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# *Introduction*

March 10, 1831. The New York City audience awaited the principal speaker of the evening unsure what to expect. They had assembled that Saturday evening to honor the memory and achievements of Alexander Hamilton, long-time resident of New York and fiscal architect of the new republic. To breathe exhilaration and eloquence into subjects as dry as currency and public borrowing would be no mean achievement. Mindful of the difficulties, the program committee had given the task to one of the foremost orators of their generation or any other. Daniel Webster would not disappoint them. After a few ingratiating remarks about New York as "the commercial capital, not only of all of the United States, but of the whole continent also," Webster turned to the topic at hand. And what a topic it was, or more correctly, what a topic it became under the spell of Webster's rhetoric: how Hamilton built a fiscal infrastructure for a young and precarious nation. "He smote the rock of national resources, and abundant streams of revenue gushed forth. He touched the dead corpse of the Public Credit, and it sprung upon its feet."[1] That same public credit could of course be overstrained to the point of collapse, as New Yorkers of the future would repeatedly demonstrate. Excessive borrowing had, by 1842, brought the Empire State, in the words of its Comptroller, to "the very brink of dishonor and bankruptcy." Time and again the greatest city of the state would totter upon that same precipice: in 1915, in 1933, and most recently, in 1975. For Webster's commercial capital of a continent, this suggested a frailty as puzzling as it was ingrained.

The puzzles in recent years have multiplied. The state that was in 1950 a colossus in the industrial heartland of America had become by the 1970s an ailing economic hulk. The city that began the postwar era as the undisputed financial capital of America by 1975 could not borrow a dime in financial markets for itself. In that same year the credit rating of the Empire State was imperiled as it attempted to rescue New York City from bankruptcy. Only the last-minute intervention of the federal government averted fiscal chaos in what Webster termed, in the euphoria of that March evening, the "singularly prosperous State, which now is, and is likely to continue to be, the greatest link in the chain of the Union."

Crisis is an overworked word. But lurking in the difficulties just sketched is the threat of a fiscal crisis that, should it materialize, will be well deserving of the name. Federal intervention may now have become indispensable to propping up the financial structure of New York City. The merits of continuing such support will be reviewed by Congress in 1982. Should it be withdrawn, the great city could go under. In the financial maelstrom that would follow, a successful rescue operation almost surely could not be mounted from Albany. The state is much too weakened by economic retardation and overburdened with fiscal problems of its own. The financial burdens of the city, now running far into the billions, are much too great. Should the state therefore attempt to save the city on its own, the only question would be whether the state would go under too.

Problems of such magnitude and gravity invariably have a long and thought-provoking history. It is a history, however, that few have been anxious to write. New York historians, fascinated by the colonial period and enthusiastic about the nineteenth century, have at best a tepid interest in the modern era. Albany bureaucrats and politicians and reporters all have expert knowledge of a host of facts, but seldom elaborate a larger tapestry that weaves such facts into a unified and coherent pattern that makes the past explicable. Such men of affairs are also by instinct usually preoccupied with the present and the future. Yesterday is already ancient history in the hurly-burly world of framing laws and implementing budgets and reporting what is newsworthy. The prospect of continued neglect was a major moving force behind the writing of this book. The tale to be told is one of high finance and power politics, of gathering forces for economic retardation, coincident with an explosion in taxes, spending, and debt the likes of which the citizens of New York had never seen before. It is also a tale of personal ambitions given too much free rein by a political structure distinguished for its feeble checks and balances.

Nowhere was this feebleness more apparent than in the processes that led to the rapid escalation of the public debt. Excessive issuance of state debt had supposedly been blocked by a constitutional provision requiring that all increases in debt proposed by the legislature must be approved by voters in a statewide referendum. The rationale for this tight rein upon the politicians was spelled out by the Chairman of the Finance Committee when the provision was enacted in 1846. The requirement of a voter referendum, he noted, "was saying that we will not trust the legislature with the power of creating indefinite mortgages on the people's property . . . Whenever the people were to have their property mortgaged for a State debt . . . it should be done by their own voice, and with their consent."[2]

This constitutional provision was a breakwater against which the irresponsible and excessive borrowing schemes of politicians shattered for 114 years. In 1960, Nelson Rockefeller devised a way around it. Writing free verse, Robert Frost once observed, is like playing tennis with the net down. John D. Rockefeller's grandson Nelson had a marked aversion to playing with the net up in fiscal matters. For him, the need for continual voter approval of debt was an intolerable restraint. He therefore established public authorities, ramming the requisite legislation through a legislature with limited knowledge of what was being done and limited power to resist a determined governor. The public authorities then issued debt with the "moral obligation" backing of the state.[3] Because the debt was not that of the state, the public did not need to approve it in a referendum, or so the argument ran.

For 15 years the courts remained silent on a legal issue crying out for resolution: Did this fiscal gimmickry violate the Constitution? When the judges of the highest court of New York finally did speak, they answered no, but only by the narrowest possible margin of four to three. One of the four was subsequently subjected to disciplinary hearings, because at the time that he reached this momentous decision, he held better than $3 million in New York City notes. The result of these hearings was "censure and disapproval," but not removal from the bench. More important, the court decision was allowed to stand. A key constitutional provision – indeed, the only constitutional provision of consequence – inhibiting the excessive issuance of debt was thereby laid open to more Rockefeller-type end runs in the future.

New York City politicians took a different route to debt excesses. They had a different set of constitutional restraints to circumvent. The main provisions were a ceiling on the total of long-term city debt outstanding (10 percent of the value of taxable real estate), and requirements that short-term debt be issued only for a short term and long-term debt be issued only for the "probable useful life" of the project into which the borrowed funds were to be channeled.

The 10 percent ceiling was amended to death by repeated exceptions for different types of borrowing (water-supply facilities, docks, rapid transit facilities, low-rent housing, hospitals, and schools). It was also circumvented by public authorities issuing debt that did not count against the 10 percent ceiling. The restrictions upon the period during which debt could be outstanding were undermined primarily by two gimmicks. One was the repeated "roll-over" of short-term debt; that is, the retiring of one short-term issue with the proceeds of a new short-term issue. On close inspection, therefore, short-term debt was often outstanding for considerably longer than the short term. As for the issuance of what was officially long-term debt from the outset, the principal gimmick was for New York City politicians to propose, and Albany politicians to approve, various "probable useful lives" of a length that boggled the accountant's imagination. Long-term borrowing was, in effect, used to pay for a short-term benefit. Spending for vocational education, for example – by most accounting norms a current expense – was financed by a 30-year bond because the state legislature judged such spending to have a probable useful life of 30 years.

These manipulations were accompanied by several other fiscal curiosities. Revenue anticipation notes (RANS) were issued for amounts far in excess of revenues subsequently received. The deficiency was then often covered by the device noted: the short-term roll-over of what was ostensibly short-term debt. Bond anticipation notes (BANS) were supposed to be issued, as the name implies, to provide temporary funds until the bonds themselves would be issued and the notes retired with the proceeds of the bond sale. Instead, these BANS in the early 1970s were first issued and then repeatedly rolled over in anticipation of a fall in interest rates that never came.

At the center of a fiscal routine worthy of Houdini were two developments that foreshadowed doom. One was repeated borrowing to cover current operating expenses, well recognized by every responsible accountant as the height of fiscal folly. The other, associated in part with the financing needs of the first, was the repeated adding to, and rolling over of, short-term city debt. The structure finally collapsed in 1975, when the city was barred from further borrowing in the nation's capital markets.

The failure of the fiscal system of checks and balances in this instance was made painfully apparent by the only check of consequence coming not from the executive, or from the legislature, or from the courts, but from the financial community. Members of that community were the ones who finally reined in the city politicians. Their concern had to do not with constitutional propriety, but with fiscal procedures so ill-advised that the city was no longer deemed to be an acceptable credit risk. A crucial flaw in the existing system of checks and balances was that the courts could decide very little. The difficulty was an absence of clear-cut constitutional provisions that could be protected by the courts striking down clear-cut violations. Albany politicians decided what was the "probable useful life" of a project to be financed by long-term borrowing. If a decision appeared ludicrous to the concerned citizen, he or she had difficulty getting judicial review of what was essentially a fiscal judgment call. Albany politicians, by amending New York's Local Finance Law, eased the rules for issuing and rolling over short-term notes. Again there was a murkiness in the law that limited the possibilities of judicial review. With special legislation from Albany and debt shuffles in City Hall (one RAN retired, but a second issued whose receipts could be used to pay off the first), the roll-over possibilities had, in practice, no clear limit except the tolerance of the financial community.

One major theme of this book is the defects in this system of checks and balances in fiscal matters at both the state and the local level. If ever a fiscal structure was well suited to getting out of hand, this was it. But if the structure favored overdoing, why did the politicians in charge prove so amenable to the challenge?

The answer touches upon a second major theme. The starting point is a question that traditionally troubles undergraduates in introductory government courses: What is good government, and how can the behavior of politicians be influenced to serve the cause of such a government? (The question, of course, was no less troubling to the founding fathers of the republic.) Any speculation about the answer converges quickly on an issue that must be confronted squarely here. It is no less fundamental, controversial, and personal than one's views concerning the nature of man.

Much of subsequent analysis will be predicated upon a behavioral premise, self-evident to some and resisted by others as a slur upon humanity: namely, that most people most of the time pursue their own self-interest. This is not to deny the existence of more admirable human traits. Nor does it deny that for some individuals, the dominant driving force can be something other than self-interest. What is being claimed is a statistical generalization: that in any large assemblage of individuals, most will be found to pursue, throughout much of their professional careers, objectives that are in their own best interests.

Two conclusions follow concerning how a political system should be structured. One is the need to foster wherever possible a congruence between what is best for the politician and what is best for the public – what Jeremy Bentham called a juncture of duty and interest. When that congruence cannot be achieved, a system must be contrived such that (1) whenever the action of a public servant (or a group of them) threatens the public interest, a second individual will be in a position to oppose it, and (2) this second individual will not have a vested interest in suppressing his or her opposition, so that for this watchdog function, there will be a juncture of duty and interest. Such reasoning, unflattering though it may be, is at the very heart of why the founding fathers of the republic passionately argued for a system of checks and balances as indispensable to the functioning of good government.

The New York failures under this heading are legion. All reflect a clash between what was best for the public and what was best for the politician or bureaucrat who controlled the allocation of public funds. Three are particularly troubling because of unresolved problems they promise for the future.

First, the matter of debt. The politician all too frequently has a voracious appetite for more. If he can borrow now, spend the funds on pet projects, and leave office before the bills come due, the advantages to him are often overwhelming. The credit for the projects thereby funded he is quick to claim. The likelihood that the headaches of repayment will be his appears remote. The problem is as old as the capacity of elected officials to issue promissory notes upon the future. So are the dangers. Centuries before Rockefeller's spending spree, the philosopher David Hume warned that "it is very tempting to a minister to employ such an expedient, as enables him to make a great figure during his administration, without overburdening the people with taxes, or exciting any immediate clamours against himself. The practice, therefore, of contracting debt will almost infallibly be abused in every government."[4] The New York abuses have been sketched above. The citizens attempted to forestall such possibilities by constitutional restraints. The indifference of New York politicians to the popular will was then blatantly revealed by their persistent and successful efforts to circumvent these restraints contrived by the very people they were ostensibly elected to serve.

The second New York failure that bodes poorly for the future concerns the politicians' persistent slighting of the priorities of fostering growth and combating economic retardation. The gradualness and longevity of the processes at work make both of these long-run objectives. Elected officials generally serve only for a brief term. Their political ambitions therefore focus their attention upon short-run objectives that will enhance their reputation and their chances for reelection. The public too is usually preoccupied with short-run objectives, a preoccupation that most candidates for office willingly reinforce. The slighting of the priority of economic growth is therefore virtually assured.

This slighting in the New York case had particularly serious consequences. From 1946 on, the economies of New York City and New York State both became progressively weakened by the forces of economic retardation. The implied necessity for gradually scaling down fiscal objectives was ignored. Instead, the taxes, spending, and borrowing of the city and the state exploded. Most of the policies implemented by the politicians, instead of alleviating retardation, made it worse. They did little to prevent the deterioration of New York City's mass transit system, for example. They drove the city to the brink of bankruptcy, while raising state and local taxes to the point where New York was the most heavily taxed state in the union. For these and other reasons, the business climate became so poisoned that by 1975 a Fantus Company survey gave the Empire State undisputed last place for "attractiveness of business climate." Finally, and perhaps worst of all, the failure to adjust public services to the growing restraints implied by economic retardation persisted for so long, and the intervening fiscal excesses were so pronounced, that the present economic and fiscal adjustment problems are massive for the state and Herculean for the city. In the city's case, it is far from clear how solvable they are.

The third New York clash between self-interest and the public welfare involves primarily bureaucrats, not politicians. Again analysis begins with the behavioral premise of self-interest. Again it must be emphasized that this is not to deny the existence of public servants who are public spirited. But if most bureaucrats, like most politicians (and most of humanity) pursue their own self-interest throughout much of their professional careers, what behavior can one reasonably expect? At the lower echelons, one would not be surprised to encounter a bias for security of tenure, a bias which can lead to promotion rules that emphasize seniority over merit and thus tend to stifle incentive. The focus here, however, is higher up. The institutions in question are New York public authorities. The motivations that matter are those of the men who ran them. The charge to be examined is that certain authority chiefs implemented policies of questionable public merit, largely because an insulated bureaucratic structure gave too much free rein to their personal ambitions.

Public authorities, or "public benefit corporations," are quasi-governmental agencies established by an act of the legislature. By their very nature, such authorities are insulated from the political process. In the language of a New York commission established to review their powers,

> An authority may be in a better position than an agency of regular government to operate a public enterprise without regard for party politics, patronage, and party favoritism. If a public authority is responsible for the management of a public enterprise, then the entrepreneurial decisions necessary to the economical and efficient operation of a public enterprise may more likely be kept out of the political arena.[5]

The point to be emphasized – and it cannot be emphasized too strongly – is that authority policy is not independent of politics. It is merely subject to a different kind of politics. To insulate public authorities from pressures generated in the executive or the legislative branches of government is to remove from their operating procedures one set of checks and balances, and leave almost nothing in the way of other checks and balances. The heads of these organizations are thereby left relatively free to pursue their own ambitions, if so inclined.

In that pursuit, are they likely to serve the public well? The New York record does not suggest an encouraging answer. Precisely because public authorities are relatively immune from external intervention and often control the allocation of vast sums of money, the prospect of heading such an organization is viewed as highly desirable by men with a bias for bureaucratic power and for "getting things done" – a phrase that usually connotes a considerable expenditure of public funds, with little interference from, or consultation with, the public or its elected representatives. Nor is this absence of communication deemed undesirable by those whose biases are elitist to the core. If they believe that they know better than the public itself what the public needs, the less communication the better.

Such elitism merges easily with personal ambitions to build a bureaucratic empire. The careers of Robert Moses and Austin Tobin illustrate the process. The key to empire building is surplus funds. These can then be channeled into projects chosen not by the people, not by their elected representatives, but by the man who controls the authority generating such funds. One technique used by authority heads to generate a surplus was to levy tolls and other charges for using authority facilities far above costs – pricing policies that if encountered in business would be roundly condemned for doing what these did: generating monopoly profits. This same bias for generating surpluses encouraged these same bureaucratic chiefs to avoid whenever possible involving their authorities in strengthening the mass transit systems of New York's urban centers, particularly those in the New York City area. Mass transit systems are notorious for generating deficits. If surpluses were what these bureaucratic chiefs desired, they could hardly be expected to lend a hand in shoring up deteriorating transit systems, however urgent the need. The result for New York City was a transit system so starved for funds that by the 1970s, after decades of neglect and deterioration, it bordered upon a shambles. For a vital artery in the economic structure of a city grappling with serious economic decline, such defects signal a range of transit problems as serious as they are unresolved.

Last, but hardly least, was the contribution of public authority leaders to the circumvention of a constitutional ideal. The bureaucratic chief's ambition to control the allocation of money – a lot of money – meshed conveniently with Nelson Rockefeller's desire to avoid voter approval of increases in state debt, as mandated by the Constitution. Rockefeller projects were therefore shunted from the state to a public authority. The authority borrowed the funds, and thus financed the projects. The effect was a kind of disguised disenfranchisement of the electorate. A public that had the power to fend off direct attacks upon its purse by voting no to more state debt was helpless before an attack mounted through these authorities, whose actions in this context gave a certain dubious ring to their official title of "public benefit corporations."

Although public authorities in New York did not originate with Nelson Rockefeller, under his leadership they mushroomed in number and size throughout the state. During Rockefeller's last 12 years as governor, for example, public authority debt outstanding quadrupled in size. At $13.3 billion in 1973, it was almost four times the debt of the state itself. That same year (Rockefeller's last in office), a single New York public authority, the Housing Finance Agency, had surpassed the entire debt of the Empire State by almost 50 percent.

Why the public tolerated such developments is a third controlling theme of this work. Democracy is an old word, a tired word. It is also an important word. Whatever makes it work, one cornerstone is an educated and concerned public, knowledgeable about the issues and watchful of the actions of their elected representatives. This is the ultimate check in any system of checks and balances in any democracy worthy of the name. Through the ballot box the people can exact the ultimate penalty upon those who slight the public interest.

That is the theory. The New York reality in fiscal matters throughout the postwar era has been a tattered remnant of an old republican ideal. Partly the problem was that public authority policy, by and large, was beyond the power of the citizens to influence, either directly or indirectly. Partly the problem was the indifference and apathy of many New Yorkers toward those state and local fiscal policies that they might have influenced. They seldom clamored for more information, or penalized at the ballot box those who told them little. Indifference was also reinforced by a long-standing tradition favoring strong leadership in government, and by the public's rising expectations that seemed – at least superficially – to be well met by the expanded government programs advocated and implemented by their political leaders. The failures of the public, however, were not entirely of their own making. The complexity of modern fiscal processes defy ready understanding, even by an expert. The sums are huge, the accounts are many, and the dollar flows almost impossible to track. What was intrinsically difficult to understand, in turn, was often made completely unintelligible by accounting gimmicks devised by those in power to keep the layman (and not a few political opponents) ill-informed. The end result was a decision-making structure in fiscal matters that was elitist to the core. A knowledgeable and powerful few dominated most fiscal processes, and the few were not given to enlightening the many. This too is an old problem, as sometime New York Governor Grover Cleveland reminds us from the distant shadows of the nineteenth century. "I am convinced . . . that the perplexities and the mystery often surrounding the administration of State concerns grow, in a great measure, out of an attempt to serve partisan ends rather than the welfare of the citizen."[6]

The fourth and final theme of this work concerns the interaction of economic and political events. Although easy to specify in general form, these are difficult to document in detail. Causation tends to run both ways. As the growth of the economy slows down, for example, so does the growth in tax receipts. If the economy slumps sharply when the political unit (say, New York City) is already overextended in debt, the resulting shortfall in revenues can threaten fiscal chaos. Politics can also disrupt the economy. At the center of retardation is the exodus of business firms and people. Anything that intensifies this exodus tends to make retardation worse. This the politicians can do through, as it were, sins of commission – raising taxes, for example – or through sins of omission – allowing a deterioration in public services, or neglecting to keep the transportation network of a city (especially mass transit) in good working order. The potential for vicious circles is almost limitless. The exodus of firms, for example, cuts tax receipts. A fall in revenues can prompt a rise in tax rates or a decline in public services (or both), and these developments in turn prompt more businessmen to leave. Or to begin with the fiscal side, the threat of a fiscal collapse of the New York City variety can make businessmen more apprehensive about staying and more prone to leaving. Their exodus, in turn, by cutting into tax revenues, makes solving the ongoing annual deficits of the city more difficult. This in turn increases the probability that what is most feared will come to pass, namely, the actual bankruptcy of the metropolis.

The most notable features of the Empire State's fiscal developments in the postwar era were rapid expansions – pell-mell expansions – in taxes, spending, and debt by both New York City and New York State in the 1960s and early 1970s. The most notable economic features were three: (1) retardation was in evidence throughout the postwar