. NORTON. Mayor Giuliani, you are given real credit for tackling the large deficit you found when you came in office, and I know the kind of credit you are given because Sandy Levinson and Al Shackley, your school boards czars, were in Washington recently, and I was at the dinner table with them, and I said, "How are you all getting along with Rudy Giuliani?" and without going into detail, what they had to say was praiseworthy. They remarked especially upon your use of buy-outs or what you call the severance plan. The District did not attempt those buy-outs until too late virtually, until the Congress had already ordered cuts. That got a huge rise out of the workers. That intimidated the city, and buy-outs were going on in the Federal Government but somehow the city did not begin that process early enough.

But what interests me is that, after New York went through this extraordinary crisis where you let go 60,000 people, in no time flat it appears that New York City grew back its government and that something like a returning crisis occurred and you were faced with something not unlike what Mayor Beame faced, and you have had to tackle that. I would like to know: One, why did it grow back; and, two, how can one make this thing permanent, everlasting, and get it over with so you never have to go through what you are now having to go through again?

Mr. GIULIANI. Your analysis is exactly correct, and sometimes I compare it to someone who has gone through the difficult process of losing a tremendous amount of weight and then gaining it all back again, and, boy, it's real hard then to do it again, but then you are going to have to do it again.

The fact is—and I think I can trace this because I used to have a chart, and I'm sorry I didn't bring it with me—that really demonstrates this. New York City's fiscal crisis was roughly in 1975, and if I just use the number of employees it would probably tell the story.

At that time, New York City had official direct employees of the city, about 240,000 employees. Between 1975 to about 1982, New York City, with a financial control board and the financial control board for a lot of that operating with full powers, New York City reduced from about 240,000 to about 185,000 employees. So you see the chart go all the way down.

Starting in 1982 to 1983, New York City started moving up dramatically, because as prosperity of the eighties happened, rather

than investing at least some of that prosperity in tax reduction, the city didn't reduce taxes, the city actually increased some taxes and just kept saying yes to everything, and yes to even things that nobody was even asking about. So it went from 1982 to 1983 till about 1987–88, moved up to about 220,000 again, and then if you actually do an apples to apples comparison, because some of these jobs had been moved out to quasi-government agencies, in 1990 when I became mayor New York City was on its way to having 250,000 employees.

So in essence, we had done all the downsizing, we had fired all of those people, we had laid all those people off, and you can see a similar thing happening in the rest of city services, and then we built way back up, and the cost of those employees in 1987, 1988, 1989, and 1990 was much greater than it was in 1975. So now we are going through the same thing all over again. Now we have taken the city work force, now it's on its way down to about 201,000. The next budget will take it down to about 195,000, and the one after it about 185–187,000.

So you are right, we are going through the same process all over again. It also, I think, underscores the way to use a financial control board, when it works and when it doesn't work.

The financial control board will work very well during the time of crisis. It kept the pressure on the city to reduce the work force, to be efficient, to renegotiate agreements with labor unions. As the financial control board became more of the political apparatus of the city, it did no good in 1983, 1984, 1985, it was there while the city gained all the weight back again.

So the real art here is a short period, a real emergency, let it exercise power, and then the city itself has to politically learn the mechanism for saying no, and it has to become politically—I see it very often as a political plus to say no, because the people of the city are sophisticated enough to understand that if you continually say yes, you are just pandering and ultimately hurting them.

Ms. NORTON. The chairman has called my time. I just want to finish this off by saying that if the control board, during this time when it was becoming more and more dormant, had helped the city recognize that a permanent range of employees is what they should continually strive for, then I take it they would have performed a useful function by calling that to the city's attention, and then you wouldn't have had the government grow back just to have to be reduced again.

Mr. GIULIANI. Or if they had followed a rule of growth in spending no greater than the rate of inflation of some standard that would have created a brake on it.

The city in 1983, 1984, 1985—and it could spend more money, it was going through tremendous prosperity, but if it had had some discipline about the amount that it was spending and had it invested some of it in tax reduction so that the private sector could also grow, I don't think we would be experiencing the difficulties we are experiencing now.

Mr. DAVIS. Thank you very much.

I would like to now call on the chairman of the Committee on Government Reform and Oversight, the gentleman from Pennsylvania, Mr. Clinger.

Mr. CLINGER. Thank you, Mr. Chairman, and, Mayor Giuliani, I want to commend you for the outstanding job you have done in turning the city around and making some very tough calls to make that happen, and I think you deserve a lot of credit for having accomplished that.

I just have a couple of questions. I think you indicated that you have reversed the outflow of businesses from the city. Is that correct?

Mr. GIULIANI. Yes, sir.

Mr. CLINGER. I mean you are now actually attracting new businesses in. You know there are a number of proposals here as to how we can reverse that in the District of Columbia, because we have had a lot of outflow from the District: Some pretty extreme things like sort of declaring the whole District an enterprise zone, or basically making a commonwealth, or a whole range of things. Do you think we need to be that extreme to accomplish the kind of reverse trend that you have seen in New York?

Mr. GIULIANI. I really don't know the details of it. My guess is, you would not have to, that there are three major things that any business looks to as to whether or not they want to stay where they are or go somewhere else or come to a new place, and safety is one, the tax structure is the second one, and then, maybe emerging from that and other things, just a general impression of whether this is a city that is going to grow or contract, and if they have a sense that this is a growth area then they are going to want to stay there.

I think the most important thing is to get the city in tune with the economic principles that provide job creators rather than having them do things that is inconsistent with the principles that are used by people who create jobs. People who create jobs own businesses, and if you can show them that their lot is going to improve then you are going to keep jobs in the city. If you do the opposite of that, if you do everything imaginable to show them that their lot is going to get worse, then, being sensible human beings, they leave.

If you have a business, you are producing jobs, and you are in a city in which crime is getting worse, the quality of life is decreasing, you are being charged more money to live there, then you say to yourself, well, this is a place I want to leave. If they see that reversing and changing, you'll see job growth increase.

The District of Columbia is a very desirable place to locate a business. Government is here, there are a lot of reasons why you would want to be in the District of Columbia, so you have to be doing things to businesses that aggressively hurt them in order to drive them out. You change that, and you are going to keep a lot of businesses here and a lot of businesses will want to come here.

Mr. CLINGER. Just one other question. One of the most serious problems that we have in the District is the enormous shortfall on the Medicaid situation and how we are going to address that. The Mayor would like us to step in and help finance that. I think there is not a tremendous amount of enthusiasm at the moment for that course of action. But what has been the situation in New York? How have you addressed Medicaid?

Mr. GIULIANI. We have very, very similar difficulties. New York City spends $2.4 billion on Medicaid. It is the largest single line item expenditure, unless you consider the Board of Education, and it is the thing that has increased the most in the last several years.

This is a shared responsibility. I think the city government, the State government, and the Federal Government, none of them are doing what they should do about Medicaid. In the case of the city, we weren't doing what we should do about cost containment; we were selecting every option. We were saying no to virtually—none of the things that were ever presented. We were maintaining hospitals, public hospitals, at levels of numbers of employees way beyond the number of beds that were actually occupied in the hospital. We have hospitals that are 65 percent occupied; they were being staffed for 95 percent. So some of the problems we were creating for ourselves. In this budget that I have presented, we do a major cutback of about $700–$800 million in what the city is spending.

The second part of it is, in New York—in New York, New York City has to pay 25 percent of the cost of Medicaid. It is the only city in the country that is required to do that, which is something that I'm trying to change with the State government, and the reimbursement rate by the Federal Government is only 50 percent. Both of those also should be adjusted.

But I see this as a three-way thing. I mean we should be doing more, and we should also be treated equitably a little bit differently by the State and the Federal Government. We should be doing more means we should be doing a lot more cost containment.

What I have done is to dramatically step up Medicaid managed care. The city of New York now has about 20 percent of its Medicaid recipients in managed care programs. That 20 percent results in a savings of about 15 percent over the other 80 percent that are in Medicaid. We are going to try to get to about 90 percent in a 2-year period. If we do that, we think we can save a tremendous amount of money, but what we would like to do with that savings is to see if the State government can return half of those savings to us so that we can use it and have discretion over it.

Mr. CLINGER. Thank you.

Thank you, Mr. Chairman.

Mr. DAVIS. Thank you very much.

Mr. DAVIS. I am going to now recognize our ranking minority member of the Committee on Government Reform and Oversight, Mrs. Cardiss Collins.

Mrs. COLLINS OF ILLINOIS. Thank you.

Mr. Mayor, the powers of the financial control boards have ranged from direct control over revenues, expenditures and borrowing, to merely exercise of review and disapproval authority; therefore, my first question is, what mix of oversight and control power do you believe to be the most effective?

Mr. GIULIANI. I think the oversight and control has to keep ultimate responsibility in the hands of the mayor and the city council. Otherwise, you don't bring about the change that you want to bring about. If the financial control board were to run the city, then at some point when it stopped running the city you would just be going back into the same set of problems that you had before. What

you should be trying to do is have the financial control board available for the emergency, to help with some of the very tough decisions that have to be made, but ultimately those decisions should have to be made by the mayor and the city council. They can use the financial control board as a device to get this done, because some of these things will be very politically unpopular and you have to really think out how long a period and then how you are going to return things to the normal political—to the normal political structure.

Mrs. COLLINS OF ILLINOIS. Which leads to another one of my questions. If a financial control board would have over independent borrowing authority, for example, who would have the responsibility for any debt that they might incur if the board's term of existence were to expire? Would it go directly to the mayor or to nobody in fact?

Mr. GIULIANI. It would have to be assumed by the city government. I would think long and hard before I would give them independent borrowing authority.

Mrs. COLLINS OF ILLINOIS. What about spending authority? Same type of question.

Mr. GIULIANI. Same type of question. I think what they should do is perform a very, very strict oversight role, provide the ability for recommendations and decisions, set parameters for reductions that have to be made, and then at a certain point, if the city's budget remains out of balance, then there would be additional power that the financial control board could maintain, but the first effort should be to try to work with the mayor and the city council to, in essence, move things toward fiscal stability, and then if that doesn't happen then there would be additional power that the financial control board could exercise, because I think what you are going to find is that the mayor and the city council will want to work with the financial control board if you do it in the right way.

Mrs. COLLINS OF ILLINOIS. Well, what role would you see the board playing in assisting city officials and structuring new contracts or benefit packages for the city's work force?

Mr. GIULIANI. Labor negotiations are like a major exercise that nobody really understands from the outside. They happen—they happen on the inside.

The financial control board can play a very useful role by making it clear how much money really exists, how much is really there. Maybe from my own experience or experience that we have had in the last year and a half, it would have been impossible for us to restructure New York City without the cooperation of the municipal labor unions. It could not have been done, at least not that quickly, and the way in which we obtained their cooperation—and it isn't 100 percent cooperation—is by being open and straight with them about how much money was available and how much money wasn't available. We opened the books of the city to them, we allowed their experts to come in, we allowed them to examine how much money we had, because our contention was that we didn't have money for raises and that we needed—in essence, we needed benefits given back to us, and we obtained about $1.2 billion last year in benefits that we were able to negotiate back to the city.

We did that because they were convinced that we weren't fooling them, they were convinced that the room wasn't there, they were also convinced that if they didn't do it then the layoffs would have been massive and they would be dealing with their membership with a very, very severe problem.

I think that is the core that has to happen. The municipal labor leaders have to be convinced that someone isn't playing a game with them, because, unfortunately, the history—and I can't say this is so for the District, the history might be that in the past games were played with them, they were asked for reductions or they were denied raises, and then it turned out that the city had a surplus 4 months later and there was money that was hidden away, and what we had to go through was a process of convincing them that that was not going on now.

A financial control board can really help in that regard, because it can give an independent assessment of that, it can independently explain to the public and to the union leaders what is available, what isn't available, what the parameters are, it can be independently certified, and if you just think about it from the point of view of a union official who is no different than you are or I am—they get elected—it is important even for their membership to understand that they are negotiating the best they can negotiate given the realities. A financial control board makes that possible.

Mrs. COLLINS OF ILLINOIS. Thank you. My time has expired. Thank you very much.

Mr. DAVIS. Thank you very much.

I now recognize our vice chairman of our subcommittee, the gentleman from Minnesota, Mr. Gutknecht.

Mr. GUTKNECHT. Thank you, Mr. Chairman, and thank you, Mr. Mayor, for being here. Your testimony has been excellent, and we appreciate it more than you know.

Through your experience—and these are kind of tough questions, and I'm not sure if you can really help us, but I'm wondering, there is pretty much a consensus now that we are going to have to have some kind of a control board here in Washington, DC. I'm wondering if you can offer any insights in terms of the kinds of people we should be looking for to be on that board, if you have any specific recommendations in terms of the number of people who should be on that board, and, finally—and this is probably the most difficult one of all—how do you know when it is time to terminate the board? Do you have any specific suggestions in those regards?

Mr. GIULIANI. The number is really—really a question of the talent that you can attract. If there are four or five or six really good people, then that would be the number. I think they have to have a mix of experience. Some have to have political experience and they have to understand how politics operates, some can be purely experts in budgeting and in city government or government in general, but a mix of people including some that understand government and how it operates and that there is a level of give and take and negotiating that has to go on.

As far as how you determine when it sunsets, you can probably set up numerical criteria for that. If the deficit is $1 billion and you get to the point where you have removed it or you have gotten close to removing it, then you no longer need a financial control board,

and probably you should review it every year or 2 years to determine how close you are getting to that goal.

Structural—I also would strongly recommend—I'm not certain if this is done in the District of Columbia, it isn't done in many State governments—I would strongly recommend that a financial control board really get the credit for putting the city on this basis of doing not just a budget but a financial plan. What that means is, your budget should really be spread out over a 4-year period so that when you do the budget for this year we really go through a two-step process.

I haven't done a budget for next year yet, what I've done is a financial plan. In early February the mayor is required to put out a 4-year financial plan in which I do a tentative budget for the next fiscal year and for the three that follow that. Then we debate that, and then I submit a budget for the next fiscal year.

Now the reason that is important is—and the financial control board can play a big role in this—is it shows you the implications of your spending in future fiscal years, it also shows you when gimmicks or tricks are being used, where someone is selling an asset and taking the benefit of that in just one fiscal year. You are not going to have that asset available for the next fiscal year or the one after that. So one of the benefits that emerged from a financial control board is changing some of those practices.

Now interestingly, in New York, the city of New York does that. Because of the fiscal crisis, this additional level of review has been imposed, which I think is very valuable, but it hasn't been done for the State. It is a very valuable exercise, and it shows you in future years if you are moving toward structural balance or you are just creating the effect of it in one fiscal year only to make things worse in the next.

Mr. GUTKNECHT. Thank you.

I yield back.

Mr. DAVIS. All right. Thank you.

I now recognize the gentleman from Ohio, Mr. LaTourette.

Mr. LATOURETTE. Thank you very much, Mr. Chairman, and in light of the mayor's schedule and the fact that his testimony has already answered so many questions, I won't ask any questions but I will make one observation.

One is that when GAO testified before this committee last week I was struck by the fact that they had indicated that New York City was actually reducing taxes at the same time it faced a budget deficit situation, and you have reconfirmed that again here today. What a revolutionary idea, to actually reduce taxes and have a model in New York City to demonstrate that you can benefit jobs creation and the economy in general, and it is something we should probably try to copy here in Washington, Mr. Chairman.

I yield back my time.

Mr. DAVIS. Thank you very much.

The gentleman from Illinois, Mr. Flanagan.

Mr. FLANAGAN. Thank you, Mr. Chairman, and I also will forego a question in lieu of an observation.

Thank you for coming here, Mayor. Your testimony has been enlightening. I'm from Chicago, Mrs. Collins is from Chicago, many people here represent large metropolitan areas, and it is always

good to have that insight not just on this side of the panel but on that side as well.

The work that you are doing to create a pro-business environment and creating private sector investment in the form of tax cuts, I think you bring a practical example of that here on how that actually works and how you can increase not only the actual raw dollars coming in but the local financial investment by the private sector which creates jobs, which drives the city in its vibrance.

Further, the entitlement programs, the workfare being the largest in the Nation and only a few months old is a testament to be the ability to be able to have a plan and execute it in a timely fashion, and the reduction in employees that you are moving toward is something that will provide absolutely a lesson learned in the governance of the capital and how we can improve our financial condition here, and I want to thank you for coming here and thank you, Chairman, and I yield back.

Mr. DAVIS. Thank you very much.

Mr. Mayor, I know you are on a tight schedule. I just want to thank you for being here.

To Mrs. Molinari, she is one of our stars here in the House. We are pleased to have her here to introduce you, and I want to thank both of you for being here.

Mr. Mayor, thanks for your willingness to be with us and share your experience and thoughts on a very difficult issue. I know you are working very hard to battle problems in New York. Your appearance here today as we consider the problems in the Nation's Capital are going to help us with the unenviable task ahead of us.

Thank you.

Mr. GIULIANI. Thank you very much, Mr. Chairman. I really appreciate the opportunity and the insightful questions.

The fact is that Congresswoman Molinari is even a bigger star in New York City than here, and we are very, very proud of her and very proud of all the good work that she is doing, and if there is any way in which we can help, I really want to emphasize that the spirit of this testimony is to offer suggestions. Some of these things, some don't work. We are all struggling with the same problem, and we want to be supportive of the mayor, the city council, and all of you in this very important effort. Washington, DC, is a very important city to all of us. Thank you.

Mr. DAVIS. Thank you, very much.

Mr. DAVIS. I'm going to at this time recognize the gentleman from Ohio to introduce our next distinguished panelist.

Mr. LaTourette.

Mr. LATOURETTE. Thank you very much, Mr. Chairman.

Mr. Chairman, it is my pleasure to welcome Governor Voinovich to this subcommittee hearing today to testify on the benefits of establishing an oversight and control board in cities facing financial crisis.

Unfortunately for the Governor, he took over the city of Cleveland as mayor in 1979 at the height of the city's financial crisis. The previous administration had defaulted on $15 million worth of notes owed to local banks, and the city had seen its access to credit markets eliminated. Fortunately for our city, Cleveland, the new mayor proved to be just the man for the job. By working closely

with the Cleveland Financial Planning and Supervision Commission and by developing a 3-year financial recovery plan that took a hard line stance on expenditures and emphasized a balanced budget as the way to get the city out of default, then Mayor Voinovich guided Cleveland back to economic health.

I think I mentioned prior to the last hearing one of my favorite quotes of the mayor, now our Governor. Upon assuming this challenge, 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 elected in 2 years from now, tough." In fact, the mayor did such a good job in restoring the economic soundness to the city of Cleveland, he was reelected five times, which is a record for Cleveland mayors.

As mayor, George Voinovich received national recognition for his management of our city. The National Urban League named him as one of four distinguished urban mayors in the country in 1987. "City and State" magazine selected him as one of the top three mayors in the Nation and named him to the All-Pro City Management Team. Additionally, Governor Voinovich has served as a board member of the National League of Cities, and he served as that organization's president in 1985.

Mr. Chairman, I don't think that we are any longer considering if we are going to recommend an oversight board for the District of Columbia, I believe we are trying to determine what shape that board will take. This hearing will go a long way in helping this committee come to that determination, and I believe that Governor Voinovich's testimony, as someone who has shepherded a major city through similar circumstances, will be a vital component to that determination, and I very much look forward to his testimony here today.

And, welcome, Governor.

Governor VOINOVICH. Thanks very much.

Mr. DAVIS. Thank you very much.

Governor Voinovich, let me say it's the policy of this committee that all witnesses must be sworn before they testify, so if you would just rise with me and raise your right hand.

[Witness sworn.]

Mr. DAVIS. Thank you very much, and it is an honor to have you here, and your reputation precedes you both as mayor of Cleveland and as Governor of Ohio, and welcome.

STATEMENT OF GEORGE V. VOINOVICH, GOVERNOR OF OHIO

Governor VOINOVICH. Thank you very much, Mr. Chairman.

I appreciate the opportunity to be here; and, Steve, thanks very much for your very nice introduction; and I must tell you, Mr. Chairman, it's a real pleasure to know that the district right next to mine and the city of Cleveland is represented by Steve LaTourette.

First of all, let me begin by commending all of you for undertaking the critical challenge of rescuing the District of Columbia from the straits of insolvency and disarray. I have always felt, and I am certain that most Americans would agree, that the District should be a model for our Nation, our shining city on a hill.

Sadly, Washington, DC, is today the opposite of that image just as Cleveland was in 1979. But the story of the Cleveland comeback proves that your challenges are not insurmountable, and here's a short version of how my home town bounced back.

From almost any vantage point in Greater Cleveland, the thing that probably stands out most is the physical architecture of the city, particularly the new downtown skyline. Of far more importance, however, is the civic architecture we erected in the early eighties to rebuild not just our neighborhoods and downtown but our very soul and our self-imagine. The bedrock upon which we constructed that civic architecture was the public-private partnership, urban pioneers rebuilding a city where Cleveland used to be. I would respectfully suggest that first and probably the most important task of this subcommittee is identifying the elements of the local civic architecture that must guide the rebirth of Washington, DC.

When I agreed to leave my post as Lieutenant Governor of Ohio and return to Cleveland in 1979 to run for mayor, I made it clear to the business and civic leaders my conviction that government was only one thread in the fabric of our community and that to turn Cleveland around we were going to have to work together and put aside all of our differences, understand we had a symbiotic relationship, galvanize our resources to solve our problems, meet our challenges, and to seize our opportunities, and it worked. Cleveland became the only city to win three All-America City awards within a 5-year period and not because of the mayor but because of the public-private partnership that was established of uniquely involving the private sector in the governance of the city of Cleveland and solving the problems that confronted it.

A key player was the Financial Supervisory Commission. I recall convincing the Ohio Legislature that the commission's membership should include stakeholders and not be completely controlled by the State. The commission developed a financial recovery plan and established a criteria that had to be met in order to terminate it, and that is laid out in the statute. Certain things had to be done in order for the commission to go away. I chose to keep the commission intact as long as I could.

One of the things that the legislation provided for us was that we could borrow money to repay the misspent bond funds. I decided that we would earmark money from the city income tax and pay it off over a period of years rather than borrowing money to repay money that we had already borrowed on. We saved the city $24 million in interest by taking the long route instead of doing it easy.

Now it took us 7 years. In fact, we had a big burning of the notes celebration. But it kept the Financial Supervisory Commission also there, and I refer to it as the rudder I needed when we went through stormy weather.

I think it's imperative that the mayor fully cooperate with the advisory board. I think it is also important to recognize that a positive working relationship with the city council was crucial to our moving our collective agenda forward, we put the city first, and one of the things that legislation provided is that any new legislation

that was passed that dealt with money, spending, in any way had to have the approval of the Financial Supervisory Commission.

So if we got to a point where council got a little jittery on some stuff and weren't maybe doing what they were doing, I always said to them, "Hey, we can't do it, not in accord with the plan, can't put the stamp on it, can't put the stamp on it, legislation is null and void." So the advisory commission was extremely important.

Let me briefly touch on the actual public partnerships we put in place in Cleveland, and I'm saying to you today that if you are just going to put in a financial recovery group or commission and you think that's it, forget it, because you'll do, it'll be around for a while, and then it will go away and things will go back to the way they were before.

Let me just tell you some other things I think you need to do. First of all, in addition to having a volunteer management audit of the books of the city, which were inauditable—I thought we were $55 million in the hole when I took over; we were actually $110 million in debt—we created an operations improvement task force which was an all-volunteer organization of 89 full-time Cleveland executives loaned by 62 companies, to determine how city services could be provided in a more efficient, economical manner. The task force was funded by two of Cleveland's major foundations, the Gunn and Cleveland Foundation. They came up with $250, and we raised $500,000 from the private sector, so there was some money there that would back up the task force. They made 650 recommendations. We implemented 75 percent of them.

Now I'm going to tell you something. It works. I did that as Governor. We did the same thing when I became Governor of the State of Ohio. We got the private sector involved, went through the whole operation, and we have saved millions and millions of dollars because of those recommendations.

The next thing we did—and I'm not sure if this is as important here as it was in Cleveland—we formed the Cleveland Roundtable. That was our urban coalition, and that roundtable addressed the issues of housing, employment, minority business development, police-community relations, racism, and education in the community, and it empowered a lot of people who were out in the city and brought them to the table. African Americans, Hispanics, Appalachian whites were sitting at the table with the bishop and the religious leaders and the bankers and the industrialists. It was like a little United Nations, a bunch of people sitting at the table who had different clout but had a voice that could be heard, and it was really important to moving us forward.

And we did one other thing, we created Cleveland Tomorrow to lend their expertise to addressing our long-term economic challenges. This group commissioned two studies to identify critical base line data and then proceeded with a three-part strategy to bolster economic development, focus city resources on job creation, and rebuild the central city and Cleveland's neighborhoods, and today Cleveland Tomorrow is still regarded as the No. 1 public-private partnership in the United States of America.

You might also know that Cleveland ranks No. 1 in the private sector's investment in housing—very important, they get involved.

Over the years other public-private partnerships were created. Build Up Greater Cleveland was a coalition of public and business officials to identify the infrastructure, our old and crumbling infrastructure: How are we going to do something about that problem? The story of Cleveland's comeback is much more involved than I could possibly impart in these few minutes. I'm going to leave some information for you.

I want you to know that if this commission is interested in coming to Ohio and to Cleveland, I'll be glad to facilitate that for you and be more than happy to bring to this table, if you would like, some other people that can add insight into what we did.

A man who—and I'll finish on this note—who I literally conned into becoming the finance director of the city of Cleveland was a man named Bill Reedy. He was with Coopers and Lybrand. I tried to find a finance director, and I couldn't find one; nobody wanted it. We had a national search, and nobody wanted the job, and Bill was the chairman of the committee, and I said, "Bill, please"—you know—"I need you." So he left Coopers and Lybrand and went to work for us, and he was our finance director for 3 years and helped quarterback the recovery along with Ernst and Young.

Bill is now the managing partner for Coopers and Lybrand in their government practice, but he has more insight into what happened and all of the intricacies than probably anybody in this country, and I think it would be really worth your while to spend some time with Bill.

Thank you very much.

[The prepared statement of Governor Voinovich follows:]

PREPARED STATEMENT OF GEORGE V. VOINOVICH, GOVERNOR OF OHIO

Thank you, Congressman LaTourette, for that introduction. You have shown real leadership in this Committee, and you are making a positive difference in the lives of Ohioans everyday. Thanks, also, Mr. Chairman, for the opportunity to address this Subcommittee.

Let me begin by commending all of you for undertaking the critical challenge of rescuing the District of Columbia from the straits of insolvency. I have always felt—and I am certain most Americans would agree—that the District should be a model for our nation—our "shining city on the hill." Sadly, Washington, D.C. is today the opposite of that image, just as Cleveland was in 1979. But the story of the "Cleveland comeback" proves that your challenges are not insurmountable. Here is the short version of how my hometown bounced back.

From almost any vantage point in Greater Cleveland, the thing that probably stands out most is the physical architecture of the city—particularly the new downtown skyline. Of far more importance, however, is the civic architecture we erected in the early '80's to rebuild, not just our neighborhoods and downtown, but our very soul and self-image. The bedrock upon which we constructed that civic architecture was the public-private partnership—urban pioneers rebuilding a city where Cleveland used to be. I would respectfully suggest that the first and probably most important task of the Subcommittee is identifying the elements of the local civic architecture that must guide the rebirth of Washington, D.C.

When I agreed to leave my post as Lieutenant Governor of Ohio and return to Cleveland in 1979 to run for Mayor, I made clear to business and civic leaders my conviction that government was only one thread in the fabric of our community. To turn Cleveland around, we were going to have to work together and put aside all of our differences, understand we had a symbiotic relationship, and galvanize our resources to solve our problems, meet our challenges, and seize our opportunities. And it worked. Cleveland became the only city to win three All-American City awards within a five-year period.

A key player was the Financial Planning and Supervision Commission. We insisted that the Commission's membership include local stakeholders, and not be completely controlled by the state. The Commission developed a financial recovery

plan and established the criteria that had to be met in order for it to terminate its work. I chose to keep the Commission in tact as long as I could, because it provided a buffer between me and our city council.

It is imperative that the mayor cooperate fully with advisory boards of this nature. My positive, working relationship with city council was crucial in moving forward with our collective agenda. We put the city first. An example of this unity involved a policy we instituted requiring the stamp of approval by our Commission on any new piece of legislation that dealt with Cleveland's finances. This kept all of the players "on the same page."

Let me briefly touch on the major public-private partnerships we put in place in Cleveland. The Operations Improvement Task Force was an all-volunteer organization of 89 full-time Cleveland executives, loaned by 62 companies, to determine how city services could be provided in a more efficient, economical manner. The Task Force was funded by two of Cleveland's major foundations and by the business community. After some 35,000 hours of pro bono work, the O.I.T. made 650 recommendations, of which approximately 75 percent were ultimately implemented.

We formed an urban coalition called the Cleveland Roundtable to address community issues. The roundtable's major areas of focus have included housing, employment, minority business development, police-community relations, racism, and education. It empowered people who normally lacked "clout," to sit at the table with community leadership as decisions were made about their quality of life. The roundtable made a positive difference in all of these areas, with the possible exception of education. But just last week, a federal judge placed the Cleveland schools under state control—a long-overdue move that should help put the last piece of the puzzle in place.

Our business community created Cleveland Tomorrow to lend their expertise to addressing our long-term economic challenges. This group commissioned two studies to identify critical baseline data, and then proceeded with a three-part strategy to bolster economic development, focus city government resources on job-creation, and rebuild the central city and Cleveland's neighborhoods. Cleveland Tomorrow is still regarded as, perhaps, the best public-private partnership of its kind in the nation.

Over the years, other public-private partnerships were created to address specific needs or problems. For example, Build Up Greater Cleveland was a coalition of public officials and civic leaders whose sole mission was identifying ways to rebuild the city's old and crumbling infrastructure.

The story of Cleveland's comeback is much more involved than I could possibly impart in these few minutes. Therefore, I am leaving with you some materials that should fill in more of the details. I urge you to travel to Cleveland and spend a day with the people who helped make it happen. I would be honored to personally assist the members of this Subcommittee in seeing, firsthand, the Cleveland miracle.

The members of this Subcommittee have undertaken a challenge that, perhaps, comes along only once in the lifetime of a city. I submit that the surest means to success will be a civic architecture that unites all elements of this community and forges a public-private partnership dedicated solely to transforming the District of Columbia into the "shining city on the hill" we all want it to be.

Mr. DAVIS. Governor, thank you very much.

You know, as you go back to the deep dark days of 1979 and take a look at what has transpired in Cleveland since that time, with the partnerships that were created and people working together, I guess it's got to give some hope to the people of the District right now who are hearing only bad news. You didn't know at that point how it was going to turn out either—I'm sure there was a lot of uncertainty with you—do you have any comment on that for the citizens of the District who are looking now, with nothing but bad news ahead of them, and it appears the debt goes higher and the layoffs are upon us and everything else?

Governor VOINOVICH. Well, I think that, you know, the problems that we have are created by people and people can solve the problems, and I think that one of the things that we were able to do, because of gathering everyone together and understanding that we had a crisis and that if we were going to be successful that we had to work together, I think that they had—they understood that, unless they intervened and got involved, it was going to get worse,

and what I'm saying is that there's got to be some people in this town, who own property and are stakeholders, who have got to say to themselves either I'm going to get involved or it's going to get worse, and I think that's what it's all about.

I can tell you something that—take Del Dewin, who was chairman of the Cleveland Tomorrow, is now retired chairman and CEO of the Eden Corp. Del Dewin will tell you the most important work he ever did was his work with the city of Cleveland as chairman of the operations improvement task force and the formation of our Cleveland Roundtable and Cleveland Tomorrow. I'm not kidding, urban pioneers, you know, they made a difference, and there are people right here in this town that are willing to do that, and you have to identify them and get them to step forward and say this is your town and if we're going to make it, it's going to have to be an ongoing commitment, it can't be just a little temporary thing, set it up and then go away and everything, because it will go back.

I mean right now the one area where we—we failed in Cleveland—for years I wanted the State to take over the system because the political leadership and the government leadership in the school system just wasn't there, and now the Federal court has said that the superintendent of public instruction has taken over. But one of the things that I know he is going to do is, he's going to get the indigenous leadership of the community involved in it, because once he leaves—and, by the way, his name is Ted Sanders. He was the head of your Illinois Department of Education. In fact, he was Assistant, Department of Education, here in Washington under Lamar. Anyhow, he is our State superintendent.

But you have got to get the indigenous leadership and the people involved in this effort and understand, you are going to be here for a while, and I know a lot of you want to stay as long as you can, but the fact is, that business community provides the continuity. Just like I said to you, that business community that we started is still there, those partnerships are still in place, and they realize they have got to continue to participate. The mayor is cooperating with them, the city council. It doesn't mean that things are perfect, but the fact is that, without that private sector, Cleveland would never have made it.

Mr. DAVIS. Was it difficult to get the private sector to buy in? I mean they wanted to see some things up front before they put their money out. They saw the city really getting worse without their involvement. How difficult was it to get them involved?

Governor VOINOVICH. Well, to be frank with you, I was Lieutenant Governor of Ohio and I wasn't going back. Mrs. Voinovich said, "You aren't going back." So I sat down with them and said, "I'll come back and run, but you pay for the campaign, and you're going to help me get this thing back on track, and I'm not going to be like those other mayors that just sit here and have these problems keep slapping them in the face, we're going to do a complete management audit of that operation, and we are going to develop a real partnership and develop a strategic plan, and you are going to help me get the job done." So I got commitments right straight up front. I said, "You are going to raise the money, you are going to provide it," and they were there.

The crisis that brought them to the table was the default of the city of Cleveland in 1978, and I think that—I don't know whether anybody thinks this is a crisis or not. If they don't, I think you have got problems. If they do think it's a crisis, then I would think there are some good people here that care about their fellow citizens and their district and their country, and I think that one of the things that you really ought to be concerned about is that this town should be the model for everything in finances, in management, in human services programs, right across the line. This is the place we ought to be able to take people and say, "This is the way it should be done in your town," and I think that's the kind of commitment you all have to make to this thing, that we are going to make this the model city in the country.

Mr. DAVIS. All right. Well, we can't do it without the city government as well, and we need to form a Federal-local partnership to help, and I think we are going to be there for them. But your testimony is critical because you have done it and you have shown that you can bring a city back. I think that gives us a lot of hope.

My last question to you before I recognize Ms. Norton is, what kind of resistance did you get from city employees and those groups as the cuts came down on the bureaucracy? Generally, institutionally, they are the ones that are most affected because there is a cleaning of house.

Governor VOINOVICH. Well, let me say when we put the Financial Supervisory Commission we had seven members, four voting members, but there were—they were like ex officio members—the mayor, the president of the city council, the director of the Ohio Office of Budget and Management, and the State treasurer; those were the four, the elected; and then we had three citizens that were on the commission that were appointed by me with the approval of the council. Jackie Presser was one of them, my good friend Jackie Presser.

Mr. DAVIS. OK. Thank you.

Governor VOINOVICH. And I had him on there because Jackie was a union leader and I knew that it was very important to have union leadership involved. The other one was Bob Bligh, who was a former chairman/CEO of one of our banks, and then another was George Grabner who headed up Lamps and Sessions, who was one of our real dynamic citizens, and we went to the unions and we talked to them that we had some problems. We zeroed out—there was—you know, these were terrible times, we were in debt, you know, the recession was there, unemployment, and I think that maybe out of 10 years—and, by the way, in 10 years, just so you know what happened, we ended up with 10 percent less employees. Our budget only increased 45 percent in 10 years, and inflation went up about 85 percent.

I had to go to the voters. In Cleveland we do have a city income tax, and Ohio cities have it, but you have to get the voters to approve it. We went to them after we did our operations improvement task force. The business community said, hey, they don't have enough money to run this joint, pay the debt, replace the infrastructure, rolling stock, and so forth, so let's—so we got it, and that passed with a two-thirds vote of the citizens.

So the fact is that the unions participated, and I'll never forget that before I went to the voters for that first tax increase I said to the unions, "I'm not going to go there unless you agree before the election in writing the limit of what you are going to ask for in wage increases, because I don't want the increase in taxes to be soaked up in wages, and the voters are going to want to know that they are not going to be sucked up in wages," and with Jackie's help and some enlightened labor we got them in the room, we talked about it, and we got them to sign up.

Mr. DAVIS. OK. Thank you very much.

I'm going to recognize now our ranking member, Ms. Norton.

Ms. NORTON. Thank you, Mr. Chairman.

What occurs to me, Governor Voinovich, is that you have seen Cleveland from the two most vital posts in the State, having moved from mayor and this crisis to become the Governor of the State, and since there is no such higher office in the District of Columbia, I guess Mayor Barry has to figure that if he does well enough he will become President of the United States.

I would like to follow up on some of what you said that most interests me. As I recall it, the oversight appeared to be for 1 year by this commission. Is that correct?

Governor VOINOVICH. No. The oversight commission was in place until we met all of the criteria that were established in the legislation.

Ms. NORTON. So how long was that period?

Governor VOINOVICH. We didn't—the commission ended—started in 19—let's see. The first meeting of the commission was January 24, 1980, and we burned the bonds in 1987. We could have terminated it earlier, but, as I said, one of the conditions was that the misspent bond funds were paid back, and so what we did was, we just entered into an arrangement. In effect, what happened was, I was able to get the banks to come forward and take care of it, and the deal was, we'd pay them off in 7 years.

I didn't want—my investment bankers all wanted me to issue those bonds because, you know—I said, I'm from an old ethnic family, we pay cash, you know, and I said I don't like paying interest, so we kept it going for 7 years, and it was great because they were always there. They didn't interfere a lot, but I knew, particularly the council members knew, that they were there, and it had a way of kind of helping us stay on track and not get off.

Ms. NORTON. Well, indeed I was interested in your testimony that you tried to keep them in place as long as possible. What was your thinking?

Governor VOINOVICH. What I was thinking is that, first of all, we had their expertise that was available to us. The State continued to give us a little money for them, not a lot but a little bit, and I thought I had this great group of experts that were available to me that are kind of, I can go to, and they were more my partners than overseers. They were there to help me, and, as I mentioned, they were very important when you were putting budgets together and when the council would start saying, "We've got to do this," and I'd say, "Wait a minute, we can't do that, that's not part of the recovery plan." So it kept us—I refer to them as the rudder that

we needed. When the weather got bad, that kept us going through those seas.

Ms. NORTON. And the State paid for the board?

Governor VOINOVICH. They paid for it, but it was minimal. We gave them free office space, and basically it was nickels and dimes.

Ms. NORTON. The staff and so forth?

Governor VOINOVICH. Yes, but—let me correct myself. The part of it that they really helped out was—and now that I—and it's been a long time. In fact, I was on the phone yesterday with Bill Reedy, and he faxed me some stuff to really, you know, refresh my memory. The State did pay for the accounting firm, the financial supervisory group that was at that time Ernst and Ernst; this is Ernst and Young. They did pay for that, and that was a benefit because we didn't have to pick up their costs from the city.

Ms. NORTON. And I know that can be a great cost.

I am very interested in the contrast between your testimony and the testimony of Mayor Giuliani who preceded you, because I asked him about the regrowth of the government which confronted him when he came into office, and you have testified that the government, in effect, did not grow because the 85 percent inflation rate compared to the 45 percent growth in the budget indicates some enormous discipline somewhere.

Governor VOINOVICH. Well, let me just point out to you one other thing, and I'm glad the Members of Congress are here. I went through the deficit reduction of 1985 that passed. The cities and the counties paid the price. I lost—not only did I have bad finances in the early eighties but I lost about $79 million of Federal money. I lost all the CETA money, I lost half the community development block grant, and revenue sharing went out the window. So I lost the Federal money that was available, and then we had the financial problem, and, as I said, we had to go to the voters and ask them for additional revenue. But in spite of that, our growth was 45 percent in 10 years versus the inflationary rate. So these were tough times.

Ms. NORTON. You had to replace the loss of those Federal funds though local funds?

Governor VOINOVICH. That's right, and part of the reason why that—you know, that put the pressure on. Some of that was good; don't get me wrong, I think pressure is good. I think that government too often doesn't—they don't get the message. I'm going to be talking to AFSCME here at noon. We are the leader in the country in quality management, of using quality—we call it quality service for partnership. The public sector doesn't get it in most places.

Businesses in my State understand you have got to work harder and smarter and do more with less, that you have got to bring technology and you have got to be more efficient and so forth, and so the work force here has got to understand that it is not business as usual. That's why having the management audit is part of this thing, to come in and look at the way things are doing.

The other thing I'd advise is that I'd get involved in quality. You have got some Federal agencies that are doing real well in quality and some that aren't, but you have to involve, you have to empower the people that are making the decisions to get involved and figure out ways that you can do more with less. The public—the private

sector demands that today, demands it, and the work force has got to understand that they have got to be part of the solution and not the problem, and I say those words in all due respect because I don't know what the situation is here in terms of the work force here; they may be the most efficient in the world. So if they are, God bless.

Ms. NORTON. Thank you, Governor Voinovich.

Mr. DAVIS. Thank you very much.

I would now like to recognize the chairman of our full committee, the gentleman from Pennsylvania, Mr. Clinger.

Mr. CLINGER. Thank you, Mr. Chairman, and, Governor. It's always a delight to have you here and to give me the opportunity to commend you on the marvelous job you did in Cleveland and are doing in Ohio.

It wasn't that long ago, I can remember one of the standard gag lines was, "The last one out of Cleveland please turn out the lights," and I think you perhaps as much as anybody made that sort of an obsolete line and no longer operative.

I thought I'd use this opportunity also to report to you as one of the great country's leaders on the question of unfunded mandates that we are coming close, I believe, and hopefully today we might actually see an agreement between the two bodies on that issue, and that would lead me to the question was that, in terms of your stewardship in the city of Cleveland, were unfunded mandates imposed by either the State or the Federal Government as part of the problem that you had to deal with?

Governor VOINOVICH. First of all, Mr. Chairman, I want to thank you very much for your leadership on unfunded mandates. Without your work this last year and this year, we wouldn't be where we are today. I really appreciate that.

The interesting thing in those days was the money that we were getting that was cutoff. What happened was, as the deficit became larger, Congress became more creative in how they were going to fund some of these mandates, and, as you well know, today that has grown, at least in Ohio, to about 12½ cents of every $1 spent for mandates, and if you don't do something about the current mandates cities have—and I'm urging you to do that after you get this done. We want to go back. Your regulatory bill that you passed in the House I think is great, and I've talked to Senator Dole about doing the same thing. But get back and look at some of this stuff. As I say, by 1998 it will be 25 percent.

The fact is that that wasn't a real—the problem that it is today for the cities, but—and I have no idea of what impact mandates are having on the District. Somebody might be interested to look at that to see. Maybe there's an area where you might let up on some stuff that might make some money available to them.

In fact, one of the things that you really ought to look at from a big picture point of view is that, if we are talking about cutting back—and I know you are going to cut back on programs for State and local governments, we know that's going to happen, but one of the ways that you can help free up some of the resources is, first, don't pass more unfunded mandates; and, second of all, get rid of some of the stuff that's there that would free up some of those dollars so that we can deal with some of the—have some more flexibil-

ity on the local level, and I think you heard me talk about the police officers. I mean if Columbus didn't have 12.5 percent of their dollar going for mandates they could take care of their own police officers. What the dickens is Congress providing police officers for? That's a local government function.

So I think that what needs to be done is to start off sifting some of this stuff out and see where, you know, indirectly or directly, you can maybe help the situation from—in terms of legislation or maybe even some government regs.

Mr. CLINGER. I think you put your finger on that. I mean the proliferation of unfunded mandates really is of fairly recent origin. That really wasn't a problem until more recent years, but it certainly increased exponentially in a very short time.

Mayor Giuliani talked about, the way you attract business back and the way you create—begin to recreate a healthy city as one of the ways is to create a climate in the city, and that has to do with crime. And I'm sorry I wasn't here to hear your testimony, but was that a problem for you in terms of making the city a livable city? How did you deal with the crime problem?

Governor VOINOVICH. I think, to start off with, a well managed city or well managed State or well managed county does more to keep businesses and get them to expand and attract them than anything you can put your finger on. They—you start with that.

I think in the area of police protection, we had an absolute paradigm. We went from a situation where I went to a meeting, my first meeting, neighborhood meeting, with the chief of police, and we got dumped on like I've never been dumped on in my entire life. The chief was ready to jump up, and I put my hand on his hand, and I said, "We're here to listen, Chief," and what we did was, we went down and we developed police community relations committees in all the districts, where we had citizens come in once a month with the district commander to talk about the problems in the neighborhoods. We established—we had an auxiliary police in the city, but they had been neglected, so I punched it up—that up, gave them money, gave them uniforms, eliminated the adversarial relationship between the regular police department and the auxiliary police. We began a very, very aggressive block watch program to get citizens involved in policing their own neighborhoods and changed the management of the Cleveland Police Department and also the complexion of that department over the years so that it was more reflective of the people in the community, and when I left, city council members and neighborhood people were having police officers, and I'd go to these and they'd honor police officers for the good work that they were doing in the community, and they'd bring in their families.

So I think that, again, if that's a major problem here—and Mayor White has done a fine job of continuing it. We put in a police review board. Everyone said it was terrible, the unions were opposed to it, and we had a couple of very, very bad racial incidents, and it has worked, it has been great. It provides kind of a place where, if somebody really feels they are aggrieved and the system isn't working, they can go there.

There were a lot of little things that we did that we put into place, and, by the way, the Cleveland Roundtable that I mentioned

is very much into dealing with the problems of racism in the community, and so that's a very important—if you don't have good human relationships in a community—I always say that relationships, human relationships, people getting along together, are more important than infrastructure, than roads and bridges and the rest of it. We forget about it, but that's fundamental to any good community, is the people work together, respect each other, and there's communication going on.

Mr. CLINGER. Thank you.

Thank you, Mr. Chairman.

Mr. DAVIS. Thank you.

I now recognize Mr. Fattah, the gentleman from Pennsylvania, if you have any questions.

Mr. FATTAH. Thank you, Mr. Chairman. I don't have any questions at this time.

Mr. DAVIS. All right. Thank you very much.

The vice chairman of the subcommittee, Mr. Gutknecht from Minnesota.

Mr. GUTKNECHT. Well, Mr. Chairman, in the interests of time I won't ask any questions either, but I would like to just make a couple of observations.

I really feel like a pair of brown shoes at a black tie event this morning, to have the excellent testimony that we have had; and, second, I want to thank the Governor again because, as grandma used to say, "the darkest part of the night is just before the dawn," and I think that you have given us reason to believe that there will be a dawning, there will be a new day for the District of Columbia, and that if we do this right, hopefully we won't have to do it—or future Congresses won't have to do this again.

So again, thank you so much for being generous with your time. You have answered the questions that I had already.

Thank you, Mr. Chairman.

Mr. DAVIS. Thank you very much.

Let me just ask Mr. Fattah—I think he had one question. The gentleman from Pennsylvania.

Mr. FATTAH. Thank you, Mr. Chairman.

Just a quick question, Governor. There's a lot of discussion about block grants, and I want to know whether you think that, as we look at the financial situation here in the District and as that might play out, including other cities around the country that are in delicate financial situations, how do you think State control over block grants versus direct appropriations and entitlements may impact? If you just have some general comment on that.

Governor VOINOVICH. I can give you some real specific comment. The temporary family assistance bill, for example, block grant, I'm in favor of that becoming an entitlement to the State and not to individuals. I'm in favor of Congress not prescribing how we spend that, that Congress give us the flexibility so that we are able to take those dollars and use them and work harder and smarter and do more with less and not have to get waivers, like we have to do today, in order to utilize those dollars in the most effective way.

We also insist that if you are going to freeze the money, that you not just use 94, that you go back and you average that amount over several years, and that you also put in place a rainy day fund, that

it's available in case some State's economy goes in the dumpers and they need help.

But I think—we have a thing called the children and family first initiative in Ohio, and, again, it's really looked at as one of the best in the country. But the whole effort there is to get human service agencies to work together and cut through the red tape so that they can provide services to their customers, and one of the frustrating things is that these categorical programs make it more difficult.

For example, Head Start and day care—we lead the Nation in Head Start. Ohio is 100 percent ahead of the national average. We have 70 percent of our kids in a Head Start Program and all of our eligible kids in the program, spend more money on Head Start, by the way, than any State does. But if you want to put Head Start—I want to put them in the day care facilities. Well, Head Start money can't be used for day care; day care can't be used for Head Start. If you could take some of these programs and meld them, I think you can get a much bigger bang for the buck than you're getting right now and do a better job of taking care of our customers.

Mr. FATTAH. Governor, let me just try to follow up, and I know it's not the case in your great State of Ohio. I come from Pennsylvania, and we have had——

Governor VOINOVICH. You have got a new great Governor, by the way.

Mr. FATTAH. We have had over the past couple of decades—and it's been reported in the literature perhaps to exist in other places around the country—something of an antibig-city bias in State legislatures as part of the kind of normal political discourse that sometimes takes place. Do you think cities, big cities, would fare better under these block grant approaches given that notion, or whether you think that notion is not really a relevant factor around the country as we look at urban issues?

Governor VOINOVICH. If you are talking about our customers, the counties in Ohio run the human services program. A lot of the money comes through the State, but in effect they are the ones that administer the program, and this is where we have established our children and family first initiatives.

I really believe that if we could blend this money and look at where the needs are and have the flexibility that we would like to have, that we can do a better job of taking care of our children and families than we are now doing today. I mean that sincerely. It's got nothing to do—I mean I just think that we can take your money and spend it better than what it's being spent today if we have the flexibility, but I don't want—you know, who's eligible, how long and all—let us worry about it, and, you know, we're the laboratories of democracy.

You know, if there's a good program out there, you want competition. I'll try to steal a program that Tommy Thompson has in Wisconsin or—we just—my wife kicked off our Help Me Grow Program. We have got $600,000 from the private sector, and the State is putting $700,000 into a major program to reduce infant mortality. That program got started in South Carolina. We thought it was so good that we're copying it. And so what you need is innovation out there, and I think that some of the stuff will work, some of it won't,

but the fact of the matter is that the system that we have right now is not working, it's broken.

Mr. FATTAH. Thank you.

Mr. DAVIS. Thank you. Thank you very much.

Mr. LaTourette, the gentleman from Ohio.

Mr. LATOURETTE. Thank you, Mr. Chairman.

I promised the Governor I'd get him on his way by noon, and since I've had the opportunity to see his handiwork up close I'll yield so Mr. Flanagan can quench his thirst.

I want to thank you, Governor, for taking the time to accept our invitation today, and if you could work one more miracle—that would be to get the Indians back on Jacobs Field come April—I would appreciate that very much.

Just to the gentlelady from the District of Columbia, I'm very comfortable with the Governor leading the State of Ohio. The observation that we have no interim step between Mayor and President of the United States may have been one of the better arguments for statehood I've heard in a while.

Mr. DAVIS. Thank you very much.

Mr. Flanagan, any questions?

Mr. FLANAGAN. Thank you, Mr. Chairman.

Thank you, Mr. LaTourette, for yielding.

Mr. LaTourette is very kind to me. He knows how windy I can be, so I'll save it to just one question Governor.

We heard earlier in your testimony a very interesting use of the advisory board in a fire wall, a political fire wall with the city council that might not want to do the recommendation, and a strong leader standing up saying no, no, this is the plan, and we have got to stick to the plan. That, I think, would certainly have efficacy here depending on the shape, size, and flavor of the board that we may use here.

I was also very interested to hear about the Cleveland Roundtable, and I was wondering, over and above its advisory capacity and a sounding board for economic and social issues, does it have any formal function over and above that, and does it complement the financial advisory board in any way?

Governor VOINOVICH. No, it had no connection whatsoever with the financial advisory board, but it did give the people who live in the neighborhoods instantaneous empowerment where they felt they were shut out of the system, and it was through the roundtable—they've got a very, very aggressive program in improving race relationships in the city of Cleveland.

A little offshoot of it was really kind of interesting, that in the area of jobs we had a lousy labor-management reputation, and through that group we created a thing called work in northeastern Ohio, where we got middle echelon labor and business leaders into school, talking about communication and quality, and that helped the—today, I think, if you talk to business they'd say, you know, Cleveland, Greater Cleveland, has a good business-labor environment.

And, let's see, what else? Got involved in our housing programs in working with our Cleveland Tomorrow group to get them to start to invest in housing in the neighborhoods. In fact, Cleveland Tomorrow provides money to neighborhood organizations for the

expertise they need to take advantage of the various programs that are out there to do housing. That is another thing. If you come to Cleveland today, Mayor White has done a fabulous job. I think there's probably more new housing in Cleveland today than probably any other city in the country because of these partnerships that have been set up.

So that a roundtable is not just a chowder society, it's a group of people that come together, and if there's a problem, and it's—it also deals—here's a real good example. We had a big racial problem at Cleveland State University, and they just couldn't resolve it at the university, and the roundtable stepped in and provided the leadership and the table where people could come together to resolve that problem, so that it's just an outstanding institution to have in place. It helped us encourage our work with our police-community relations committees and very, very helpful.

Mr. FLANAGAN. It sounds like, although lacking a formal function, it sounds relatively indispensable to the overall picture for the future of Cleveland as it was seen then and as it is now, and that's indeed encouraging, being that government doesn't always have to take an active hand, but in an advisory level. For financial, economic, or social reasons, the community can come together and provide leadership on levels such as these which turn out to be indispensable.

I thank you, Governor, and I thank the chairman. I yield back.

Mr. DAVIS. OK.

Governor Voinovich, thank you very much for your willingness to appear today on such short notice, and I know that Mr. LaTourette was instrumental in contacting you. He deserves this subcommittee's thanks. He is an outstanding product of Ohio, doing a great job here for us. We appreciate having him here and on this subcommittee.

I think your story should inspire the people and the government of the District of Columbia rather than frighten them. I'd also point out to anyone who fears the presence of such a board in the District that you were so wounded by your services as mayor that you went on to be Governor and voted almost by acclimation last November, so we wish you well in your future endeavors and thank you very much for your testimony today. It has really enlightened us as we move through a very, very tough next few weeks in working through this legislation.

Governor VOINOVICH. Well, I'm glad to be here, and I'm genuine when I say if somebody on the committee wants to get in touch with me and plug in with some folks that know a lot more about this in terms of the details, I would be more than happy to do it.

Mr. DAVIS. Thank you very much.

Ms. NORTON. Mr. Chairman, could I say that I would be very interested in being in touch with the Governor with respect to that business roundtable and what appears to be an extraordinary contribution that they made to the city's recovery.

Governor VOINOVICH. Thank you.

Mr. DAVIS. We've got the names, and this subcommittee will be in contact with them. Thank you very much.

Governor VOINOVICH. I might just mention to you that your good friend Carol Hoover—Carol was the genesis. She's the one. We

went to Detroit. It's really—Mr. Chairman, with your permission, Carol Hoover is one of our great leaders. In fact, she is now president of the Greater Cleveland Growth Association, which is our Chamber of Commerce. But Carol encouraged me to create that Urban Roundtable. We went to Detroit to copy what they were doing in Detroit, and the irony of it is that I guess 3 years ago Detroit invited them back to Detroit to tell them how it's done. So Carol really has the—knows how that works.

Mr. DAVIS. Thank you. Thank you very much.

For our next panel we have got a truly distinguished panel to discuss the original New York crisis and how it was dealt with. First of all, we have former Governor Hugh Carey. He was a seven-term Member of the House of Representatives. He was born in Brooklyn, NY; graduated from Saint John's University and Saint John's University Law School; represented the old 12th Congressional District in Brooklyn for seven terms before he was elected the 51st Governor of New York on November 5, 1974; and as Governor he was the architect of the financial plan that averted the bankruptcy of New York City and began a sweeping program of fiscal reform and economic development to restore the State's vitality.

His extensive tax reduction program in excess of $2.5 billion was the keystone of restoring New York's competitive economy in the 1970's. He instituted the I Love New York Program and founded the Empire State Games. Nationally, he was the spokesman for regional concerns and a proponent of comprehensive programs for urban industrial revitalization, and he founded the Conference of Northeast Governors.

In 1991 Mr. Carey was chosen by his fellow Governors as the first chairman of the National Institute of Former Governors and was reelected as chairman through 1994. He is a director of Meditrust, Inc., First Albany Corp., the China Trust Bank, and Triarc Co.'s, and is currently with the W.R. Grace Co. in their government relations division.

We also have Ed Regan, who is currently policy advisor to the Jerome Levy Economic Institute and is a member of numerous corporate and foundation boards, but he was the New York State comptroller from 1979 to 1993 engaged in governmental financial management systems and pension system investments. Mr. Regan is a frequent lecturer and author on national and regional economic trends and infrastructure investment and governance processes of U.S. corporations.

It is the policy of the committee to swear in witnesses. Governor Carey, you are exempt from that if you would like, or you can do it as a former Member.

Mr. CAREY. Let's play safe.

[Witnesses sworn.]

Mr. DAVIS. Please be seated.

Governor Carey, would you like to proceed, and let me just say how thrilled we are to have you here, and with the experience that you bring to this subcommittee. We are honored to have you here.

STATEMENT OF HUGH L. CAREY, FORMER GOVERNOR OF NEW YORK STATE; AND EDWARD V. REGAN, FORMER COMPTROLLER OF NEW YORK STATE

Mr. CAREY. Thank you, Mr. Chairman, members of the committee. I'm delighted to be here to sort of celebrate an anniversary. I'm very conscious of anniversaries in my advanced age, but today I'm sort of celebrating a dual anniversary. Thirty years ago I was encouraged to cross the Remagen Bridge, and I was comforted because there were so many brave men ahead of me, and 20 years ago I was comforted because I decided to cross the Rubicon and go from Albany to save New York City, the Rubicon of the Hudson and Harlem River, I don't know which it was, but I was encouraged because so many brave men and women followed me, and therein began kind of an odyssey in terms of getting to know what a control board is. So maybe I can best address that metaphorically.

A control board is not a hair shirt, it is nonpenitential, it's not a straightjacket or restraining sheet to prevent the governance of the people involved. A control board is somewhere between Slim Fast and Weight Watchers, it's a budgetary regimen to produce fitness over a designated period. To really stretch the metaphor, it's best compared to Dr. Warner's corset which became eventually the two-way stretch girdle and is now Victoria's Secret. In a word, wear it; you'll like it.

I've provided the committee with a chronology, compendium, of all the steps to the control board. It's a rather deep document, it's very weighty, it goes through all of the procedures we had to undertake to involve ourselves in a control board, and I've entrusted it to your staff for research and resources, and we'd be glad do help in terms of helping on that any time.

I trust that the circumstance which led to New York, New York City's condition, in the seventies are rather well known to the committee. New York had an immediate cash-flow shortage of over $750 million, a budget gap of over $3.6 billion, credit markets were closed to the city, and the city condition threatened to affect the credit of the State which was being safeguarded by the then comptroller.

Joblessness was a major problem in the seventies and very severe in big cities like New York and, indeed, Washington.

But there's one job nobody wanted, and that was to be the person responsible for the rescue plan for New York City. As a result, as a Governor with some discretion, I decided that the best way to do it was not to do it alone, and, as Mayor Giuliani has said and Governor Voinovich, the best deal is to bring together a coalition, the private sector, labor organizations, nonprofits, and voluntary agencies, and do it together.

In other words, in our days of hardship we formed that kind of partnership or coalition. It was really modeled on the wartime experience of Harry Truman. My history tells me that when we faced the peacetime conversion in Harry Truman's term in office, he didn't do it alone, he reached out, grappling with the problems of lack of resources and wartime economy, needed to shift gears to a peacetime, shall we say, worldwide leadership role. He did it with the dollar-a-year men. Harry's dollar-a-year men came to Washington, stayed long enough to get the job done, and went their way.

That's the way we did it in New York City as well, using the Truman model. It was bipartisan and needs to be bipartisan. For instance, the Governor was chairman, but the mayor of the city was on the board, the comptroller of the State the comptroller of the city, members from the private sector, members from labor, a professional staff headed by an executive director.

Now how did the board conduct itself? As chairman for 8 years, I can recount, the sessions were friendly, forthright, often turbulent, frequently humorous, but constructive. In 8 years of dealing with several budgets toward recovery, we achieved consensus and never heard one dissenting vote when it counted.

Where did the board come from in 1975? Well, President Gerald Ford, the White House, and Treasury Secretary were Republicans, one part the Democratic Governor, two parts State legislature, one Republican, one House Democratic.

For the benefit of the record, let me refer to the involvement of President Ford and his staff in 1975. Contrary to misleading reports, President Ford never told New York to, "drop dead." Rather, he and I agreed we had to have a plan that would work so the city and State would not become chronic invalids depending on Federal support. Strengthen the unit of government, work it out, and then back away and let it work out its own future resolution with a reinforced kind of structure.

We worked out a seasonal loan plan under the guidance of Bill Seidman, advisor to the White House, the same Bill Seidman who lately headed up the FDIC with such an outstanding performance record.

The implementation of SLA, the seasonal loan agreement—was headed by Secretary of the Treasury Bill Simon, whom we often referred to as "Simon Legree." Bill was tough but very fair. Time would not permit me now to note all the other Federal officials involved, but in the next administration under President Carter, Roger Altman, as Deputy Secretary of the Treasury, became our mentor, and he was most effective and helpful in those difficult years.

Yes, President Ford helped us again in securing passage of the required legislation in Congress with only one onerous stricture. President Ford looked me in the eye and insisted that all documents involved in the loan agreement would provide that my personal guaranty would be on those documents in my signature. So at one time I was a guarantor for $3.6 billion with interest. Two comments: One, we paid the principal and interest in 6 years; and during that time, at least on paper, my signature was worth more than my predecessor's, Nelson Rockefeller. [Laughter.]

On working on the structure of the control board, I have given the committee a compendium of the organizations involved, including the funding as well of what became a rather famous organization, the Municipal Assistance Corp. known as Big MAC. Some of these were of course control organizations, and some were funding, and my good friend the comptroller is most familiar with the conduct of them because he was a watchdog on these agencies.

We have a heroes list, we have a heroines list, of people that came forward and served on that board. The private sector was heavily involved, private sector in labor and private sector in man-

agement. I can go into those names, but, candidly, everyone in New York with those names has gone forth to the private sector, and I can encourage you, when you go to the private sector, they are all in the six and seven-figure earnings capacity now. It didn't hurt them, they learned a lot, and they went forth to make their fortunes.

I have even spoken to the longest-serving member of that board, Mr. Stan Shuman, who is still on the board after these 20 years, and he has agreed if you want him to come as an expert and tell you what it's like to serve on the board for 20 years.

I don't expect this board will last that long. I hope not. Indeed, we are planning for a reunion of our group in April. In the course of our discussions they have all agreed that if you want them to help, they will be here to do it. They do not mind coming to the District of Columbia. They have other reasons to be here, and that's the kind of support that I'd like to see this committee get.

Let me state what I think is a proper metaphor for a control board, and I looked to the cerebral regions to come up with this metaphor. I think it should be looked upon as a "guardian angel." Critics may look upon the control board as an intrusion on home rule and may suggest a guardian angel is more like Lucifer, but I see the board as more resembling the Archangel Michael with his sword in his scabbard ready to smite waste and inefficiency, to safeguard the security of the residents and save the children and needy from hardship caused by lack of resources at this time. That's the job of the control board.

In no case, in no case in 20 years, in New York has any mayor ever raised a complaint or charge of intrusion on the conduct of the city. In fact, as I heard Mayor Giuliani, he said he only wished that his predecessor had used the board more. But access to the board to safeguard the financial plan from those excesses that began to creep into the plan because times were rather good, and payrolls began to edge upward, and—if the control board had taken a closer look, perhaps New York would not have the difficulty that Mayor Giuliani faced.

So the control board is a good watchdog, a good guardian. It does not—does not come forcing its way into city hall but is there to help, and the principal feature of that board is such. I don't know how any mayor, I don't know how Mayor Barry or any mayor that is in today's complex situation can evolve a city budget in 1 year or for 1 year ahead.

The beauty of a control board is that it sets up a financial plan, and in that board plan not 1 year, but in 1975, in September, the financial control board, with the Municipal Assistance Corp., laid out a plan of financing for the city of New York through 1978, actually a 4-year plan. When that plan is there, this is what happens. The mayor can see the resources he is going to get 3, 4 years ahead and can therefore plan more effectively for the use of those resources. In addition, the mentor, whoever it may be, in this case the executive branch, once he puts those resources in the financial plan, once that agency puts the resources in the financial plan, they must be delivered, you can't cut back. So it's a dual obligation, one to perform proper planning, the other one for the rendering agency, whoever it may be, on the advice of this committee, to bind

the funding agency to put in the resources so you can plan ahead properly. I think that is one of that forward planning as I see it right now.

As I heard the Mayor more recently, he is talking about trying to close his $700 million more budget gap by this October, and then he is looking forward to what he calls the miracle budget a year away. I would encourage this committee to guide the Mayor past the miracle budget to a budget that we can count on 3 or 4 years ahead. Why? If we are going to ask the private sector, as we did in New York City, to come in, you can't do what laboratory technicians won't do, scientists won't do, you need lead time, you need to plan these resources so if this is going to be the city on the hill, if this is going to be the capital of which we are proud, we can say we have taken care of this problem and now we can go about the business of bringing business in, bringing initiatives in.

What helped New York? The I Love New York Program. It grew tourism from $2 billion to $7 billion because we had something to offer, not dirty streets and empty buildings, we had great theaters, we have the opera. We began, I remember, in Germany when the Germans said, "Your city is in great trouble; your opera is on strike." I said, "We have three opera companies. Only one's on strike." They didn't know that.

We have got to tell the world, this is the world's leading city for the example of a good government. We have got to show that. I dare to say in time that this city can rival in a small way the benefits of New York City, in a small way. [Laughter.]

I would quote our late President John F. Kennedy. He said, "The District of Columbia is a wonderful combination of northern charm and southern efficiency." Now I believe President Kennedy. I think that can happen. I really think you have an opportunity here.

The urgency, as I see it, is, the Mayor is grappling with a budget and a gap by October. You need a longer process than that. The control board, properly comprised, will have private sector people, some of the labor leaders he is dealing with should be sitting on that board, the confluence of interests come forth on the board. The leadership will be provided.

I don't know how it is going to work because none of you, thank God, are eligible, you can't serve on the board, but you can certainly find in this government of ours at a time when we are talking about restructuring, downsizing, making government more efficient, a model for the District of Columbia. I think it's a great opportunity. I stand ready to help in any way I can, and, as I said, 30 years ago I got involved in crossing a bridge. Thank God, brave people were ahead of me. I'm glad you are ahead of me now. I'll follow your lead.

Thank you.

Mr. DAVIS. Governor, thank you very much.

Mr. Regan, I apologize for putting you after Governor Carey. That's a tough act to follow.

Mr. REGAN. No, that's happened to me on many, many occasions, but I was always his auditor.

Mr. CAREY. He used to grade my papers.

Mr. REGAN. I was his auditor, so it worked.

Would you have me——

Mr. DAVIS. Go ahead.

Mr. REGAN. Mr. Chairman, thank you very much, and Governor Carey.

I have distributed to you and your members a statement which I am not going to read. It is really a history of the financial oversight process in New York City. It is the first one, strangely enough, we discovered—it's the first one that has ever been done. You referred—other than Charles Morris's book, which you have just referred to, and perhaps the Governor's testimony which you just listened to.

But we, myself and some staff assistants, we did this in the transition period of Governor Pataki. Myself and my staff interviewed 42 people, including Governor Carey and Mayor Koch and everybody that was involved in this process, reviewed every document. We have them all, every budget document, all of the legislation, the whole history we now have, and then I summarized it in that five or six-page report as to how New York City's oversight process got formed and what the process should be going forward, and I'd be happy to answer questions. Many of the questions that were asked are covered in that five or six—are answered really in that five or six pages.

Just two points. Why a control board process? Why an oversight process? Well, the first is that what you are really going to do is bond out. I don't care how you call it, you are going to take the present deficit, the structural deficit, the accumulated problems, and you are going to borrow, or the city is going to borrow. That means, as it did in New York State, as it did in New York City, as it did in Cleveland, as it did in Bridgeport, and any place elsewhere this has been done, that future generations are going to have to pay the principle and interest and are going to have to pay for the problems created by others who came before them, and if you are going to ask future generations to pay 5, 10, 15, and 20 years, now you have got to guarantee them that this will not occur again and you have got to guarantee them that this cure is permanent. That is the tradeoff you make with the people that have to pay the debt service in the coming 10 to 20 years.

A second reason, it seems to me, you do an oversight process is that it reflects how government really works, and I've spent 27 years in government, I have some feel for it. There is action in government when everybody's backs are to the wall. That's when action occurs. Well, an oversight process or a control board has the effect of moving the "wall up to their backs," then things can happen. That's the democratic process. That's just the way it works. You force people to do things that are very difficult to do without either the wall at their backs or their backs to the wall, and of course you create an environment among the electorate, among the constituents, the stakeholders, the unions, the citizens, you create an environment that change is absolutely needed and change is required.

So the fact that you have pretty much, as I understand it, Mr. Chairman, and your other colleagues, resolved the idea that you are going to move ahead with an oversight process is commendable, and now, it seems to me, is: how does it now work, which is my final point.

In New York State there were three agencies, and we have only mentioned one here, although the Governor now and then looked over as he, of course, had a habit of doing, wondering what his former auditor was going to say next, and that because the auditor, an independent auditing agency, while not as important as a control board, which I'll touch on in a minute, is a vital part of the process. I don't know how you do this in this great city without having an independently elected auditor, whether you call it an auditor general, whether you call it comptroller or whatever the label is. That's one of the agencies that seems to me it worked well in New York and you would want it here.

Actually, I took over the office of comptroller from Arthur Levitt, Sr., who had established the parameters of this office, and for years to come following both when Mr. Levitt was the comptroller and then myself, we were known as the one true source of accurate numbers. There would be shouting and yelling; this person, that person, this set of numbers, that set of numbers. Here's the important fact: The independently elected comptroller, who was accountable to the people, so that there was power there to bounce that person out, either Mr. Levitt or myself, lets say if the Governor said and could prove those numbers are wrong, or the mayor. The credibility and the authority that went with that office because it was elected, I think, was an enormous help in the control board, the whole oversight process. So that's one of the agencies.

The second Governor Carey just referred to, and that was a separate agency to do the borrowing, because the markets are the ultimate discipline here, they really are, as we all know, and the rating agencies are going to, in many ways, call the tune, and it's terribly important to have an independent group whose only function is to access the markets to borrow and who develops credibility with the markets, with the rating agencies, separate from the control board and separate from the auditing agency. Again, Governor Carey established and just referred to the Municipal Assistance Corp—MAC—who performed that duty and still is there to perform it if need be.

The third and most important agency is the control board itself—but notice the significant impact and importance of the other two. The control board itself has to be—and I back up what the Governor has said, after all of our interviews and all of our work with the people that have been involved in the last 20 years in New York City and New York State, the process, has to be composed of everybody that's a player, and that includes the mayor of the city.

I do not see, in spite of the strong differences between the city of Washington and the other cities, how you leave the mayor out of the process. The compromising, the working the problems out, has to go on—prior to the control board meetings or at the meetings, and the mayor must be—the mayor's constituents and the mayor himself or herself must feel part of it—it seems to me that's the history of New York City. It is the control board that of course imposes strictures or eases up and because they have got all the important people on, and like any democratic process, like your own committee caucus meetings, Mr. Chairman, that's where a lot of problems are worked out, and that's how the control board, as

you heard the Governor allude to and refer to, that's how it worked in New York City.

But one final point. The chairman of the control board—and I'll use that phrase. You might up end up calling it something different, or you might have a different person, but at the top of this process has got to be somebody who will exercise leadership when it is called for. They don't have to bark and yell every time a new budget comes out, but when a crisis starts to develop there has got to be somebody at the top that has developed influence, that has created a constituency, that in this environment who, when he or she speaks, is able to move the process.

Without that leader—and let's say that a chairman of the control board, which Governor Carey was, without a leader like that, then you run into problems, and the control board, as you heard Mayor Giuliani refer to, could slip into becoming just another part of the political process.

So we can establish all the great agencies we want, and they can be the best constructed, and you have heard from New York City and Cleveland, the State of Ohio, and the State of New York, you have probably had the best advice you could possibly get with the three individuals that preceded me, the best advice you could get in the country, as to how to structure things and how to set it up, but without somebody at the top who understands both the numbers and understands the public and understands how to exercise policy in a political environment, without that, you will continue to bump into difficulty. That's my testimony.

[The prepared statement of Mr. Regan follows:]

PREPARED STATEMENT OF EDWARD V. REGAN, FORMER COMPTROLLER OF NEW YORK STATE

This is a slightly edited version of a report, originally written by Julia Vitullo-Martin and myself, on New York State oversight of New York City's fiscal situation.

I. INTRODUCTION

The New York State oversight agencies were created almost 20 years ago, and this report represents the first time they have been re-examined. In preparing this report we interviewed over 42 individuals who either had been or still are involved in the city's fiscal situation (list attached). They included former senior elected officials, current office holders and those involved in the agencies mentioned.

While there have been some differences of opinion, the report reflects the strong consensus of those interviewed: state oversight is necessary, but there is unnecessary redundancy in the oversight structure.

Duplicative reports may contribute to unintended consequences, as some recent events illustrate. The city is suffering from the double impact of a long-term structural deficit and currently deteriorating revenues. Proper state oversight is supposed to ameliorate (if not prevent) the consequences of this situation—namely, as we have seen this fiscal year (7-1-94–6-30-95), a city budget having to be drastically cut several times and a huge deficit looming for the next fiscal year. Numerous reports by the monitors, issued for the past several years, accurately called attention to the problems, but they were diffuse, with little focus, and were not subject to follow-up by senior officials or state action.

The oversight structure is necessarily complex. It requires someone at the very top, that when the appropriate occasion arrives, will pinpoint the facts, and, using his or her powerful "good offices" generate an environment for, and the necessary action to resolve problems before they become difficult—even impossible—to handle.

II. NEW YORK CITY'S FISCAL CRISES

New York City's mid-1970s fiscal crisis was characterized by enormous short-term debt, huge unfunded pension liabilities, and severe operating deficits—all worsened by years of shoddy accounting procedures and fiscal gimmicks. The crisis broke upon

the world on April 1, 1975, when Standard & Poor's withdrew its rating of the city's bonds, saying the bonds were not credit-worthy. In practice, the suspension of the rating shut off the city's ability to borrow, even for routine cash flow, raising the very real specter of bankruptcy.

Most experts at the time agreed that had New York City declared bankruptcy, New York State would have followed with its own fiscal disaster. Yet neither state officials nor anyone else had any mechanism for tracking and monitoring the city's complex and obtuse operating and capital budgets. As a result, the legislature passed the Financial Emergency Act (FEA) in 1975, setting up the oversight structure.

Under the FEA, as amended in 1978, the Emergency Financial Control Board (EFCB) had full powers to review and approve the city's financial activities until the city met certain conditions:

(1) no federally guaranteed debt outstanding

(2) city had adhered to GAAP-balanced budgets for three years, as determined by the control board

(3) state and city comptrollers jointly certify that the city has market access to meet substantially its capital and seasonal financing requirements

The EFCB ruled on June 30, 1986, that these conditions had been satisfied, moving the board into "sunset." Under sunset, the board's name was changed to the Financial Control Board, and certain of the board's powers were suspended, particularly the requirement that the board approve the city's budget. A "control period" could be reimposed should the board decide that any one of five statutorily defined events has happened, the significant ones being:

* the city's incurring of a deficit over $100 million

* the inability of the state and city comptrollers to jointly certify that termination of control was appropriate

Some close observers of the city's finances fear that conditions for re-control could be near. A roughly $3 billion structural gap looms in future years, even though the mayor managed to close this years gap, and his budget for potential 1995–96 purports to close that years $2.5 billion potential deficit.

III. THE STATE FISCAL MONITORS

As amended in 1978, the FEA set up three agencies: the Municipal Assistance Corporation (MAC) to borrow in place of the city; the Emergency Financial Control Board (FCB), to analyze, review, and approve the city's finances; and the Office of the Special Deputy Comptroller (OSDC), to provide technical reviews of budgetary transactions, including contracts.

The functions of the three agencies complement one another and bring to the oversight process a productive symmetry. One agency does the financing, another exercises specific oversight powers and a third functions as an independent auditor.

The Municipal Assistance Corporation is a state authority that sells bonds secured by the city's sales tax revenues. It has gone to market more than one hundred times to produce nearly $19 billion in bonds and notes, including refundings. It holds roughly $4.9 billion in bonds, with maturities stretching to 2008. Having won market confidence, MAC has a higher bond rating and better market access than either New York City or New York State.

Its staff manages a huge portfolio efficiently. It also, by statute, issues an annual report on the city's finances, which is usually a good analysis of the underlying reports of the monitors.

MAC has nine directors, appointed by the Governor—four on the recommendation of the Mayor—with the advice and consent of the Senate for four-year terms. In the past, the chairman, appointed by the Governor, often functioned as a strong, independent voice on the city's finances.

The Financial Control Board, chaired by the Governor, is both the major oversight agency and the Governor's most direct mechanism for obtaining information and directing policy. In practice, the staff serves the Governor and the Governor's appointed private members, who at times have issued forceful, non-partisan public analyses of troubling fiscal issues.

The bulldog of the agencies during the control period, the FCB issued reports that were aggressive in attacking city financial problems in difficult times. In seeming good times since sunset, the FCB has often taken a "cooperative" stance and seldom criticized city budgets severely. In the early 1990s, the FCB warned of serious long-term structural imbalance, while being gentle on current problems. Nonetheless, in the fall of 1993, FCB private members warned of a huge multi-billion dollar out-year deficit that would be very hard to close. The FCB's most important influence lies in the threat of re-control.

The FCB has seven members, including the Governor, State Comptroller, Mayor, City Comptroller, plus three persons (the private members) appointed by and serving at the pleasure of Governor with the Senate's advice.

The Office of the State Deputy Comptroller regularly issues reports on financial plan submissions, status and efficiency of city operations, and labor contracts submitted to the control board. OSDC first called attention to the city's structural deficit in 1991 Under FEA, OSDC was scheduled to go out of business six months after control ended. An amendment extended its life in 1985 and renamed it the "Office of the State Deputy Comptroller."

IV. THE RATING AGENCIES

The oversight structure was set up to restore confidence to the bond markets, which function as the true control on the city with credit ratings that, in effect, withhold money or charge excessively for money. The markets did both in the mid-1970s.

Today the major bond rating agencies—Standard & Poor's and Moody's Investors Service—are far from optimistic about the city's finances. S&P's rating on New York City general obligation bonds today stands at A−. S&P has kept the city on its "negative outlook" watch for four years. In February 1991, it confirmed the rating but said there was a chance that rating would go down. In July 1993, S&P made it widely know that the rating was in difficulty.

In February 1991, Moody's downgraded its rating on city bonds from A to Baa1, where it stands today.

V. OTHER MONITORS AND FACTORS

Since the fiscal crisis, the city has implemented major accounting reforms, including the successful installation of the Integrated Financial Management System (IFMS) computer system, which tracks revenues and expenditures in detail that any interested participant can access.

The city also has a new budget monitor authorized under the 1990 City Charter. The City Comptroller has established a 12-person Bureau of Fiscal and Budget Studies, funded at $689,000 annually. The bureau has issues numerous major reports on the city's budget and economy. It has quickly developed as a source of information on the city's fiscal situation.

In addition, various public and private agencies have created or augmented their analytic staffs to monitor the city's fiscal developments. These include the rating agencies; staffs of the State Department of Budget, Senate Finance Committee and Assembly Ways and Means Committee; municipal union oversight through District Council 37 and Program Planners; a private "watchdog" group, the Citizens Budget Commission; and the City Council Finance Committee. This means there are a total of 13 organizations whose abilities run from fiscal data gathering and analysis to sophisticated budget and economic analysis and forecasting.

So New York City has come from a situation, 20 years ago, of a murky, almost unfathomable budget document with no independent monitoring, to an accurate, detailed and understandable budget with numerous outside monitors.

VI. GENERAL AGREEMENT ON THE ISSUES

Most informed observers agree on several propositions:

1. The most important discipline on the city involves its need to borrow in the public markets. It needs to maintain investor confidence as defined by the rating agencies and underwriters.
2. The city's financial problems are serious.
3. Continuing state oversight of the city, particularly by the FCB, is imperative for both substantive and political reasons.
4. Nonetheless, the oversight structure as currently constituted has some redundant and inefficient elements, and in today's environment, trimming is appropriate.

Is this oversight structure the right one? The general answer is yes: this structure has served the state and city well through some very difficult times. At the same time, given the current presence of numerous groups focusing on city finances, the structure can surely be slimmed down. Past and present city officials complain of the many reports—issued, at times, in seeming competition with one another—to which they must respond under excessive time pressures.

The oversight agencies are paid for by New York City funds via the city sales tax, whose revenues are channeled through MAC. Trimming the oversight structure will therefore save city funds. The justification for this arrangement is in part that the city had been responsible for getting itself into its fiscal mess and should therefore

be financially responsible for the costs incurred in getting itself out. But the city should not have to pay more than was absolutely necessary for oversight, and the three original agencies should function as outlined below.

The Financial Control Board, since sunset, continues to play an important role. It reviews the city's budget but does not have any responsibility for approving the city's budget and financial plans.

The requirement that the control board approve city contracts and city borrowings is also suspended. The control board monitors the possible occurrence of any of the five triggering events for reimposition of control and must formally consider each event annually, publishing its determination that none has occurred.

The Office of the State Deputy Comptroller, continues to provide thorough, detailed analysis of the city's finances, and provide a potential back up in the event of furture trouble.

The Municipal Assistance Corporation no longer issues new bonds. Nonetheless, its existence is important because of its excellent reputation on Wall Street and in the bond markets, and because of its vital connection to city and state credit ratings. It also should remain organized to retain its ability to:

* issue debt on the city's behalf should the city hit its debt limit under the state's equalization law
* initiate refundings should the interest-rate environment be favorable
* as part of a comprehensive, all-inclusive plan to aid the city, issue new debt or stretch out old debt

In sum, it is in the interest of the city, the state, and the bond markets, that oversight be strong and attentive. At the same time, redundancy is a problem, and leadership is required in times of approaching crises.

APPENDIX A

STANDARD & POOR'S RATING OF NYC GO BONDS

1974: A rating
April 75: rating suspended
March 81: suspended rating went to BBB
mid-year 85: BBB went to BBB+
Oct. 87: BBB+ went to A−
rating 1995: A−
The rating today stays at A−. But there have been a couple of close calls;
Oct 1990: "credit watch negative," S&P saying there was potential for a downgrading in the short run
Feb 1991: rating confirmed without downgrading, but S&P said the outlook for the rating remained negative with a chance that rating would go down
June-July 1993: fairly well publicized that the rating, while not downgraded, was in difficulty.
Today the negative outlook remains. S&P is taking a hard look at the financial plan right now. While there is no reason to think Mayor Giuliani won't stay the course, the city is now going on four years of "negative outlook."

MOODY'S INVESTORS SERVICES RATINGS OF NYC GO BONDS

7/16/65 A to Baa
5/3/68 Baa to Baa1
12/18/72 Baa1 to A
10/2/75 A to Ba
10/29/75 Ba to Caa
5/24/77 Caa to B
11/19/81 B to Ba1
11/9/83 Ba1 to Baa
12/17/85 Baa to Baa1
5/31/88 Baa1 to A
2/11/91 A to Baa1

Mr. DAVIS. Mr. Regan, thank you very much.

We are going to go now to questions, and I'll start by first of all thanking you both very much for coming here. Once again you give a lot of encouragement to the process, which may look very dark right now, but New York came out of it very well, and you probably

got some liaison and some cooperation between groups that had never been there before that process.

Governor, let me ask you, you had probably the most varied control board of all of the ones we have looked at because you had wide representation on it. When the final decisions were made, were they often split decisions? Were they four to three? Did they come down along any lines? Would you care to share any comments?

Mr. CAREY. No. As Comptroller Regan says, there is a consensus that develops, and I could go down a list of tough decisions: The ceiling on the city budget, a moratorium on additional taxes, dismissals of thousands of municipal workers, elimination of positions, the city budget, and freeze on new hiring, a suspension of wage increases, an increase in the transit fare, the imposition of tuition at the City University for the first time in the history of the city and State, significant reduction in the capital budget, appointment of a special mayoral deputy for finance, a professional came in to help the mayor. Big tough decisions for everybody.

Every one of those passed without a dissenting vote because, as the comptroller said, you thrash these things out in a political atmosphere, but you look at the future of the body which you are trying to govern. You say for the long pull we have got to take care of this city, we have got to take care of the District of Columbia, and I suggest to you it's is very—it's a very, I'd say, trying process, but as mayor—as Governor Voinovich said and as Mayor Giuliani says, you are surrounded by a private sector that wants to help you come in and help that decision process.

It's extremely important to bring in those business heads, and I mention them in passing. Over the course of years, every one of those individuals were helpful in urging the right decision on the people in the political system. So the political system works better when you have this consensus, and it can be achieved. As I said, we had Democrats, Republicans, we had labor leaders sitting there, and the labor leaders will challenge the business people to come up with the right answers. It is a very good thrashing process in which the truth comes forth, and the truth is what governs the process.

The benefit to the city is, the local unit of government, it gets the resource it needs, and they are pledged, and they are delivered. That isn't the way it is now. Year to year I don't think the District knows what its emolument is going to be and never did. That's one of the most difficult things, to run a railroad where you don't know where the coal is coming from at the next stop.

Mr. DAVIS. Great.

Governor Carey has given over a number of his public papers and addresses on this issue that will be included in the record. I very much appreciate your doing that because by both of you giving us some of the substance behind these decisions over the years, it will add to our record as we draft this legislation and move it through the Congress.

[The information referred to is on file in the subcommittee.]

Mr. DAVIS. I just want to quote something. I was just thumbing through this, having received it this morning, from some testimony

that you gave back in 1975 where you talk about New York City as the city with the strongest municipal unions in the Nation.

Mr. CAREY. The toughest.

Mr. DAVIS. But you had a wage freeze, which I think had been unheard of——

Mr. CAREY. And givebacks.

Mr. DAVIS. And givebacks.

Mr. CAREY. And then the unions invested their pension funds in the various securities which we offered them.

Mr. DAVIS. With the largest construction industry in the Nation in the city, you put a freeze on new capital construction. In the financial capital of the world you couldn't borrow money without going through this—the city couldn't borrow money. So it shows that tough times sometimes bring some strange people together for the good of all.

But I think as we look back we have to say this was really one of the successes in this country, one of the creative successes.

Mr. CAREY. On the borrowing I've noted, I think, some statements by Dr. Norton, a great neighbor of ours in New York City during other hay days, and she pointed out that the benefit of this control board is that over the period of time it will reduce the cost of borrowing and those moneys which are earned by the city by a better credit rating and reduced cost of borrowing can go to the benefit of children, of the elderly, and what's needed in the city. If you don't give the money to Wall Street because of a financial plan which lowers your cost of borrowing, then the money is there for the neighborhoods.

Mr. DAVIS. OK. Let me, if I could, just note the presence in the room, Governor, of your son Paul, who is with White House legislative liaison.

We are happy to have you here and note, as we draft this legislation, we are trying to get a consensus among some very disparate groups in Congress that ordinarily don't cooperate on issues, but I think we are all trying to work together and with the White House on this and with the Mayor and council and try to forge ahead.

But your testimony is very helpful about being more inclusive in the process, making sure everybody is here, and you are telling us that it can all work out.

Mr. CAREY. I can only note a moment of history again, that it was my return to this body in a very tough election in 1962 that my son Paul was born, and the birth of him as the seventh son was such a big event in the District, he accounted for 280 votes, which was my margin. [Laughter.]

Mr. DAVIS. Well, we're glad to have him with us today.

Let me just ask Mr. Regan, we hear a lot about individuals expressing concern for the children and the District and so on, but it seems to me the biggest harm is to continue to pile up debt that these children are going to have to pay for out of programs as they get older. Do either one of you have a comment on that?

Mr. REGAN. Sure. I'll start it because it is finishing my statement or elaborating on it more you let it drift, the higher the debt. There is no magic bullet; there are good solutions. You have heard about them. But the first thing you do is stop the bleeding. You just cannot let it go on, and this is why you are here, Mr. Chairman, with

your staff. You just can't let it go on and force future generations to pay for something that should have been stopped 5 or 10 years back. That's unfair, and that we have talked about elections here—terribly distorts the whole election process, and it distorts what we believe in in a democracy, that—and I've run for office, the Governor has—that you distribute services here, and you tax for them there, and then you run for office, and you go to the electorate, and they have the services and the taxes to equal. But if a situation exists where you can deliver more services here and tax less there, then the democratic process is distorted, and 5 or 10 years from now somebody faces just the opposite. So of course stop it now, draw the line in the sand, which is why you are here, and your committee, and impose the solution, and it will be easier on everybody.

Mr. DAVIS. Governor, you have balanced eight budgets. Can you comment?

Mr. CAREY. Let me suggest something else which I think can happen in the District which I believe, candidly, should happen. You have sort of reached the Plimsoll Line now because your personal income tax level in the city is just about 10 percent. That's about where it was in New York City when New York City got in real trouble. So you can't go much further into those pockets without people leaving. That's No. 1.

No. 2, when you do this process something else is going to happen. We are talking block grants, and it's a great principle of, you know, devolution to get to the spending levels, a more effective way of handling funds, and the Governor spoke about that. However, something else has to occur. At every level of government there are burdens which are properly borne by that level of government, and there are those which are beyond that level of government. Two ways you can handle the overburden in a city like Washington. One, you need collaboration and cooperation in the surrounding region.

In New York we had the Regional Plan Association which looks at the complex of New York State, Connecticut, Pennsylvania, and New Jersey and says these things you should work on together. I don't know that that's happening in the District and Delmarva Peninsula. I don't see that exchange and collaboration in the surrounding area. Even many of our employees and visitors come from that area and go home without sharing in the burden that perhaps they should. That's one.

The second thing is, in terms of the planning you need besides the Metro plan, other ways in which you plan for the future of this district as a region, and that can come out of this too.

Finally, in terms of burden shifting, when the State was forced to look at the city condition in New York City—and Yonkers, by the way, another city that had a control board—we had to say OK, the time has come, we can't ask the city to pay for the cost of the courts, so the State assumed the cost of the courts. The State—the city, for the first time, gave to the State and the State accepted the funding of the City University as part of a Statewide system. The State, in turn, picked up the deficit of the transit fare. So some burdens will shift from the District, and I heartily encourage this because you had better look at what you are making this inter-

national city do to handle the raft of visitors coming in here, official parties that come here, and look how much of that might be shifted to the rest of us in the United States, because it's our city too.

Mr. DAVIS. Thank you. I happen to agree with that, and I think our Mayor of the city agrees with that, but it's important for somebody from the outside to come in and lend that perspective.

Thank you very much.

I'm going to yield now to Ms. Norton, the ranking member.

Ms. NORTON. Thank you very much, and I very much appreciate this testimony, Governor Carey, and Comptroller Regan.

Governor Carey, the list that you just rattled off of what New York had to do initially is a shocking list. It's a kind of list of horribles. Around Washington already has gone the number of people that had to be laid off, the 60,000 number, which is 50 percent more employees than we even have, laid off at one time. I would like to ask you about the role of the board in that list of horribles, and then I would like to ask you whether it simply meant that New York was that far gone, and the reason I ask you is because we are further gone than New York. Was New York so far gone that it became necessary to do all of these things at once in order to save it or to get a loan, and what role did the board play in taking you through this extraordinary list of changes in the city itself when nothing at that point had been transferred to the State and more things were to follow?

Mr. CAREY. Well, the timing is exquisite and indeed painful. However, I see the Mayor grappling now with an attempt to get his budget under control by next October. That's an awfully—as you know, when you have a half year to deal with, the cuts have to be doubled in size. That's a difficult, difficult situation to face.

The answer is, you do it in a progressive way. You forecast the force levels in different departments going a year ahead. You bring into bear attrition. You may have to deal with some sabbaticals. You may have to look at other sources in order to help, in other words, that given department to fulfill its function. You do all these in common planning, and the severity is not going to be less than extreme. I know it is going to be difficult, but the only way you get back on course again is to get the force levels in the city that will do the job.

Ms. NORTON. Does that mean that the situation had gotten so bad, there wasn't the time and the space at that time to sequence some of that out so it might have occurred over a longer period of time?

Mr. CAREY. A lot of things occur at once. The freeze on new hirings has to take place, the attrition process goes into play, early retirements are encouraged, and in a sense you get the labor leaders, the ones who have run the department, to come in and suggest what are the proper force levels that we can deal with. There is an input there, and that's when you set the ceilings on various departments.

In terms of productivity, there are gains there. Those productivity gains belong to the work force. If they can show productivity gains it will bring down the cost of doing services. Less overtime, or maybe a little less generous pension plan. That goes to the bene-

fit of the plan instead of laying people off. All those things take place.

Ms. NORTON. But, Governor, those weren't on your list, the things like the tuition in the City University. Your list of horribles——

Mr. CAREY. That was long overdue. When we went down to see President Ford and we said, "We need your help," he said, "You want my help when my State University in Michigan charges tuition and yours doesn't? You are not going to get any help until you do it." So we were told to do it, and, by the way, we have offsets, the tuition assistance plan for needy students offsets those cuts, so nobody is denied a college education, as you well know, in New York City for lack of means. That's the way it works. So there are offsets that you get as benefit when you impose tuition.

The transit fare had to be done, but out of that transit fare increase we got stability in the system and put $6 billion into improving the transit system. So we have a better system now, as you have in Metro here. There are offsets and gains as you begin to impose, as I said, these strictures. That's part of the planning process, which the mayor can't do alone.

Ms. NORTON. Your point is an important one though, that in order to get what you needed you had to, on your side of the ledger, come up with a number of very strict changes for New York City all at once.

Mr. CAREY. No doubt about it, because the city had fallen into a pit, and the old rule in holes is, when you are in a big hole stop digging, you are getting deeper and deeper, so we had to say that's it, the hole is too deep, and that's why we—thank God the District of Columbia is not in that condition yet, but it's going to get there if you don't step in.

Ms. NORTON. I would like to ask Comptroller Regan about a part of his testimony. If you change the name, it says the District of Columbia. It says New York City's mid-1970's fiscal crisis was characterized by enormous short-term debt, huge unfunded pension liabilities, and severe operating deficits, all worsened by years of shoddy accounting procedures and fiscal gimmicks.

Anybody who has been in the District of Columbia for the last 2 seconds recognizes that as a description that we have heard over and over again of the District. I would like to particularly ask you about the unfunded pension liability. We have a huge unfunded pension liability. This was handed on to the District at the time of the home rule by the Federal Government. Almost all the growth has been in interest actually, from what the government handed us.

What did New York do about its unfunded pension liability in particular?

Mr. REGAN. It was with the help of actuaries. It was another one of the problems you can add to the Governor's list. It was done all at the same time. There were actuaries hired and contributions had to rise, and I think it was amortized over, in the case of firemen, 40 years and others that weren't as bad, perhaps a lesser period.

Once again, it became part of the whole package. And I would echo the Governor's words, you get all of these things done at once.

And it is painful and traumatic and there aren't enough words, I suppose, to describe what goes on, but when you hit the critical mass and then everybody starts to give a little, you get it done so that's—it was simple. Again, it's kind of the "bonding out" illusion. Future generations had to pay for the mistakes of those in the past. But it was worked out.

Mr. CAREY. Perhaps an enactment which occurred during my terms in Congress which is now in being would be of help to you. I understand when the Congress went for home rule or modified home rule, whichever you called it, those unfunded pension liabilities were there before under the aegis and jurisdiction of the then-Federal Government and those are being carried on the city's budget now.

I recall that the ERISA program was put in effect more than a dozen years ago. Where was ERISA? ERISA applies to the private sector. Why wasn't some function of ERISA directed to the city situation in the District and seen to it that the pension funds needed to fund out pensioners and retirees were properly provided for? Somebody was asleep at that switch. Maybe we go back to the Federal Government and say you weren't vigilant, you didn't perform your due diligence, help us get out this particular one. Maybe that can be done.

Mr. REGAN. Of course, at the same time, benefits may be on a two-tiered basis. That would seem a little rich. Again, that goes into the pot and has to be adjusted.

Mr. CAREY. On that note, we had a Kincell Commission, again from the private sector, an accountant, an auditor who was an actuarial expert with the Union Carbide Corp. came in. The Governor had to face the recommendation of the Kincell Commission, and they were adopted and put a ceiling on the pension. You couldn't enrich the pension by taking holiday time.

Lots of reforms came in. I'm painfully aware of those because there is a tier three which gives the least pension benefits in the history of New York State. The Governor was put in tier three. I have had to work hard ever since to offset the fact my pension is so scant.

Ms. NORTON. Like you, Governor, the workers of the District of Columbia have already agreed to very large modifications in their pension plan and have already agreed to a two-tiered system for new employees, but as of yet, the Congress has not stepped up to do its part.

Mr. REGAN. I am aware of that.

Mr. DAVIS. Thank you.

The gentleman from Pennsylvania.

Mr. FATTAH. No questions, other than I would just congratulate both of you for your involvement in saving New York City at a time of crisis. And your explanation and comments this morning are helpful.

But I have no questions, Mr. Chairman.

Mr. DAVIS. OK.

The gentlelady from Michigan, Miss Barbara-Rose Collins.

Miss COLLINS OF MICHIGAN. I thank you, Mr. Chairman.

I don't have any questions, but I have read the testimony and I thank the gentlemen for coming to help us out of this debacle that

we are in. And as I said at the hearing last week, that perhaps what we learn here will help the other cities throughout the country, in particular, my city of Detroit, MI.

And I still don't know what the answer would be with people using and enjoying all of the services of a central city and then going home to the suburbs or the surrounding communities where our tax base has fled, where the middle class has fled, and the jobs have fled. So you leave a central city derelict with no funds but expect it to maintain the same services.

What Governor Carey said, you know, just made a lot of sense, that you are expecting an awful lot of the District of Columbia to be the living room of America for all of the tourists, all of the citizens of America and the citizens of the world that come here and all of the embassies, and yet we don't make allowances for helping us keep this living room up.

I don't know—I think that the board, the financial board probably is the only answer, the good answer for the crisis but, to me, that is not an answer for the long run and I think that we also need to find answers for the long run besides the crisis.

Mr. REGAN. May I respond to that?

Mr. Chairman, I was involved when Wayne County assumed numerous powers and was involved with your mayor at the time, Mayor Young, because I'd done the same thing in the city of Buffalo as we shifted powers, therefore taxes, to Erie County. And of course, I watched the New York City experience and the commuter tax.

My own view, my own experience prior to becoming comptroller, which was the city of Buffalo in Erie County, and my involvement in the shift of some responsibilities off the Detroit tax base to Wayne County all makes me put forward this suggestion: That when the people in the surrounding areas, surrounding in Maryland and in Virginia, see that the city of Washington has done everything it possibly can and you no longer have those kind of headlines, which I am sure the people in the suburbs love to chuckle about and decry, when that is gone, you will have created the atmosphere for a suburban tax or a shift of services or a combination of both, but it will never occur until you create the proper environment.

But my own experience is, once that environment is created, and I am not naive, but people will recognize their broader obligations and will want to share and will participate. That day, as you well know, is a little bit off into the future.

Mr. DAVIS. Mr. Regan, Governor Carey, thank you both very much. I think you have added greatly to the dialog. As we move forward, I hope we can call on you. You have offered your services. I am sure we will be taking you up on that. We appreciate you coming before the panel today. Thank you.

At this point, with a vote pending on the floor, I would like to recess for 15 minutes at which point we will come back and Mr. Fattah, I will let you introduce our next panel.

All right. We will be in recess.

[Recess.]

Mr. DAVIS. I apologize for the delay. The hearing will be back in session.

I would now like to yield to the distinguished Representative from the city of Philadelphia, Mr. Fattah, to introduce the members of our final panel.

Mr. FATTAH. Thank you, Mr. Chairman.

And now we have heard from the rest, we will hear from the best. I take exception in the comment of the former comptroller from New York who said, after hearing from the Governor of Ohio and the former mayor of Cleveland and from Governor Carey himself, we had gotten the best advise we could get on this subject matter because there is a truly spectacular story of the experience in Philadelphia, and the three gentleman who are going to testify were very much a part of that activity.

And as a member of legislature at that time in the State Senate, I was able to be a part—a small part of the creation of a process that led to Philadelphia being well positioned to enter the next century out of debt and responding to the problems in its neighborhoods.

I want to introduce the three people who are going to be testifying here today. Dr. Bernard Anderson, who is an Assistant Secretary at the U.S. Department of Labor, was in fact a Governor's appointee to the PICA Board, the Intergovernmental Cooperation Authority.

Note the notion of cooperation rather than control. It was indeed a cooperative process between the State government and the city of Philadelphia's elected government to find a way through a financial crisis and Dr. Bernard Anderson was the Governor's appointee and chair of the PICA Board that worked through that problem.

Dave Cohen, who is the chief of staff to America's mayor, Mayor Ed Rendell, who has both been congratulated and recognized for his work here in the Congress in a bipartisan way and for all of his hard work to help lead Philadelphia and, in fact, help lead the way for the rest of the country's mayors on a number of critical issues.

Dave Cohen is considered in Philadelphia one of the co-mayors because he is one of the significant players in the relationship between the administration and the council that has helped move the city forward.

And Ronald Henry, who served as the first executive director of the PICA Authority, which you are going to hear much more about in his testimony, helped craft, through a cooperative working arrangement between the board and the city's key players, an arrangement that has returned Philadelphia's financial health and fiscal house to order.

So I want to welcome and introduce these gentlemen as they come to bring the Philadelphia story and help this committee think through its obligations.

Thank you.

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

We are very pleased to have all of you here today. I know what you say is going to be very important which is why we want you here today. We appreciate you staying with us through that last vote recess.

And Mr. Anderson, we will start with you.

STATEMENTS OF BERNARD E. ANDERSON, ASSISTANT SECRETARY FOR EMPLOYMENT STANDARDS, U.S. DEPARTMENT OF LABOR, AND FORMER CHAIRMAN, PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY; DAVID COHEN, CHIEF OF STAFF TO THE MAYOR OF PHILADELPHIA; AND RONALD G. HENRY, FORMER EXECUTIVE DIRECTOR OF PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY

Mr. ANDERSON. Thank you very much, Mr. Chairman. I am very pleased to have an opportunity to come here today and offer to you and other members of the committee the Philadelphia story with respect to the oversight board, and I am very happy to offer in the presence of my good friend, Eleanor Holmes Norton, and my good friend, Congressman Chaka Fattah, who was very instrumental in helping us solve the problem in Philadelphia.

Let me say, Mr. Chairman, that I have submitted for the record my statement which I would ask be recorded as an official part of these hearings and I also want to put in a disclaimer at the outset that I am speaking today as an individual expressing his own views on this matter, not speaking for the administration, for the Office of Management and Budget, or for the Department of Labor. And so my views are my own on this issue and should be taken as such in the record of these hearings.

Let me say that from June 1991 through December 1993, I had the great privilege to serve as chairman of the Pennsylvania Intergovernmental Cooperation Authority which we fondly call PICA. What I would like to do is simply describe briefly our experience, the goals, structure, the background of PICA Board members, its staff, and our operating style, because I think that is very important in understanding how an entity like this can work and how it can help a city in fiscal distress.

First, in a nutshell, Philadelphia's problem. Between fiscal year 1986 and 1991, Philadelphia was clearly spending more than it was receiving in revenue. The rate of spending per annum was about 5.6 percent, revenue was coming in around 3.2 percent per year. It was projected in fiscal 1991 that if that rate of spending had continued, the accumulated deficit would have been more than $450 million by fiscal year 1996. And in fact, the accumulated deficit by fiscal 1992 was over $200 million.

In the midst of that darkening storm of fiscal travail, it was very clear that the mayor and the city council were unable to come up with a plan to attack the structural deficit and to put in place those measures that were necessary to get spending under control.

In fact, the disagreement between the mayor and the city council was compounded also by the disagreement between the city officials and State officials on a wide variety of issues, not the least of which was the State contribution to the city for certain human service expenditures and the court costs and other expenditures of that type.

And I think that the result was that without a plan in place to address the city's worsening fiscal crisis, the bond markets lost confidence in the city of Philadelphia and in late 1990, the city lost its investment grade rating on the bonds.

That then spurred the State into action which created PICA by statute. The rationale for creating PICA was that the threat of a fiscal emergency would lead to the interruption of essential public services that would threaten the public health and safety, not only of the people of Philadelphia, but also other people in the Commonwealth of Pennsylvania.

And so the board was created to do essentially two things. One was to help the city regain access to capital markets and the other was to foster sound financial planning and budgetary practices to get the city out of the position it was in at that time.

Let me very quickly say something about the board because this might be of some interest to you as you contemplate an entity for the District of Columbia. The PICA Board includes seven individuals. Five of them are voting members of the board, all of whom are private citizens. The five voting members of the board are appointed, one each by the Governor and by the minority and majority leaders of State House and Senate.

There are two additional public members of the board. One is the finance director of the city of Philadelphia. The other is the secretary of the budget for the Commonwealth of Pennsylvania.

Let me tell you who the five voting members were. One was the head of a local science museum who was also a venture capitalist. Another, a woman, was a small business owner who operates a personal computer services company, which provides training for people to learn how to operate computers.

A third member of the board, another woman, was a partner of one of the city's leading law firms. The fourth member of the board was a stockbroker who had previously served earlier in his life as the chairman of the Philadelphia Stock Exchange. And the fifth voting member of the board was your humble servant who formerly served as a tenured faculty member at the Wharton School of the University of Pennsylvania.

None of the five voting members of the board were active in politics at the time they were selected, but one member of the board had previously been a candidate for mayor of the city of Philadelphia.

The term of office for members of the board is coterminous with the appointing authority which of course varies depending upon the election cycle. The members of the board were not compensated for their services. Let me emphasize that. We never received a dime for the numerous hours that we spent in assisting in dealing with this problem. In fact, I had recently organized a small consulting firm but at the time I was appointed chairman. At the PICA Board, I was spending over 60 percent of my time in a noncompensated effort.

The chairman of the board is elected by the board, not appointed chairman. However, in the tradition of the Pennsylvania Authorities, usually the person who is appointed by the Governor is elected chairman and that was the reason I was elected chairman of the PICA Board.

We had a professional staff that included four professionals and two support staff. Ron Henry, whom you will hear from in just a minute, was the executive director of the staff. The staff, obviously, is paid.

However, in selecting members of the board, the requirement was that individuals be persons with a background either in finance or economics and management, that they either be residents of the city of Philadelphia or they have their principal business or employment in the city of Philadelphia. Several members of the board who were not residents of the city of Philadelphia but they all had an economic stake in the city of Philadelphia.

We were authorized to provide assistance to the city of Philadelphia to deal with its financial problems, but in the formation of the statute creating PICA, there were two things required before we could offer any financial assistance to the city of Philadelphia. One was that we had to enter into an intergovernmental cooperation agreement with the city of Philadelphia. The IGA describes the requirements and standards for the preparation, approval, and monitoring of the financial plan, the terms and conditions for the issuance of bonds, and the establishment and management of a city account which is the account into which certain tax funds and bond proceeds would be placed.

The 5-year financial plan was designed to offer a balanced budget in each of the 5 years and the establishment of certain measures that would eliminate the structural deficit in the city's accounts.

The board was authorized to review and approve the financial plan after it was adopted both by the mayor and by the city council.

We received quarterly reports and we would have to review those quarterly reports on the city's progress in living up to the terms of the financial plan. I think it is also important here to get some sense of how the influence was exercised. In any quarterly report in which there was a variance in the city's meeting of the balanced budget with respect to revenue and spending, we would publicly pronounce that a variance existed.

The city would then be required to submit monthly reports to the board, and the mayor then would be informed that he had 30 days to come up with a plan to balance the budget in the future, that is in the next quarterly report and every quarterly report after that. If over a period of 30 days, I believe, the variance which was established or identified in a quarterly report was not corrected, then the board had the obligation to inform the State of this development and we had the authority to withhold tax revenues, State funds, certain State funds and bond proceeds from the city of Philadelphia until such time as the variance was corrected. So that was the stick that we had to encourage compliance with the 5-year financial plan.

Let me say that our operating philosophy was one of cooperation and not control. In the very first press conference that I had after being appointed to the board, I made a public statement that, in my view, we did not intend to control the city of Philadelphia. The city of Philadelphia has elected officials who were put in place by the taxpayers of that community. And what we wanted to do was to be of assistance to the elected officials in coming up with ways to address the city's fiscal crisis. That is the way we operated.

We engaged in a close examination of the accuracy of financial data submitted to us by the city, the assumptions of revenue and spending which appeared in the financial plan. I can report to you

that over the period that I was chairman of PICA, every vote we had was a unanimous vote on every critical issue. There was not a public disagreement among members of the board over what we had to do.

Now, that does not mean that we did not have vigorous debate among ourselves out of the glare of the public light, over how we should come down on the quarterly reports and the review of what we were doing. But we were able to reach a consensus among ourselves so that on every major issue, we had a unanimous vote. And I would also add that it was critical that we worked very closely with the mayor and members of his staff, with the city council, while preserving the independence of the oversight board.

There were numerous meetings with senior city officials in an effort to understand what was going to be in the financial plan, what the city's plans were for meeting its financial needs, what the size of a bond issue should be and other matters that we would have to ultimately act on.

I want to emphasize that we worked very closely with the city's elected officials in attempting to resolve these questions.

I think that the PICA experience in Philadelphia was a success. The city is now on the way to solving its fiscal crisis and great progress has been made since 1992. But there are many challenges that remain and I might add here that one of the things that is necessary to really achieve a long-term solution to this problem is sustained economic growth in the city of Philadelphia.

I was chatting with David Cohen earlier and asking him how employment was growing and—since I came to Washington, I haven't kept up as closely with this as I might otherwise do and unemployment is still high in the city of Philadelphia. Employment is not growing rapidly. There is still a serious problem of poverty, a demand for social services. These are the necessities that make—require city expenditures for various purposes because there are no funds to meet these needs of significant level other than through general revenues of the city. I might mention that 48 percent of the city's revenue is based on the wage tax and the wage tax is applied both to city residents and to persons who work in the city but live in other places.

I would say that part of the reason we were successful is that an oversight board of the type we have gives elected officials the political cover they need to make unpopular choices and to control spending. In other words, the oversight board, in effect, is a heat shield. The mayor, members of city council can make decisions on spending and blame it on the board because they don't have any choice in the matter, and this can be a very useful device for allowing the city to reduce payrolls, to eliminate services, to restructure government, to introduce new management techniques, to renegotiate labor contracts and do all of the other things that are necessary.

I would say in closing that I don't believe that we could have achieved success in this venture had we not received the full support and cooperation of Mayor Rendell and the President and members of the city council. Our objective was to see that the city put in place the financial planning systems and the management systems necessary to control spending. And that was done. It was a

very difficult task, but the city was able to use this institutional device as a framework within which to do many of the things that I think elected officials knew they had to do in order to restore the city's fiscal solvency.

I'll stop there, and I'd be happy to answer any questions that members of the committee might have.

Thank you.

Mr. DAVIS. Thank you.

[The prepared statement of Mr. Anderson follows:]

PREPARED STATEMENT OF BERNARD E. ANDERSON, ASSISTANT SECRETARY FOR EMPLOYMENT STANDARDS, U.S. DEPARTMENT OF LABOR, AND FORMER CHAIRMAN, PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY

Mr. Chairman and Members of the Subcommittee;

I am pleased to offer testimony for these hearings on the role of a financial oversight board for the District of Columbia. My testimony is based on my work as a member of the Pennsylvania Intergovernmental Cooperation Authority (PICA), and is not meant to represent the views of the Administration, the Office of Management and Budget, or the U.S. Department of Labor. The views that I am about to give are my own, in an attempt to assist the Congress in its oversight responsibilities in this important area.

From June 1991 to December 1993, it was my honor to serve as the first Chairman of PICA the fiscal oversight board for the City of Philadelphia. Perhaps our experience might be helpful to this Committee, and to the other Members of Congress as you contemplate the structure, functions, and responsibility of a fiscal oversight entity to assist in addressing the financial crisis now facing the District of Columbia.

In my brief remarks, I want to describe the goals of PICA, its structure, the background of its seven original members, its administrative staff, and its operating style. Next, I want to explain why I think PICA has been successful in helping the City of Philadelphia to get its fiscal house in order as it moves toward the restoration of fiscal solvency and sound financial practices in the management of its fiscal affairs.

PHILADELPHIA'S PROBLEM IN A NUTSHELL

Philadelphia's fiscal problems, which reached a peak in late 1990 when the City lost the investment grade rating on its debt, was the result of persistent spending in excess of available revenue. The City's revenue sources are tied closely to local economic conditions. In Fiscal Year 1991, about 48 percent of revenue came from wage and net earnings taxes, 17 percent from real estate taxes, 20 percent from business taxes, and 14 percent from federal and state appropriations.

Between Fiscal Years 1986 and 1991, City spending grew at a rate of 5.2 percent per year, while revenue rose by 3.1 percent per year. In 1991 financial projections showed expected spending growth of 7.6 percent per year for Fiscal Years 1992 and 1996, while revenues were expected to grow by only 3.5 percent per year.

The persistent gap between spending and revenue produced annual deficits of $78 million in FY 1990, $75 million in FY 1991, and an accumulated deficit of nearly $200 million for FY 1992. If no action had been taken, the accumulated deficit was expected to reach $450 million by FY 1993.

Despite these unfavorable fiscal conditions, the City's elected officials were unable to agree on a plan to bring spending under control and to follow sound financial management practices. The stalemate between the Mayor and Members of the City Council, and between City officials and State officials in Harrisburgh, the State capitol, contributed to the loss of confidence in the City by the financial markets, which led to a downgrading of the City's bond rating below investment grade in late 1990. The loss of access to capital markets crystallized the City's fiscal crisis and spurred action by the legislature and the Governor of Pennsylvania.

CREATION OF PICA

PICA was created through the efforts of Philadelphians and State officials who envisioned a structure to give Philadelphia enough fiscal breathing room to put its revenue collection and spending processes in order, and to reach a consensus on its priorities, assets, and limitations. The PICA board, created by statue in June 1991, consists of seven members: five non-governmental private citizens, plus the Finan-

cial Director of the City of Philadelphia, and the Secretary of the Budget of the Commonwealth of Pennsylvania, both of whom serve as ex-officio, non-voting members of the board. The five non-governmental members of the board are appointed, one each, by the Governor, and by the majority and minority leaders of the State House and Senate. The Chairman is elected by the voting members of the board, but in the tradition of Pennsylvania authorities, the person appointed by the Government is expected to assume the chair.

All members of the board must have had experience in finance or management, and must be residents of Philadelphia, or have their primary place of business or employment in the City. Among the five original voting members of the PICA board were the President and CEO of a local science museum, who also is a venture capitalist; the President and CEO of a personal computer training and consulting company; a partner in one of the City's leading law firms; and a local stockbroker, who was formerly President of the Philadelphia Stock Exchange. I am an economist by profession, and formerly served as a tenured professor on the faculty of the Wharton School at the University of Pennsylvania. Members of the board were known by key political leaders in the City and the State and had the respect and support of the business community. While not active politically at the time of his appointment, one board member formerly had been a candidate for Mayor of Philadelphia.

Board members are not compensated for their services, and are prohibited from seeking public office for one year after completing their terms. Board members serve at the pleasure of their respective appointing authority, and their term of office is coterminous with their appointing authority.

PURPOSE OF PICA

PICA was created in an atmosphere of crisis in which many believed the City's government was "out of control", that its officials did not responsibly manage the estimation, collection, or disbursement of revenues, and generally had failed to address the many economic and social challenges facing Philadelphia. But PICA was expected to be a combination of cooperation, assistance, and oversight. It is not a "control board" with the power to hire, fire, enact or repeal taxes, or otherwise disenfranchise the people of the City. It is intended to be a catalyst for spurring elected officials into responsible behavior in the management of the City's fiscal affairs.

PICA was created because of the threat that a fiscal emergency would interrupt delivery of essential services and would adversely affect the health, safety and welfare not only of the City, but also of other citizens of the Commonwealth of Pennsylvania. For that reason, the State created the oversight board to enable the City to gain access to capital markets for deficit elimination and seasonal borrowings and to avoid default on existing obligations and chronic cash shortages. The board was also required to foster sound financial planning and budgetary practices by City officials. Both goals, i.e., financial assistance and the requirement of sound fiscal management by City officials, were co-equal objectives of PICA, and both received careful attention in PICA operations.

PICA's borrowing authority on the City's behalf was secured by a dedicated revenue source of 1.5 percent of the City's resident wage tax. Board operations are expected to be self-financing; in fact, the initial $156,000 extended to the board by the State to get operations up and running was repaid to the State from proceeds from the first bond offering.

THE NATURE OF OVERSIGHT

Before the board could assist the City in addressing its fiscal problems, the PICA statute required the adoption of an Intergovernmental Cooperation Agreement (ICA) between the City and the board. The Agreement spells out the requirements and standards for the preparation, approval, and board monitoring of the City's financial plan; the terms and conditions for the board's issuance of bonds; and the establishment and management of the "City Account," which is the repository of the proceeds of taxes or other revenues pledged by the Authority to secure any bonds.

In addition, before any financial assistance could be provided, the City was required to develop a five-year financial plan providing for a balanced budget, and a plan for eliminating the structural deficit. The Authority was empowered to approve the financial plan after its adoption by the Mayor and the City Council.

Quarterly reports on the financial plan are required to be submitted by the Mayor to the Authority. If the quarterly report shows a variance from a balanced budget, the Mayor is required to explain how the variance will be corrected within the next three months through enhanced revenues or reduced spending. In the meantime, monthly rather than quarterly reports on spending and revenue must be sent to the Authority until the variance is corrected.

On receipt of the quarterly reports, the Authority must review and publicly report on the City's progress in managing its fiscal affairs. In addition, the Authority is required to issue an annual report on its operations to the Governor and to leaders of the State legislature. The public scrutiny to which the Authority's operations are subjected, together with its public reports on the City's efforts to manage its financial affairs places great pressure on City officials to adhere to the terms of the financial plan.

All meetings of the Authority are announced in advance, and are open to the public. The Authority's operations are closely covered by the press, and widely reported throughout the Philadelphia region.

City officials have a strong incentive to cooperate with the Authority because of the need for access to financial markets. But the PICA statute provided additional power by authorizing the board to withhold State funds and selective bond proceeds from the City if City officials failed to comply with the financial plan.

PICA OPERATING PHILOSOPHY

From the beginning, PICA board members chose a path that emphasized cooperation rather than confrontation with City officials. While preserving all powers, authority, and independence granted by the enabling statute, board members viewed their role as helping City officials to help themselves to restore fiscal stability and adopt sound fiscal practices. No effort was made to substitute the board's judgement on priorities of public spending or levels of taxes for the judgement of elected officials on such issues. The main objective was to see that the financial plan provided for a balanced budget and that City officials adhered strictly to the plan.

A major device for promoting sound fiscal practices was the board's requirement to examine, and if necessary question the accuracy of financial data and the assumptions on which revenue and spending projections were based in the financial plan. The plan was expected to be based on reasonable estimates of revenue and spending. While the board did not set priorities in budget allocations, it could, and did, suggest areas in which expenditures did not seem consistent with sound fiscal practices and the protection of health and safety.

Board members worked hard to achieve consensus among themselves on all the major decisions regarding the review and approval of the five-year financial plan and the quarterly reports on progress. During the thirty months I chaired the board, all our decisions were made with a unanimous vote.

THE FIVE-YEAR FINANCIAL PLAN

The first five-year plan developed by Mayor Rendell and adopted by the City Council chose not to raise taxes, or to reduce services in pursuit of a decline in the deficit. Instead, the plan was designed to reduce the cost of providing public services. This was accomplished by seeking $353 million in reduced labor costs, and $658 million in savings from productivity and management reform over the five year duration of the first financial plan. Labor savings were expected to comprise 60 percent of the total cost reductions in the first year of the plan and declining to 30 percent of savings in the fifth year as management savings phased in over time. The labor savings were to be achieved by workforce reductions through attrition, the adoption of new work rules, and the negotiation of a new labor management agreement after the expiration of the existing contract during the first year of the Authority's operation.

Management and productivity savings were to be achieved through the adoption of a broad range of management initiatives in virtually every department of City government. To assist in identifying potential cost savings opportunities, the Mayor organized a private sector task force headed by one of the City's leading, corporate executives. The task force conducted reviews of City operations, and made recommendations that were implemented with the urging of the Mayor and his senior staff.

With adoption of the Intergovernmental Cooperation Agreement and the Five-Year Financial Plan, PICA moved forward toward its first borrowing on the City's behalf. The bond issue was for $475 million, with proceeds allocated as follows:

Deficit Reduction	$256 million
Capital Projects	120 million
Productivity Bank	20 million
Issue Costs	11 million
Total	$457 million

ELEMENTS OF SUCCESS

Philadelphia is now well on its way towards the restoration of fiscal stability through the assistance provided by PICA. Although the fiscal crisis of 1990-91 has passed, and much progress has been made, the City still has some distance to go before one can say that fiscal stability has been fully restored. Several factors should be noted in searching for the essential elements of Philadelphia's progress in addressing its fiscal crisis, and meeting the challenges that remain.

First, the City's revenue base is heavily dependent upon the growth of the local economy. Throughout the 1980's, employment growth was either non-existent, or anemic. Employment has improved since 1991, but joblessness remains a serious problem in some sectors of the City. Until City leaders find a sustainable source of economic development, there will continue to be strong pressure on revenue that must be matched by close control of spending. In 1994, Philadelphia in cooperation with Camden, New Jersey, was designated an Empowerment Zone city, and will receive nearly $100 million for neighborhood economic development. Such funds should help relieve some of the fiscal pressure that remain a drag on local revenue growth.

Second, the City continues to be adversely affected by a disproportionately high rate of poverty among a large segment of its population. This generates a strong demand for costly social services that must be paid through the general fund because State and federal funds fall short of meeting the need. State funding has steadily increased since Fiscal Year 1991, and newly adopted measures for the management of social service delivery has reduced the annual rate of growth of such costs since 1991. But the human services budget remains a large part of City expenditures.

Third, PICA has played a vital role in facilitating the adoption of spending controls and more efficient management practices throughout City government. The essence of an oversight board is that it stiffens the spine of elected officials and gives them a heat shield to make the difficult and unpopular choices that are necessary to control spending. The Mayor and leaders of City Council may find it easier to cut payrolls, eliminate superflous services, restructure government agencies, introduce new management techniques, and renegotiate labor contracts under cover of political protection provided by an oversight board. This feature might well be the most important ingredient in the success of an oversight board.

Finally, PICA could not achieve success without the full cooperation of the Mayor and his senior staff. The board, the Mayor, and the City Council worked closely together to improve financial reporting systems, contracting procedures, management initiatives, and other aspects of City government fiscal management. The ICA specified the terms and condition of City reporting to the Authority, but Authority staff and City government staff collaborated closely on the details of what was required and the standards that had to be met in order to meet the Authority's requirements for steady progress under the financial plan. Without close cooperation between city officials and the oversight board, little progress can be expected toward effectively addressing the City's fiscal problems.

Thank you for the opportunity to express my views of the role of an oversight Board for the District of Columbia. As I stated at the outset of my testimony, these views are my own, and are not meant to represent the views of the Administration. I look forward to answering any questions you might have about my testimony or my role in PICA.

Mr. DAVIS. I think we will go ahead and hear from Mr. Cohen at this point.

Mr. COHEN. Thank you, Mr. Chairman, and members of the committee. Thank you, Congressman Fattah, for that introduction. I must say it is a pleasure to testify before Congressman Fattah in this body, having previously testified before him in the Pennsylvania State Senate, and I don't know where the next place I will get to testify in front of you will be.

What I would like to do in a brief opening statement is to give some of the highlights of the Philadelphia story, not to brag as to what Philadelphia has accomplished but rather to give you a sense as you confront the District of Columbia's problems that these problems are not unique, that they are not unlike those that were faced by the city of Philadelphia only 3 short years ago, and that

there is light at the end of the tunnel. And that that light is not the headlight of an on-rushing locomotive, but it is the light of a potential solution to these problems, and then to give you some specific comments on Philadelphia's oversight board which Dr. Anderson has so ably described, the Pennsylvania Intergovernmental Cooperation Authority.

If we can turn the calendar back 3 years ago to 1992, Philadelphia at that point, at the time when Ed Rendell was sworn in his office and John Street, who is president of the city council, was elected to that position, the city confronted a $200 million cumulative deficit that was projected to grow about $250 to $300 million a year over the ongoing years unless corrective action was taken.

That annual structural deficit was about 10 to 12 percent of the city of Philadelphia's operating budget and the total projected deficit at the end of fiscal year 1996, that was in June 30, 1996, would have been about $1.4 billion, which at that point would have represented about 50 percent of Philadelphia's operating budget.

The city's credit ratings were at junk bond status. There had been no access at all to the long-term credit markets for about 18 months and it was only through what I guess could be charitably described as creative and unbelievably expensive financing gimmickry had the city been able to access short-term credit markets to make cash-flow borrowing in order to meet its payroll during the periods of year when our real estate taxes and business taxes were not going in.

All four municipal union contracts were expiring, all four on June 30, 1992. And in addition to that, our public transit agency contract was expiring in March and the school teachers contract was expiring at the end of August. When you think of all that, you might wonder why in the world would anyone have wanted to walk in the door and some of us are still wondering about that.

The bottom line, I think, was provided by City and State Magazine which called Philadelphia the municipality that sets the standard for fiscal distress in the 1990's. And in 1992, there was no truer statement that could have been made. And as Dr. Anderson said, the pressure to negotiate an intergovernmental cooperation agreement to prepare a 5-year financial plan that projected balanced budgets in each of the 5 years.

We had to have a zero fund balance or better in each of the 5 years of that initial 5-year plan in order to enable PICA to do a borrowing for the city that would fund that $250 million cumulative deficit. So we were in a position where, in answer to one of the questions that was asked Governor Carey, where all those changes had to be made essentially over a period of 6 months. There was no luxury of time to be afforded to the city of Philadelphia as a result of that structure.

Now, in 1995, we are a long way from 1992 in a number of respects. The city of Philadelphia has just completed running two fiscal years with small budget surpluses and it is the first time we have had two consecutive budget surpluses in the city of Philadelphia since the early 1980's.

The answer as to how we did that is enormously complicated. I have provided to the committee a copy of the city's current 5-year financial plan which recites some of this history and, in a sense,

gives you a sense of the types of things that a city can do in order to deal with the financial crisis that virtually all major urban areas face today.

Some of the issues that are included there, and I will summarize them quickly, is a total of almost $800 million in what we call gap closing initiatives that have been successfully adopted since 1992. They are efficiencies, better revenue collections, no tax increases, no dramatic cuts in services, no across-the-board layoffs. None of the draconian things, frankly, that you have heard about in some other cities because a lot of that had been done before 1992.

Dr. Anderson and I were talking about the fact that in the 5 years before Ed Rendell was elected mayor, the city of Philadelphia was downsized from an employee work force of about 30,000 to an employee work force of 25,000, so there had been a substantial reduction in work force before the financial crisis hit. And there was a lot of consternation about just how it was that Philadelphia was going to save all this money given that the work force had already been winnowed out through an early retirement program, through layoffs, through attrition, through hiring freezes, through cutbacks in services, through closure of the city's only publicly owned hospital, through increases in tuition at the community college. All of the things you heard about were all pre-1992 actions taken by the city of Philadelphia and were actions, therefore, that were not really available to us as we approached our fiscal crisis in 1992.

I think that the guts of our plan was a collection of about 250 individual management and productivity initiatives, some of them saving as little as $10,000 a year, many of them saving millions of dollars a year, developed in cooperation with PICA, in cooperation with the city council, in cooperation with the management and productivity, the task force which was staffed by over 100 corporations in the Delaware Valley that participated in a partnership with the city in figuring out how it is that we were going to get our budget under control and bring expenditures in line with revenues.

Some of those—some of the highlights of that include lease renegotiations, better tax collections, consolidation of telephone system, numerous utility savings, computerization that resulted in further reductions of personnel and really literally a series of hundreds of these types of initiatives that reshaped and reformatted the way the city of Philadelphia government does business.

We also adopted a contracting-out program, not an easy situation in the city of Philadelphia which is such a strong union city in and of itself. It is a program that has affected 28 city services directly. Twenty-six of those services have been contracted out. Two of them, the unions have won the competitions that we have run. And the total annual savings to the city are now running in excess of $30 million a year as a result of that competitive contracting program.

Mayor Rendell was fond of saying in the campaign, and has tried to say in the past 3 years, that we call this competitive contracting and not privatization as other citizens have called it because the goal is not to privatize anything. The goal is to inject competition into the delivery of city services to improve the quality of those services being delivered and to drive down the cost. And if you inject competition, it doesn't make any difference whether you pri-

vatize the service or you don't privatize the service. And in fact, the service that has the largest single savings of all, 28 of those initiatives is a competition that was won by the union work force involving the sludge disposal, sludge processing facility in our water department. That is an operation that was costing $24 million a year to run.

You can look in our budget and you can see we were spending $24 million a year in fiscal year 1992 and fiscal year 1993. We brought in a consultant to design an RFP and to see what we could do if we would competitively contract out that initiative, and the consultant concluded that if we had that work done by a private contractor that work could be done at $16 million a year.

The union came to us and said, if we can do this work for $16 million a year, will you pull the RFP? And we said, yes. And they agreed to reductions in work force. They agreed to changes in work rules and in the 1994 budget and the 1995 budget, and the 1996 budget, that plant is spending—we are spending $16 million a year to run that plant with a city unionized work force savings of $8 million a year.

Last and not least significant, but also not most significant, is that we negotiated tough but fair labor contracting with our municipal unions. Those contracts are saving us in excess of $100 million a year. The bulk of those savings are in the health care area because we negotiated a complete restructuring of our health care plans with our unions but we also have savings as a result of disability reform.

As a result of changes in work rules, there have been more than 150 changes in work rules in the way that our municipal work force is organized to do business, whether it is scheduling, job classifications, or work rules such as the fact that a custodial worker under the old practice was not permitted to clean walls above the shoulder level. If they were cleaning walls above the shoulder level you had to be a wall washer, and wall washers were paid more than custodial workers, and that 5,000 person attrition that I discussed. All the wall washers have been attrited out of the work force. There haven't been any hired, which means there were no walls being cleaned in the city at shoulder level for about 5 years. Not a very logical way to approach doing custodial services in any business let alone in the government.

Overall, as I said, over a 3-year period, over $800 million of gap-closing initiatives were successfully adopted which was required in those two balanced cuttings that I talked about. All of that, together, has enabled the mayor this year—and we are by the way in the midst of our budget process now—to propose a fiscal year 1996 budget that includes the city's first tax cuts since 1945, first tax cuts in 50 years for the city of Philadelphia and also includes significant enhancements of services in such thing as the library system, the recreation department, the Fairmont Park System, the police department and the fire department. I would suggest probably the most critical departments from a citizen service delivery—citizen service delivery perspective.

One of the lessons that we can take from the Philadelphia experience, first, and I think foremost, you need the political will to accomplish difficult things. Nothing that has been explained to you

by any of the witnesses earlier in the day, nothing that I have just outlined for you, was easy. I think we have been fortunate in Philadelphia in the way that our press has described us that we didn't bludgeon anyone. We didn't cut anyone's aorta. We just nicked 1,000 people in different places, so everybody was walking around the city with paper cuts instead of gaping wounds.

But when you nick everybody with paper cuts, they still come down to the mayor's office and demonstrate. And the mayor loves to tell the story of a phone call that he received from a very good friend and a significant contributor who was apologizing to the mayor saying that he had to be part of a group that was going to come down to city hall the next day and demonstrate in front of his office and he wanted the mayor to understand that.

And the mayor said, "Jim, hold on a second if you don't mind and let me check something." And he said, "OK, sure." And put him on hold and kept him on hold for 30 seconds and picked up the phone and said, "Hi, you can come down. I have to check the book, we have so many demonstrators coming in down here, I wanted to make sure that you won't be put out of the limelight because of other demonstrations that are going to be held outside my office."

And you have to have that attitude. You have to accept that if you are going to do these things, that for a year, you can't leave or go into your office without being heckled or bothered by somebody who is complaining about what it is that you have done. And both the mayor, the president of the city council, and the members of the city council stood up to that political will and had the political will to stand up to do what was necessary in the city of Philadelphia.

Second, and Congressman Fattah knows this very well, you need some level of cooperation from, in Philadelphia's case, the State government, and I will suggest that in the District of Columbia's case, the Federal Government.

We made a very big deal over the fact and we continue to make the big deal over the fact that we have never asked anyone for a bailout. We never asked the State to pay that $250 million deficit. When PICA borrowed $475 million on behalf of the city of Philadelphia, in 1992, it is the city of Philadelphia that is going to pay every nickel of that borrowing back.

And in fact today, we pay $54 million a year to pay off the deficit reduction bonds that PICA issued in 1992. So if you want—when people talked earlier about the fact that spending excesses and digging that hole becomes a mortgaging of the future that future generations will have to pay off, in the city of Philadelphia, we can quantify what the mortgaging of the future was done over the half decade preceding 1992. It is $54 million a year which is almost 3 percent of our operating budget over a 10-year period in order to pay off that cumulative deficit that this developed.

By the same token, we did ask the State to step to the plate and pay its fair share of the services it was supposed to pay for. And in Philadelphia's case, as Congressman Fattah remembers, that was children and youth services, an area that was the State's responsibility and, historically, had been underfunded and neglected by the Commonwealth of Pennsylvania. And the State did step to

the plate and did that, under the leadership of the Philadelphia delegation of the legislature, and did provide the funding for that.

Now we would also like them to pay for court costs and other things that they should pay for, and we continue to work on that, but we have accomplished what we have without that.

Mr. DAVIS. Mr. Cohen, can I interrupt you? I want to hear your testimony and I have got some questions. Mr. Fattah and I need to get over and vote very quickly.

So, if you could bear with us for about 15 minutes, to take a recess, and then you can summarize. I appreciate you bearing with us and we will be right back. I declare a recess.

[Recess.]

Mr. DAVIS. Thank you. I appreciate you bearing with us.

Mr. COHEN. No problem at all.

Mr. DAVIS. It was all to no avail. We missed the vote by 1 minute, but we paired off so we were covered. This was great testimony. We want to give you a chance to finish and then I have some questions. We really appreciate your being here.

Mr. COHEN. Thank you. Where I was, I think, was to a point on the three key lessons from the Philadelphia story. The first is the political will of the mayor and council, the second was the level of cooperation that we received from the State government—again, not to bail us out, but to pay its fair share—and the third is the importance of PICA as an oversight board in that process, and the importance of that board simply cannot be overstated or overestimated.

Dr. Anderson has described the way in which the PICA Board is structured and has functioned. I would just note the following things that I think were keys to the success of PICA and PICA's relationship with the city.

The first, that it was a nonpolitical expert interested board. Because I am not surprised to hear that Dr. Anderson was spending 60 percent of his time working on PICA because I know all the evening meetings we had and weekend meetings we had and 6:30 a.m. meetings we had to be able to air these issues and to discuss them.

And at virtually all of these meetings, all members of the PICA Board and as well as Mr. Henry, as the executive director, were present. And in the absence of that type of a committed and interested board we could not have had the successes that we had.

The second, a relatively small board. I am not saying that five or seven members is the right size, but I will tell you, if you get to 15, you are in deep trouble. You need as small a board as you can put together to deal with the constituencies that you need to deal with in order to make the board work as part of that process.

The third was a highly professional and expert staff, and a staff that was truly interested in working with the board and with the city in figuring out a way to solve the problems and not at making headlines itself as being the architects of solving the fiscal problems of a particular city.

And I have known Ron Henry for a long time, he and I practiced in the same law firm before we went our slightly separate ways and, as he pointed out to me right before he took this job and I took my job, he said, this is great, I will get to be your banker, and

he was my friendly banker. It was a very important relationship to have a staff that knew what it was doing and knew the limits of its power and the authority of the PICA Board and did not tread over those lines.

The third—the fourth item is a cooperative relationship with the city. And I think that should be coupled with the fifth item, which is independence from the city. And there is a difference between being cooperative and just being a captive of the city process and being cooperative in terms of being constructive but still maintaining independence and not hesitating to criticize or to comment publicly on areas of disagreement that might exist between the city and the PICA Board.

And for credibility on Wall Street, and for credibility of the ultimate turnaround of the city, you needed both the cooperative side, the collaborative side, as well as the independence side that the outside world would know that—would know that the board was independent and was prepared to blow the whistle when it was necessary to blow the whistle.

The sixth item I would say is, have a bias on this. I am a city employee and a city official, but I think the role that Dr. Anderson described on at least a half a dozen occasions in his testimony, the emphasis on the word oversight as opposed to control was a critical element of the success in Philadelphia.

I don't think you can impose the political will or the solution on the independent elected officials of any particular government. I think you can structure the kind of a relationship that existed in the city of Philadelphia without putting the decisionmaking authority in the hands of the outside oversight board, but putting the weapons and the bully pulpit—and the power of the bully pulpit in the hands of that board to make—to be able to move the elected officials to making the appropriate decisions that they are supposed to make. And I guess I feel very strongly that that is what the officials were elected to do. It should be their job, ultimately, to make decisions.

I am a strong believer in the importance of home rule and in the importance of local officials making their own decisions. I understand when that power is abused and you get into a situation where you need an oversight board, that there are certain restrictions and limitations, but I think the oversight structure that we used in Philadelphia is much preferable to a control structure where Bernie Anderson and Ron Henry, and as much respect as I have for the two of them, I think our system was better where you had Ed Rendell, John Street, and 16 other elected members of city council making the decisions under the oversight of a PICA Board as opposed to Bernie Anderson and Ron Henry making the decisions and the elected mayor and city council sitting on the sidelines, so I feel quite strongly about that.

The next two—my last two items are also linked and that is the possession, the oversight board's needs to hold a nuclear weapon to ultimately get its way and they have to have the willingness to use the nuclear weapon. In Philadelphia's case, the nuclear weapon was the ability, as Dr. Anderson described, to inform the State that the city has at variance with its plan had not submitted an acceptable corrective action and that, therefore, the State should with-

hold all of—virtually all grant revenues and support from the city of Philadelphia.

We could not function for very many days in the absence and in the cutoff of State revenues and, as a result, it was a nuclear weapon. And I think the PICA Board made quite clear from the day of its formation that although it did not want to use that weapon, that it would not hesitate to do so if it needed to in order to ensure compliance of the city with the statutory framework that resulted in its creation.

So in summary, I believe that without all of these elements, the Philadelphia success story would not be present. Without political will and leadership from the elected officials of the city, without support from the State government, and without the rational intervention and cooperative intervention by an independent oversight board created under State legislation, I would not be able to be here today talking about Philadelphia as a success story but, instead, would probably be appearing in front of the State legislature and the Federal Government trying to figure out some way for a bailout for this city.

And I am very pleased that I don't have to do that because I personally don't think I would have very much chance of success. So it is a lot easier to talk about what we have been able to accomplish with the help of the PICA process.

Thank you very much.

Mr. DAVIS. Mr. Cohen, thank you very much.

Mr. Henry. Thank you for bearing with us.

Mr. HENRY. I always wanted to be anchorman on a relay team like this one. In July 1994, I testified before the previous House District of Columbia Committee and I have left a copy of that testimony with the stenographer for inclusion in the record.

I noted at that time, in most cases of fiscal distress, matters have to become undeniably bad for a critical mass of either of the public or elected officials to acknowledge that something is wrong. I also said that the most critical obstacle to achievement of a long-term solution is the ability of the District of Columbia to receive additional financing from the U.S. Treasury without the imposition of stringent conditions or performance standards. Those observations are still true today.

It appears, notwithstanding the truly dire situation in which the District government finds itself, that most of its elected officials have not reached the point where they acknowledge the full impact of getting to the undeniably bad stage or that there are no other viable alternatives to a control board with real power over the operations of the District government.

With that as a context, it is sad to say that it is likely that matters will get somewhat worse before they can get at all better. There have been discussions about the nature of the structure the Congress inevitably will put in place. Whether you will follow the New York model that we heard about today, the Philadelphia model which we have just discussed, or even the Chelsea, MA model which is a complete receivership.

I would suggest that discussions of structure begs some of the questions that should really underlie your consideration of the legislation. The first question which comes to mind is what respon-

sibility are you prepared to have the new agency assume under your sponsorship. Practically speaking, it is not difficult to confer authority but the acceptance of responsibility for the exercise of those powers is another matter entirely.

The issue that sits squarely on the Federal Government's plate as the appointing authority is whether you, as their sponsors, will be willing to give the appointees the substance of the authority that the law will ostensibly grant. That means that you should resist the urge to micromanage from here unless that amount of intervention from Capitol Hill is an explicit understanding on the way in.

I would suggest, however, that the more you get in, the more you will be in and the more visible the wisdom of your decisions will be.

You should ask, does the solution fit Washington's problems and its opportunities? Unsuccessful generals fight the last war rather than the one they have before them today. The situation here is unique, made particularly so by the relationship which the District has with the Federal Government and its neighbors. What has worked elsewhere may not work in this case.

In Philadelphia, as David mentioned, we had a new mayor with a very broad base of public support who was unattached to a generally agreed-upon crisis and we had all of the major labor contracts coming up within months of his ascension to office. That is not the case here and your actions and reactions have to recognize that there are critical differences.

There is little question that the Federal-District relationship will be reformulated as a result of the fiscal crisis and your reaction to it. If you as a matter of policy do not intend something to be on the table as a candidate for change, make those rules clear at the beginning.

You should ask: What are the most important things to accomplish after the District does not run out of cash? The focus on the District has been on the cash crisis, and although I don't want to minimize its importance, it is likely that a device can be put in place in fairly short order to address immediate liquidity demands. There is a risk, however, that after a funding device is created, there will be such a sigh of relief from Wall Street to M Street, that the consensus around the immediacy of the issue will dissipate.

Issues, as we know, have a habit of coming to a boil and then evaporating. The real task is to figure out what to do next, how to keep things from continuing to get worse and to slow the rate of descent. Making things better is at least one step beyond that point. What critical first choices have to be made and who are the architects and the custodians of a long-term plan? The visible task and programs, the most critical one is to articulate the challenges which lie ahead. Keep the problem in public view and use the funding as a means to buy time toward addressing the larger and the more difficult items on the agenda.

Therefore, a logical question from the beginning is looking ahead: What are the long-term goals of this effort? Everyone knows that the first challenge for the new agency will be to keep the bus from hurdling over the cliff to make sure that bills get paid, that the

District meets its financial obligations as soon as possible. That said, what do you see down the road, 2, 5, 10 years from now?

I would not even guess to attempt to set those goals for you, but urge you to set a standard that will permit the Congress, the citizens of the District, and the citizens of the Nation to judge whether the war has been won or lost.

It will be the standard for you to apply to decide what you should do next and when. It will begin the painful process of making people responsible for their decisions.

The next questions which flow from that point are what are the most critical things that you need to have done tomorrow and don't have a prayer to accomplish even within the next 2 years? How then do you get along without them? Everyone has their own stories about how bad some part of the District government is, and even if a relatively small percentage of them is true, you have a huge problem to deal with. Sad to say, most of those problems aren't going to be fixed today, tomorrow, or even by the time the baseball strike is over. It could be that long.

Institutionalization of fundamental change is the single most difficult and frustrating part of the effort upon which you are about to embark. But it can also be the most rewarding. You can be very sure that there are people within the District government who give the taxpayers a day's work for a day's pay, and labor under extraordinary difficult decisions. You can also be sure that there are those who will decide that their future relationship with the District of Columbia, residential, educational, financial, and commercial on the basis of what they believe the structure you put in place will be able to do.

Please remember that there are hundreds of thousands of people who have done nothing to cause this cataclysm. They want only to make a decent living, educate their children, and live in a safe and stable community with reliable services. As dysfunctional as the current system is, it is all they have. It will be immensely difficult to turn the District government around even if, or perhaps especially, things go well, there will be bruised egos and shattered power bases strewn around the landscape. You have, however, no alternatives. You know that things have indeed become undeniably bad. And I wish you luck.

Thank you.

[The prepared statement of Mr. Henry follows:]

PREPARED STATEMENT OF RONALD G. HENRY, FORMER EXECUTIVE DIRECTOR OF PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY

Mr. Chairman, I am Ronald G. Henry. From 1991 through 1994 I served as the Executive Director of the Pennsylvania Intergovernmental Cooperation Authority, the fiscal oversight agency for the City of Philadelphia. I previously worked as both a public finance attorney and as an investment banker, and I currently maintain a consulting practice in matters relating to public finance and management.

I complement you on your effort to reach out to those of us who have been involved in work with distressed local governments in an effort to pull them back from the brink of insolvency, and thank you for the opportunity to testify. The process should encourage the Congress to take the broad view that will be necessary to help the District government regain its financial footing.

In July of 1994 I testified before the House District of Columbia Committee. I noted that in most cases matters have to become undeniably bad for a critical mass of either the public or elected officials to acknowledge that something is wrong.

I also said that ". . . the most critical obstacle to achievement of a long-term solution is the ability of the District to receive additional financing from the U.S. Treasury without the imposition of stringent conditions or performance standards."

Both observations are still true today. It appears, notwithstanding the truly dire situation in which the District government finds itself, that most of its elected officials have not yet reached the point where they acknowledge the full impact of getting to the "undeniably bad" stage, or that there are no other viable alternatives to a control board with real power over the operations of the District's government.

With that as the context, it is likely that matters will have to get somewhat worse before they can get at all better.

There has been discussion about the nature of the structure that Congress inevitably will put in place—whether you will follow the New York model (one of oversight and contingent control), the Philadelphia model (oversight with the capacity to withhold funds under certain circumstances) or the Chelsea model (a complete receivership). I would suggest that discussions of structure beg the questions that really should underlie your consideration of the legislation:

- The first questions which comes to mind is, "What responsibility are you prepared to have the new agency assume under your sponsorship?"

Practically speaking, it is not difficult to confer authority, but the acceptance of responsibility for the exercise of that power is another matter entirely. The issue that sits squarely on the Federal government's plate, as the appointing authority, is whether you (as their sponsors) will be willing to give the appointees the substance of the authority the law ostensibly will grant them. That means that you have to resist the urge to micromanage from here, unless that amount of intervention from Capitol Hill is an explicit understanding on the way in. I would suggest, however, that the more you get in the more you will be in, and the more visible the wisdom of you decisions will be.

- You should ask, "Does the solution fit Washington's problems and opportunities?"

Unsuccessful generals "fight the last war," rather than the one they face today. The situation here is unique, made particularly so by the relationship which the District has with the Federal government and its neighbors. What works in one place may not work somewhere else. In Philadelphia, we had a new mayor with a very broad base of public support who was unattached to a generally agree-upon crisis. And we had all four major labor contracts coming up within months of his ascension to office. That's not the case here, and your actions and reactions have to recognize that there are critical differences.

There is little question that the Federal-District relationship will be re-formulated as a result of the fiscal crisis and your reaction to it. If you, as a matter of policy, do not intend something to be on the table as a candidate for change, make those rules clear at the beginning.

- You should ask, "What are the most important things to accomplish after D.C. doesn't run out of cash?"

The focus on the District has been on the cash crisis, and although I don't want to minimize its importance, it is likely that a device can be put in place in fairly short order to address immediate liquidity demands. There is a risk that after a funding device is created that there will be such a sigh of relief from Wall Street to M Street that the consensus around the immediacy of the issue will dissipate. Issues, as we know, have a habit of coming to a boil, only to evaporate.

The real task is to figure out what to do next, how to keep things from continuing to get worse and to begin to slow the rate of descent. Making things better is beyond that point. What first-line choices have to be made, and who are the architects and the custodians of the long-term plan?

The "visible" task (and perhaps the more critical one) is to articulate the challenges which lie ahead, and use the funding as the means to buy time towards addressing the larger and more difficult agenda.

- Therefore, a logical question from the beginning is "Looking ahead, what are the longer-term goals of this effort?"

Everyone knows that the first challenge for the new agency will be to keep the bus from hurtling over the cliff—to make sure that bills get paid and the District meets its immediate financial responsibilities. That said, what do you see down the road 2, 5 and 10 years from now?

I would not attempt to set those goals for you, but urge you to set a standard that will permit Congress, the citizens of the District and the nation to judge whether the war has been won or lost. It will be the standard for you to apply to decide what you should do next, and when. It will begin the painful process of making people responsible for their decisions.

• The next questions, which flow form that point, are "What are the most critical things that you need to have done tomorrow and don't have a prayer to accomplish even within the next two years? How, then, do you get along without them?"

Everyone has their own stories about how bad some part of the District government is, and even if a relatively small percentage of them is true, you have a huge problem to deal with. Sad to say, most of those problems aren't going to be fixed today, tomorrow, or even by the time the baseball strike is over.

Yes, it could be even that long.

Institutionalization of fundamental change is the single most difficult and frustrating part of the effort upon which you are about to embark, but it also can be the most rewarding.

You can be very sure that there are people within the District government who give the taxpayers a day's work for a day's pay, and labor under extraordinarily difficult conditions. You also can be sure that there are those who will decide their future relationship with the District of Columbia—residential, educational, financial and commercial—on the basis of what they believe the structure you put in place will be able to do.

Please remember that there are hundreds of thousands of people who have done nothing to cause this cataclysm. They want only to make a decent living, educate their children and live in a safe and stable community with reliable services. As dysfunctional as the current system is, it is all they have.

It will be immensely difficult to turn the District government around. Even if (or perhaps especially if) things go well, there will be bruised egos and shattered power bases strewn about the landscape.

You have, however, no alternatives. You know that things have, indeed, become "undeniably bad," and I wish you luck.

I wish you luck.

I would be pleased to answer your questions. Thank you.

SUPPLEMENTAL PREPARED STATEMENT OF RONALD G. HENRY, EXECUTIVE DIRECTOR OF PENNSYLVANIA INTERGOVERNMENTAL COOPERATION AUTHORITY, FROM THE HEARING ON JULY 14, 1994

Mr. Chairman, I am Ronald G. Henry, and I serve as Executive Director of the Pennsylvania Intergovernmental Cooperation Authority (known as PICA), the fiscal oversight agency for the City of Philadelphia. I would note that the views I will express today are my own, and should not be interpreted as those of PICA or any other entity or individual.

PICA was created by the Commonwealth of Pennsylvania in 1991 after Philadelphia's investment grade ratings were withdrawn by the major credit agencies. That, in turn, caused the City's annual public note offering to fail and precipitated both a cash crisis and a crisis of confidence in the capacity of Philadelphia to manage its fiscal affairs. In short, the City lost the ability to finance itself. It had no choice but to seek help.

The PICA process is based upon the philosophy that the City should not be "bailed out", but rather should be given the time and tools to re-make itself. Philadelphia was given the right to apply to the Authority for financial assistance in the form of PICA bond proceeds. Our bonds, which may be issued through the end of 1994, are secured by a pledge of a portion of the tax imposed on the wages and earnings of City residents—over ten years in the case of deficit reduction bonds and over up to thirty years in the case of debt issued for capital purposes.

In 1992 PICA issued bonds, in the amount of $474.6 million, $120 million of which was allocated to capital projects, in addition to funds set aside for both accumulated and anticipated operating deficits. In 1993 we issued $174 million for capital purposes, and additional amounts to refund both City and PICA bonds. With PICA assistance, Mayor Ed Rendell's administration and City Council have moved the City from huge projected operating deficits to what we expect will be a substantial operating surplus for the fiscal year ended June 30, 1994.

PICA does not have powers like those of the New York State Financial Control Board, but the City is required by statute to develop a five-year financial plan based upon reasonable estimates of both revenues and expenditures, and which shows balanced budgets for each of its years. PICA approval of the plan is a precondition for any assistance, and there are sanctions which may be imposed if the Plan should become unbalanced and the imbalance is not remedied by the City.

When the District (or Congress, for that matter) will come to terms on a long-term basis with the underlying realities of is fiscal condition is speculative, and I

suspect it will take some cataclysmic event to bring a sharp focus to the situation. While I would not hold myself out to be an expert on Washington's finances, the difficult and complicated issues which the next mayor and council must face inevitably offer opportunities in this election year for inflammatory rhetoric at the cost of rational debate. At base, however, until there is consensus on the scope and nature of the problem, it is unlikely that there will be consensus on the scope and nature of the solutions. Unfortunately, in most cases matters have to become undeniably bad for a critical mass of either the public or elected officials to acknowledge that something is wrong, and I complement you on addressing the problem at this time.

In the case of Philadelphia, the PICA Act mandates that the City develop a five-year plan, report results quarterly (or when extraordinary events occur) and annually update the plan and add another year to it. The current plan, the third, covers fiscal years 1995 through 1999. At one point, in December of 1992, the Authority declared the existence of a Plan variance, and monthly reporting was required thereafter until a plan of correction was set in place in May of 1993. The plan and reporting regimen have been valuable, as have periodic PICA Staff reports on the details of the budget and government operations.

We have learned several things over the last three years, and while I would offer the cautionary thought that all situations are different, I would like to share some of those lessons with you.

The first: a financial plan is not just a "financial" plan. Fiscal results do not exist in a vacuum. What we have been doing with the City of Philadelphia since 1991 has been the creation and monitoring of a management plan and its financial results. While the goal of the process is the production and maintenance of a budget that is balanced from year to year and to highlight areas of financial risk, it is equally clear that the fiscal picture is a representation of the results of a series of other choices. Many of those decisions are made elsewhere, whether by other levels of government or the private sector, but many more are made by the city itself. It is imperative in any planning effort to step back and assess what the budget numbers mean in terms of services, burdens and the long-term prospects for the city and its citizens. It should be an objective view of assets, liabilities, threats and opportunities. A budget that is "balanced" in an accounting sense at the same time may be financing a government that is not functional.

The second: there is no such thing as a "value neutral" public policy. When public officials are urged to "make hard choices" they are being asked to make value judgments. Whether it is the Internal Revenue Code's preference for single family home ownership, or whether D.C. should be permitted to enact a non-resident income tax, every decision implies a judgment of relative social value. I believe that individuals are economically rational and that they will react to external events which impact them within their capacity to do so. It is, therefore, inevitable that decisions made by government will provoke a response that creates fiscal and programmatic ripples (and at times tidal waves).

Fundamental to the problem is a reluctance on the part of many public officials to face the reaction when they make choices mandated by limited resources. I would suggest that public aggravation and opposition to so-called "hard choices" arises almost as much from a perception of unfairness as it does from the actions themselves, and the reaction at times represents pent-up hostility against the system that happens to be focused on one event. As we quickly learned in Philadelphia, a government that seems to be out of control, out of touch and the source of anecdote after anecdote of inefficiency and abuse has a credibility problem at least as large as its fiscal crisis.

The third point is that expecting the process to be free of politics is like trying to repeal the law of gravity. Politics is the process by which decisions are made and power allocated in society, and our system relies upon interests being articulated and advocated as forcefully as possible. In such an environment it is hard to reach consensus on the nature of a fiscal problem, and it is even more difficult thereafter to create and maintain the degree of unity among the stakeholders whose participation and cooperation is necessary to reach a solution. Not the least risk is that the participants in the "grand coalition" created by perceived adversity have only that adversity to hold them together. Long-standing animosities or other institutional pressures will drive them apart once the perception of adversity moderates, and support for reform diminishes accordingly.

In Philadelphia, the 1990-1993 period was marked by a unique convergence of political power clustered around the issue of the City's solvency. Elected officials on the local, regional and State level found enough common ground to pass the PICA Act and for the City to construct a series of credible financial plans and concessionary labor contracts. In even the most stable systems, however, relationships and in-

terests shift, and the pressures imposed upon people in public life require them to pay constant heed to the warning signs of incipient political problems. Philadelphia certainly is not an exception to that rule, and I would expect the District to be the same.

What that means, among other things, is that any system has only a limited amount of time for "business as usual" to take a back seat to institutional change.

The fourth point is that good accounting and reporting will explain the results of prior decisions, and help with future choices. We found very early on that Philadelphia's internal reporting system left much to be desired. While the Administration is spending significant amounts to upgrade its systems, they still fall far short of contemporary standards, and it will take at least another year to bring them up to par. It is a truism in city government that "everyone knows exactly what they have to spend, but no one knows (or cares) what anything costs." That makes educated decision-making very difficult, and camouflages the results of prior decisions.

The effects of government choices are seen in choices made by individuals, and they in turn over time show up in revenue numbers, changing demands for services and variations in expenditures. As systems become more efficient, and analysis is more sophisticated, the information produced becomes more useful and dramatically compresses the time between a policy decision and the ability to assess its result. I should note, however, that in political terms this also increases the likelihood that observers will be able to understand the cause and effect relationships between decisions and their results, and thereby make people responsible for their actions. Not everyone is prepared for that result.

The fifth point, then, is that accountability is necessary for reform, but it threatens established administrative and political relationships. If a plan-making and reporting system is to be successful, it must be comprehensive and the product of input from all levels of the government. Its results should also circulate within government and be used as tools to make fundamental changes, alter policies and influence decisions. One goal is to build capacity for informed decision-making and assessment of results—in short, to pick winners and losers. Taken to its logical conclusion, the system could produce a radical re-orientation of budgetary authority, programs, personnel and policy emphasis as the results of previous decisions are analyzed and current and future needs are prioritized.

In a general sense, cities do not find themselves at the brink of insolvency because they've done everything right. Notwithstanding grave problems in the aggregate, however, there are individuals and groups—internal and external constituencies—which rely upon particular decisions and programs. They also rely upon the control of information as a critical resource in their struggle for survival. An effective planning and reporting system is antithetical to the way in which many within government (both elected and non-elected) have done business for generations, and it is naive to expect them to roll over and play dead when confronted with a copy of a financial plan. They will oppose, critique, delay and sabotage institutional reform, and they understand that the staying power of any particular group of reformers is limited.

One virtue of the PICA process is that the Authority has the capacity to stay at the table and critique programs time and time again, and to place visible pressure on the governing process to behave in a consistent manner, while not substituting PICA's judgment for that of elected officials. Even with all of that has occurred in the City of Philadelphia, however, the system is very resistant to change, and every day is a challenge to claim a little more without losing what has been gained.

The final point is to recognize the nature of your situation. The relationship between Federal government and the District of Columbia is truly unique, and offers particular problems and opportunities.

In my opinion, the most critical obstacle to achievement of a long-term solution is the ability of the District to receive additional financing from the U.S. Treasury without the imposition of stringent conditions or performance standards. As long as there is the impression that an essentially "blank check" is sitting on the counter at the other end of Pennsylvania Avenue, I am concerned that the political system will not come to terms with the underlying problems or develop the political will that is born of the conclusion that there are no opportunities available to avoid coming to grips with fundamental issues of finance and governance.

Another area of concern is the role of Congress. I would urge you examine the mandates which you have imposed, and assess both their necessity and their cost. The Federal relationship is a legitimate issue in the debate about the District's fiscal future, but should not be one which is brought out as a device to avoid meaningful discussion.

Also important, given your intimate role as an approving authority for the budget of the District, is to differentiate between budget balance and cash flow, and to look

through the numbers you receive. It is imperative that you take a truly long-term view of what fiscal choices are being made today which will have an impact in the months and years to come. The warning signs are visable—this hearing is acknowledgment enough of that. Use this time to develop a plan and gather consensus. There are hundreds of thousands of people whose lives will be touched in a very direct way by the District's fiscal crisis, and they deserve your best efforts to lay the groundwork for a long-term solution. I wish you luck.

Thank you for your attention. I would be pleased to respond to questions.

Mr. DAVIS. Thank you very much.

I am going to ask just a few questions. Let me start with Mr. Anderson, first then if either of our other witnesses want to say anything, I would be happy to hear your comments.

How would the PICA Board have worked if you had an obstinate mayor and council? It worked because it was cooperative. Everyone recognized the problem and rose to the occasion. I am not saying there weren't some differences. But you have to write this legislation in a way that you have to assume the worst, even though you hope it doesn't happen. You had that bomb back there in that case. Is that what made it work? What would have happened if everyone decided they just wanted to continue to be obstinate about things?

Mr. ANDERSON. I think that if the mayor and the leaders of the city council were determined not to cooperate with the board, we would have long delayed our ability to address the problem. For example, in order for the board to do its work, we need information on the city's finances, on the tax revenue that it is receiving, on its plans for expenditure levels, other kinds of information that we would not be able to obtain if we didn't get it from the city government. We simply need that.

One of the issues, for example, that came up in our negotiation of an intergovernmental cooperation agreement was what the role of the PICA Board would be with respect to labor management agreements. We did not have, as they had in New York, the authority to approve labor-management agreements and we did not want that authority.

However, we did want to be informed about any agreement or recommendations that the mayor would make in negotiations in order to determine in advance what the impact of that agreement would be on the city's ability to balance the budget, and so we negotiated a clause in the ICA specifying that through the negotiations when the mayor reaches a point where he was making his final offer and they were about to agree on the terms and conditions, that we would be informed about that.

That was an issue on which the unions of the city disagreed. They expressed that disagreement to members of city council. They sued us. That case went to the Pennsylvania Supreme Court and the city council, in the 11th hour action on—literally 11 o'clock on one Saturday night, voted against the intergovernmental cooperation agreement.

On Sunday, I made a statement, in response to a call from a reporter, indicating that we would not accept that. That is the board would need to have an intergovernmental cooperation agreement that provided for us the information we needed to do our job and, until that was done, we simply would not go along with it.

Now, we had an election coming up. And members of the city council who were running for reelection said, in effect, and one is

a long-time Republican member of the city council and—I will mention him, Thatcher Longstrat—whom I had known for many years. He is a grand old man of the Republican Party. He is not so old. What is he, 73 now? He is in his 70's now, but a great guy, really. He is a wonderful man.

Thatcher said, look, you are crazy. He said, no member of city council is going to buck the unions and vote for this with an election coming up. And they didn't. This was in October. There was a period of time when we could do nothing. We were absolutely unable to move forward with that agreement until after the election.

When the election ended, then the city council came back 2 weeks later and put the clause in and agreed to it, and the intergovernmental cooperation agreement went forward. So what I am saying is, when you have resistance, it means that it becomes far more difficult to get the information that the board needs to do its job.

Let me mention something else. When we went into office in June 1991, at the very first meeting we had with the city, we were asked to extend to Philadelphia a short-term loan to help them through a cash crisis instead of them issuing a tax anticipation note and paying usurious rates of interest on it. They wanted us to come in and use our authority despite the fact that the statute mentioned very clearly that we had to have an intergovernmental cooperation agreement and a 5-year plan.

There was a period of time, I should say, when we could have extended financial assistance to the District without a plan and without an agreement in place, a very short window of opportunity. We took the position that we should not do that for the reasons that Ron Henry referred to in part of his testimony. Because once you extend the money without having the agreement in place, without having the plan in place, then the heat is off. So we said, no, we want the 5-year plan before we will extend any financial assistance.

That spurred the city, then, to start working on developing the plan rather than asking us for our assistance in extending money to deal with the short-term financial crisis.

So to answer your question, without cooperation, it makes the job very difficult. It makes—there is a pulling and a hauling and an arguing and court suits and all the rest about our authority versus the city's authority and you can't do the job.

Mr. DAVIS. Thank you very much. But that, I guess, goes back to the question, you need to have good board members who will force those issues, too, on the control board.

Mr. ANDERSON. Oh, absolutely. You need board members who are absolutely fearless. Listen, I—the mayor was a friend of mine. We were in high school together. Wilson Goode. And, incidentally, he never met with the board. I met with him over dinner and we came to a meeting of the minds about this. And I said, Wilson, we are here. You might not want us here, but we are here, and you are there. I respect your position as the mayor of the city of Philadelphia.

You have got to respect our position and I never spoke of me as an individual, but the board itself. You have got to respect what we have to do and that the people of Philadelphia can reasonably—

should reasonably expect you and this board to work together. And I think it had a salutary effect and no mayor wants to operate under these restrictions, but when they know that it is in their interests as well as in the interests of people of their city, they can do it.

Mr. DAVIS. The makeup of your board was different than New York's and Cleveland's to hear the testimony earlier today. You had no labor or union leaders, per se, on the board.

Mr. ANDERSON. No.

Mr. DAVIS. And the elected officials were not there, per se. You had, I guess, the finance director for the city but that was a bit different.

Mr. ANDERSON. Also the budget director for the State.

Mr. DAVIS. Were they voting members?

Mr. ANDERSON. They were not voting members. There were five—the only voting members were the five private sector members.

Mr. DAVIS. And what kind of access did the mayor and council have in the decisionmaking process? As you were making decisions, were they able to get their 2 cents across to you?

Mr. ANDERSON. Oh, yes. There was extensive communication between the board, the staff of the board, and the city government. We were in communication every day. We had no secrets.

Mr. DAVIS. They were at the table but they weren't able to vote. Would that have helped——

Mr. COHEN. If I could, Mr. Chairman, the model here, and this is a very important distinction, I think, because the model here is that the decisions were really being made by the mayor and, to a lesser extent, by the city council. And what was—the PICA Board and we had, I can't tell you how many times we had these discussions, and Dr. Anderson, if you did a Nexus search of newspaper clippings with his name, you would find this sentence 10 times which is, it is not the PICA Board's business to tell the city of Philadelphia how many fire stations to have, what to negotiate in its labor contracts, to lay people off, to cut wages, to do anything. It is our job to see that the city of Philadelphia has a balanced budget.

And it is up to the city to develop a plan to eliminate the structural deficit, to project 5 years' worth of balanced budgets, and then it is up to us to assess the reasonableness of those assumptions and the capacity of the city to deliver on its plan so that you do not have a PICA Board voting to contract out any services or to have a contracting out program or to negotiate a 2-year wage freeze or to do any of those things.

Mr. DAVIS. Would it be an "almost send the wrong message" and be counterproductive to put the mayor on there? This would have said the board has the authority as opposed to the mayor and council. You had your role and they had theirs.

Mr. ANDERSON. That is the very correct way to view that, that it would have been counterproductive, ineffective to have the mayor on the board. It seems to me that that is the difference, Mr. Chairman, between a control board and an oversight board.

Mr. DAVIS. OK. I have some questions before I yield to Ms. Norton.

I want to ask Mr. Cohen, just to get into an issue that I think the city is wrestling with now, and that is fiscal discipline doesn't mean no compassion at all, does it? In fact if you could just discuss in terms of being on the compassionate side of politics and understanding what that is all about, but at the same time recognize that you must have money to pay for it.

Mr. COHEN. That is absolutely the case. Frankly, that is a great phrase. I have to remember that and pass it along to the mayor. Being fiscally responsible, balancing your budget, absolutely does not require you to be punitive with respect to anyone and I think that probably one of the greatest parts of the Philadelphia success story is that we have not been punitive to anyone. We have not cut services anywhere, to be perfectly candid. We have not laid off a single person in 3 years as a result of any of the 5-year plans that we have developed.

Even in our contracting out program, where we have essentially eliminated more than 800 union jobs within the city government as a result of that program, none of those people has been laid off. They have all been offered alternative employment within the city government at other vacant or available city jobs.

We have, as I described the approach of this plan and of the initial plan, a plan of 1,000 paper cuts and that is—I mean, there are lots of people that got nicked, that nobody had any gushing wounds as a result of what we have done. And even on the labor side, and I—I mean, Mayor Rendell and I try and talk about this all the time because I think Mayor Rendell gets this sometimes almost horrific national reputation of how he beat the labor unions and how he created this plan by goring the labor unions.

And I will tell you that at the end of our contract, at the end of our contract negotiations in 1992, municipal employees in the city of Philadelphia, first of all, had their jobs. As I said, no layoffs in 3 years. Second of all, no pay cuts. There were no unpaid furlough days. There were no rollbacks in wages. Yes, there was a 2-year wage freeze that was negotiated as part of that contract. But in April 1992, our entire municipal work force received an 8 percent pay increase. It was a back-loaded pay increase at the end of their last contract, so that in April 1992, everyone got 8 percent. Then they had to wait another 2½ years before they were to receive their next pay increment.

Because of our step system and nonmerit, pay-based increases, that 2½-year period 51 percent of the municipal work force has received a raise. Even though there has been a wage freeze, 51 percent of the municipal work force received a raise and, among those people who have received raises, the average raise is about 6 percent, which is higher than the rate of inflation over that period of time.

Our workers ended up with 10 paid holidays, with anywhere from 10 to 20 paid vacation days, 4 personal leave days. A generous bereavement benefit. Probably still one of the wealthiest and luxurious pension plans in the city of Philadelphia.

Mr. DAVIS. I have to keep you quiet before my staff hears about this deal.

Mr. COHEN. Fully paid health insurance under a managed care model with fully paid dental, optical, and prescription benefits. No

co-pay or premium for yourself or your family if you are in a managed care health plan.

This is not a terribly burdensome, repressive labor contract from the perspective of a benefit level that is being maintained in the city of Philadelphia today, and that package that I have just described to you, is saving the city of Philadelphia more than $100 million a year. It gives you a sense of where we were beforehand.

And I think the point the Chair makes is absolutely the case. You can be fiscally responsible, you can gain control of your fiscal destiny, and have compassion for your work force and your public and your citizens who are receiving the services you are delivering. And in fact the argument that we have made is that not making the difficult choices that we have made would have precisely the consequences that people fear, that is, if we did not negotiate changes in the benefits structure of the plan, we would have had to lay people off and we would have had to go to wage rollbacks or unpaid furlough days.

Ironically, we would have created a worse situation for our work force by not negotiating these concessions than we have achieved for them as a result of the negotiation of the concessions and certainly from the perspective of the taxpayer which is not facing declines in services, but in fact 3 years after the fact is now experiencing a service level that surpasses that which was available to them before the fiscal crisis. The fiscal sanity has meant their government doing more for them and not their government doing less for them.

Mr. DAVIS. Thank you very much. I am going to pass the baton here to Ms. Norton who I know has some questions.

Ms. NORTON. Thank you, Mr. Chairman. There is a kind of contrast there between New York, which had to take these draconian measures immediately just to get some extra money, and what happened in Philadelphia. And as I try to search for what was the ingredient that led to the roster of benefits you described, you indicate that the board didn't do this, the city did it. It suggests that in order to be in that position, that you need city leadership that is willing to look for innovative alternatives pretty quick or else the notion of no layoffs and indeed the opposite, increases, becomes hard to understand.

So am I right in believing that what made this possible was that the city leadership, the elected leaders hustled to find ways to get changes that would make for real dollars and eliminate the need for the ultimate remedy such as layoffs?

Mr. COHEN. That is accurate and I think I would support what Dr. Anderson said in his testimony, which is that the presence of PICA Board, as I said, cannot be—the importance of that cannot be overstated because what we had, I mean, what we had was this pile of unpaid bills. I mean, there were $200 million of unpaid bills.

You could go and look at a computer printout of the bills that were not paid and it made you sick to your stomach because you saw all those bills, but you also realized that you were on a very short string, that there is a limit to how long the telephone company is not going to be paid. Yes, it is the city of Philadelphia but, eventually, after 8 months of not being paid or 9 months of not

being paid, they will eventually do what they would do to anyone else.

Ms. NORTON. Wait a minute. Dr. Anderson testified that that is what they wanted but didn't get.

Mr. COHEN. What we had to do, we had to negotiate the agreement and then we had to do a plan, and the plan had to specify exactly how we were going to eliminate that deficit, all those innovative ideas, all those creative ideas. Then the PICA Board would look at that plan and, if they found our ideas reasonable and believed that we would proceed to implement it, then the PICA Board was prepared and did issue bonds in order to fund that deficit.

Ms. NORTON. I am trying to figure out how——

Mr. ANDERSON. I think, Ms. Norton, that I understand what you are driving at here with respect to the timing of this. And let me walk you through it.

The PICA Board came into office in June 1991. At that time, the city was facing difficulty in paying its bills. There was a short-term note offering in August 1991 in which this—although the city did not have an investment grade rating on its securities, they put together a private sector loan transaction that was backed up by a number of banks similar to what the District of Columbia did a month or so ago, as I recall it, when the former mayor—one of her last acts.

Then the city had enough to go through around December and the wolf was at the door again. They then sold—what?—$100—$110 million.

Mr. HENRY. A small amount.

Mr. ANDERSON. A small amount under one of these special transactions for which they paid a usurious rate of interest. But that got them through around February or March when the property tax revenues started to come in. What was happening is the city was sort of bouncing along, meeting its financial responsibilities, not paying the merchants. There were some merchants who were 60 to 90 days behind payment. That went on. That number of merchants was continuing to rise.

But the point here is that nothing was done to reduce the structural deficit. The deficit was continuing to rise. They were not dealing with that. They were dealing with short-term cash needs.

When Mayor Rendell came in—first of all, to respond to a part of your question, when Ed Rendell was running for mayor of Philadelphia, at that time, he came up with certain ideas that he wanted to implement when he got into office if he won the election. So when he came in, very early in his term, we began discussions with him on the terms and conditions, the content of a 5-year financial plan.

We got the intergovernmental cooperation agreement in place. He got it to us in February 1992. After we approved his 5-year plan, we began immediately the process of structuring a bond offering which we consummated in June 1992 for $475 million.

So the point here is that we did not extend funding early on. We insisted that these other mechanisms be in place because, in our view, that was the only basis on which we could assure that a plan would be in place to reduce the structural deficit. In the meantime, the city bounced along on its own accord borrowing money at very

high rates of interest and did nothing to reduce the structural deficit.

Mr. HENRY. If we had not borrowed by the end of fiscal year, which was June 30, the city would have missed a payroll, stiffed the pension fund, or missed debt service.

Mr. COHEN. Or all three.

Ms. NORTON. Sounds like where the District is now.

Mr. COHEN. And it really was the hammer, if you will. We didn't have to implement everything to get access to the cash infusion. We had to have the plan that the board approved as being reasonable if implemented that would have solved the structural deficit.

Mr. DAVIS. If the gentlelady would yield.

I would just say what you have done, you have reversed the internal politics of the city. All of a sudden the politics are to come out and make these decisions as opposed to not letting your employees get paid.

Mr. HENRY. That's correct, but also the point that you have asked before, Mr. Chairman, is absolutely the proper one. Do you have a board that is able to take the heat? You have to have a board that is prepared not to accept the plan, that is prepared to have payless paydays, interestless interest payment days and pensionless pension payment days.

You have to be willing to let the bus go over the cliff. It is a very high stakes game of chicken, but if that means that the government has to shut down as a way of giving a wake-up call to the people who are elected to do the job, that's what you have to do.

Ms. NORTON. Did PICA ever have to withhold funds or threaten to withhold funds?

Mr. HENRY. There was one variance in December 1992 following the labor negotiations. However, we understood that was coming in the sense that the city did not get all that it had tried to get at the negotiating table, so it was not a shock or a surprise, but it was a variance.

Ms. NORTON. Finally, just let me ask about your wage tax. We were always told, if there is a wage tax, then business moves out of the city, so it is counterproductive. What is the experience with Philadelphia wage tax?

Mr. ANDERSON. There are many, Ms. Norton, views on that matter. I think the consensus is that the level of Philadelphia's wage tax is a disincentive to the location of businesses in the city.

Now, bear in mind that the wage tax is assessed on people who live outside the city but work in the city as well.

I don't think there is any question that the wage tax is a drain on economic growth in the city of Philadelphia. However, as an economist who has looked at this issue over a long period of time, it is my judgment that the city wage tax is not as great a disincentive for economic growth in the city of Philadelphia as many other economists and some others in the business community believe it is.

But there is no question that if we could reduce that wage tax, it would have an incentive to keep some people in the city who otherwise would have a significant incentive to move out and I think it also would allow Philadelphia to retain more of the businesses that are there.

Ms. NORTON. It would have to have an extraordinarily incentive to make up for——

Mr. ANDERSON. Forty-eight percent of our revenues.

Ms. NORTON [continuing]. Forty-eight percent of your revenues.

Mr. COHEN. If I can, we propose in this 5-year plan that the mayor has just proposed, there is a 7 percent reduction in the wage tax proposed over the next 5 years. And this plan—and that is on top of an 8 percent reduction in our business privilege tax over the same period of time. So that this plan actually includes an—over a 5-year period, a term reduction in two of the most difficult taxes for—and we could quibble about the size of the impact they have on economic development in the city.

I think everyone agrees that, at their current levels, they are two, very, very difficult taxes. Every national survey that has been done in the past 5 years has concluded that Philadelphia's businesses are the most taxed businesses in the country and that Philadelphia's individual citizens are the most taxed individual citizens in the country. So that the individual and business tax burden has become a disincentive to economic development. And this plan does contain a plan for the first time, as I said, in 50 years to begin a long-term incremental strategy of reducing those taxes ever so slightly every year and every budget, every year, stays in balance even with those reductions.

Ms. NORTON. Thank you, Mr. Chairman. And thank all three of you for this very useful testimony.

Mr. DAVIS. I have two other brief comments.

First of all to Mr. Cohen, you talked about the goal, really, is competition, not privatization. Sometimes we get driven by whether you privatize or not, but what we are really trying to do is, bring competition to government and privatization is a mechanism to do that. Sometimes the private sector wins out, but sometimes the public sector gets leaner and meaner.

Mr. COHEN. Correct. We have found our commissioners tell us that the impact of this program has perhaps been greatest in areas where we haven't even talked about privatizing any services, yet because all of a sudden the whole government says—and I am—I am not just talking about workers, I am talking about managers, too, who also run the risk of losing their jobs in a successful privatization, that say we had better get our act together or we could be next on their list. And this really had a positive impact in the way people approached the thinking about how they should do their jobs and how the business of government should be conducted.

Mr. DAVIS. Finally, Mr. Henry, as I hear your admonition—I think you are telling us to look as we go through this process, at where we want to be at the end of this process before we get in the process. Where do we want the end result to be. And you need to look at that by stepping back and seeing where it goes instead of just setting up a process.

Mr. HENRY. That's correct. You are going to put some forces in play here that will reverberate up and down Pennsylvania Avenue and each decision you make will foreclose some others at a later date. It is important, I think, as I believe Ed Regan mentioned to have an exit strategy to know how you get out of this. It is inappropriate to declare victory and leave.

I think you have to have an orderly process to get in, run it, and get out of it so you can extricate yourself and leave behind something of value.

Mr. DAVIS. Great. Thank you all very much. We appreciate you being here with us, sharing the public record with us. This was outstanding.

I think Ms. Norton will agree as we go into the record and work through a very difficult situation, your testimony has helped tremendously in that regard. Thank you.

The subcommittee will be adjourned.

[Whereupon, at 3:02 p.m., the subcommittee was adjourned.]

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