GAO

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General Accounting Office
Washington, D.C. 20548

General Government Division

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August 21, 1996

The Honorable Peter J. Visclosky
House of Representatives

Dear Mr. Visclosky:

This letter responds to your request for information on the fiscal crisis and subsequent financial recovery of the city of Cleveland in the 1970s. As you know, we collected information on Cleveland's response to its economic crisis as part of a broader review, covering five cities that had experienced financial difficulties, at the request of the Subcommittee on the District of Columbia, House Committee on Government Reform and Oversight. We presented this information in summary form at a March 2, 1995, hearing of the Subcommittee.[1] On May 22, 1996, you asked that we reopen our work papers with the objective of presenting more fully the information they contained on Cleveland's situation, with particular emphasis on the actions that the city took to improve its financial standing, management practices, and relationships with the private sector. You also asked that we summarize what Cleveland officials had told us were lessons they learned from the recovery experience.

This letter contains a brief summary of the information you requested and a description of the issues that led to the city's crisis. The enclosure provides details on Cleveland's financial recovery, improvements to its financial and general management systems, actions to revitalize its community, and lessons learned during the recovery.

In doing our original work on Cleveland, from December 1994 to June 1995, we conducted structured interviews with Cleveland city officials. We also obtained and analyzed relevant documents to define the nature, processes, and results of changes made by the city to recover from the fiscal crisis. We did not independently evaluate the information provided. However, a draft copy of our previous work was sent to Cleveland's Assistant Finance Director for review and verification by the

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[1] District of Columbia: Actions Taken in Five Cities to Improve Their Financial Health (GAO/T-GGD-95-110, Mar. 2, 1995).

relevant city officials. Their comments were included in this letter where appropriate. We did our work in accordance with generally accepted government auditing standards.

RESULTS IN BRIEF

Like many cities, Cleveland experienced a loss of jobs and flight of its middle class to the suburbs. The loss of jobs and residents, along with outdated management practices in city government, caused a financial crisis in Cleveland in 1978. Cleveland took several steps to recover from its financial crisis.

During the crisis, the citizens of Cleveland elected a Mayor who said that government was only one thread in the fabric of the community. He perceived the private sector to be another thread, and he got the business community involved in turning Cleveland's financial situation around. Several public/private partnerships were formed, and the then Mayor credited those partnerships for much of Cleveland's success in its comeback. The state of Ohio established a Financial Planning and Supervision Commission to help the city develop a recovery plan. To improve its finances the city issued bonds to pay off debt. Residents ultimately approved increases in the city income tax.[2] With these increases, the income tax, 76 percent of which was generated by nonresidents, as of 1995, superseded the property tax as the general fund's principal source of funding. In addition, the city set up an improved financial management system to track and control expenditures and made a number of other management improvements. Cleveland's recovery is largely attributed by city officials to strong leadership and the public/private partnerships that were formed as a result of the crisis.

ISSUES THAT LED TO THE CITY'S CRISIS AND SUBSEQUENT ACTIONS

Like many cities, Cleveland experienced the flight of its middle class to the suburbs. According to a 1992 League of Women Voters study,[2] Cleveland's population reached an all-time high of 914,808 in 1950 but declined during the following decades. By the 1990 Census, the city was left with 505,616 residents, little more than half of the number it had at its peak. Many residents and businesses were pulled from the city by new suburban housing developments and shopping centers. The people who stayed were often poorer than their suburban counterparts.

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[2]Ohio law authorizes municipalities to impose an income tax on corporate income and employee wages, salaries, and other compensation at a rate of up to 1 percent without voter authorization and at a rate above 1 percent with voter authorization.

[2]A Citizen's Guide to Cleveland, League of Women Voters of Cleveland Educational Fund, Inc., 1992.

Industries were leaving; as a result, the number of available jobs was down. Neighborhoods were deteriorating, buildings were being abandoned, and department stores were closing. Crime was increasing. Also, according to the League, the quality of education in the city's public schools was declining.

The financial crisis in Cleveland occurred in 1978, although the city's budget had not been balanced since 1971. In 1970, the Mayor found that revenues were inadequate to maintain city services. He proposed an income tax increase from 1 to 1.8 percent which required voter approval. To get the voters to accept this increase, he proposed a decrease in the property tax levy. The voters turned down the income tax increase but approved the property tax reduction. According to city estimates, losing the tax levy cost the city about $139 million in property tax revenue over the next 7 years. In addition, the voters turned down two subsequent income tax increases.

To keep his promise to the voters not to raise taxes, during the early to mid-1970s, the next Mayor, who was elected in 1971, issued bonds to cover operating deficits. The Mayor also sold city assets. For example, in 1972, the city sold its sewage treatment facilities to a regional authority for $32 million. The city used the proceeds from this sale to make general debt service payments and to defray operating costs. In 1975, the city also sold the city transit system to a regional authority for $8 million.

The Mayor also wanted to sell the city-owned Municipal Light and Power Company (MUNY) to the privately owned Cleveland Electric Illuminating Company (CEI). However, the citizens rejected this proposal. In 1976, after years of neglect, MUNY was forced to shut down its generating plant and purchase electric power from CEI. The courts later required Cleveland to pay CEI $13.9 million for past purchases of electricity by MUNY.

As the 1970s progressed, the city's condition continued to deteriorate, and the city's costs continued to increase. As a result, the next Mayor, elected in 1977, faced a financial situation that was critical, with the city on the verge of bankruptcy. About $33 million dollars in short-term debt came due at the end of 1978; local banks held $15 million of these debts. Five of the six banks reached an agreement with the Mayor to refinance the notes the city owed them in return for a pledge from the Mayor to raise the income tax. But the sixth bank also wanted the city to sell MUNY to CEI. The Mayor agreed to a referendum both to sell MUNY and to raise the income tax from 1 to 1.5 percent. The banks, in turn, agreed to hold off taking the city into bankruptcy and seizing city assets until the outcome of the vote. However, the voters refused to increase income taxes or sell MUNY.

At the beginning of December 1978, $15 million of the $33 million came due. Because of the city's financial difficulties, the local banks refused to refinance these loans. On December 15, 1978, the city defaulted on its debt. As a result, the city's bond ratings were downgraded below the investment grade, thus making it impossible for the city to issue more notes.

In March 1979, the citizens agreed to increase income taxes from 1 to 1.5 percent. However, the city used the increased tax revenue to continue providing city services rather than to repay the defaulted loans. Because of the city's financial difficulties, the next Mayor, upon taking office in November 1979, immediately commissioned a special audit of the city's records to assess its financial condition. The auditors concluded that as of November 11, 1979, the city had an accumulated deficit of about $110 million, more than half the size of its operating budget of $158 million. On November 29, 1979, the state of Ohio passed the Municipal Fiscal Emergencies Act to help Cleveland and any other Ohio city that got into financial difficulty. On January 4, 1980, the state auditor declared a fiscal emergency in Cleveland on the basis of the city's December 1978 default.

Under the provisions of Ohio's Municipal Fiscal Emergency Act, the state established a Financial Planning and Supervision Commission. This commission was to remain in existence until the city had (1) planned and was implementing an effective financial accounting and reporting system, (2) corrected and eliminated all the fiscal emergency conditions without introducing new fiscal emergency conditions, and (3) met the objectives of the city's financial plan. The commission was terminated in 1987 after all of these conditions had been met.

Because of the Municipal Fiscal Emergency Act, the city was able to obtain special authorization to issue bonds. The city subsequently issued short-term notes to the state for $15 million in July 1980. The city also issued 14-year general obligation bonds for $36 million to eight Cleveland banks in November 1980. By issuing these notes and bonds, on November 18, 1980, the city paid its defaulted loans and thus eliminated the immediate condition that caused the financial emergency. The balance of the $110 million deficit was addressed through another income tax increase from 1.5 percent to 2 percent in 1981.

To ensure its fiscal recovery, the city set up an improved financial management system to track and control expenditures, reduced its workforce by about 1,300 full-time employees between 1981 and 1984, and required MUNY and other city enterprises to operate on a self-supporting basis. Most importantly, according to the then Mayor, the city and business community established public/private partnerships, such as the Operations Improvement Task Force, a volunteer organization of business executives who worked together to determine how city services could be provided in a more efficient, economical manner. The then Mayor said that public/private partnerships such as this were the bedrock of Cleveland's recovery. (See the enclosure for details of the actions the city took).

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We are sending a copy of this letter to the Mayor of Cleveland and will make copies available to others upon request. Please contact me on (202) 512-9039 if you have any questions regarding this letter. Major contributors to this letter included John Needham, Katharine Cunningham, and Kiki Theodoropoulos.

Sincerely yours,

Michael Brostek

Michael Brostek
Associate Director,
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ACTIONS THE CITY TOOK TO RECOVER

FINANCIAL RECOVERY

The following sections describe some of the financial recovery measures that Cleveland city, commission, and business officials believed either helped the city recover from its fiscal crisis or helped it maintain its financial soundness.

Capital Budgeting

According to city officials, Cleveland's capital budget contributed to Cleveland's 1978 financial crisis in that capital funds were used to pay operating expenses.[1] To prevent this commingling of operating and capital funds from occurring again, the city established a restricted income tax fund in 1981. This fund, which was one-ninth of the city's total income tax revenue, was a set-aside for servicing debts from bonds issued to finance direct capital projects and capital expenditures. The fund could be used only after the city has ensured that the city's sinking fund[2] has sufficient funding to meet debt obligations. Specifically, the city could use the fund for (1) annual recurring capital expenditures or (2) capital projects that were precluded from being funded by bonds because of Internal Revenue Service regulations, state law, or local financial policy. The city could not use the restricted income tax fund for any other purpose.

A city official said that the budgetary process for the capital budget was the same as that of the operating budget for that portion of the capital budget funded by the restricted income tax, since the budget was annually appropriated and both budgets were reviewed and approved under the same timetables. However, the portion of the capital budget that was funded by bonds and that had a multiyear appropriation was reviewed in connection with the bond issuance process. (See further description of the budgetary process under the Budget section.)

As part of the capital budget process, Cleveland prepared a 5-year capital improvements plan. The capital improvements plan for fiscal years 1991 to 1995 included $1.9 billion in proposed projects. These projects fell into three major groups: basic services, development projects, and major enterprises.

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[1]A capital budget is a plan of proposed acquisitions and replacements of long-term assets and their financing.

[2]The sinking fund is a fund set aside for periodic payments, aimed at reducing, or amortizing, a financial obligation.

According to the manager of the capital budget, as of January 1995, the city made debt service payments monthly, rather than on an annual basis as they did in the past. This change gave the city more flexibility, more interest earnings, and greater consistency with its revenue stream.

Accounts Payable

Under the provisions of the Municipal Fiscal Emergency Act, the existence of overdue accounts payable[3] in excess of one-twelfth of the general fund budget for that year was one of several conditions that could warrant the state auditor to declare a fiscal emergency. During the time of its financial crisis, Cleveland met this criterion because it had overdue accounts payable that were approximately $36 million, more than one-twelfth of its general fund budget. The city issued bonds in November 1980 to pay off these overdue accounts payable.

The city's director of finance was required by city ordinance to annually submit complete, itemized, and detailed statements of all outstanding accounts payable to the City Council. At that time, the director was also to provide the City Council with a complete statement of the revenues expected to be used for payment of the accounts and an explanation of the reasons, if the revenues were insufficient for the payment of those accounts.

Pension Unfunded Liabilities

According to Cleveland's Comprehensive Annual Financial Report (CAFR),[4] dated December 31, 1993, Cleveland employees were covered by two state-administered pension programs: (1) the Public Employees Retirement System (PERS) and (2) the Police and Firemen's Disability and Pension Fund (P&FDPF).

According to the CAFR, Cleveland was obligated to pay the state for its share of the $1.1 billion underfunded pension obligations for P&FDPF. The city's allocated share of this obligation was $104.7 million, which was payable in semiannual installments of $2.7 million through May 15, 2035. However, instead of making these semiannual payments, the city and P&FDPF reached an agreement that allowed the city to make a one-time payment to eliminate this liability. This was accomplished in June 1994 through the use of the proceeds of a $74.7 million bond issuance. The city estimated that it saved $3 million in 1994 by making this one-time payment. Subsequently the city was to make annual payments that were roughly equal to the prior schedule until about 2022, after

[3]Overdue accounts payable include final judgments, fringe benefit payments, and amounts due and payable to persons and other governmental entities.

[4]The official annual financial report of the municipal government.

which the bonds were to be retired, producing annual savings of $5.4 million through the year 2035.

According to a city official, the state had not determined the city's portion of the unfunded liability for PERS.

Cash Management

According to the city's cash management and investment policy document, each day, the city Treasurer was to deposit all public money, less any money kept for the city's daily operations. Each bank depositary for these deposits was to notify the Commissioner of Accounts before noon the following day of the amount of deposits made by the city Treasurer the preceding business day. Also, then, the depositary was to pay out money deposited on checks signed by the Commissioner and Treasurer.

The Treasurer was to provide the Commissioner of accounts and the city Controller with a daily sworn statement showing (1) the total amounts deposited in each depository the preceding business day, (2) the number and amount of checks issued to each depository, and (3) additional information on tax abatements or refunding that had been cashed. The city Controller was to maintain records showing the cash balance for each fund and was not to issue warrants payable from any fund unless there was sufficient money for payment. The city Controller, who was to maintain his own daily records of cash balances, was to certify to the correctness of the city Treasurer's daily statements.

According to the CAFR, Cleveland segregated fund accounts for debt service, capital projects, municipal courts, and the major enterprise accounts–water, sewer, electric services, and airport facilities–and for the tax collection agency and certain other accounts. Accounts of the general fund, restricted income tax, and street maintenance and repair funds were maintained and invested in a common group of bank accounts. Collectively these common bank accounts and investments represented the pooled cash account. The city also pooled funds for (1) the internal service funds, which included user fees charged to city departments for various services, such as printing, copying, and vehicle maintenance; and (2) small enterprise funds, which included user fees and general fund operating transfers for the Convention Center, West Side Market, East Side Market, and the city's cemeteries, golf courses, and parking facilities.

According to a city official, since the city's financial crisis, Cleveland adopted a more sophisticated approach to managing its investment portfolio. According to this official, the city patterned its investment policy after a model investment policy recommended by the Municipal Treasurers' Association of the United States and Canada. The city's 1993 CAFR said that the city's cash management policy was to minimize credit and market risks while maintaining a competitive yield on its portfolio. The city's cash management policy also included efforts to refinance loans at lower rates and to ensure that idle funds were profitably invested.

Budgetary Process

The city's fiscal year begins January 1. Before then, according to city officials, the City Council was to adopt a temporary appropriation to cover expenditures during the first quarter of the fiscal year. By February 1, the Mayor was to submit an appropriation ordinance to the City Council. This ordinance was to include a detailed estimate of revenues and expenses based on information from city departments. Public hearings were to be held before the City Council's finance committee, and the proposed appropriation was to be published in the city record before passing. The City Council was to pass a budget by April 1.

According to city officials, Cleveland's budgetary process did not contribute to the city's financial difficulties, but budgetary controls were missing. City officials said that they since added and strengthened controls. For example, each month the city's Office of Budget and Management (OBM) was to prepare a report for management that showed estimated and actual revenues and expenditures. As a further budgetary control, estimated expenditure amounts were to be encumbered[5] before the release of purchase orders to vendors or finalization of other contracts. Encumbrances that exceeded their available appropriation level were not to be approved or recorded until the City Council authorized appropriations or transfers. Unencumbered appropriations lapsed at the end of each calendar year. The city did not apportion funds, but instead relied on the monthly variance reports to monitor the budget.

According to a city official, each year from 1984 through 1993, Cleveland won the Government Finance Officers Association Distinguished Budget Presentation Award. The city won this award because its budget met the Association's criteria as a policy document, an operations guide, a financial plan, and a communications device.

Comprehensive Annual Financial Report (CAFR)

In addition to the budget document, the city prepared a CAFR. The city began preparing CAFRs in 1980. The CAFR presented comprehensive financial and operating information about the city's activities. According to a city official, the Government Finance Officers Association awarded the city a Certificate of Achievement for Excellence in Financial Reporting for its CAFR every year from 1984 through 1993.

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[5]Encumbrances are charges to an appropriation for purchases of goods and services before actual delivery and payment.

Tax Budget

Cleveland's Budget Manager said that each summer OBM was to prepare the tax budget as a preliminary look at what expenditures would be required to fund current service levels in the coming year and used these budget estimates to certify Cleveland's property tax levy for the coming year. She said that OBM also used the tax budget to establish target expenditure levels for each department of the city government. The departments were to meet these targets as they formulated their budgets for the next year.

According to the Mayor's 1994 Budget Estimate, state law required that the preliminary estimate of revenues and expenditures in the proposed tax budget be submitted to the County Budget Commission for certification. However, the City Council had to approve the tax budget before it was submitted for review and approval by the County Budget Commission and the county auditor. The commission used these estimates to levy Cleveland's property tax appropriation for the coming year.

Federal/State/Regional Payments

Although Cleveland continued to receive funds during the crisis from the federal government for such things as community development, it did not receive any federal aid specifically to assist with its fiscal crisis. According to the Mayor's budget estimate, in 1995, Cleveland received about 19 percent of its revenue from the federal government.

According to a city official, Ohio distributed part of its inheritance, liquor, and cigarette tax revenue to Cleveland and other municipalities. State payments to the city were about 16 percent of the city's budget in fiscal year 1994. In addition, the state also funded certain special projects. For instance, the Ohio Department of Transportation paid a share of the cost of many city road and bridge projects by either (1) providing state funds generated by highway user fees or (2) passing federal payments to Ohio's Highway Trust Fund on to the city. Also, the Ohio Public Works Commission provided funding for other city infrastructure improvements.

Sources of Revenue

Previously, Cleveland's largest source of revenue was property taxes. In 1970, when the Mayor asked the voters to reduce property taxes and increase income taxes, the voters accepted the reduction in property taxes and rejected the increase in income taxes. According to Cleveland officials, the city never fully recovered from these lost tax revenues.

In 1994, the city's largest source of revenue for the general fund–about 57 percent–was the income tax. The income tax revenue was generated by a 2-percent tax on businesses and wages and earnings of Cleveland residents and nonresidents who worked in the city. Because Cleveland residents who worked outside the city were to pay income taxes at their place of employment, the city credited their Cleveland income tax by 50 percent. For example, a Cleveland resident who worked in a city that had a 2-percent income tax would have had a tax liability of 3 percent–2 percent to the city of employment and 1 percent to Cleveland. Previously, this tax credit was 100 percent, but it was reduced to 50 percent in 1984 to generate more revenue for the city. According to Cleveland officials, about 76 percent of the city's income tax revenue was generated from nonresidents.

The Local Government Fund was the second largest source of revenue in Cleveland and was the city's portion of the state's income, sales, corporate franchise, and public utilities excise taxes. In 1994, the Local Government Fund comprised about 12 percent of Cleveland's general fund budget. Property taxes were the third largest revenue source, also representing about 12 percent of the operating budget in 1994.

In addition, the city received a small amount of revenue from the collection of fines and forfeitures, about 4 percent of the operating budget in 1994. Other sources of revenue included both local and state-collected sources. Locally, the city received a 6-percent admissions tax for most entertainment events and an exhibition tax for boxing and wrestling matches. The city also charged user fees for city services, such as emergency medical service, medical care at the city's health centers, and the care of county prisoners at city jails.

According to the Mayor's 1994 budget estimate, the most common method of financing capital improvements was through the issuance of general obligation bonds. The city's major utilities generally funded their capital improvements through either operating revenues or revenue bonds that were then repaid by user fees.

Debt Limit

According to a city official, the Ohio Revised Code provided that a city's net principal amount of both voted and unvoted debt,[6] excluding exempt debt, was not to exceed 10.5 percent of the total tax valuation of all property in the city as listed and assessed for taxation. The code further provided that the net principal amount of unvoted nonexempt debt could not exceed 5.5 percent of that valuation. In 1994, the city's outstanding

[6]Voted debt included general obligation bonds of the city authorized by vote of the electors and notes issued in anticipation of such bonds. Unvoted debt included general obligation bonds of the city not authorized by vote of the electors and notes issued in anticipation of such bonds.

nonexempt debt was about $18 million, which was well within its statutory debt limit of $269 million. In fiscal year 1994, Cleveland's operating budget was about $700 million and its capital budget was about $800 million.

Other Financial Issues

In addition to MUNY, Cleveland owned other public utilities including two airports (Cleveland Hopkins and Burke Lakefront), a countywide water system, and a local sewer system with no treating capacity. Before the city's financial crisis, the airports were self-supporting, and the city subsidized the other utilities.

Because of the crisis, the city adopted a policy that required each public utility to become totally self-supporting. To make MUNY, the water system, and the water pollution control system self-supporting, the city raised fees for their services. According to the CAFR for fiscal year 1993, Cleveland successfully made these utilities self-supporting.

MANAGEMENT PRACTICES

Cleveland's financial accounting and reporting system was a major problem during the crisis. Through 1994, Cleveland made improvements to this system and other management functions. Descriptions of these improvements follow.

Financial Management System

According to a city official, Cleveland's financial accounting and reporting systems were prime contributors to the city's financial crisis. The city had a single entry accounting system.[7] Checks were deemed paid when written, without follow-up reconciliation. As a result, the city had no idea how much money was in the bank. The official said that private accountants who audited the city books during the crisis deemed them "unauditable." In 1979 Cleveland had only one accountant for the entire city government.

To meet the requirements of the Municipal Fiscal Emergency Act of November 29, 1979, Cleveland was required to bring its financial accounting and reporting system into compliance with Chapter 117 of the Ohio Revised Code. To meet these requirements, the city contracted with an independent auditing firm to set up a new financial accounting and reporting system. Cleveland's Financial Accounting and Management System (FAMIS) was implemented in March 1980. This system maintained cash, budget, and

[7]An accounting system in which transactions are recorded in a single record. An example is a checkbook showing expenditures. It does not rely on equal debits and credits.

financial accounting data based on generally accepted accounting principles.[8] The system also included a treasury account that was to be balanced daily with all funds and monthly with the designated depositories of the city.

To better manage its accounting using FAMIS, the city established the Division of Financial Reporting and Control, headed by the city Controller, as part of the Department of Finance. The city also hired nine accountants.

Periodic Reports

Along with daily cash statements, the city was to prepare weekly and monthly reports of encumbrances. In addition, the city was to prepare weekly and monthly reports showing variances between budgeted and actual expenditures for each department.

Hospitals and Medicaid

Other cities that suffered financial problems similar to those of Cleveland also faced managerial problems with hospitals and Medicaid. Cleveland avoided this issue because hospitals generally were the responsibility of counties in Ohio. Cuyahoga County operated all of the public hospitals located in Cleveland. The county also administered the various basic state and federal welfare and public assistance programs, including Medicaid and Aid for Dependent Children.

Personnel

Cleveland did not have critical personnel issues during the crisis. It did, however, reduce the number of full-time employees. During the height of the crisis in 1980, Cleveland had about 9,600 full-time employees. Between 1981 and 1984, the city reduced its workforce by about 1,300 full-time employees through attrition and layoffs. As of January 1995, the city government had about 8,300 full-time employees.

Cleveland did not have a pay cap on its employees' salaries and wages during the crisis. All city government employees were required to live in the city, except those hired before November 29, 1982. In May 1995, a city official told us that the Mayor vigorously enforced this requirement.

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[8]Standards, conventions, and rules that accountants follow in recording and summarizing transactions and preparing financial statements are known as generally accepted accounting principles.

Personnel and Payroll Systems

In 1994, Cleveland contracted out its payroll function. The city estimated that it would save $195,000 in operating costs annually and that it saved $603,000 in capital costs in fiscal year 1994. The contractor provided the city with a package of services to manage human resource files, including software for payroll and processing payroll data. With the new system, employees' checks were to be automatically processed at a central processing center, thus eliminating the need for employees to manually prepare pay envelopes.

Benefits Management

Health care, leave, or pension obligations did not contribute to the financial crisis in Cleveland. The city had, however, made changes in the early 1990s.

Health Care

According to a city bond statement, the city made two important changes to its health benefits in fiscal year 1993. First, it adopted a managed health care program for all employees. Second, the city began requiring a health insurance copayment from employees. Together, these changes held health benefit costs constant for fiscal year 1993.

Leave

According to a city official, employees generally accrue leave throughout their time of service and are paid in a lump sum at termination. In 1991, the city began an effort to reduce these leave balances by requiring the use of vacation (annual) leave in the year that it was earned; otherwise the employee would lose it.

Pensions

The state of Ohio managed pension benefits for most of the state's municipalities, including Cleveland. In 1994, Cleveland issued bonds and made a one-time payment to the retirement fund to save the city money. (See Pension Unfunded Liabilities section for more details.)

Information Management

In 1991, Cleveland prepared a 4-year information resources management plan that laid out how the city would transition from a mainframe to a personal computer-based system network. This plan was updated to reflect expected completion of this network in fiscal year 1996. Once completed, the city's cable television franchise was to have connected all city departments to the network.

Schools

Cleveland's public school system did not contribute to the financial crisis since it was operated and financed independently from the city and was governed by Ohio law. The system had its own budget, taxing power, and sources of revenue. Approximately 72,728 pupils in 127 elementary, intermediate, and senior high schools, including magnet and special schools, were enrolled in 1994. The state superintendent did, however, take over control of Cleveland's public schools in March 1995 because the school system was insolvent.

Public Safety

Well over half of Cleveland's general fund budget (61.6 percent) was devoted to public safety. According to a city official, in 1994, Cleveland brought in 120 civilians to do desk work that had previously been done by police officers, thus freeing more police officers for street duty. This was the city's way of increasing police presence without hiring additional police officers.

Court Orders

According to a city official, the city was under court order to repay general fund money that it had previously used to subsidize MUNY, which had since been renamed Cleveland Public Power (CPP). Under the court-approved payment plan, CPP was to make nine annual installments of $4.4 million and a tenth installment of $7.6 million to the city's general fund. CPP made the first payment on December 31, 1993, but in 1994 it issued $219 million of mortgage revenue bonds and used $37 million of these funds to liquidate CPP's debt to the city's general fund.

Contracting Out and Procurement

Cleveland Competes, an initiative created by the Mayor in 1994, was a process to improve city services and save money by having city departments compete with the private sector. Through this initiative, city managers looked at what core services the city should be providing and then looked to the private sector to provide all other services.

In its first project under Cleveland Competes, the city, in 1994, contracted out computerized payroll and time and attendance services. According to the Mayor, this service was cost-effective because the contracting firm's computers replaced a more costly and obsolete city payroll system. (See resultant savings in Personnel and Payroll Systems section.)

Other services the city was looking to contract out included: dead animal pickup; resurfacing of local streets; trash collection and disposal from downtown; vacant lot cleaning and cutting; and management of the convention center, golf courses, and cemeteries.

The city charter required that all contracts over $10,000 be authorized by the City Council. City officials said this requirement slowed the contracting process.

ACTIONS THE CITY HAS TAKEN TO REVITALIZE THE BUSINESS COMMUNITY AND NEIGHBORHOODS

Despite losing residents and businesses and the accompanying fiscal crisis, Cleveland's government and business community turned Cleveland into a nationally recognized leader in programs to retain and attract businesses and revitalize neighborhoods. They achieved this recognition through what a former Mayor called a "civic architecture" of public/private partnerships. These partnerships were established to help identify and fund a broad array of economic development programs. After the establishment of these partnerships, the city enjoyed a downtown building boom and was beginning to see the return of its business sector. Some of these public/private partnerships are discussed in the following sections.

Cleveland Tomorrow

The most important of these public/private partnerships was Cleveland Tomorrow. In 1982, a group of major business leaders formed Cleveland Tomorrow to create a forum where the private sector could mobilize to turn the tide in Cleveland. According to a report by Cleveland Tomorrow, officers were chosen because of their ability to coordinate, stimulate, and support various efforts aimed at restoring Cleveland's economic vitality. The partnership initiated its efforts by working with the city to staff a downtown steering committee that would guide all of the city's investments. Up to 1994, Cleveland Tomorrow had invested more than $5 billion in downtown Cleveland and its neighborhoods.

To carry out its investments, Cleveland Tomorrow designed a three-part strategy. Specifically, it wanted to (1) focus the government's resources on economic development; (2) rebuild the central city, both downtown and neighborhoods; and (3) encourage business development.

Focus Government's Resources on Economic Development

In 1990, the voters in Cuyahoga County approved an increase of taxes on alcohol and cigarettes to help build the Gateway Sports Complex, which consists of a ballpark, multipurpose arena, and two parking garages. Costs of this sports complex (over $500 million) were paid for from a variety of sources. These sources included:

- bonds issued by the Gateway Economic Development Corporation of Greater Cleveland, payable from the tax increase;

- revenue bonds issued by the Gateway corporation, payable from stadium premium seating rentals;

- revenue bonds issued by the county, payable from arena premium seating rentals and nontax revenues of the county;

- revenue bonds issued by the city to finance two parking garages, payable from revenues from certain municipal parking facilities and other nontax revenues of the city;

- state capital appropriations; and

- grants and loans from local foundations and civic organizations.

This debt was guaranteed by the county.

No objective analysis had been done at the time of our visit in January 1995 on the amount of money the Gateway Sports Complex had generated, whether it had been financially successful, or whether it had been a contributor to the city's increasing economy. However, according to the Executive Director of Gateway, additional ballpark ticket sales had increased the admissions tax on all entertainment by $1.2 million; 17 restaurants, 2 retail stores, and 6 nearby housing projects had been opened; and revenue from the wage tax increased with the additional 2,450 employees hired for the ballpark and arena.

Rebuild the Central City, Both Downtown and Neighborhoods

The city of Cleveland and Cleveland Tomorrow were partners to help rebuild Cleveland's downtown and neighborhoods. First, the city published Civic Vision 2000 to document Cleveland's 10-year plan for economic development. According to a report by Cleveland Tomorrow, Civic Vision 2000 was the most comprehensive plan ever developed for Cleveland. It updated the city's land-use plans, zoning codes, and capital and operating budget investment plans.

Second, Cleveland Tomorrow, using the Civic Vision 2000 plan as a blueprint, joined with another private organization, the Cleveland Neighborhood Partnership Program, to provide sustained operating support to leading neighborhood organizations. Funds from this program enabled neighborhood organizations to concentrate on completing projects of significant size and scope rather than focusing on how they will meet operating expenses.

Since the creation of Cleveland Tomorrow, downtown redevelopment included restoration of Playhouse Square, a complex of four 1920s theaters; renovation of the Cleveland Convention Center; and a building renewal of the city's warehouse district.

Encourage Business Development

Finally, Cleveland Tomorrow attempted to encourage business development by fostering growth industries through research and entrepreneurship and by helping the greater Cleveland manufacturing base. Four programs were initiated to achieve those objectives. First, the Primus Capital Fund was created to make capital available to entrepreneurs. Second, with the support of Cleveland Tomorrow, Enterprise Development, Inc., was established at the Weatherhead School of Management to help entrepreneurs. Third, the Cleveland Advanced Manufacturing Program was launched to create advanced technology that could be transferred to existing companies and serve as a base for new companies. Finally, Cleveland Tomorrow supported the efforts of the Work in Northeast Ohio Council to improve manufacturing competitiveness through improvements in product quality, productivity, and quality of worklife.

The city's Department of Economic Development complemented Cleveland Tomorrow's efforts by using enterprise zone tax incentives to retain, expand, and attract businesses. From 1990 to 1993, 26 incentives were executed under this program. According to city estimates, these incentives retained over 7,300 jobs, created over 1,100 new jobs, and resulted in total business investments of over $252 million.

Build Up Greater Cleveland

Build Up Greater Cleveland was another public/private partnership that was established in 1981 to rehabilitate greater Cleveland's road, bridge, transit, sewer, and water systems. Funding for Build Up Greater Cleveland was provided by the Greater Cleveland Growth Association, a private organization, and five local government entities: the Cuyahoga County Commission, the Office of the Cuyahoga County Engineer, the City of Cleveland, the Greater Cleveland Regional Transit Authority, and the Northeast Ohio Regional Sewer District. For 4 years, from 1992 to 1996, an estimated $2.1 billion in projects was to be incorporated into the community's capital investment strategy.

Community Reinvestment Act

Realizing that the city could not finance revitalization with public funds alone, the city began a concerted effort in 1991 to enlist local lenders as partners. The federal Community Reinvestment Act was used to encourage increased support from financial institutions. The act required local banks to invest in building and restoring neighborhoods, including minority and low-to-moderate income communities. As of January 1995, formal commitments had been obtained from seven major banks. Total commitments negotiated through December 1994 exceeded $1.2 billion dollars and were to be used to fund various projects to improve housing, help small business owners, and fund a wide range of loan programs for consumers and small businesses.

Whenever a bank proposed a neighborhood initiative, this proposal was to be documented and signed by the bank's chief executive and the Mayor of Cleveland. The city had begun to have discussions with area savings and loan associations to make similar commitments.

City Council and the Business Community

During the financial crisis in Cleveland, a delegation of top businessmen asked Ohio's then Lieutenant Governor to run for Mayor. He agreed to run, with the commitment that, if he won, the business community would provide funding and expertise to help improve city management and operations. Upon gaining office in 1979, the Mayor, the City Council president, and the business community initiated a high profile effort to show that they were working together. In the view of the then Mayor, this amicable working relationship was crucial in the city's moving forward with a collective agenda to address its financial difficulties. He said it allowed the City Council and the business community to put the city first.

To capitalize on his already strong working relationship with the business community, the Mayor requested and received volunteers from accounting firms and local corporations. For instance, in 1979 the accounting volunteers spent 11 weeks auditing the city's "unauditable" books. They eventually found that the city's deficit was $110 million.

The then Mayor also asked business and civic leaders to establish a citywide task force to improve city management and operations. The business community responded by providing 89 executives and $800,000 in foundation and corporate grants to hire additional outside experts. This group, which became known as the Operations Improvement Task Force, spent 3 months scrutinizing the operations of city government and looking for ways to impose corporate efficiency without reducing services. Eventually, the task force made 650 recommendations. In 1981, the task force reported that the city had carried out about 500 of these recommendations, which it estimated would save the city about $57 million dollars annually.

Other Civic Associations in Cleveland

Cleveland also formed an urban coalition, called the Cleveland Roundtable, to address community issues. The Roundtable's major areas of focus included Cleveland's housing and employment issues, minority business development, police-community relations, racism, and education. According to the then Mayor, during the 1980s, this coalition empowered people who normally lacked clout to sit at the table with community leadership in making decisions about their quality of life.

The New Cleveland Campaign and the Greater Cleveland Marketing Partnership were also organized to market Cleveland to both outsiders and Cleveland area residents. Their strategies were designed to boost the image and morale of the community in order to support targeted economic development efforts.

LESSONS OFFICIALS LEARNED AND THEIR OBSERVATIONS

According to Cleveland's city, commission, and business officials, the following are lessons they learned and observations based on their experiences in addressing the city's crisis:

- A substantive planning process that was built around clear priorities and had extensive community participation was necessary to give a city a sound basis for planning and making investments.

- If businesses leave, a city needs to find out why.

- The city and the business community had to work from a mutual agenda. A city that was committed to public/private partnerships and could articulate what these partnerships envision could not fail to get things done.

- It was government's role to ensure that certain services were in place so that the private economy could employ people.

- A city's business community could come up with a better economic development plan for the city than the city's government because governments did not have as clear an understanding of the private economy. Also, if the city wanted to gain citizen commitment to something, it needed to ensure that they felt they had a hand in creating it.

- The Cleveland Tomorrow model might not work elsewhere. Unlike Cleveland, many cities do not have 55 large companies. Cleveland Tomorrow worked in Cleveland because of the critical mass of chief executive officers who lived there and could make decisions.

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